Labor Supply, Unemployment and the Challenge of Job Creation in the Maghreb

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Preface

Since the publication of ***Unlocking the Employment Potential for the Middle East and North Africa: Toward a New Social Contract*** *in September 2003, the MENA region has undergone a dramatic shift in regard to expected growth outcomes.* Built largely on the rising oil prices, growth has risen to an estimated 5.6 percent per year over the past two years, compared to 3.6 percent a year over the 1990s. Per capita growth has risen to 3.7 percent a year over the same period, the region's strongest growth performance since the mid-1970s.

Despite this growth, MENA still faces an unprecedented job creation challenge. In 2000, the labor force in the region totaled nearly 104 million workers. This is estimated to reach 146 million in 2010 and 185 million in 2020. Given this expansion, the economies of the region will need to create 80 million new jobs in the next two decades to provide jobs for new entrants. With unemployment now at 13.4 percent, the more ambitious goal of absorbing unemployed workers in addition to new entrants implies to need to create close to 100 million jobs over the next 20 years. Meeting this challenge will require economic growth of between 6 and 7 percent per year, close to double that experienced during the 1990s and still a quarter higher than the exceptional growth of the past two years.

The challenge of job creation holds true for the countries of the Maghreb. Between 2000 and 2020, labor force growth in Maghreb countries will have averaged nearly 2.4 percent per year. This amounts to an increase of nearly 16 million jobs needed between 2000 and 2020 to provide for new entrants. And with unemployment in the Maghreb estimated at 20.4 percent, to absorb the unemployed as well as new entrants, these countries will have to create nearly 22 million jobs in the next two decades. This is equal to the current level of employment in the Maghreb.

This report provides an updated overview of core messages of the MENA Development Report on Employment as evidenced in the Maghreb. It describes the historical basis for the employment challenge, an assessment of current labor market outcomes, and the steps the Maghreb economies will have to take to counter this challenge.

Acronyms and Abbreviations

ALMP	Active Labor Market Program
ANSEJ	Agence Nationale de l'Emploi
CDD	Contrats a duree determine
CIOPES	Centres d'Information et d'Orientation pour l'Emploi
CPE	Contrats pré-Emploi
ESIL	Emploi Salarié d'Initiative Locale
EU	European Union
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
IAIG	Indemnités pour Activés d'Intérêt Général
MENA	Middle East and North Africa
MFA	Multifibre Agreement
OECD	Organization for Economic Cooperation and Development
PAFTA	Pan-Arab Free Trade Agreement
SOE	State-owned enterprise
TUP-HIMO	Travaux d'Utilité Publique à Haute Intensité de Main-d'œuvre
WTO	World Trade Organization

Executive Summary

Almost every country in MENA region, including the Maghreb countries, suffers from high unemployment, which mostly affects the young, educated and women. While MENA's labor market dysfunctions share structural features with other regions of the world, its labor market dynamics are nonetheless unique in the extent to which rigidities coexist with a rapidly expanding labor force. This combination poses an overwhelming burden for MENA governments. Based on the expansion of the labor force alone, it is estimated that the economies of the region will need to create some 80 million new jobs in the next two decades. In addition, the region will have to create an additional 20 million jobs to employ the currently unemployed. Countries in the Maghreb will have to create nearly 16 million jobs to provide jobs for new entrants, and countering unemployment as well as the challenge of employing new entrants will require the creation of nearly 22 million jobs.

Overall, the labor markets in Maghreb countries are constrained by insufficient (Tunisia) or slow growth (Morocco), or are affected by volatile growth (Algeria) at the macro level coupled with restrictive trade policies and weak incentives for the private sector. Algeria, Morocco and Tunisia have shown considerable success in employment creation in recent years. With economic growth rates of nearly 5.4 percent per year in 2003 and 2004, Maghreb countries have decrease unemployment, which has fallen by nearly 4 percentage points since 2000. Despite this news, the degree to which the current reduction in unemployment is permanent is questionable. Many of the jobs created in recent years are of a temporary nature, and the Maghreb, as a whole, exhibits artificially high employment creation relative to the recent growth upturn. The elasticity of employment growth in respect to output growth averages almost 0.9, well above international averages for longer time horizons. Although the employment-output relationship varies from country to country, this elevated pace of employment creation relative to output growth suggests that recent strides in countering unemployment are unsustainable.

At the micro level, poor labor market outcomes are driven largely by reduced demand from the public sector and slow growth of the private sector. As a result, unemployment rates are highest for young new entrants to the labor market with intermediate and higher educations. The structure of unemployment also suggests that a significant part of unemployment results from high job expectations by workers with some formal education, as well as low absorption by the private sector because education systems have concentrated on making public sector jobs accessible rather than on building skills. Moreover, the dominant role of government as employer has introduced rigidities in the wage structure that distort labor market incentives and promote expansion of the informal sector.

Reforming the institutional and regulatory framework is integral to better functioning labor markets. Since regulations limit job creation and reduce flexibility for private employers, more flexible hiring and dismissal procedures are the most relevant policy issues in the reform of labor regulations in the Maghreb. However, while labor market reforms are necessary component of policy reforms, they are not sufficient for addressing the scope of the employment challenge facing the region. These countries have had some success in creating jobs through active labor market policies. However, despite high spending on these programs, only a small share of the labor force is covered by these schemes. Also, migration plays an equilibrating but limited role in the Maghreb. While there is hope that migration could serve to ease labor market pressures in the future, its role is currently restricted by the policy environment in Europe.

The Need for New Development Policies

The countries of the Maghreb require a broad-based transformation of their economies to strengthen the core drivers of economic growth and create viable prospects for job creation to absorb the millions of men and women entering the work force over the coming two decades. The MENA Development Reports on Employment, Trade, and Governance argue that MENA countries, including those of the Maghreb, must complete three fundamental and interrelated realignments in their economies in order to accelerate job creation and growth:

- **From public sector dominated to private sector dominated:** Maghreb countries have tried, with varying intensity and success, to expand private sector activity. In recent years, they have taken steps to improve the business environment. However, new firms still face significant barriers to entry, both in terms of the time and the cost of administrative approvals. Regulations do not facilitate the restructuring of still-viable businesses, while nonviable firms are not permitted to close operations expeditiously, raising the social and economic costs of bankruptcy. Businesses also suffer from weaknesses in infrastructure, the financial system, and administration of licensing, regulations, taxes and import duties. Additionally, governments still represent a large share of value-added in these countries. As a result, the contribution of the private sector to value-added has increased only marginally. The same pattern has characterized the share of the private sector in total investment, which did not increase enough in the 1990s to compensate for the decline in public investment. Improving these outcomes requires substantial reform in the business environment so as to encourage entrepreneurship and firm creation.

- **From closed to more open economies**. MENA remains one of the least integrated regions, having failed to take advantage of the expansion in world trade and foreign direct investment (FDI) in the past two decades. The Maghreb is, by and large, on the positive end of MENA in regard to trade. In the last several years, Maghreb countries have made substantial progress in establishing bilateral and regional trade accords. Starting in the mid-1990s, these countries sought to strengthen trade with Europe through Euromed and eventually EU Association Agreements (currently in force in Algeria, Tunisia, and Morocco). Recently, Morocco and Tunisia have also developed greater intraregional ties. In the context of these agreements, the Maghreb has made notable progress in removing barriers to trade and decreasing non-tariff barriers (Morocco and Tunisia). However, trade regimes in these countries are still among the most protective in the world. These countries maintain some of the highest tariffs in the MENA region, well above the developing country average. In addition, the WTO's Multifibre Agreement (MFA) in January 2005 will increase competition for dominant textile exporters Morocco and Tunisia, which is expected to lead to export declines. This will have particular ramifications on female employment opportunities, which is already high

- **From oil dominated and volatile to more stable and diversified.** Algeria needs to undergo a third transition to become a more stable and diversified economy, which requires better management of oil resources and a broadening of the productive base of economic activities. This implies setting up institutions and fiscal rules that insulate public expenditures from oil price volatility and save oil revenues so that they benefit citizens when oil resources decline. This also means improving the efficiency of public expenditures through a better system of budgeting that emphasizes performance and accountability. Diversifying productive activities is a growing priority.

Better Governance Is Central to the Transition

The government's role in the economy needs to be redefined. If states no longer serve as employers of first resort, they can be more engaged as partners in creating and sustaining opportunities for employment. New state capacities are required for the effective administration of social programs aimed at overcoming dysfunctions in labor markets and protecting workers during economic transition. Maghreb economies need to ensure the credibility of governments and promote the capacity of state institutions to manage a complex, long-term process of change. More specifically, they need the institutional and regulatory instruments to manage the difficult process of economic transition under conditions of economic volatility and social vulnerability. They must create rule-of-law mechanisms to ensure their own accountability and transparency, including in budgeting and fiscal policy, to enable citizens to scrutinize government performance and hold officials accountable for their actions.

Reform of the Social Contract is Crucial for the Future of Labor Markets

Currently, the redistributive social contract in the Maghreb offers a minority of workers employment security, but at the expense of declining wages and standards of living. The social contract is important in preserving programs that benefit the working poor, but safety nets are stretched beyond their capacity. Declining state revenues and the worst projected employment gap in the world renders the existing social contract unsustainable. Yet, reforms will not be credible unless they take into account the social needs of workers and ensure that economic outcomes are socially acceptable among citizens. This requires a renewed political commitment to widely valued social policies—a new social contract that links reform to the principles of poverty reduction, income equality, and income security.

A new social contract will have long-term benefits. It will balance the need for labor market flexibility with the rights of workers, helping to avoid social dislocation and conflicts by offering a positive role to labor in the transition to and coordination of more flexible systems of production. Furthermore, it will create mechanisms for supporting workers as they respond to changes in the structure of employment associated with the shift to more open economies with different skill requirements and greater dependence on new information technologies. Securing these gains demands a clear vision of how tomorrow's labor markets should be organized.

CHAPTER I.
LABOR MARKET PRESSURES AND THE STATE IN THE MAGHREB

Over the next two decades, countries in the Maghreb will need to create nearly 16 million jobs to provide jobs for new entrants, and countering unemployment as well as the challenge of employing new entrants will require the creation of nearly 22 million jobs. Given these rising labor market pressures, the economic future of the Maghreb will be determined by the fate of its labor markets. In turn, current labor outcomes in the region and the region's ability to address the future employment challenge are restricted by the region's social contract.

The Social Contract in the Maghreb

The social contract in the Maghreb was established in the wake of independence from France in the late 1950s and early 1960s. The social contract defines the relationship between the state, workers, firms and other economic actors, and is guided by a strong interventionist and redistributive development model. Its foundations date to post-independence constitutions, laws, and public policies that established the state as an instrument of social transformation, political mobilization, and economic distribution. Core attributes of the social contract in the Maghreb include a preference for redistribution and equity in economic and social policy, an inclination towards states over markets in managing national economies, reliance on state planning in determining economic priorities, and an encompassing vision of the role of the state in the provision of welfare (particularly in Algeria and Tunisia).

Labor markets in the Maghreb have been directly affected by the orientation of economic and social policy. Starting in the 1950s, governments moved from regulating private sectors to direct control of production through nationalization of private assets. In response, public sectors grew to become the dominant employers in these economies. Workforce regulations expanded under state ownership, mandating job security guarantees, social security programs, relatively high public sector wages with generous compensation benefits and restrictions on the dismissal of workers. Such policies were intended to provide economic security to workers. However, expanded state intervention was often accompanied by increasing limits on the rights of workers, such as the right to strike.

The social contract in the Maghreb was initially strengthened by the high economic growth and social development that followed its emergence and consolidation. This reinforced redistributive mechanisms that sustained the well-being of large segments of the Maghreb's population and deepened the popularity of the social contract among social groups that governments identified as core constituencies. The welfare gains also helped cement an "authoritarian bargain," with citizens trading restrictions on political participation for economic security and the public provision of services.

Over time, however, gaps widened between the institutional arrangements of the social contract and the diminishing capacity of governments to sustain commitments. By the mid- to late 1980s, these strains had grown into an economic crisis, triggered by declining oil prices, shrinking demand for migrant labor, and reduced remittance flows. In response to growing economic difficulties, the governments of Algeria, Morocco and Tunisia each adopted some form of economic stabilization program. Policy shifts were marked by caution and gradualism, but governments cut subsidies, reduced public expenditure, and reformed exchange rate regimes. By the early 1990s, these reforms began to have beneficial effects. Debt levels declined, inflation was brought under control, and macroeconomic performance was, on average, positive.

Governments also began a gradual and selective transition from economic stabilization to structural adjustment. Reforms included privatization of state-owned enterprises, fiscal reform and trade liberalization, deregulation, and strengthening the institutional foundations for a market-led economy. However, the implementation of these reforms was uneven, hesitant, and incomplete. Partly as a result, economic recovery in the 1990s was generally weak. Between 1985 and 2000, GDP per capita growth in the Maghreb averaged less than 1.0 percent a year, labor productivity was low, and unemployment rates increased.

Efforts at reform have been dampened by the institutions and norms established by the social contract. As it has developed, the social contract has given rise to enduring institutions, interests, norms and legitimating discourses that have proven deeply resilient. In turn, these inform and limit debate about social and economic policy reform, even as their impact on employment, wages, working conditions, foreign investment, trade and overall macroeconomic performance has become deleterious.

Rising Labor Force Pressures and Declining Labor Outcomes

The decline of economic outcomes in the 1980s and 1990s coincided with a rapid rise in labor force pressures as the region's population structure matured and a rising number of young workers entered into the labor force. These pressures were compounded by increasing levels of education among young workers and accompanying wage expectations

A. Demographic Transition and Rising Working Age Population

The Maghreb, like most of MENA, has experienced declining rates of population growth since the mid-1980s. In fact, these countries largely led the region in bringing down high population growth, with Maghreb population growth averaging 1.8 percent a year between 1990 and 2000 compared to a regional average of 2.2 percent. Currently, population growth in Algeria and Morocco is at 1.6 percent a year, while Tunisia's population is growing at nearly 1.1 percent a year.

The declining trajectory of population growth in the Maghreb has resulted in a maturing of the overall age structure of the population. This has placed these countries in a unique position: between 1990 and 2020, the growth of the economically active population (ages 15-64) will have exceeded that of the economically dependent population by a much greater amount than witnessed in any other region. As East Asia's experience in the 1980s has shown, this differential – the so-called demographic gift – provides the countries of the Maghreb with an opportunity to accelerate economic growth through a faster accumulation of factors of production.

Lower dependency ratios imply a potential for higher savings and investment. Rapid labor force growth, especially with increased education and longer life expectancy, provides economies with a larger pool of productive workers. While creating the potential for employment and growth, however, the dynamics of demography in the Maghreb have created intense pressures on labor markets. With the expansion of the working age population, coupled with rising labor force participation rates, policymakers in Algeria, Morocco, and Tunisia are now facing new challenges. Demographic changes have shifted the priority from providing health care and education for a young population to facilitating employment and output growth for a rapidly rising number of workers.

B. Burgeoning Labor Force Pressures

Maghreb countries experienced the strongest labor market pressures between 1970 and 2000, as growth in the working-age population averaged 3.5 percent a year. However, the pressure of young workers on labor force growth remains high, largely the result of rising participation rates among young male and female workers. Labor force growth in the Maghreb will have averaged nearly 2.4 percent between 2000 and 2020. This means that nearly 16 million jobs, or 790 million per year, will have to be created in that time period to absorb new entrants to the labor force. Rising female labor participation since the 1980s, in particular, constitutes one of the most important developments affecting the size and gender composition of the labor force in the Maghreb. Not only are young men and women entering labor markets in greater numbers, but they are increasingly more educated, a consequence of the considerable resources devoted by governments to human capital accumulation.

Figure 1.1: Labor Force Growth in Developing Regions, 1970-2010 (percent)

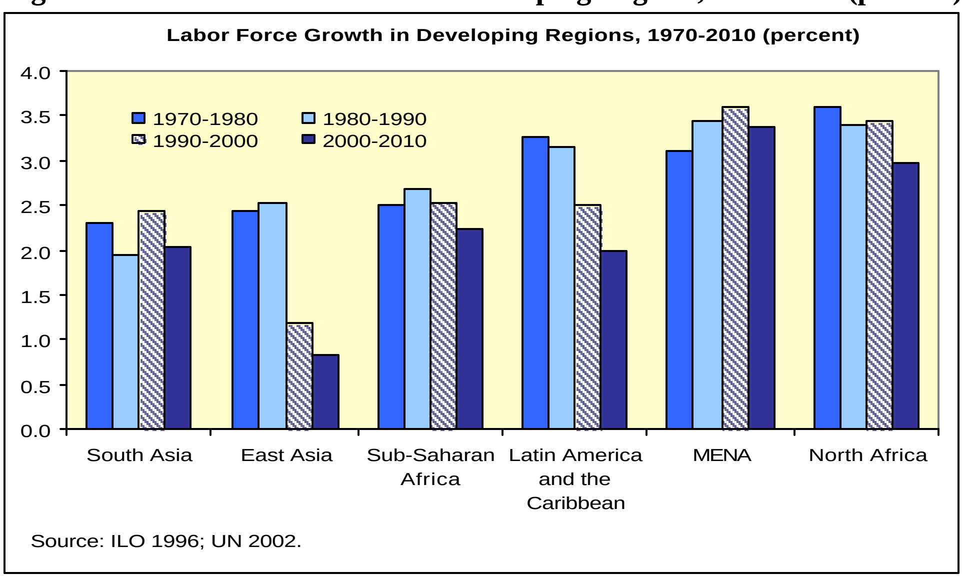
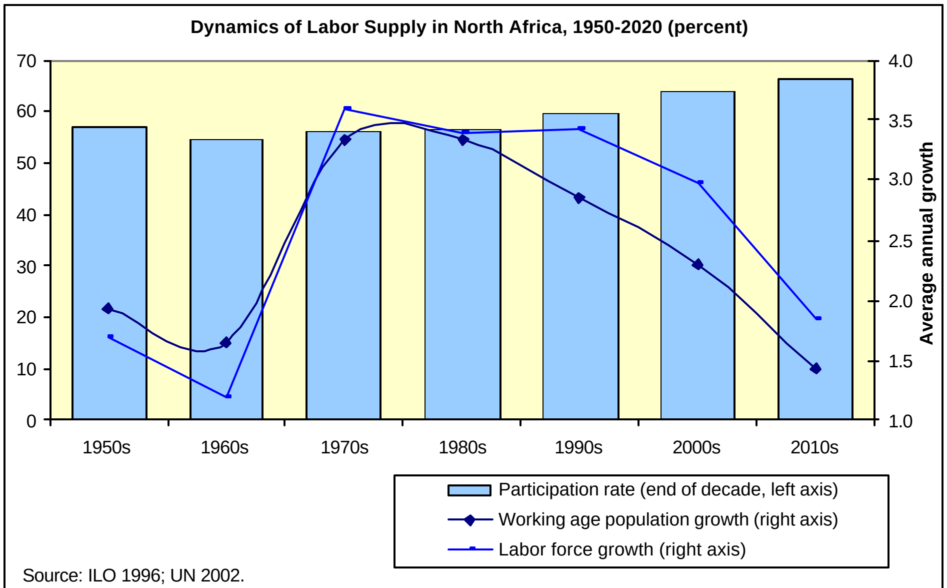


Figure 1.2: Dynamics of Labor Supply in the Maghreb, 1950-2020 (percent)



Source: ILO 1996; UN 2002.

CHAPTER II:
ECONOMIC GROWTH AND EMPLOYMENT CREATION

Generally, the distribution of employment and value added (output) in MENA reveals a decline in agriculture during the oil boom, followed by a slow down or reversal of that trend after the collapse of oil prices in 1986. Manufacturing has remained fairly static, with most employment growth occurring in the services sector. However, patterns of growth by sector differ widely in the region. What are the sources of employment growth in the Maghreb, and what sectors are contributing to labor absorption?

Sources of Employment Growth in the Maghreb

The Algerian economy is dominated by the oil sector. While oil provides a rich source of government revenue and can stimulate growth in other sectors, its direct role in job creation is weak. Outside of oil, manufacturing and industry have remained stagnant throughout the past three decades at about 30 percent of employment. Agriculture has declined steadily as a share of employment, from 31 percent in 1977 to 12 percent in 1995. Services on the other hand, which are mainly present in the public sector, have increased from 36 percent in 1977 to 58 percent in 1995. More recently, Algeria has been able to translate rising oil revenues into increased employment. However, most of this job creation has been carried out through the Economic Reform Program, and consists of temporary and subsidized employment in services.

In Morocco, manufacturing as a share of employment and value-added increased gradually through the 1980s and declined again in the 1990s. Still, manufacturing and industry have remained fairly stable, even rebounding slightly toward the end of the 1990s. Agriculture continues to make up the greatest share of employment creation. While agriculture provides jobs for a large number of Morocco's low-skilled population, the sector is subject to volatility, as witnessed in the late 1990s when Morocco suffered from severe drought. During the 1990s, private sector paid employment outside agriculture was the most dynamic segment of the Moroccan economy, growing at an annual rate of 6.2 percent (five times the average) and accounting for more than 100 percent of the net employment creation in the 1990s (see table 2.2). This outcome reflects Morocco's decreasing dependence on the public sector as an engine for job creation.

Overall employment growth in Tunisia was the highest in MENA during the 1990s at 2.7 percent. The country has also maintained the highest levels of employment in manufacturing among MENA countries for which data is available. In addition, the country has also performed well in increasing services as a share of employment. Agriculture has steadily declined as a share of total employment as the country's economy has shifted toward manufacturing and services. Most employment growth in Tunisia has occurred in private nonagriculture work. This bodes fairly well for Tunisia's attempts to remain competitive in a globalizing environment. However, the public sector remains a relevant source of job creation. Survey data from 1997 and 2001 suggest that public sector employment has made up 4.6 percent of employment growth. (see table 2.2).

By and large, employment in the Maghreb has been in sectors that are not high value-added sectors. The private sector, in particular, has not hired in areas that demand higher-level skills from workers. These countries need to stimulate employment growth in higher value sectors to promote competitiveness, take advantage of the rising human capital held by young workers, and to promote the high levels of economic growth needed to create needed jobs.

Table 2.1: Structure of Employment and Production in the Maghreb

	Employment					Valued-added production				
Country	Year	Agri-culture	Manu-facturing	Other industry	Services	Year	Agri-culture	Manu-facturing	Other industry	Services
Algeria	1977	31	12	20	36	1977	8	10	45	36
	1991	24	12	16	48	1980	9	11	47	34
	1995	12	30a	n.a.	58	1991	10	12	41	37
						2000	9	8	52	31
Morocco	1971	58	11	6	25	1971	20	16	11	53
	1982	44	17	9	31	1982	15	17	15	53
	1991	49	13	5	33	1991	20	17	14	49
	1999	44	14	7	33	2000	14	18	15	54
Tunisia	1975	39	18	13	30	1975	18	9	17	56
	1984	28	19	23	30	1984	14	15	19	52
	1994	22	34a	n.a.	43	1994	12	19	11	59
	2001	22	21	13	44	2000	8	15	11	66

Note: Other industry includes mining, construction, and electricity, water and gas, except as noted with an 'a', in which manufacturing includes other industry.
Sources: Employment data are from ILO 2003a. Value-added data are from World Bank 2003e.

Table 2.2: Employment Creation in Morocco and Tunisia

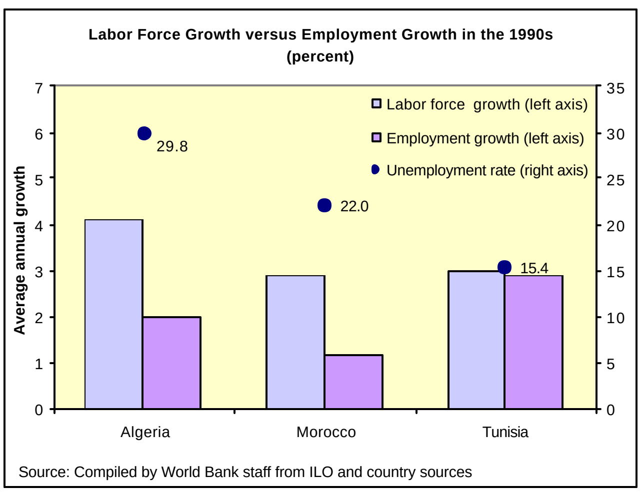
Employment Growth in Morocco and Tunisia (percent)				
	Morocco (1991-99)		Tunisia (1997-2001)	
	Share of growth	Annual rate of growth	Share of growth	Annual rate of growth
Government	-9.0	-1.2	7.1	1.0
State-owned enterprise	-7.9	-4.5	-2.5	-1.5
Subtotal public sector	-16.9	-1.8	4.6	0.5
Private agriculture wage work	8.2	1.7	24.4	4.2
Private agriculture nonwage work	-5.0	-0.1	12.4	5.3
Subtotal agriculture	3.2	0.1	37.1	4.5
Private nonagriculture wage work	110.1	6.2	20.4	3.4
Private nonagriculture nonwage work	-5.5	-0.3	45.7	3.2
Subtotal private nonagriculture	104.7	3.1	66.2	3.3
Total	100.0	1.2	100.0	2.7

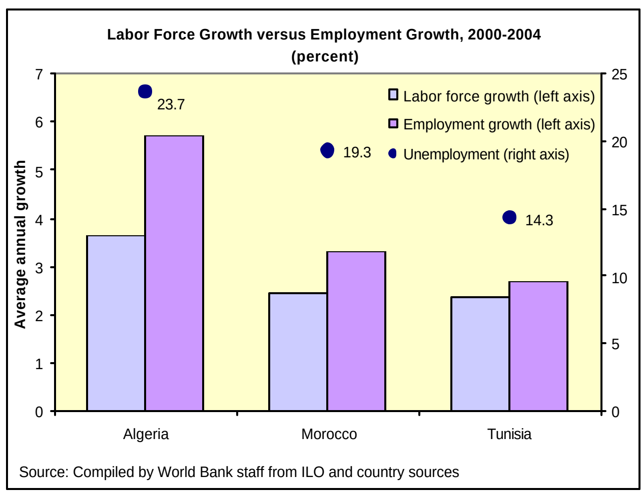
Source: For Morocco, MLSS 1991 and 1999; for Tunisia, AES 1997 and 2001.

Lower labor demand accounts for the slow pace of job creation in the 1990s, contributing to high unemployment. The most important indicator of trends in labor demand is output growth. Strong output growth both reflects and leads to employment growth and lower unemployment because the work force is an essential factor of production that contributes directly to the expansion of output. In the Maghreb, as elsewhere, faster output growth has generally gone hand in hand with lower unemployment, while slower growth has invariably implied higher levels of unemployment. Thus, the story in the Maghreb in the 1990s is one of weak output performance in the face of rapid labor force growth, with the result that output per laborer barely improved. In turn, since 2000, rising output has led to declining aggregate unemployment rates; however, unemployment remains high across the Maghreb.

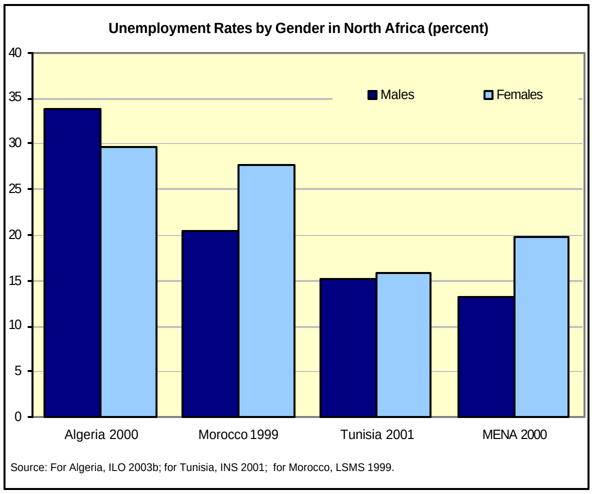
High Unemployment, Low Productivity, and Stagnant Real Wages

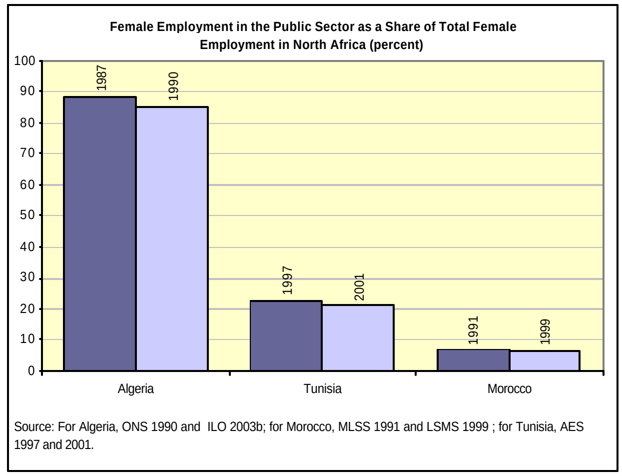
Unemployment rates are high in the Maghreb, estimated at nearly 20.4 percent. By definition, if labor supply exceeds the level of employment, the unemployment rate rises. In the past two years, given the outstanding growth performance of these countries, employment growth has outstripped labor supply growth. Subsequently, unemployment rates have fallen nearly 4 percentage points. However, over the past decade, the labor force has exceeded employment growth in all three countries in question. As a result, unemployment in Algeria stands at 23.7 percent, although it has fallen from 29.8 percent in 2000. Unemployment in Tunisia stands at 14.3 percent, down from 15.4 percent in 2000. And in Morocco, urban unemployment is 19.3 percent (down from 22 percent in 2000).





Unemployment in the Maghreb, like that in MENA as a whole, is concentrated among youth. In Morocco, youth unemployment is estimated at 37 percent of total unemployment. In Algeria, it is 66 percent of total unemployment. And in Tunisia, youth unemployment is nearly 68 percent of total unemployment. There is also a gender dimension to the profile of unemployment. Unemployment rates for MENA as a whole are nearly 50 percent higher for women than for men. In the Maghreb, results are not as stark. While unemployment for women in Morocco is 36 percent higher than for men, and in Tunisia it is 5 percent higher. Unemployment rates for men in Algeria are higher than those for women, but this is largely due to the public sector make up of female employment. In Algeria, the public sector has historically employed nearly 85 percent of all working women.





Profiles of the Unemployed in Morocco

Survey data for Morocco provide a detailed profile of the unemployed and the reasons for their status. About a third of the unemployed in 1999 said that they were unemployed because of "firm closure," up from 22 percent in 1991. This fact suggests that economic restructuring may be emerging as an important contributor to unemployment.

Unemployment is highest among primary school and lower secondary school graduates, in contrast to the results for most countries in the MENA region. However, it should be noted that 68 percent of working-age Moroccans in 1999 had less than a primary education. Unemployment also affects workers in the upper third of the educational distribution in Morocco, perhaps because unemployment affects primarily young people who tend to be more educated than older cohorts. If the sample is limited to those ages 20 to 24, unemployment is significant only for people in the top half of the education distribution.

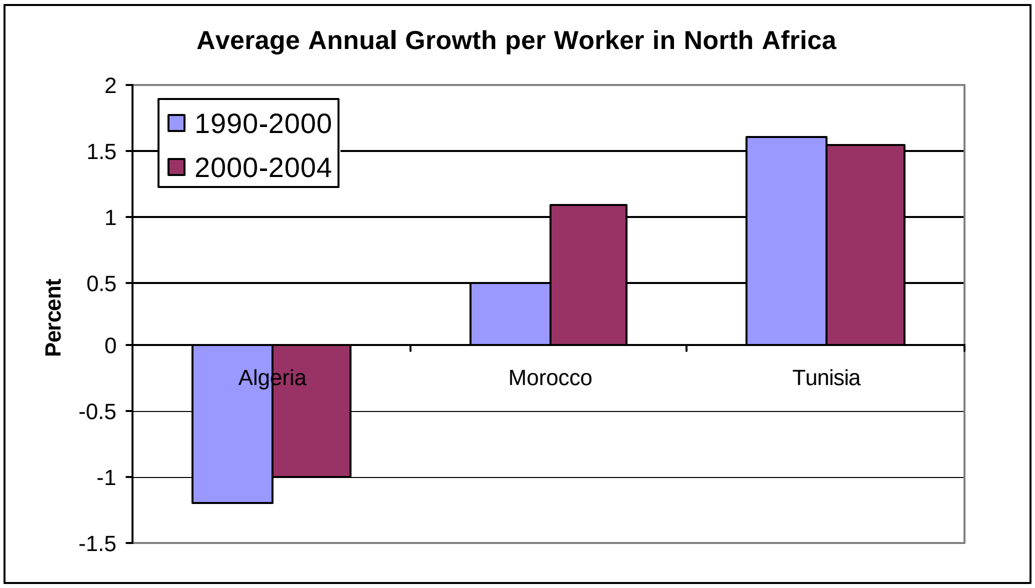
The average age of the unemployed in Morocco has increased slightly, from 26.5 in 1991 to 27.4 in 1999. The average number of years in schooling went from 6.8 to 8.2. There is little evidence that unemployment is spreading to older or less educated groups. This finding is important because the older and less educated an unemployed worker is, the more vulnerable the worker's household is to poverty.

The average duration of unemployment has increased sharply, rising from 79 weeks in 1991 to 178 weeks in 1999. Although recall and reporting problems may cloud these figures, the increase in duration is striking. The data also suggest that unemployment is longer among first-time job seekers than among those with previous work experience.

The degree to which the current reduction in unemployment is permanent is questionable. Many of the jobs created in recent years are of a temporary nature, and the Maghreb, as a whole, exhibits artificially high employment creation relative to the recent growth upturn. The elasticity of employment growth in respect to output growth averages almost 0.9, well above international averages for longer time horizons. Although the employment-output relationship varies from country to country, this elevated pace of employment creation relative to output growth suggests that recent strides in countering unemployment are unsustainable.

The weak labor market outcomes in the 1990s were also characterized by stagnant real wages. While real wages increased marginally in Tunisia, they stagnated in Morocco and declined in Algeria, extending a trend that began in the 1980s. In MENA as a whole, worker productivity, the basis for real wages, increased in the 1990s by less than any other region except Europe and Central Asia, which had been undergoing significant economic restructuring.

Figure 2.5: Average Annual Growth per Worker in the Maghreb

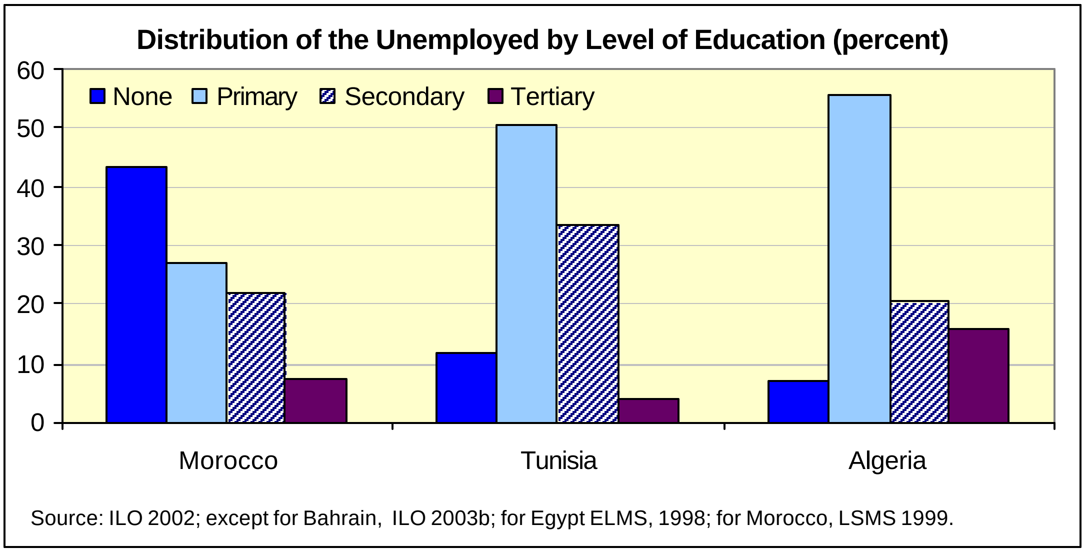


More recent outcomes suggest that while employment has increased since 2000, worker productivity has remained low or even decreased. This is true despite high rates of economic growth. While Morocco has seen growth in output per worker, Tunisia has seen growth per worker stagnate. And in Algeria, output per worker continues to decline at nearly 1 percent per year. This suggests that while job creation has been high, it has taken place in low productivity sectors that do not contribute much to overall output. Job creation is not happening in more dynamic and competitive sectors including high value-added manufacturing and services.

Skill Mismatch between Workers and Employers

Poor labor market outcomes are impacted by a mismatch between the skills demanded by producers and those held by workers, particularly young, first-time job seekers. This is reflected in the distribution of unemployment by educational attainment. Unemployment rates are generally lower for those with less than a primary education, suggesting lower wage expectations and a relative abundance of lower-skill jobs (as well as lower female participation rates). Similarly, workers with postsecondary educations are more likely to find employment, because their skills are in demand by employers, particularly the public sector. Among those with intermediate levels of educational attainment, unemployment rates are generally higher. This holds, at least, for Algeria and Tunisia. In Morocco, unemployment rates are highest among those with less than primary levels of education. However, it should be noted that 68 percent of the working-age population in Morocco had less than a primary education in 1999 (see box above on the unemployed in Morocco).

Figure 2.6: Distribution of the Unemployed by Level of Education (percent)



This mismatch between the skills is driven largely by a lack of absorption from the demand side. Private sector firms in the Maghreb are hiring, but they are not hiring in sectors that require skilled workers. Instead, employment has grown in low-skill, low-productivity sectors such as construction and agriculture. Unemployment is highest in high-skill sectors, such as technical specialists and craftsmen. Where unemployment has been brought down in higher-skill sectors, it is largely due to public sector employment. Despite efforts to downsize, the public sector still absorbs most of the educated young workers. Although the level of education of the workforce has increased over time, job creation in the Maghreb has not yet made a decisive turn toward high-skill sectors and demand for educated workers remains low.

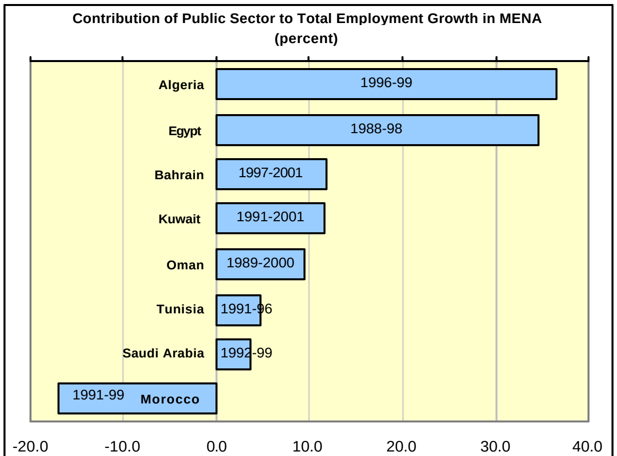
Public Sector Employment Affects Labor Market Outcomes

At the microeconomic level, poor labor market outcomes are driven largely by reduced demand from the public sector and slow growth of the private sector. Unemployment rates are generally highest for young, new entrants with intermediate and higher educations. Thus, the unemployed are essentially those who would have had a change at a formal job in government after years of guaranteed public sector employment. Unemployment rates are low for those with no formal education who are not eligible for employment in the public sector.

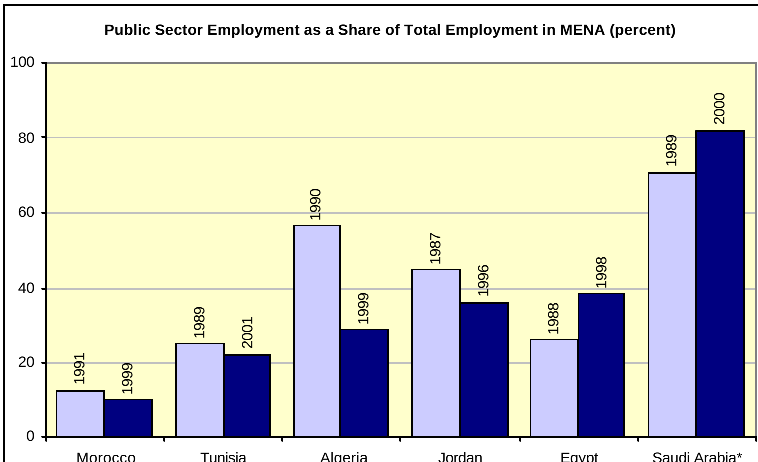
A significant part of unemployment results from high job expectations by workers with some formal education and a low valuation of these credentials by the private sector. This is because education systems in MENA countries, including Maghreb countries, have concentrated on making public sector jobs accessible rather than on building skills for the private sector. Although government hiring has been curtailed in recent years and public sector wage differentials have declined, the structure of the labor market remains segmented. Nonwage benefits in particular, such as job security and social protection, continue to attract workers and provide incentives to wait for public sector employment instead of seeking work in the private sector. Thus, educated new entrants continue to queue for government jobs.

The dominant role of the government as employer introduces rigidities in the wage structure that distort labor market incentives. Higher returns to formal education in the public sector encourage the accumulation of such credentials even if they do not add to worker productivity and are undervalued by the private sector. The resultant concentration of educated workers in unproductive public sector employment goes a long way toward explaining the low contribution of human capital to economic growth in the region and in the Maghreb.

Although efforts have been made to reduce public sector employment, the public sector is still important, both in terms of its size and its role managing the economy (employment in particular). All three Maghreb countries made progress in rationalizing public sector employment in the 1990s and rank low when compared to other MENA countries. In Algeria, public sector employment is estimated at 29 percent (1999), down from 56.6 in 1990. In Tunisia, public sector employment is estimated at 21.9 percent (2001), down from 25 percent in 1989. Morocco maintains the lowest level of public sector employment at 9.9 percent (1999), down from 12.6 percent in 1991. Still, job creation in the public sector in Algeria made up nearly 36.6 percent of total employment growth between 1996 and 1999, while public sector in Tunisia made up 4.6 percent of job creation. These countries are still dependent on the public sector as a major engine of job creation. Only in Morocco did the shedding of public sector jobs result in a real decline in the contribution of public sector employment growth to total employment growth.



Source: For Algeria, ILO 2003b; for Egypt, LFSS 1988 and ELMS 1998; for Morocco, MLSS 1991and LSMS 1999; for Tunisia, World Bank 2003; for Bahrain, Kuwait, Oman and Saudi Arabia, Girgis, Hadad-Zervose, and Coulibaly 2003.



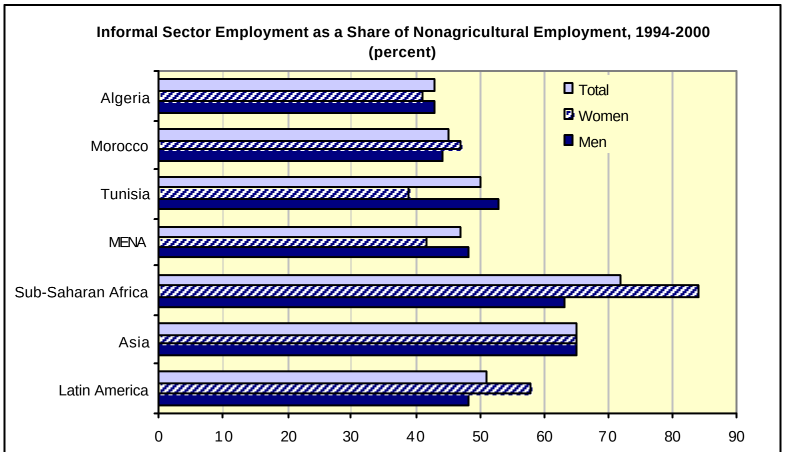
Notes: * Includes only nationals.
Source: For Morocco, MLSS 1991 and 1999; for Tunisia, Said 2001 and World Bank 2003; for Saudi Arabia, Girgis, Hadad-Zervose, and Coulibaly 2003.; for Jordan, DOS 1991 and ILO 1996; for Algeria, ONS 1990 and ILO 1996; for Egypt, LFSS 1988 and ELMS 1998.

Informalization of Work in the 1990s

The estimate of informal employment in the Maghreb countries is above 40 percent of nonagricultural employment. Although moderate compared with other developing regions, these estimates are high given the large share of public sector employment in the region. Informal employment in Algeria is estimated at 43 percent. In Tunisia, it is estimated at 50 percent and in Morocco, it is nearly 45 percent. Self-employment accounts for about half of informal employment in Tunisia, two-thirds in Algeria, and nearly four-fifths in Morocco, with wage employment in enterprises of fewer than 10 workers accounting for the rest.

At one end of the spectrum, the informal economy can include productive, small-scale activities with the potential for growth and technical upgrading. Such small enterprises may employ several workers. They tend to use capital more efficiency and relay on labor-intensive technologies. At the other end of the spectrum, the informal economy includes survival activities that employ people without any particular skills. In the middle are family enterprises that rely primarily on household labor, self-employed workers with close subcontracting or piece-rate relationships with others, and artisans who have acquired some craft skills.

Figure 2.9: Informal Sector Employment as a Share of Nonagricultural Employment, 1994-2000

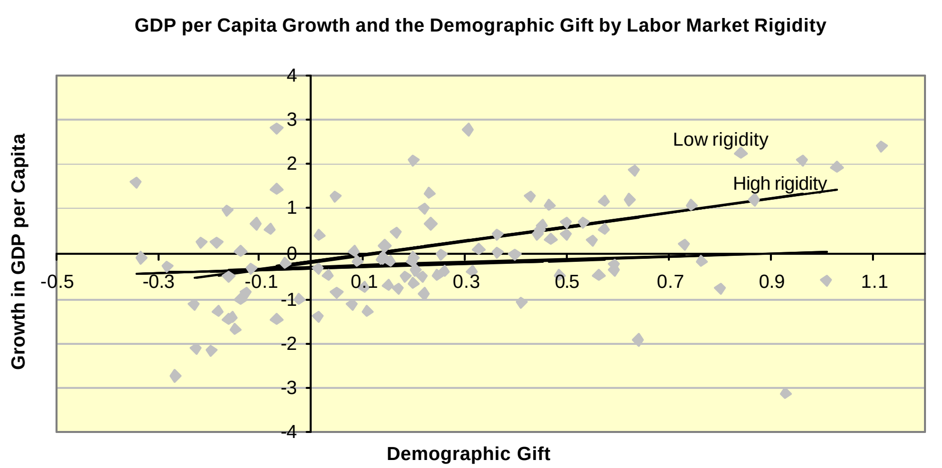


Source: ILO 2002.

Chapter III:
PUBLIC INTERVENTIONS IN THE LABOR MARKET

Reforming the institutional and regulatory framework is integral to better functioning labor markets. Policy proposals that aim to alleviate current pressures and generate better outcomes must address structural rigidities, including the state's role as both employer and labor market regulator. To be effective and sustainable in the long run, the realignment of incentives toward work in the private sector should rely on both push and pull factors. The menu of policies for reducing the public sector's share of employment ranges from natural attrition and hiring freezes, to accelerated attrition through substantial wage adjustments or benefit cuts, to explicit retrenchment through layoffs. The government should also effect changes in the regulatory environment that promote private sector growth and investment while protecting workers who might be negatively affected by such reforms.

Figure 3.1: GDP per capita growth and the demographic gift by labor market rigidity



Note: The figure shows the relationship between GDP per capita growth and the demographic gift conditional on a set of geographic, economic and policy variables. Data are averages of the period 1965-1990. The relationship is shown for countries with high and low levels of labor market rigidity.

Source: Estimated using data from Sachs and Warner 1997; Labor market rigidity data, Forteza and Rama 2001.

Rationalizing the Public Sector

There are many reasons to rationalize the role of the public sector in the labor market. The often cited reason is to reduce the financial burden on government. Efficiency loss attributable to falling productivity in the public sector is another. Across MENA, most branches of the public sector remain overstaffed, even in countries that have tried to shed public sector labor. In the 1990s, the share of underused workers in the public sector ranged from 17 percent in Algeria to 21 percent in Egypt. These estimates suggest that the scale of overstaffing is greater than ever. In Algeria, redundancy remains a concern despite layoffs of more than half a million workers during the 1990s.

Significant financial savings and efficiency gains would result from rationalizing public sector employment, themselves justifying a scaling back of the state's presence in labor markets. Even more important, the dominance of the public sector is linked to the structure of unemployment and the supply of skills in the economy. Implicit and explicit employment guarantees in government hiring and mismatched wage expectations resulting from generous public sector compensation policies perpetuate market segmentation and ensure continued queuing for public sector jobs, especially among educated first-time job seekers.

Policymakers have several instruments for reducing public employment, containing the public sector wage bill, and directing new labor market entrants toward private sector employment. They include an allowance for natural attrition, reducing remuneration, and layoffs.

- *Natural attrition* can be high as employees leave public employment for private sector jobs or withdraw from the labor force due to retirement, disability or other reasons. The age structure of public employment in the Maghreb provides a notion of natural outflow rates. For instance, nearly 15 percent of public sector employees in Morocco are more than 50 years old. The average age of public sector employees is increasing as inflows of younger workers is decelerating. Thus, there is significant potential for employment reductions as workers retire over the next 10 years. Combined with a hiring freeze, attrition alone could translate into substantially reduced employment levels in the public sector.

- *Reducing remuneration* could also accelerate the process of attrition and shift greater supply of labor to the private sector. Lower compensation raises the appeal of private sector employment for job seekers as their reservation wage falls and for current employees as the wage differential with the private sector shifts. However, reducing wages is politically difficult. Alternative measures, such as lowering remuneration for new entrants, adjusting the pay scale to strengthen the link between compensation and productivity, and focusing on nonwage benefits, may be needed. Addressing nonwage benefits is particularly important. In MENA, the nonwage benefit premium can be as must as 50 percent of the total compensation. In Algeria, for example, workers are provided allowances for the total number of dependents, and there is no ceiling on the number of these dependents.

- *Layoffs and voluntary separations* can also facilitate public downsizing, and Maghreb countries do have enabling legislature for such an approach. Because laid off workers and dependents incur income losses through no fault of their own, retrenchment is typically accompanied by some income support to smooth consumption over the period of joblessness. Severance packages also reward workers for years of past service. There are also macroeconomic stabilizing effects from severance packages, because large-scale layoffs lead to declines in income that depress aggregate demand (see table 3.1).

Labor Market Regulations for the Private Sector

Government intervention in labor markets has been extended to the private sector to provide social protection and justice to workers. Whether covering hiring contracts, minimum wages, severance pay, dismissal, the right to unionize, or the scope for collective bargaining, labor regulations aim to protect workers from arbitrary or unfair actions by employers while addressing potential market failures stemming from insufficient information and inadequate insurance against risk. These policies can be beneficial to workers, but they also raise the cost of doing business for private firms, reducing productivity and growth. Rigid rules and procedures discourage enterprise restructuring by imposing excessive costs and administrative burdens.

Effects of Minimum Wage in Morocco

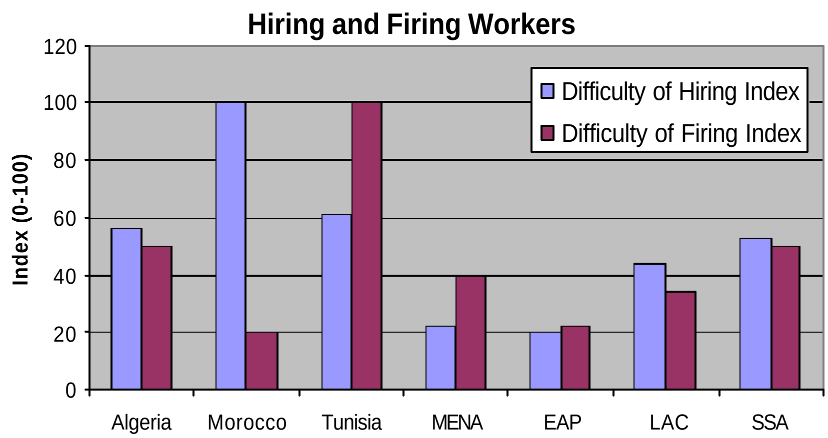
Officially, the minimum wage in Morocco is to be adjusted whenever the consumer price index increases by 5 percent. In practice, however, political discretion and pressure by labor unions tend to determine increases. During 1970-2000, the urban minimum wage rose an average of 6 percent a year, which translates into a 1.1 percent increase in real wages in urban areas. In the 1990s, growth of the real minimum wage in urban areas rose to 1.3 percent a year, exceeding the growth in labor productivity in the formal sector. By 2000, the minimum wage was close to half the average wage in the formal private sector and 178 percent of GDP per capita. Evidence suggests that the urban minimum wage is observed by the public sector and is well enforced in the formal private sector.

Several observers have argued that the increase in the urban minimum wage (a) reduced demand for unskilled labor; (b) contributed to a rise in unit labor costs, reducing Morocco's external competitiveness; and (c) encouraged the informalization of production. These factors may have pushed more unskilled workers outside the formal sector, where compensation is lower than the official minimum wage.

In simulations of a dynamic general equilibrium model for Morocco, a permanent 5 percent reduction in the urban minimum wage leads to a 3.7 percent increase in the demand for unskilled labor in the private sector in the first year. As a result, the unemployment rate for unskilled workers drops by about 2.4 percentage points a year. Employment of unskilled workers in the informal sector, as well as rural-urban migration rates, declines. By reducing the costs of unskilled labor, the reduction in the minimum wage also leads the private sector to substitute labor for capital. The effects on private consumption and output are also positive.

More flexible hiring and dismissal procedures are the most relevant policy issues in the reform of labor regulations affecting the private sector in Maghreb countries. These regulations limit job creation by reducing flexibility in the work force. Firms are hesitant to hire workers when it is unduly costly to hire or terminate them as economic conditions change. As a result, workers endure long unemployment spells, leading to skill degradation and lack of work experience. Unemployment of women and youth also rises with hiring and firing rigidities, which may limit the opportunities of disadvantaged groups to emerge from poverty. With few job opportunities in the formal economy, workers are pushed into the informal sector where social protection is lacking.

Hiring and firing procedures in the Maghreb are among the most restrictive in the world (see figure). Despite some recent reforms, the basic model of regulation persists in Maghreb countries. In Tunisia and Morocco, in particular, dismissed workers can purse legal measures that can result in heavy costs for firms and that subject firms to an unpredictable and inconsistent legal process. These countries have recently implemented legislation that expands the possibilities for part-time work and fixed-term contracts, which allow greater flexibility for firms (see box). However, this flexibility largely targets seasonal and low-skill workers. Thus, it does not address the most pressing issue of increasing flexibility for firms in more competitive, skill-intensive sectors, and does little to create incentives for firms to hire young, educated workers.



Note: Indices are from 1-100, with higher values denoting more restrictive environments.
Source: Doing Business 2004

There must also be more balance between restrictions on hiring and firing. While restrictions on hiring in Tunisia have been reduced, restrictions on firing are still high. And while restrictions on firing in Morocco have been reduced, they are still high in regard to hiring. Unbalanced reform of hiring and firing restrictions does little to effect change in the behavior of firms, since even those facing reduced hiring costs worry about the high costs of firing employees should the economic situation change. As a result, employers seeking flexibility are likely to find it attractive to offer nonpermanent positions and to avoid the obligations that still exist regarding layoffs and dismissal procedures

In an increasingly open economy, the Maghreb countries would benefit from alternative approaches to protecting workers that are external to the firm instead of internal to the firm. This could be achieved through (i) appropriate social protection system for those who risk losing their jobs (e.g., retraining, income supports, employment services that facilitate job search) and (ii) revision of the labor regulation to facilitate enterprise restructuring. In this context, active and passive employment policies are becoming more relevant.

Labor Regulation Reforms in Morocco and Tunisia

Morocco's Labor Code of 2003 introduced the following provisions:

- *Term contracts*: Nonagricultural sector firms that are newly established and are producing a new product may set up term contracts for one year, which may be renewed one time. If renewed again, the contract becomes open ended. Agricultural sector firms may conclude term contracts for a six-month period, which may be renewed up to three times before becoming an open-ended contract.

- *Open-ended contracts*: The new labor code permits a three-month probation period for high-level employees, a 1.5-month period for middle-level employees, and 15 days for lower-level employees. The probation period is renewable one time.

Tunisia's Labor Code of 1996 introduced the following provisions:

- *Fixed-term contracts*: The Labor Code establishes two categories of fixed-term contracts or *contrats à durée determinée* (CDDs). The first category is work of a definite term, which is stipulated as work stemming from (a) a temporary increase in activity, (b) the replacement of an absent employee, (c) seasonal activities, or (d) work that is by definition fixed in duration. In these cases, employers have no restrictions on CCDs. The second category is work of indeterminate length. In this case, fixed-term contracts are permitted for a maximum of four years and are subject to the agreement of both parties. CDD workers have the same rights as indeterminate-contract employees.

- *Part-time work*: This new category of work is defined as work for fewer than 70 percent of normal hours. It is intended to promote freedom of choice for all employees and equal treatment for part-time employees. According to the most recent Tunisian Employment Survey, 14 percent of all employment in 2001 was part time.

High nonwage labor costs in the Maghreb reinforce the incentives to hire workers on a temporary basis or to avoid registration requirements. In Morocco and Tunisia, nonwage costs paid by employers and employees make up, on average, 25 percent of the wage bill. In Algeria, contributions to the social security system constitute more than 36 percent of total labor costs. In Morocco, employers' share of social security payments is about 19 percent of the wage bill, whereas in Tunisia, it is about 16 percent. Other surcharges range from medical coverage, injury insurance, and safety provisions to vocational training. These costs force employers to reduce labor costs by hiring fewer workers or by employing more workers on a temporary or illegal basis. Furthermore, investment incentives that reduce the use cost of capital may have encouraged firms to adopt more capital intensive processes in order to improve flexibility in the face of such rigidities in the labor market.

Severance payments can be too generous. In the case of retrenchment, minimum severance requirements are established in the labor code in Morocco and Tunisia. In terms of generic severance pay, the most generous system is found in Morocco. Morocco's severance program also has the most complex design in the region. A unique feature of this system is that the rate of benefit growth increases in four steps for different brackets of seniority. Consequently, a Moroccan worker with up to six years of service receives the equivalent of six monthly wages per year of services, whereas a worker with 11 to 15 years of service is entitled to receive the equivalent of 1.15 monthly wages for each year of service. After 15 years of service, a Moroccan worker receives a constant rate of 1.43 monthly wages per year of service, capped at a maximum of 36 monthly wages. This ceiling is only reached after 26 years of service.

Other severance package schemes in the Maghreb are more modest. In Tunisia, eligible workers are entitled to generic severance pay of 1 day of salary for each month of service with a maximum of 3 monthly wages. This ceiling causes the benefit to become flat after only six years of service. Severance pay for arbitrary dismissal is generally higher. The most modest schemes are found in Algeria, where the final amount of the severance pay is set by court decision but is subject to a maximum of 6 monthly wages. This maximum is constant across all levels of seniority. This modest benefit reflects the use of an unemployment insurance scheme, as discussed below.

Table 3.1: Severance Pay Provisions for Termination of Labor Contracts in the Maghreb

	Type of Benefit	**Formula** MW = monthly wage HW = hourly wage DW = daily wage	**Restrictions**	**Eligibility/Coverage**
Algeria	Severance Pay for Abusive Dismissal	**6 MW** and salary for the period when employment was abusively suspended *	None	All salaried workers
Morocco	General Severance Pay Indemnity	**96 HW**/year for first 5 years of service; **144 HW**/year 6-10 years of service; **192 HW**/year 11-15 years of service; **240 SH**/year above 15 years of service	None	Workers with open-ended contracts and tenure of more than 6 months.
	Abusive Dismissal	**1.5 MW** per year of service*	Max: 36 MW	All salaried workers
	Dismissal for Economic Reasons	General Severance Pay Indemnity plus Advance Notice Indemnity	None	All salaried workers
Tunisia	General Severance Pay Indemnity	**1 DW**/month of service	Max: 3 MW	Salaried workers with an open ended contract
	Abusive Dismissal	One time amount*	None	All salaried workers

** Final amounts are set by court decision along the lines of the general formulas.*
Source: Labor Codes of Algeria; Tunisia and Morocco

The Limitations of Direct Policy Interventions

The outcomes from direct policy interventions are limited. Empirical simulations indicate that direct policy interventions would lead to positive labor and macroeconomic effects, in most cases contributing to higher employment, private investment, and output growth in the long run. Reflecting complementarities between policies, the simulations suggest that a comprehensive rather than a piecemeal approach delivers the biggest impact. However, the employment and growth payoffs associated with even the most comprehensive package of interventions are modest considering the magnitude of job creation needed in the Maghreb.

Thus, labor market reforms are a necessary component of policy reforms, but they are not sufficient for addressing the scope of the employment challenge facing the region. While certain priorities for reform are common to all countries in the region, such as reducing the role of the public sector in labor markets, the importance and likely impact of other reforms will vary across countries. Economic and political conditions and a careful understanding of labor market issues in each country must determine the priority areas of reform.

Active and Passive Labor Market Programs

Outside of state intervention in labor markets through public employment and private sector regulation, governments can effect changes in employment through the use of active and passive labor market policies. The most effective of these are passive labor market policies such as unemployment insurance programs. In lieu of such programs, however, active labor market policies can provide an important – if limited – instrument for tackling labor market dislocations and combating aggregate unemployment.

Of Maghreb countries, only Algeria has employed passive labor market policies to date. Algeria introduced unemployment insurance in 1994 as part of a broader retrenchment program. It was implemented relatively efficiently by tying it to the existing social security infrastructure. Benefits in the Algerian unemployment insurance system consist of an upfront, firm-financed severance payment equivalent to one month's salary per year of tenure up to three years, followed by a monthly benefit paid by the unemployment insurance fund at a level proportional to salary. Benefit levels are subject to a minimum (three-fourths of the minimum wage) and a maximum (three times the minimum wage) standard. Workers laid off for economic reasons, who have been affiliated with the social security system for at least three years, and who receive no alternative earnings are eligible to collect benefits. This unemployment insurance system has given employers some flexibility in their labor decisions and stimulated labor reallocation. It has shifted some of the responsibility for the welfare of dismissed workers and their families from internal to the firm to mostly external to the firm. However, total costs for employers associated with layoffs have not changed much. Instead of one upfront severance package, employer costs are now spread out over a one- to two-year period.

All Maghreb countries have used active labor market programs (ALMPs) extensively to create employment. From wage and employment subsidies, to training and retraining for the unemployed and particularly youths, to direct job creation programs and job search and assistance services, these policies are designed to create employment opportunities and manage labor market risks. In countries that lack functioning national unemployment insurance systems, ALMPs constitute a relevant instrument for tackling labor market dislocations. Morocco and Tunisia have a long tradition of using these programs, and Algeria introduced them following the structural adjustment in the 1990s.

Table 3.2: ALMPs in the Maghreb by Cost and No. of Beneficiaries

Program Name	Costs (% of GDP)	No. of Beneficiaries
	ALGERIA	
ESIL	0.05	66,000
CPE	0.04	8,000
ANSEJ	0.08	22,000
Public Works	0.18	139,000
TUP-HIMO	0.04	4,000
IAIG	0.14	135,000
Vocational Training	0.22	380,000
Others	0.10	..
Total	**0.60**	**616,000**
	MOROCCO	
Vocational Training	0.42	181,000
CIOPES	0.12	19,500
State Credits	0.10	6000
Seed Money	0.05	..
Total		**206,500**
	TUNISIA	
Public Employment Services	0.07	1,843
Labor Market Training	0.06	15,270
Youth Measures	0.56	69,480
Subsidized Employment	0.79	96,568
Unallocated	0.02	..
Total	**1.49**	**183,161**

Note: For abbreviation definitions, see page 2.
Source: Country sources and World Bank staff estimates.

Spending on these programs is high and the impact of the programs is not evaluated. Currently, Tunisia spends 1.5 percent of GDP on ALMPs. Morocco spends about 0.7 percent and Algeria spends 0.6 percent. Still, only a small share of the labor force is likely to be covered by these programs. Furthermore, to be effective, ALMPs need to be carefully targeted and monitored. Inappropriately designed, such programs may have high fiscal costs and negative economic effects. To date, Tunisia is one of the few countries in the region to have instituted an outcome evaluation program for ALMPs, and it is limited in its capacities.

The structure of ALMPs in the Maghreb is different from other developing regions and the OECD. The Maghreb spends much less, as a share of total spending, on public employment services, administration, and labor market training than other regions. On the other hand, spending is much higher on youth measures (including pre-employment training) and support for self-employment. In contrast, many countries in the OECD spend virtually nothing on these latter types of interventions. While this emphasis on youth training is understandable given the young nature of the Maghreb's unemployed population, such emphasis may be misplaced. Youth unemployment is largely an issue of high reservation wages of young, educated workers. Additional training does not make them more competitive in the private sector since, in essence, they are overqualified for the positions that the private sector is willing to offer them.

Furthermore, the emphasis on youth leaves older workers largely outside of the safety net provided by ALMPs, leaving them particularly vulnerable in the face of retrenchment.

Despite the political appeal and contribution to poverty alleviation of ALMPs, evidence from industrial and developing countries suggests that such policies do little to remedy structural problems in labor markets or to reduce high unemployment. In short, they are a poor substitute for good macroeconomic policy in creating vital labor markets. To more effectively combat high levels of unemployment in the long term, countries will have to address underlying structural problems and move to create more dynamic labor markets. The remainder of this paper is focused on how to best secure the vital labor markets needed in the Maghreb to achieve sustainable job creation and alleviate high levels of unemployment

Chapter IV:
UNLOCKING THE POTENTIAL FOR JOB CREATION

The challenge of job creation requires a comprehensive approach to reform, although the priorities and sequencing of policy reforms will vary across countries by specific initial conditions, including resource endowments, reform progress to date, and the quality of institutions. The need for a comprehensive approach does not diminish the value of incrementalism in advancing reform agendas. Nor does it underestimate the importance of sequencing reforms in ways that maximize prospects for success. It does, however, shape the view of what is needed to restore economic opportunity and secure the well-being of the population. The countries of the Maghreb require a broad-based transformation of their economies to strengthen the core drivers of economic growth and create viable prospects for job creation to absorb the millions of men and women entering the work force over the coming two decades.

Weaknesses of Traditional Engines of Job Creation

It is highly unlikely and even undesirable for the public sector to remain a leading sector of job creation in the future, although government may continue to be a source of employment for a minority of new job seekers. Fiscal constraints and low worker productivity imply that any expansion of public sector employment would come at an increasing fiscal cost and would not be sufficient to absorb the lines of unemployed and new graduates queuing for government employment. Barring an acceleration of employment growth in the formal private sector, the rising numbers of new entrants would be pushed into the informal economy.

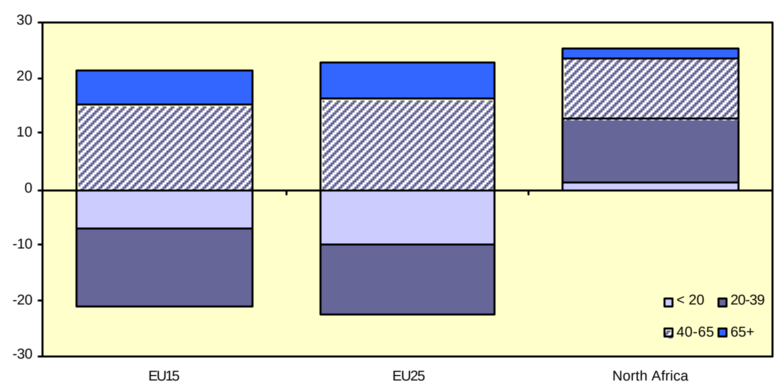
The prospects for labor migration are equally limited in the near future. While intraregional migration provided an important outlet for workers in the labor-exporting countries during the oil boom in the 1970s and 1980s, the past decade has seen a rapid deceleration in the net outflows of MENA workers in the receiving countries. Migration to Europe, particularly important to Maghreb countries, is constrained by policy. While demographic outcomes in Europe and the Maghreb suggest that migration opportunities should increase in the future, this would only provide a partial solution to the employment challenge (see box).

Future Migration between Europe and the Maghreb

The dynamics of demography in sending countries in the Maghreb and receiving countries in Europe provides hope for migration prospects. According the United Nations projections, the working-age population (ages 15-64) in the European Union will increase by 1 million people a year between 2000 and 2010, while the retirement age population will expand by close to four times as much (3.6 million a year). The resulting increase in dependency ratios is expected to adversely affect the sustainability of Europe's pension systems. As such, replacement migration on a large scale has been proposed as one of the few means of raising the number of workers relative to retirees. The likelihood that migrants from elsewhere in Europe could completely fill the demographic gap is limited given the similarities in age structure of EU accession countries.

The Maghreb's young population structure and rising working-age population are a potential source of workers. However, the political economy governing Europe's current migration policy runs to the contrary. Migration has become a contentious issue in Europe driven by a host of factors, including labor market conditions and cultural identity. With a large pool of long-term unemployed workers in the EU, competition from foreign workers is not viewed positively. Moreover, EU migration policy in the medium term is likely to focus first on accommodating workers from accession countries, who are likely to provide competition to the already dwindling flows of workers from the Maghreb. The Euromed Initiative focuses almost exclusively on trade flows and provides little institutional scope in support of labor mobility between the Maghreb and Europe. Increasing migration to Europe would require a significant change in EU migration policy and would provide only a partial solution to the employment challenge in these countries.

Net Population Increase in the European Union and North Africa, 2000-2010 (millions)



Notes: EU15 includes current members of the EU; EU25 includes applicant accession countries; North Africa includes Algeria, Egypt, Morocco and Tunisia.
Source: UN 2002.

The Need for New Development Policies

The MENA Development Reports on Employment, Trade, and Governance argue that for MENA countries, including those of the Maghreb, to accelerate job creation and growth, they must address longstanding policy and institutional challenges in order to complete three fundamental and interrelated realignments in their economies:

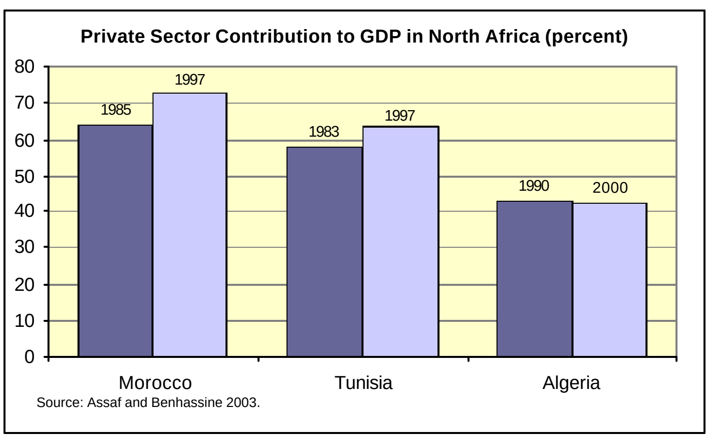
- ***From public sector dominated to private sector dominated.***
- ***From closed to more open economies.***
- ***From oil dominated and volatile to more stable and diversified.***

The growth and employment impact of such an integrated package of policy realignments is potentially large. Based on the experience of comparable countries, the MENA Regional Trade Report estimates that output per worker could increase by some 2 to 3 percent a year. The companion governance study, using similar international evidence, estimates that a commitment to improving the institutions of accountability in public administration could raise output growth per capita by between 0.8 percent and 1.3 percent a year. Together, these studies suggest that output per worker growth could be raised by at least 3.5 percentage points.

The positive implications of such performance for future job creation are profound. In MENA, for instance, bridging only half the gap between the current 6 percent share of nonoil merchandise exports in total exports and its potential of 20 percent, with the associated increases in domestic and foreign private investment, would cut the unemployment rate in the region by 4 percentage points of the labor force. The broader reform agenda would bring even larger benefits.

Transition 1. Reinvigorating the Private Sector

Since the late 1980s, most Maghreb countries have tried, with varying intensity and success, to expand private sector activity. At the same time the importance of the public sector has declined, as seen in steps taken to privatize and reduce subsidies to SOEs. But governments still represent a large share of value-added in these countries. As a result, the contribution of the private sector to value-added increased only marginally in the 1990s. The same pattern has characterized the share of the private sector in total investment, which did not increase enough to compensate for the decline in public investment. Improving these outcomes requires substantial reform in the business environment in order to encourage entrepreneurship and firm creation.

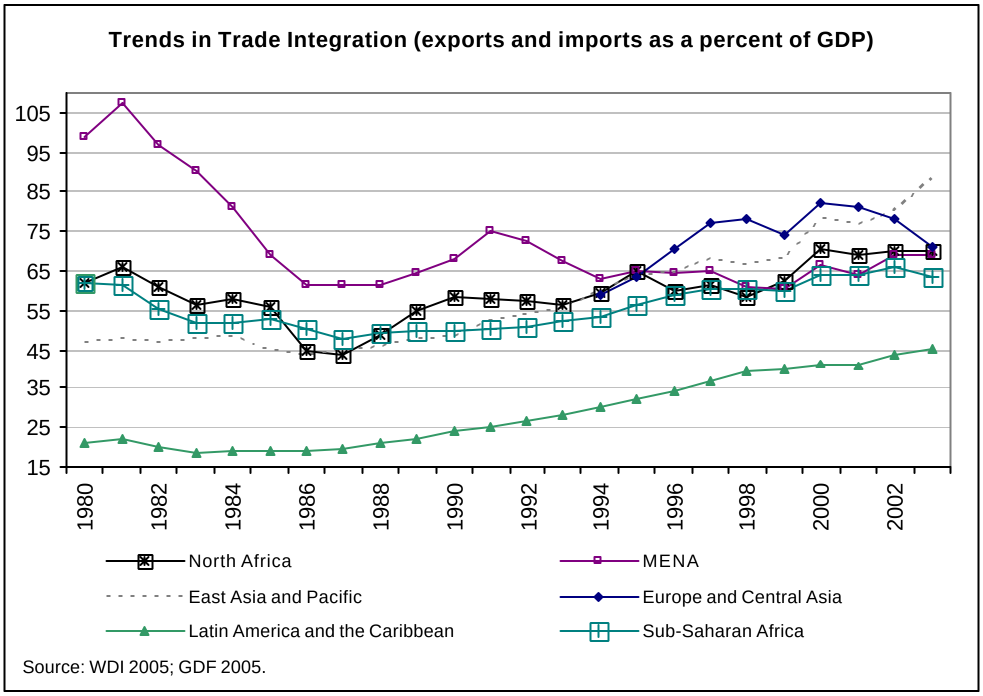


Maghreb countries have made steps in recent years to improve business environment. As part of industrial modernization efforts under the *Mise a niveau* program, Morocco and Tunisia have implemented new measures to create a more favorable investment climate and encourage private sector growth. Morocco has cut the number of procedures for starting a business from 11 to 5. In addition, Morocco's privatization progress has been strong, with 40 companies wholly or partially privatized in the oil refining, road transport, telecommunications, and banking sectors. Morocco has made efficient use of public–private contracts in several sectors and is continuing to liberalize the communications and air transport sectors. Serious improvements have also been made in the business environment in Tunisia, including recent reforms in the legal framework for asset recovery and bankruptcy. Deregulation legislation in Algeria opened nearly all economic sectors to private and foreign investment and competition, including banking, telecom, pharmaceuticals, transport, and heavy industry (excluding hydrocarbons). However, the structural reform agenda was subsequently paralyzed. Only 19 companies were privatized in 2003, out of 1200 SOEs.

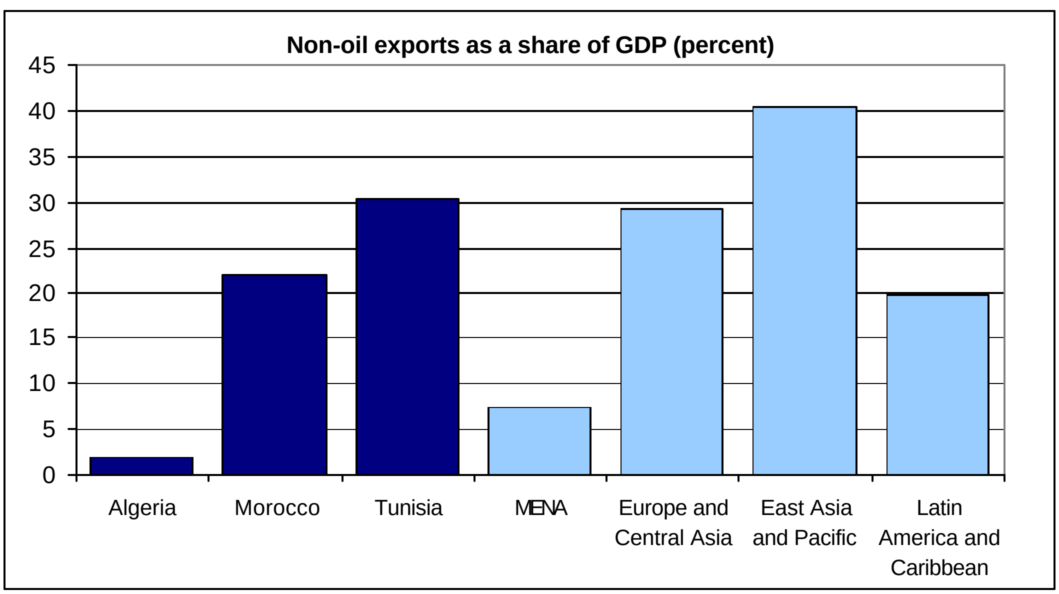
Despite these efforts, new firms face significant barriers to entry, both in terms of the time and cost of administrative approvals. New firms also face significant difficulties securing start-up and operating capital with public banks. Regulations do not facilitate the restructuring of still-viable businesses, while nonviable firms are not permitted to close operations expeditiously, raising the social and economic costs of bankruptcy. In addition, the Maghreb compares poorly with other regions in the complexity of filing a legal claim and in the time needed to initiate and complete such a claim. Even where the legal processes are defined, the unpredictability of enforcement creates problems for entrepreneurs. Businesses also suffer from weaknesses in infrastructure and the financial system, as well as poor administration of licensing, regulations, taxes and import duties.

Transition 2. Integrating with the World Economy

MENA remains one of the least integrated regions, having failed to take advantage of the expansion in world trade and foreign direct investment (FDI) in the past two decades. Since the mid-1980s, global trade has expanded more than output, to the advantage of middle-income countries. In MENA, despite large hydrocarbon exports, trade declined from about 100 percent of GDP in the mid-1970s to 60 percent in the mid-1980s and stagnated in the 1990s. Trade has risen as a share of GDP since; however, this is largely based on rising oil prices and non-oil exports as a share of GDP remain low, particularly for Algeria. These negative outcomes have been accompanied by high and increasing product concentration, loss of export dynamism in nonfuel exports, and little participation in global production sharing.

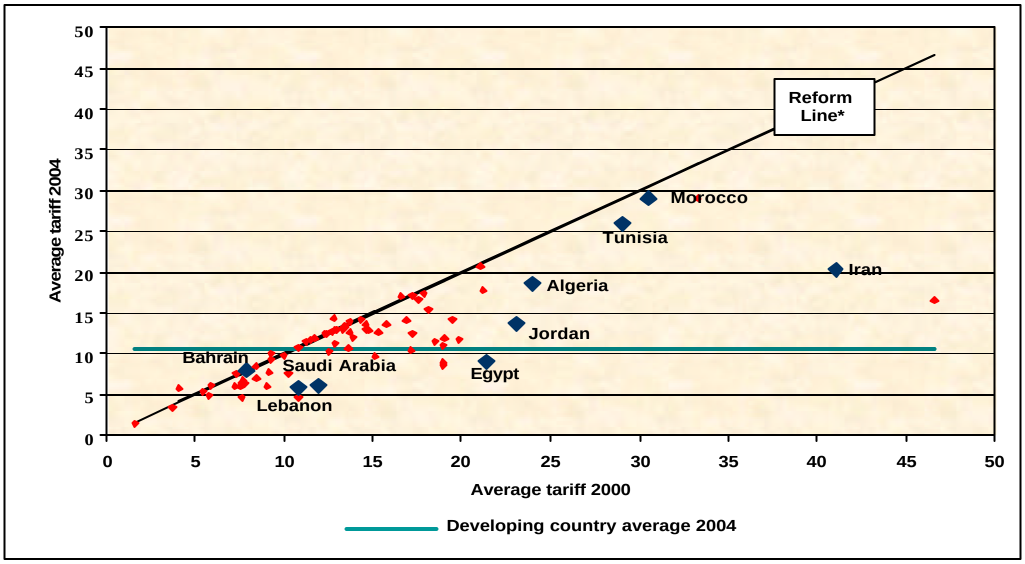


The Maghreb is, by and large, on the positive end of MENA in regard to trade. In the last several years, North African countries have made substantial progress in establishing bilateral and regional trade accords. Starting in the mid-1990s, these countries sought to strengthen trade with Europe through Euromed and eventually EU Association Agreements (currently in force in Algeria, Tunisia, and Morocco). Recently, countries have developed greater intraregional ties through the Pan-Arab Free Trade Agreement (PAFTA) and the Agadir Agreement (signed by Morocco, Tunisia, Jordan and Egypt in 2004). Also, Morocco signed a bilateral trade agreement with the US in 2003.



Largely in the context of these agreements, Maghreb countries have made notable progress in regard to removing barriers to trade. There have been observable declines in average tariffs in all three countries in recent years, while Morocco and Tunisia have made substantial progress on decreasing non-tariff barriers. However, these countries still maintain some of the highest tariffs in the MENA region and are well above the developing country average.

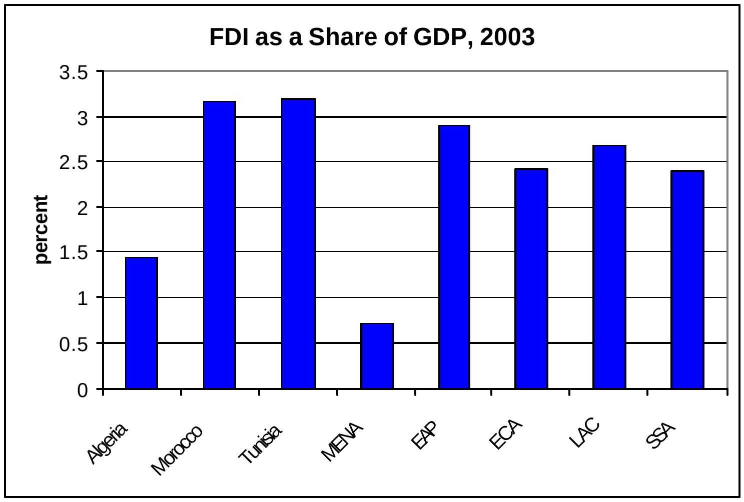
Unweighted average tariffs in MENA versus the world
2000 and 2004



Source: TRAINS database. Note: * Countries below and to the right of the line can be considered "reformers" in that they lowered the average unweighted tariff.

In addition, the expiry of the WTO's Multifibre Agreement (MFA) in January 2005 will increase competition for dominant textile exporters Morocco and Tunisia. It is expected that this increase in competition will lead to export declines in the textile sector. This will have particular ramifications on female employment opportunities in a region where female unemployment is already high.

On the other hand, Maghreb countries have been successful in drawing foreign investment. While integration with global private capital flows in MENA has also been sluggish, with FDI making up about 0.7 percent of its GDP, Maghreb countries have attracted much higher level of FDI. In 2003, FDI was 1.4 percent of Algeria's GDP. In Morocco and Tunisia, it amounted to 3.2 percent of GDP. This compares to 2.9 percent in East Asia and the Pacific, 2.7 percent in Latin America and the Caribbean, and 2.4 percent in Sub-Saharan Africa. The Maghreb's relatively strong performance in this regard is largely the result of efforts to increase investment incentives and reduce constraints for foreign investors in recent years, as noted above.



Transition 3. Managing Oil Resources Better

Many MENA countries, including Algeria, need to undergo a third transition to become more stable and diversified economies. This requires better management of oil resources, which implies setting up institutions and fiscal rules that insulate public expenditures from oil price volatility and save oil revenues so that they benefit citizens when oil resources decline. It also means improving the efficiency of public expenditures through better systems of budgeting that emphasize performance and accountability. In terms of managing the recent oil revenue windfall, Algeria has maintained a due level of prudence in comparison to previous booms. It has substantially drawn down external liabilities, with its debt-to-GDP ratio declining over 25 percentage points since 1998. However, other public expenditures have been focused on alleviating short-term pressures more than implementing sustainable economic development through long-term reform efforts. Under the Economic Recovery Program, only 9 percent of spending was allocated to specific structural reforms, none of which came to fruition. Nearly 40 percent was allocated to public works programs creating temporary, low-skill jobs.

Broadening the productive base of economic activities is also a growing priority. While oil prices have rapidly increased since 2000, long-term stability and growth is dependent on diversifying into other sectors, particularly sectors that provide strong impetus for job growth. The oil industry is capital intensive and does not serve as an engine of job growth in and of itself. Algeria could make advances by diversifying into privately-provided services and by opening its economy further in order to gain additional access to international markets. Expansion of services with high locational benefits, including tourism and ports, enable greater competitiveness. Increased trade integration will allow Algeria to boost the returns to scale for producers and boost consumer welfare by enabling access to cheaper products from abroad.

Better Governance Is Central to the Transition

The government's role in the economy needs to be redefined. If states no longer serve as employers of first resort, they can be more engaged as partners in creating and sustaining opportunities for employment. A vigorous state role in improving social services, especially health, education, and social security, is essential to establishing the conditions that will permit workers to thrive and economies to grow at rates high enough to address the job creation challenge. State support will be needed to transform existing institutions of labor representation into a true system of collective bargaining. New state capacities are required for the effective administration of social programs aimed at overcoming dysfunctions in labor markets and protecting workers during economic transition.

Efforts to complete the reform effort hinge on the credibility of governments and the capacity of state institutions to manage a complex, long-term process of change. Maghreb governments are handicapped by the limits of institutional structures organized to support redistributive and interventionist policies and the difficulties such institutions confront in adapting to new tasks, new policy demands, and new regulatory environments. Governments need effective institutional and regulatory instruments to manage the difficult process of economic transition under conditions of economic volatility and social vulnerability.

Accordingly, governance reforms are essential to permit these governments to credibly articulate and realize a new vision of state–society relations. The tasks associated with this aim demand a degree of government initiative, creativity, and competence that must be cultivated aggressively throughout the region. To move forward, governments themselves must link economic performance to the quality of governance. They must create rule-of-law mechanisms to ensure their own accountability and transparency (including in budgeting and fiscal policy) to enable citizens to scrutinize government performance and hold officials accountable for their actions.

The Need for a New Social Contract

Reform of the social contract is crucial for the future of the region's labor markets. The rigid, exclusionary and inefficient aspects of the redistributive–interventionist social contract jeopardize the well-being of workers. It shifts economic activity to the informal sector and leaves too many workers unprotected. It constrains investment and growth, undermining the capacity of governments to deliver on their commitments to economic and social justice. Under conditions of high unemployment, resistance to reform deepens among those whom the social contract protects.

The Maghreb's social contract offers a minority of workers employment security, but at the expense of declining wages and standards of living. The social contract is important in preserving programs that benefit the working poor, but safety nets are stretched beyond their capacity. Declining state revenues and the worst projected employment gap in the world renders the existing social contract unsustainable. Yet, reforms will not be credible unless they take into account the social needs of workers and ensure that economic outcomes are socially acceptable among citizens of the Maghreb countries. This requires a renewed political commitment to widely valued social policies—a new social contract that links reform to the principles of poverty reduction, income equality, and income security that have guided these political economies for almost 50 years.

A new social contract will have long-term benefits for the Maghreb. It will balance the need for labor market flexibility with the rights of workers, helping to avoid social dislocation and conflicts by offering a positive role to labor in the transition to and coordination of more flexible systems of production. Furthermore, it will create mechanisms for supporting workers as they respond to changes in the structure of employment associated with privatization and the shift to more open economies with different skill requirements and greater dependence on new information technologies.

Securing these gains demands a clear vision of how tomorrow's labor markets should be organized. The desired outcome is not an unregulated labor market that exposes workers to harsh working conditions, employment volatility, and income insecurity. Nor is it a labor market in which growth is achieved through a race to the bottom, accompanied by declining living standards for workers and worsening income inequality. New development policies are needed that support a race to the top and ensure that workers participate in the benefits of economic growth.