MIDDLE EAST and NORTH AFRICA

Growth in the Middle East and North Africa region is estimated to slow sharply from 5.0 percent in 2016 to 1.8 percent in 2017, 0.3 percentage point lower than June projections. The impact of oil production cuts and heightened geopolitical tensions on oil exporters has more than offset a pickup among oil importers. Regional activity is forecast to strengthen gradually over the medium term, in response to policy reforms and easing fiscal adjustments. Key downside risks to the outlook include continued conflicts in the region, weakness in oil prices, and obstacles to reform progress, which are only partly offset by the effects of possible stronger-than-expected Euro Area activity.

Recent developments

Growth in the Middle East and North Africa (MENA) region is estimated to have declined markedly to 1.8 percent in 2017 from 5.0 percent in the previous year, contributed by hydrocardon-sector-led growth decelerations among regional oil exporters.[1] In contrast, growth in oil importers in 2017 has strengthened to 3.7 percent from the previous year, supported by reforms and improved competitiveness. Growth in both groups of economies continue to face headwinds from fiscal consolidation plans and geopolitical tensions.

Growth among the oil exporters was affected by OPEC oil production cuts and fiscal consolidation (Figure 2.4.1). Besides the effect of a slowdown in its oil sector following an exceptionally high 2016 surge, activity in the Islamic Republic of Iran was dampened by weak foreign investor confidence associated with geopolitical tensions (including new sanctions and hardened nuclear-deal stance by the United States). Algeria and Iraq's growth are also estimated to have decelerated in response to fiscal consolidation, moderating hydrocarbon sector growth, and weak non-oil activity. Lower growth among the Gulf Cooperation Council (GCC) members mainly reflects lower oil output from production cuts. Data for first half of 2017 and purchasing managers' indexes point to a modest recovery of the non-oil sector in the GCC.

In June 2017, Bahrain, Saudi Arabia, the United Arab Emirates, and the Arab Republic of Egypt cut diplomatic and economic ties with Qatar. All seaborne and air travel links from the involved countries to Qatar were shut and bank lending to Qatar was restricted. This led to financial market disruptions in Qatar, where non-resident deposits have fallen by 27 percent, although the government has intervened heavily by injecting public sector deposits to the banking system. The diplomatic rift is estimated to have weighed somewhat on activity in Qatar in 2017, but its impact on other neighboring economies has been limited.

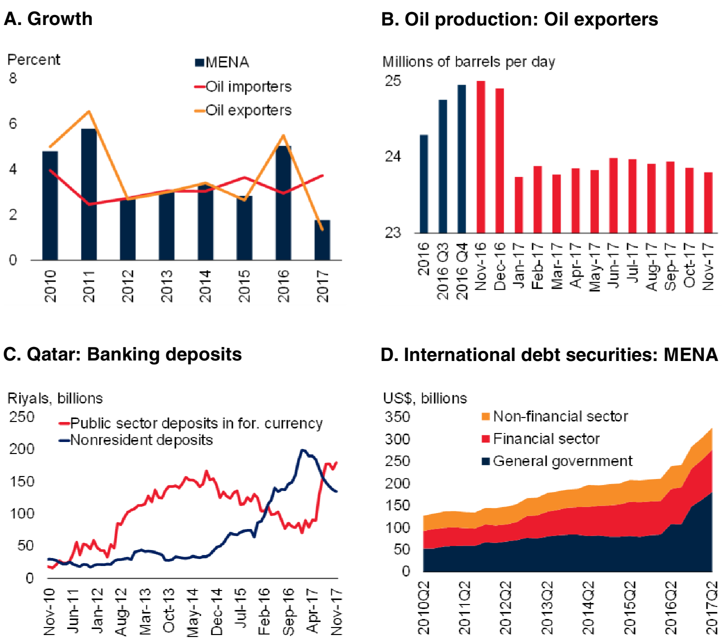
Among the region's oil importers, growth improved in 2017, including as a result of reforms and improved competitiveness. Egypt experienced strong industrial production, investment, and exports, supported by the effects of the exchange rate devaluation on competitiveness. In Morocco, a strong rebound in agricultural production in the

Note: This annex was prepared by Lei Sandy Ye. Research assistance was provided by Ishita Dugar and Shituo Sun.

[1] The World Bank's Middle East and North Africa aggregate includes 16 economies, and is grouped into three subregions. Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates comprise the Gulf Cooperation Council (GCC); all are oil exporters. Other oil exporters in the region are Algeria, the Islamic Republic of Iran, and Iraq. Oil importers in the region are Djibouti, the Arab Republic of Egypt, Jordan, Lebanon, Morocco, Tunisia, and West Bank and Gaza. The Syrian Arab Republic, the Republic of Yemen, and Libya are excluded from regional growth aggregates due to data limitations.

FIGURE 2.4.1 MENA: Recent developments

Growth in MENA is expected to decelerate in 2017, driven by weakness in oil exporters. The latest oil production data show significant reductions associated with OPEC agreement among major oil exporters. The onset of the Qatar diplomatic rift led to Qatari nonresident deposit outflows and interventions through public sector deposits injections. Large recent sovereign bond financing has contributed to a rapid expansion in international debt securities raised by MENA economies.



Sources: Bank for International Settlements, Haver Analytics, International Energy Agency, World Bank.
Notes: MENA = Middle East and North Africa.
A. Weighted average growth of real GDP.
B. Sum of daily crude oil productions of the Islamic Republic of Iran, Iraq, Kuwait, Saudi Arabia, and the United Arab Emirates. Red columns denote months since November OPEC agreement. Blue columns denote 2016 annual, Q3, and Q4 average daily productions. Last observation is November 2017.
C. Data for commercial banks. Last observation is November 2017.
D. Sum of international debt securities outstanding for 14 MENA countries. Last observation is 2017Q2.
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first three quarters of 2017 from severe droughts in the previous year further supported the economy's recovery. Tunisia has experienced gradual recoveries in agricultural and manufacturing sectors. Policy reforms in the region have helped boost domestic business confidence and foreign investment. Coupled with an improvement in net exports, foreign reserves have risen and current account deficits appear to have remained stable in 2017 for some oil importers.

Inflation is generally well-contained across the MENA region, averaging less than 3 percent (monthly y-on-y) in the GCC, as well as easing in most other countries. An important exception is Egypt, where inflation has risen rapidly from 2016 and remains elevated (above 25 percent, y-on-y, by November 2017). This has reflected the effects of the currency float in November 2016, higher food prices, and administered price hikes, prompting the central bank to hike interest rates twice in 2017, taking its overnight rate to 18.75 percent. These inflationary pressures have eased somewhat, however, towards the end of 2017.

Financial sector developments within the MENA region have been generally favorable. Equity market indexes in the GCC remained stable in 2017, notwithstanding the effects of the dispute with Qatar. And despite the shadow of geopolitical tensions, long-term investor confidence has been bolstered by reforms to foreign investment accessibility and capital market development (e.g., leading to the potential inclusion of Saudi Arabia in the MSCI EM index in 2018 and supporting the economy's planned IPO of Aramco), as well as large sovereign issuances, contributing to a rapid expansion in international debt securities (Lorente, Ismail, and Schmukler 2016). Banking sector liquidity in oil exporters has generally eased in 2017 relative to the previous year, as higher oil prices have supported higher government deposits.

Fiscal and structural weaknesses remain key challenges in many MENA countries. However, supported by IMF and World Bank programs, many economies (e.g., Egypt, Morocco) have improved their fiscal positions. These efforts were accompanied by broader reforms, such as steps to improve the functioning of labor markets, which promise to boost overall and female labor force participation in the region and spur stronger long-term growth (Chapter 3). Business climate reforms, such as measures to ease business registration and to strengthen investor protection, have also been introduced across both oil exporters and importers.

Outlook

Regional growth is projected to increase steadily after 2017, to 3.0 percent in 2018 and 3.2 percent by 2020, reflecting accelerations among both oil exporters and importers. This forecast reflects assumption of a moderation of geopolitical tensions as well as a modest rise in oil prices.

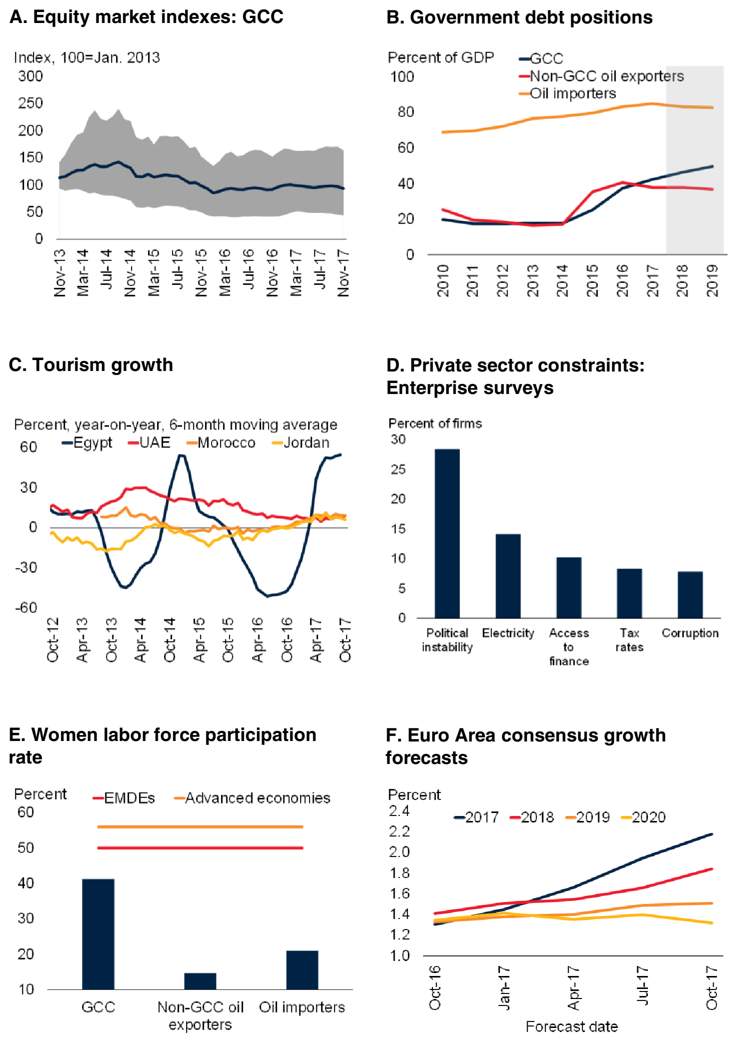
The pickup in growth among oil exporters would be led by the GCC economies. Growth in the GCC is expected to reach 2.7 percent by 2020, supported by easing fiscal adjustments, infrastructure investment (e.g., Dubai Expo 2020; Qatar World Cup 2022), and reforms to promote non-oil sector activity. Equity market indexes in the GCC suggest stable business prospects in the corporate sector (Figure 2.4.2). Growth in the Islamic Republic of Iran, the second largest economy in the region, is expected to reach 4.3 percent by 2020, with higher investment growth offset by lower oil production and limited access to finance. In Algeria, new government investment spending associated with the 2018 budget and a more expansionary fiscal stance than previously planned is expected to raise growth in the short-term. Iraq's activity is expected to improve amid more favorable security conditions.

Growth among oil importers is expected to further improve over 2018-20, as business and consumer confidence are boosted by reforms and as external demand improves. A key challenge to growth among these countries stems from their elevated levels of public debt, which will require cuts in public spending and infrastructure investment. The collapse in world oil prices has helped spur needed reforms of energy subsidies and other fiscal adjustments (see Special Focus 1). Moreover, in Egypt, the move to a floating exchange rate has improved competitiveness and provided a needed boost to industrial activity and exports, which are expected to strengthen further as the business climate improves. Lastly, there is scope for a further recovery of tourism, an important revenue source in oil importers (e.g., Egypt and Morocco), if geopolitical tensions remain contained.

Fiscal balances are expected to improve further over 2018-2020, reflecting plans for reducing subsidies and tax increases in many economies (e.g., a GCC-wide VAT tax of 5 percent is scheduled to launch in 2018), as well as the effects of somewhat higher oil prices on revenues among the oil exporters. Current account balances in the MENA region are also expected to strengthen as a

FIGURE 2.4.2 MENA: Outlook and risks

Forward-looking indicators suggest stable momentum in the corporate sector of the GCC. Elevated debt burdens of oil importers serve as a headwind to medium-term growth for the region. Potential growth in the region is expected to be supported by reforms, but is limited by a range of obstacles to private sector activity. The region faces downside risks from heightened geopolitical tensions, which may deter tourism, and upside risks from stronger-than-expected activity in the Euro Area.



Sources: Consensus Economics, Haver Analytics, International Monetary Fund, World Bank.
A. Sample includes Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates. Last observation is November 2017. Unweighted average. Shading denotes range.
B. General government gross debt. GCC, non-GCC oil exporters, and oil importers include 6, 3, and 6 economies, respectively. Unweighted averages. Shaded area denotes forecasts.
C. Growth of tourist arrivals for Egypt, Jordan, and Morocco. Data for the United Arab Emirates denote hotel guest arrivals in Abu Dhabi.
D. Percent of firms citing each noted indicator as biggest obstacle. Unweighted averages. Based on the World Bank's enterprise surveys for 9 MENA economies and latest available data since 2011 for each country.
E. Workforce as a percent of female population ages 15+. Unweighted average of 5 GCC economies, 2 Non-GCC oil exporters, and 5 oil importers. Based on latest available data since 2010 for each country.
F. Annual consensus growth forecasts for each year denoted in the legend. 2017 denotes estimates. X-axis denotes the date for which the forecast is conducted.
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result of stronger external demand, higher oil prices (for oil exporters), and the effects of fiscal consolidation. Remittance inflows are expected to be supported by strength in Euro Area activity and confidence in exchange rate stability in Egypt (World Bank 2017t).

Risks

The risks to the outlook, while varying between oil exporters and importers, are generally to the downside. The regional outlook faces four main risks: amplification of geopolitical tensions, weak momentum in oil prices, obstacles to reform progress, and stronger-than-expected Euro Area activity. Geopolitical risks remain elevated, and are complicated by a variety of intra-regional diplomatic tensions. These risks may weigh on growth prospects and may harm investor confidence in the MENA region, reducing investment, driving up sovereign bond spreads, and complicating the prospects for achieving needed fiscal adjustments.

While economic conditions appear to be improving among the oil importers, their prospects are vulnerable to spillovers from armed conflicts in fragile economies (e.g., Libya, Syrian Arab Republic, Republic of Yemen), such as via disruptions of trade routes or reduction of cross-border investment. These conflicts have also challenged residents' basic access to food services, education, and health (e.g., cholera outbreak in the Republic of Yemen). Furthermore, the protracted displacement of people in the fragile economies has generated a refugee crisis that not only raised the macroeconomic challenges (e.g., structural changes to labor markets) for host countries like Djibouti, Jordan, and Lebanon, but also amplified fundamental development challenges in education, health, jobs, water, and livelihood for refugees, such as through expansion of health service delivery (World Bank 2017u).

Weaker-than-expected global oil prices may further cloud growth prospects for the MENA region's oil exporters. It remains to be seen whether OPEC and non-OPEC production cuts will affect prices in light of the fact that U.S. oil inventories remain at high levels, despite stabilizing recently. This suggests the risk that if compliance with the agreement waivers, world oil prices could fall, complicating the ability to achieve planned fiscal adjustments and weakening growth.

Although reforms are expected to support potential growth and enhance the business climate environment, the pace of improvement may be constrained by obstacles to private sector activity, such as political instability and electricity deficiencies (World Bank 2016k). This is further complicated by high youth unemployment and low labor force participation rates, especially among women (Box 2.4.1 and Chapter 3; Schiffbauer et al. 2015). Multi-year public-private financing initiatives in the region, such as the International Finance Corporation's new investment and technical assistance in Egypt's solar capacity, are expected to alleviate these constraints by facilitating private sector participation.

On the upside, stronger-than-expected economic activity in the Euro Area would provide an important support to growth in the MENA region. A number of economies in North Africa (e.g., Tunisia) are heavily dependent on the European Union (EU) for trade, remittances, or financial flows, and stronger-than-expected activity in the Euro Area is already expected to support the recovery of these economies (World Bank 2017p; chapter 1). It is also capable of offsetting the potential negative spillovers of weak growth in the GCC, from which some (e.g., Jordan, Lebanon) are also dependent on remittances and foreign direct investment.

TABLE 2.4.1 Middle East and North Africa forecast summary

(Real GDP growth at market prices in percent, unless indicated otherwise)

	2015	2016	2017e	2018f	2019f	2020f	Percentage point differences from June 2017 projections: 2017e	2018f	2019f
EMDE MENA, GDP[1]	**2.8**	**5.0**	**1.8**	**3.0**	**3.2**	**3.2**	**-0.3**	**0.1**	**0.1**
(Average including economies with full national accounts and balance of payments data only)[2]									
EMDE MENA, GDP[2]	2.6	4.8	2.0	2.9	3.3	3.3	-0.2	0.0	0.1
GDP per capita (U.S. dollars)	0.7	3.0	0.3	1.3	1.8	1.9	-0.3	-0.1	0.0
PPP GDP	2.6	5.1	2.2	3.1	3.5	3.5	-0.2	0.1	0.2
Private consumption	-0.2	4.2	2.3	3.0	3.3	3.3	0.0	0.0	0.1
Public consumption	0.3	-5.0	1.5	1.6	1.9	1.8	0.5	0.0	0.3
Fixed investment	1.2	-1.4	2.9	5.1	6.1	6.0	0.0	0.5	0.5
Exports, GNFS[3]	2.5	6.4	2.1	3.7	3.6	3.7	-0.2	0.0	-0.3
Imports, GNFS[3]	-2.3	-1.9	2.9	3.3	3.3	3.3	-0.1	0.3	-0.1
Net exports, contribution to growth	2.1	3.7	0.0	0.6	0.5	0.6	0.0	0.0	0.0
Memo items: GDP									
Oil exporters[4]	2.6	5.5	1.3	2.8	3.0	2.9	-0.5	0.3	0.2
GCC countries[5]	3.6	2.5	0.7	2.0	2.7	2.7	-0.6	-0.3	0.2
Saudi Arabia	4.1	1.7	0.3	1.2	2.1	2.2	-0.3	-0.8	0.0
Iran, Islamic Rep.	-1.3	13.4	3.6	4.0	4.3	4.3	-0.4	-0.1	0.1
Oil importers[6]	3.6	2.9	3.7	3.9	4.3	4.5	0.0	-0.2	-0.1
Egypt, Arab Rep.	4.4	4.3	4.4	4.9	5.6	5.8	0.1	-0.1	0.3
Fiscal year basis[7]	4.4	4.3	4.2	4.5	5.3	5.8	0.3	-0.1	0.0

Source: World Bank.

Notes: e = estimate; f = forecast. EMDE = emerging market and developing economy. World Bank forecasts are frequently updated based on new information. Consequently, projections presented here may differ from those contained in other Bank documents, even if basic assessments of countries' prospects do not differ at any given moment in time.

1. GDP at market prices and expenditure components are measured in constant 2010 U.S. dollars. Excludes Libya, the Syrian Arab Republic, and the Republic of Yemen due to data limitations.
2. Aggregate includes all countries in notes 4 and 6 except Djibouti, Iraq, Qatar, and West Bank and Gaza, for which data limitations prevent the forecasting of GDP components.
3. Exports and imports of goods and non-factor services (GNFS).
4. Oil exporters include Algeria, Bahrain, Iraq, the Islamic Republic of Iran, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates.
5. The Gulf Cooperation Council (GCC) includes Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates.
6. Oil importers include Djibouti, Egypt, Jordan, Lebanon, Morocco, Tunisia, and West Bank and Gaza.
7. The fiscal year runs from July 1 to June 30 in Egypt; the column labeled 2017 reflects the fiscal year ended June 30, 2017.

For additional information, please see www.worldbank.org/gep.

TABLE 2.4.2 Middle East and North Africa economy forecasts[1]

(Real GDP growth at market prices in percent, unless indicated otherwise)

	2015	2016	2017e	2018f	2019f	2020f	Percentage point differences from June 2017 projections 2017e	2018f	2019f
Algeria	3.7	3.3	2.2	3.6	2.5	1.6	0.4	2.6	1.0
Bahrain	2.9	3.2	2.4	2.0	1.6	1.7	0.5	0.1	-0.7
Djibouti	6.5	6.5	7.1	7.0	7.0	7.0	0.1	0.0	-0.2
Egypt, Arab Rep.	4.4	4.3	4.4	4.9	5.6	5.8	0.1	-0.1	0.3
Fiscal year basis[2]	4.4	4.3	4.2	4.5	5.3	5.8	0.3	-0.1	0.0
Iran, Islamic Rep.	-1.3	13.4	3.6	4.0	4.3	4.3	-0.4	-0.1	0.1
Iraq	4.8	11.0	-0.8	4.7	1.7	1.9	2.3	2.1	0.6
Jordan	2.4	2.0	2.1	2.2	2.4	2.5	-0.2	-0.4	-0.6
Kuwait	0.6	3.6	-1.0	1.9	3.5	3.5	-1.2	-0.8	0.6
Lebanon	0.8	2.0	2.0	2.2	2.0	2.0	-0.5	-0.4	-0.6
Morocco	4.5	1.2	4.1	3.1	3.2	3.2	0.3	-0.6	-0.4
Oman	4.7	5.4	0.7	2.3	2.5	2.5	-0.2	-0.1	-0.4
Qatar	3.6	2.2	1.7	2.6	3.0	3.0	-1.5	0.0	0.5
Saudi Arabia	4.1	1.7	0.3	1.2	2.1	2.2	-0.3	-0.8	0.0
Tunisia	1.1	1.0	2.0	2.7	3.3	4.0	-0.3	-0.3	-0.2
United Arab Emirates	3.8	3.0	1.4	3.1	3.3	3.3	-0.6	0.6	0.1
West Bank and Gaza	3.4	4.1	3.0	3.0	2.9	2.9	-0.5	-0.4	-0.5

Source: World Bank.

Notes: e = estimate; f = forecast. World Bank forecasts are frequently updated based on new information. Consequently, projections presented here may differ from those contained in other Bank documents, even if basic assessments of countries' prospects do not differ at any given moment in time.

1. GDP at market prices and expenditure components are measured in constant 2010 U.S. dollars. Excludes Libya, the Syrian Arab Republic, and the Republic of Yemen due to data limitations.

2. The fiscal year runs from July 1 to June 30 in Egypt; the column labeled 2017 reflects the fiscal year ended June 30, 2017.

For additional information, please see www.worldbank.org/gep.

BOX 2.4.1 Potential growth in the Middle East and North Africa

The Middle East and North Africa's (MENA) potential growth has been held back by structural challenges over the past decade. These include low labor force participation (especially of women), low economic diversification outside of oil production, and weak private sector dynamism. Potential growth in the region is expected to strengthen somewhat in the coming years, supported by recovery in investment and productivity growth. Continued commitment to reforms, such as those aimed at encouraging diversification, improving governance and business climates, and strengthening fiscal management, has the potential to further improve potential growth.

Introduction

Growth has been uneven over the past decade in the Middle East and North Africa (MENA) region. Like other emerging market and developing economies (EMDEs), the region experienced high growth during 2003-07, which in MENA's case was supported by rising oil prices. However, growth slowed during 2010-14, mainly in response to the effects of political turmoil and military conflict, including Arab Spring revolutions in Egypt, Tunisia, Libya, and Yemen and associated conflict spillovers to neighboring countries, civil wars in Iraq and Syria, and the war on ISIS that halted economic activity and trade. Growth performance decelerated further after the oil price collapse of 2014 (Figure 2.4.1.1).

A key policy question for the region is whether this slowdown has been a temporary phenomenon or reflects deeper-seated structural impediments that will need to be tackled, especially in the context of subdued oil prices. Against this backdrop, this box will discuss the following questions:

- How has potential growth evolved in the MENA region and what were its main drivers?
- What are the prospects for potential growth?
- What are the policy options to lift potential growth?

The literature covering these issues is sparse, but has documented a broad-based decline in potential growth within the MENA region, including both oil exporters and oil importers. Moreover, relative to the EMDE average, this deterioration has been more severe, reflecting low total factor productivity growth and labor supply growth (Mitra et al. 2015; Alkhareif and Alsadoun 2016; IMF 2016e; IMF 2017g). These studies have underscored that reversing these trends requires policies to boost investment, especially in oil importers, as well as steps to improve the business environment, strengthen worker skills, and deepen financial markets (Mitra et al. 2016; World Bank 2017v).

The analysis here also highlights that the MENA region's poor growth performance in recent years has been largely driven by a slowdown in its potential growth, in turn driven by broad-based decelerations in capital stock growth, weak total factor productivity (TFP) growth relative to other regions, and slowing working-age population growth. It highlights, however, that a commitment to structural reforms would help improve potential growth and provide greater scope for improvements in living standards within the region.

Evolution of potential growth and its drivers

Growth in the MENA region declined sharply from 6 percent prior to the global financial crisis (2003-2007) to about 3 percent in 2013-17, and empirical analysis suggests that this was in large part the result of a deceleration of the region's potential growth, a slowdown that was more severe than those experienced by other EMDEs. A production function approach and an alternative estimate based on long-term (5-year-ahead) growth expectations suggest that potential growth during 2013-17 has fallen below its long-term average (1998-2017) rate of about 4 percent (Figure 2.4.1.2).

The recent decline in potential growth occurred against the backdrop of high geopolitical tensions, volatile oil prices, high structural imbalances, and conflict within the region, factors that have contributed to the region's relatively lackluster potential growth performance for at least two decades. However, an important factor behind the more recent slowdown has been investment growth, which more than halved in recent years. In fragile areas of the region, this was compounded by the outright destruction of capital (World Bank 2017w).[1] Also

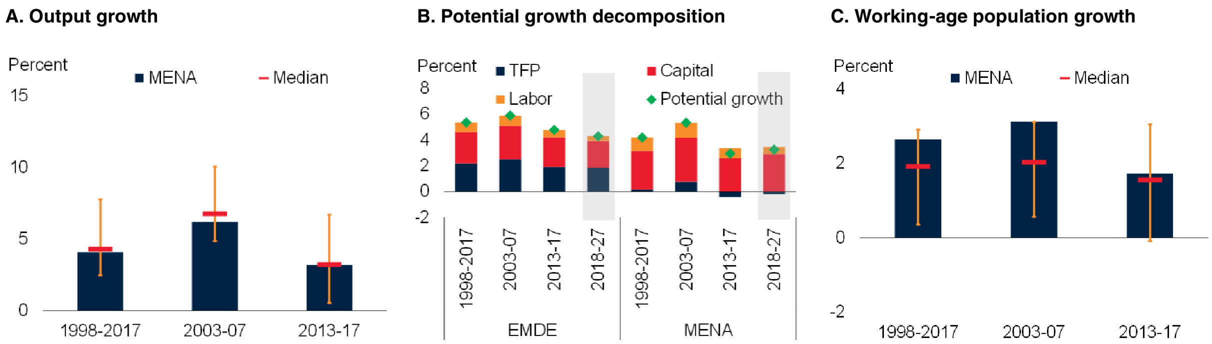
Note: This box was prepared by Lei Sandy Ye, Sinem Kilic Celik, and Modeste Some. Ishita Dugar and Shituo Sun provided research assistance.

[1] In the fragile areas, prolonged crises impose large negative impact on potential output in the short run, followed by a prolonged period of slow growth as economies adjust to their post-crisis growth paths. These countries face a "permanent level loss" in the potential output meaning that the economy eventually would return to its pre-crisis potential growth rate but would fail to recoup all of the lost output.

BOX 2.4.1 Potential growth in the Middle East and North Africa *(continued)*

FIGURE 2.4.1.1 MENA potential growth

The slowdown of MENA's regional output growth in recent years has partly resulted from a decline in its potential growth rate. A wide range of factors have underpinned this slowdown, including weak investment, persistently low productivity growth, and slowing working-age population growth.



Sources: International Monetary Fund, Penn World Tables, United Nations, World Bank estimates.
Notes: GDP-weighted averages.
A. C. Red markers show median GDP-weighted averages of the six EMDE regions and whiskers denote range of regional GDP-weighted averages.
B. Estimates based on the production function approach for 50 EMDEs and 7 MENA economies. See Annex 3.1 for more details.
C. Working-age population refers to population of ages 15-64.
Click here to download data and charts.

contributing were a continued slowdown in labor supply growth and stagnant TFP, the latter related to the region's high reliance on oil production and corresponding lack of economic dynamism.

While the slowdown in potential growth is broad-based across oil exporters and importers, the relative importance of contributing factors varies. In oil exporters, TFP growth has been negative (partly reflecting low labor market efficiency and subsidized energy), capital growth is weak, and employment growth is declining. In oil importers, while TFP, labor supply, and capital growth are all slowing, low investment growth is especially a concern.

However, common to the entire region are female labor force participation rates that are among the lowest in the world. For example, women make up half the population in the GCC and yet represent only about one-fourth of the labor force (Constant 2016). Overall labor force participation rates are also very low outside of the GCC. Moreover, while educational attainment has risen during the post-crisis period, the quality of education, such as measured by primary school proficiency tests, remains low compared to most other regions (World Bank 2017j).

Potential growth: prospects and policy options

Over the coming years, potential growth in the region is expected to strengthen somewhat from its 2013-17 average rate of 2.9 percent. This is predicated upon trend improvements in educational and health outcomes, median fertility projections in population dynamics (as in the UN Population Projections), and continued investment growth at its long-term average rate (Annex 3.1). While projected change in demographic structure is expected to weigh on potential growth, the long-term trajectory of potential growth is marked by considerable uncertainty. For example, unlike many other EMDEs, the youth share of population is currently high (more than a third of the region's population is under the age of 25). This generates a large potential pool of new entrants into the labor force as well as a large consumer base for innovative activity, despite an aging population structure. But such capacity can only be realized to boost potential growth if the private sector is sufficiently vibrant, such as having a flexible labor market and more educated workforce, to create new jobs.

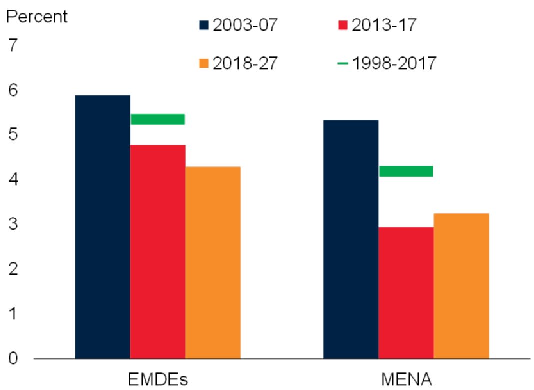
Raising private-sector participation. Looking ahead, the challenge for the region is to tackle the deep-seated structural impediments to sustained and private sector-led growth, the type of growth that allows job creation to support higher per-capita living standards. This will require policies to promote economic diversification; measures to improve the business climate (e.g., the recent introduction of the investment law and industrial licensing act in Egypt and a bankruptcy protection law in the United Arab

BOX 2.4.1 Potential growth in the Middle East and North Africa *(continued)*

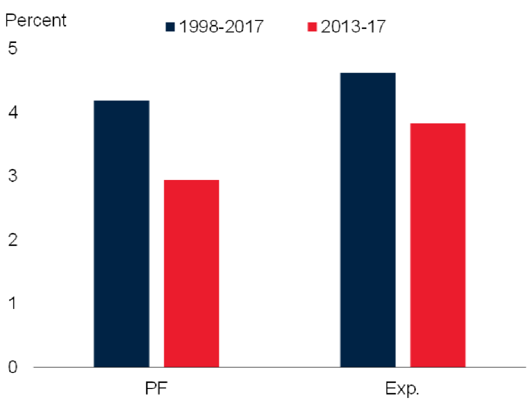
FIGURE 2.4.1.2 MENA potential growth

The slowdown in MENA's potential growth coincided with that of other EMDEs. Both production function and expectations-based measures suggest that post-crisis potential growth was substantially weaker than long-term average potential growth.

A. Potential growth



B. MENA potential growth: Alternative estimates



Sources: International Monetary Fund, World Bank estimates.
Notes: GDP-weighted averages.
A. Production function approach based on 50 EMDEs and 7 MENA economies. See Annex 3.1 for more details.
B. "PF" refers to production function approach (7 economies). "Exp." refers to potential growth based on long-term IMF WEO (5-year-ahead) growth expectations (16 economies).
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Emirates); financial sector deepening; and policies to promote education and skills development.

Reconstruction investment. In fragile economies of the region, reconstruction investment that maintains adequate provision of health, education, electricity, water and sanitation services, remains a high priority (World Bank 2017w). In host countries of refugees, these efforts require adapting to the structural changes that the refugee crisis has brought to their economies, such as adopting more innovative financing mechanisms to fund higher demands for health service delivery (World Bank 2017u).

Improving public sector efficiency. Improving the quality and effectiveness of government will have to be an important part of the reform effort, especially in an environment where fiscal space is limited, public sector employment is excessive, revenue systems are over reliant on oil revenues, and energy subsidies are high. This will require measures to improve the efficiency of public investment, ensuring that broader spending programs deliver "value for money," and a careful review of revenue systems to enhance tax administrations, improve compliance, and cut wasteful and ineffective tax incentives.

Improving governance. Strengthening potential growth also relies on improving the governance environment, as weak governance in the MENA region has been found to crowd-out private investment and discourage private-sector growth (Nabli 2007; Benhassine et al. 2009). Improved governance, such as more structured measurement of results in training and educational programs, enhances the match of skills across workers and employers and may provide more quality jobs in the private sector (Gatti et al. 2013). Weak governance may also be reflected in perceived corruption, which is among a highly-cited constraint to business activity in MENA based on the World Bank's Enterprise Surveys. Higher levels of corruption are associated with lower employment and productivity and may discourage interactions between private firms and public authorities, subsequently deterring allocative efficiency (World Bank 2016k). Strengthening the legal framework, including in areas such as corporate governance and bankruptcy resolution, can alleviate these constraints and facilitate market transactions.

Cross-country experience suggests that education, health, and labor market reforms can yield significant benefits in terms of higher potential growth (Chapter 3). A scenario analysis applied to the MENA region suggests that labor market policies to raise the female labor force participation rates by its largest 10-year improvement historically could

BOX 2.4.1 Potential growth in the Middle East and North Africa *(concluded)*

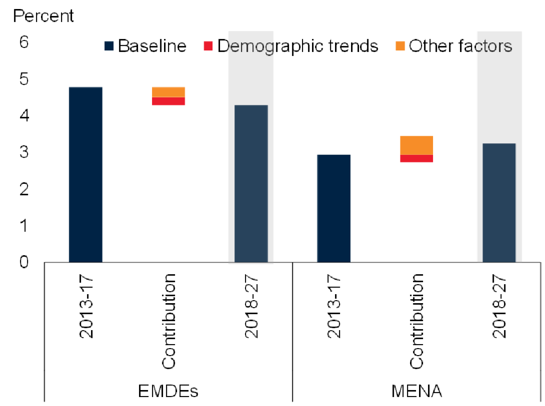
lift potential growth by 0.1 percentage point, while similar steps to address gaps in investment could yield a further 0.5 percentage point (Figure 2.4.1.3). If policy reforms were stronger than historical improvements, the gains realized from these policies could be substantially greater.

The MENA region has made substantial progress in structural reforms in recent years, including the formulation of national development plans to encourage inclusion of women in the workforce (Constant 2016).[2] Multi-pronged approaches through diagnostics, investment climate assessment, value-chain analysis, and labor skills review in areas like North Lebanon may also help lay the foundation for job creation (World Bank 2017x). Early childhood education programs in Morocco are expected to help boost educational attainment. The continued commitment to implementing these reforms will be critical for realizing higher potential growth dividends in the coming years.

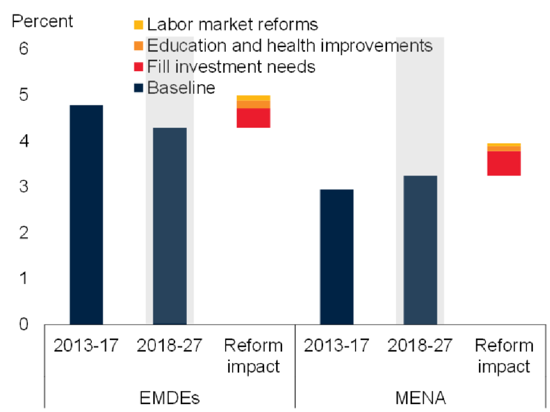
FIGURE 2.4.1.3 Policies to stem weakness in potential growth

Potential growth in MENA is expected to strengthen somewhat over the coming years, partly reflecting improvements in investment and productivity. However, reforms that boost investment, labor market participation, or educational and health outcomes have the capability to further improve potential growth.

A. MENA potential growth



B. MENA potential growth under reform scenarios



Source: World Bank estimates.

Notes: GDP-weighted averages. Derived using the production function-based estimates of potential growth (see Annex 3.1).

A. "Other factors" reflects changes unrelated to population structure. See Annex 3.1. for methodology.

B. Policy scenarios are described in methodological Annex 3.1.

Click here to download data and charts.

[2] The World Bank and other international financial institutions have also participated in these efforts, such as by adopting the Women Entrepreneurs Finance (We-Fi) initiative, a multilateral financing facility; the Tunisia Youth Economic Inclusion Project to boost young workers' prospects; the Jordan Innovative Startups Fund Project to boost entrepreneurship; or the Concessional Financing Facility (WB-UN-Islamic Development Bank) to facilitate refugee host country development.

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