

SME Contributions to Employment, Job Creation, and Growth in the Arab World

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Abstract

Recent economic and political developments have highlighted a challenge shared across the Arab region of generating employment, promoting inclusive growth, and improving competitiveness. In the short run, weakened macroeconomic fundamentals in the developing economies of the Middle East and North Africa are a key challenge. The region's main challenge is to achieve sustainable growth that delivers the quantity and quality of jobs needed. An inclusive and competitive private sector has proven to be one of the most effective and long-term solutions for this challenge. This paper provides an analytical framework to diagnose and identify key challenges to the growth of small and medium enterprises that is supported by a quantitative model

based on the World Bank's Enterprise Surveys database. The findings reconfirm that the route to a sustained role for small and medium enterprises in job creation requires improving the credibility of reforms, the effectiveness of policies, and equitable enforcement. Although one size fits all is infeasible for Arab countries, it is important to design policies across sectors to create productive employment and promote economic growth. Supporting innovation and enhancing access to finance are central to the development agenda for small and medium enterprises. And creating an enabling environment and setting up accountable institutions are key to ensure equal opportunity and inclusive growth.

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SME Contributions to Employment, Job Creation, and Growth in the Arab World¹

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I. INTRODUCTION

The recent economic and political developments have highlighted a challenge shared across the Arab region of generating employment, promoting inclusive growth, and improving competitiveness. It has revealed the common demands of the people who want more equitable and fair societies with better economic outcomes for the majority of citizens. The recent developments in the region have brought to the forefront key challenges: the need to create jobs, equal access, a level playing field, transparency and accountability, and a competitive environment. Failure of consecutive governments in meeting people's aspirations in the aftermath of the Arab Spring is stimulating more political, social and economic instability. There is a strong need for a government that is able to balance between quick delivery in the short term and a long-term forward look especially in creating decent and productive jobs to those who have suffered losing their sustainable source of income since their country's uprising and are waiting for political stability to be in place in order to ensure sustainable economic recovery. Crony capitalism—the privileged access of certain elites to favorable legal and regulatory treatment, access to markets, and the coincidence of political and economic power—was a major concern contributing to the uprisings in several Arab countries. Many saw privilege and corruption as the source of unemployment and inequality, effectively raising barriers to entry and growth for the majority of entrepreneurs. Practices such as connected lending and preferential land allocations were also perceived as contributing to the poor performance of key institutions, underpinning the market economy.

The aforementioned complexities position sustainable growth that delivers the quantity and quality of jobs as the region's key challenge. A competitive and efficient private sector appears to be one of the most effective solutions for this challenge. In this context, this paper will contribute to the empirical literature on firm dynamics and job creation in the Arab world.

Section II discusses recent economic developments in the Arab world. Section III provides a literature review on employment dynamics as well as cross-country evidence on the relation between firm size and jobs creation. Section IV benchmarks employment dynamics and job creation in the Arab region. Section V looks at the key challenges confronting SMEs in generating employment opportunities and growth. It then examines the relationship between firm size, employment, and productivity growth. Section VI provides a profile on SME and employment dynamics in selected Arab countries in comparison to selected emerging economies from other regions. Finally, Section VII concludes with recommendations on means of enhancing the role of SMEs in the creation of employment opportunities, and in contributing to sustainable and inclusive economic growth.

II. RECENT ECONOMIC DEVELOPMENTS IN THE ARAB WORLD

In 2013, growth in MENA is expected to slow to 4.3 percent from 6.4 percent in 2012, when the region was recovering from the political turmoil of 2011. The growth deceleration in 2013 largely reflects a return to more sustainable growth in some oil exporting countries. Egypt's growth will weaken relative to 2012, but growth of all other oil importers will likely accelerate relative to 2012. In the short run, weakened macroeconomic fundamentals in MENA's developing economies are a key challenge. Fiscal vulnerabilities have increased, reflecting sustained, high public spending in response to political upheaval. External deficits have widened and currencies have weakened, despite moves by governments to avoid currency depreciation by drawing down on foreign exchange reserves. In the longer term, MENA countries still face the structural problems that predate the 'Arab Spring.'

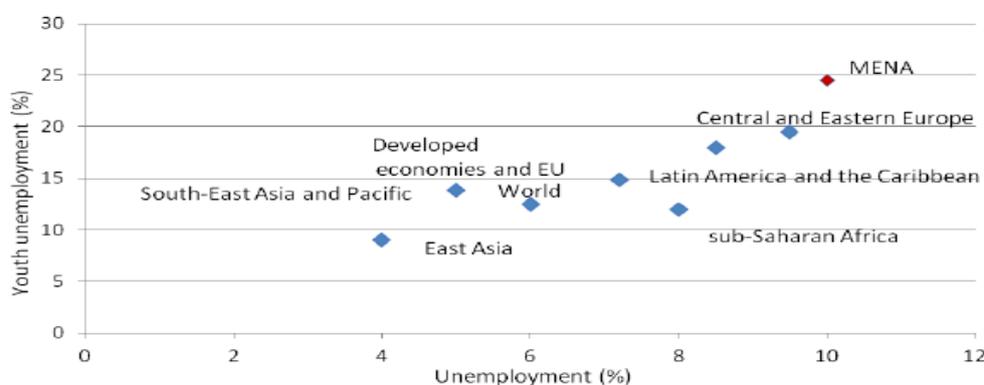
The region's main challenge is to create sustainable growth that delivers the quantity and quality of jobs needed. An inclusive and competitive private sector has proven to be one of the most effective and long-term solutions for unemployment, and will be critical in tackling the scale of

the problem in MENA. Oil importers, especially those recovering from political turbulence; remain in vulnerable positions with diminishing foreign reserves and rising fiscal deficits, as well as high unemployment rates. The macroeconomic outlook remains highly uncertain and is contingent on political developments in the region as well as external downside risks including volatility in oil markets, a deeper than expected global slowdown, and potentially weaker growth in developing countries. The global crisis has indeed left several countries a legacy of high unemployment, unsustainable public finances and lower potential output, exasperating the problems in the Arab countries. Domestic and regional factors as well as the global environment will play a key role, and contribute in shaping country-specific outlooks in the Arab region.

While the focus has been on the recent change in government in Egypt, five countries in the Middle East and North Africa Region, including Egypt, Tunisia, Lebanon, Jordan and Iran are seen to be driving the region's growth slowdown. Continued political turmoil in Egypt and spillovers from the civil war in Syria to Jordan and Lebanon threaten to make their economic situation worse. While easing political tensions in Tunisia and post-election improvements in Iran's international relations may help these countries, the overall macroeconomic outlook in all five countries for the rest of 2013 is grim.

Although growth over the past decade in region has accelerated, averaging 4.7 percent, it still lags behind other developing regions' average of 6 percent. Economic growth has been below its full potential and has failed to generate enough employment. More importantly, economic growth in the region has not been inclusive. The region has been unable to make substantial progress in reducing persistently high unemployment rates, especially among youth and women, and in several countries regional disparities remained if not widened. Growth is typically, but not always, associated with reductions in aggregate unemployment. How much economic growth will lead to job creation, will be dependent on the sectoral composition of growth and the structure of labor markets. It is critical for the Arab countries to achieve the aspirations of their people and attain sustainable and inclusive economic growth through expanding private-led employment and creating entrepreneurship opportunities. This would require a better understanding of employment dynamics and identifying the main sources of job creation.

Figure (1): Regional Structure of Unemployment by Age Group:



Source: World Bank's World Development Indicators Database

Demand for decent and productive jobs is on the rise globally. In this context, youth make up 17% of the world's population. Recent estimates show that 1.2 billion youth in the world aged between 15 and 24. Moreover, almost 87% of youth live in developing countries. Youth make up 40% of the world's unemployed. The global adult unemployment rate reached around 4.5%,

while the youth unemployment rate was approximately 12.6%⁴. While youth employment is a growing challenge, it is seen as more chronic in the MENA region that peaks unemployment and particularly youth unemployment relative to other regions, putting this issue as the primal threat to the regions stability and growth (see Figure 1).

The demographic transformation of the region has led to an abundance of young working-age adults. The Middle East and North Africa⁵ (MENA) countries face a rising labor supply that has outstripped demand, leading to stubbornly high unemployment rates of around 10 percent or more with even higher female unemployment rates of 16 percent. The most shocking high unemployment rates are among the youth, at 25 percent, the highest in the world. In addition to the global slowdown, the problem of unemployment has been sharply exacerbated in the aftermath of the social unrest and revolutions associated with the “Arab Spring”.

The uncertain political situation, and fragile macroeconomic status as well as the risks associated with the “Arab Spring” in a number of Arab countries have weakened investor confidence, leading to a decline in private investment, and consequently rising unemployment rates. Prior to the Arab Spring, private investment rates had been relatively high in a number of Arab countries: Morocco and Lebanon experienced private investment rates of up to 25 percent; while Tunisia and Jordan achieved investment rates around 18 percent between 2004 and 2010. Nevertheless, these countries failed to create sufficient productive employment opportunities for skilled labor. The Arab Spring and the associated disruptions and risks led to a decline in private investments, and foreign direct investment (FDI) inflows to the region. The number of announced investment projects, a predictor of future FDI inflows, fell substantially over the first three quarters of 2011, except for Algeria and Morocco, signaling that FDI inflows to the region may continue their downward trend in 2012. The private sector fell short of creating sufficient jobs for young entrants into the market. At the same time, the public sector jobs that account for a majority of formal employment in a number of countries, have created distortions in the market and contribute to exacerbating long term unemployment spells.⁶

The number of projects with foreign majority ownership established in the Middle East and Africa (MEA) declined by 11.78% in 2012 to 1,370 projects. Capital investment in the region fell by an estimated 43.31% and job creation by an estimated 23.32%. Of the top 10 countries for inward FDI into the MEA region, Morocco experienced the biggest decline with project numbers falling by 34.25% to 48 projects in 2012. Due to the widespread political instability and civil unrest in Syria, the country saw a massive decline in the number of inward FDI projects by 92.86% in 2012⁷.

High unemployment rates have been aggravated by the recent drop in private investments. The investment climate was not very conducive to private sector development. The large informal

⁴ World Economic Forum’s Report on Global Agenda Council on Youth Unemployment, 2013.

⁵The MENA Region includes: Algeria, Bahrain, Comoros, Djibouti, Egypt, Iraq, Jordan, Kuwait, Lebanon, Libya, Mauritania, Morocco, Oman, Qatar, Saudi Arabia, Somalia, Sudan, Syria, Tunisia, United Arab Emirates, West Bank and Gaza, and Yemen (World Bank).

⁶Since public sector jobs are still associated with relatively generous benefits, many educated young graduates, mainly females, are still keen on getting a government job.

⁷ For details on FDI trends to MENA please see fDi Report 2013 - Middle East and Africa, FDI Intelligence, accessible at <http://www.fdiintelligence.com/Custom/Special-Reports/fDi-Report-2013/Middle-East-and-Africa#microsite>

sector in multiple countries in the Arab world highlights the difficulty of enterprises to enter into a relatively closed formal private sector. These were symptoms of a discriminatory business environment that prevents firm entry or exit and hence distorts the competitive process of “creative destruction” (firms’ entry and exit), which motivates productivity growth and innovation. This has been evident in the relatively low number of registered firms per capita and the high age of firms by international comparisons. In a recent field survey in Egypt, employers’ findings indicate that they tend to be more profitable in the trade sector and have higher probability to remain informal in the manufacturing sector (Abd El-Fattah 2012). Moreover, the nonconductive business environment has prevented start-ups from entering the market and hindered the expansion of existing firms. This has led to a growing young population confronted with the lack of job and entrepreneurship opportunities. All this has more severely affected women.

Small and medium enterprises (SMEs) suffer disproportionately from the burdensome business climate. Although SMEs contribute significantly to Gross Domestic Product (GDP) and are a major source of private sector employment in the region, they often lack access to the type of business development and financial services that they need to start-up, operate and grow. Among the major challenges facing the SME sector are non-conducive legal and regulatory frameworks as well as weak judicial and legal systems. In many countries SMEs are confronted with regulatory burdens which have constrained their development and hindered their potential to create private-sector jobs and entrepreneurship opportunities. The large, well-established firms operate in a limited competition regime while SMEs strive to survive. Most Arab countries also suffer from the lack of effective and well enforced competition and consumer protection policies. This requires countries in the region to level the playing field so that marginalized or discouraged enterprises and entrepreneurs can compete fairly with large enterprises.

The recent political and economic developments in the region not only raised various challenges but also enhanced prospects for change and an appetite for reforms. Addressing these challenges and building on the opportunities to create greater economic dynamism and inclusion at this critical time is essential. With huge popular expectations, the authorities are keen on finding best practice solutions to the substantial challenges facing regional economies. Leaders will need to proceed with designing reforms to meet the demands for expanded opportunity. There is a momentum for change and reform that needs to be taken advantage of. Policymakers are looking for effective tools and levers to stimulate job creation, and inclusive economic growth.

III. LITERATURE REVIEW ON EMPLOYMENT AND JOB CREATION DYNAMICS

There is a growing body of empirical literature that supported the fact that small firms employ a large share of workers and create most jobs in developing economies. This positioned SMEs development as a key priority for authorities. Recent research confirms that small firms are important contributors to total employment and job creation. Fast-growing SMEs are essential generators of new employment in developed as well as developing economies. Data of firm dynamics in developing economics suggests that aggregate productivity and growth is held back to an important degree by constraints that affect SMEs more.

Policies to support SME’s spanned developing measures to improve the business regulatory and legal environment, build the capacity of institutions, and enhance access to finance for SMEs. SME development for job creation has become an even higher priority since the recent uprisings in some of the Arab countries.

First, Birch (1979) provided early evidence in support of the idea that small businesses are the primary engines of job growth. His findings showed that 66 percent of all net new jobs in the United States during 1969—1976 were created by firms with 20 or fewer employees, and 81.5 percent were created by firms with 100 or fewer employees.

Meller (1981) concluded that in 25 out of 40 manufacturing sectors direct employment effects are greater than 50% of the total effect. Large industries create more indirect jobs (as indicated by larger multiplier), while small industries are more labor intensive and create more direct jobs relative to both indirect jobs and direct jobs for same industry large firms. When based on the backward and forward linkages the following sectors are determined to be the key sectors (having either backward and forward linkage coefficient higher than 1, or the sum of those higher than one), the following sectors are key: food and wood (large), wood (small), beverages (large), textiles (large), paper (large), leather (large), basic metals (large), machinery with exception of electrical and diverse manufactures (small).

Kirchhoff and Phillips (1988) examined the contribution of small and large firms to United States job growth and also found that firms with fewer than 100 employees are the major sources of net new job creation. In contrast, firms with more than 1,000 employees provided only 13 percent of all new jobs despite their 37 percent employment share. Moreover, the more recent work of Haltiwanger, Jarmin, and Miranda (2010) suggests that startups and surviving young businesses are critical for job creation and contribute disproportionately to net growth.

Aterido, Hallward-Driemeier and Pages (2007) analyzed the impact of various constraints to finance, corruption, regulation and infrastructure across firm type and firm size in Firm level data based on 70,000 enterprises in 107 countries. They find that for the same amount of financing, smallest firms gain the most, also between exporters and non-exporters, improved capital markets have a greater impact on non-exporters. As for consistent enforcement, it was found to help all firms with greatest benefit to small firms. Moreover, corruption was found to hamper growth in small, medium and large firms. Finally, when business climate is weak firms may be confined to industries with limited innovation and growth opportunities

Haltiwanger, Jarmin and Miranda (2011) used data from the Census Bureau Business Dynamics Statistics and Longitudinal Business Database to explore the many issues regarding the role of firm size and growth that have been at the core of this ongoing debate (such as the role of regression to the mean). They find that the relationship between firm size and employment growth is sensitive to these issues. However, their main finding is that once one control for firm age there is no systematic relationship between firm size and growth. Their findings highlight the important role of business startups and young businesses in U.S. job creation. Business startups contribute substantially to both gross and net job creation. In addition, they find an “up or out” dynamic of young firms. These findings imply that it is critical to control for and understand the role of firm age in explaining U.S. job creation.

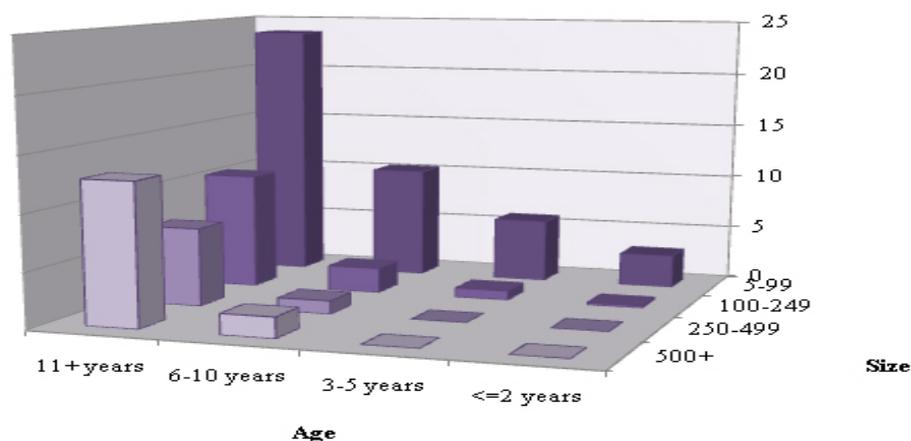
Large firms have a significant employment share; the small mature firms have the largest share of employment in developing economies. On job creation, the US evidence suggests that small mature firms have net job losses whereas in developing countries we find that small mature firms have the largest share of job creation. Moreover, in countries that have had net job losses in the economy as a whole, it is only the small firms, especially small mature firms that have net job gains (Ayyagari, Demirgu-Kunt, and Maksimovic 2011).

Characteristics of high growth firms in European economies were the focus of many recent studies. An expanding literature on “gazelles” suggests that a small percentage of fast-growing SMEs generate the majority of new jobs in diverse economies. In broad brush, the gazelle

literature finds that 5 to 10 percent of the firms deliver 50 to 80 percent of employment generation.⁸ A recent summary of the literature found that gazelles can be accurately characterized by four propositions: (i) in a population of firms, net employment growth is generated by a small number of high-growth firms; (ii) on average, these firms are younger than other firms; (iii) fast-growing firms can be of all sizes, small firms are overrepresented but larger “Gazelle” firms are important job contributors in absolute terms; and (iv) fast growing “gazelles” exist in all industries, and there is no evidence that they are overrepresented in high-technology industries.⁹ These characteristics are derived mainly from evidence from high-income countries.

Consistently, Ayyagari, Demirguc-Kunt, and Maksimovic (2011) shows that for 99 countries SMEs are important and in some cases, the biggest contributors to total employment and job creation, across developing countries). SMEs also have the largest share of employment in developing countries accounting for more than 71 percent of the jobs in the region. Not only do they employ the largest number of people, but they also generate most of the new jobs. Moreover, SMEs have the highest employment growth rates. In developing countries, small mature firms have the largest share of job creation. Moreover, in countries that have had net job losses in the economy as a whole, it is only the small firms, especially small mature firms that have net job gains.

Figure (2): Median Job Creation Shares by Size and Age In Countries with Net Job Creation



Source: Ayyagari, Demirguc-Kunt, and V. Maksimovic (2011).

Data provide strong support to the fact that SMEs account for the lion’s share of employment creation in both countries (2007-2011) with overall employment growth and countries that did not grow. On aggregate, they are the largest contributors to total employment, accounting for around 23.7 percent (Figure 2). Cross-country analysis shows that small firms (in particular, firms with less than 100 employees) and mature firms (in particular, firms older than 10 years) have the largest shares of total employment and job creation. Moreover, even small and young firms have higher job creation rates than large and mature firms. Large firms will have a larger share of

⁸ See Hölzl, Werner. 2008. *Gazelles: Findings from the Sectoral Innovation Watch Project and the Europe Innovation Panel on Gazelles* (Vienna: WIFO, 2008).

⁹Henrekson, Magnus and Dan Johansson. 2010. *Gazelles as Job Creators: A Survey and Interpretation of the Evidence*. Small Business Economics: An Entrepreneurship Journal, (Springer: Volume 35, pp. 227-244, 2010).

employment, while smaller, younger firms will have a higher rate of job creation due to rapid firm births.

Freund and Rijkers (2012) show that “employment miracles” are much less frequent in MENA than in other regions. They find that employment miracles tend to coincide with an acceleration of growth, an overall improvement in macroeconomic conditions (manifested, for example, in higher trade flows, high investment, and lower government spending), and improvements in the regulatory framework.

IV. BENCHMARKING EMPLOYMENT DYNAMICS AND JOB CREATION IN THE ARAB WORLD

It is important for policy makers to understand and consider the impact of government policies on private firms’ entry, operation and growth, as well as their contribution to job creation. To face the central challenge of unemployment, conditions are needed that promote private sector investment and encourage the sort of fast-growing SMEs that empirical evidence has shown to be the most significant job creators. Yet there was little MENA focused research to suggest what policies or types of enterprises might make this possible in the Arab region.

In order for the private sector to act as an “engine of growth” and advance the development process, it is necessary for firms to survive and grow. Access to financial services is seen amongst the main constraints to young small firms’ survival. Recent survey’s for the MENA showed that SME were able to only access less than 10% of banks’ credit in 2011 with a financial gap reaching more than 125% of current outstanding banking finance to SMEs (see Figures 3 and 4).

Figure (3): SMEs Share of Bank Finance (2011)

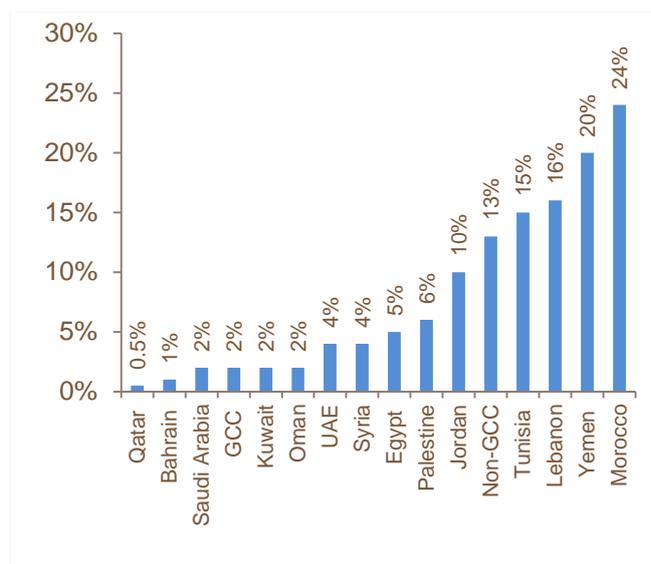
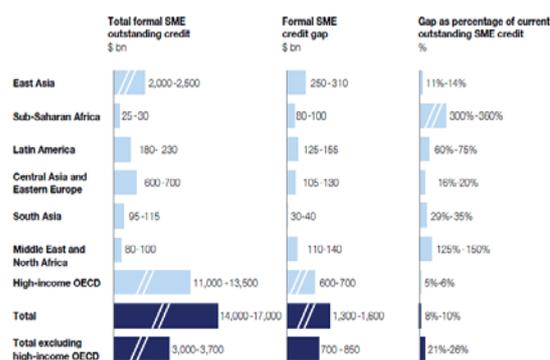


Figure (4): MSME Financial Gap (2011)



Source: World Bank’s MENA Financial Sector Flagship report, 2011

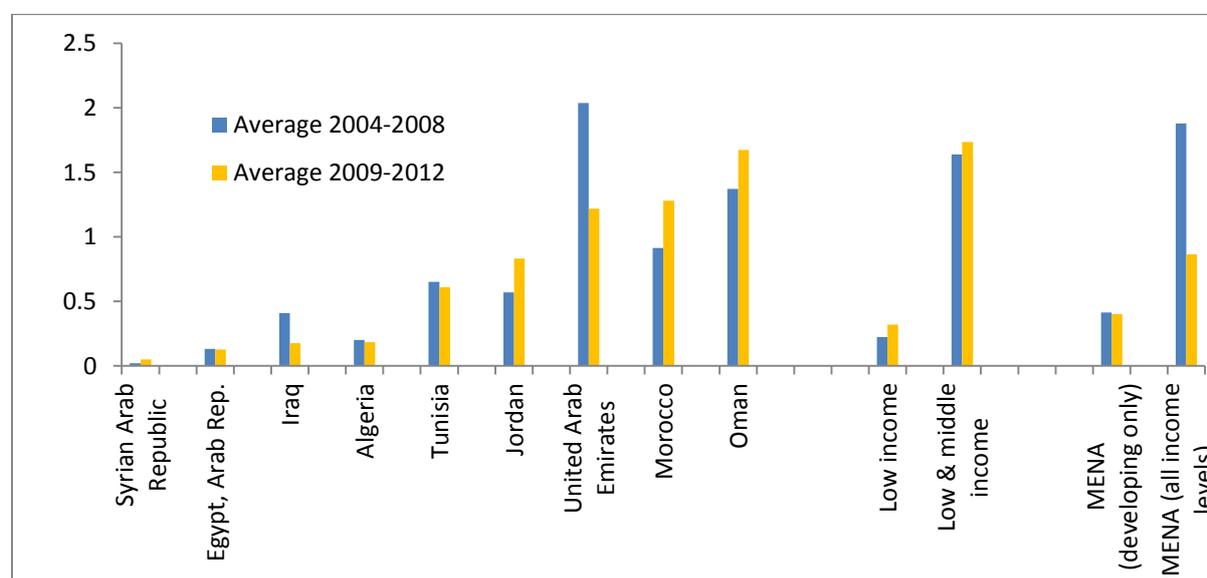
Source: IFC MSME Database 2011

Labor productivity is in general higher on average in formal firms than in informal ones. Other potential advantages of the formal sector include access to formal credit institutions, use of formal worker contracts, greater access to foreign markets, and less vulnerability to competitors and bribes. Successful enterprises that remain informal are often unable to realize their full growth potential. These weaknesses in the informal sector suggest that understanding the drivers of formal firm’s entry and survival are key to promoting economic growth and employment. High-growth entrepreneurship, which is most likely to lead to formal job creation and macroeconomic growth, is most likely to happen through formally registered firms.

Jobs are essential for individual well-being, income, and a sense of dignity. The creation of employment opportunities is critical for the Arab countries, and has become even more so following the recent uprisings and revolutions in several countries. The Arab region has been suffering from a high and growing unemployment rate. In that context, it is useful to understand the employment dynamics in developed and developing economies in order to identify the main sources of job creation. This would help in identifying the main drivers and generators of jobs in the Arab world, as well as the characteristics of these enterprises that are fast growing, productive and are able to expand employment, generate most of the new jobs, and enhance overall economic growth.

Similarly, Klapper and Richmond (2011) show that new firm creation appears to be a potentially important source of job creation. This suggests that expanding opportunities for entrepreneurial potential is important for employment expansion and macroeconomic growth. Their analysis also related job creation to the process of creative destruction that occurs in dynamic economies. Allowing old firms to exit and new more productive firms to enter and grow occurs more easily when regulations are fair and lean. In general, a growing literature on labor dynamics across firms finds that new businesses are a vital source of job growth.

Figure (5): New business density (new registrations per 1,000 people ages 15-64)



Source: World Bank's World Development Indicators Database

However, amongst the many challenges that face young firms' survival in MENA is having an enabling environment in place that enables free entry as well as healthy competition. Recent data on new firm's density relative to population in MENA countries was severely affected by the Arab Spring as it dropped from an average of 1.9 firm/1000 citizen on average during 2004-2008 to reach 0.9 firms/1000 citizen on average for 2009-2012 (see Figure 5). Moreover, only a small proportion of high performing SMEs have the potential to grow into internationally competitive companies, generating significant economic benefits through raised productivity, employment, and economic stability. Research by Ayyagari, Demircuc-Kunt and Maksimovic (2011) confirms that small firms are important contributors to total employment and job creation, but suggests that their productivity and growth is held back by SME-specific constraints. Hence, only a small number is able to grow fast and create a large number of jobs.

A. Unemployment Challenges in the Arab Countries

The Arab region faces no greater challenge than employment generation. It has the lowest employment-to-population and labor force participation rates, as well as the highest levels of unemployment of any region in the world. Despite efforts made, the region has been unable to make substantial progress in reducing persistently high unemployment rates, especially among youth and women, and in several countries regional disparities remained if not widened. The lack of employment opportunities in the region is also reflected in relatively large informal sectors. There is also substantial heterogeneity across countries. There are several distortions that prevented a more productive use of human capital, which led to high unemployment rates that produced a sense of exclusion.

Unemployment in the Arab world is high at 10 percent. A critical challenge in the MENA region is high unemployment rates, which has been aggravated by the recent slowdown in economic growth and, calls for an increase in job creation. The demographic transformation of the region has led to an abundance of young working-age adults. MENA countries face a rising labor supply that has outstripped demand, leading to stubbornly high unemployment rates of 10 percent with even higher female unemployment rates of 16 percent. It is estimated that there is a need to add between 40 and 50 million jobs by 2020 (Freund and Rijkers, 2012) to address unemployment concerns given the projected demographics for this decade. Unemployment rates may be affected by changes in labor participation. If labor force participation rises, for example because of demographic trends, unemployment may increase, even if the number of employment opportunities rises. However, the demographic structure of a country's population appears to have little bearing on the likelihood of a miracle happening *ceteris paribus*. Alternatively, decreases in unemployment may be driven by reductions in labor force participation. Yet, the qualitative results presented below are robust to ruling out cases where labor force participation declines.

Table (1): Youth Employment and Disparities in Selected MENA Countries*:

	Share of unemployed (age 20 – 40) to total unemployed	GINI index	Poverty headcount ratio at national poverty line (% of population)	Income share held by highest 10%	Income share held by lowest 10%
Egypt	79%	31	22%	27%	4%
Morocco	44%	41	9%	33%	3%
Syrian Arab Republic	49%	40	30%	32%	3%
Tunisia	71%	39	19%	30%	3%
West Bank and Gaza Strip	66%	37	27%	29%	3%
Yemen	65%	38	35%	31%	3%

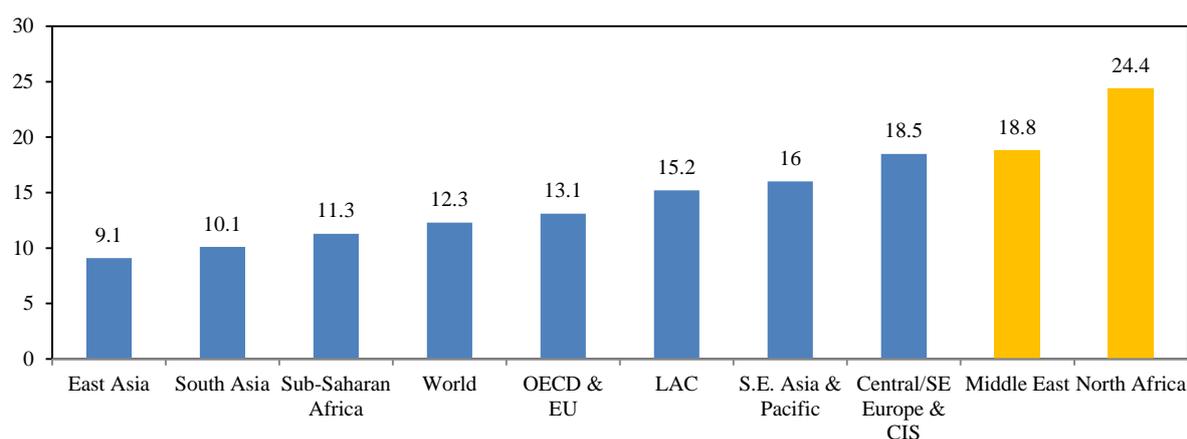
Source: World Development Indicators and ILO Statistics

* Average 2001-2010 data.

Unemployment remains a chronic challenge for Arab countries – particularly those in transition. The core cohort in the productive age of 20-40 years old represents more than two thirds of the unemployed in Arab states in transition (see Table 1). It can also be seen that unemployment in these countries coupled with severe inequality and uneven distribution of resources that magnified poverty challenges. This is evident from the fact that the highest 10% of the population hold more than one third of these countries' income, which is 10 folds of what the lowest 10% threshold are able to receive. This blend of youth unemployment and misallocation of resources held back productivity and congested economic growth triggering the social unrest.

With youth unemployment above 25 percent in recent years, a top priority for governments is to create an environment where employment expands, especially for the growing young population (Figure 6).¹⁰ This is a key issue of concern, as young people, especially those from the lower- and middle-income households often lack the resources to be able to cope with unemployment. Youth benefit more from aggregate unemployment reductions, but also appear to suffer more during down-turns. Youth unemployment and the lack of quality jobs for graduates are often cited as key motivations for protest.¹¹ Experience has shown that youth unemployment contributes to social instability and unrest. Unemployment (and a feeling that growth has left out large segments of the population) is at the heart of the discontent associated with the “Arab Spring” in several countries in the region. Female employment to population ratios are the lowest in the world by a wide margin.

Figure (6): Youth Unemployment Rate in Different Regions (15-24)



Source: Freund (2012).

Simultaneously the region records the highest female unemployment rates at 18 percent; and the lowest female labor force participation. For example, the female unemployment rate in Egypt is 23 percent, in Tunisia 17 percent, and in Morocco, 10 percent in 2011.¹² On average, over the past decade, more than two out of three women did not participate in the labor market, this is due to societal traditions, which make it much harder for women to participate in the labor market outside their homes. These low aggregate labor force participation rates are thus predominantly driven by limited female participation. Although countries have invested in women in their education and health care services, countries have not benefited sufficiently from this productive human capital through a gender-neutral playing field for entrepreneurship and employment.

B. Employment Dynamics in the Arab Region

Access to employment and income-earning opportunities is a vital issue for the Arab region. It is difficult to find reliable longitudinal data on firm dynamics in the Arab region, but a rough observation of enterprise survey data suggests a different pattern from that of international experience.¹³ A large amount of formal job creation occurs in large firms and within governments (2007-2011) (Figure 7). In multiple countries, the amount of job creation in large

¹⁰ Youth defined as those between the age of 15–24.

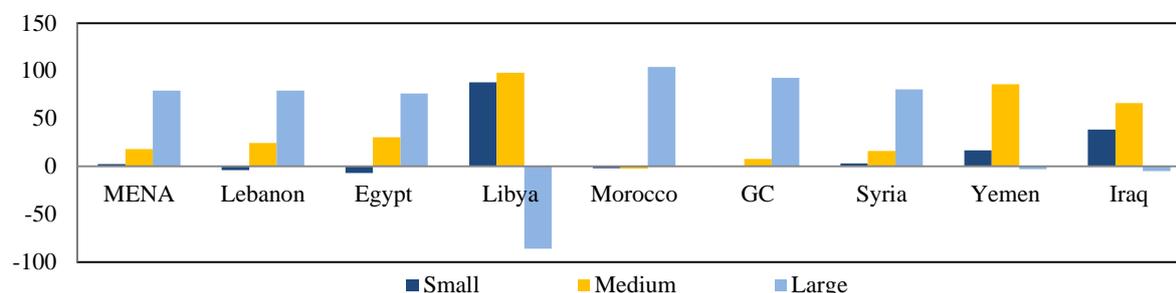
¹¹ See, for example, The Economist, *Bottom of the pyramid: Job-hunting lessons for young Egyptians*, September 10, 2011.

¹²SaharNasr, and Douglas Pearce (2012).

¹³Stone, A, and Lina, T. Badawy.*SME Innovators and Gazelles in MENA: Educate, Link, Train, Certify, Compete!* (MENA Knowledge and Learning Quick Note #43, September 2011, World Bank).

firms outweighs that created by formal SMEs, however, countries like Yemen, Iraq and Libya are exceptions. The rise of SMEs and their importance in Libya can be partially attributed to the fact that the economy suffers from non-diversification of economic activities; mostly concentrated in construction, oil, and gas sectors.

Figure (7): Percentage of Jobs Created by Firm Size in ICA Enterprise Survey



Source: World Bank Enterprise Surveys (2007-2011).

This evidence must be tempered by several cautions. First, not all of the samples are perfectly proportional to the employment-weighted presence of firms in the economies. Second, the samples do not include microenterprises, and clearly a large amount of employment and, potentially, employment growth, takes place among these firms. Third, since our data is from multiple years, we cannot account for the full dynamic effects of exit and entry on employment. But clearly there is a strong indication that SMEs are not fulfilling their potential to produce a small number of high growth firms that account for the great bulk of job growth.

Many countries in the region record a large share of jobs in government services compared with other countries. However, in recent years the public sector has been unable to support job or income growth. Consequently, the number of jobs created in the last decade was considerably less than the number needed to address key challenges, such as high youth unemployment, low labor force participation rates, especially among women, and fast-growing labor forces. In all countries, job quality has been a particular concern. Jobs in government services have been increasingly difficult to get while finding similar quality jobs in the private sector has been hard. The report shows that nongovernment services and manufacturing can serve as engines of both job creation and income growth. Services have been a source of strength both on income and jobs, in levels and growth, especially in oil importers. Manufacturing has contributed to growth in income and jobs, but its size is small on average in MENA relative to other developing countries.

C. The Role of SMEs in Job Creation in the Arab World

SMEs are major contributors to employment and the overall economy in the Arab region¹⁴. They account for a large share of enterprises, representing between 80 percent and 90 percent of all formal sector enterprises. Moreover, SMEs contribute a large share of private sector employment opportunities, typically accounting for somewhere between 20 and 40 percent of all private

¹⁴Ayyagari, Demirgu-Kunt, and V. Maksimovic (2011).

sector employment; and between four percent and 16 percent of total employment, including public sector and non-governmental organizations (NGOs) employment(Figure 8).¹⁵

Obviously the situation varies considerably from one Arab country to the next. While most non-oil economies are dominated by SMEs, Gulf Cooperation Council (GCC) countries tend to be dominated more by larger corporations (a fact related to the importance of oil and gas).¹⁶ In non-GCC countries, SMEs are estimated to employ as much as 67 percent of the labor force informally (Loayza and Wada 2010).¹⁷ Naturally, it is likely that these numbers would increase in countries with large informal sectors.

Figure (8): SMEs as Employers in Selected Arab Countries

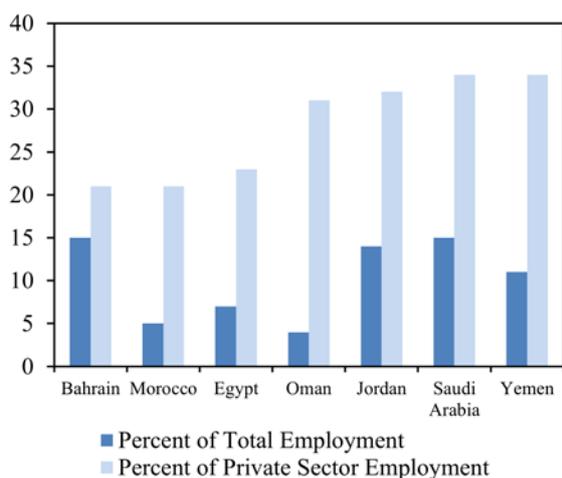
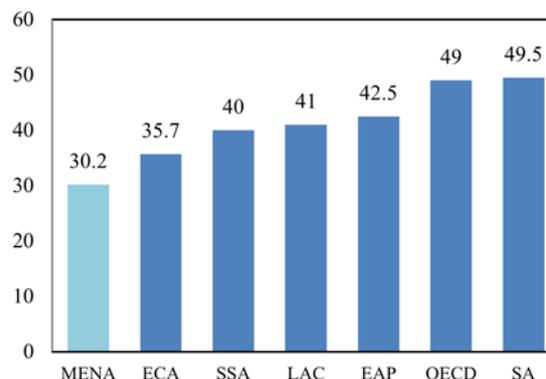


Figure (9): SME Employment as a Percentage of Total Private Employment, by Region



Source: Government databases, and World Development Indicators.

Source: World Bank Enterprise Surveys (2006-2009).

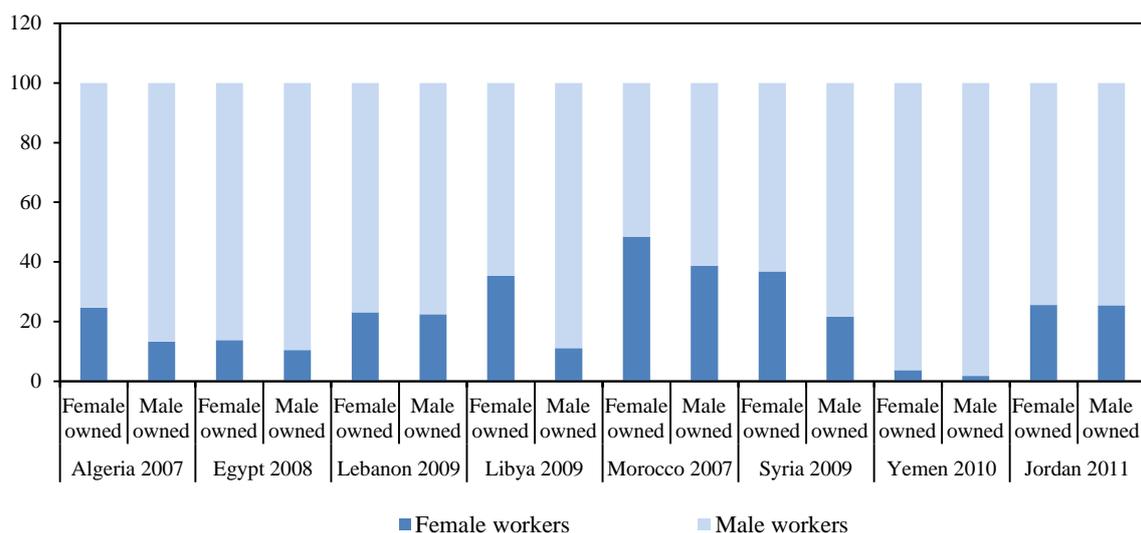
SMEs are not only major contributor to employment but they also help in achieving inclusive growth through addressing gender disparities. The firms' surveys and the workers module show that increasing the number of woman entrepreneurs could lead to a rise in the percentage of women in the workforce in the Arab region. This is mainly due to women-owned firms hiring more women as opposed to male-owned firms because of various factors including cultural traditions and work environment (Figure 10). Women workers report that there is less potential for harassment in SMEs that are women-owned, as well as in large firms irrespective of the gender of ownership, as in the latter there are in general clear institutional set up, transparent HR rules, labor protection and human rights policies.

¹⁵It must be noted that in healthy economies, SMEs account for the great majority of jobs and this is clearly not the case in MENA. However, SMEs are still important because of their potential for rapid and sustained growth rather than for their current role in employment because it is not as high as it would be in more a healthy economy or can be in the region as a whole.

¹⁶ The majority of enterprises are microenterprises, rather than SMEs in many MENA countries, including Egypt, Morocco, Lebanon and Yemen. In Saudi Arabia, SMEs are the majority, while the United Arab Emirates enterprise sector is more balanced between microenterprises and SMEs.

¹⁷It is worth noting that employment in SMEs is likely to be significantly under-counted in official records due to imprecise records on the informal sector, mainly due to the under-reporting of employment for tax reasons, or enterprises not being registered. Accordingly, the number would rise particularly in countries with large informal sectors. However, it is estimated that only six percent of GCC labor is estimated to be informal.

Figure (10): Gender of Workers by Gender of Principal Owner in the Arab Countries

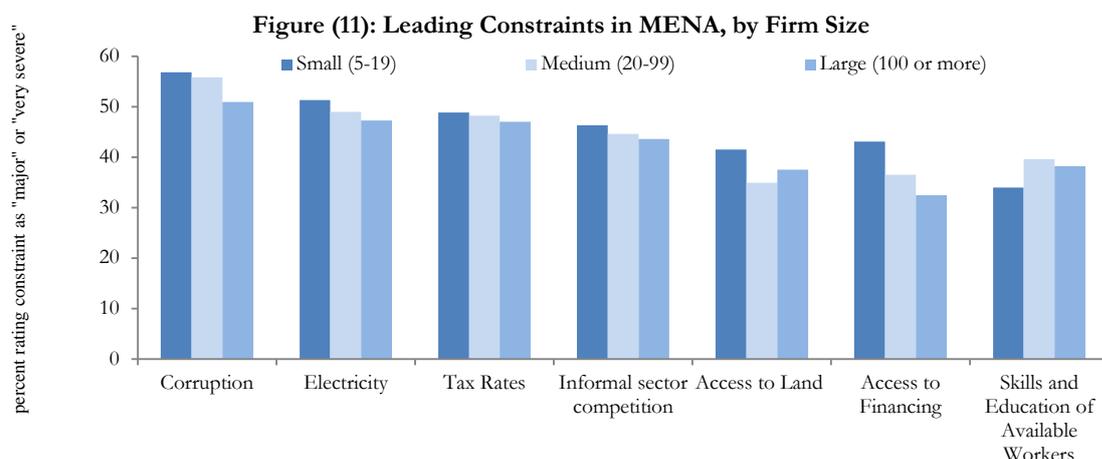


Source: ICA's (various series).

Although the level of recorded employment in MSMEs appears to be significant in the Arab world, it is lower as a percentage of total employment in the region than in many other regions. On average, SMEs are responsible for around 30 percent of all private sector employment in the Arab region, compared to 41 percent in Latin America; 49 percent in the OECD; and 49.5 percent in South Asia (Figure 10) this is due to how SMEs are defined. The micro enterprises mainly in the informal sector account for much larger number, making the aggregate percentage of jobs created reach 71 percent.

V. KEY CHALLENGES CONFRONTING THE SUSTAINABILITY OF SME GROWTH IN THE ARAB WORLD

Most Arab countries have put SMEs development as one of their key priority areas. Nevertheless, SMEs are still confronted with key obstacles that have constrained their development and hindered their potential to create private-sector jobs and entrepreneurship opportunities (Figure 11). Constraints include regulatory burdens, lack of access to financial services, and inadequate skills and capacities. There is an increasing awareness that the difficulty of entry into relatively closed private markets holds back the growth and competitiveness of SMEs. There is evidence that smaller firms stagnate in terms of employment growth: small firms stay small. This is largely due to the fact that many of the large entrepreneurs in the region are privileged, and come from the highest political and country leadership spheres, receiving preferential treatment that puts the SMEs at a disadvantage. A comparison between the Arab countries and Latin America demonstrates that firms start out larger when young in the Arab countries but grow more slowly over time so that firms in Latin America are about twice as large after being in operation for 10 years.



Source: World Bank Enterprise Surveys.

A. Regulatory Burden

Countries with good investment climates and business regulations are characterized by lower unemployment levels. A conducive business environment and improved regulations are important enablers of job creation. Most governments in the Arab World have undertaken major reforms to improve the business environment by streamlining their regulations, restructuring the financial sector, and removing trade and investment barriers. International indices of the business environment point unequivocally to these improvements. The business regulations measured by the Doing Business Indicators offer good proxies of reform trends, reports that the average number of reforms achieved in Arab countries has been increasing steadily over the last few years (Annex II). Consistently, OECD reports show that the macroeconomic indices in most Arab countries are not that much different than those in high-growth dynamic emerging economies.

Nevertheless, the private sector in several Arab countries faces constraints that prevent it from exploiting its full potential. Privileges and cronyism distort private sector competition and economic dynamism by creating a *de facto* business environment that is not the same for all firms. (World Bank, 2009). Barriers in the business environment, such as costly and timely procedures to obtain licenses, register property and movable collateral, resolve disputes, and close a business constrain private sector growth and job creation. Lack of a level playing field is another key challenge. Even when the legal and regulatory framework is set it is not implemented consistently and predictable for all firms. The exclusion of a large number of private sector firms, mainly underserved SMEs, from access to a competitive business environment, limits labor demand and corresponds to the exclusion from formal employment on the labor supply side. Hence, burdensome business regulations, lack of transparency and poor governance can constrain job creation.

When examining the leading seven constraints to SMEs in nine recent enterprise surveys (Table 2), corruption is the most commonly identified as the top constraint, appearing in the top seven constraints in all ten countries. Informal sector competition rates second, identified in seven countries. Electricity is next, identified as a leading constraint by SMEs in six countries. Among infrastructure challenges, only unreliable electricity supply stands as an inescapable obstacle to business success. This is followed by regulatory policy uncertainty and political instability, each identified in five countries. Access to finance, access to land and macroeconomic uncertainty are each identified in four countries as leading constraints (Figure 12).

Table 2: Leading Constraints to SMEs in ICA Enterprise Surveys

Source: World Bank Enterprise Surveys.

	Algeria 2007	Egypt 2008	Jordan 2011	Lebanon 2009	Libya 2009	Morocco 2007	Syria 2009	West Bank and Gaza 2006	Yemen 2010	Iraq 2011
Leading constraint to SMEs	Corruption	Macroeconomic uncertainty	Tax rates	Political instability	Access to land	Tax rates	Corruption	Political instability	Corruption	Electricity
2nd leading constraint	Informal sector competition	Informal sector competition	Macroeconomic uncertainty	Electricity	Regulatory policy uncertainty	Electricity	Regulatory policy uncertainty	Macroeconomic uncertainty	Electricity	Political instability
3rd leading constraint	Access to finance	Skills and education of available workers	Informal sector competition	Corruption	Access to finance	Informal sector competition	Courts	Regulatory policy uncertainty	Access to land	Corruption
4th leading constraint	Access to land	Regulatory policy uncertainty	Regulatory policy uncertainty	Tax rates	Tax rates	Access to land	Electricity	Corruption	Political instability	Access to finance
5th leading constraint	Electricity	Tax rates	Corruption	Cost of financing	Macroeconomic uncertainty	Access to finance	Skills and education of available workers	Electricity	Regulatory policy uncertainty	Informal sector competition
6th leading constraint	Political instability	Corruption	Tax administration	Informal sector competition	Informal sector competition	Courts	Customs and trade regulations	Transport	Courts	Access to land
7th leading constraint	Tax rates	Cost of financing	Business licensing and operating permits	Skills and education of available workers	Corruption	Corruption	Tax administration	Crime, theft, and disorder	Tax rates	Crime, theft, and disorder

Although the overall business climate in the Arab world is not very conducive to private sector development, constraints still vary with size of firms. SMEs do not suffer alone from these constraints, so it is interesting to examine where they identify themselves as more constrained than larger firms. Here, it becomes clear that corruption, electricity, access to land and access to finance are a greater problem and more serious concern for smaller firms. In the case of both access to land and access to financing, it is small as opposed to medium-sized firms that identify themselves as most acutely affected. Regulatory policy uncertainty could weigh more heavily as a problem with SMEs either because they experience more of it, or because they have fewer resources and facilities to cope with it when it occurs. Surveys provide a direct indication of the first explanation. In Algeria, Egypt, Lebanon, West Bank Gaza and Iraq, SMEs are substantially more likely than large firms to disagree that interpretations of regulations are consistent and predictable.

Figure (12): SMEs Reporting that Informal Payments are Made to "Get Things Done"

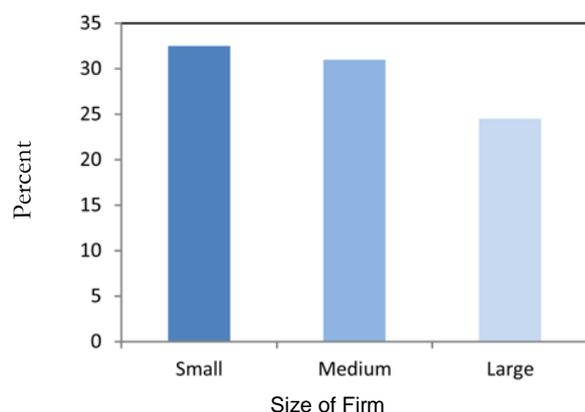
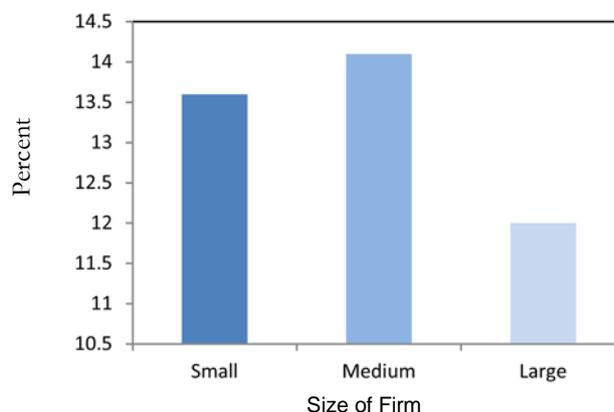


Figure (13): SME Managers Spending More of their Time Dealing with Regulation

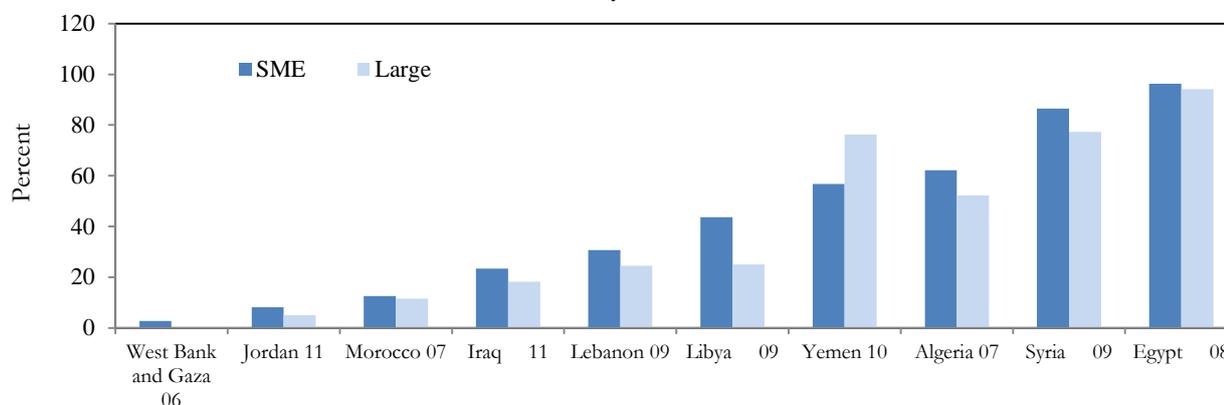


Source: World Bank and Union of Arab Banks. (2010).

SMEs suffer more than large firms from many policy and institutional constraints arising from imperfect markets and, as a result, they benefit disproportionately from reforms. Small firms in particular significantly stand out in the degree to which they identify regulatory policy uncertainty, corruption, access to land, taxation, access to finance, and electricity as serious constraints. For example, senior managers of SMEs spend a higher percentage of their time dealing with bureaucracy (Figure 13), and are more likely to report that informal payments to

officials are needed “to get things done” (Figure 14). Country specific data show that Jordan, Iraq, Lebanon, Libya, Algeria and Syria, SMEs are at least 10 percent more likely to have to make such payments than are large firms. In most countries, those SMEs that do end up paying, on average, pay a higher percentage of their annual revenues than do large firms. This pattern holds for Egypt, Jordan, Lebanon, Libya, Morocco, Syria and Iraq. This may be because interactions with officials have a minimum fixed cost element, irrespective of the value of the “transaction”.

Figure (14): Percent of Firms Required to Make Informal Payments to "Get Things Done" in Selected Arab Countries, by Firm Size



Source: World Bank Enterprise Surveys.

SMEs also sometimes have a different experience in direct interactions with officials in the context of business inspections. While large firms experience more frequent tax inspections, for example, SMEs report being more likely to be asked to make an informal payment during an inspection. Application of routine regulatory procedures sometimes works to the disadvantage of SMEs. For example, in seven of eight countries for which there is survey data, SMEs experience slower processing of imports than do large firms. This may be because large firms can use skillful intermediaries, or benefit from a learning curve in dealing with ports and customs, but it may also be due to unequal treatment by authorities. Intermediaries may be too costly for smaller enterprises, plus they lack connections that give them access to these intermediaries. Of course it is not only regulatory interpretations that may cause problems, but also the regulations themselves. Regulatory frameworks in the region range from the very good to the very poor but in general smaller firms will be less well equipped to deal with complex and costly regulations.

SMEs also face greater hurdles when attempting to enter export markets. According to World Bank enterprise data, the percentage of large firms that export is over three times that of small firms and almost double that of medium firms,¹⁸ implying difficulties for SMEs to enter export markets. Another indicator on ease of exporting is average number of days to clear customs. On average, small firms spend an extra day and a half to clear customs compared to medium and large firms.¹⁹ Small firms are at a disadvantage if there are fixed costs relating to obtaining market information, product standards and quality certification and other procedures necessary to enter export markets. Newer and smaller firms may not have the contacts of established firms in export markets and large firms may control key distribution channels. Also, due to their disadvantaged access to finance, SMEs may have profitable opportunities to export for which they cannot obtain funding.

On the regulatory environment, SMEs overall face a bigger challenge, as SMEs place a high priority on rule of law—they feel they could operate and grow better with better governance and

¹⁸Around 35 percent for large firms vs. 21 percent for medium and 9 percent for small enterprises

¹⁹7.3 days vs. 5.8 days for medium firms

more transparency, more even-handed application of the “rules of the game”, a clear set of regulatory rules, and a stable polity. Thus an important part of SME priorities could be characterized as fair rules of the game for economic participation, free from corruption, informal and unfair competition, regulatory policy uncertainty and political instability.

Among the major constraints facing the private sector is a weak judicial and legal system. Most Arab countries underperform in the enforcement of contracts, according to the Doing Business Indicators. The legal and regulatory framework of contract enforcement has not changed significantly in many countries. However, the legal business environment in the GCC countries compares well with most advanced OECD countries in many policy areas. Even across the individual sub-indicators Saudi Arabia, the United Arab Emirates, Qatar, Bahrain, and to a lesser degree also Kuwait and Oman appear to perform well. A second group comprises countries with a legal business environment that is among the most difficult and restrictive to private sector development in the world, including Syria, Iran, Algeria, Iraq, and Djibouti. These countries require first generation legal business regulation reforms. A third group consists of Egypt, Lebanon, Tunisia, Morocco, and Jordan, have legal business environments that are comparable to dynamic emerging economies. All of these countries have improved their corporate legal systems in the last decade. However, there still remain issues of concern that urgently need to be addressed in these countries.

Good business regulations and governance are associated with lower levels of unemployment. A recent World Bank study (2012), showed that business regulation and governance are more important than labor regulations in generating “employment miracles”, where the unemployment rate drops at least three percentage points over a four year period. According to Freund and Rijkers (2012) a one point improvement in economic regulation as proxied by the Economic Freedom Index increases the probability of the onset of an employment miracle by approximately 3.6 percent to 5.0 percent. The findings also suggest that better regulation not only improves average labor market outcomes, but also minimizes vulnerability. Moreover, the formulation and enforcement of sound regulation goes hand-in-hand with good governance. Countries with better rules of law, good governance, and effective governments are more successful in creating employment.

B. Access to Finance

Finance matters for inclusive growth, and enhancing financial intermediation for SMEs is central in that context. The evidence suggests that financial innovation is important in fostering economic growth and expanding economic opportunities. As reviewed by Levine (2005), a large and growing body of research shows that the services provided by financial markets and intermediaries have a positive impact on the rate of long-run economic growth. This is evident in that countries with better functioning financial systems grow faster over many decades (Levine and Zervos, 2008). Moreover, the rate of economic growth is accelerated through improvements in the operation of financial systems (Haber *et al.*, 2003).

One of the ways in which a better functioning financial system promotes economic growth is by

Figure (15): Percentage of Investment Finance by Banks

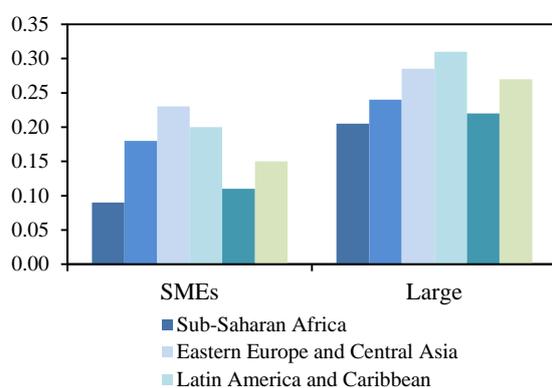
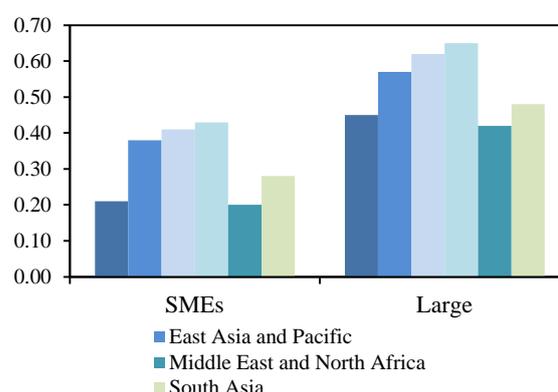


Figure (16): Percentage of Firms with a Line of Credit



spurring entrepreneurship. Indeed, a well-functioning financial system is one that does a good job of screening firms and allocating resources efficiently to those with the best projects, ideas, and entrepreneurial energy. Poorly-functioning financial systems, in contrast, funnel credit to the rich and powerful, limiting economic opportunity and prosperity to only a few. An effective financial system can foster competition by allocating resources to new, more promising firms to enter the market, which forces less efficient incumbent firms to improve their performance or exit. An ineffective financial system can become an impediment to entrepreneurship and growth (Aghion and Howitt, 2010). Furthermore, financial development has been found to have a large, positive impact on small firms, which again suggesting that improvements in financial services foster competition and efficiency throughout the economy. Thus the financial system affects entrepreneur’s economic opportunities, and it influences who can launch a new business venture and who cannot.

Financial development should be a central component of the employment growth agenda facing the Arab countries. The banking systems are large in most Arab countries, but they also have some of the highest rates of credit concentration in the world. SME finance in the Arab region is dominated by banks, with capital markets and non-bank financial institutions (NBFIs) being less significant financing sources for SMEs as compared to other regions. Bank lending to SMEs varies significantly by product, size of loan and client, and lending technology used. The majority of Arab banks already provide SME finance: 92 percent of the banks already have SMEs as clients. Around 70 percent of banks have SME units focused on SME finance. However the average share of the Arab bank portfolios made up of SME lending is only 7.6 percent (World Bank, 2011a). Certain segments of the population, such as women, may be excluded from business activity and from finance, for example because they traditionally do not own land, which is often still the preferred collateral for SME lending (See Box 1).

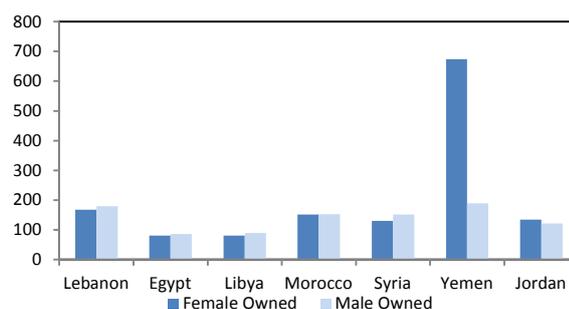
The Arab region has the lowest levels of usage of bank loans of all regions except Sub-Saharan Africa, according to the World Bank enterprise and banks surveys (World Bank, 2011a). Only 20 percent of SMEs have a loan or line of credit and the average share of SME lending on total loans is only eight percent in the region, which is the lowest ratio among all the regions (Figures 15 and 16). Bank lending tends to be directed to large, corporate customers, and many banks still prefer to utilize excess liquidity to finance the government’s deficit or the activities of large established corporations.

Box 1: Gender Disparities—Women’s Economic Empowerment

Female SME owners can face gender-related barriers that affect their access to finance. These barriers tend to vary by country and household. Women suffer more from constrained access to finance compared to men, whether in terms of the cost of finance, ability to gain approval for financing, or legal disputes and conflict resolution in case of bankruptcy. In addition, banks request more strict collateral requirements when dealing with women investors as they are perceived as more risk (Figure 18).

Although the law gives women ownership rights, they often have less productive assets and lack independence in managing these assets (being under the guardianship of their brother, husband, or even son). In many cases they are prevented from using their property as collateral for loans, limiting their ability to participate as independent agents in private-

Figure (17): Collateral Value for SMEs, by Gender of Principal Owner



Source: World Bank Enterprise Surveys (2007-2011).

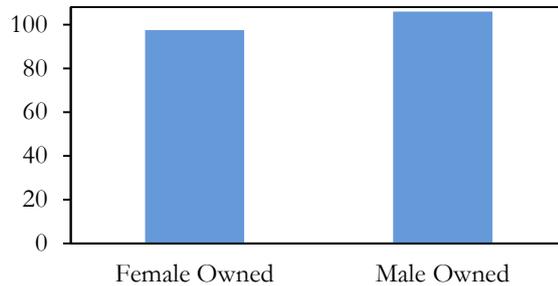
sector activity. The allocation of resources within the family is greatly influenced by the perception of roles, where the men are seen as the main, if not the sole bread-earner (even in the cases when they are not).

Moreover, many young women remain inactive because of choice or family pressures. Broader constraints include women's limited mobility due to socio-cultural reasons. Social traditions reduce women's flexibility to leave the house, reach out to financial institutions, and deal with "strangers". As a result, women rely more on the informal financial market, which is not sustainable compared to men who have better access to the formal financial market. They are also more likely to draw on funds from family and friends. In Egypt, few women entrepreneurs use commercial banks for credit (around 20 percent), but those who do are confronted with higher rejection rates (6 percent compared to 4.5 percent for men). The proportion of Egyptian women who complained about collateral requirements was double that of men. Moreover, women entrepreneurs often have access to lower loan term than men (Figure 15).

Hence, gender mainstreaming is crucial, especially post Arab Spring. It has become even more important now to empower Arab women economically as this will allow them to have an equal opportunity to participate in the labor market as an entrepreneur and employer or as an employee. Much remains to be done to translate economic reforms into real positive changes. Promoting an enabling institutional legal and regulatory environment for women's equal ownership and access to economic resources and assets such as land, finance, and property is essential for economic empowerment. Freeing women and their families from poverty requires strengthening their economic capacity as entrepreneurs, producers, and informal workers so that they can access and shape markets.

Source: Nasr (2010).

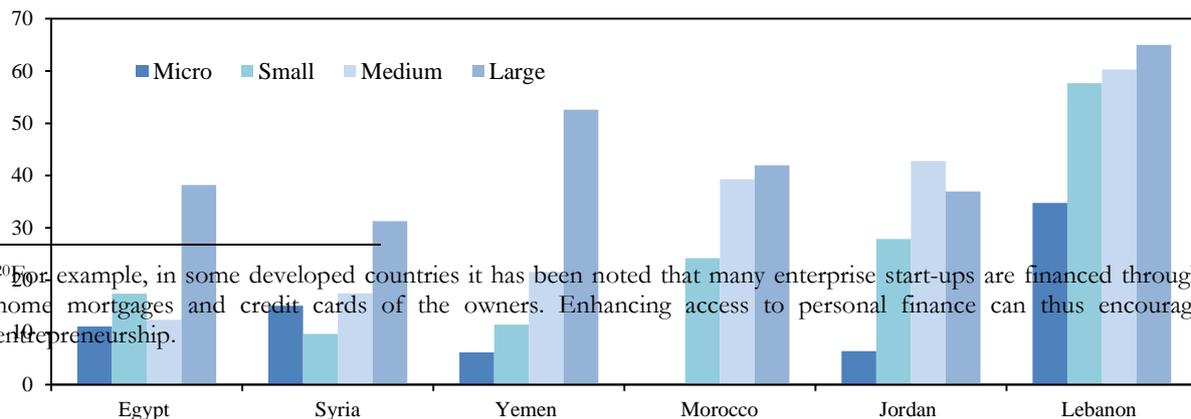
Figure (18): Term of Loan to SMEs by Gender



Source: World Bank Enterprise Surveys (2007-2011).

Moreover, SME growth potential is constrained by entrepreneurs not being able to access start-up or growth capital. SMEs may be denied credit despite having sufficient cash flow or purchase orders, due to collateral requirements. SMEs may only be able to access short-term credit facilities and not the type of financial products they need (such as factoring, leasing, or longer term loans). In general, even in well-functioning financial systems, smaller and younger firms have a harder time getting credit. Even in the context of good credit information, the track record of a new firm is slim. This is why many financiers will find it difficult to evaluate the risk of lending to the enterprise. This leaves start-ups with the options of using the personal assets and credit record of the firm owners to leverage finance; and accessing finance based on their business plan or the potential return to their project.²⁰ Financing based on business plans or project returns is generally not done by traditional banks, and may require the development of venture capital firms or seed capital funds.

Figure (19): Percentage of Firms with a Loan, in Selected Countries



²⁰For example, in some developed countries it has been noted that many enterprise start-ups are financed through home mortgages and credit cards of the owners. Enhancing access to personal finance can thus encourage entrepreneurship.

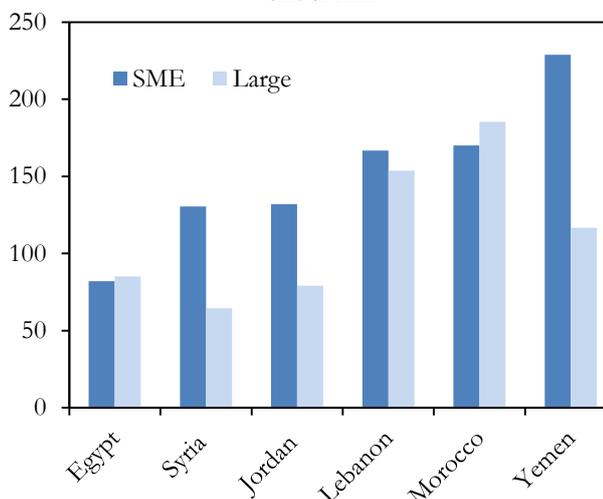
Source: World Bank Enterprise Surveys (2007-2010).

Small enterprises have notably lower rates of usage of credit services than medium and large companies. Generally, less than half the proportion of SMEs as compared to large enterprises uses credit from financial institutions in the Arab region (Figure 19). Many SMEs prefer to finance longer-term, more risky, investments from internal funds, which are the dominant source of financing for MENA SMEs. Greater bank involvement in SME finance in the Moroccan and Lebanese markets is reflected by the much larger percentage of SME borrowing from banks than in the other MENA countries, which suggests that usage does increase with access. When credit is available on sufficiently attractive terms and forms, a higher proportion of SMEs do borrow. Therefore countries with very low percentages (less than 10 percent) for SME borrowing from banks, such as Saudi Arabia, Egypt and Yemen, have SMEs that are credit constrained, and not only SMEs that choose not to borrow.

Banks tend to require higher collateral values as a ratio to loan value for SME loans (Figure 20). Around 78 percent of GCC banks and 48 percent of non-GCC banks say they have higher collateral requirements for SMEs as compared to large corporations. Moreover, banking sector competition in the Arab region is weaker than in other regions, with lower market contestability. This dilutes the incentives for banks to expand SME finance and develop products and delivery mechanisms for smaller firms and to serve the range of enterprise financial needs.

In the Arab region the adoption of efficient transaction lending techniques to lower the cost and risk of SME lending has been relatively slow. This is linked to the deficient financial infrastructure, legal frameworks, court systems, and bank reporting systems and skills. This is more evident as firms move out of the main cities, where there is less physical access to financial services. For example, the percentage of firms with a loan in Upper Egypt is much less compared to main urban cities, such as Cairo, Alexandria, and Post Said (Figure 21). The situation is similar in Yemen, where firms in Sanaa have much better access than Aden and Taiz (Figure 22).

Figure (20): Collateral Value as a Proportion of Loan Value by Size of Firm



Source: World Bank Enterprise Surveys (2007-2011).

Figure (21): Percent of Firms Having a Loan in Egypt, by Location

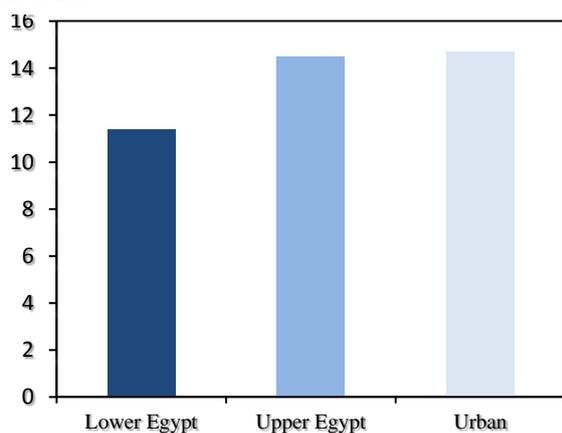
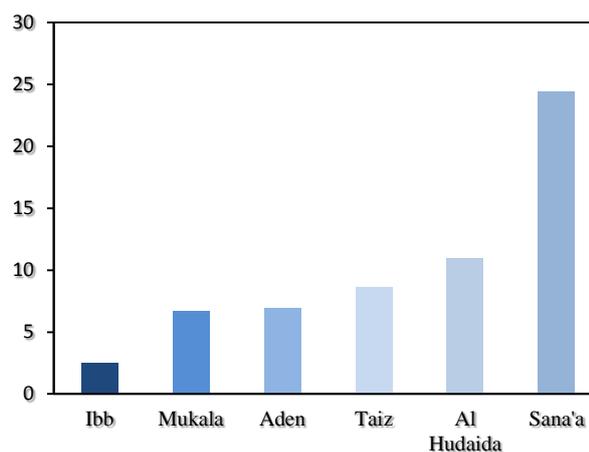


Figure (22): Percent of Firms Having a Loan in Yemen, by Location

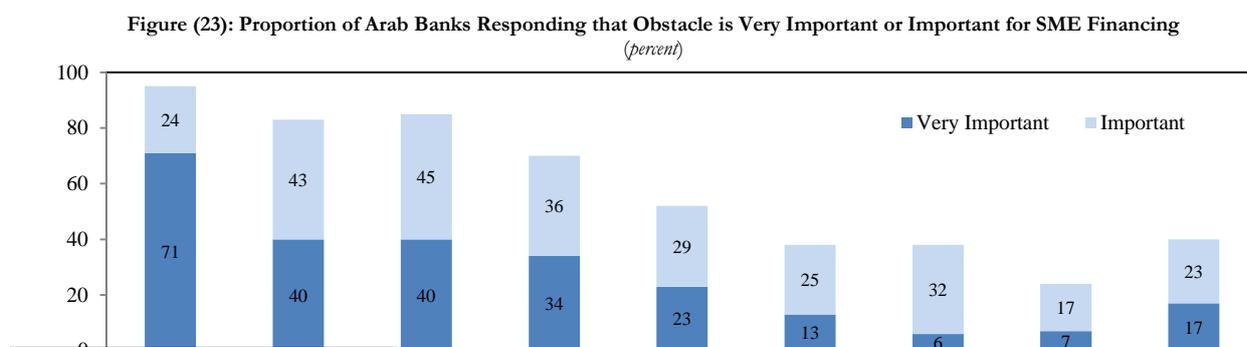


Source: World Bank Enterprise Surveys (2007-2011).

Recent estimates conducted by McKinsey for the IFC-led G20 Experts Group on SME Finance suggest that there is a considerable financing gap for SME lending in MENA, totaling US\$ 2.26 billion for Egypt, Jordan, Morocco, Tunisia, and Lebanon alone.²¹ The estimated SME credit gap for Egypt is US\$ 1.05 billion, for Jordan US\$ 547 million, for Morocco US\$ 497 million, for Tunisia US\$ 247 million, and for Lebanon US\$ 26 million. According to McKinsey, SME lending would have to increase by 125 to 150 percent in the MENA region in order to meet demand, that is more than double, which is the second highest regional percentage increase projected, after Sub-Saharan Africa (Stein, Goland, and Schiff 2010).

Key constraints hindering access to finance for SMEs in MENA include the financial sector regulatory and supervisory framework, financial institutional infrastructure, and financial intermediaries lending capacity. The recent World Bank report(2011) shows that the failure to broaden access to finance is due to a number of factors including, a weak financial infrastructure that increases lending risks, historical connections between large banks and large industrial groups, weak banking competition, and many missing non-banking financial institutions, markets and instruments, all of which are closely related. Therefore, the Arab countries face a challenging financial development agenda, able to improve substantially access to finance to the private sector, in order to generate more inclusive growth and employment opportunities. Economic analysis also suggests that SMEs in countries that have stronger secured transaction laws and registries have greater access to credit, better ratings of financial system stability, lower rates of non-performing loans (NPLs), and a lower cost of credit (Alvarez de la Campa 2010). According to the World Bank (2012), the latest estimates of SMEs NPLs are 12 percent of total loans. The financial system can play a pivotal role in economic growth, as well as, job creation as it influences who can start a new project, and who cannot; and who can expand their business and who cannot.

On the demand side, according to banks interviewed in the Arab region, enterprise creditworthiness, liquidity of the financial intermediaries, and the availability of risk-sharing instruments, also pose key constraints. Banks cite a lack of enterprise transparency, difficulties in using collateral, especially movable collateral, and uncertainty over creditor rights as primary barriers to their greater involvement in finance (Figure 23). Several Arab countries suffer from government-enforced interest rate caps, the absence of national SME strategies, the scarcity of credit information and scoring system, and lack of integration of SME credit information into public credit registries or private credit bureaus.²² There are also concerns regarding absence of effective and well enforced consumer protection policies.



²¹ See McKinsey (2011).

²² Over the past three years, several MENA countries have developed their credit bureaus. Only six MENA countries have operational credit bureaus, with the oldest established in Kuwait in 2002. Three countries, namely, Morocco, Egypt, and the UAE, have recently established private credit bureaus. Two-thirds of MENA countries still entirely rely on public credit registries. A lack of widely available and comprehensive credit information limits SMEs access to finance.

In addition, financial intermediaries often lack the capacity to lend to SMEs, with high administrative costs for small-scale lending, as well as, inadequate banking skills for dealing with SMEs. Most banks have outdated SME lending technologies and are not able to expand SME lending significantly while also managing costs and risks. Banks therefore prefer to lend to large well-established firms or to buy government bonds and treasury bills. The “crowding-out” effect—whereby government borrowing reduces bank lending to the private sector—is a concern. Some countries in the region have tried to reduce this effect by borrowing externally rather than domestically. Increased demand from governments led to banks and other financiers having a reduced appetite for overall lending, especially to SMEs that are considered more risky. Banks in the Arab region have not fully emerged from a reliance on lending to governments and a narrow set of well-established corporates.

C. Skills Development

SMEs in the Arab countries suffer from various deficiencies and face problems limiting their development. These problems include the SME’s difficulty in finding skilled workers, lack of capacity to prepare a business plan and loan application, opaque or non-existent financial statements, and insufficient collateral. SMEs also lack the managerial skills and connections in order to deal with the cumbersome legal and regulatory framework as well as a highly bureaucratic system. They suffer from a lack of adequate business development services, accurate information, advanced technology, and skilled labor. Moreover, there are also gender-related constraints in terms of access to finance; these include higher costs of finance, difficulties in gaining approval for financing and stricter collateral requirements. These problems complicate lending to SMEs by non-governmental organizations (NGOs) and explain the low level of bank finance to them.

The World Bank’s enterprises surveys show that between 20 percent and 40 percent of firms in most developing regions identify the lack of appropriate skills as a major constraint to development. In the Arab region, relevant and quality skills continue to be scarce. The region has the highest percentage in the world of firms reporting that inadequate labor force skills are an obstacle to growth. At the same time, firms offer little training to their workers, probably because their low exposure to competition provides few incentives to do so. With limited demand, and voice, from the private sector, and a long history of state-led industrialization, according to the recent World Development Report on Jobs (2013), the main focus of the education system continues to be the production of future employees for the public sector. Skills acquired do not meet the needs of the market—there is a skills mismatch. Although lack of skilled workers is a problem confronting all firms, SMEs face a bigger challenge because it is more difficult for them to attract top talents. Skills development systems are adversely affected by government failures as well as inefficiencies, rent-seeking, corruption. Regardless of the source of the problem, low quality government provision of education and training services depresses demand for such services, and contributes to the observed low levels of skills.

Poor quality financial statements, informality, and lack of business skills of enterprises are key aspects of lack of transparency and information asymmetry on the part of SMEs. Information asymmetry as a constraint on SME finance has not yet been effectively addressed in the MENA region. An SME’s ability to provide relevant quantitative and qualitative information for rating assessments increasingly determines its ability to access finance, and the cost and terms of that finance. Probability of default is also calculated in part based on past credit history. The Basel II framework further increased the need for good quality SME information, given its emphasis on ratings-based approaches for risk and capital adequacy assessment. Although the intention to make lending decisions and capital adequacy assessment more risk sensitive and contingent on the individual quality of borrowers is important, its application can in practice be a constraint on broadening SME access to finance.

Reporting and audit requirements for SMEs, whether regulatory or simply required by banks as a consideration for accessing markets, sometimes act as a barrier to SME finance and to SME growth. External audits can be costly and difficult to justify, as SME accounting is usually straightforward, relying on historical cost-based, rather than fair value, measurement. They may also act as an incentive to stay disengaged from the formal sector and full regulatory compliance. For example, the Central Bank of Egypt requires banks to have three years of audited statements for their enterprise clients. In West Bank and Gaza, all companies with limited liability, including SMEs, are required to undergo an annual independent audit, which can act as an indirect barrier to SME finance. This can also act as an incentive to enterprises operating informally and therefore less transparently.

Such requirements particularly affect smaller enterprises, which may not keep standardized financial statements in line with bank or auditor expectations. In some cases, enterprise owners may even keep more than one version of financial records for instance, if they do not present all relevant information to tax authorities. SMEs are also constrained by financial or management skills and by a lack of access to information about markets, product standards, and buyer trends. Excessive bureaucratic requirements for, enterprise registration, and payment of fees and taxes can also act as a disincentive to enterprises operating in the formal sector, which would further exclude enterprises from many market opportunities. SME owners may lack the range of skills needed to successfully run a business as it grows and becomes more complex, and tend to place insufficient importance on financial management and accounting.

VI. DETERMINANTS OF JOB CREATION IN SELECTED ARAB COUNTRIES - AN EMPIRICAL INVESTIGATION

It is important to identify the determinants of firms' growth in the Arab countries. While little work has been done in this respect we bring new empirical evidence on the significance of location, innovation, access to bank finance costs and performance of enterprises in terms of the economic and regulatory framework as determinants for firms' growth. The proxy for high growth is to achieve employment growth above 10%.

We use data from the World Bank's enterprise survey considering responses from 4,211 SMEs in nine Arab countries. Several models were applied, in part to accommodate the different variables available from different countries. Model specifications were applied with many sub samples to ensure robustness of results, controlling for firms sizes, to view the relationship of job growth to explanatory factors across the full sample of formal enterprises surveyed in each country.

The data used for this exercise is comparable across countries since they are all sourced from the World Bank database focuses mainly on formally registered firms. We identify SMEs using comparable employment size definitions, looking across sectors as well as specifically at the manufacturing sector (see Annex I for details on the specification of logistic regression models adopted). Nevertheless, the findings of this analysis are subject to a number of caveats.

Most importantly, enterprise surveys cover only the formal sector, excluding the informal firms²³, and typically exclude microenterprises as well as most rural enterprises. Hence our results do not speak to informal enterprises and focus primarily on the urban economy. While this database is the best available source, we recognize these limitations.

We adopt a logistic regression empirical motivation that is adopted to predict the outcome of a categorical dependent variable (i.e., a firm with high (10% or more) growth in employment)

²³The typical country in MENA produces about 27 percent of its GDP and employs 67 percent of its labor force informally (Loayza and Wada, 2010).

based on one or more predictor variables (determinants of high employment). This class of models estimates values parameters in a qualitative response model. It describes the possible outcomes as a function of the explanatory (predictor) variables, using a logistic function (Bishop 2006).

Logistic regression measures the relationship between a categorical dependent variable and one or more independent variables, which are usually (but not necessarily) continuous, by using probability scores as the predicted values of the dependent variable

We follow Clarke and Barton (2000) and Kotsiantis and Kanellopoulos (2006) as they conclude that discretization refers to the process of converting or partitioning continuous attributes, features or variables to discretized or nominal attributes/features/variables/intervals. This can be useful when creating probability mass functions – formally, in density estimation (which is the logistic function for our case). Accordingly, we chose a threshold of 10% employment growth to define whether a firm is a high growth firm.

Logistic regression is adopted to predict whether a firm possess a given feature (more than 10% employment growth), based on observed characteristics of that firm (location, innovation, access to bank finance costs and performance of enterprises in terms of the economic and regulatory framework)²⁴.

Finally, we undertake this exercise under an assumption that all explanatory variables are exogenous and the absence of simultaneity and omitted variables. Future research will build on the existing results, and augment it to ensure that there is no loop of causality between the independent and dependent variables and eliminate possible endogeneity²⁵.

Table 3: Summary of Models' Results:

	Model 1	Model 2	Model 3	Model 4	Model 5
Constant	-1.151	-1.035	-1.009	-0.907	-0.876
Manufacturing	- 0.312		- 0.402	- 0.345	- 0.325
Large	- 0.257				
Medium				0.272	0.268
Formal Training	0.223	0.217	0.312	0.269	0.299
Exporter	0.246	0.367			
Innovating	0.533		0.339		
Using Email		0.266			
High Regulatory Compliance Cost			0.254	0.278	
Internationally Recognized Certificate				0.315	
Have a Loan				0.331	0.259
Gulf Country		0.778			- 0.712
Yemen			0.494		

The logistic model is done using STATA package, Forward Log likelihood Ratio ratios where variable by variable is entered. This model will be tested with a significance level of 5%. Our response variable is "having high growth in employment (10% or more)" and the explanatory variables are " country, sector, size, firm offering formal training to employees, using email, number of power outages, export status, using technology licensed from a foreign owned company, developing a new product or upgrading an existing one or both, using bank financing for working capital, and using bank financing for new investments".

²⁴ See Hosmer 2000 for details on the motivation and adoption of logistic regressions.

²⁵ See Green 2007.

The first model specifications, we find that:

- A services firm is 37% more likely than a manufacturing firm to have high employment growth (10% or more).
- A SME is 29% more likely than a large firm to have high employment growth (10% or more).
- A firm that offers training is 25% more likely than a firm that doesn't to have high employment growth (10% or more).
- An exporting firm is 28% more likely than a non-exporting firm to have high employment growth (10% or more).
- A firm that innovated (develops a new product or upgrades an existing product or both) is 70% more likely than a firm that didn't innovate to have high employment growth (10% or more).

For the second model specification, we find strong evidence that:

- A firm in a Gulf country is twice more likely than a firm in Yemen to have high employment growth (10% or more).
- A firm that had formal training is 24% more likely than a firm that didn't to have high employment growth (10% or more).
- A firm that uses email is 30% more likely than a firm that doesn't to have high employment growth (10% or more).
- An exporting firm is almost one and a half times more likely than a non-exporting firm to have high employment growth (10% or more).

The third model specification suggests that:

- A services firm is almost twice more likely than a manufacturing firm to have high employment growth (10% or more).
- A firm that offers formal training is almost one and a half times more likely than a firm that doesn't offer formal training to have high employment growth (10% or more).
- A firm that has high regulatory compliance time cost is around 30% more likely than a firm that has low regulatory compliance time cost to have high employment growth (10% or more).
- A firm that developed a new product or upgraded an existing one is almost one and a half times more likely than a firm that did neither to have high employment growth (10% or more).

The fourth model specification suggests that:

- A services firm is around one and a half times more likely than a manufacturing firm to have high employment growth (10% or more).
- A medium firm is 31% more likely than a small firm to have high employment growth (10% or more).
- A firm that received an internationally recognized certificate is 37% more likely than a firm that didn't to have high employment growth (10% or more).
- A firm that had formal training is 31% more likely than a firm that didn't to have high employment growth (10% or more).
- A firm that has a loan is 39% more likely than a firm that doesn't to have high employment growth (10% or more).
- A firm that has high regulatory compliance time cost is 32% more likely than a firm that has low regulatory compliance time cost to have high employment growth (10% or more).

Finally the fifth model specification suggests that:

- A firm in Lebanon is twice more likely than a firm in a Gulf country to have high employment growth (10% or more).
- A services firm is one and a half times more likely than a manufacturing firm to have high employment growth (10% or more).
- A medium firm is 31% more likely than a small firm to have high employment growth (10% or more).
- A firm that had formal training is 35% more likely than a firm that didn't to have high employment growth (10% or more).
- A firm that has a loan is 30% more likely than a firm that doesn't have a loan to have high employment growth (10% or more).

Table 4: Logistic Regression Correlates High Growth to Explanatory Factors in Selected Arab Countries

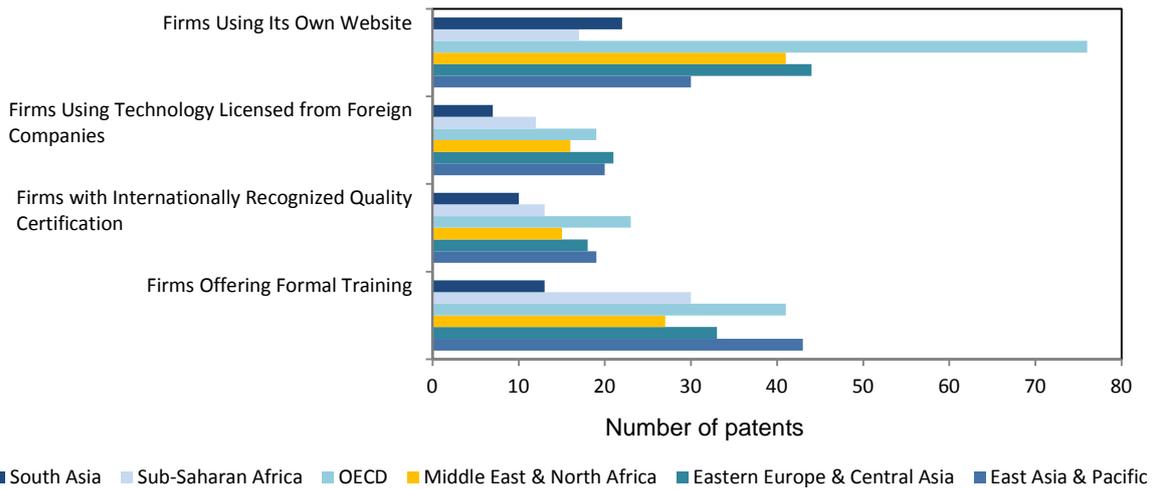
Logistic Regression Results on High Growth	9 Countries SMEs	7 Countries SMEs	6 Countries SMEs	9 Countries includes large	7 Countries, includes large
Offers formal training	+	+	+	+	+
Services sector	+	+	+		+
Medium size	+	+			
Has a loan	+	+			
Int'l Quality certification		+			
High regulatory compliance cost		+	+		
Innovated			+		+
Exports				+	+
Uses email for clients				+	
SME					+

Source: World Bank Enterprise Surveys.

The findings indicate several important correlates of high growth in the sampled enterprises as follows; (Table 4).

- First, in all five specifications, firms that offer formal training to their employees are significantly more likely to experience high growth than firms that do not, controlling for a variety of other characteristics.
- Second, in four of five specifications, firms in the services sectors were more likely than those in manufacturing to have experienced high growth.
- Third, in two of the three SME models, medium-sized firms were more likely to have experienced high growth than small firms (some of these firms could have started as small firms and grown to be medium).
- Fourth, in two of three SME models, a firm having a loan was significantly more likely than a firm without a loan to be a high growth firm. This variable was not significant in the models including large firms, implying that at the margin, having a loan may be a more important factor for growth for SMEs.
- Fifth, in one specification, firms with an international quality certification were significantly more likely to experience high growth than firms without (Figure 24).

Figure (24): Innovation Indicators for MENA and Comparator



Source: World Bank Enterprise Surveys (2007-2011).

The main takeaway from our empirical exercise is that a firms’ success by outperforming other firms in terms of productivity and quality is one key measure of that performance. Innovation through new products and new strategies is a process of elevating productivity and quality. Overall, survey evidence and other indicators suggest that the Arab region lags in innovation, compared to other regions. This is evident in the lack of export diversification, limited productivity growth, and low technological sophistication of exports. An analysis of the investment climate enterprise survey data described above for five countries in the Arab region concluded that firms that had innovated by introducing a new product or upgrading production of an existing one were far more likely to have experienced high growth. Upon the application of analytical models to data that included large firms, three additional factors emerged. Firms that exported more than 10 percent of their sales value were significantly more likely to have experienced high growth than firms that did not. In one model, firms that used email to contact customers and suppliers were significantly more likely to have experienced growth. Finally, in another model, being an SME as opposed to a large firm increased the likelihood of rapid growth.

VII. RECOMMENDATIONS AND POLICY IMPLICATIONS—AN AGENDA FOR SHARED PROSPERITY THROUGH JOB CREATION IN THE ARAB WORLD

Policy makers in the Arab world are working on identifying means of attaining a sustained reduction in unemployment, and achieving inclusive economic growth. With several countries struggling to recover from the recent economic and political developments, job creation policies are at the top of the agenda. It is important for policymakers not only to create more jobs, but also to create better quality jobs to promote growth. Countries in the Arab region are exerting efforts to make their labor force more employable and productive. Without broad-based growth, economies will struggle with social tensions and unrest with a large number of young people who cannot find jobs. The government needs to move promptly, and make policy decisions about how to boost employment, raise wages, and improve productivity.

Governments that are under tremendous pressure to deliver results quickly and are faced with demonstrations, strikes, and social unrest; may overlook longer-term policies focused on creating sustainable, private sector job opportunities and instead consider populist measures that only temporarily address the unemployment problem and alleviate short-term hardship. These

policies can impose a substantial fiscal burden, are distortive to the market, and are difficult to retrench (Paciet *al.*, 2012). Moreover, it will also be difficult for some countries in the Arab region to undertake ambitious reform agendas in the midst of the current fiscal situation.

The key question to address is how to design appropriate policies to create jobs, increase employment opportunities, and strengthen growth and make it inclusive and sustainable over time. When designing policies, it is important to take into account that there is no model that fits all. Challenges facing the oil exporting countries differ from those facing the oil-importing ones. Moreover, the market structure and the enterprises characteristics and size are not the same throughout the region. Nevertheless, the policy issues—business climate, financial development, governance, innovation, regulation and political economy issues—are relevant to all countries, albeit at varying degrees, depending of their level of development and specific conditions.

The route to sustained, private-led growth and job creation requires improving the credibility of reforms, the effectiveness of policies, and their equitable enforcement. Reforms should be directed towards a fairer and more competitive economy that utilizes market mechanisms to generate equal opportunities and create jobs. Attaining an inclusive system through equal access to markets and a level playing field is critical. Without reinvigorated efforts to open the economy and strengthen the foundation for competitive markets, sustained employment growth cannot be achieved. The private sector is the only sustainable source of productive employment generation. Experience in emerging and developing economies have shown that SMEs can play a major role in employment generation and economic recovery.

The only way countries can unleash the real potential of sustainable growth through the private sector is to move from nurturing a privileged class of entrepreneurs to allowing a level of playing field for all classes and businesses. It is critical to create a conducive policy environment through allowing the smooth entry and exit of private businesses, reduced red tape, speedier licensing approvals and access to land, and reduced regulatory rigidity. This entails removing constraints to competition and entry, enabling a new generation of entrepreneurs to emerge, who are oriented towards competing in global and domestic markets based on their firms' performance. For this to happen, business-friendly policy reforms will need to remove traditional sources of rent and privilege. In that context, the promotion and enhancement of SMEs is essential given their instrumental role in increasing employment.

SME development should be considered a key policy priority. Although SMEs are important contributors to total employment and job creation, their productivity and growth is held back by SME-specific constraints. The expansion of SMEs requires a policy focus on the potential obstacles, which range from lack of skills of workers and entrepreneurs, non-conducive regulatory framework, and weak access to finance. It is also essential to address other constraints, such as taxes, red tape, regulations and corruption. Structural reforms can do much to unleash opportunities for investment and to allow countries to tap new sources of growth. This includes improving the investment climate, and attaining equal access to markets and services with no discrimination between larges connected firms and the smaller ones that were underserved or even unserved in some cases.

It is important to design policies across sectors to create productive employment and promote economic growth. The challenge of sustaining inclusive growth is that there are relatively few sectors that have already achieved international competitiveness or have prospects of achieving that rapidly. This is important as the rapid growth and employment generation that some developing countries have experienced in recent years can be traced to their achievement of global competitiveness in a few sectors.

Another major challenge that must be addressed is that of access to finance. Despite the financial sector reforms undertaken, financial intermediations is in general low in most Arab countries. A key step is promoting inclusive growth by accelerating measures that enhancing access to finance for SME, strengthening the institutional framework, improving the credit information system, reforming the judicial system, and developing non-bank financial services. This should be accompanied with increasing the capacity of regulators to monitor SME finance providers, and strengthening consumer protection are important steps that need to be taken by states if they wish to see the SME sector flourish. These are areas where immediate results can be achieved.

Financial institutions can expand SME finance prudently through transaction-based lending techniques, packaging a bundle of products to clients, and effectively serving female-owned SMEs. At the same time financial product diversification is needed to improve the viability and outreach of SME finance, with NBFIs playing a greater role. Banks also have an essential role to play in the growth and development of SMEs. Setting up a dedicated SME unit is the first step that banks should take to ensure that staff specialized in smaller-scale lending, and not those signing off on billion dollar deals, are the ones making the credit decisions for SME lending. Having a specialized SME Department is also contributes to the effort of understanding the needs and wants of the SME market and in developing a wide range of products that specifically target and serve SMEs. Also the creation of non-credit as well as credit products, and taking advantage of improvements in payment systems and electronic technology will need to become a priority for MENA banks.

There are a variety of approaches to assisting firms through industry associations, direct matching grants, public support for export financing or export incentives; and the development of factoring. Governments can sometimes subsidize information on export markets or facilitate collective action by small producers through sectoral business associations to jointly learn about export opportunities and to raise production quality and conformity to international standards. One of the key issues to be addressed is the lag in innovation in the Arab countries, compared to other emerging economies. This obviously varies from one country to the other. In general, pursuing policies to improve entrepreneurship and innovation are important as innovative “gazelle” enterprises are fast growing and can create more jobs. Innovation goes beyond R&D and calls for investment in human resources and appropriate competition policies to encourage entrepreneurship. Innovation is harnessing knowledge and new technologies that can also create jobs in a sustainable manner. Pro-growth policies that remove impediments to job creation would contribute at the same time to fiscal consolidation by creating revenue for the budget.

Good governance and accountable institutions are also central to the SME development agenda. Experience has shown that high-growth countries were able to rely on strong, rule-bound institutions to reduce discretion and create dependable incentives for rapid private-led economic growth. Key to this is strengthening of institutions to implement private sector policies equitably and consistently without biasness towards large well established firms. Discretion and interference in applying the rules should be reduced, and, where it persists, it should be made more transparent through such means as mandatory disclosure, and equal access. Discriminating between firms based on size and connections is a problem that needs to be addressed. SMEs should not be marginalized, and should be provided with the same opportunities as larger firms. This agenda demands reducing conflicts of interest between civil servants and private interests--key sources of corruption. In this context strengthening of accountability mechanisms is critical. Strategic engagement with all stakeholders can help in pushing these reforms forward.

Transparency and disclosure of information must be at the core of reform. SME creditworthiness can be improved through better information provision, more appropriate reporting and auditing standards. They need a better understanding of the importance of

financial and enterprise information for banks in their lending decisions. This will assist these enterprises in playing their part when it comes to information asymmetry when approaching banks. Accordingly, banks could be required to openly share information requirements and ratings criteria with SME loan applicants, as well as how ratings impact their credit terms. In doing so, there would be more cohesion and understanding between banks and SMEs, establishing a framework that sets out the principles for rating-process disclosure for banking and SME association.

Skills development is often an important aspect of that job creation agenda. While important progress has been made in the Arab countries in increasing access to education, quality and relevant skills are still scarce. The ability to acquire skills such as creativity and entrepreneurship helps in the creation of employment opportunities. Training and advisory services are also required for SMEs, whether it be from banks, service firms, or from industry associations. At the same time, administrative and legal barriers to enterprise registration, growth and innovation should be removed. SME development agencies, SME associations, and chambers of commerce can play a role in this regard, while private sector service provision can be stimulated through output-based aid approaches that link subsidies to performance. The emergence of networks of entrepreneurs and angel finance investors in MENA noted in this paper, as mentors and sources of market information, business advice, and finance, is a very promising development for improved SME creditworthiness and competitiveness.

Promoting an enabling institutional legal and regulatory environment for women's equal ownership and access to economic resources and assets such as land, finance, and property is essential for economic empowerment. Freeing women and their families from poverty requires strengthening their economic capacity as entrepreneurs, producers, and informal workers so that they can access and shape markets. The progress and pace of the gender efforts have been commended over the past decade in the Arab world, however, there has been recent concerns of a set-back in some countries that are currently facing turbulences. As the 2012 World Development Report on Gender Equality and Development notes, providing an equal footing for women is not just a core development objective in its own right, but also smart economics; greater gender equality improves living standards and enhances productivity. Addressing gender disparities, in that context, is essential.

Expectations are extremely high, especially among the youth. At the same time, the hostility towards those who benefited improperly from preference under the old system should not yield a universal condemnation of market mechanisms, and private sector-led growth. Instead it should be directed towards a fairer and more competitive economy that utilizes market mechanisms to generate equal opportunities and create jobs, bolstered by building the capacity of institutions, and developing the skills of the market players. Experience has shown that high-growth countries were able to rely on strong, rule-bound institutions to reduce discretion and create dependable incentives for rapid private-led economic growth. Key to this is the strengthening of institutions to implement private sector policies equitably and consistently. Much remains to be done to translate economic reforms into real positive changes.

ANNEX I

Logistic Regression Model (1) for Employment Growth in MENA

Employment Growth >= 10%	Odds Ratio	Std. Err.	z	P>z	[95% Conf.Interval]	
Egypt	1.08	0.18	0.46	0.65	0.78	1.51
Libya	1.55	0.43	1.60	0.11	0.91	2.66
Morocco	0.96	0.28	-0.13	0.90	0.55	1.70
Gulf country	1.92	0.73	1.70	0.09	0.91	4.05
Syria	0.86	0.30	-0.44	0.66	0.43	1.70
Yemen	1.41	0.52	0.93	0.35	0.68	2.90
Jordan SME	1.13	0.25	0.54	0.59	0.73	1.74
Manufacturing	0.73	0.09	-2.41	0.02	0.57	0.94
Large	0.77	0.10	-2.08	0.04	0.61	0.99
Had formal training	1.25	0.14	2.02	0.04	1.01	1.55
Uses email	1.19	0.14	1.52	0.13	0.95	1.50
25 or more power outages per year	1.09	0.25	0.36	0.72	0.69	1.71
Exporter	1.28	0.16	2.00	0.05	1.00	1.63
Uses technology licensed from a foreign owned company	1.06	0.15	0.41	0.68	0.81	1.39
Developed a new product or upgraded an existing one or both	1.70	0.19	4.67	0.00	1.36	2.13
Used bank financing for working capital	0.88	0.13	-0.87	0.39	0.67	1.17
Used bank financing for new investments	1.32	0.22	1.63	0.10	0.94	1.84

Logistic Regression Model (2) for Employment Growth in MENA

Employment Growth >= 10%	Odds Ratio	Std. Err.	z	P>z	[95% Conf. Interval]	
Egypt	0.94	0.15	-0.37	0.72	0.69	1.30
Libya	1.22	0.31	0.79	0.43	0.74	1.99
Morocco	0.69	0.19	-1.38	0.17	0.41	1.17
Gulf country	2.18	0.83	2.05	0.04	1.03	4.58
Syria	0.94	0.33	-0.18	0.86	0.48	1.85
Yemen	1.53	0.53	1.24	0.21	0.78	3.01
Iraq	1.20	0.32	0.71	0.48	0.72	2.01
Jordan SME	0.94	0.20	-0.27	0.79	0.62	1.44
Manufacturing	0.83	0.10	-1.51	0.13	0.65	1.06
Large	0.80	0.10	-1.89	0.06	0.63	1.01
Had formal training	1.24	0.13	2.04	0.04	1.01	1.53
Uses email	1.30	0.14	2.44	0.02	1.05	1.61
25 or more power outages per year	1.04	0.20	0.19	0.85	0.71	1.50
Exporter	1.44	0.17	3.10	0.00	1.14	1.82
Uses technology licensed from a foreign owned company	1.18	0.15	1.24	0.22	0.91	1.52
Used bank financing for working capital	0.90	0.13	-0.77	0.44	0.68	1.18
Used bank financing for new investments	1.36	0.23	1.83	0.07	0.98	1.89

Logistic Regression Model (3) for Employment Growth in SMEs in MENA

Employment Growth $\geq 10\%$	Odds Ratio	Std. Err.	z	P>z	[95% Conf. Interval]	
Egypt	0.93	0.19	-0.38	0.70	0.62	1.38
Libya	1.56	0.43	1.63	0.10	0.91	2.68
Gulf country	0.38	0.22	-1.66	0.10	0.12	1.19
Syria	0.90	0.41	-0.23	0.82	0.37	2.18
Yemen	1.64	0.41	1.99	0.05	1.01	2.66
Manufacturing	0.67	0.10	-2.65	0.01	0.50	0.90
Medium	1.23	0.15	1.69	0.09	0.97	1.57
Received an internationally recognized certificate	1.27	0.21	1.44	0.15	0.92	1.77
Had formal training	1.37	0.19	2.22	0.03	1.04	1.80
Has a loan	1.38	0.23	1.95	0.05	1.00	1.92
High regulatory compliance time cost ($\geq 12\%$)	1.29	0.16	2.03	0.04	1.01	1.65
Uses technology licensed from a foreign owned company	1.06	0.20	0.33	0.75	0.74	1.54
5% or more workers have university degree or higher	0.79	0.12	-1.58	0.11	0.59	1.06
Lowered prices due to pressures from local competition	0.86	0.11	-1.20	0.23	0.67	1.10
Developed a new product or upgraded an existing one or both	1.40	0.20	2.38	0.02	1.06	1.86
Has a website	1.19	0.16	1.25	0.21	0.91	1.56

Logistic Regression Model (4) for Employment Growth in SMEs in MENA

Employment Growth $\geq 10\%$	Odds Ratio	Std. Err.	z	P>z	[95% Conf. Interval]	
Egypt	0.85	0.16	-0.89	0.37	0.59	1.22
Libya	1.13	0.28	0.49	0.63	0.69	1.84
Gulf country	0.55	0.18	-1.88	0.06	0.29	1.03
Syria	0.82	0.37	-0.45	0.65	0.34	1.97
Yemen	1.45	0.36	1.51	0.13	0.89	2.35
Iraq	1.48	0.33	1.75	0.08	0.95	2.30
Manufacturing	0.71	0.10	-2.36	0.02	0.53	0.94
Medium	1.31	0.14	2.46	0.01	1.06	1.63
Received an internationally recognized certificate	1.37	0.22	2.00	0.05	1.01	1.87
Had formal training	1.31	0.18	2.01	0.05	1.01	1.70
Has a loan	1.39	0.22	2.13	0.03	1.03	1.89
High regulatory compliance time cost ($\geq 12\%$)	1.32	0.16	2.34	0.02	1.05	1.67
Uses technology licensed from a foreign owned company	1.35	0.23	1.74	0.08	0.96	1.89
Education rating higher than 4	0.82	0.11	-1.48	0.14	0.63	1.07
Lowered prices due to pressures from local competition	0.91	0.11	-0.76	0.44	0.72	1.16
Has a website	1.02	0.14	0.14	0.89	0.79	1.32

Logistic Regression Model (5) for Employment Growth in SMEs in MENA

Employment Growth \geq 10%	Odds Ratio	Std. Err.	z	P>z	[95% Conf. Interval]	
Egypt	0.87	0.14	-0.85	0.39	0.63	1.20
Libya	1.16	0.27	0.63	0.53	0.73	1.82
Morocco	0.67	0.15	-1.86	0.06	0.44	1.02
Gulf country	0.49	0.14	-2.45	0.01	0.28	0.87
Syria	0.79	0.34	-0.55	0.58	0.34	1.84
Yemen	1.52	0.35	1.82	0.07	0.97	2.39
Iraq	1.31	0.27	1.31	0.19	0.87	1.96
Jordan SME	1.05	0.23	0.21	0.84	0.68	1.60
Manufacturing	0.72	0.10	-2.45	0.01	0.56	0.94
Medium	1.31	0.13	2.74	0.01	1.08	1.58
Received an internationally recognized certificate	1.20	0.16	1.33	0.18	0.92	1.57
Had formal training	1.35	0.16	2.49	0.01	1.07	1.71
Has a loan	1.30	0.16	2.04	0.04	1.01	1.66
Uses technology licensed from a foreign owned company	1.23	0.18	1.38	0.17	0.92	1.65
Education rating higher than 4	0.80	0.10	-1.87	0.06	0.63	1.01
Has a website	1.02	0.12	0.13	0.90	0.81	1.27

ANNEX II

Doing Business Rankings 2012 for MENA and Selected Emerging Economies

	Overall	Starting a Business	Dealing with Construction Permits	Registering Property	Getting Credit	Protecting Investors	Paying Taxes	Trading Across Borders	Enforcing Contracts	Closing a Business	Getting Electricity
Saudi Arabia	12	10	4	1	48	17	10	18	138	73	18
UAE	33	42	12	6	78	122	7	5	134	151	10
Qatar	36	116	24	37	98	97	2	57	95	37	18
Bahrain	38	82	7	30	126	79	18	49	114	25	49
Tunisia	46	56	86	65	98	46	64	32	76	38	45
Oman	49	68	64	21	98	97	9	47	107	76	61
Kuwait	67	142	121	88	98	29	15	112	117	48	57
Morocco	94	93	75	144	98	97	112	43	89	67	107
Jordan	96	95	93	101	150	122	21	58	130	104	36
Yemen	99	66	35	55	159	133	116	118	38	114	52
Lebanon	104	109	161	105	78	97	30	93	120	125	47
Egypt	110	21	154	93	78	79	145	64	147	137	101
WBG	131	177	129	78	166	46	39	114	93	183	85
Syria	134	129	133	82	174	111	111	122	175	102	83
Iran	144	53	164	163	98	166	126	138	50	118	162
Algeria	148	153	118	167	150	79	164	127	122	59	164
Iraq	164	176	120	98	174	122	49	180	140	183	46
Djibouti	170	179	142	148	177	179	70	37	160	141	143
Average MENA Rank	93	98	91	82	119	95	62	79	114	99	71

Source: Doing Business Report (2012).

ANNEX III

Cross Country Comparisons

Figure A3.1: Doing Business 2012

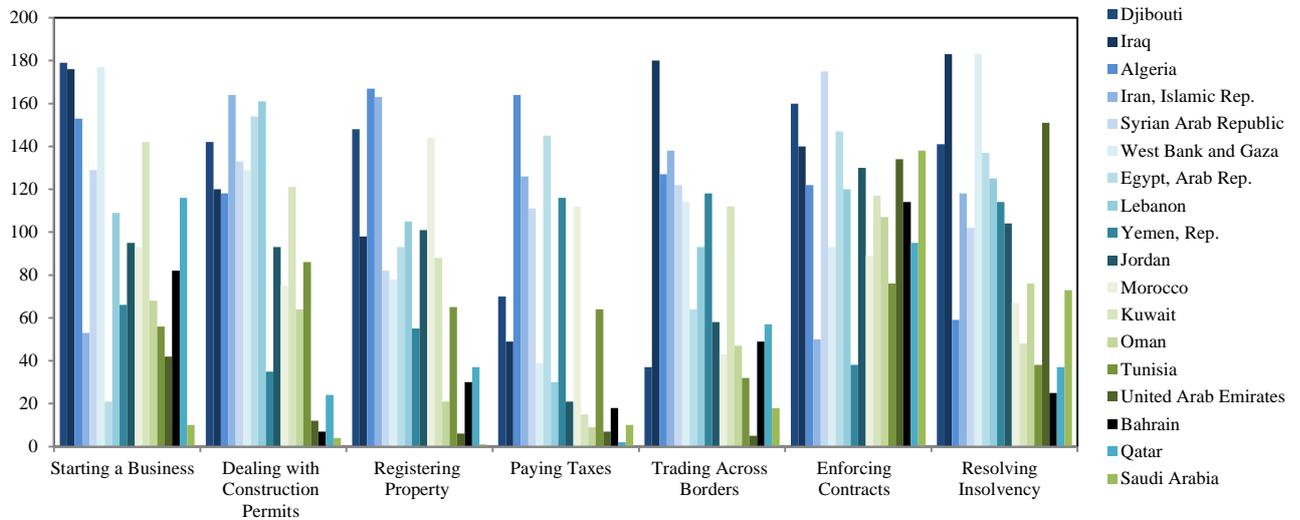


Figure A3.2: Percent of Firms Disagreeing that Interpretations of Regulations are Consistent and Predictable

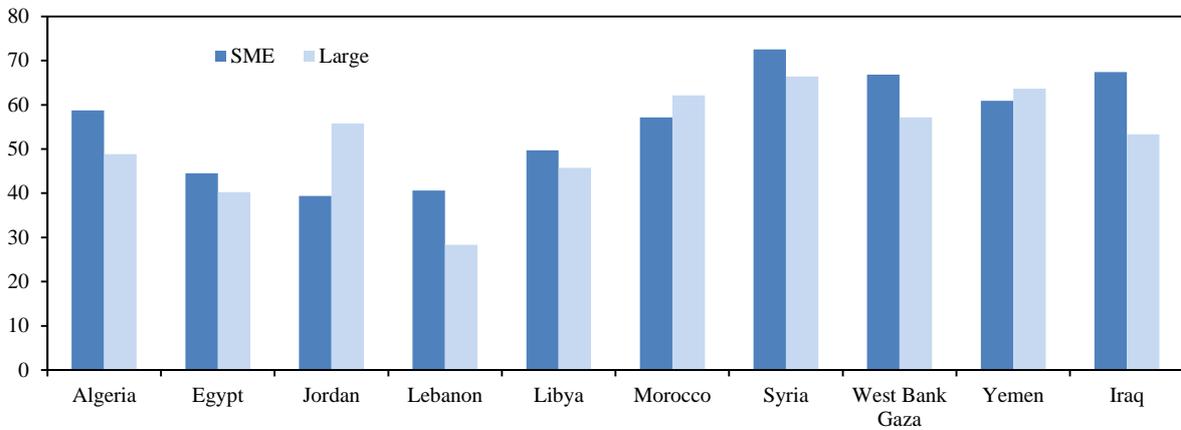
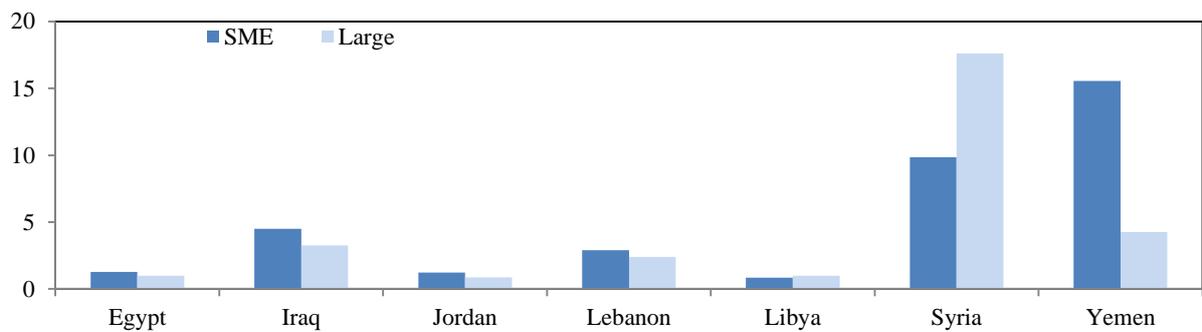


Figure A3.3: Police Inspections



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