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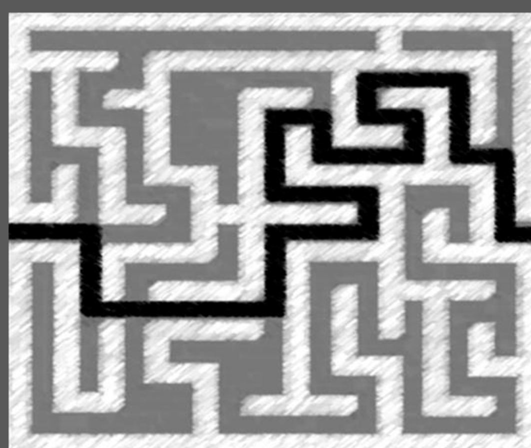
Predictions, Perceptions and Economic Reality



Challenges of seven Middle East and North Africa countries described in 14 Charts

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Predictions, Perceptions and Economic Reality

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This issue of the MENA quarterly brief assesses the macroeconomic performance of seven of the MENA countries: Egypt, Tunisia, Iran, Lebanon, Jordan, Yemen and Libya. All of these countries experienced rapid economic growth during 2000-10, and suffered a sharp economic slowdown in the aftermath of 2011. The brief focuses on the challenges facing these countries with a closer look at the actual growth performance in comparison with their forecasts and highlights the limitations of forecasting in the wake of the 2011 uprisings; and at the consequences of the growth slowdown, including unemployment, where perceptions may diverge from reality. The story is told in fourteen charts.

ACKNOWLEDGMENTS

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Predictions, Perceptions and Economic Reality

Challenges of seven Middle East and North Africa countries described in 14 Charts

The macroeconomic performance of seven countries--Egypt, Tunisia, Iran, Lebanon, Jordan, Yemen and Libya–stand out among the diverse countries of the Middle East and North Africa (MENA) region. All of these countries experienced rapid economic growth during 2000-10, and suffered a sharp economic slowdown in post 2011, as a result of several economic and political factors. This issue of the Quarterly Economic Brief looks at the actual growth performance of these countries and highlights the limitations of forecasting in the wake of the 2011 uprisings, at the consequences of the growth slowdown, including unemployment, where perceptions may diverge from reality. The story is told in fourteen charts.

Recent developments

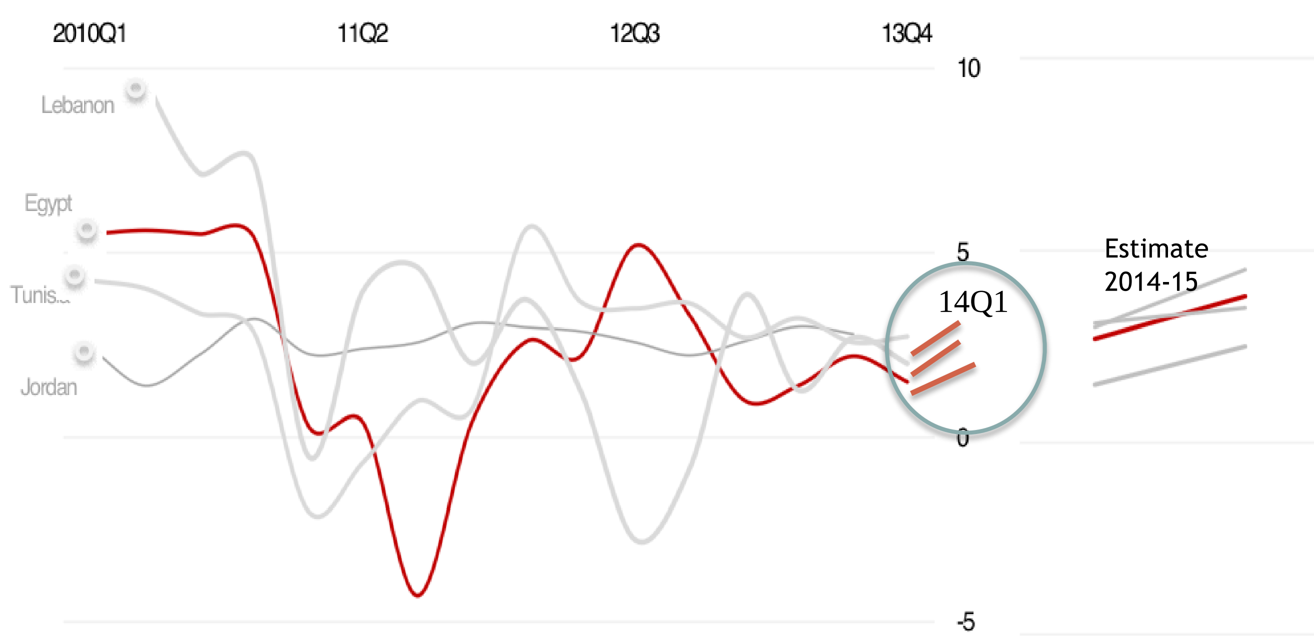
Since the World Bank's MENA Regional Economic Update published in April, there have been incipient signs of economic improvement in some of the MENA 7 countries. Economic growth in Egypt and Tunisia has started to rebound after slowing in the previous year. Easing political tensions appear to have stimulated economic activity in these countries, as Egypt elected the new President in May, and the parliamentary elections in both countries are expected to be held later this year. The official data as of June showed that the Egyptian economy grew by 2.5 percent (q/q) in the third quarter of fiscal year (FY) 2014 (January-March), similar to the growth rate achieved in the same period of last year, but up from 1.2 percent average growth during the first half of FY2014. GDP growth in Tunisia increased in the first quarter of 2014 after a slowdown in the last two quarters of 2013 (See figure below).

There are signs that remittance inflows and tourism revenues have been rising for Egypt. Official data show that net Foreign Direct Investment (FDI) in Egypt rose by 71.2 percent in the first quarter of 2014 (January-March 2014) compared to the same period of last year. The large bulk of the increase in FDI inflows came from the Euro area including Germany, France, and the UK, and also Saudi Arabia and UAE. Total net FDI inflows reached $4.7 billion in the first nine months of the FY ended in June, an increase by 30 percent over the same period of the previous year. Still, FDI inflows remain well below the pre-revolutionary period. Further, remittance inflows in Egypt have increased to $4.7 billion in the third quarter of the current FY (started in July) from an average $4.2 billion in the previous two quarter, but in line with the level of remittances received during the third quarter of FY13. On the other hand, tourism has been badly hit by the political events in Egypt since early July 2013. Thus tourism revenues dropped to $15.5 billion in the third quarter of FY14, compared to $25 billion in the same quarter a year earlier. It is worthy to note, however, that the rate of decrease in tourism revenues has started slowing gradually with the improvement in security conditions and foreign offices lifting travel bans on Egypt.

Elsewhere, the government of Iran has recently announced a comprehensive economic package to stabilize the economy and boost growth. The economic package that includes a series of reforms in the regulatory environment, and the tax system intends to attract FDI, boost non-oil exports, promote tourism, and restore fiscal discipline. There have been some signs that economic activity is improving after a serious decline due to the tightening of the international sanctions and mismanagement of the economy. Official data show that tourist arrivals have doubled in the first quarter of the new Iranian year (March – May 2014) compared to the same period of last year. The inflation rate has been halved to 23 percent in early 2014, from its high rate of 45 percent registered last July. Official quarterly data are not available for Iran, but estimates show that real GDP growth appeared to have been rebounding in the first half of FY 2014/15 after two consecutive years of sharp contraction. While short term risks remain, the IMF has forecast growth of between 1-2 percent for FY 2014/15 (started in March).

Growth performance in selected MENA 7 countries

Real GDP growth rate (quarterly and annual), percent



Source: National official sources and World Bank.

Official quarterly data for Jordan show some positive signs of improvements in economic activity on the back of the increase in public spending and private consumption both of which were supported by the Gulf grants. Tourism activity is improving after years of slowdown, with increases of about 7 percent in the number of arrivals in the first quarter of 2014 compared to the previous quarter. Further, remittances have increased by 3 percent in the first six months of 2014 compared to the same period of last year. In Lebanon, tourist arrivals (from Arab countries) picked up in June after Gulf countries lifted their ban against travel to Lebanon. Despite the volatile political environment, estimates for 2014 show that Lebanon's real GDP growth is expected to double its rate in 2013 and reach 1.5 percent this year. However, this rate remains far below the growth rate of about 9 percent registered in 2009-10.

In Yemen and Libya, the economic situation has remained lackluster due to growing insecurity. Libya is still gripped by instability and the battle between the militia and the government is holding back economic activity in the country. Oil production (a major contributor to the government's finances and output) is still low - at 500 thousand barrels per day (bpd) in July - compared to the pre 2011 level of about 1.4 million bpd. There is growing speculation that oil production can increase within the next year provided that the ongoing violence subsides. However, production recovery could take longer due to the extensive repairs and maintenance that would be needed. Finally, in Yemen crude oil production and export revenues continue to decline due to sabotage in the oil fields. During the first five months of 2014, government oil revenues halved compared to the same period of last year. This situation has deteriorated the government's finances forcing it to rely on domestic borrowing. Domestic debt, which increased to 33 percent of GDP in 2013 from 29.9 percent of GDP in 2012, is expected to increase to 34.5 percent this year and total public debt is expected to reach 48.2 percent of GDP.

Recent political and economic developments are mixed and expected to affect the short term prospects of these countries in different ways. On the regional front, the recent crisis in Iraq, where militants from the Islamic State of Iraq and alSham (ISIS) have been controlling large areas in Iraq and Syria, has curtailed trade with neighboring countries such as Jordan, and Lebanon. Iraq is an important export market for Jordan, representing 20 percent of total Jordanian exports. Exports to Iraq doubled during the last few years from US$530 in 2007 to around US$1 billion in 2012. The decision to close the Jordanian – Iraqi border in late June, for security reasons, would adversely affect both Jordanian and Iraqi trade volumes. For Lebanon, Iraq is both a trading partner and a transit route to the Gulf, and the ongoing Iraqi crisis has blocked Lebanese exporters' access to Gulf markets. The latest conflict in Gaza has also created a serious humanitarian crisis which has adversely affected not only that economy but also neighboring countries such as Egypt.

On the global front, the World Bank has revised its 2014 growth projections for developing countries downward by 0.5 percentage points to 4.8 percent from 5.3 percent in January. Among these countries, China is expected to grow by 7.6 percent this year, though slightly lower than 7.7 percent estimated for last year, still reasonable for the MENA 7 countries' trade relations. Quarterly data show that growth in the second quarter of 2014 in China was in line with expectations. China is one of the top trading partners for most of the MENA 7 countries particularly Iran, Libya and Yemen. The overall global recovery will continue its pace in 2014 and 2015 due to improvements in economic activity in advanced countries, particularly the Euro Zone. The EU is an important trading partner, especially for Tunisia accounting for 62.9 percent of trade in 2012 and 22.9 percent of Egypt's trade in 2013.

Meanwhile, the six-month interim deal between Iran and the P5+1 group that took place in January has been extended for four months. The possibility of a comprehensive nuclear deal with the lifting of sanctions and easing of oil exports could add one million barrels or more of Iranian oil to the global oil market. The additional supply could likely soften oil prices, but the total effect remains to be seen depending on global demand and supply. On the supply side, there are major players, including Russia, the U.S. and OPEC that supply over 40 percent of the world's oil. Compared to the other two countries, OPEC has an output ceiling, and it is still unclear how the group would react as it has to both accommodate the additional output from Iran and keep oil prices from falling. Most of the GCC and developing oil exporters in MENA need an oil price of at least $100 per barrel to keep their fiscal budgets in balance.[1] On the other hand, geopolitical tensions especially in Iraq and Libya (that have kept 1 million barrels off the global market), and Russia's conflict over Ukraine could increase the "risk premium", keeping international oil prices elevated.

Notwithstanding these developments, economic estimates are optimistic about the growth recovery in Egypt, Tunisia, Jordan and Iran in 2015 and economic activity could likely resume in the rest of the MENA 7 countries provided that security concerns subside in Libya, Lebanon and Yemen. However, the pace of the projected growth remains far below the rate of the rapid growth that all of the MENA 7 countries experienced in the 2000s. Moreover, the sustainability of growth remains uncertain as these economies have been long suffering from structural problems which have restrained them from moving to a higher and sustainable growth path. The story is explained in the next 14 charts.

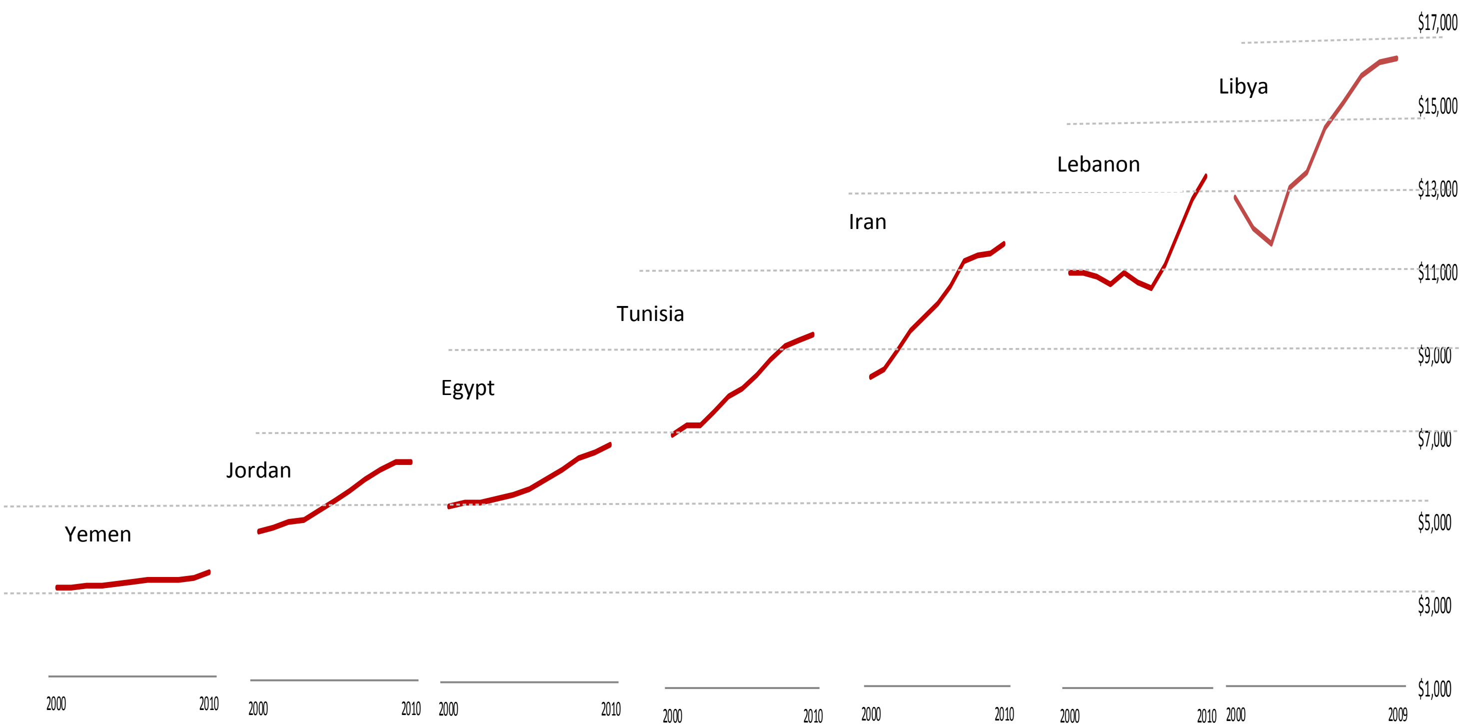
[1] The Gulf Cooperation Council (GCC-6) countries; Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and United Arab Emirates, and developing oil exporters include Algeria, Islamic Republic of Iran, Iraq, Libya, and Yemen.

14 Charts to Describe the Challenges Facing the MENA 7 Countries

Historical growth trends show that most of the MENA 7 countries were enjoying rapid growth rates at the time of the 2011 revolutions. In the 2000s most of these countries took advantage of the high oil prices starting in 2003, the strong interest of global investors in MENA, combined with a positive trend in tackling some reforms. These factors allowed these countries to grow at an average rate of more than 5 percent for a decade, particularly in Egypt, Tunisia, Iran, Lebanon, Jordan, Libya and Yemen. Most international and national forecasters predicted that this rapid growth would continue.

1. Prior to 2011, GDP per capita was growing steadily for majority of the MENA 7 countries.

GDP per capita constant 2005, USD

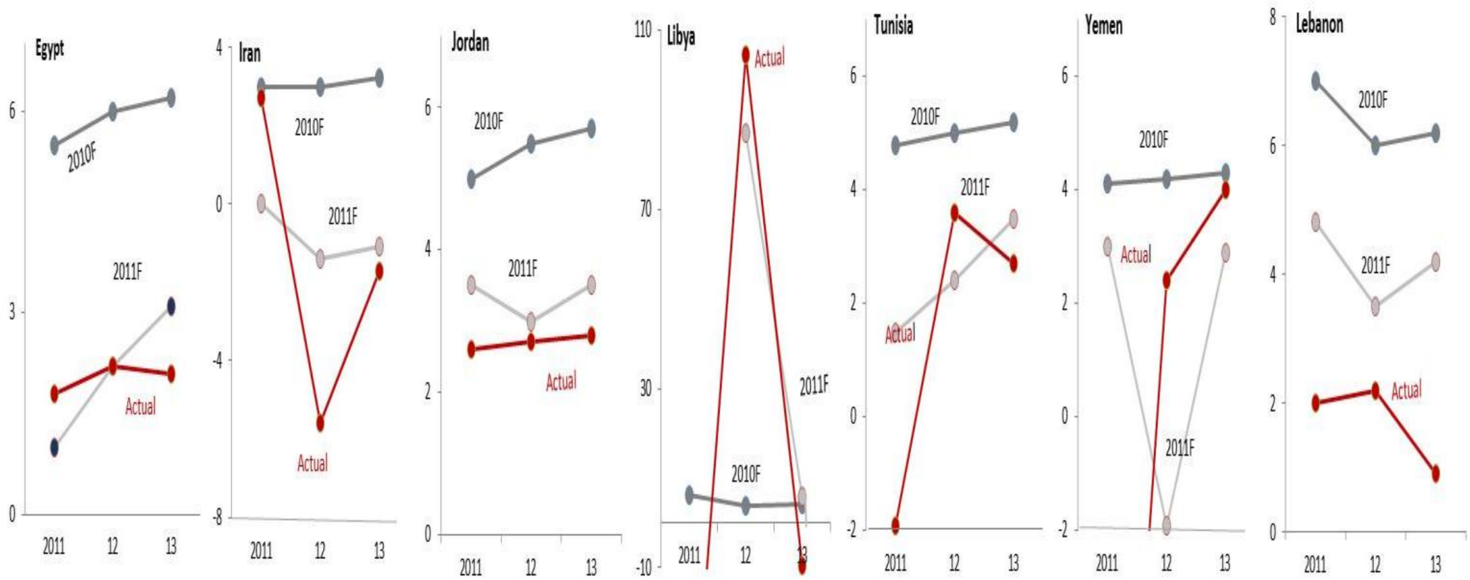


Source: World Bank.

In Egypt, Tunisia, Lebanon and Jordan, real GDP growth exceeded 6 percent for some years. While economic growth slowed slightly in 2009 due to the global financial crisis (except for Lebanon where real GDP grew by 1 percentage point in 2009), these economies avoided a major economic downturn because of their weak integration with the rest of the world. In 2010, growth recovered in almost all 7 countries; they grew by more than 5 percent with Lebanon and Yemen growing at 7 percent. In line with the robust trend of the rapid growth in the 2000s, major international and national forecasters projected that these countries will continue to see rapid growth over the period of 2011-13.

2. But the 2011 events in the region highlighted the limits of these forecasts.

Real GDP growth rate, percent

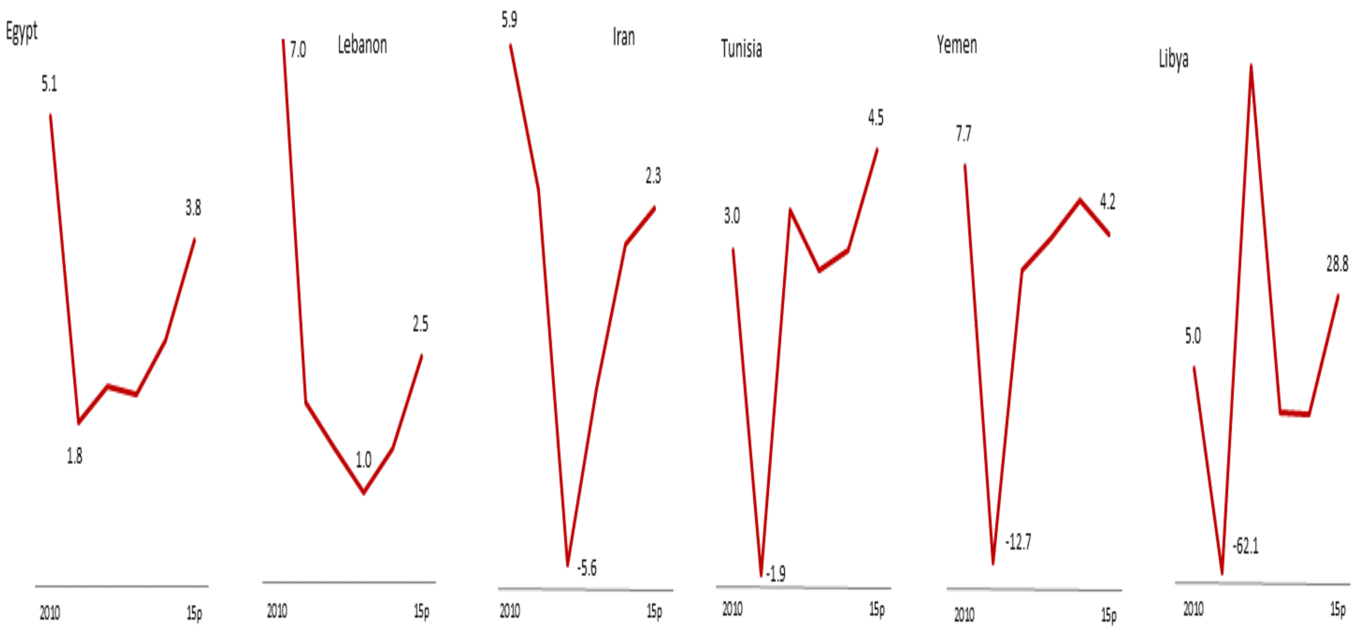


Source: World Bank. Note: F stands for forecast.

After the 2011 Arab Spring, growth projections for the 7 countries were revised downward. Forecasts for Egypt, Tunisia, Lebanon and Jordan were reduced sharply in 2011. Projections from the World Bank in 2010 showed that the Egyptian economy was expected to grow at 5.5 and 6 percent in 2011-2013. The projection from September 2011 was cut by more than 3 percentage points, to 2.2 percent. Similarly, in October 2010, Tunisia was expected to grow by almost 5 percent in 2011-12. These projections were reduced by more than 3 percentage points for 2011, and another 2.5 percentage points for 2012-13. Actual growth for Egypt and Tunisia was 1.8 percent and *negative* 2 percent for 2011 respectively. Growth for Jordan and Lebanon was forecast to be around 6 to 7 percent for 2011-13; growth rate forecasts were cut by half for both countries and reduced sharply for the rest of the MENA 7 countries.

3. And MENA 7 countries suffered a growth slowdown between 2011 and 2013.

(Real GDP growth rate, percent)



Source: World Bank, p stands for projections.

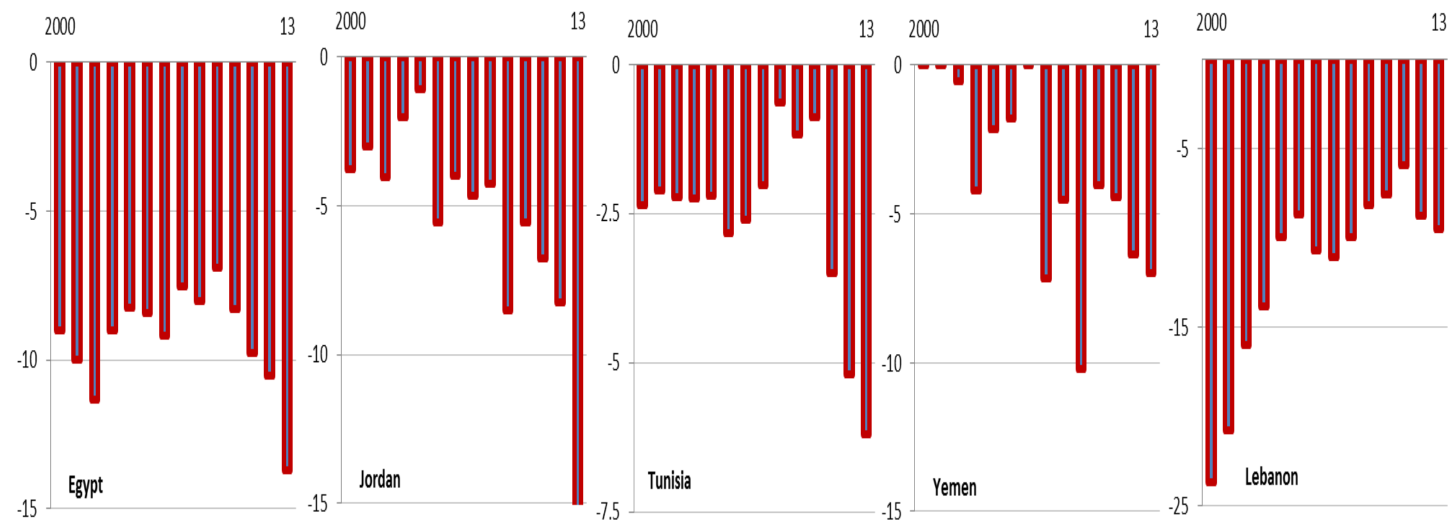
The wide divergence between actual growth and the estimates, particularly after the 2011 uprisings, suggests that these forecasts were over-optimistic. It should be noted that "optimism bias" is common among forecasters including major international institutions where they also missed the early signs of the 2008 financial crisis.[2] There are two reasons for this: first, forecasting models are not sensitive to current developments and new information that becomes available at the time of the forecasting. Further, forecasters tend to overlook the economic booms and busts particularly sudden shifts caused by political and geopolitical change. Second, the inaccuracy of forecasts seems to be sticky; optimistic growth forecasts remain optimistic, pessimistic forecasts remain grim, and over-optimistic forecasts remain over-optimistic over time.

The 2011 uprisings highlighted the limitations of growth forecasts. They neither recognize the alarming signs nor account for structural breaks and exogenous shocks. Although some structural breaks cannot be predicted at all, it is important for forecasters to spot the alarming signs as they happen. Therefore, recent growth forecasts for the MENA 7 countries that show a mild economic recovery underway in 2014-15 should be interpreted cautiously since we also had rosy forecasts for these countries in 2010.

[2] General Accounting Office (GAO), 2003, International Financial Crises: Challenges. Remain in IMF's Ability to Prevent and Resolve Financial Crises, GAO-03-734, Washington.

4. The growth slowdown has been accompanied by an increase in fiscal deficits.

Fiscal balance as percentage of GDP, ((-) deficit)



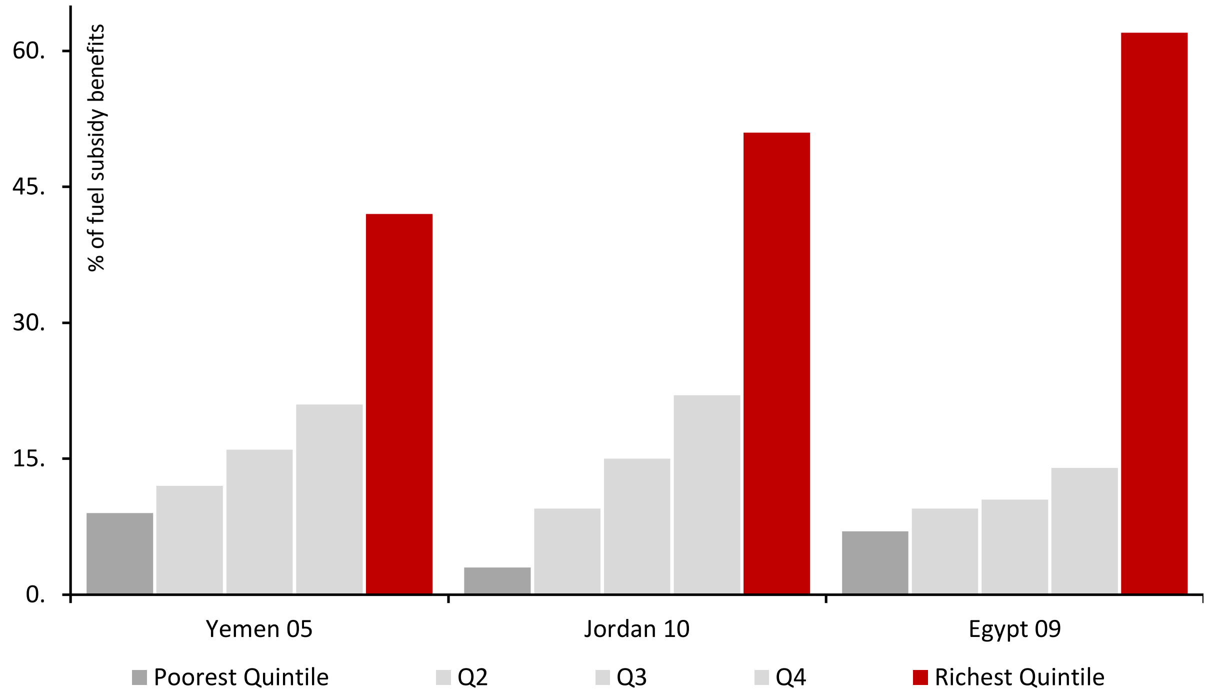
Source: World Bank.

In response to popular discontent in the region, governments increased spending--particularly on fuel and food subsidies and the public sector wage bill--putting further pressure on government budgets.. For example the bulk of the 2014 budget deficit in Libya goes to subsides and salaries. Gross government debt has also increased substantially after 2011 to finance the budget deficit, particularly in Egypt where official data show that the stock of total (domestic and external) government debt to GDP ratio remains elevated and unsustainable at 88.8 percent at the end of March 2014, in line with its ratio a year earlier, but around 9 percentage points higher than its level at the end of FY2010, before the January 2011 revolution. In Jordan, public debt increased by 6 percentage points in the first quarter of 2014 compared to the same quarter of the previous year.

An effective way to lower the fiscal deficit is to remove fuel subsidies and replace them with cash transfers that are targeted to the poor. This could produce significant fiscal savings and lower the burden on these countries' budget. Part of the fiscal savings could be used to strengthen the social safety nets accompanied by an increase in spending both on health and education. Of course, governments need to put an extensive preparedness plan in place to raise public awareness about the subsidy removal in advance.

5. Large fuel (and food) subsidies have burdened the government's public finances

Allocation of fuel subsidies: Fuel subsidies have mostly benefitted the rich



Source: World Bank.

General subsidies including fuels and food account for more than 10 percent of GDP and at least 20 percent of total expenditures in all MENA 7 countries (except in Iran where general subsidies have been replaced by universal cash transfers since 2012). For example, food and fuel subsidies in Libya exceed government's social spending on health and education; Egypt spends seven times more on fuel subsidies than on health. Yemen spent a third of its revenue on general food and fuel subsidies in 2013. While there have been some efforts to rationalize subsidies in Jordan, Tunisia and Egypt--the new government of Egypt has proposed a budget cut of about $6 billion in the new draft state budget by reducing energy subsidies (See Box 1)--reform remains a thorny issue in the rest of the MENA 7 countries.[3]

[3] There have been some efforts to rationalize subsides in Yemen and the government raised the official price of petrol by 60 percent to 200 Yemeni Riyals per liter at the end of July.

Box 1. Energy Subsidy Reform in Egypt and Tunisia

On July 5, 2014 the Government of Egypt approved comprehensive price increases for fossil fuel to curb the rising budget deficit. The price hike which ranged between 12 to 80 percent (the price increase is highest for electricity and natural gas which increased more than 140 and 170 percent, see table 1) is an important step to reduce the massive energy subsidies, currently standing at 7 percent of GDP and 22 percent of total government spending. It should be noted that, with these price increases, gasoline in Egypt is still US$ 0.22 per liter, or about one quarter of the world market price. Nevertheless, the subsidies reform is expected to lower the budget deficit to 10 percent in 2014/2015 (compared to an estimated budget deficit of 12 percent in FY2014). In the new budget the allocation for fuel subsidies is reduced to LE100 billion compared to LE135 billion last year, a reduction of 30 percent, about 3 percent of GDP. This reform package is intended to move resources from consumption to investment with growth inducing potential. Estimates by the World Bank show that the energy subsidy reform could reduce consumption by 1.2 percent and investments are expected to rise by 19 percent.

While the reforms are necessary to address Egypt's sizable fiscal deficit, and to ensure the long term sustainability of the energy sector, they will undoubtedly affect people who consume fuel and electricity both directly as well as indirectly. As a mitigation measure, the government will allocate some of the fiscal savings from these reforms to health, education, and social protection measures such as targeted cash transfers, including a scale-up of existing program are being considered. As the price reforms do not touch LPG that constitutes a substantial proportion of the household energy basket, the direct poverty impact is moderate.

Egypt has an inefficient system of subsidies for commodities such as petroleum and flour that is hugely expensive. Government's spending on energy subsidies has increased substantially over the past decade reaching 22 percent in FY2013 from 9 percent in FY2002. The share of fuel subsidies in GDP has increased dramatically to 7 percent of GDP in FY2013 from 3 percent in FY2002. However, in terms of the impact on the poor, the energy subsidies have supported the wealthier rather than the poor. An estimate for FY2009 showed that more than 60 percent of the fuel subsidies went to the richest quintile of the population while the poorest quintile received only 7 percent of the subsidies (chart 5). In addition, fuel subsidies have had a corrosive effect on several aspects of the economy. They have encouraged energy-intensive industries, which are also capital-intensive, thereby hurting employment-creating industries. Furthermore, subsidized gasoline prices encourage people to drive cars, especially in urban areas like Cairo, contributing to the perpetual traffic congestion.

In a recent move to reform energy subsidies in Tunisia, the government introduced in July 2014 a supplementary bill to reduce the high public spending. Tunisia's planned subsidy reforms and public spending cuts are intended to help reduce the budget deficit by 1.5 billion dinars or $927 million in 2014. The fiscal savings are expected to be used to create more jobs, lowering the high unemployment rate from 15.9 percent to an expected rate of 15.2 percent by the end of the year. The reform includes raising prices of lead-free petrol 6.3 percent, from 1.57 dinars (0.93 dollars) per liter to 1.67 dinars (0.99 dollars), price of diesel raised to 1.25 dinars (0.74 dollars) per liter from 1.17 dinars (0.69 dollars), and prices of the low-sulfur diesel fuel went up to 1.50 dinars (0.89 dollars) from 1.40 dinars (0.83 dollars).

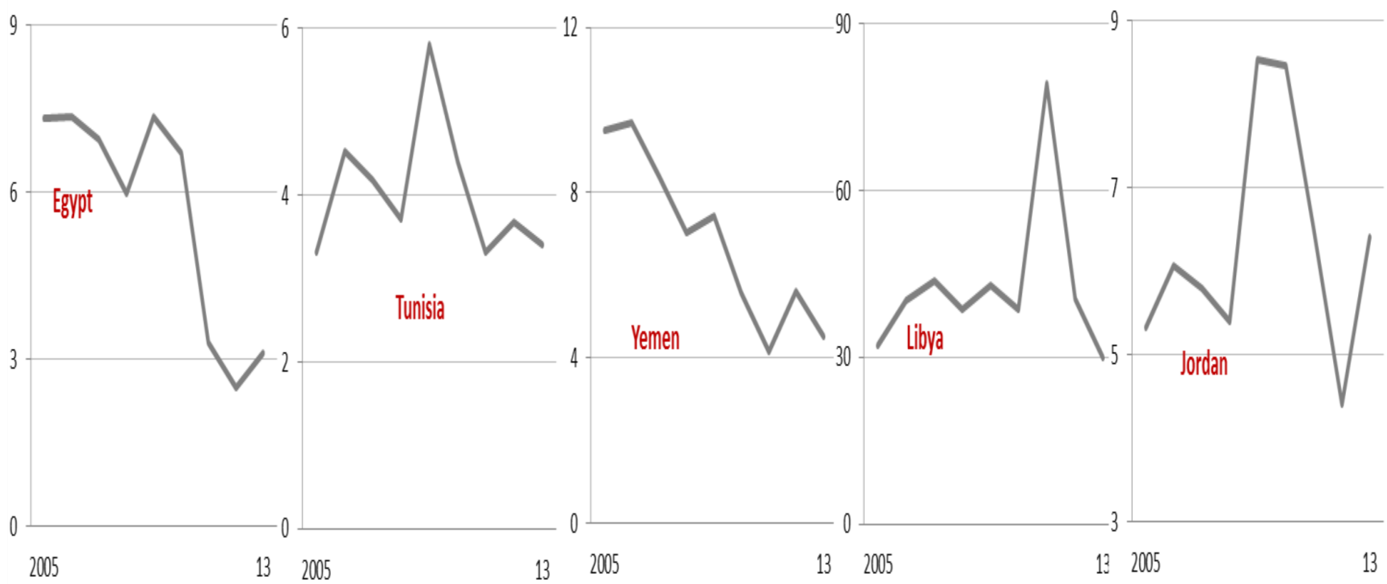
Table 1 – Egypt: Petroleum Product Price Increases

			Current Prices	Change
Natural Gas	**LE/M3**	Iron - Copper - Aluminum - Glass - Ceramics	4.0	75%
		Fertilizer – Petrochemicals	4.0	12%
		Cement	6.0	33%
		Other Manufacturing	4.0	25%
		Electricity Generation	1.1	173%
		Transport (Compressed Natural Gas)	0.45	144%
		Residential	0.50	0%
Gasoline	**LE/Liter**	80	0.90	77%
		92	1.85	41%
Fuel Oil	**LE/Ton**	Food Industry	1000	40%
		Cement	1600	40%
		Electricity Generation	2300	0%
		Other	1500	30%
Diesel	**LE/Liter**		1.1	64%
LPG	**LE/CYL**	Residential	8.0	0%
		Commercial	16.0	0%

Source: World Bank and media sources.

6. Governments have tapped into their foreign reserves, reducing fiscal space

Foreign reserves in months of imports

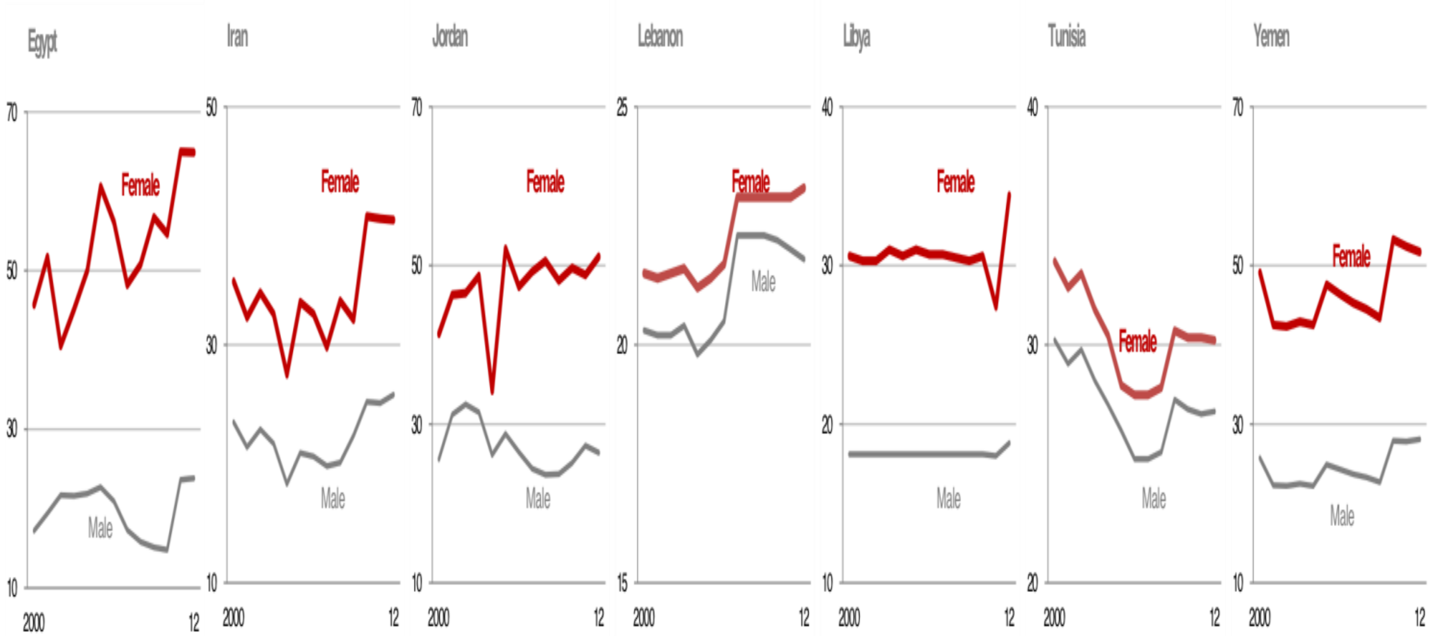


Source: World Bank.

International reserves have been depleting in almost all MENA 7 countries particularly in Egypt where the latest data show that net international reserves reached $16.7 billion at the end of June 2014, less than half of the total reserves prior to the revolution. Libya and Iran have had to dig into their (albeit sizable) stock of reserves to finance their growing budget deficits in 2013 and 2014. Both countries suffer from declining oil export receipts. Yemen failed to secure oil exports and foreign reserves slipped for the fifth consecutive month to $4.6 billion in May 2014 (about 4 months of imports), their lowest level since June 2012. Estimates show that while Egypt could gradually re-build its stock of reserves with the help of the Gulf funds, Iran, Yemen and Libya will drain their foreign reserves by at least one third in 2015.

7. Unemployment levels have remained high, and particularly high for females

Youth unemployment rate, (% of total labor force ages 15-24)



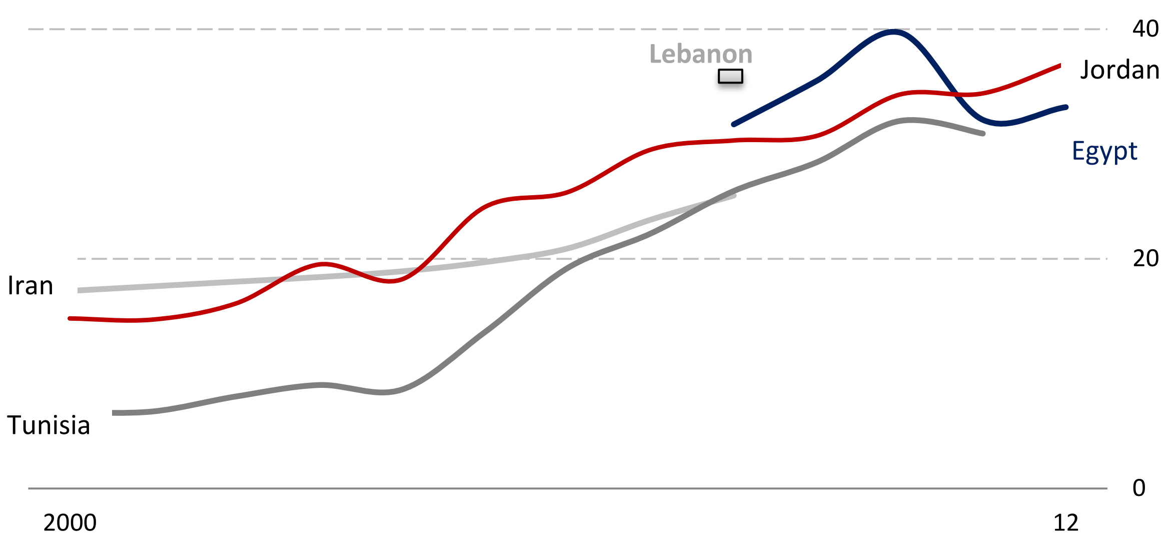
Source: World Bank.

Along with slow growth, unemployment rates have remained stubbornly high particularly among youth (15–24 years) with an average rate of 22 percent for young males and 39 percent for young females in the MENA 7 countries. For example, some estimates show that the youth unemployment rate is as high as 40 percent in Tunisia and even higher in inland governorates. The latest official figures put the youth unemployment rate in Iran at 25 percent while the unofficial estimates suggest that the real figures are as much as double the official rates. The gender gap in unemployment is large: the female youth unemployment rate is almost 3 times the male youth unemployment rate in Egypt and double in Iran, Jordan and Yemen. Female youth unemployment rates in Egypt remains at 65 percent, Jordan and Yemen at 50 percent and Iran at 40 percent.

While unemployment has been exacerbated by the slowdown in economic growth, much of it is due to long-standing structural factors on both the labor supply and demand sides.

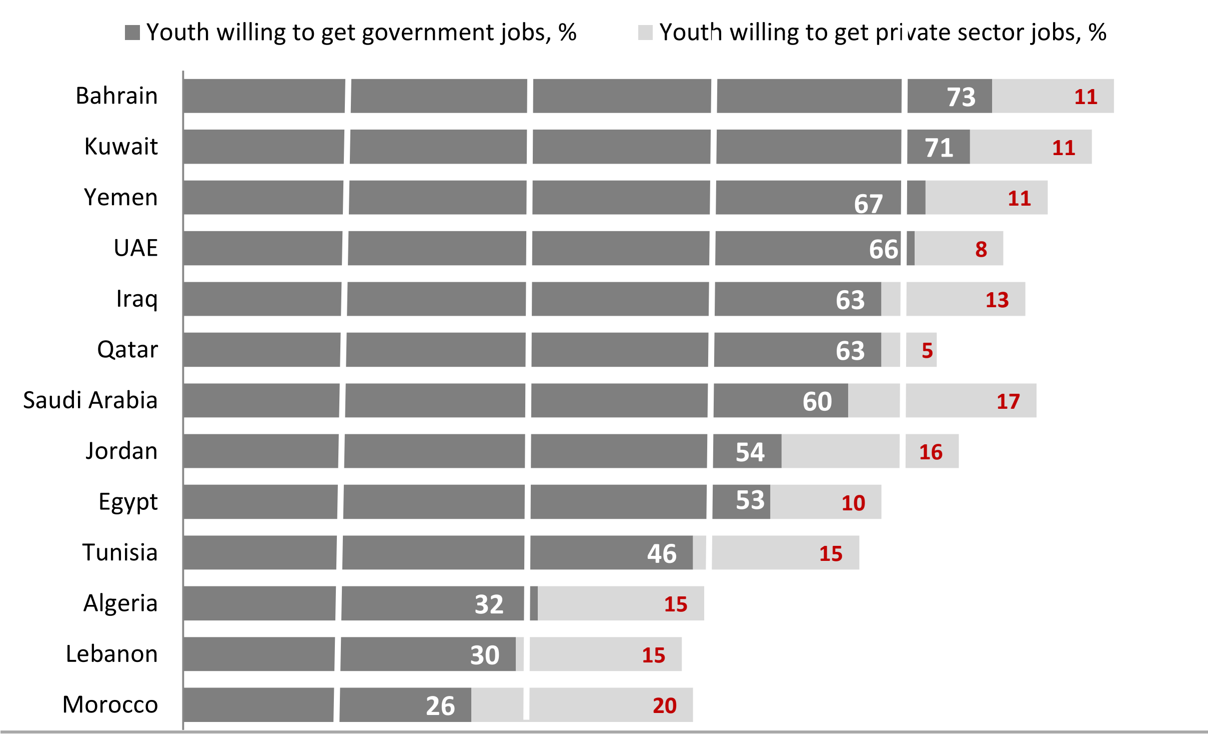
8. Most of the unemployed are educated

Unemployment rate with tertiary education (% of total unemployment)



Source: World Bank.

9. Youth prefer public sector jobs to private sector jobs

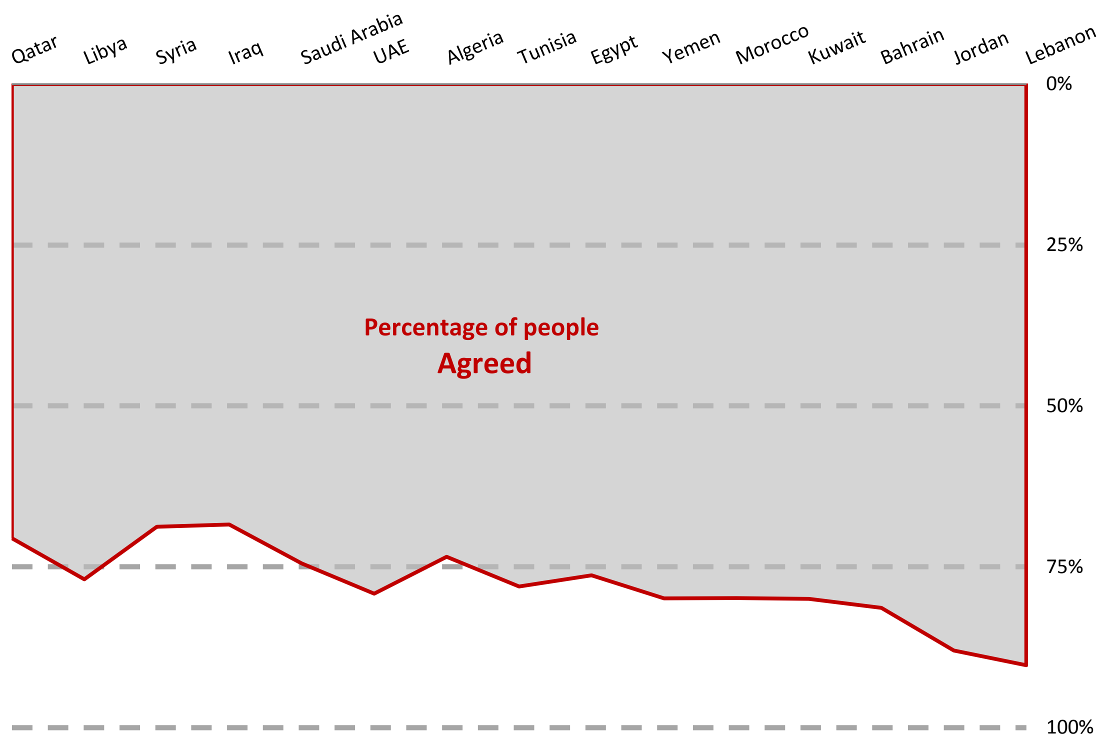


Source: Gallup survey, 2010.

A salient feature of unemployment in these countries is that it is higher among the more educated: over 30 percent of those with tertiary education were unemployed in Egypt, Tunisia and Jordan in 2011 and 2012. Among the most educated women, unemployment rates exceed 60 percent in Jordan and 40 percent in Egypt. One reason for the high rate of youth unemployment in MENA 7 countries is that many educated young people are willing to wait for jobs in the public sector to open up. Public sector jobs are attractive since they offer high salaries, job security, and good benefits. A Gallup survey in 2011 showed that more than half of the unemployed young people in Egypt, Tunisia and Jordan were seeking a government job compared to only 10 percent who were looking for a private sector job. Public sector employment constitutes a large share of total formal employment in Egypt followed by Jordan and Iran. More than 70 percent of non-agricultural employment in Egypt and Libya and 40 percent in Yemen, Jordan and Iran in the 2000s were in the public sector.

10. But they need connections (Wasta) to get these jobs

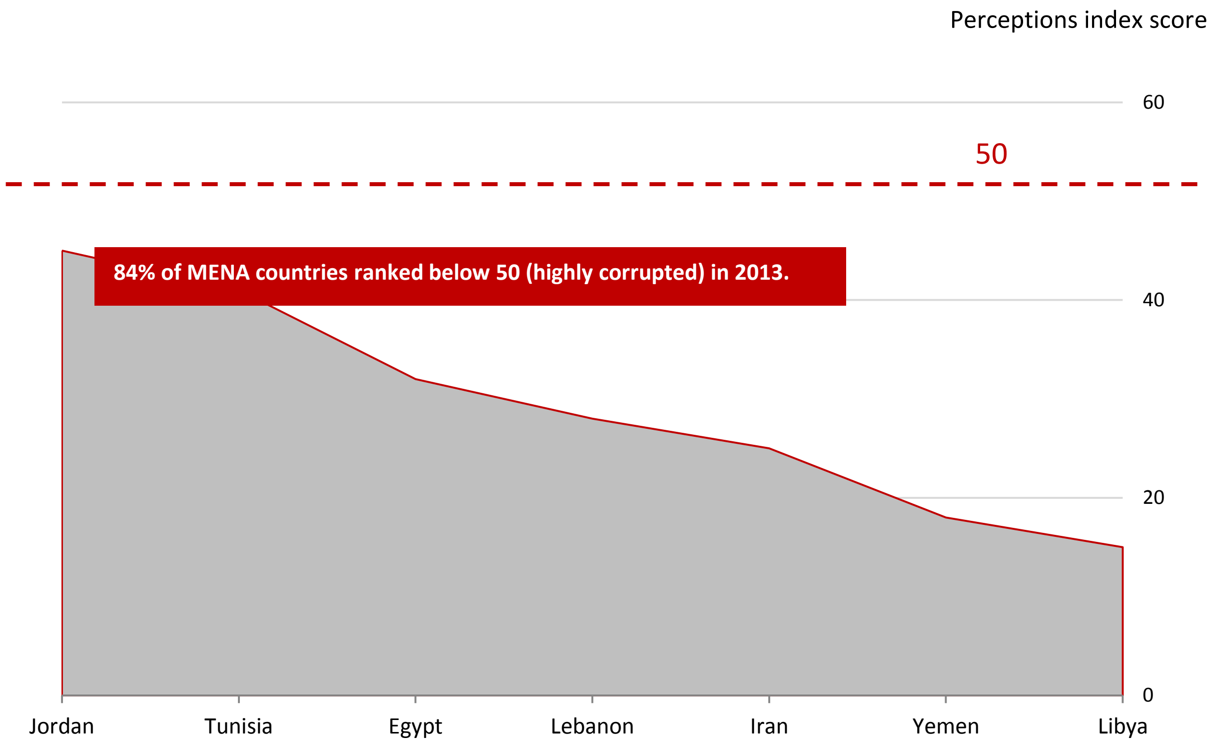
Question: In general, do you mostly agree or disagree with the following:
Knowing people in high positions is critical to getting a job (Wasta)?



Source: Gallup survey, 2012.

The overwhelming majority of people think that Wasta (Arabic for connection and favoritism) is necessary for getting a public sector job. A survey in 2000 in Jordan revealed that 86 percent agreed that Wasta is a form of corruption and 87 percent thought it should be eliminated. At the same time, 90 percent said they expected to use Wasta at least "sometimes" in the future and 42 percent thought their need for it was likely to increase, while only 13 percent thought their need would decrease. In a recent survey by Gallup, 36 percent of Tunisian youth believe that corruption is widespread in government while 83 percent believe that knowing people in high positions is critical to getting a job.

11. Because of the corruption that is widespread in the public sector



Source: Transparency international 2013.
Note: A country's score indicates the perceived level of public sector corruption on a scale of 0-100, where 0 means that a country is perceived as highly corrupt and a 100 means that a country is perceived as very clean.

Corruption and cronyism is perceived to be widespread in all of MENA 7 countries and have distorted the economies in the form of weak private sector and poor governance. All of these countries have performed poorly on indicators of transparency, voice and accountability. For the voice and accountability indicators, Egypt and Tunisia had a negative score of 0.7 and 0.2 (score ranges between -2.5 and +2.5) respectively in 2012 and ranked in the 42nd percentile or lower. Perceptions index estimates calculated by the Transparency International Corruption shows that the MENA region scored lower than the world median in 2013. Among them, the MENA 7 countries were widely perceived as very corrupt with an average score of 29, ranging from Libya with a score of 15 to Jordan with a score of 45 (Score ranges between 0 being highly corrupted, and 100 being very clean). Iran and Egypt ranked 144th and 114th respectively among 177 countries under study for the 2013 index.

12. And the weak private sector that is not dynamic enough to generate jobs due to the constraints in the investment climate hindering private sector growth.

(Average ranking on sets of Doing Business indicators, 2014, ranking 1-189

Source: World Bank staff calculations based on World Bank Ease of Doing Business 2013.
Note: Strength of legal institutions refers to the average ranking on getting credit, protecting investors, enforcing contracts and resolving insolvency, while complexity and cost of regulatory processes does the average ranking on starting a business, dealing with construction permits, getting electricity, registering property, paying taxes and trading across borders.

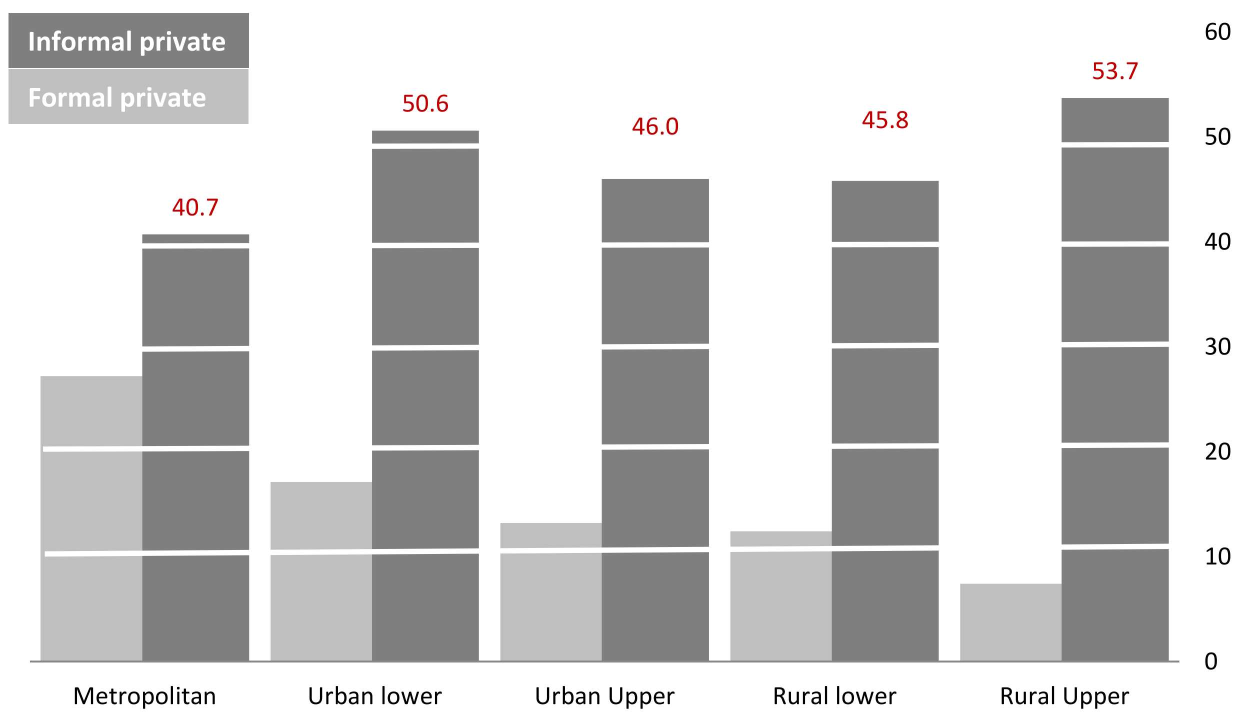
The private sector in the MENA region, particularly in the MENA 7 countries, is not dynamic due to a weak regulatory environment and limited access to credit mostly. The public sector including state owned enterprises (SOE) is large in size and has privileges in all aspects of the economy leaving little space for the private sector to grow. A World Bank report showed that in Tunisia, over a 17 year period, 25 decrees were issued to benefit firms connected to the ruling family that made it difficult for other companies to enter the market.

In the World Bank's indicators that capture the quality of the business environment, all of these countries are ranked towards the lower end of the spectrum. For example, the ease of doing business indicators ranked Libya, Iran, and Egypt close to the bottom of the list in 2013 with Libya standing at 187th out of 189 countries. One of the constraints in improving private sector activity is access to credit and foreign exchange, which are mostly allocated to the elite. Furthermore, laws and regulations related to investor protections are not clear and limit the ability of investors to raise capital.

Finally, most of the labor force in these countries is not unemployed. They are engaged in the informal sector, either as self-employed or in household enterprises. These people, who are not part of the unemployment statistics, are in an even worse situation, since they lack any security in their earnings. Yet they have to work because they, or their families, cannot afford to have them unemployed and looking for a job. They are the most vulnerable segments of the population.

13. Most of the labor force is engaged in the informal sector and their jobs provide no security.

Egypt: Job status by region, male labor force participations aged 15-64, percent



Source: ELMPS 2012.

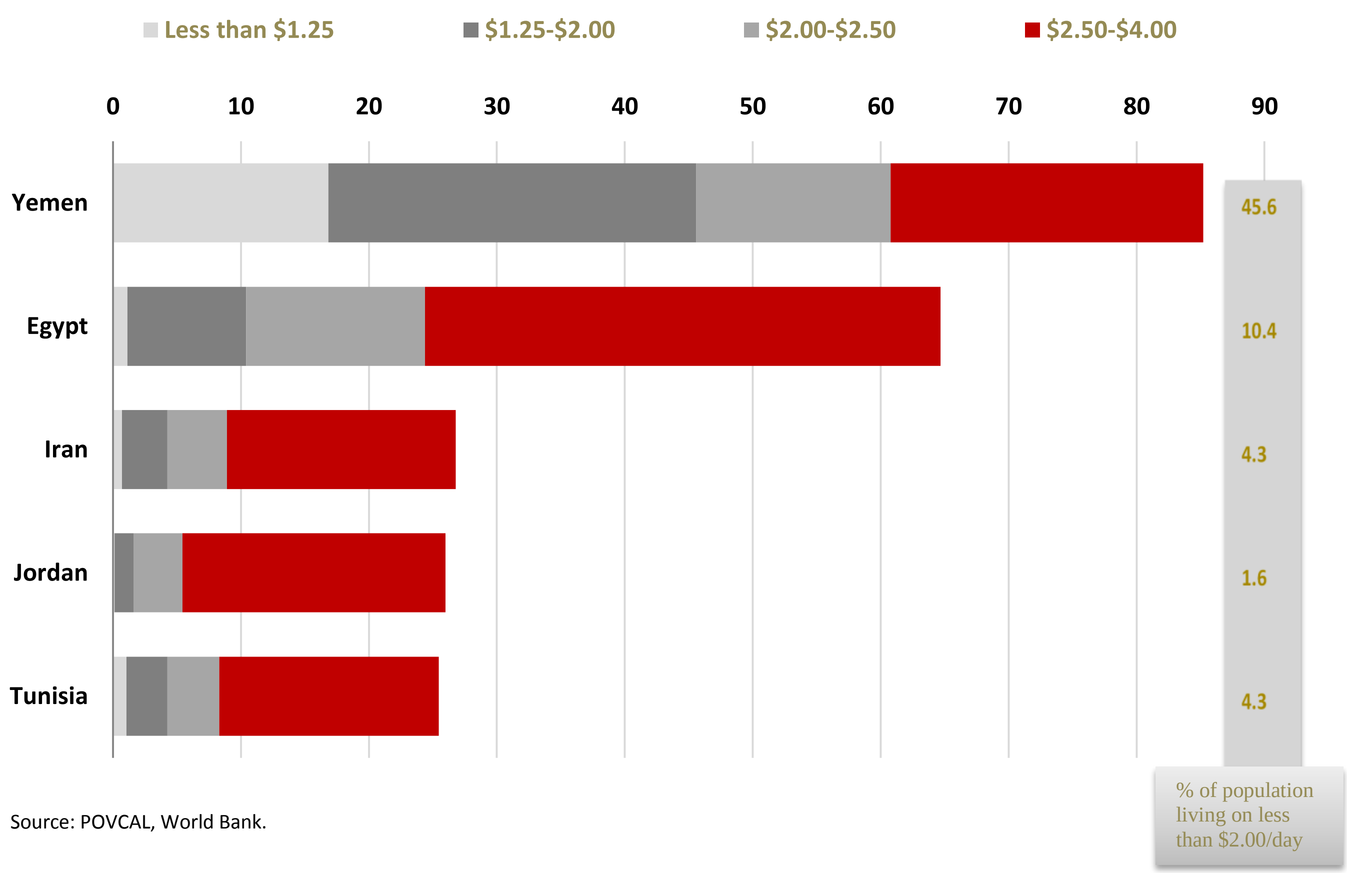
Informal sectors are large and have been expanding in the MENA 7 countries. They consist of small firms that are disconnected from the formal sector and suffer from low productivity because of the nature of the sector which requires less capital, less skilled labor and less investment. Workers in the informal sector lack social security coverage and medical insurance and have fewer possibilities to participate in formal education and training program. These are vulnerable people and are significantly exposed to exogenous shocks. The IMF estimates that informality rates across these countries range from 17 percent in Jordan to 35 percent in Tunisia.

Informal sectors are associated with developing countries, and some estimates show that about 60 percent of the labor force work in the informal sector. Governments can support the informal sector by enforcing regulations and improving access to markets and finance for the firms, and supporting the workers by creating both a safer work places and access to social services.

14. These are people who most likely live near the poverty line.

Poverty rate

Population living on $4.00 or less per day, 2010 or latest available, percent



Source: POVCAL, World Bank.

Large segments of population in the MENA 7 countries live in vulnerable situations and are exposed to external shocks. In some of these countries, those who are not considered poor by the international poverty line (living under $1.25 PPP a day) are in fact only a bit better off than those who are considered poor. About 14 percent of the population (11 million) in Egypt lived on $2.00 – 2.50 a day in 2010. Moving the poverty line from $2.50 to $4.00 a day will drive about 40 percent of Egyptians into poverty. In Yemen, with the highest poverty rate in the MENA region, about one third of the population lived on under $1.25 - $2.50 a day in 2010. Estimates show that more than 60 percent of Yemen's population (about 14 million) is currently living below $2.50 a day and almost all of the population lives under $4.00 a day. In Iran, an increase of $0.5 a day in the poverty line (from $2.00 to $2.50 and from $3.00 to $3.50) could put between 4 to 6 percent of the population – over 4.5 million people - into poverty.

A "**poor policy – poor growth**" cycle mainly characterized the MENA 7 countries before 2010. While these economies grew rapidly, growth was not sustainable to create jobs. Events post-2011 suggests that these countries are still trapped in the "poor policy-poor growth" cycle. Economic growth continues to be weak and cannot generate enough jobs, fiscal deficits are still high and public debts are growing at a faster pace than before, leaving little space for growth-promoting investment. Private sector activities are sluggish, and the few jobs that are created in the public sector are filled through connections, leaving young people frustrated. Many workers move to the informal sector, creating a large vulnerable group exposed to external shocks. World Bank estimates show that by growing at 5 percent per year (the same pace as the last decade), MENA can create 24 million jobs in the next 7 years (2014-20). This is just enough to keep the unemployment rate from rising. The region will need to create at least 30 million jobs for the same period in order to make a dent in the high unemployment rate. This requires an annual growth rate of at least 6.5 percent, about 1 percentage point higher than the average growth in the last decade. The growth rate required for the MENA 7 countries is estimated to be even higher, exceeding 7 percent. To break the cycle, growth rates need to more than double from their current low levels in all of the MENA 7 countries. Further, growth sustainability can be achieved with prompt acceleration in reforms paving the way for the private sector to become a growth driver and create jobs.

There is a risk of policy error if policymakers trust economic forecasts that construct a positive outlook for their economies and resist necessary reforms. Studies have shown that there is an optimism bias in growth forecasts for developing regions and in particular for MENA. One reason is that forecasting models do not necessarily take into account both new information that comes in at the last minute, and the underlying factors that contribute to the well-being of the economy. More importantly, economic forecasts tend to overlook the alarming signs of structural breaks and the boom and bust cycles in the economy. **At this important juncture**, governments in the MENA 7 countries need to foster structural reforms, such as targeting of subsidies, strengthening the investment climate, improving governance, and removing rigidities in the product and labor markets. As these 14 charts (in reverse order) suggest, these reforms are necessary whether the short-term economic prospects are rosy or gloomy.

Annex Tables - High frequency data

Egypt		GDP Growth (%)	Unemployment rate (%)	Domestic Debt (% of GDP)	FDI (Million US$)
2010					
	Q1	5.5	9.1	66.7	1,731
	Q2	5.6	9.0	68.7	895
	Q3	5.5	8.9	71.5	1,706
	Q4	5.4	8.9	73.6	2,426
2011					
	Q1	0.3	11.9	68.5	1,597
	Q2	0.4	11.8	70.2	656
	Q3	-4.3	11.9	73.1	-164
	Q4	0.4	12.4	76.2	99
2012					
	Q1	2.6	12.6	69.5	440
	Q2	2.2	12.6	71.9	-858
	Q3	5.2	12.5	75.1	636
	Q4	3.3	13.0	78.6	1,861
2013					
	Q1	1.0	13.2	75.9	108
	Q2	1.4	13.3	78.7	1,316
	Q3	2.2	13.4	83.3	1,075
	Q4	1.5	13.4	87.1	1,629
2014					
	Q1	2.5	13.4	77.7	1,246
	Q2	...	...	80.6	1,603
	Q3	...	...	83.3	...

Note: Egypt Q1 is July-Sep.

		Jordan			Lebanon		Tunisia		Iran
		GDP Growth (%)	Unemployment rate (%)	Domestic Debt (% of GDP)	GDP Growth (%)	Domestic Debt (% of total debt)	GDP Growth (%)	Unemployment rate (%)	Unemployment rate (%)
2010									
	Q1	2.4	12.4	54.5	8.1	67	4.2	...	11.1
	Q2	1.4	12.2	52.0	10.3	67	4.0	...	11.3
	Q3	2.2	13.5	55.4	8.2	68	3.3	...	11.3
	Q4	3.2	11.8	61.1	5.4	65	2.8	...	14.1
2011									
	Q1	2.3	13.1	57.4	-0.9	63	-2.0	...	13.5
	Q2	2.4	13.2	58.5	-0.3	61	-0.7	18.3	13.6
	Q3	2.6	13.1	60.4	3.2	62	1.0	...	12.1
	Q4	3.1	12.1	65.5	6.2	62	0.8	18.9	14.6
2012									
	Q1	3.0	11.4	64.6	7.1	60	5.6	18.1	...
	Q2	2.9	11.6	68.0	5.2	64	3.7	17.6	...
	Q3	2.6	13.1	72.2	-1.2	65	3.5	17.0	...
	Q4	2.2	12.5	75.5	-2.2	67	3.6	16.7	...
2013									
	Q1	2.6	12.8	70.2	-0.7	65	2.7	16.5	...
	Q2	3.1	12.6	72.2	-1.2	67	3.2	15.9	...
	Q3	2.8	14.0	76.8	3.5	68	2.6	15.7	...
	Q4	2.9	11.0	80.1	1.6	68	2.7	15.3	...
2014									
	Q1	3.1	11.8	77.0	...	...	3.0	15.2	...

Source: National official sources.

Note: Iran: Q1 start in March. World Bank calculated quarterly coincidence indicator for Lebanon.

		Egypt		Jordan		Lebanon	
		Foreign Reserves (bn US$)	Tourism, # of Arrivals (Thousands)	Foreign Reserves (bn US$)	Overnight visitors (Thousands)	Foreign Reserves without gold (bn US$)	Tourism, # of Arrivals (Thousands)
2010							
	Jan	34.2	1,054	11.7	281	26.8	106
	Feb	34.3	...	11.7	271	27.0	129
	Mar	34.5	1,339	11.9	332	27.2	158
	Apr	34.6	1,244	11.9	426	27.3	169
	May	35.1	1,198	11.4	352	27.3	170
	Jun	35.2	1,029	11.1	382	27.4	231
	Jul	35.3	1,303	11.7	634	27.9	362
	Aug	35.5	1,143	12.0	467	28.2	166
	Sep	35.5	1,185	12.0	416	28.5	203
	Oct	35.5	1,486	12.1	328	28.2	157
	Nov	35.6	1,404	12.8	386	27.7	164
	Dec	36.0	1,275	13.1	283	28.6	152
2011							
	Jan	35.0	1,148	13.1	...	28.3	98
	Feb	33.3	...	12.7	...	28.4	107
	Mar	30.1	535	12.1	...	28.5	136
	Apr	28.0	800	11.9	...	28.8	135
	May	27.2	709	11.9	...	28.4	121
	Jun	26.6	732	11.6	...	28.3	178
	Jul	25.7	936	12.6	...	28.9	220
	Aug	25.0	907	12.6	...	30.6	133
	Sep	24.0	917	12.2	...	30.6	149
	Oct	22.1	1,077	12.0	...	30.5	125
	Nov	20.1	1,018	11.8	...	30.8	124
	Dec	18.1	855	11.5	...	30.8	130
2012							
	Jan	16.3	820	11.1	316	30.7	96
	Feb	15.7	753	10.7	267	30.8	98
	Mar	15.1	927	10.4	326	31.0	120
	Apr	15.2	1,047	9.8	379	31.8	124
	May	15.5	846	8.8	340	29.6	120
	Jun	15.5	850	8.0	382	29.3	157
	Jul	14.4	1,014	8.0	457	29.6	157
	Aug	15.1	1,038	8.3	413	29.5	115
	Sep	15.0	994	8.4	351	30.0	100
	Oct	15.5	1,163	8.5	...	29.5	93
	Nov	15.0	1,103	7.9	...	29.8	76
	Dec	15.0	978	8.1	...	30.0	111
2013							
	Jan	13.6	903	9.1	315	31.0	81
	Feb	13.5	845	9.6	260	30.3	87
	Mar	13.4	1,117	9.9	329	30.4	106
	Apr	14.4	1,102	11.0	343	30.7	102
	May	16.0	969	10.6	313	31.4	111
	Jun	14.9	989	10.9	370	31.7	136
	Jul	18.9	...	11.1	308	31.3	130
	Aug	18.9	565	12.0	447	31.0	137
	Sep	18.7	301	12.0	337	32.0	86
	Oct	18.6	559	12.0	...	31.9	103
	Nov	17.8	673	13.4	...	31.8	83
	Dec	17.0	678	13.3	...	31.7	111
2014							
	Jan	17.1	642	13.6	336	32.3	72
	Feb	17.3	617	13.6	269	33.4	74
	Mar	17.4	755	13.8	327	33.6	83
	Apr	17.5	...	...	...	33.7	102
	May	17.3	...	...	...	...	111
	Jun	16.7	...	...	...	...	...

	Libya	Tunisia			Yemen	
	Foreign Reserves (bn US$)	Foreign Reserves (bn US$)	Tourism, # of Arrivals (Thousands)	FDI (Million TD)	Foreign Reserves (bn US$)	FDI (Million Rials)
2010						
Jan	97.5	10.4	333	...	6.5	27,270
Feb	96.9	9.8	325	275	6.4	28,091
Mar	95.3	9.7	441	476	6.1	29,774
Apr	96.4	8.8	495	609	6.1	30,427
May	96.2	8.8	612	764	5.8	30,892
Jun	97.4	8.7	703	937	5.8	28,854
Jul	97.2	8.8	1,064	1,179	8.8	32,452
Aug	98.3	9.0	810	1,433	5.8	29,154
Sep	99.1	9.5	690	1,699	6.0	29,120
Oct	102.1	9.7	646	1,901	5.9	31,135
Nov	101.5	9.3	368	2,227	5.7	31,098
Dec	99.9	9.5	416	2,418	5.9	236,569
2011						
Jan	103.8	9.4	178	...	5.9	240,312
Feb	107.6	9.2	184	215	5.9	234,267
Mar	107.6	9.2	252	339	5.3	225,939
Apr	109.3	8.4	314	518	5.1	224,020
May	107.9	7.9	358	580	4.8	217,430
Jun	107.4	7.7	...	775	4.7	216,092
Jul	106.8	8.2	656	868	8.2	211,807
Aug	106.9	8.6	...	1,077	4.7	211,327
Sep	104.3	8.0	...	1 238	4.7	210,211
Oct	105.5	8.0	494	1,379	4.8	209,058
Nov	104.6	7.7	372	1,451	4.5	211,885
Dec	105.0	7.5	326	1,718	4.5	212,081
2012						
Jan	106.4	7.5	310	172	4.6	206,576
Feb	108.5	7.3	256	321	4.7	206,753
Mar	112.3	7.1	372	441	4.7	206,929
Apr	113.9	6.6	469	628	4.7	244,871
May	114.2	6.4	499	942	4.6	208,026
Jun	116.5	6.4	596	951	4.6	218,608
Jul	112.2	6.5	743	1,116	6.5	236,277
Aug	116.0	6.5	740	1 166	4.9	238,153
Sep	117.9	6.5	689	1 554	6.1	231,980
Oct	118.6	6.4	495	1,440	5.9	221,741
Nov	119.0	6.4	386	1,547	6.0	227,461
Dec	118.6	8.4	396	3,079	6.1	231,747
2013						
Jan	119.5	8.3	396	206	6.2	230,399
Feb	119.4	7.4	248	290	5.7	240,388
Mar	120.6	7.3	279	424	5.9	244,871
Apr	121.5	7.2	...	479	5.9	245,841
May	119.8	6.6	...	...	5.7	245,260
Jun	120.5	7.2	...	939	5.6	239,627
Jul	122.1	7.2	...	1,079	7.2	235,641
Aug	121.2	7.1	...	1,208	5.6	243,288
Sep	122.1	7.2	...	1,492	5.6	243,863
Oct	122.1	7.2	...	1,668	5.5	249,018
Nov	118.9	7.3	...	1,777	5.5	251,409
Dec	115.4	7.3	...	1,960	5.3	267,523
2014						
Jan	109.6	7.5	...	...	5.2	268,732
Feb	111.3	...	...	192	5.0	269,740
Mar	...	...	...	441	...	263,467
Apr	...	...	...	407	...	261,971
May	...	...	...	...	...	257,757

Note: December data on FDI is cumulaive for the year. TD: Tunisian Dinars

Source: International Financial Statistics, National official sources

Youth Unemployment (% of labor force ages 15-24)

	2010			2011			2012		
	Female	Male	Total	Female	Male	Total	Female	Male	Total
Egypt	54.6	14.8	26.3	65.0	23.6	35.5	64.9	23.8	35.7
Iran	40.8	25.2	28.4	40.6	25.1	28.4	40.5	25.8	28.9
Jordan	49.7	25.1	30.1	48.8	27.3	31.6	51.1	26.4	31.3
Lebanon	22.2	23.1	22.8	22.0	23.1	22.7	21.8	23.3	22.8
Libya	30.6	18.1	22.1	27.4	18.0	21.0	34.4	18.8	23.9
Tunisia	27.3	30.3	29.4	27.1	30.3	29.3	27.2	30.2	29.3
Yemen	53.3	27.9	35.1	52.4	27.8	34.8	51.7	28.1	34.8

Source: World Bank

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