MENA Advisors

MENA Development, Escaping the Trap

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- The MENA region is at risk of falling into the middle-income trap with rising unemployment in some countries and a dependence on oil income in others

- To escape the trap, the region needs to raise productivity growth by encouraging technological development and continuing to focus on education

- The best way to achieve this is by encouraging private sector investment through deregulation, improved business environments, privatisation, public-private-partnerships and more flexible labour markets

- MENA has a relatively skilled labour force but doesn't have the jobs, de-regulating and incentivising private investment in the digital economy could help provide the jobs and raise technological development, which would lead to faster productivity growth and higher living standards for the long term

Countries across the MENA region are facing long-term development challenges. In countries that are not net exporters of oil and gas, growth is too low to create the needed jobs and unemployment is rising, particularly among the young. In oil exporting countries, growth is too dependent on oil revenue to achieve genuine diversification. Although growth rates can reach relatively high levels, this is mainly achieved by hydrocarbon-financed investment and hiring of foreign labour. Depending on technological developments, this may not be a very sustainable model.

The lack of "healthy" growth in the MENA region is a symptom of a lack of growth in productivity (the amount produced from workers and capital). In turn, weak productivity growth is mainly a result of the region lagging in technological development. Non-oil countries suffer from weak infrastructure, especially in the critical energy and transport sectors. In oil countries, outside the hydrocarbon sector, growth is mainly derived from capital investment in construction and buying in cheap foreign labour, not from improving technology. As a result, the region risks a long-term decline in living standards, especially if oil revenues decline, ending in permanent stagnation in the "middle-income trap". To escape the trap, the region needs to increase productivity growth.

The main path to higher productivity growth lies in improving the workforce skill level or encouraging technological development in the economy. The labour force skill level can be improved through better education, but this could just result in a brain drain from the region. The problem is that there are no jobs for skilled and educated labour. As a result, MENA faces high unemployment and a brain drain in non-oil countries as workers look overseas for jobs while in oil countries, local workers take unproductive public-sector jobs, leaving the menial private sector work to cheap foreign labour.

This leaves technological development as the best way to improve productivity and to create skilled local jobs. How can the region achieve better technology? In short, by unleashing and incentivising the private sector to invest in new technology and create new jobs. The private sector is currently stifled by regulations that protect markets for local incumbents. There are a number of ways that the private sector can be encouraged to invest, many of which are already being addressed in the region.

First, governments can deregulate the economy by fully opening up all sectors to private investment. The UAE and Qatar have both recently proposed new laws to allow 100% foreign ownership across most of the economy, which we go into in more detail in our recent article, *Gulf states ease foreign investment restrictions*.

Second, governments can work to make other improvements to the business environment by:

- Making business procedures quicker as is being done with: Egypt's new industrial and investment laws that were introduced in 2017 which streamlined business registration and operations; new "one-stop shops" that have recently been established in Kuwait, Oman and Qatar; and faster customs processes that have been addressed in Bahrain and Oman
- Allowing better access to finance for the private sector as existing tight relationships between the public sector and banking systems in the region make the crowding out of the private sector an issue
- Developing capital markets, which would broaden financing options for the private sector

Third, sectors can be privatised. Saudi Arabia is planning for the privatisation of 16 sectors and is considering the potential sale of a stake in Aramco, the national oil company.

Fourth, public-private-partnerships can be developed to encourage investment. PPP programmes are currently being developed in Algeria, Oman, Qatar, Saudi, UAE.

Finally, a more flexible labour market would attract a deeper pool of talent to the region, encouraging private sector investment. Bahrain, Qatar and the UAE have enacted reforms to the visa system that improve internal mobility of labour and Qatar has introduced a formal legal route to permanent residency for some workers.

Once an environment is created that is conducive to private sector investment, the next, and even more interesting question, is what technologies should they be investing in? The MENA region is going to find it very tough to compete in manufacturing exports as Asia is already highly technologically advanced in this area. A faster route to higher productivity growth could be through developing the digital economy. The young and educated workforce in the region has the skills and is adept at utilising the digital economy. However, these digital skills are currently mainly being used for social media and not for creating companies that can generate new sources of income. To encourage the development of the digital economy, governments should focus on creating a light-touch environment for digital regulations and digital tax-free zones and other incentives. A good recent example of this is sandbox for fintech companies recently established by the Bahraini central bank. Investment in digital infrastructure is also key, fast broadband everywhere in the region would help and other digital infrastructure such as payment systems would push the region forward. This would help provide the jobs and raise technological development, which would lead to faster productivity growth and higher living standards for the long term.