

# Towards a Productive and Inclusive Path: Job Creation in the Arab Region



Shared Prosperity Dignified Life



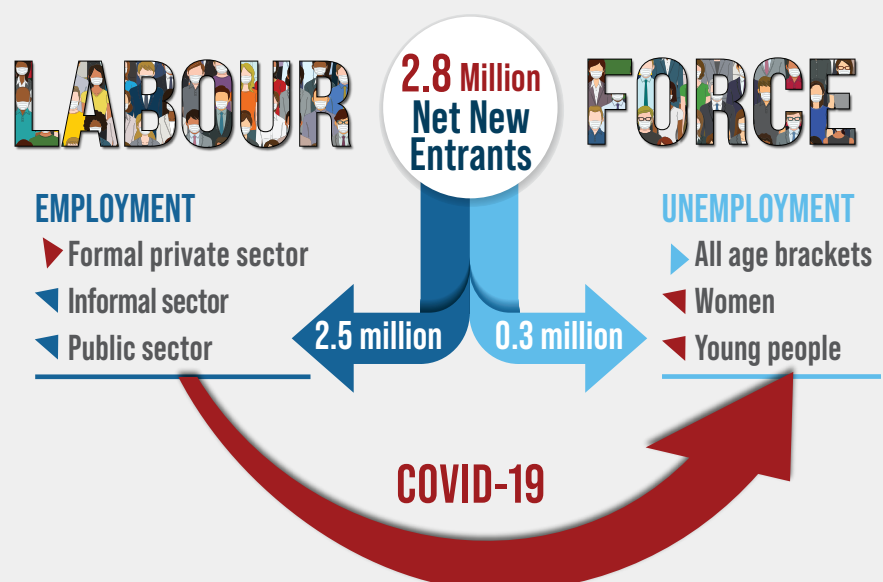
International Labour Organization

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## Introduction

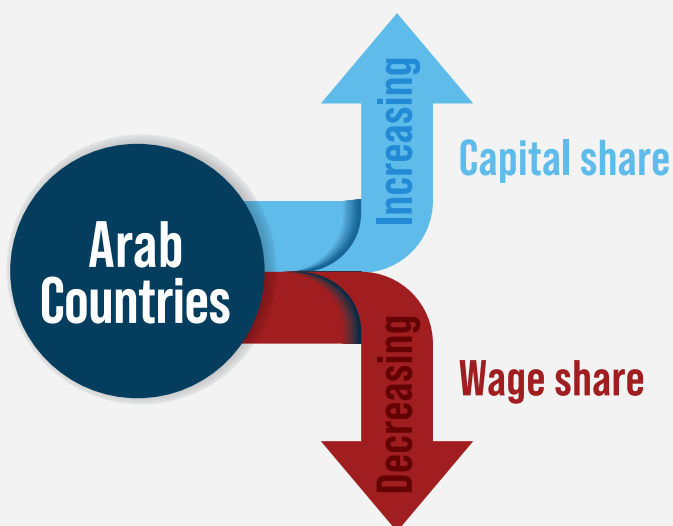
Growth in the working age population in the Arab region has been accompanied by stagnant labour force participation, limited employment creation in the formal private sector, and the highest unemployment levels worldwide, especially among women and young people. Of the 2.8 million net new job market entrants each year, the majority find jobs in the informal sector or in the public sector. This employment reality puts into question the ability of the formal private sector to absorb new skills. The COVID-19 pandemic has further compounded the issue of employment creation, and it is expected to increase unemployment significantly on top of the existing 14.3 million unemployed individuals.



# Impact assessment

- 1. Before the COVID-19 pandemic, 33.3 million new jobs needed to be created in the Arab region to reduce the unemployment rate to 5 per cent by the end of 2030,** this number will double if we increase female participation to global averages. Also pre-COVID-19 projections estimate that the number of unemployed persons in the region will rise from 14.3 million in 2019 to almost 17.2 million in 2030. However, these projections do not factor in the employment repercussions of the pandemic and the impact of the Fourth Industrial Revolution on the region's skill mismatch.
- 2. The 2.76 per cent average annual increase in female labour force participation over the period 2000-2020 was accompanied by an average 3.4 per cent increase in the number of unemployed women.** The region is not creating enough jobs to absorb the growth in the female labour force. Women's economic participation in the region is clustered in public or quasi-public firms and in sectors that are deemed 'female-friendly', but they are largely under-represented in other formal private-sector occupations. Women-owned businesses tend to be micro, small or medium enterprises (MSMEs), with greater restrictions in accessing credit and a limited role for women in top management, which may result in limited firm growth and low firm survival prospects.
- 3. Around 64 per cent of total Arab employment is informal.** The weak regulatory framework in the Arab region, together with underdeveloped labour market institutions, inadequate fiscal space and the concentration of economic activity in low-productivity sectors, in addition to protracted conflict and political instability, have contributed to a limited creation of decent formal jobs in Arab labour markets. Coupled with low quality of education, these factors are seen as major obstacles to formalization, and require an integrated approach to encourage the shift from informal to formal employment.
- 4. Employment in the formal private sector in the Arab region is growing at a weighted annual average of 2 per cent, with employment in small enterprises witnessing the lowest average growth of 1 per cent annually.** The formal private sector in the region is not sufficiently diversified and lacks the required structure to absorb the large numbers of new labour market entrants. SMEs have the lowest employment growth of 1 per cent, while employment in large firms is growing at around 3.5 per cent annually.

## Inequality between capital owners and wage earners



## Firm level technology is lower than global averages

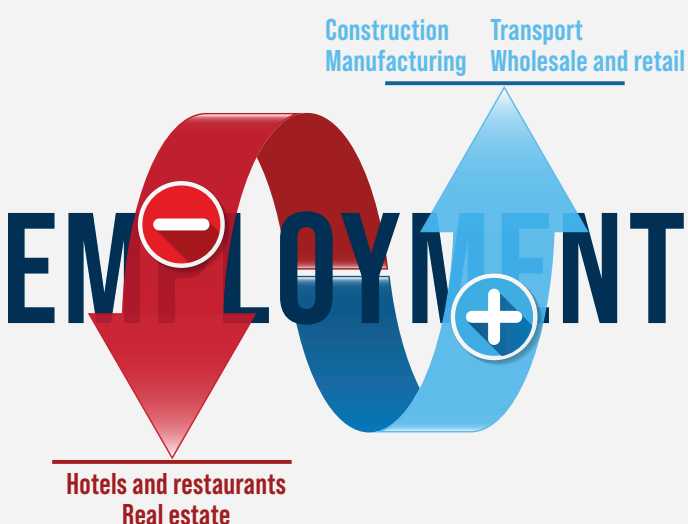


5. **The formal private sector is characterized by high income inequality between capital owners and income earners**, as indicated by a higher share of capital to revenues compared to the share of labour to revenues in the region's formal private sector. This gap increases with firm size. An increasing share of capital in production may eventually widen the inequality gap between capital owners and wage earners. Eventually, a large share of capital in production could also bias new technologies to augment capital and not labour.
6. **The labour productivity of the formal private sector is comparable to other regions, but has a lower total factor productivity (TFP)**. Arab firms have a lower TFP in manufacturing compared with countries of similar income levels. They also have a comparable level of labour productivity owing to more capital intensity. SMEs have a lower total factor productivity and shorter survival rates than large firms.
7. **The impact of innovation on employment creation in the Arab region is sector-dependent, with different types of innovations in various sectors affecting employment differently**. In some sectors, any type of innovation could result in more employment creation, as it is the case in manufacturing, construction, transport, wholesale and retail. In other sectors, such as real estate, innovations that enhance production and increase the process efficiency reduce employment creation. Similar negative effects of

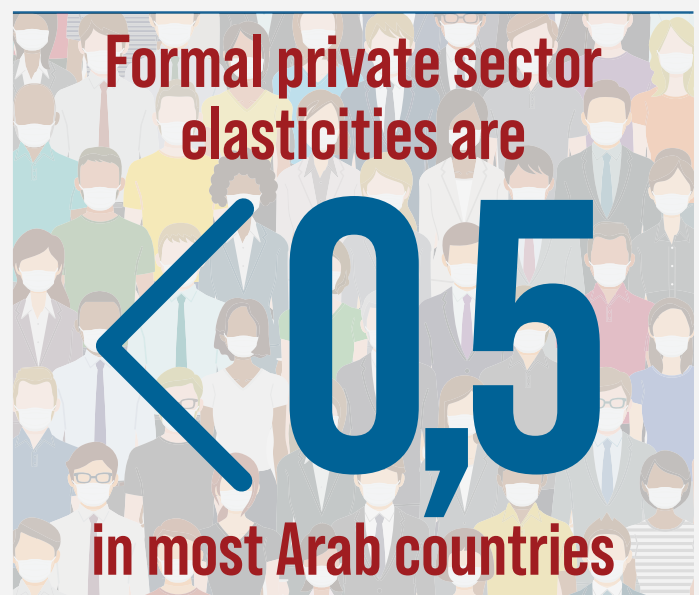
innovation on employment have been witnessed in the hotel and restaurant sector.

8. **Unlike the rest of the world, employment elasticity in the formal private sector is low in the region, and significantly lower than the average income for most Arab countries, with Iraq experiencing negative employment elasticity in all sectors**. Overall, most sectors in all Arab countries (except Morocco) have an employment elasticity below 1 (and many below 0.5), indicating that an increase in output by 1 per cent increases employment by less than 0.5 per cent. Moreover, firms' employment elasticities in most Arab countries are below those of non-Arab countries with similar income brackets. These elasticities tend to change over time depending on changes in the economy.
9. **According to the ILO COVID-19 Monitor, nearly one third of the employed population in the region is facing high risks of layoffs or reduced wages and/or working hours owing to the pandemic**. As global economies are hit hard by the pandemic, the region is struggling to respond to labour market repercussions that have exacerbated pre-existing challenges and structural labour market deficits. An estimated 39.8 million individuals in the Arab region are employed in sectors that are identified as most-at-risk. Furthermore, 12.8 per cent of working hours are estimated to have been lost in the third quarter of 2020, which is equivalent to 15 million full-time jobs.

#### Technologies impact employment differently



#### Low employment elasticities in most countries





# Policy response

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## 1. Implement an immediate structured policy response to address the challenges resulting from the pandemic.

It is necessary to stimulate the economy through more expansionary fiscal and monetary policies, including financial support to the most affected sectors. Arab Governments should also extend social protection to all, implement employment retention measures, and apply financial and tax relief to support the most vulnerable firms. Moreover, workers should be protected by strengthening occupational safety and health measures, providing health access to all, adapting work arrangements, expanding access to paid-leave, and preventing discrimination and exclusion. COVID-19 spending should be prioritized through fiscal readjustments to secure the required financing. International and regional coordination, such as the ESCWA solidarity fund, remains vital to tackling pandemic challenges.

## 2. Develop proactive and comprehensive national employment policies.

These policies are key to addressing structural, longstanding and multidimensional labour markets challenges in Arab countries, including the inefficiency of the private sector and its limited potential and capacity to create decent jobs.

## 3. Rethink macroeconomic policies that promote private sector development.

While macroeconomic policies play a crucial role in generating decent work opportunities, such policies need to be carefully formulated to encourage decent employment creation, productivity and inclusive growth. This includes designing effective fiscal policies and tools, re-emphasizing the role of monetary policy in supporting private-sector development, particularly SMEs, increasing financial inclusion, and designing and implementing pro-employment sectoral and industrial policies for improved diversification efforts. Governments in the region should also encourage patent systems and foreign direct investment.

## 4. Support the formalization and expansion of social protection.

Formalization is closely linked to the issue of private sector development. Arab countries need to develop an integrated framework that addresses various decent work deficits,

based on a proper assessment of their national contexts. Expanding social protection remains critical to providing adequate protection from rising poverty and vulnerability in the region, and realizing the fundamental human right to social security. The formalization of enterprises should also be encouraged, including through pro-SME macroeconomic frameworks and well-designed tax systems that incentivize SMEs to formalize. This, however, should not be achieved through short-term job losses in the informal sector.

## 5. Improve women's labour market prospects to promote gender equality and women's empowerment.

This requires challenging prevalent socio-cultural and discriminatory perceptions to promote women's labour mobility, and capitalize on their high level of education in all sectors. Furthermore, reforming labour laws to ensure a more gender sensitive environment is a must. The private sector should enhance its internal promotion policies, so that women and men have an equal chance to assume senior positions and be represented on boards of directors. In addition, financial intermediaries can support female entrepreneurs by providing credit to promote growth-oriented entrepreneurship for women. Downsizing public sector spending should not come at the cost of additional female employment.

## 6. Reform educational programmes and develop effective active labour market policies, particularly for young people.

Arab Governments need to address the issue of skills mismatch through a holistic approach that also reforms the education system and curriculums, thus inculcating creative and critical thinking, raising competency in STEM subjects, and investing in teacher training and facilities, while promoting greater involvement of business in curriculum design and delivery, and greater investment in career counselling and guidance. Investments in public employment services and active labour market policies also need to be boosted in the short run to ensure young people's successful transition from school to work.

## 7. Offer additional incentives for private sector innovation, with a focus on labour-augmented technologies in production to compliment employed

**capital and advance TFP.** Spending on research and development should be scaled up to match global trends. This will increase knowledge production, innovate new products, expand existing markets and create more jobs. Innovations also increase the productivity of capital and labour and enhance production competitiveness. At the same time, policymakers should develop sound and fair income redistribution policies to reduce the gap between capital owners and income earners.

- 8. Develop sector-specific policies that tackle the negative impact of technology on employment and harness employment creation opportunities.** Since innovation increases employment growth in the construction, manufacturing, transport, wholesale and retail sectors, policies incentivizing innovation in such sectors should be advanced. However, policymakers in collaboration with firm owners should create reskilling and upskilling incentives for disadvantaged employees in sectors that could be negatively impacted by innovation, such as the real estate and hotel and restaurant sectors.

- 9. Rethink policies that incentivize SMEs to help them grow faster.** This requires reviewing the overall private sector development atmosphere, enhancing digital transformation, reducing competition with the informal sector, increasing capacity-building, and enabling the required structural transformations in sectors where SMEs can grow and thrive. Moreover, the SME support ecosystem needs to be significantly strengthened beyond access to finance, to also include research and development and business innovation to serve the dual purpose of SME sustainability and job creation.

- 10. Update labour laws and regulations, build a more skilled workforce, and ensure a stronger and more competitive and innovative business environment.** Additional employment creation requires revising labour regulations to support inclusiveness and fairness in the labour market and to accommodate more workers, including women. Moreover, a vibrant and growing private sector supported by government policies is associated with higher output-employment elasticity.



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