BETTER POLICIES FOR INCLUSIVE GROWTH AND ECONOMIC INTEGRATION IN THE MENA REGION

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BETTER POLICIES FOR BETTER LIVES

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Foreword

Many things have changed in the world since 2005, when high-level government officials and other stakeholders met at the Dead Sea to launch a co-operation platform between the Middle East and North Africa (MENA) and the OECD. Back then, global economic activity was expanding, with dynamic emerging economies, increasing trade and investment flows and high commodity prices. The MENA region itself was registering relatively dynamic economic growth and investment rates, supported by reforms to increase economic openness, diversification and private sector development.

While the global economic and financial crisis of 2008-10 had limited effects on most MENA economies, the massive protests that started in 2011 have demonstrated that the region's reform efforts did not lead to sufficient prosperity and inclusiveness for large parts of the Arab populations. Persistent inequalities of opportunity, high poverty rates in the most vulnerable economies and weak job prospects, especially for the many young people wishing to enter the labour market, are major sources of social distress.

MENA economies and OECD members share many goals, including the need to undertake ambitious and coherent structural reforms to regain growth, create jobs and achieve more inclusive and sustainable development models. They also have a shared interest in fostering stability and resilience in the MENA region. Building on more than ten years of MENA-OECD co-operation, this report aims to help the region identify reform priorities to promote more inclusive and sustainable growth. The list includes improving the effectiveness and efficiency of public administrations, enhancing tax design and collection, fostering private sector development, boosting international trade and investment, upgrading the region's infrastructure, ensuring sustainable management of water and energy resources, fostering social inclusion of women and youth, raising the performance of education systems and strengthening resilience in the region.

This publication has been prepared for the MENA-OECD 2016 Ministerial Conference on 4 October 2016 in Tunis. The meeting marks the start of a new phase of the MENA-OECD Initiative on Governance and Competitiveness for Development, a platform for policy dialogue at both political and technical levels. The report aims to contribute to the substantive discussions and decisions at the Ministerial Conference and to the future activities of MENA-OECD initiatives. Together, the OECD and its MENA partners will continue to design, develop and deliver better policies for better lives across the MENA region.

Angel Gurría
Secretary-General, OECD

Content

1 Introduction

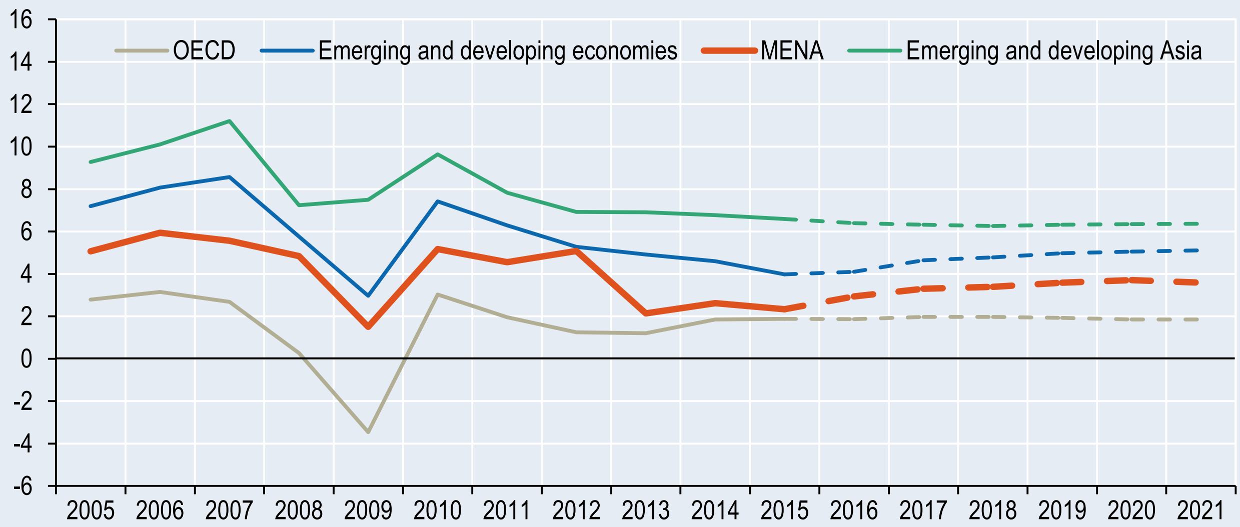
The MENA region registered relatively dynamic economic growth and investment rates during the first decade of the century, even during the global economic and financial crisis. This was helped by important reforms by many governments to increase economic openness, diversification, private sector development and institutional reform. The participation of Tunisia and Jordan in the Open Government Partnership, the massive investment in infrastructure by Morocco and Egypt to increase connectivity and improve participation in global trade, and the efforts of the United Arab Emirates to diversify its economy demonstrate the great potential of the region to achieve progress. However, recent political instability and security threats have considerably slowed economic prospects. Reforms have not succeeded in tackling deeper structural challenges, such as corruption, unemployment, uneven development and unequal opportunities, especially for disadvantaged regions, women and youth. Appropriate policy responses are needed to regain stability and lay the foundations for a more open economy and a more inclusive development model. While the MENA region is profoundly heterogeneous, there are significant common economic and institutional trends that support the need for more concerted action to exploit the immense potential of the region and ensure its fruitful integration into the global economy.

MENA economies face daunting challenges

The MENA region enjoys a privileged geographic location, a young and increasingly educated population and comparative advantages in certain sectors, such as renewable energies. However, MENA's growth is lagging behind that of other emerging and developing regions (Figure 1.1). While the impact of the 2007 financial crisis was less severe than in other parts of the world, it still exacerbated the structural problems of the region. Despite the high diversity of the region (Figure 1.2), many MENA economies continue to be affected by low oil prices and deepening political conflicts that have weakened investors' confidence and limited important revenues in the extractive industries and in tourism. This has hindered the already weak private sector expansion and public infrastructure development. Today, the MENA region has not regained its pre-crisis growth levels.

FIGURE 1.1. **ECONOMIC GROWTH IN THE MENA REGION IS LAGGING BEHIND OTHER EMERGING AND DEVELOPING ECONOMIES**

Real GDP growth rate, in %

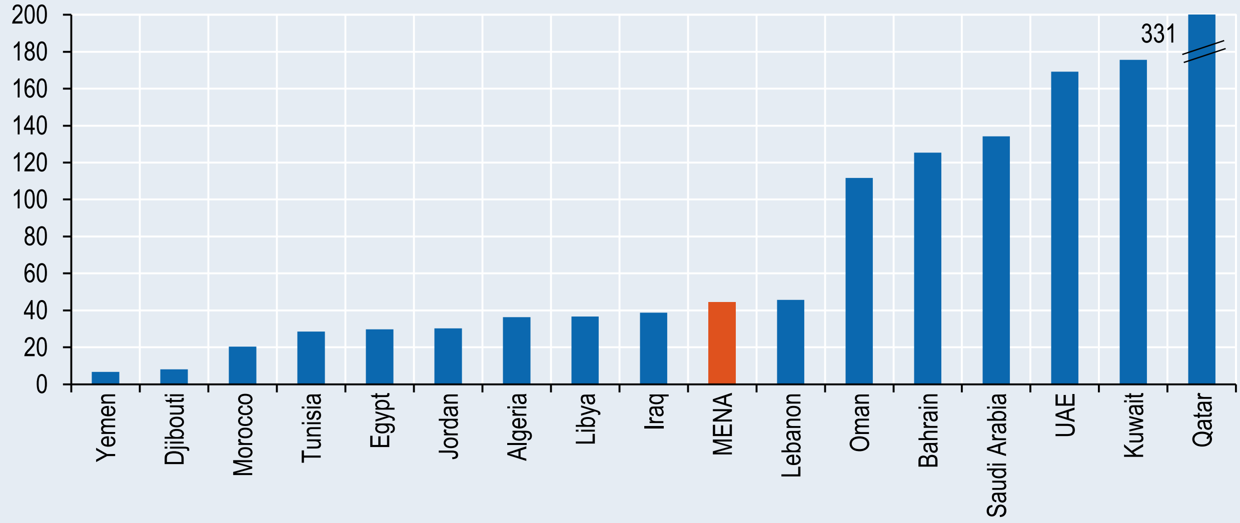


Note: Values for 2016 to 2020 are projections.

Sources: OECD Economic Outlook Database and International Monetary Fund (IMF) World Economic Outlook Database.

FIGURE 1.2. **DESPITE REGIONAL WEALTH DIVERSITY, GDP PER CAPITA REMAINS WELL BELOW THE OECD AVERAGE IN MOST MENA ECONOMIES**

GDP per capita in % of OECD average



Note: GDP is calculated in current PPP US dollars.

Source: IMF World Economic Outlook Database.

Annual growth between 2009 and 2015 was 2 percentage points below the pre-crisis rate, and the region's long-term growth prospects have significantly declined. Although it has one of the fastest growing populations in the world, the MENA region is expected to see its relative size in the global economy decrease in coming years. Moreover, despite significant efforts by many governments, reforms have not succeeded in tackling the region's pressing social challenges. Development and opportunities remain unequal, with particular impact on women and youth. Between 2009 and 2015, youth unemployment in the MENA region increased from 24% to 29%, reversing the trend decline of the previous decade. Income inequality is not particularly high in the MENA region (the Gini coefficient averaged 38% between 2000 and 2010, well below levels seen in some other emerging regions such as Latin America, where the Gini coefficient is above 50%). But perceived inequality of opportunity, high poverty for the most vulnerable economies and a lack of job opportunities for the many people wishing to enter the labour market have surfaced as major causes of social distress. This challenging situation calls for a concerted and urgent response by economies in the region to regain stability and lay the foundations for a more sustainable development model.

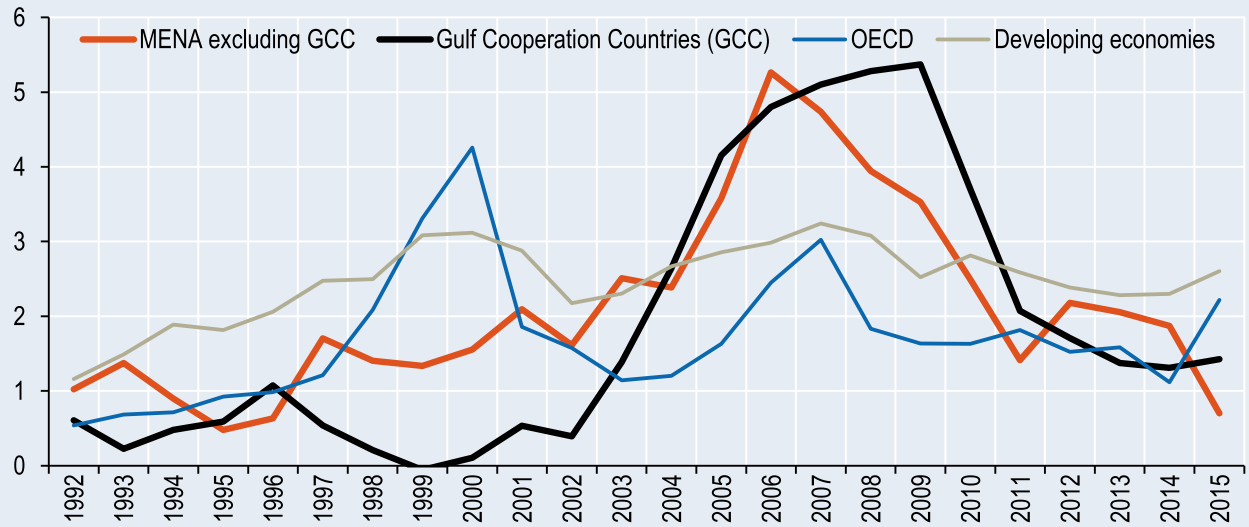
Diversification – the first pillar of a more sustainable development model

While security tensions may be a temporary factor and long-term oil price developments are uncertain, the growth deceleration of MENA economies clearly highlights the region's high exposure to oil price movements as well as broad-based weaknesses in competitiveness. Exposure to oil price movements is foremost a problem for oil-exporters. They have to rely on their substantial net foreign assets to avoid currency depreciation and urgently need to diversify public revenue sources to safeguard fiscal sustainability (Chapter 2). Weak competitiveness applies to oil-exporting and oil-importers alike, and many MENA economies have launched ambitious reform strategies to tackle underlying structural weaknesses.

Strengthening the role of the formal private sector should be the most important element of any strategy to boost diversification and competitiveness (Chapter 4). In 2014, on average across the region, the private sector accounted for around 40% of GDP, below the OECD average of 59%. Furthermore, although statistics on the split of employment between the private and public sector are scarce and outdated, it is well known that public sector jobs in the region are considered more secure and more desirable than jobs in a generally underdeveloped private sector.

FIGURE 1.3. **FDI INFLOWS INTO THE MENA REGION HAVE FALLEN**

FDI inflows, % of GDP



Source: UNCTAD latest data and OECD staff calculations.

Fostering private sector development will require efforts to eliminate unnecessary and burdensome regulations, implement effective policies for entrepreneurship and small and medium-sized enterprises (SMEs), facilitate access to finance and improve corporate governance.

These reforms should be complemented by a reduction of barriers to trade and ground-level obstacles to investment (Chapter 5). Intra-regional trade is weak, with only 10% of total trade of the region between MENA economies. Trade restrictions remain significant, exports' value-added and diversification are weak, and integration into global value chains (GVCs) is still limited. Inflows of foreign direct investment (FDI) fell significantly in recent years (Figure 1.3), and the correlation between real GDP growth and investment has been weaker than in other parts of the world.

It is also essential to improve the quality of the region's infrastructure to facilitate trade and investment and foster integration into regional and global value chains through better connectivity (Chapter 6). While infrastructure development is needed in a wide range of areas, including transport and logistics, energy and water warrant specific attention (Chapter 7). Improving energy efficiency, expanding infrastructure capacity, enhancing accessibility and, most importantly, shifting public and private investment towards clean energy should remain key priorities both for oil-importing and oil-exporting MENA economies, especially in light of the region's comparative advantage in solar power. Similarly, the region needs to increase efforts to manage the scarcity of water. Water stress is expected to significantly intensify in the next decades, as a result of strong population growth and increased economic activities, making better water management crucial for sustainability of the region in the medium and long term.

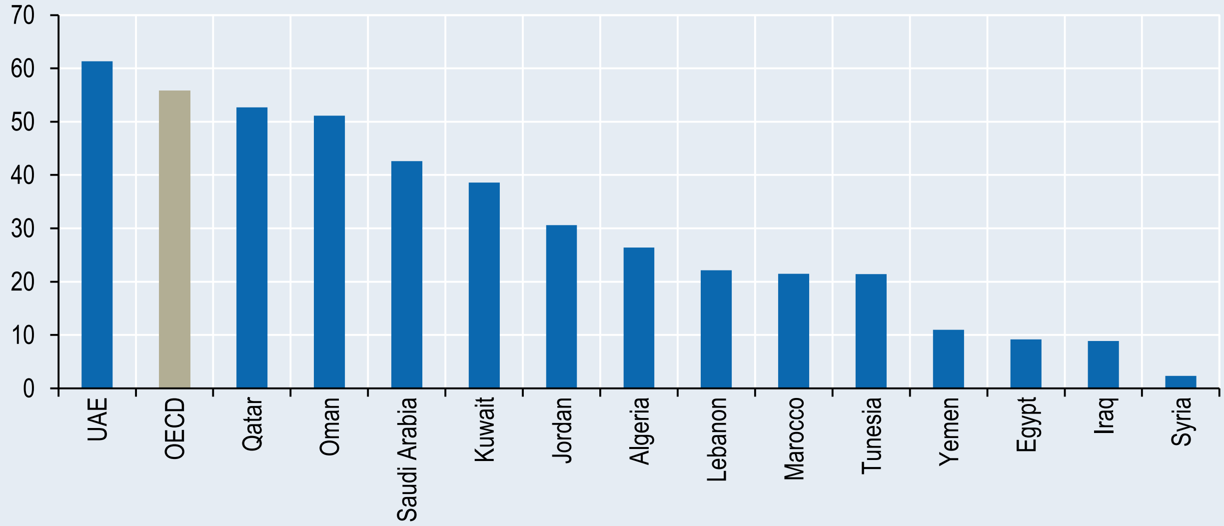
Inclusiveness – the second pillar of a more sustainable development model

Conflict and fragility have become pervasive in the MENA region. The ongoing conflicts in Iraq, Libya, Syrian Arab Republic (hereafter "Syria") and Yemen are having a devastating impact in these countries and impose significant pressures on their neighbours. Ongoing conflicts have taken a toll on human and physical capital, disrupted production methods and trade routes, and created uncertainty. At the same time, the Arab upheavals have highlighted the profound dissatisfaction of large parts of the population, particularly youth, with how their economies are governed and how the benefits of economic growth are shared (Figure 1.4).

The main legacy of the Arab upheavals is social pressure to build more efficient and transparent public administrations and to fight corruption at all levels (Chapter 2). Promising reforms are underway in several countries, aiming to strengthen the rule of law, promote more open

FIGURE 1.4. **FEW YOUTH IN MENA ECONOMIES ARE SATISFIED WITH THEIR LIFE**

Percentage of youth thriving, 2013



Note: Response options in the survey include thriving, struggling and suffering.

Source: OECD calculations based on Gallup World Poll 2011-13.

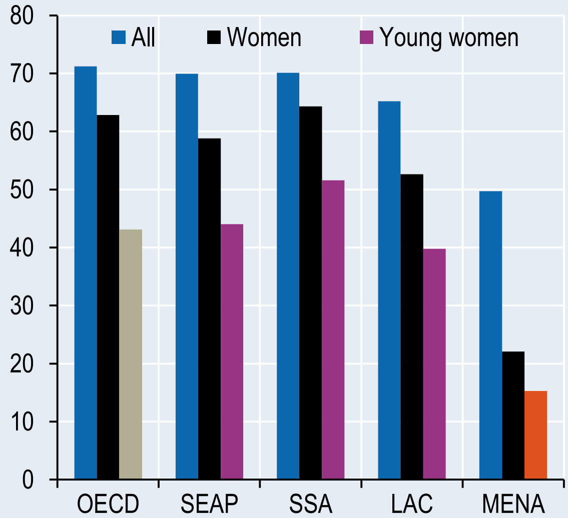
and inclusive approaches to designing policies and services, build effective safeguards against corruption, and modernise the machinery of government. In this context, making tax collection more effective and efficient to ensure that all contribute their fair share should be an important priority (Chapter 3).

Making labour markets more inclusive is another key priority for MENA economies (Chapter 8). Labour markets in the region are highly conditioned by clientelistic and family networks. Women and youth in particular suffer from the ineffectiveness of labour markets, with the MENA region trailing global rankings of female and youth labour force participation (Figure 1.5). People with access to quality education are typically more likely to find a job and participate more actively in civic life. Ensuring that all students, not just the privileged few, acquire the skills necessary to succeed in life is therefore essential to build social stability and lead to better economic outcomes (Chapter 9).

Making the MENA region more resilient to conflicts requires a better understanding of how to strengthen economies' assets, reduce risks, deal with the consequences of shocks and embed a resilience focus into crisis response. As recognised in the Resilience Agenda, the private sector is essential for economic recovery, reconstruction, and stabilisation of the region. The private sector can play a positive role by responding to reconstruction needs and helping with labour market integration of displaced population groups. In this sense, promoting economic and social resilience will require developing policies that link immediate responses with long-term development policies, transforming mitigation actions into development opportunities (Chapter 10).

FIGURE 1.5. LABOUR FORCE PARTICIPATION RATES ARE LOW IN THE MENA REGION, PARTICULARLY AMONG WOMEN

Labour force participation, % of active population, 2015 or latest available year



Note: SEAP = South East Asia and the Pacific, LAC = Latin America and the Caribbean, SSA = Sub Saharan Africa.

Source: ILO, ILOSTAT and Key Indicators of the Labour Market.

2 Improving the efficiency and effectiveness of public administrations

The public sector in the MENA region traditionally plays an important role in many areas of public and economic life, and it spends a higher share of GDP than the OECD average. MENA economies are currently undergoing major public administration reforms to promote efficient, effective and inclusive delivery of quality services to citizens and business. This recognises the fact that good public governance can translate into inclusive growth, with positive effects on incomes, jobs and living standards. The United Nations Sustainable Development Goals call for "effective, accountable and transparent institutions at all levels". Strong political commitment is needed to ensure that reform processes contribute to the emergence of a new approach for the public sector of MENA economies, to put citizens' interests first. Pursuing inclusive growth requires a whole-of-government approach to align this vision with incentives and delivery mechanisms across the policy-making cycle. The heterogeneity of the MENA region requires different solutions to what appear to be common problems. Promising reforms now underway aim to implement new policy tools to strengthen the rule of law, promote more open and inclusive approaches to designing policies and services, build effective safeguards to fight corruption and modernise the machinery of government.

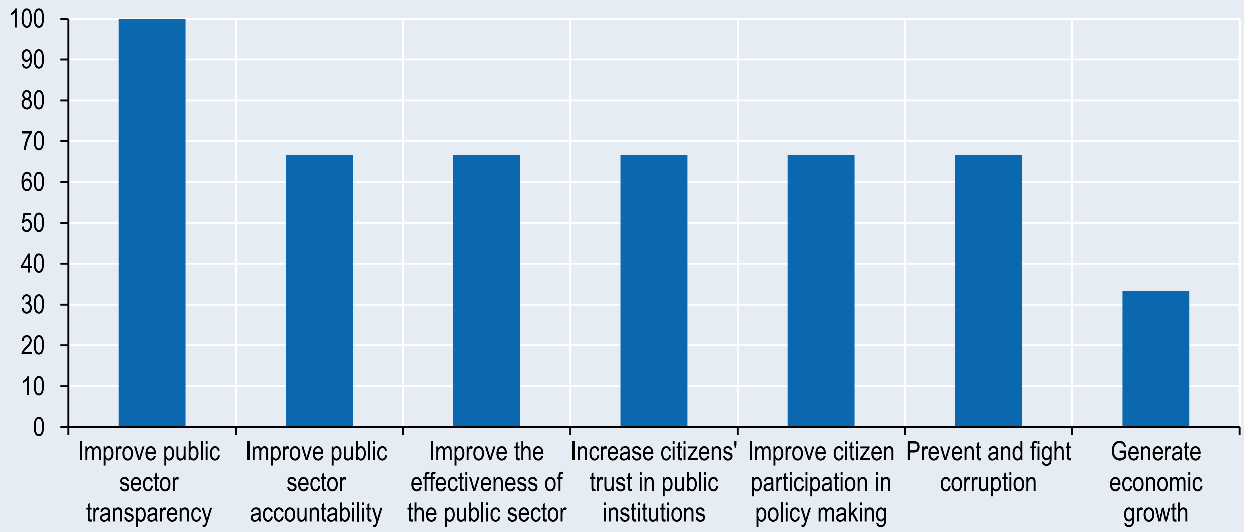
Implementing open government at central and local level

Open government has been defined as a key vehicle to partner with citizens in the design and implementation of public policies and services (OECD, 2016a). With a view to increasing the transparency of government actions, the accessibility of government services and information and the responsiveness of government to new ideas, demands and needs, some MENA economies have started to mainstream open government initiatives at both central and local levels. Concrete activities include the introduction of new tools and mechanisms for stakeholder engagement at different stages of the policy-making cycle (OECD, 2014a).

In the framework of the Open Government Partnership, of which both Jordan and Tunisia are members, MENA economies have drafted joint Action Plans with civil society, including measurable commitments for reform. Morocco has engaged in important efforts to support democratisation of its public sector and institutions.

FIGURE 2.1 **MENA ECONOMIES WANT TO ACHIEVE VARIOUS POLICY OBJECTIVES THROUGH OPEN GOVERNMENT**

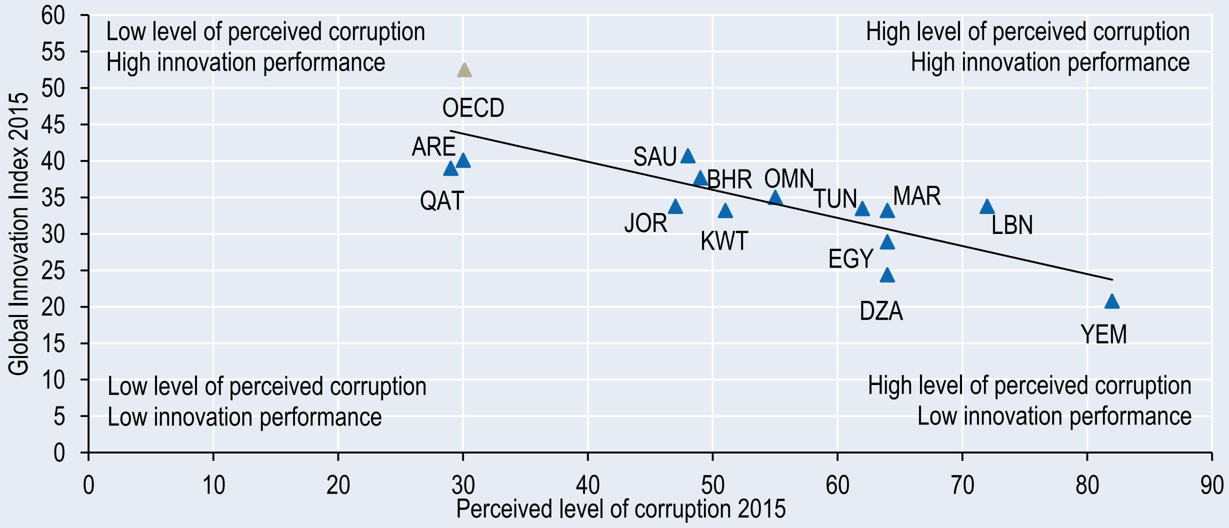
Percentage of MENA economies with these policy objectives included in their open government agenda



Note: MENA includes Jordan, Morocco and Tunisia.

Source: OECD Open Government Survey 2015.

FIGURE 2.2. **HIGH CORRUPTION TENDS TO BE ASSOCIATED WITH WEAK INNOVATION PERFORMANCE**



Note: Without making any inference with respect to causality, the figure helps to demonstrate that higher levels of perceived corruption are observed together with lower levels of productivity, a relationship confirmed by a number of econometric studies controlling for other variables.

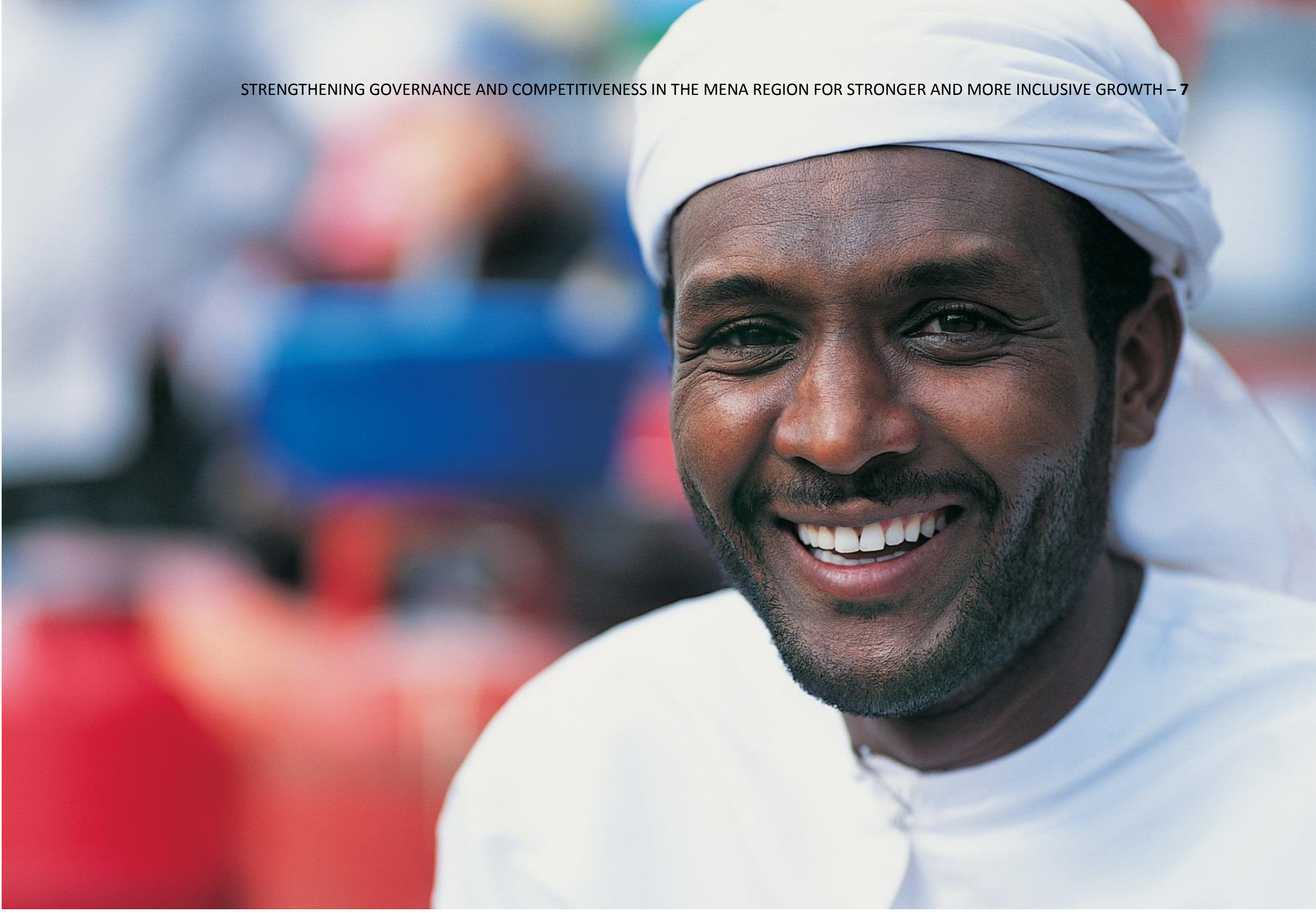
Sources: Transparency International 2015 and Cornell INSEAD WIPO 2015.

The new Constitutions in Tunisia and Morocco enforce principles such as protection of human rights, democratic participation, decentralisation, access to information, freedom of the press and association, good public governance, transparency and integrity, which are also founding principles of open government. Moreover, the decentralisation process in countries like Morocco, Tunisia and Jordan holds the promise of new partnerships between citizens and public officials at the subnational level. However, in many aspects, the political commitments for more open government still need to translate into concrete impacts for all segments of society, including women and youth (see Chapter 8). In order to fully reap the benefits of open government policies, it is important that they are not seen in isolation, as they are indeed critical to achieve a number of policy outcomes. The objectives of open government agendas in MENA economies and OECD countries include integrity, fighting corruption, public sector reform, building trust and better public service delivery (Figure 2.1).

Promoting public sector integrity and fighting corruption

Trust in government and public institutions is crucial for effective implementation of policy reform. In MENA economies, citizen and market trust in government has been battered by crisis and corruption. Corruption undermines the performance of public administrations and results in increasing inequality in access to public services. It endangers public and private sector productivity by creating incentives to allocate resources to unproductive activities, deterring innovation, biasing decisions in public procurement and expenditures, impairing the skills and professionalism of the civil service and reducing public resources available to support productivity in the economy (Figure 2.2). Recognising these adverse effects has moved fighting corruption to the forefront of political agendas in many MENA economies.

Several economies have started to put in place tools to increase integrity, such as codes of conduct for public officials, control and audit frameworks and risk management practices. For example, Tunisia recently developed a Code of Conduct for public officials (OECD 2013a; OECD, 2016b), which applies to 600 000 public officials at both central and local levels. The Palestinian Authority also successfully implemented a Code of Conduct and Ethics for its civil service, as part of its broader strategy to build more open and transparent institutions. Jordan implemented national anti-corruption strategies that combined reforms of legislative and institutional frameworks and also introduced specific integrity instruments.



Such reforms require strengthening oversight and monitoring capacities of Supreme Audit Institutions (e.g. Courts of Accounts), as well as their capacity to co-ordinate with other partners, such as parliaments, anti-corruption commissions and ombudsmen (OECD, 2014b). In Morocco, the Anti-Corruption Agency and the Ombudsman Office recently established a joint committee to strengthen oversight and accountability mechanisms. Existing legal safeguards must be reinforced, notably by developing efficient legal frameworks to protect whistle-blowers and implementing asset declaration systems. Raising awareness within the private sector and facilitating public-private dialogue on integrity standards, tools and instruments through peer learning and dissemination of best practices are also important. This is especially true for public procurement, which is a high-risk area, due to the close interaction between the private and public sectors. The MENA-OECD Business Integrity Network and the MENA-OECD Public Procurement Network could help advance the regional anti-corruption agenda in this regard.

Putting in place efficient machinery of government

Strengthening fiscal governance by increasing transparency and accountability is instrumental in improving the functioning of public administrations in the MENA region. Effective government machinery is needed, along with tools such as performance-based budgeting systems to better link national policy priorities to the budget. Achieving a trustworthy public budgeting system also requires better monitoring tools and indicators to foster evidence-based policy making, measure progress and adjust strategies in line with economic developments. In addition, local finance systems need to be strengthened, in light of the efforts of various MENA economies to implement more decentralised governance frameworks. For local public institutions to fulfil their new mandate, adequate financial means are of paramount importance to allocate public expenditures in line with local development needs.

In Tunisia, the government is currently implementing a Medium-Term Expenditure Framework based on macroeconomic variables such as economic growth, inflation and exchange rates. This should help ensure fiscal discipline ex ante and ex post and facilitate assessment of budget-related decisions (OECD, 2013a). These budget tools are also more widely used in the Gulf countries, as they are experiencing a sharp decrease in revenue, due to the slump in oil prices. Some countries are therefore accelerating public financial management reforms to improve their forecasting capacities and better control public spending.

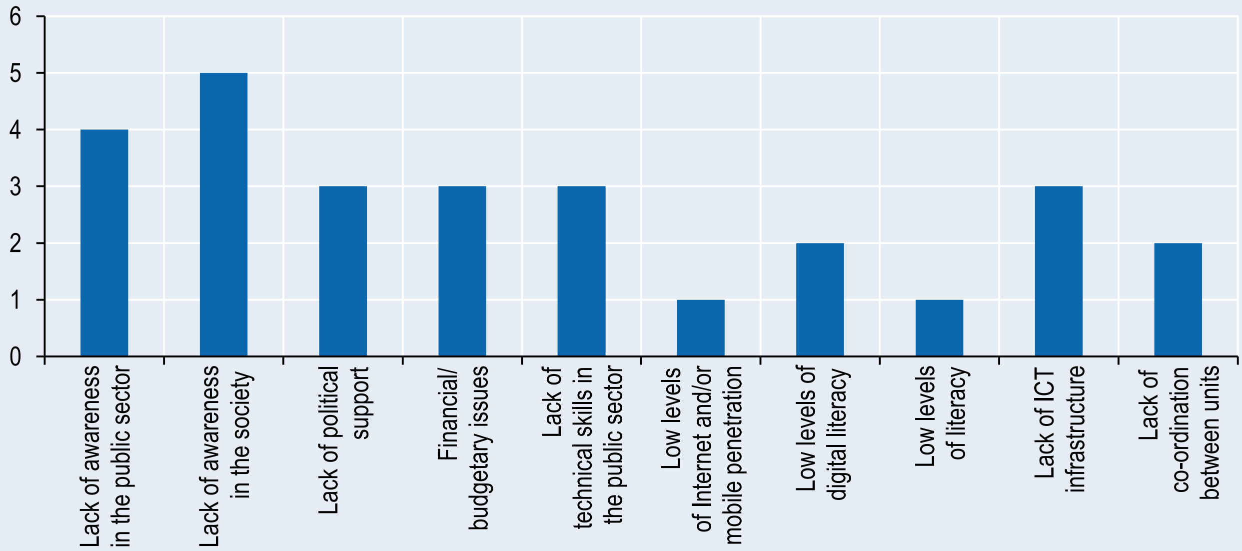
Public procurement is a key economic activity of governments and also one of the largest government spending activities, accounting for around 18% of GDP in MENA economies (OECD, 2013b). Well-governed public procurement systems are therefore crucial. One of the priority actions is combating collusion in public procurement to level the playing field for suppliers and allow them to do business with the public sector on a fairer basis (OECD, 2012a). Many MENA economies, such as Morocco and Tunisia, have recently modernised their procurement policies and institutional frameworks, developing guidelines, building procurement professional capacity and raising awareness of the importance of competition in procurement. Other countries, such as Jordan and Egypt, are currently reviewing their public procurement systems.

Use of digital technologies is a cross-cutting component of all public sector modernisation strategies. Improved data and information management and new channels of interaction provide the public sector with the opportunity to operate more efficiently and to better understand and tackle outstanding problems of public interest. The strategic use of technologies can enhance transparency, public engagement and participation in the MENA region. To realise these objectives, economies in the region need to develop a strategic approach to the use of new technologies in the public sector and progressively build institutional capacities to implement digital government strategies.

Despite the challenge of embedding digital government policies into public sector reforms, economies throughout the region are starting to look for ways to improve their use of technologies for public sector modernisation.

FIGURE 2.3. **MAIN CHALLENGES FOR IMPLEMENTING DIGITAL GOVERNMENT STRATEGIES**

Number of MENA economies that identified these challenges



Note: The survey was completed by Egypt, Jordan, Lebanon, Morocco and Tunisia. Multiple answers were allowed.

Source: MENA-OECD Questionnaire on Digital Government, 2015.

Morocco and Tunisia, for instance, are concerned about the way they use technologies to promote more open and inclusive governance systems (OECD, 2015a; OECD, 2016c), and the United Arab Emirates has closely examined the opportunity offered by re-assessing their digital government policies in order to improve their governance frameworks, digital service delivery and institutional capacities (OECD, 2013c).

Insufficient institutional capacities are another crucial challenge for the region. A 2015 OECD survey covering five MENA economies showed that most of the economies in the region lack standardised ICT project management models. Business cases for ICT investments are scarcely used, and 80% of economies lack a strategy dedicated to ICT procurement or to attract, develop and retain ICT-skills in the public sector (Figure 2.3). Improving the public sector's ability to structure, manage and monitor ICT investments should be a high priority in the region's agendas for public sector reform.

Justice institutions are also a key component of good governance and efficient machinery of government. Effective and trustworthy judicial systems guarantee against possible misbehaviour of other public institutions. They build greater government accountability and reservoirs of public legitimacy and service effectiveness. Justice institutions in MENA economies often lack independence and autonomy and do not have the capacity to efficiently and effectively handle cases, ensure legal security for citizens and businesses and draft clear and consistent legislation. In addition, there is a need to strengthen consultation mechanisms in the rule-making process to improve citizens' trust in rule-making.

Key recommendations

- Harmonise integrity measures with the overall reform programme to create a whole-of-government effort to promote integrity and fight corruption.
- Improve implementation of open government principles and public access to information to provide a better basis for public scrutiny of government.
- Reform public financial management to protect public funds from misuse and ensure that oversight institutions are effective in controlling bias, fraud and corruption.
- Raise awareness of the relevance of digital government policies and build capacities for their implementation.
- Continue administrative simplification efforts.
- Modernise justice institutions and improve their performance, notably with the objective of providing more citizen-centred justice and legal services.
- Enhance the public procurement system, especially in terms of capacity, transparency, accountability, oversight, risk management, e-procurement and efficiency.
- Reinforce competition enforcement, tender design and capacity building to combat collusion in public procurement.

3 Enhancing tax design and collection

Fairness has emerged as a key concern across the MENA region, and economies face the challenge of raising tax revenues through tax systems that are both efficient and equitable. The degree of sophistication of tax systems varies significantly across the region. Some countries have relatively well-developed tax systems, while others, particularly oil-exporting economies, have yet to establish modern tax systems. Priority tax reforms will therefore depend on countries' specific economic and social circumstances as well as on the stage of development of their tax systems.

Gradually increasing tax revenues and rebalancing tax mixes

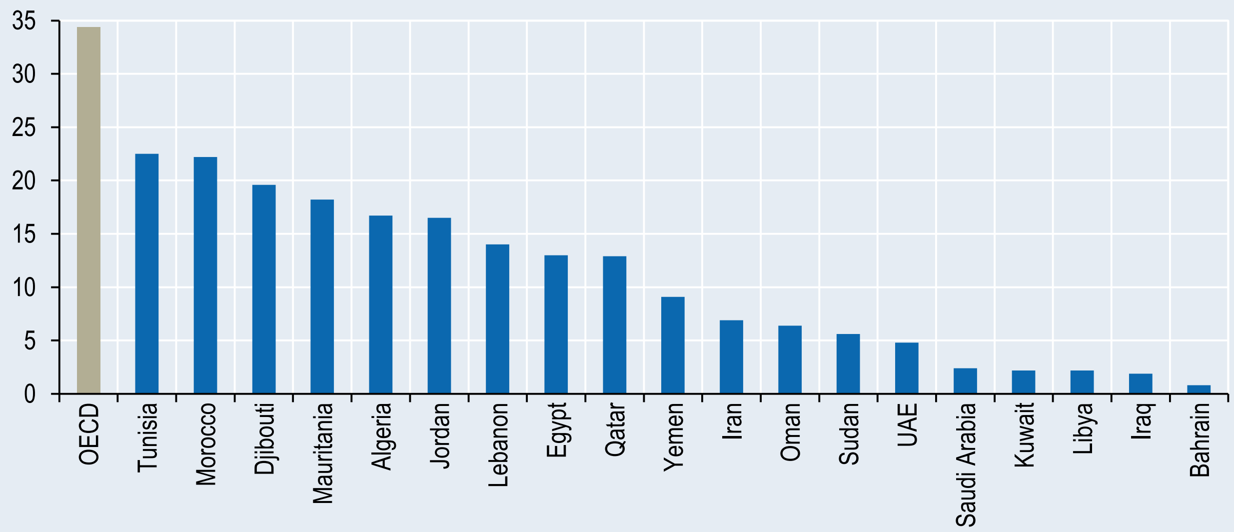
A number of MENA economies rely on relatively diversified sources of tax revenues, but their tax revenues tend to be lower than in other emerging and developing countries. These countries include oil-importers (e.g. Morocco, Tunisia and Mashreq economies) as well as a few oil producers (e.g. Algeria and Egypt). In these economies, tax revenues have been stable, but they remain lower on average than in other emerging and developing economies and lower than in OECD countries (Figure 3.1). Tunisia and Morocco, the only MENA economies included in Revenue Statistics in Africa (OECD/ATAF/AUC, 2016), have the highest tax-to-GDP ratios in the MENA region, but their tax revenues remain below the OECD average.

The composition of tax revenues is relatively diversified, with corporate income tax (CIT) and value-added tax (VAT) accounting for significant shares of total tax revenues. MENA economies with relatively well-developed tax systems could seek to gradually collect more tax revenues, in particular through taxes that are currently under-represented in their tax mix, such as personal income tax (PIT), recurrent taxes on immovable property and environmentally-related taxes.

On the other hand, most oil-exporters, in particular in the Arab Gulf, are characterised by less developed tax systems and remain overly dependent on oil revenues. Non-resource tax revenues are very low. They account for less than 5% of non-oil GDP in oil-exporting MENA economies, significantly below the average in the rest of MENA (Jewell et al., 2015).

FIGURE 3.1. **TAX REVENUES ARE RELATIVELY LOW IN MOST MENA ECONOMIES**

Tax revenues as a share of non-oil GDP, 2014



Note: For the OECD average, tax revenues are expressed as share of GDP.

Source: Jewell, A. et al. (2015), "Fair Taxation in the Middle East and Northern Africa", IMF Staff Discussion Note, IMF, Washington, D.C.

With the fall in oil prices, oil-exporting countries, which historically enjoyed large budgetary surpluses, are now experiencing fiscal deficits of 10% and more. Regardless of future and existing policies, the cumulative fiscal deficit of MENA oil exporters is expected to increase significantly in the next five years, making most of the economies net debtors. This will imply financing challenges, in particular for the Gulf Cooperation Countries (GCC), as their public expenditure is considerably higher than that of other emerging markets. In early 2016, the sovereign credit ratings of a number of GCC members were downgraded. This highlights the urgent need for policy makers to find the right balance between policy reforms and issuing local and external debt, as funding costs will be higher.

For most oil exporters in the region, restoring fiscal sustainability and adjusting the economy to long-term low oil prices will require exceptional measures. The availability of significant oil revenues has sometimes limited governments' incentives to develop modern tax systems, and some countries still lack basic taxes, such as VAT and PIT. However, the recent decline in oil prices underlines the risks of relying excessively on oil revenues and the importance of diversifying public revenue to ensure resilience. The current context may, therefore, be a good opportunity to reform tax systems. Some countries have already started to act by cutting public spending or increasing taxes, and a VAT has been created in the GCC.

Scaling back energy subsidies will also be central to raising public revenues. For decades, both oil importers and oil exporters have been using generalised energy price subsidies as a key social policy instrument. In 2011, total pre-tax energy subsidies in the MENA region reached USD 237 billion – amounting to almost half of the world's subsidies (Sdralevich et al., 2014). In addition to imposing a heavy burden on governments' budgets and constraining their capacity to invest in basic public services and infrastructure, subsidies are not a well-targeted social policy tool. Indeed, they provide more benefits to the better-off, who consume more of the subsidised energy. Energy subsidies can also lead to overconsumption and adverse effects on the environment (see Chapter 7). Thus, gradually replacing subsidies with well-designed social safety net instruments could enhance social protection and free up substantial amounts of public resources (Sdralevich et al., 2014).

Enhancing the fairness of tax systems

Due to the size of the informal sector – it ranges between 30% and 70% of total employment according to the International Labour Organization (ILO, 2015) – the tax burden in MENA economies is often borne by a small number of taxpayers. This limits the fairness of tax systems, as a sizeable share of individuals and businesses do not pay taxes. This is even more problematic because governments in economies with high levels of informality that wish to collect more revenues often resort to raising tax rates on formal taxpayers, generating additional distortions between formal and informal operators. More generally, it is important to combat informality because of its wider negative implications on the economy and society. To expand the "tax net" (the number of taxpayers), governments can use a variety of tax policy instruments, including incentives (such as reduced tax burdens or simplified tax regimes for certain types of individuals or businesses to promote formalisation) and dissuasive measures (i.e. measures to increase the probability that informal operators will be detected and sanctioned).

MENA tax systems typically lack progressivity. In economies which have relatively well-established tax systems, personal income taxes tend to be characterised by limited levels of progressivity. Limited progressivity is due to a number of factors, including low top tax rates that only apply to very high income levels and exclusion of non-wage income from the tax base (Jewell et al., 2015). In oil-exporting economies with less developed tax systems, personal income taxes are rare and often exclusively applied to foreigners. In these economies, other tax instruments may be used to strengthen overall progressivity of tax systems. In particular, the role of recurrent taxes on immovable property could be strengthened, as wealth is highly concentrated in real estate in the MENA region (Jewell et al., 2015). Higher excise duties on luxury products may also be used to raise the effective tax burden on high-income individuals.

Some tax systems still contain explicit gender biases, which also reduce fairness. Explicit biases exist when tax codes make explicit distinctions between tax treatment of male and female taxpayers. For instance, in Morocco, married men automatically receive deductions for dependents, while married women must prove that they are the head of their households to qualify. Implicit biases, on the other hand, may arise when tax systems indirectly penalise women. For instance, if taxes are imposed on family income as opposed to individual income, the tax wedge applied to secondary earners – typically married women – is higher. However, this appears to be less of an issue in MENA economies, as almost all the economies that have personal income tax systems use individual-based taxation.

The quality of public services that taxpayers receive in return for their tax payments could also be enhanced. The quality of public services is central to people's perception of the fairness of tax systems and their willingness to pay taxes. Enhancing the quality and availability of public services should therefore be a priority. In addition, despite valid arguments against earmarking – in particular the fact that it may constrain governments' flexibility to manage public funds and lead to inefficient overspending on earmarked objectives – there may be good justification for the wider use of earmarking in MENA economies. Earmarking may raise transparency and taxpayers' trust in government and ultimately encourage greater tax compliance. However, if adopted, earmarking should be transparent and introduced for fixed periods, probably of no more than five years (Moore, 2012).

Making tax systems more efficient and improving transparency

Tax systems are generally characterised by the existence of many exemptions, particularly in the areas of CIT and VAT. Tax exemptions generate distortions between different types of taxpayers or businesses and make the tax system harder to administer and to comply with. They also tend to make tax systems less equitable, as better-off individuals often benefit more from tax incentives than poor people. In addition, in the area of CIT, exemptions are often provided in non-transparent and discretionary ways (Jewell et al., 2015). Removing or scaling back exemptions would therefore enhance both efficiency and fairness. In some economies, efficiency could also be increased by simplifying the multiple tax-rate structures that exist under VAT and CIT systems. Finally, reporting on tax expenditures, ideally in the budget alongside spending programmes which have the same purpose, should become a more regular practice.

Administrative improvements are needed to make tax systems more efficient. Tax administrations are often inefficient, and they operate in arbitrary ways in a number of MENA economies (Jewell et al., 2015). Efforts should be made to modernise tax administrations, through computerisation, rapid and transparent dispute resolution, risk-based compliance assessments, the elimination of bonuses based solely on amount of tax collected and introduction of modern taxpayer assistance services. At the same time, effective penalty regimes should be in place to deter widespread tax avoidance and evasion and level the playing field between those who comply with tax rules and those who do not. Tax returns, information bulletins and taxpayer service offices should be readily available to taxpayers.

Such tax administration improvements will generally require investments in human and IT resources.

Domestic tax base erosion and profit shifting (BEPS) negatively affects the domestic revenues that economies can mobilise. BEPS has a particularly negative effect on tax revenues in MENA economies, which rely more strongly on CIT revenues from multinational enterprises (MNEs). BEPS also undermines the efficiency, credibility and fairness of the tax system. Protecting domestic tax bases against international tax avoidance and evasion is therefore a priority. To prevent MNEs from exploiting gaps and mismatches between different economies' tax systems and to enable collection of tax on profits from economic activities that take place within the economy, MENA economies should strengthen tax base protection rules, including thin capitalisation rules, anti-treaty shopping rules, transfer pricing rules and controlled foreign corporation rules.

Strengthening tax systems against BEPS challenges could be achieved by participating in the implementation phase of the OECD's BEPS package. The OECD has developed an inclusive framework, which allows interested countries and jurisdictions to work with OECD and G20 members to develop standards on BEPS-related issues and review and monitor implementation of the whole BEPS Package. A significant number of countries and jurisdictions, including MENA economies, have expressed interest in joining the framework. At the inaugural meeting of the Inclusive Framework, in Kyoto, Japan at the end of June 2016, over 80 countries and jurisdictions started working on an equal footing to set standards on remaining issues, including transfer pricing and interest deductibility, and to develop practical guidance to support consistent, global implementation of their commitments to the BEPS package.

In the framework of the programmes of the Deauville Partnership MENA Transition Fund, Tunisia and Morocco have already benefited from a BEPS diagnostic by the OECD, as well as capacity building to improve the efficiency of the tax audit of transfer pricing issues. Moreover, recognising that exchange of information (EOI) for tax purposes is one of the most effective ways of combating international tax avoidance and tax evasion, as well as illicit flows, over 130 jurisdictions have committed to transparency and EOI on request and have joined the Global Forum on Transparency and Exchange of Information (GFTEI), including Morocco and Tunisia. In the framework of the MENA Transition Fund tax programmes, they are receiving technical assistance to improve their legal framework and practices to facilitate exchange of information to better counteract tax avoidance and tax evasion.

Key recommendations

- Gradually increase tax revenues to meet public spending and investment needs.
- Diversify sources of public revenues, particularly in oil-exporting economies.
- Develop internationally comparable revenue statistics data in order to make better informed decisions on tax policy, possibly by joining the OECD Revenue Statistics project (if not yet a member).
- Expand the "tax net" through a combination of incentives and dissuasive measures.
- Increase the progressivity of tax systems through better-designed personal income tax systems or alternative tax instruments, including recurrent taxes on immovable property.
- Remove the remaining explicit gender biases in tax systems.
- Remove the many exemptions, in particular in the areas of corporate income tax and value-added tax, and introduce more systematic reporting of tax expenditure.
- Enhance the efficiency of national tax administrations and invest in human and IT resources.
- Strengthen the protection of domestic tax bases against international tax avoidance and tax evasion by joining the BEPS inclusive framework.
- Improve transparency by joining the GFTEI (if not yet a member) and the Multilateral Convention on Mutual Administrative Assistance in Tax Matters.

4 Further developing the private sector

In recent decades, MENA economies have introduced a number of measures and reforms to enhance the role of the private sector as a driver of jobs and economic growth. These reforms contributed to relatively dynamic economic growth and investment during the first decade of this century. But economic performance was unevenly distributed and insufficient to respond to the needs and aspirations of very large parts of these expanding and increasingly educated societies. MENA economies need to step up their efforts to develop a dynamic private sector to provide jobs, foster economic diversification and achieve more resilient, inclusive and sustainable economies. The current scenario of low hydrocarbon prices, subdued economic activity and conflict spillovers accentuates the need to replace piecemeal approaches with ambitious and articulated reform packages to increase the role of the private sector in the economy and scale back the role of the state.

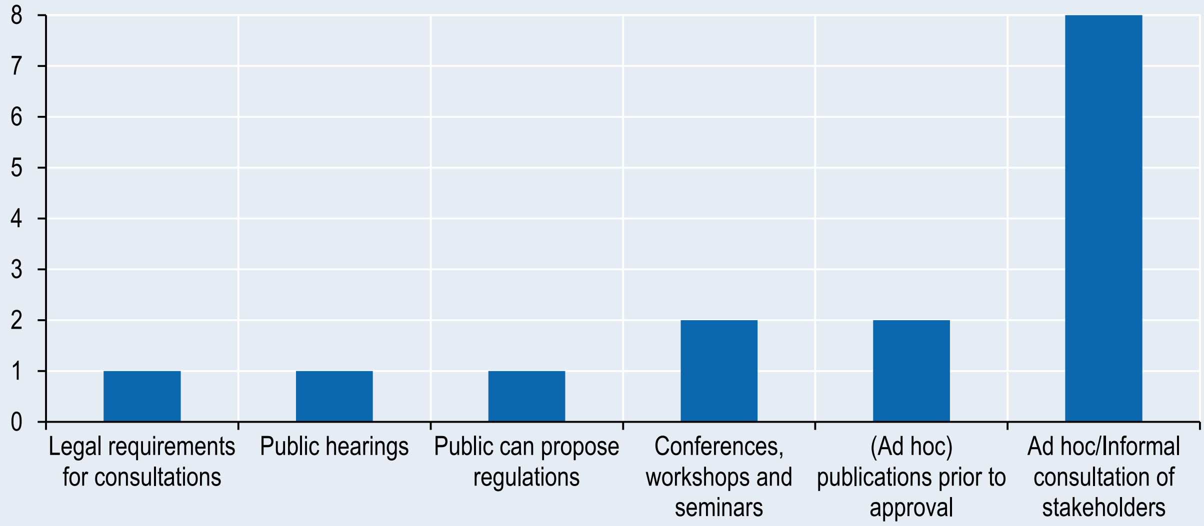
Streamlining the regulatory environment for all businesses

Effective business regulations that do not place an undue burden on enterprises can support economic, social and environmental goals. They also reduce the likelihood of corruption and informal activity. OECD analysis suggests that pro-competitive product market reform has the potential to raise GDP by as much as 30% in some large emerging economies (OECD, 2013d). MENA economies have implemented a number of initiatives in recent years to improve their regulatory frameworks. For example, Tunisia has taken steps to introduce a "regulatory guillotine" (i.e. paring down regulation that is deemed unnecessary). Egypt is implementing a programme for regulatory simplification, and Jordan is reforming its public procurement framework to promote transparency and reduce administrative burdens and costs. Morocco plans a whole-of-government reform of the regulatory system.

Although valuable, these initiatives remain ad hoc and limited to simplifying the stock of regulation, without addressing the full set of issues faced by businesses. For instance, according to Doing Business 2016 (World Bank Group, 2016), starting a business in the region takes on average 8 procedures and 19 days and costs the equivalent of 26% of income per capita.

FIGURE 4.1. **CONSULTATION ON DRAFT REGULATION IS AD HOC OR INFORMAL IN MENA ECONOMIES**

Number of MENA economies that apply certain procedures during the preparation phase of regulations

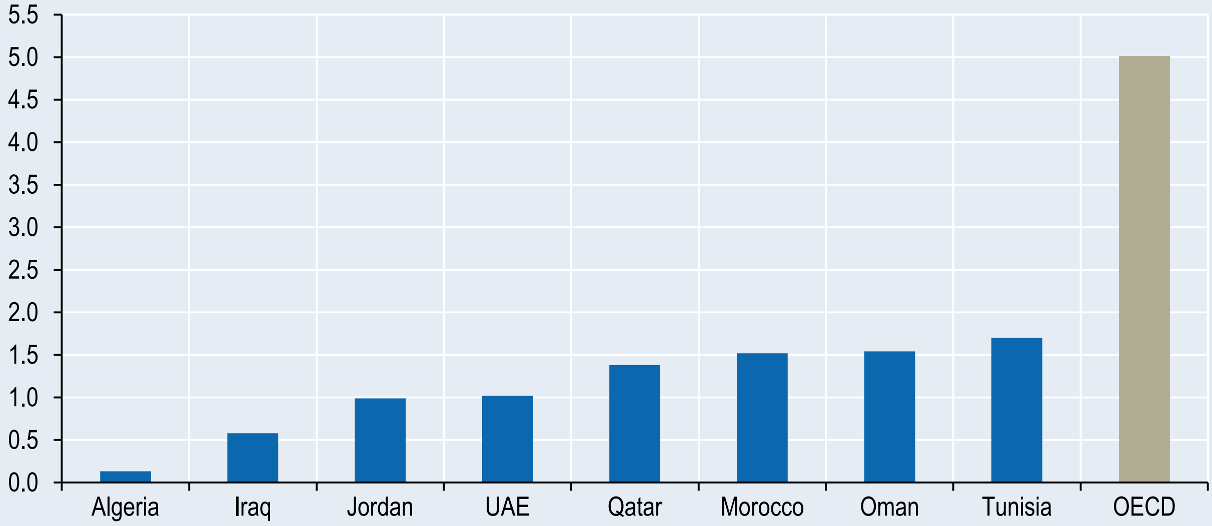


Note: Data based on the answers of eight MENA economies.

Source: OECD (2013e), Regulatory Reform in the Middle East and North Africa: Implementing Regulatory Policy Principles to Foster Inclusive Growth, OECD Publishing, Paris, http://dx.doi.org/10.1787/9789264204553-en.

FIGURE 4.2. **RATES OF FIRM CREATION ARE VERY LOW IN THE MENA REGION**

New businesses, per 1 000 working-age people, 2014



Source: World Bank (2014), Entrepreneurship Database, Washington DC.

This performance is comparable to that of Latin America and Sub-Saharan Africa, but well below that of OECD countries, where it takes on average less than 5 procedures, 8 days and 3% of income per capita. The only exceptions are Morocco and the United Arab Emirates, whose performance is similar to that of the OECD area.

Improving regulatory environments requires a systemic programme of reforms that involves the entire government and has the commitment of its leadership (OECD, 2016e). A number of tools and practices should support these programmes, notably regulatory impact assessment, promotion of e-government and one-stop shops and specific tools to ensure proper consideration of SMEs' concerns during the early stages of policy making. As part of regulatory impact assessments to improve business regulations, MENA economies could undertake competition assessments of regulations (i.e. scanning sector regulation for barriers to competition). The OECD's Competition Assessment Toolkit would be a particularly useful instrument for MENA economies.

Successful implementation of these tools hinges on comprehensive capacity-building programmes. Consultation mechanisms are also pivotal for collecting information, managing expectations, assessing costs and benefits, and identifying the most efficient regulatory policy options. Despite their importance, consultation procedures on draft legislation remain informal in the MENA region (Figure 4.1). Policies on open government and enhanced communication mechanisms are examples of good regulatory practices (see Chapter 2).

Promoting the development of start-ups and SMEs

MENA economies have a number of institutions and policies to strengthen the important economic and social role of SMEs and entrepreneurs. For instance, SME policy is a key component of Morocco's overall economic policy, Jordan is implementing a multi-year SME strategy, and the Palestinian Authority has established a Private Sector Council to improve SME policy co-ordination.

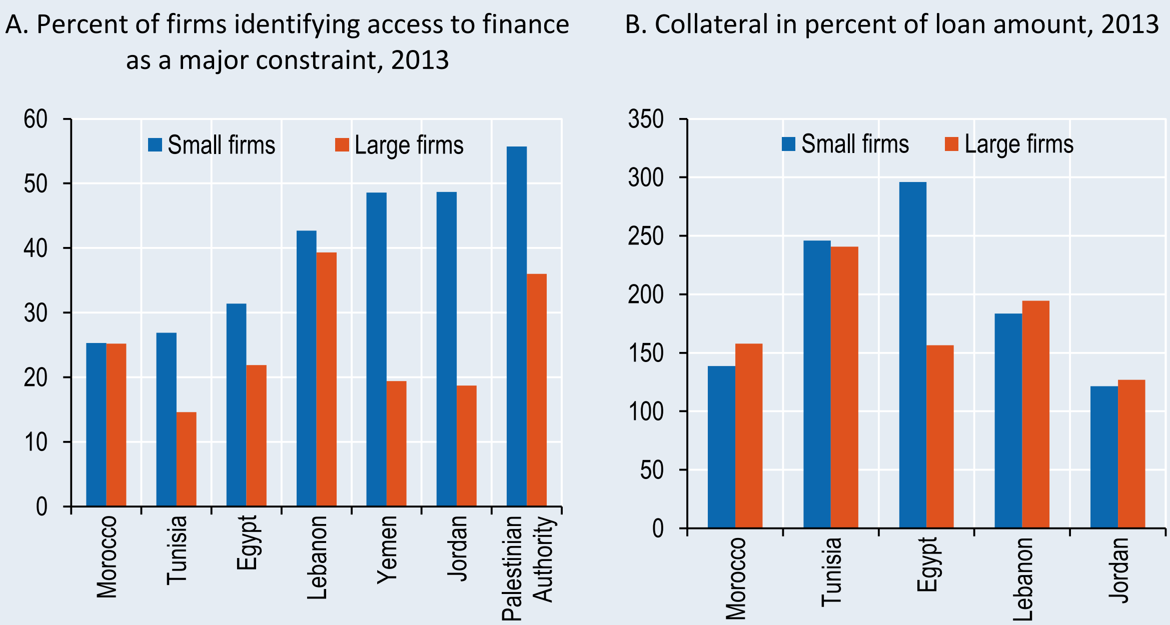
However, low rates of firm creation show that much more could be done to foster entrepreneurship and SME growth (Figure 4.2). The vast majority of enterprises in MENA economies are micro firms, often engaged in informal activities and contributing little to employment, value added and productivity. Micro firms represent 85% of all firms in Egypt and 90% in Jordan, and shares are as high as 96% in Algeria and 98% in Morocco, according to national data.

MENA economies could adopt more comprehensive and coherent approaches to SME policy. There are currently many actors and agencies providing support, with little co-ordination and an almost complete absence of monitoring and evaluation mechanisms. MENA economies also need to improve the availability, reliability and timeliness of statistics on SMEs and on private enterprises in general. Economies in the region also need to improve support in specific areas. For instance, to increase access to the wide array of existing business support services, MENA economies could extend their geographical reach and ease of access to information about those services. They could also facilitate SME access to public procurement by simplifying tendering documents and procedures, cutting tenders into lots and/or allowing for consortia of suppliers, and having in place efficient e-procurement systems.

SMEs and entrepreneurs in the MENA region face a structural lack of access to finance. This is largely due to underdeveloped banking and financial markets. For instance, domestic credit to the private sector averaged 49% in the MENA region in 2014 (compared to over 146% in the OECD), and the average number of commercial bank branches was 14 (compared to 24 in the OECD). The share of people aged 15 or older with a bank account surpasses 50% only in the GCC countries and Algeria. Furthermore, next to Sub-Saharan Africa, MENA economies register the highest regional shares of firms identifying access to finance as a major constraint (Figure 4.3, Panel A): 35.7%, compared to 11.6% in OECD countries. At the same time, collateral requirements remain high and can reach well over 200% of the value of the loan (Figure 4.3, Panel B).

To address these and other issues, MENA economies have put in place institutions and mechanisms to facilitate SME financing, including credit guarantee schemes, microfinance institutions, leasing instruments, and frameworks for private equity and venture capital. To increase the effectiveness of these measures, MENA economies should improve the quality of the legal and regulatory environment, enhance the depth of financial markets and strengthen competition among banking and financial institutions. For instance, increasing bank competition would lead to higher incentives to lend to SMEs, develop financial and lending products adapted to their needs and enhance expertise to assess business proposals of small firms and entrepreneurs. Strengthening creditors' rights and laws of secure transactions would also help decrease the high levels of collateral needed to secure a loan.

FIGURE 4.3. **SMALL FIRMS FACE IMPORTANT HURDLES TO ACCESS BANK CREDIT**



Source: World Bank, Enterprise surveys.

Improving cadastres and movable asset registries, and setting-up or extending the coverage of credit bureaus would also result in lower information asymmetries and greater access to loans. On the demand side of finance, financial education for the population in general – and especially for entrepreneurs and SME owners and managers – would help them to deal effectively with financial institutions and explore sources of financing other than bank overdrafts.

Reinforcing corporate governance and reforming state-owned enterprises

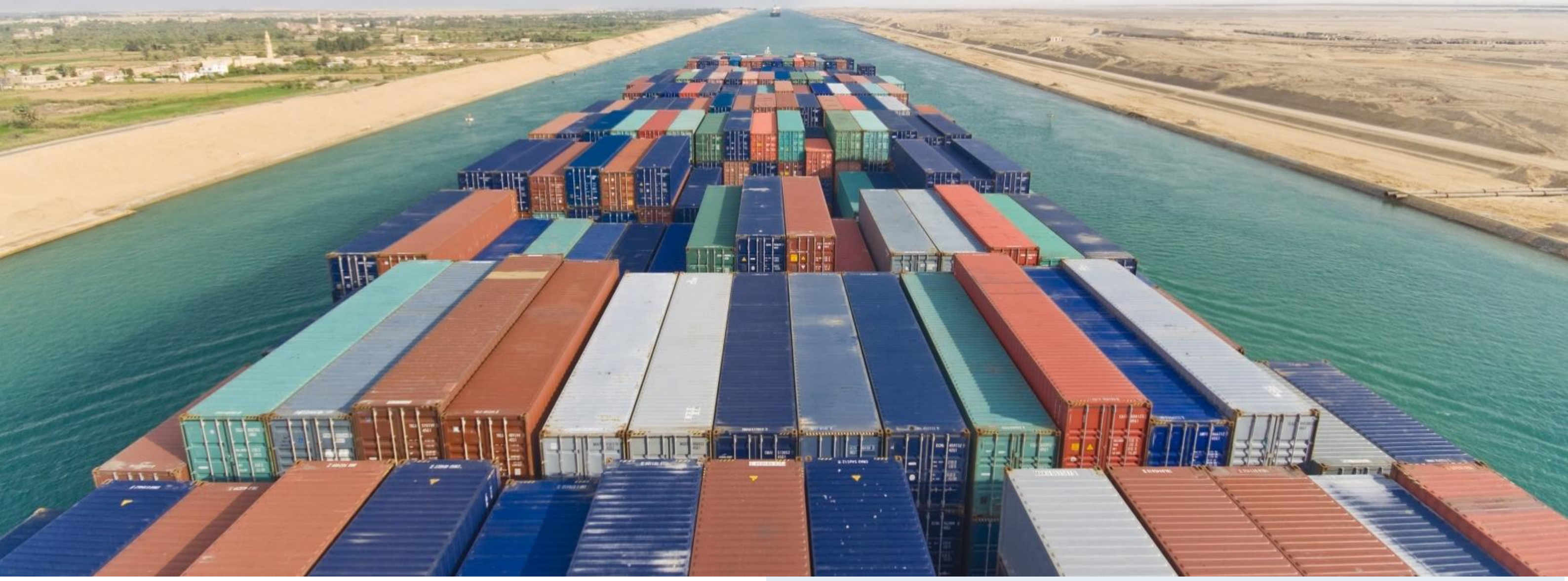
Good corporate governance is an essential building block for countries that want to attract capital, develop the private sector and boost investment. By creating an environment of trust, transparency and accountability, good corporate governance supports the development of sound capital markets that can serve the real economy.

Corporate governance frameworks in the MENA region have undergone a substantial evolution in the past decade. Better enforcement of rules and regulations has recently emerged as both a policy challenge and a priority for the region. This reflects a number of trends, including political changes in some countries and a global call for better surveillance of the adoption of governance rules, as well as low investor engagement in the region. The various sources of rules, laws and recommendations related to corporate governance should be reviewed, with a view to ensuring coherence among them. Experience from several MENA economies demonstrates that the requirements contained in the national corporate governance code are at times inconsistent with those in the companies law, leading to confusion among listed companies about the applicable governance standards.

The need to develop sound corporate governance also includes state-owned enterprises (SOEs). The public sector accounts for most of the economic activity in the region, and much of the public sector activity in the MENA region is directly linked to state-owned firms, although figures vary from economy to economy. Furthermore, companies with majority or significant investment by the state account for around 45% of the total stock market capitalisation in the MENA region, also higher than the global average. Ensuring that SOEs operate efficiently is thus crucial for the region's development. In additional, unless there is a level-playing field between SOEs and other enterprises, SOEs may actually crowd out small and entrepreneurial private competitors, with detrimental consequences for economic development. The G20/OECD Principles of Corporate Governance and the OECD Guidelines on Corporate Governance of State-Owned Enterprises contain a wealth of practical experience which is highly pertinent to the ongoing reform priorities in the MENA region.

Developing the private sector through multi-dimensional, multi-stakeholder initiatives

Given their multi-dimensional character, designing and implementing comprehensive and articulated private sector development policies will require open, frank and well-structured dialogue between an important number of actors, including government agencies and ministries, private sector associations and civil society. Such efforts have been made by countries like Morocco. While implementing an enterprise development strategy based mainly on a sector approach, it realised the need to add an additional pillar covering the general business environment. To address the issue, the Moroccan government established a national committee (*Comité National de l'Environnement des Affaires*, CNEA) charged with steering a wide program of horizontal reforms to improve legislative and regulatory frameworks and reduce administrative barriers (OECD/European Commission/ETF, 2014). The committee is chaired by the Prime Minister and operates as a public-private platform to identify and design key reforms. Membership includes ministries and government agencies with a mandate covering specific aspects of the business environment, as well as high-level representatives from the main private sector organisations. Recent activities of the CNEA include the development and application of electronic systems for exchange of information between government agencies and the private sector and digitalisation of several documents and administrative procedures.



Using Sovereign Wealth Funds for private sector development

Oil-exporting economies could devise actions to increase the funds available for private sector development through Sovereign Wealth Funds (SWFs). This would represent a shift from the traditional SWF role of smoothing large swings in commodity revenue (stabilisation) and spreading a economy's wealth more equitably across generations (savings). Among MENA oil-exporting economies, Bahrain, Kuwait, Libya, Qatar and the United Arab Emirates have SWFs investing domestically and abroad in a wide range of industries. Saudi Arabia's announcement of a series of measures to diversify the economy away from oil, including the flotation of a stake in the national oil company and investing the proceeds in the creation of the largest SWF in the world, could, if successfully implemented, provide a blueprint for other oil-exporting economies.

The use of SWFs for private sector development should consider balancing the macroeconomic and structural needs of a country. Stabilisation funds need to be liquid, so that investments can be withdrawn quickly to meet pressing fiscal needs. Savings elements allow for greater risk-taking and lower liquidity; they may invest in alternative asset classes, acting as venture capitalists. This could help improve the availability of financing sources, especially for innovative and higher-risk businesses. Yet, it is important that SWFs invest based on either the performance and the returns of projects, or on the development or social merits of specific projects (e.g. needed infrastructure for which no other sources of financing are available).

Key recommendations

- Replace fragmented policies for private sector development with more coherent, strategic reform packages, taking into consideration the interactions between policy areas.
- Introduce systemic reform programmes to enhance SME and entrepreneurship policy co-ordination.
- Make wider use of good international practices to improve the regulatory business environment, including regulatory impact assessments, consultation mechanisms and competition assessments of regulations.
- Strengthen SMEs' access to finance by fostering competition in the banking sector, strengthening the legal and regulatory framework, improving information systems, such as cadastres, and promoting financial literacy.
- Support the implementation and enforcement of corporate governance codes, including for state-owned enterprises.
- Extend the geographical reach of support services for SMEs and the ease of access to information about those services.
- Facilitate SMEs' access to public procurement, for example by simplifying tendering procedures and cutting tenders into lots.

5 Further opening to international trade and investment

With sluggish growth in foreign trade and a strong decrease of FDI inflows, MENA economies need to boost openness to trade and investment and facilitate efforts to support their national development plans. When sound macroeconomic and structural policies contribute to strengthening the absorptive capacity of host economies, international trade and investment can deliver important benefits, from enhanced economic and inclusive growth to job creation and innovation. In 2015, MENA economies accounted for 5% of world imports and 9% of world exports. Increasing regional integration, upgrading activities in regional and global value chains and targeting quality investment can contribute to tapping trade and investment potential at both regional and national levels.

Improving the framework conditions for foreign investment

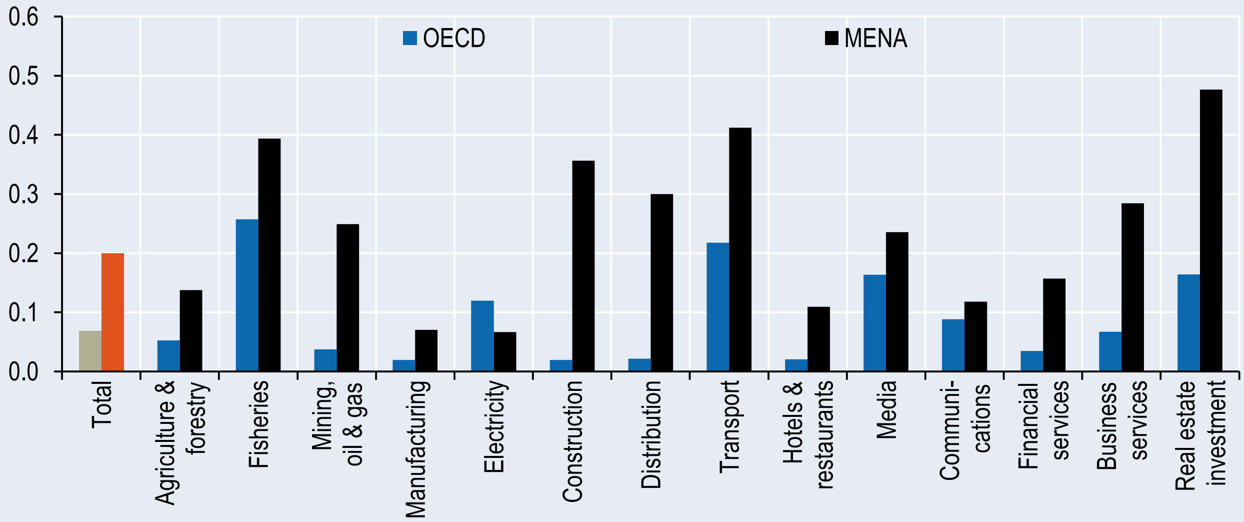
Recent years have been particularly challenging for the region, with foreign direct investment (FDI) inflows decreasing from a peak of 5.3% of GDP in 2006 to less than 1% in 2015. In some countries, trends in 2015 show a slight rebound, particularly in Egypt. While the region offers important investment opportunities, such as strategic location and access to markets and a well-educated work force, most countries continue to face important challenges. Investors' confidence is undermined by political instability, poor security conditions, the decline in oil prices, weak infrastructure, a lack of regional interconnectedness, corruption, as well as regulatory, legal and administrative obstacles. Moreover, despite emerging economic diversification, many MENA economies remain heavily dependent on commodity exports.

To sustainably reverse the FDI decline, several countries have embarked on legal and institutional reforms. In 2014 and 2015, Egypt, Iraq, Jordan and Kuwait revised their investment laws. New investment regimes are about to be adopted in Morocco and Tunisia. Investment promotion strategies and agencies are being reformed in some countries, with expanded one-stop shops, and services and processes targeting investors.

However, ground-level obstacles and regulatory restrictions are still limiting trade and investment. Some MENA economies, in particular GCC countries, prohibit foreign investment

FIGURE 5.1. **REGULATORY RESTRICTIONS IMPEDE FDI INFLOWS**

OECD FDI Regulatory Restrictiveness Index (open=0, closed=1), 2015

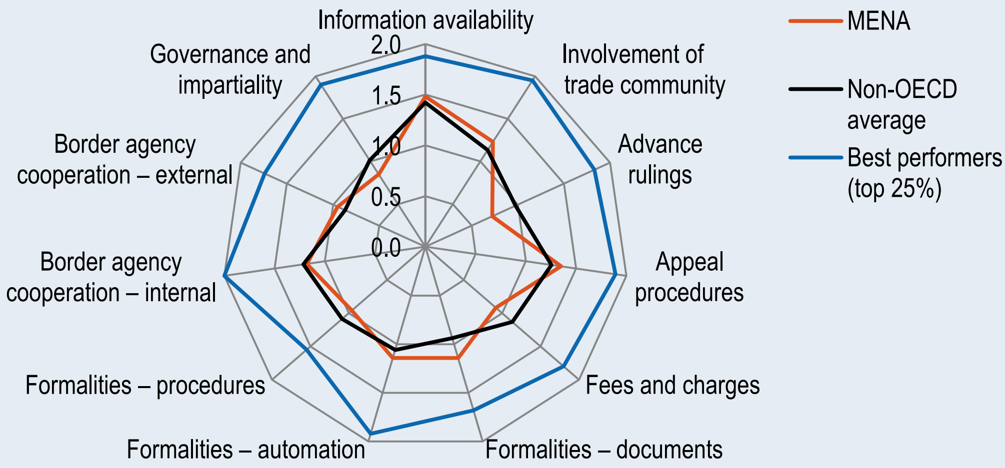


Note: MENA refers to Egypt, Jordan, Morocco, Saudi Arabia and Tunisia.

Source: OECD FDI Regulatory Restrictiveness Index database.

FIGURE 5.2. **MENA ECONOMIES HAVE AMPLE ROOM TO FURTHER FACILITATE TRADE**

OECD Trade Facilitation Indicators, from 0 (worst performance) to 2 (best performance), 2015



Note: "Best performance" denotes the average of the top quartile for each of the trade facilitation areas covered, across all countries within the database. MENA refers to Algeria, Bahrain, Egypt, Jordan, Kuwait, Lebanon, Morocco, Oman, Qatar, Saudi Arabia, Tunisia, United Arab Emirates, and Yemen.

Source: OECD Trade Facilitation Indicators, Promoting Responsible and Inclusive Investment.

above a certain threshold, have sponsorship requirements whereby a local intermediary is required to operate or facilitate investment projects, or have screening mechanisms that are not always rapid and transparent. Sectoral restrictions to FDI are still common across the region. While Egypt and Morocco are imposing restrictions close to OECD levels, according to the OECD FDI Regulatory Restrictiveness Index, Jordan and Saudi Arabia are reaching higher levels of restrictions (Figure 5.1). Some countries impose additional conditions, such as local content requirements and limitations on visas and permits. Current liberalisation reforms are being implemented against this background. For example, in the framework of its National Transformation Plan, released in June 2016, Saudi Arabia opened its retail sector to foreign investors. Jordan adopted a new by-law on FDI restrictions in May 2016, and the new investment regime of Iraq, adopted in January 2016, has no closed or restricted sectors – except the oil-and-gas and banking-and-finance sectors.

Improving investor protection is also critical. Access to effective mechanisms for enforcing contracts and property rights remain important obstacles for foreign investors. Expropriation and contract breaches are the most common grounds of the growing number of investor-state disputes in the region. Since 2011, 16 international arbitration cases were initiated by foreign investors against Egypt pursuant to international investment agreements. With the noticeable exceptions of Egypt and the United Arab Emirates, alternative means for dispute resolution and prevention mechanisms remain underdeveloped. In some contexts marked by low investor confidence, investment treaties can mitigate high perceived risks. Together, the 18 MENA economies have signed over 700 bilateral investment treaties, of which over 220 are with OECD countries, and are signatories of nearly 60 trade- and investment-related agreements. However, this proliferation has resulted in multi-layered rules, with provisions that are often confusing to investors, and to uneven protection status, depending on the country of origin and foreign or domestic ownership of investment. MENA economies should consider addressing inconsistencies through improved delineation of investment protection principles and better alignment between treaty provisions and domestic legal and regulatory frameworks.

While governments continue to open their legal regimes to attract more investment, they also need to maximise their qualitative impact. FDI can trigger the diffusion of technology and innovation, raise productivity, enhance human capital through skills transfers to domestic suppliers and the local workforce, foster exports, and improve competitiveness, with positive effects on growth and jobs. MENA economies must avoid creating two-tier economies or enclaves of foreign investment with limited spillovers on the domestic economy – as Tunisia did when it provided foreign investors with corporate taxation exemptions and duty-free access to inputs under its so-called "offshore regime", but did not extend these advantages to local investors – which often failed to become local suppliers or sub-contractors of foreign investors. Governments must also stimulate FDI in labour-intensive sectors (e.g. infrastructure, agribusiness, retail and merchandising, tourism and traditional manufacturing) and encourage linkages with domestic SMEs. Investment in network industries such as transport, ICT and energy, particularly renewable energy, can also support more balanced, sustainable and inclusive development.

In addition, most governments have yet to develop comprehensive policies for responsible business conduct to enhance the positive impact of multinational enterprises (MNEs), leveraging *inter alia* the OECD Guidelines for MNEs, a tool adopted by the four MENA economies that adhere to the OECD Declaration on International Investment and Multinational Enterprises (Egypt, Jordan, Morocco and Tunisia). While negotiating investment and trade agreements, governments should preserve their right to regulate in the public interest; they should not derogate from their domestic health, safety, labour and environment standards to encourage investment.

Lowering trade costs

The attractiveness of countries and regions as locations for investment depends not only on statutory FDI restrictions, but also on the costs of doing business across borders. Much of FDI is conducted by MNEs that locate segments of their operations in different countries to tap into natural and human resources, achieve economies of scale and boost efficiency. Some of the costs related to the fragmentation of the production process accrue at the border, notably through tariffs and customs inefficiencies, but many accumulate long before the border is reached, because of low-quality infrastructure (see Chapter 6), high-cost and low-quality logistics services, as well as high regulatory burden (see Chapter 4). Further lowering tariffs is important, since fragmented modes of production imply multiple border crossings and magnification effects of even small tariffs. OECD analysis suggests that relatively low import tariffs and, in particular, high coverage of imports and exports of intermediate products by regional trade agreements, make the MENA region relatively attractive for value chain location. Still, in a number of countries, such as Morocco or Tunisia, further liberalisation of policies could significantly boost participation in GVCs, by 15% or more.

Tariff removal is a necessary, albeit insufficient, condition for further integration, if products are held back at the border by onerous customs procedures or if supply chains are disrupted by burdensome regulations. Trade facilitation efforts can contribute to boosting investment and job creation. The OECD's Trade Facilitation Indicators show that the overall performance of the MENA region is average, but that countries could focus their efforts on improving advance rulings, fees and charges as well as governance and impartiality (Figure 5.2). Some countries are moving in the right direction. Facing an unprecedented refugee crisis, Jordan and Lebanon are negotiating preferential market access with the European Union, reviewing quality standards and easing rules of origin. This can play a critical role in boosting international trade and fostering integration into GVCs.

Key recommendations

- Enhance FDI performance through targeted investment promotion and linkages with the host economy.
- Deepen market access through trade and investment agreements.
- Reduce regulatory and administrative obstacles to trade and investment with a view to easing business and upgrading activities in GVCs.
- Enhance alignment between international trade and investment agreements and domestic legal and regulatory frameworks to foster regional and international integration.

6 Upgrading the region's infrastructure

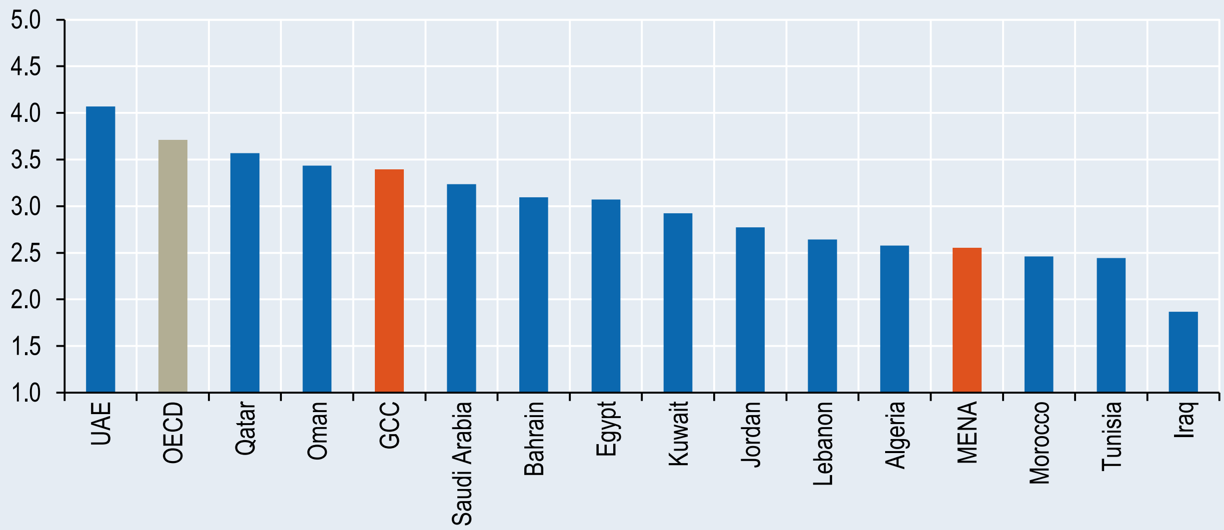
Infrastructure and basic services facilitate trade and investment by connecting producers to markets. Performance of these services is essential for a competitive economy and integration of businesses into global value chains (see Chapter 5). Infrastructure investments are expected to provide tangible impacts on growth, quality of life and productivity. Despite significant achievements in recent years, the quality and quantity of infrastructure in the MENA region, apart from the GCC countries, still lags behind. Upgrading the region's infrastructure is constrained by weak private investment and limited availability of public financing. Governments in the region, supported by donor countries, should strive to improve the institutional framework to better manage public investment and provide a more predictable and lower-cost environment for private investors. Regardless of the source of financing, weak infrastructure governance is a major obstacle to making needed infrastructure services available, i.e. inadequate procedures, institutions and tools to identify, develop and execute infrastructure investments.

Encouraging more private investment in infrastructure

With the exception of the GCC countries, the quality and quantity of infrastructure and infrastructure services in the MENA region are generally rather poor (Figure 6.1). While the oil-exporting economies of the region have largely used direct provision and public investment funded by oil revenues to develop advanced infrastructure, other countries have limited capacity to publicly finance infrastructure – and even the oil exporters have been hit by volatile oil prices and uneven growth in key emerging markets. These new pressures mean that there is a general interest in leveraging private finance for infrastructure investment and greater attention to ensuring value for money in publicly funded projects. In many countries, the fiscal base is limited, and significant fiscal reform would be needed to generate additional public funds for infrastructure. While broadening the tax base is a common general policy objective in the non-oil exporting MENA economies (see Chapter 3), attracting new sources of private finance will be essential.

FIGURE 6.1. **THE QUALITY OF TRADE- AND TRANSPORT-RELATED INFRASTRUCTURE IS LOW IN MANY MENA ECONOMIES**

Infrastructure quality indicator, from 1 (worst quality) to 5 (best quality), 2016



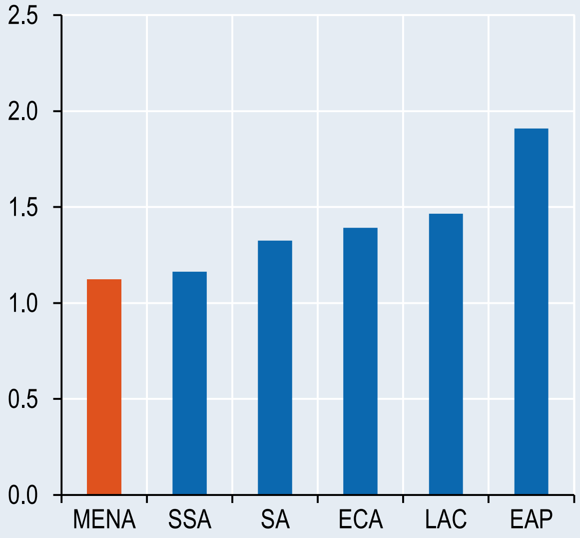
Note: MENA excludes GCC.

Source: Logistics Performance Index, the World Bank.

The need to draw in more private finance is clear from comparisons with other regions in the world. Private investment commitments in infrastructure in the MENA region have been lower than in any other region of the world for the past two decades, pointing to structural characteristics and challenges that are specific to the region (Figure 6.2).

FIGURE 6.2. **PRIVATE PARTICIPATION IN INFRASTRUCTURE DEVELOPMENT IS LOW RELATIVE TO OTHER REGIONS**

Total investment commitments between 1992 and 2015, % of GDP



Note: The database covers only projects awarded in low- and middle-income economies as classified by the World Bank. SSA = Sub-Saharan Africa, SA = South Asia, ECA = Europe and Central Asia, LAC = Latin America and the Caribbean, EAP = East Asia and Pacific.

Source: Private Participation in Infrastructure Database, the World Bank.

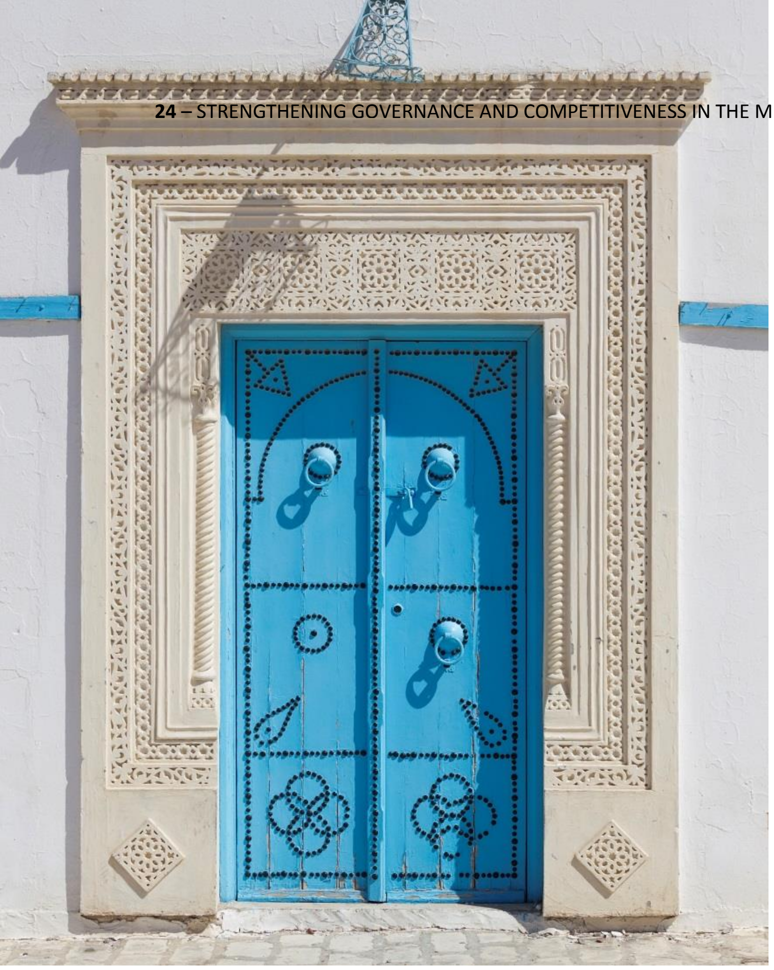
A number of barriers have constrained private financing of infrastructure in the region in the past, including lack of observance of the rule of law and political instability, as well as inefficiencies and lack of integrity of public administrations. Strengthening regulatory frameworks and ensuring a level playing field for businesses will help to create the stable, predictable business environment that investors expect (see Chapter 4). In addition to clear legislation and consistent enforcement of rules, this can also mean offering specific, long-term and transferable guarantees to offset political risk. Enhancing the transparency of public purchasing processes would also help to draw in new investors (see Chapter 2).

Reliance on foreign capital due to the limited scale of local capital markets is another problem for the region. In general, this means that infrastructure development is dependent on the region's relative competiveness vis-à-vis other capital markets in which multinationals and other investors operate. Investors are not able to borrow in the local currency, which increases exposure to foreign exchange risk. Mixing foreign and local sources of funding via local capital markets helps to spread risk and also, importantly, to build capacity among local actors.

Enhancing the governance of infrastructure projects

Building capacity is an issue for both public and private institutions involved in infrastructure development in the MENA region. In particular, public authorities often lack the legal and contracting skills, as well as the planning experience, to manage complex projects. Fragmentation and silos across government departments and regulators can also hinder effective co-ordination of investment. This can frustrate private companies that are keen to invest or participate in tenders but may lack knowledge of local legal and regulatory frameworks, customs and practices and consequently struggle to accurately evaluate risk. Therefore, delivering projects on time and on budget requires increased and co-ordinated government capacity at all stages to provide the necessary agility to respond to risks and opportunities, from project design and approval to execution and appropriate communication of outcomes.

The OECD Framework for the Governance of Infrastructure identifies some keys to successful project delivery relevant for the MENA region, notably the need for: 1) a coherent strategy that integrates across sectors and levels of government; 2) effective consultation, stakeholder engagement and transparency; 3) a planning system that ensures cost efficiency and affordability for users while also encouraging a pipeline of investments; 4) integrity in procurement; and 5) evaluation of the social and economic impacts of infrastructure investment, including spillovers in areas such as local employment creation or SME development.



The choice of the delivery mode of infrastructure projects is also key to upgrading the region's infrastructure. Countries can choose between different delivery modes with different levels of involvement of the government and the private sector: privatisation with regulation, public private partnerships (PPPs), public procurement (see Chapter 2) and direct provision. The choice of delivery mode has strong implications for public sector discretionary control, value for money and affordability. Countries should, therefore, carefully assess which is the best option for each infrastructure project.

The issue of infrastructure governance is particularly important today, given the increasing interest in establishing PPPs for infrastructure, as a tool to reduce the reliance on public investment, draw in private financing and share risk more widely. PPPs can improve infrastructure provision by mobilising additional private investment and expertise in infrastructure while reducing the burden on MENA government budgets. This is particularly important in a context of reduced fiscal capacity due to falling oil prices. But for PPPs to succeed while providing value for money, it is essential that they be part of a sound legal, institutional and budgetary framework aligned with international best practices, such as the OECD Principles for Public Governance of PPPs.

Some countries in the region have already updated their PPP laws and set up new PPP agencies or specialised units within existing institutions (e.g. Jordan, Morocco, Tunisia, and Egypt). These actions should bring further clarity and transparency to their PPP regimes and should help these countries better mobilise private sector investment (OECD, 2015b). Tunisia, for instance, recently adopted a PPP law closely aligned with international standards. The law enshrines the principles of competition and transparency in the bidding process, provides a better supervision framework for public and private initiatives in the contracting procedure, and offers more innovative evaluation criteria, such as performance-based criteria aiming at maximising the economic impact of projects on the local economy (OECD, forthcoming-a). The law also provides a more robust institutional framework that includes the creation of a PPP Central Unit. Many other countries recently updated (or are currently updating) their legal and institutional frameworks for public procurement to align them with international best-practices (see Chapter 2).

Key recommendations

- Promote measures to de-risk infrastructure projects in the MENA region to make the region more attractive to global investors, for example by more widely using PPPs.
- Draw on the OECD Framework on Governance of Infrastructure to strengthen the capacity of governments to measure needs, identify priorities, and align investments across sectors.
- Build capacity and expertise in project selection and planning to demonstrate a track record of successful projects.
- Strengthen integrity frameworks relating to infrastructure investment, including procurement systems and conflict of interest.
- Draw on the OECD Principles for Public Governance of Public-Private Partnerships to increase public sector capacity to work with private sector actors to develop PPPs.

7 Ensuring efficient and sustainable management of water and energy resources

Water and energy are essential drivers of green growth in the MENA region. The two resources are intertwined, as a significant amount of energy is needed to pump groundwater, desalinate seawater, treat wastewater and transport water over long distances. Some of the main challenges concern energy security and access to water supply and sanitation, with implications for food security against high population growth, political instability, migrations and climate change. Coherent policies and good governance are key, and OECD studies demonstrate opportunities for reform as the region moves towards sustainable water and clean energy sectors.

Encouraging efficient and sustainable water use through effective resource and service management

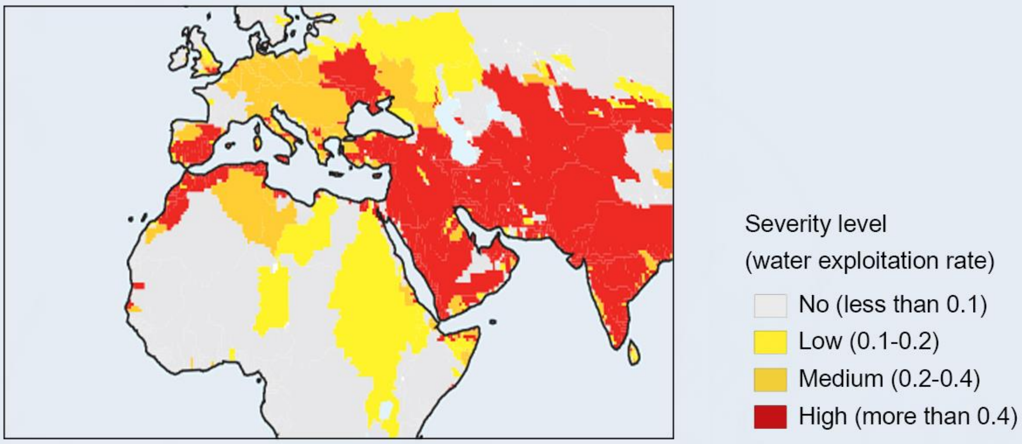
MENA is one of the most water-stressed regions in the world (Figure 7.1). The OECD Environmental Outlook to 2050 (OECD, 2012b) projects that water stress will further intensify in the coming decades. In addition, nutrient effluents from wastewater and from agriculture are projected to rise. This situation derives from a disconnect between the growth of urban population and investment in the collection and treatment of wastewater. It also results from intensive use of nitrogen and phosphorus to grow food and contribute to food security.

Policy simulations indicate that the right policy mix can reduce the intensity of water use, while reducing nutrient discharges that contribute to eutrophication of water bodies and seas. Experience from OECD countries suggests that targets to reduce freshwater use, as well as economic incentives to improve freshwater allocation across consumers, increase efficiency of fertiliser use and livestock production, invest in sewage systems and recycle treated wastewater back into agriculture, can help reduce water use and eutrophication.

Supplying water to growing populations entails significant upfront investment in the necessary infrastructure and high cost to operate infrastructure and provide water and sanitation services. Public funding and international assistance can be significant sources of finance for water in the region, but they remain unpredictable.

FIGURE 7.1. THE MENA REGION IS AND WILL REMAIN ONE OF THE MOST WATER-STRESSED REGIONS IN THE WORLD

Water stress by river basin, projections for 2050



Source: OECD (2012), OECD Environmental Outlook to 2050: The Consequences of Inaction, OECD Publishing, Paris, http://dx.doi.org/10.1787/9789264122246-en.

Sustainable financing, including private investment, will only materialise when price-based instruments and governance conditions are in place to secure sufficient, stable and affordable revenues to recoup capital and operating costs. This involves important efforts to reduce operating costs of water supply systems, improve revenue collection, apply rigorous strategic financial planning and increase synergies between water and energy sectors to reduce the energy costs.

Competent, autonomous and financially sustainable water operators have a crucial role to ensure sustainable management of the region's scarce water resources. Establishing appropriate accountability mechanisms and fostering a culture of internal control and audit could improve the management of water suppliers and facilitate their transition towards a culture of performance-based management and oversight. Coherent development, use and publication of a single set of performance indicators across water utilities is crucial in this regard, as it can help promote better monitoring and exert pressure on operators to improve their performance. The credibility of the information will depend on both the importance that operators give to its use for supporting policies (e.g. tariff setting or penalties in case of weak performance) and the trust that stakeholders have in the information.

In this context, the existence of an independent third party with the capacity and credibility to monitor performance and ensure the quality of information is a solution that has been considered widely across the region, as illustrated by the establishment of utility regulators in several countries. Success will depend on their capacity to promote a high-quality and credible water regulatory framework.

The capacity of the various governments to engage stakeholders will be critical to the success of reforms. In most countries, while there are platforms for engaging users on different aspects of the water sector, consultation with the public remains inconsistent. There is no systematic approach to undertaking customer surveys and analysing users' needs and constraints. Assessment stemming from such information, and likely to trigger policy action, is not publicly available. As a result, there is low awareness of the economic value of water and the dangers associated with water scarcity and its linkages to energy and food security. Efforts to engage stakeholders will involve strengthening the information base to raise citizen awareness on critical issues such as the state of national water resources and the real cost of water services.

It will also require strengthening existing mechanisms and platforms for stakeholder engagement, to build consensus on investment priorities, tariff levels, conflict prevention and improved quality of service.

Scaling up the share of renewable energy sources

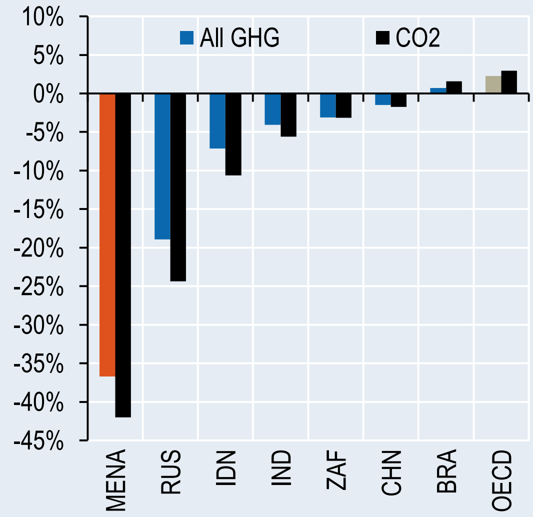
The MENA region is characterised by low prices for fossil fuels, which are heavily subsidised, and a high reliance on oil and natural gas to meet energy needs. The deployment of renewable energy in the power sector has the potential to increase economic growth and local jobs, improve energy security by diversifying the energy mix, reduce fiscal pressures and scale up climate action to better manage exposure to climate risks. Despite modest total greenhouse gas emissions relative to other regions, carbon dioxide emissions in the MENA region grew at a rate of 4.5% in 2012, much faster than the world total of 0.8%.

Scaling up the investment in renewable energy can improve energy security, particularly for net energy-importing countries like Jordan, Lebanon, Morocco, Syria and Tunisia. Overall, the MENA region has one of the highest solar-power potentials worldwide, including in solar photovoltaic (PV) and concentrated solar power. However, the share of renewables in electricity capacity remains low compared to global trends. Renewables are estimated to account for almost two-thirds of net capacity growth in the medium run globally, but for less than 15% in the MENA region (IEA, 2015a). The share of installed renewable energy capacity in the power mix varies across the region, from 32% in Morocco in 2012 (6% from solar and wind energy and 26% from hydroelectric power) to 4% in Jordan (RCREEE, 2013; OECD, forthcoming-b).

Progress has been made, as several governments in the MENA region have supported renewable energy investment over the past five years. The International Energy Agency estimates that 80% of the projected additions to non-hydro renewable capacity in the MENA region between 2014 and 2020 will be made in Jordan, Morocco, the United Arab Emirates and Egypt (IEA, 2015a). Net fossil-fuel-importing countries, such as Jordan and Morocco, have been among the first to reinforce enabling conditions for investment in renewable electricity generation. At the same time, renewable electricity technologies have become cost-competitive relative to fossil-fuel-based options.

FIGURE 7.2. **MENA ECONOMIES HAVE A HUGE POTENTIAL TO REDUCE GHG EMISSIONS BY PHASING OUT FOSSIL-FUEL SUBSIDIES**

Impact on GHG emissions of phasing out fossil-fuel subsidies, 2050



Note: GHG emissions exclude land use, land-use change and forestry. A lower demand for fossil fuels in the reforming economies will cause a decrease in global energy prices. Moreover, unless the OECD countries cap their total emission levels, this decrease in international prices could create an increase in emissions in some OECD countries (relative to baseline), leading to a partial offset of the original reduction of demand and GHG emissions. Despite this leakage effect, the net effect on global emissions is, however, projected to be positive.

Source: OECD ENV-Linkages model using IEA fossil-fuel subsidies data (IEA,2009).

One of the main challenges in the MENA region is to create an environment conducive to delivering a large-scale pipeline of bankable projects and to shift investment from high-carbon investment to low-carbon and climate-resilient options while reforming fossil-fuel subsidies (Figure 7.2). The global share of Middle East oil exporters has increased from 35% to 40% over 2010-14, and fossil-fuel subsidies for that group of economies represented, on average, more than 25% of government expenditure over 2009-14 (IEA, 2015b).

Lessons for the MENA region can be drawn from the forthcoming Clean Energy Investment Policy Review of Jordan (OECD, forthcoming-b). The case of Jordan illustrates the importance of developing robust policies and targeted incentive schemes in the MENA region to create a stable pipeline of bankable projects in solar PV and wind energy. For example, Jordan's 2012 Renewable Energy and Energy Efficiency Law included a feed-in tariff for the first procurement round in 2012-13 (the first in the Middle East) and competitive tenders for the second procurement round for solar energy in 2014. Most economies in the MENA region still need to encourage competition and entry of independent power producers for renewable energy. Jordan is a positive example, as it has unbundled generation, transmission, and distribution in the electricity sector, following the 2003 General Electricity Law.

Overall, economies in the MENA region need to address grid capacity constraints, streamline the land acquisition and land lease process, increase the participation of local banks in financing renewables projects, improve the awareness and technical capacity on wheeling and net metering, and enhance co-ordination and dialogue between project developers, public officials and donor agencies. Ensuring policy co-ordination and coherence on renewable energy projects will be crucial to enhance investor confidence and attract renewable-energy investors in the long term. Lessons for the MENA region can be learned from the Solar Plan carried out by the Moroccan Agency for Solar Energy, which designs and manages integrated solar projects and conducts competitive bidding procedures for solar plants and related land allocation. It also carries out technical, economic and financial studies and co-ordinates grants and loans provided by multilateral and bilateral donors.

Key recommendations

- Promote sound water governance, following the OECD Principles on Water Governance.
- Signal water scarcity through pricing mechanisms, following the GWP/OECD Task Force Report on Securing Water, Sustaining Growth.
- Factor water security into economic and urban development policies.
- Develop strategic financial plans, mapping sources of revenues and expected expenditures to stimulate debate on the feasibility of various policy choices and phase out unsustainable options.
- Apply investment policy principles following the OECD Policy Guidance for Investment in Clean Energy, including non-discrimination, transparent land access and contract enforcement.
- Set predictable incentives for renewable investment and reform fossil-fuel subsidies.

8 Fostering the social inclusion of women and youth

Governments in the MENA region are increasingly aware of the importance of broadening inclusion to reach all groups in society. The surge of public activism in recent years created momentum for reforms, increased networking and communications via technological advances and social media, and sparked an overall rise of civic participation and political engagement by both men and women. Constitutional changes in some MENA economies addressed gender equality and acknowledged youth's role as an active force in the development of their country. However, inequalities persist in society, as reflected by the low inclusion of women and youth in the labour force and in public life.

Improving the integration of women in social, economic and public life

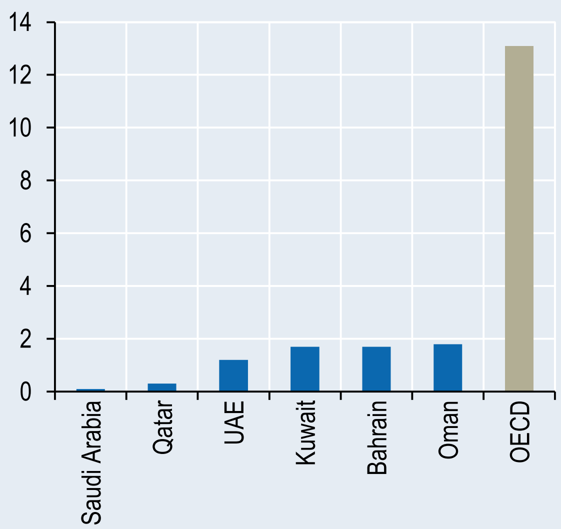
Women remain an untapped resource for MENA economies, especially in light of important improvements in their educational attainment. Only 21% women were employed or looking for paid work in 2014, well below the OECD average of 54%, and well below the rate of participation in the labour force of men in the MENA region (74%). Despite low participation of women in the labour force, the MENA region faces the highest female unemployment rate and the widest gender wage gap in the world. Female unemployment tends to be higher in North Africa than in the GCC countries. Strengthening the participation of women in the labour force will empower them and help achieve gender equality, with a view to building more inclusive and prosperous societies. This in turn will translate into improved household welfare outcomes, as women tend to spend a greater share of income on their children's education and health. This will have beneficial effects on long-term growth.

When working, women favour the public sector, as these jobs are more socially acceptable and, relative to private sector jobs, they offer higher salaries and job security as well as better reconciliation with family duties. Despite declining public sector employment opportunities due to structural adjustment policies, women's employment in the private sector remains low. At the same time, vulnerable employment (defined as unpaid family and own-account work) has increased in recent years, further reducing women's access to markets and community services.

Women entrepreneurs in the formal sector are rare in the MENA region, and women generally have low levels of work experience, fear failure and are less optimistic about potential business opportunities. They are more involved in consumer-oriented sectors and services, where start-up costs and entry barriers are lower. However, these sectors are also characterised by low development potential. To boost the rate of business creation and survival, women's entrepreneurship could be supported through targeted business development services such as incubators, enterprise accelerators and business planners. Providing greater access to business networks, associations and information on business opportunities could also prove very useful.

FIGURE 8.1. **WOMEN ARE VERY RARE AMONG BOARD MEMBERS IN THE MENA REGION**

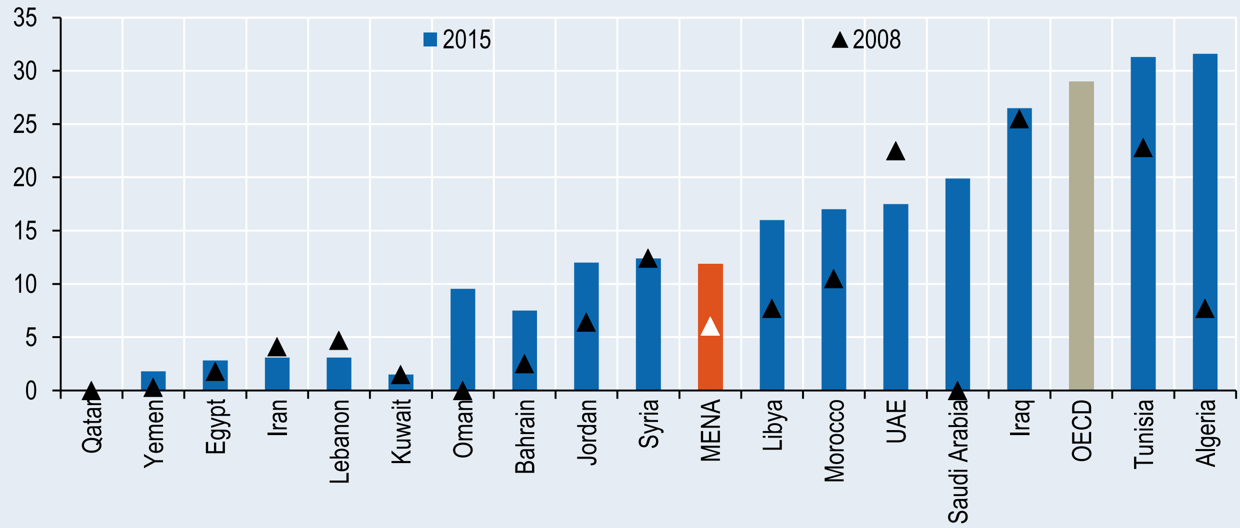
Percentage of board seats held by women in listed companies, latest available year



Source: Catalyst (2014), Quick Take: Women on Boards. Catalyst, New York.

FIGURE 8.2. **PARTICIPATION OF WOMEN IN PARLIAMENT IS VERY LOW IN MOST MENA ECONOMIES**

Percentage of women in lower or single house of parliament



Source: Inter Parliamentary Union.

Credit guarantees and measures for financial education and inclusion would help tackle the lack of collateral and financial acumen that holds back many female entrepreneurs.

Unsurprisingly in this context, women are extremely rare among board members or top managers in the region. They hold less than 2% of board seats and represent less than 15% of managers in the region's economies, well below the OECD averages (Figure 8.1). However, public policy developments in some countries offer signs that these numbers could improve in the future. For example, in 2012, a ruling was issued by the Cabinet of the United Arab Emirates stipulating that all state-owned corporations must include at least one female board member. In addition, different kinds of related initiatives, such as the Women on Boards Programme and the OECD-MENA Women's Business Forum, could provide additional and relevant support for progress.

Two factors explaining the low participation of women in economic activities are social institutions and legal discrimination. The MENA region was the poorest performer in the 2014 edition of the OECD's Social Institutions and Gender Index, with the majority of economies having high to very high levels of discrimination. For example, a number of discriminatory provisions in family laws and personal-status laws continue to negatively affect women's lives, such as women's equitable rights in marriage and polygamy, divorce and inheritance, custody of children and transfer of nationality to children. Discriminatory practices and customary laws block women's access to land and non-land assets, despite the existence of legislation granting women and men equal rights in this area. Two-thirds of economies lack legislation addressing violence against women, reinforcing norms that posit violence as a "private" matter and explain high levels of acceptance among women that prevent survivors from seeking justice.

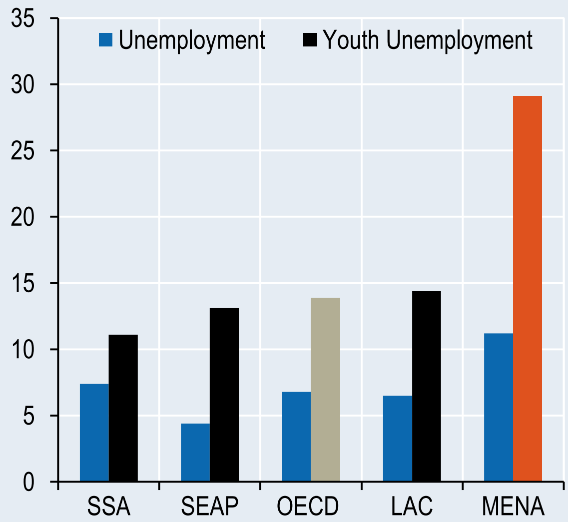
With regard to women's participation in public life, recent data show that women's presence in representative and political executive bodies has improved, but it remains below the OECD average (Figure 8.2). Women's access to the most senior levels of civil service remains elusive. In MENA economies, women make up 17.9% of legislative bodies, far from the 30% critical mass perceived to be the tipping point for tangibly influencing policy. Some countries, such as Algeria, Jordan and Morocco, have introduced legislated quotas as a way to catalyse women's political representation (OECD, 2014c). In the political executive, the proportion of women ministers hovers at around 8%, while in the justice sector, women's rate of participation as jurists reached 25% in 2011, close to the global average.

Fostering the inclusion and engagement of youth

Young men and women account for an increasing share of the population of MENA economies. In Jordan, for example, those under age 30 make up a staggering 70% share of the population. Policies in favour of youth are thus an investment not only in the future but also in the well-being of today´s population. However, despite average annual growth rates in real GDP of 4.2% in MENA economies between 2006 and 2014, the economic upswing has not led to increased job creation and economic opportunities for youth. The MENA region exhibits the highest rates of youth unemployment worldwide (Figure 8.3), with more than one in four young people in the labour force unemployed in 2015. However, youth unemployment rates vary considerably across MENA economies. Among the non-GCC economies, Moroccan young people have the lowest unemployment rate (17.4%).

FIGURE 8.3. **THE MENA REGION HAS THE HIGHEST YOUTH UNEMPLOYMENT RATE IN THE WORLD**

Total and youth unemployment rate, 2015



Note: SSA = Sub-Saharan Africa , SEAP = South-East Asia and Pacific, LAC = Latin America and Caribbean.

Source: ILO Key Indicators of the Labour Market 2015.

Youth inactivity, in terms of the share of young people not in employment or education, and training (NEET) is nowhere higher than in the MENA region (OECD, 2016f). In 2014, the NEET group made up an estimated 29% of youth in both Jordan and Egypt. Young women are much more likely to fall in the NEET category than young men, with 44% of young women being NEET in Jordan, compared to 15% per cent for young men (Barcucci and Mryyan, 2014) and 49.5% of young women being NEET in Egypt compared to 9.3% for young men (Barsoum, Ramadan and Mostafa, 2014). The pattern of restricted access to social, economic and political opportunities puts MENA youth at significant risk of lasting exclusion from a successful transition to adulthood and developing a genuine sense of citizenship.

Overly rigid labour regulations make it difficult for youth to find jobs. Employers are reluctant to employ youth in permanent positions because of high dismissal costs, and internships and short-term contracts difficult to set up. In addition, labour markets of MENA economies are highly segmented. More than two-thirds of nationals work in the public sector in several GCC countries, while foreign workers represent 80% of private sector jobs. This segmentation reflects differences in wages between national and foreign workers and between the public and private sectors. These differences are a strong incentive for young nationals, particularly those with lower skills, to favour public sector employment and a disincentive to invest in skills that are important for the private sector. In addition, they create a preference for private sector employers to hire foreigners instead of young nationals. In non-GCC economies, fiscal constraints have led to a decrease in hiring in the public sector that has not yet been counterbalanced by job creation in the formal private sector. Young people who do not want to wait to find a job in the public sector tend to turn to the informal sector, which offers lower wages, less social protection, and much less opportunity for human capital accumulation. Most of the measures applied by MENA governments to tackle the problem, particularly in Arab economies in transition, have consisted of wage increases, higher subsidies and renewed public sector hiring among youth. In addition, Tunisia has set up traineeship and entrepreneurship programmes, but with limited success, at least with respect to entrepreneurship programmes.

Despite the constitutional changes in a number of MENA economies, systematic opportunities for political engagement of youth are still sparse. As a policy area cutting across various departments and agencies, youth policy traditionally suffers from the lack of a coherent cross-government approach to address challenges, for example through an integrated national youth policy.

Recent efforts in countries such as Morocco, Tunisia and Jordan to elaborate a multi-year strategy for youth across various departments represent a significant improvement, although effective implementation remains a major challenge. Representative bodies, such as youth councils at national and local levels, are either absent or need increased capacities or connection to the centre of decision-making to be powerful instruments for youth engagement. The lack of youth-disaggregated data impedes the formulation of policies tailored to the real needs of the younger generation. In the absence of effective mechanisms for youth to shape policy outcomes in their favour, governments risk developing public policies poorly tailored to their specific needs and reproducing a vicious cycle in which young people's frustration with those in power results in low levels of trust in government and further disengagement.

Key recommendations

- Increase awareness among political leaders and public officials of the need to tailor public policies and services to the specific needs of women and youth, as well as vulnerable groups.
- Collect sex-disaggregated data that can inform gender-sensitive policymaking and create mechanisms to monitor progress of women's economic empowerment.
- Increase the representation of women in decision-making bodies by encouraging voluntary targets, disclosure requirements and private initiatives that enhance gender diversity on boards and in senior management of listed companies.
- Foster entrepreneurship for women and youth, including by tackling specific areas such as access to business development services, finance and business networks.
- Formulate integrated national youth policies in collaboration with youth representatives, outlining clear objectives, indicators, time frames and budgets allocated to mainstream youth considerations in public policies.
- Increase the coherence of youth policy across ministries and departments.
- Create or strengthen the role of youth representative bodies (e.g. youth councils).
- Promote new forms of youth engagement (e.g. use of digital technologies) to engage youth across the policy cycle.
- Focus youth employment programmes on job creation in the private sector and provide the right conditions for businesses of all sizes to grow and expand their workforce.
- Promote more flexible labour regulations and create social protection systems that are linked to all individuals, irrespective of employment status.
- Evaluate current active labour market programmes and collect more information on the labour market situation of youth.

9 Raising the performance of education systems

More than ever before, higher levels of education and skills pay off in terms of social and economic outcomes. Those with access to quality education are more likely to find a job, participate more actively in civic life and generally have improved levels of well-being. Results from the MENA economies that participated in the 2012 OECD Programme for International Student Assessment (PISA) reveal that the region's 15-year-olds perform below the OECD average in mathematics, reading and science, with large numbers of low-performing students. Ensuring that all students achieve basic skills is essential to sustained economic growth and social stability. MENA economies also need to expand and improve the quality of vocational education and training to help increase employment opportunities, address skills mismatches, and, for the region's oil-producing economies, create a more diversified economy that can withstand commodity price shocks.

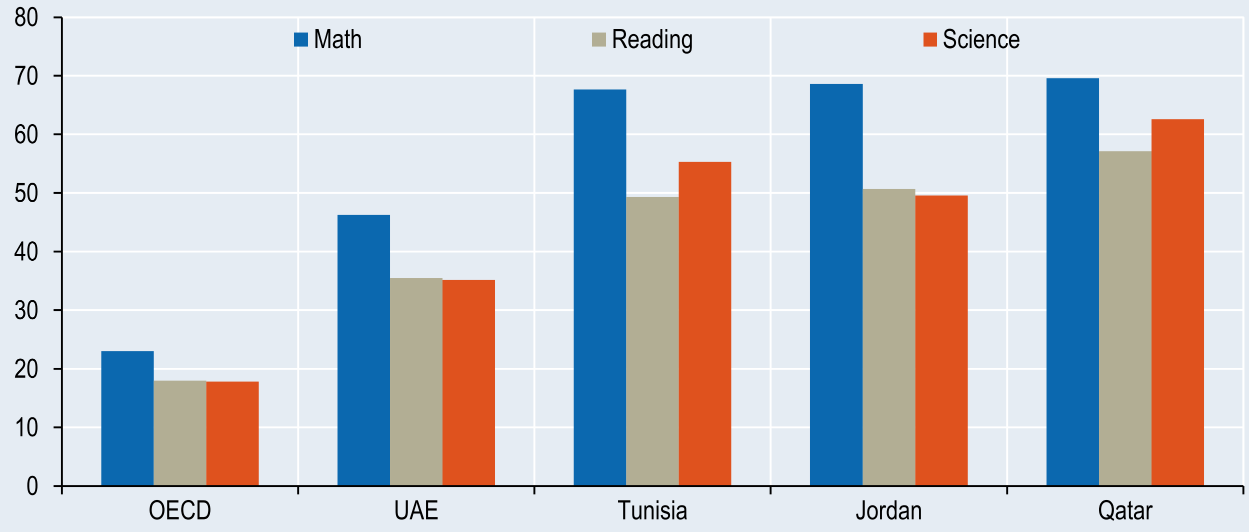
Helping low-performing students

Many countries in the MENA region have made progress in raising attainment levels over the past decade, as increasing numbers enrol in education. Enrolment in tertiary education in the region has been steadily increasing and reached 35% of the total population in 2013, a ratio higher than in South Asia (21%) and East Asia and the Pacific (33%). However, there is still substantial room for improvement. Despite enhanced access to higher education, more than 30% of youth in Morocco and more than 50% of all youth in Yemen are not enrolled in secondary education. School dropout remains a challenge at the secondary level, and school life expectancy in the region (including repeaters) remains low compared to OECD countries (five years in Arab economies, compared to seven years on average in OECD countries (UIS, 2016).

Moreover, despite higher levels of educational attainment, the quality and relevance of education remains a key challenge. The average performance of the MENA economies that participated in the 2012 OECD PISA study (Algeria, Jordan, Lebanon, Tunisia, the United Arab Emirates and Qatar) is also well below the OECD average, with a gap equivalent to about two years of education.

FIGURE 9.1. **MENA ECONOMIES HAVE A HIGH SHARE OF LOW-PERFORMING STUDENTS**

Share of low performers in percent of all students, 2012



Note: Low performers are students who score below the baseline level of proficiency, that is, who are proficient at Level 1 or below in PISA

Source: OECD, PISA 2012 Database.

Results from PISA also show that, on average, roughly three out of fiveMENA students do not have basic mathematics skills, thereby creating a barrier to formal employment and productivity growth (Figure 9.1). The risk of unemployment in the MENA region increases with higher educational attainment. While this does not imply causation between having higher levels of education and being unemployed, it points to a structural problem that might be linked to skill mismatches and labour market rigidities (see Chapter 8). In order to improve learning outcomes, education policies in MENA economies must shift their focus from access alone to access plus quality.

Education spending varies considerably among MENA economies. In 2012, 2% of GDP and 7% of public expenditure in Lebanon was spent on education, compared to 6% of GDP and 22% of public expenditure in Tunisia (UIS, 2016). UN targets recommend that developing countries allocate between 4%-6% of gross national income and 15%-20% of public expenditure to education to ensure all students complete secondary education with basic skills. Tackling low student performance is not only a matter of how much (or how little) countries spend on education. Gains can also come from efforts to improve achievement at the bottom end. For example, education policy and practices can raise learning outcomes by identifying who the low-performing students are and providing them with targeted support that involves the school and the family. Offering special programmes for immigrant, minority-language and rural students, in addition to addressing gender inequities, can also help students achieve a minimum standard of skills.

Starting strong

Intervening early is another way to ensure that all children have a strong start in life and a solid foundation for the development of skills. Of the MENA economies that participated in PISA in 2012, an average of 32% of students attended pre-primary education for more than one year, compared to the OECD average of 74%. Given the high number of low performers in MENA economies, preventive approaches and early interventions should be enhanced to ensure that all students consolidate basic skills from the earliest stages onwards.

Low enrolment rates in pre-primary education also have societal implications, particularly on women's ability to work. OECD studies reveal that there is a positive relationship between childcare provision and female employment. While girls perform better at school than boys in some MENA economies, women only make up 21% of the total labour force in the region (see Chapter 7). Across the MENA region, girls are fast closing the gap with boys in terms of school enrolment. With growing numbers of well- educated and qualified women in these economies, it is a misuse of human potential that many are not able to contribute to their economies.

Strengthening links between the education system and the labour market

In addition to raising student performance at the school level, MENA economies need to strengthen the link between learning and labour market needs and create more opportunities for workers to adapt and build their skills throughout their careers. Of the total labour force, 11% of workers in the MENA region were unemployed in 2014, compared to 7% in OECD countries (ILO, 2014a). Young people make up the bulk of the unemployed in the MENA region. Measures to increase their employability are essential.

The labour market relevance of higher education systems varies among countries. OECD studies have shown that the higher education systems in some countries are failing to balance the supply of higher education graduates and demands in the labour market. For example, according to the World Economic Forum's Global Competitiveness Report, Qatar was ranked second (of 140 countries) in 2015 for "availability of scientists and engineers", while Tunisia was ranked at 48 and Oman at 108 (WEF, 2015). The World Economic Forum also found that an "inadequately educated workforce" is a problematic factor for doing business in some countries in the region. Higher education systems need to produce graduates with the mix of knowledge and skills needed by the labour market.

High-quality vocational education and training (VET) pathways can help engage youth who have become disaffected with academic education, improve graduation rates and ensure smooth transitions from school to work. However, the provision of VET remains underdeveloped in the region, with only 11% enrolment in VET among Arab states in 2012, compared to the OECD average of 46% (UIS, 2016). The OECD's experience in this area has identified three characteristics of successful VET systems: 1) they are responsive to the needs of the labour market; 2) they build in a strong core of foundation skills; and 3) they have strong elements of work-based learning. Countries also need to properly assess and anticipate skills needs, in both VET and higher education, to ensure that this information feeds effectively into policies to reduce skills mismatch and shortages.

Key recommendations

- Build stronger and more relevant skills throughout the education system, with specific attention to reducing the number of low performers.
- Properly assess and anticipate skills needs, ensuring that this information feeds effectively into policies to reduce skills mismatch and shortages.
- Strengthen the provision of VET to better engage youth and ensure smooth transitions from school to work.
- Increase access to quality early childhood education and care.

10 Raising resilience through private sector engagement

Promoting economic resilience in countries affected by conflict implies increasing their ability to mitigate vulnerabilities and transforming them through structural reforms. The recent refugee crisis in the Middle East is adding new challenges to the countries that face the massive arrival of displaced populations. The role of the private sector – domestic and international – is critical. A solid private sector, inspired by entrepreneurial culture and able to provide jobs, particularly to youth, is a powerful stabilising factor. For countries absorbing large flows of displaced populations, it is also a critical factor for integration. The international private sector can play a positive role if it responds to the opportunities emerging through reconstruction needs. To do so, it is important to work on investment and trade regimes to deal with the very specific features of conflict and fragile situations. It is particularly important for governments in these fragile situations to strengthen their capacity to promote responsible conduct of the private sector.

Addressing the root causes of conflict and fragility

The MENA region is facing multiple and complex emergency situations on an unprecedented scale. Civil wars in Syria, Iraq, Libya, and Yemen have caused many human losses and infrastructure destruction that will have long-lasting effects. According to the International Monetary Fund, MENA economies that have been in conflict for the past five years have lost an average of 2.25% of GDP per year (IMF, 2015). These conflicts have also imposed significant pressures on their economically strapped neighbours, such as Jordan, Lebanon, and Tunisia. The World Bank estimates that the influx of refugees is costing Jordan over USD 2.5 billion a year, which represents 6% of GDP and one-fourth of the government's annual revenues (World Bank, 2016). The Syria crisis has also affected annual growth rates, with a drop of 8% in Lebanon and 5% in Iraq between 2013 and 2014. These challenges highlight the importance of building resilience among individuals, communities, and institutions in the MENA region. Governments in the region need to implement policies to better absorb incoming refugees, while not disregarding host communities, to avoid further destabilisation.

Building resilience requires a better understanding of how to strengthen countries' assets, reduce risks, deal with the consequences of shocks and also embed a resilience focus in international and national crisis response. In Lebanon, the Resilience Systems Analysis (led jointly by the United Nations and the OECD) helped convene a diverse set of stakeholders, including the private sector, to undertake a multifaceted analysis of the Lebanese context. They worked to holistically assess and identify critical assets that are vital for maintaining well-being in the country, as well as which stakeholders are best placed to help strengthen those assets (OECD, 2014d). The analysis identified stronger local engagement and capacity-building efforts with municipal-level actors and civil society groups as key mechanisms for supporting greater social cohesion. In addition, several cross-cutting priorities emerged, including the need to significantly strengthen youth employment opportunities and develop vocational training for both host communities and refugees. In addition, the analysis highlighted the opportunities that exist for increased private sector engagement in service provision. Drawing on the available capacity and willingness of private sector actors was recognised as a key means of meeting the needs of vulnerable communities in a politically sensitive way. These findings informed the development of the Government of Lebanon and United Nations' Lebanon Crisis Response Plan.

Providing institutional and legal support to the refugees

Assisting the large number of refugees within the region is one of the most important challenges at the moment. Jordan and Lebanon are most affected by the ongoing refugee crisis (Figure 10.1). By May 2016, Jordan had registered 650 000 Syrian refugees with more than 85% living outside of camps, and by March

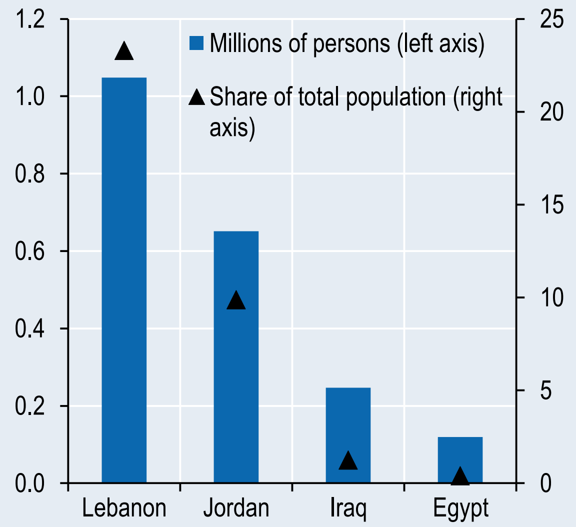
2016, Lebanon had registered 1 million Syrian refugees (UNHCR, 2016a). In order to provide asylum seekers and refugees with protection as well as access to jobs, health services and education, local and central administrations need to swiftly increase capacity and resources, as well as overcome normative barriers and lengthy bureaucratic procedures. In addition, legal restrictions that limits immigrants' ability to join the formal labour market need to be removed.

There are some positive signs that administrations are meeting refugees' needs. In Jordan, for example, 61.6% of school-aged Syrian refugee children attended formal education, and in Lebanon, 69.3% of Syrian refugee households reported that medical attention was sought and received, while only 8.2% reported that medical attention was sought but not received (UNHCR, 2016b). Access to employment has also been improved in some countries. In April 2016, Jordan launched a 90-day grace period that allows employers in the informal sector to freely obtain work permits for Syrian refugees. Also, since the beginning of March 2016, Syrian refugees are allowed to use UNHCR-issued asylum-seeker cards and Jordanian Ministry of Interior cards to fast-track obtaining work permits.

But there is also a need to support host communities, since competition from newcomers has a significant impact on their employment and salaries. For instance, 54% of Syrian refugees in Lebanon are concentrated in the Bekaa and the North, which are highly impoverished (UNHCR, 2013; UNHCR, 2016c). Governments have to support SMEs, focusing on sectors where the skills of vulnerable populations can be particularly relevant, and to reform labour regulations. But refugees also need to be seen as an opportunity for the host country as they can help upgrade professional, cultural and social skills as well as promote technology transfer (ILO, 2014b).

Figure 10.1. Lebanon and Jordan are the most affected by the ongoing Syrian refugee crisis

Stock of Syrian refugees, May 2016



Source: UNHCR, http://data.unhcr.org/syrianrefugees/regional.php.

Involving the private sector in economic recovery and stabilisation of the region

As recognised in the UN's Resilience Agenda, the private sector is essential for economic recovery, reconstruction, and stabilisation of the MENA region. By facilitating financial flows, driving job creation and capital investment, the private sector can promote economic opportunities that can in turn reduce the scope for extremism by bringing people out of poverty and giving them a stake in peace. Moreover, during times of crisis, when the public sector may be overwhelmed, the private sector can help provide basic services such as education, water and electricity (OECD, 2014d). Empowering the private sector to fulfil this critical role requires regulatory reform to improve the general business climate, as well as promotion of entrepreneurship and SMEs, among other measures (see Chapter 4).

Private sector engagement also needs to rely on foreign investors that can bring sorely needed investment (see Chapters 5 and 6). Infrastructure projects are especially central in a post-crisis context to address reconstruction needs, provide essential services to refugees and support the resilience of host communities through economic development and job creation. FDI inflows have fallen sharply in recent years, particularly in some fragile and conflict-affected states and economies. Higher transaction costs, information asymmetry and continued political instability undermine predictability and investors' confidence. Trade routes are severely affected by ongoing conflicts, disconnecting some countries from the rest of the region and the world more generally.

Lebanon, for instance, has become isolated, with no land access to markets. Solid policy, legal, contractual and institutional frameworks are often not present in conflict-hit countries, further weighing on investment.

But investment opportunities still exist in specific sectors and areas that are less exposed to conflict within countries, although information is not easily available for potential investors. Efforts to promote investment in fragile contexts need to account for the specific barriers on the ground in a multifaceted way. In particular, such promotion efforts need to better target those sectors and geographical areas where investment is feasible despite conflict and focus on those investors that are willing to invest in conflict-affected countries. It is also necessary to reinforce the legal and institutional framework for investment and responsible business conduct, together with complementary reforms to enhance enforcement mechanisms.

The OECD's project on improving the business and investment climate in Iraq illustrates this multidimensional approach. Among other actions, the government revised the Investment Law and ratified the Convention on the Settlement of Investment Disputes to provide investors a mechanism for dispute resolution, which is critical given the weakened Iraqi judicial system. Stakeholders from different political backgrounds were invited to project-related events to ensure the reflection of a broad spectrum of views from Iraq. Relations were built with central stakeholders, especially the National Investment Commission chairman and the members of the Project Working Group, to foster ownership and increase local acceptance. The project also involved a broad range of other relevant institutions, as well as representatives from business associations in Iraq and the foreign private sector to strengthen intergovernmental and public-private dialogue. The project took a flexible approach to respond quickly to emerging or changing reform priorities of the Iraqi government and linked individual activities to broader political security and development objectives, such as poverty reduction and gender mainstreaming.

Key recommendations

- Expand economic opportunities benefitting vulnerable communities.
- Strengthen public-private dialogue and partnerships in delivering basic services and participating in reconstruction projects.
- Develop employment and training programmes to increase the number of highly skilled workers.
- Adapt labour laws to allow refugees to work and formalise businesses without creating distortions.
- Strengthen national statistics systems and data collection mechanisms to promote private sector engagement.
- Identify the specific risks and vulnerabilities faced by refugees and other migrants, while facilitating prompt access to social and legal protection.

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