

## BACKGROUND NOTE

### Thematic Session 3: Bringing Young People into the Labor Market<sup>1</sup>

*This note provides a brief overview of the challenges that the Arab Countries in Transition (ACTs) face concerning youth employment, and discusses key areas in which education and labor market reforms are needed. Given countries' different problems and starting conditions, solutions will vary across countries.*

#### I. THE CHALLENGE

**Unemployment in the Middle East and North Africa (MENA) region is the highest in the world.** Unemployment, estimated for 2013 at 12.2 percent in North Africa and 10.9 percent in the Middle East, is persistent and rising. In the ACTs alone (Egypt, Jordan, Libya, Morocco, Tunisia, Yemen), the overall number of unemployed rose by more than 1.5 million since 2010; though Morocco and Tunisia have seen a stabilization in unemployment rates. At the same time, labor force participation is very low, especially among women. The participation rate in the ACTs over the past decade has been below 50 percent, compared with more than 60 percent in emerging and developing countries (IMF, 2014; Abdih, 2011; Ahmed and others, 2010).

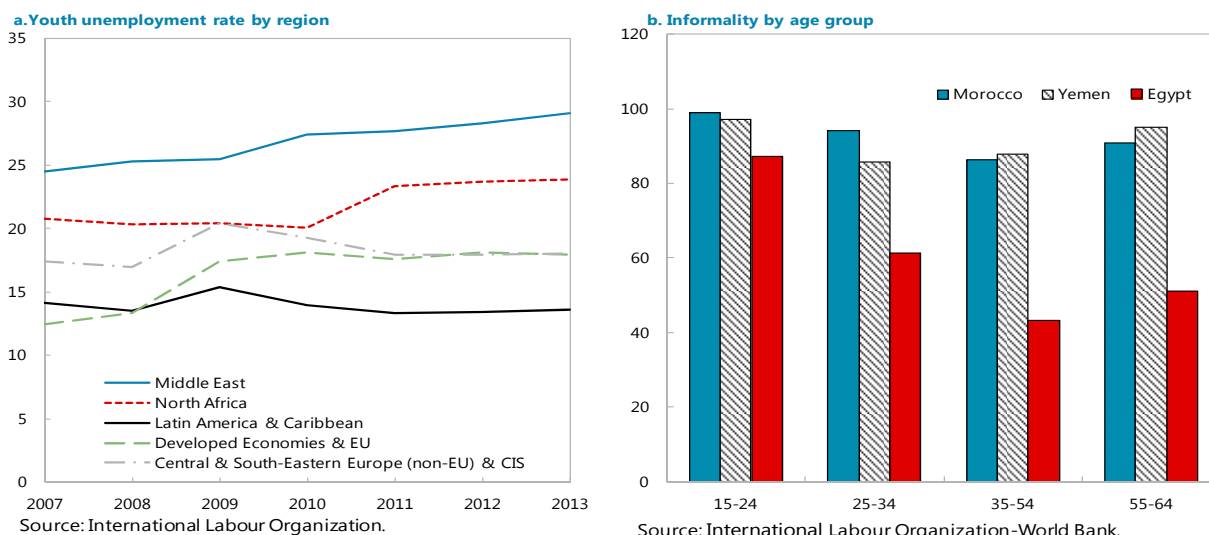
**A large share of employment is informal.** Informal employment is often characterized by low productivity, inadequate working conditions, high labor turnover, and limited opportunities for investment and business growth. On average, a third of GDP is produced informally and 67 percent of the labor force is employed informally in MENA (Gatti and others, 2011).

**Youth are at a disadvantage.** Because they have little work experience and networks, and because they are “learning the ropes”, youth are particularly likely to be unemployed, employed informally or in low-paying jobs (Figure 1a and 1b). For many, the transition from school to work has become protracted. In the ACTs, these issues have been exacerbated by several years of slow growth—and the growth outlook is unlikely to change quickly in a way that would make a qualitative difference.

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<sup>1</sup> This Note was written by Gaëlle Pierre with excellent research assistance by Daniah Orkoubi. It benefitted from comments from Daniela Gressani, Bjorn Rother, Chris Jarvis, and Carolin Geginat. **This Note should not be reported as representing the views of the IMF.** The views expressed are those of the author(s) and do not necessarily represent those of the IMF or IMF policy.

**Figure 1. Poor Labor Market Outcomes**



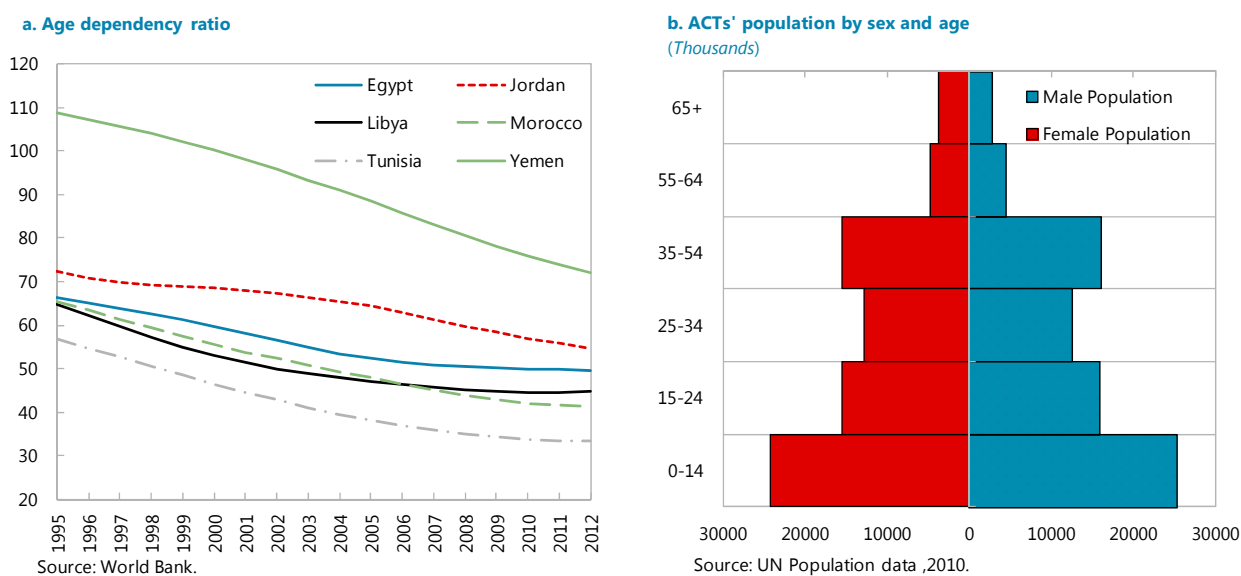
**High youth unemployment has long-term consequences.** Evidence suggests that youth who do not transition smoothly from education to employment can suffer long-term consequences to their productivity and on their likelihood of finding a job in the future, in addition to the immediate effects associated with income loss (Mroz and Savage, 2006). In addition to the negative impact on individual earning potential, this implies that youth unemployment can have a lasting effect on a country’s potential growth and income.

**Time is of the essence to capitalize on the demographic dividend.** The MENA region has one of the highest shares of youth in its total population. The age dependency ratio—the ratio of the non-working groups (0–14 and 65+) to the working-age population (15–64)—has been declining steadily over the past 30 years (Figure 2a). Even though the rate of new entrants into the labor market has been slowing down recently, large cohorts are preparing to enter the labor market over the next several years (Figure 2b). With policies geared toward including new labor market entrants into the labor force, such demography can lead to higher growth (Roudi, 2011).

**The youth do not want to wait.** Young people – especially after the Arab uprisings – have high expectations, which are difficult to satisfy in the context of economic transformations that take time to produce tangible improvements to unemployment and living standards.<sup>2</sup> There is significant potential for socio-political conflict in this tension (Burson-Marteller, 2013 and 2014; Dhillon and Yousef, 2009).

<sup>2</sup> Recent opinion polls in ACTs suggest that only about half of youth believe their country is going in the right direction; more than 70 percent of youth believe government should subsidize energy; around 70 percent of youth in five out of the six ACTs believe young people of their generation are more likely to start a business; and a small but increasing majority of youth embraces modern values.

**Figure 2. The Demographic Dividend**



## II. A POSSIBLE WAY FORWARD

Youth will benefit from policies that bring higher job creation: improving the business climate and addressing public policy distortions so that private enterprises can grow are of fundamental importance to reduce unemployment overall.<sup>3</sup> Reforms in education and in labor market policy are also needed to promote youth employment.

### A. Overcoming key issues hampering educational systems

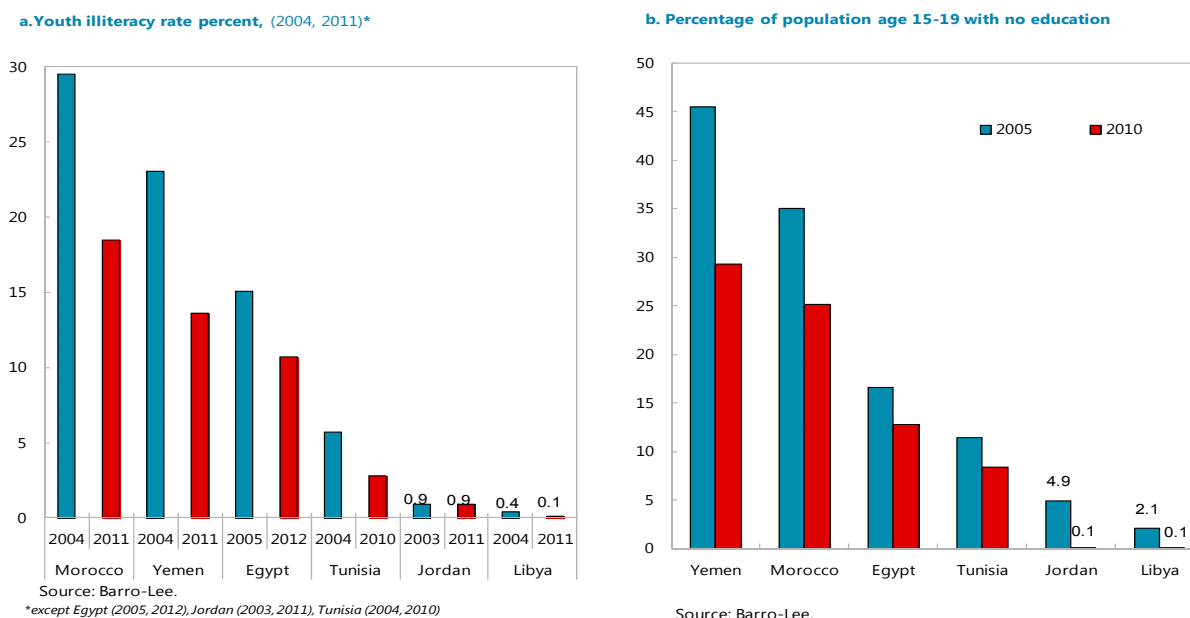
**The educational attainment of ACTs' populations has been steadily improving.** More and more people are becoming educated (Figures 3a, 3b), and girls have been catching up with boys. For example, the gender parity rate for literacy improved in all countries.<sup>4</sup>

**However, students are not getting a good-quality education.** For ACTs for which data are available, the number of children failing international literacy and numeracy assessments at Grades 4 and 8 are striking: 91 percent of primary-level children are not learning in Yemen; this number is 76.5 percent in Morocco and 65 percent in Tunisia. At the secondary level, 64 percent in Morocco and 44.2 percent in Tunisia are not learning; in Jordan the number is 47.9 percent (Brookings, 2014).

<sup>3</sup> Public policy distortions often benefited a small group of privileged firms in non-labor-intensive sectors. Severe and persistent market failures (business environment, energy subsidies, access to land or credit) have impeded the emergence of a dynamic private sector and the creation of jobs.

<sup>4</sup> World Bank data show the ratio of women's literacy rate to men's literacy rate increased from 0.07 to 1 in Libya; 0.64 to 0.83 in Morocco; 0.83 to 0.98 in Tunisia; and 0.43 to 0.79 in Yemen between 1994 and 2011.

**Figure 3. Improvements in Educational Attainment**



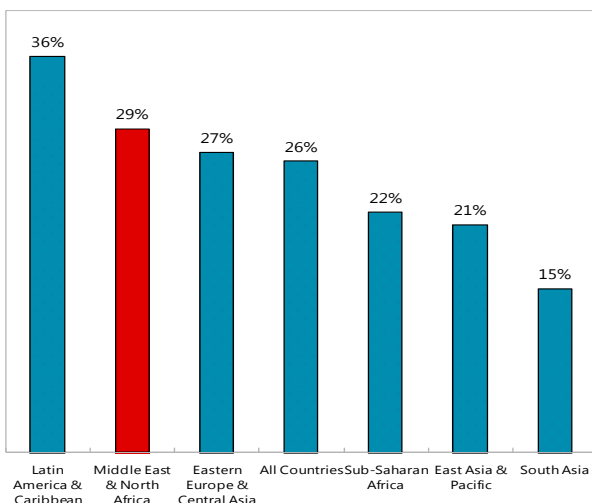
**In MENA, students are not acquiring the skills needed for success in the private sector.** Close to a third of employers report that skill shortages are a major constraint for them in MENA (Figure 4a). The reasons are well known. Curricula are disconnected from the needs of employers; and are geared towards rote learning in order to pass entrance exams for universities rather than towards skills for the labor market. Vocational curricula are developed without the input of the private sector, and provide inadequate skills. Moreover, university education is seen as a panacea by students, who disproportionately choose academic courses, as well as by employers, who take university diplomas as an indicator of student quality (World Bank, 2013a,b; Dhillon and Yousef, 2009).

**In addition, workers are offered few opportunities for lifelong learning.** Once in employment, workers have limited opportunities to improve their skills, as only about 30 percent of firms provide formal training to their workers. This compares with more than 40 percent in East Asia and the Pacific (Figure 4b).

**Well designed education reforms could help.** Several ACTs have already started reforming their education systems, but all need to step up such efforts (World Bank, 2008; Dhillon and Yousef, 2009). Three elements of education reforms deserve to be highlighted: improving the quality of education (for example through improving teachers pay and training; moving away from rote learning; and reviewing curricula to include a broader range of competencies such as problem-solving, learning, communication, personal, and social skills); taking an overall approach to skills formation, from basic education to entry into the labor market; and linking education curricula, especially in vocational schools, to private sector needs, which is crucial to improving the school-to-work transition for youth.

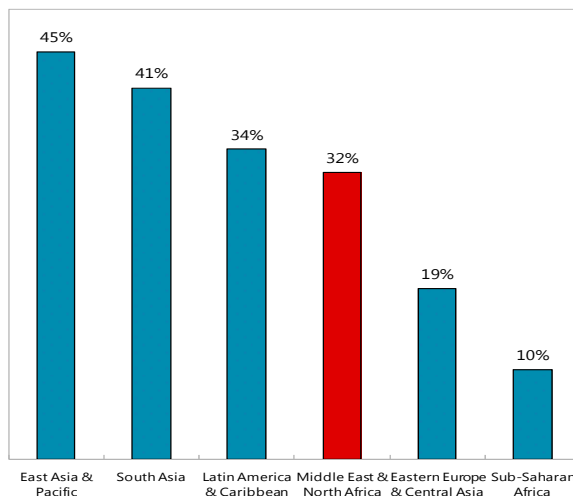
**Figure 4. Quality of Education and Skills Do Not Meet Employer's Needs**

**a. Percent of firms identifying an inadequately educated workforce as a major constraint**



Source: World Bank, Enterprise Surveys.

**b. Percent of firms offering formal training**



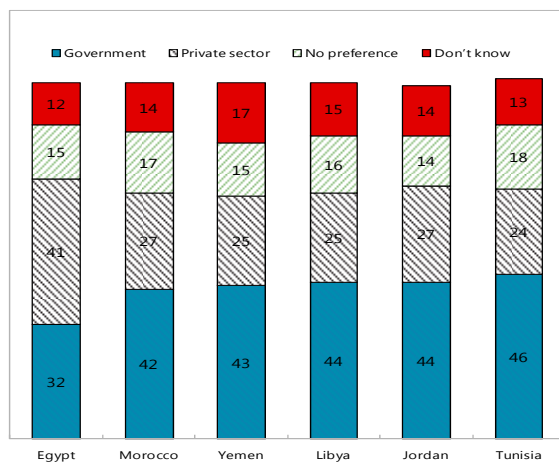
Source: World Bank, Enterprise Surveys.

## B. Overcoming labor market failures

**Large distortions in the labor market through large public sectors.** Despite decreasing opportunities, public sector employment, with high wages and benefits, remains a more attractive option for students in MENA countries than jobs in the private sector (Figure 5a). This leads to a situation where youth keep living with their parents and prefer to wait rather than look for employment elsewhere (Figure 5b) —except the poor, who are forced to accept low-paying and informal jobs (Bodor, 2010).

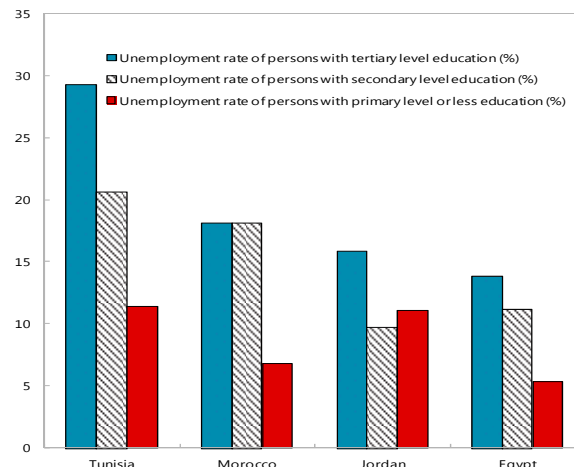
**Figure 5. Distorted Labor Markets**

**a. Would you prefer to work for government or for the private sector?**



Source: Arab youth survey, Buson-Marteller, 2013.

**b. Unemployment rate by level of education**



Source: World Bank.

**Firms report labor market regulations as a business constraint.** Enterprise surveys show that 23 percent of firms in the MENA region perceive labor regulations as a major constraint, by far the highest share among the world's regions. For example, 24 percent of employers in Egypt would increase their hiring in the absence of restrictions, while only 3 percent would fire workers (AfDB, 2012a). Youth, and, especially women, are disproportionately affected by labor market regulations, which tend to raise the cost of labor. These groups are less likely to be hired, and more likely to be in temporary and precarious jobs (Kahn, 2007).

**Minimum wage laws could discourage hiring of younger workers.** Setting wage floors helps promote good quality jobs and reduce poverty among workers. But it can also reduce the employability of low-productivity workers if wages are set too high. The disemployment effects of minimum wages are typically concentrated among those they are intended to support: young, low-skilled, and female workers. Introducing a discounted minimum wage for youth can reduce their informal employment and improve their job prospects. In Tunisia, for instance, the minimum wage rate for juvenile workers is 85 percent of the rate applicable for adults.

**Severance pay is used as compensation for unemployment risk.** In the ACTs, regulations governing firing are not especially burdensome. Notice periods are within typical ranges and all ACTs now allow firing for redundancy reasons (Doing Business Database, 2014). At the same time, firing costs remain high. This is largely explained by the fact that, in the absence of unemployment insurance schemes, severance pay is used as a compensation for unemployment risk. However, in addition to representing high costs for business, such payouts provide inadequate coverage against unemployment risk for workers and are regressive.<sup>5</sup> Severance payments are particularly inadequate for the youth, who tend to have repeated, short unemployment spells.

**Weak enforcement of labor regulations leads to an uneven playing field.** Labor regulations apply to formal sector workers only. Their coverage is therefore limited, as formal employment in the private sector is often a small share of total employment. Moreover, the regulations are not enforced consistently, even for formal firms. In Tunisia, for example, rules and procedures for laying off workers for economic and technological reasons are complex and rarely used (AfDB, 2012b).

**Well-designed active labor market policies (ALMPs) can help to offset youth disadvantages on the labor market.** There is evidence that vulnerable groups such as youth can benefit from programs that are targeted to their needs. For example, training or wage subsidies directed at vulnerable youth can significantly increase their chances of getting employment. Such programs have been developed in several ACTs. When developing ALMPs, it is important to adopt and adapt best practices (for example, targeting, training content, coordinating the roles of the public and private sectors), to combine ALMPs for greater effectiveness, and to plan for appropriate evaluation and monitoring. The success of ALMPs is ultimately contingent on having a successful jobs and growth strategy (ESCWA, 2012).

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<sup>5</sup> This is because they are linked to tenure and provide low benefits to workers with short employment spells; and they tend to be poorly enforced even among formal sector workers: only a fraction of workers are de facto covered by them—often the more educated ones, which makes severance payments regressive.



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