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The Role of Institutions in Economic Development

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Despite the global liberalization of trade, financial and technological flows, there still are tremendous disparities in terms of income per capita and growth rates across countries (Hall and Jones, 1999). Among the plethora of explanations proposed in the economic literature on this phenomenon, institutions have become a common factor for long-term economic performance (Acemoglu et al., 2001) as well as international activities such as trade (Dollar and Kraay, 2003) and foreign direct investments (Ali et al., 2010) and the legitimacy or failure of states (Subramanian et al., 2004). Given these pivotal implications of institutions for the social and economic welfare of countries, this chapter proposes to review the current institutional background of countries in the Middle East and North Africa (MENA) region and provide some insights into the historical and more recent evolution of formal institutions in this part of the world.

Quality of Institutions and Economic Development

Definition and Classification of Institutions

Economists and political scientists provide many definitions for the concept of institutions. North's (1990) pioneering analysis was that institutions are "the rules of the game in a society or, more formally, are the humanly devised constraints that shape human interaction." Other researchers have contradicted the definition provided by North

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by noting that public communications are organized by the coordination of traditional and deep-rooted codes of the society, and these constitute institutions (Hodgson, 2006). Institutions are also defined as a structure of societal features, like organizations, codes, faiths, and criteria. These features direct, empower, and restrain the activities of persons (Greif, 2000; Dixit, 2004). The perceptions about institutions and organizations are combined so that organizations are seen as instances of institutions. Institutions are also considered as policies to be chosen by persons (Dixit, 2004). According to Schotter (1981), institutions are seen as uniformity in societal conduct that is acceptable to every constituent of the community. This conduct is controlled either by the self or by a foreign power.

Overall, there are many facets of institutions that are considered in the literature as the results of different typologies that are discipline-specific (i.e., sociological, political science, managerial, etc.); consequently, certain studies center on the role of informal elements (i.e., more tacit, embedded aspects of institutions—such as societal trust or cultural values), while others emphasize the impact of formal aspects (i.e., codified elements that govern societal interactions—such as laws, regulations, or policies). Within the realm of economics, the emphasis is clearly on the latter, as these formal institutions are a key moderating factor in all interactions between different economic agents, such as firms, individuals, or governments (North, 1990). Thus, the present chapter follows this tradition and subscribes to the Northian view of institutions.

Importance of Institutions

Institutions make up some of the most significant determinants of any economic outcome, for numerous reasons. First, institutions safeguard investors' academic privileges, provide a fitting atmosphere for inspiration and creation, and boost competition for opportunities. Institutions are then essential to society. Although each individual is treated without prejudice or preference, institutions increase the competition for possibilities. The value of institutions also impacts countries as well as persons. In case the decree of rule is enforced and visibly defined, shielded rights of assets exist in a nation, and consequently result in relatively better economic growth, even in nondemocratic governments (Olson, 1993).

Second, a substantial amount of research demonstrates the major influence of institutions on economic growth. After all, economic growth is affected by numerous elements such as assets or location, but

a lack of well-built institutions affects economic growth negatively, even when these elements are favorable. Institutions influence more than just growth in an economy. Direct overseas endeavors are stimulated by a well-organized judicial structure, less bribery, and national dependability (Asiedu, 2006). The degree of corruption decreased when there was an increase in overall overseas distribution allotted to minerals and fuels and, as a result, it was seen to have a clear impact on foreign direct investment, which resulted in growth among African countries.

Finally, decreasing the level of corruption went a long way in leading to a positive impact on economic growth. Although democracy might not constantly add to growth, it is more advantageous to economic prosperity because it involves capitalist conduct and helps persons scrutinize prospective expenditures liberally (North, 1990). Since democratic systems protect public privileges and rights of assets, they are more favorable to economic growth, but they do not always lead to development. Democratic systems could employ bad strategies to expand politically, but dictatorships may not be subjugated by such demands. Long-term stability is not seen in dictatorships although, when they are stable, they contribute to the growth of the economy. Sought-after institutions offer safety of assets, rights, implementation of agreements, motivation for free enterprise, sustained steadiness of economic science, supervision of venturesome fiscal mediators, and public assurances and security dividends. This results in improved influence and liability (Rodrik, 2008). Rodrik (2000) claims that managing conflict prospects in nations with participatory institutions produces less growth instability than in nondemocratic civilizations.

Measuring Institutions

Systematic reviews of existing literature suggest that there is less agreement on how to empirically measure institutions (Woodruff, 2006). Dietsche (2007) partly attributes this challenge to the fact that different theorists and empirical researchers have defined institutions and the functions they provide on the basis of various ontological frames of reference. According to her, those who are intellectually grounded in economic theory tend to view institutions as incentive structures and constraints to the pursuit of individuals' self-interest. In contrast, those more closely associated with sociology and anthropology ascribe to institutions cognitive roles through which individuals' behavior are coordinated. Nevertheless, efforts to measure institutions can take on one or more of the following forms: measures of formal institutions, measures of a mixture of formal and informal institutions, expansive

measures of property rights, and slim measures of specific institutions; yet, some are founded on impressionistic surveys performed by legal experts, business people, or academics, and others are constructed on analyses of laws and constitutions (Woodruff, 2006). Some specific examples of proxies—identified by Dietsche (2007)—to measure the quality of institutions include:

(1) Governance index: an average of six measures of institutions, such as
    a) Voice and accountability;
    b) Political stability and absence of violence;
    c) Government effectiveness;
    d) Regulatory burden;
    e) Rule of law; and
    f) Freedom from corruption.
(2) Corruption perception index, by Transparency International
(3) Checks and balance, as measured by Keefer and Stasavage (2002)
(4) Doing Business Indicators, by the World Bank
(5) Fragmentation of the political field, by Database on Political Institutions (DPI)
(6) Polity measures regarding level of democracy and autocracy in a country and democratic measures concerning the extent to which electoral competition prevails, by Polity IV database
(7) Civil liberties and political rights, by Freedom House
(8) Index of social division (e.g., ethnicity)

While these measures (i.e., proxies) of institutional quality have been particularly useful and have aided empirical research, a number of concerns have frequently been raised in the literature. First, Arndt and Oman (2006) show that the problem with proxies that measure institutional quality is that they often do not fully capture the attributes that are associated with them. For example, Glaeser et al. (2004) have argued that most current measures of institutions found in the literature measure outcomes rather than institutions. Another critique is that the proxies indicators used to measure institutional quality were often not originally designed for that purpose and, in some instances, indices have been created retroactively, such as the Polity IV data that goes back to 1800 (Dietsche, 2007; Woodruff, 2006). Finally, it has also been suggested that in almost all cross-country or cross-regional studies, measured institutions are interconnected with other measured or unmeasured institutions, which limits what can be said about this approach (Woodruff, 2006).

Taking most of these critiques seriously, Voigt (2013) has proposed that a measure of institutions should be exact, objective, and account for *de jure* and *de facto* elements. In addition, he suggested that when estimating the economic effect of institutions, there is the need to incorporate a number of covariate proxies for informal institutions.

Impact of Institutions on Economic Development

Although many studies propose that institutions are indeed vital to economic growth, they are not, however, the only cause of growth; for instance, Knack and Keefer (1995) show that the explanatory influence of the regressions is greater when indicators of political violence are involved. However, due to data restrictions, the empirical investigation of cross-country growth was constrained to a constricted investigation of the institutions' role. Many other studies were done, such as the one by Acemoglu et al. (2000), in which they discovered the presence of a solid correlation between colonial institutions and economic performance. By studying European colonization practices, they show how the only effect on per capita GDP was witnessed through the use of institutions, and so it goes to show that the process of improving institutions will beget an improvement in the per capita income. It has been proven time and time again that institutions seem to have a rather strong influence on economic performance, one that could be powerful when related to other factors.

Through continued empirical studies, it has been highlighted that even considering economic growth determinants such as geography and integration, as well as institutions, yields results showing that the latter trumps all else (Rodrik et al., 2004). Integration does not possess a direct effect on income, and geography displays only a weak and rather inaccurate one. On the other hand, integration is positively and significantly affected by institutional quality; Robinson et al. (2006) reason that institutions regulate the comparative statics of the equilibrium as well as the income level and its growth rate. The secret lies in the strength of institutions, such that a response would be positive in the company of solid institutions. Institutions then clarify, more than any other aspect, the disparities in growth among countries.

Besides their direct influence, it is important to consider the indirect impact institutions have on growth and how this impact is twofold and involves either intermingling with additional variables or through operating as a network to govern the impact of those variables on growth. The variables to be considered are trade, policy, democracy,

and human capital. When it comes to trade, varied studies done by Dollar and Kraay (2003), Acemoglu et al (2005)., and Baliamoune-Lutz and Ndikumana (2007), in different parts of the world, display that the core factor shaping the impact of trade on growth is the presence of institutions. When it comes to policy, Easterly and Levine (2002) as well as Fatás and Mihov (2005) found that the influence policy has on growth is largely dependent upon the nation's institutional quality. In studying democracy, Acemoglu and Robinson (2008), Commander and Nikoloski (2010), and Rigobon and Rodrik (2005) found that there was very little association between democracy and growth, but by studying the relationships between different institutions, the results suggested that democracy as well as the rule of law are valuable to economic performance. Asiedu (2003), Banerjee et al. (2005), Lee and Kim (2009), and Miletkov and Wintoki (2012) primarily examine institutional quality, low-income countries, and financial development's role in improving property rights. Woodruff (2006) suggested that scholars like Acemoglu et al. (2001; 2002) and Engerman and Sokoloff (2000) developed a historical perspective of the links between institutions and economic development. At its core, this perspective addresses the problem of reverse logic and associated criticisms that were leveled against the previous arguments linking institutions to economic development.

Although the notion is that institutions are essential, some have confronted it. Bardhan (2005) argues that the measures of institutions are being confused, while North (1981) contends that institutions must be "designed." Glaeser et al. (2004) debate the measurements used as a way to point out how the lack of relationship between economic growth and the proposed constitutional measures of institutions. Their claim is that the reason the quality of institutions could possess significance when it comes to the growth regression is because there is improvement in the quality of institutions as income increases. Other scholars bring up some other valid critiques, but despite that, none of it hampers the empirical research performed on institutions.

Quality of Institutions: Where Do MENA Countries Stand?

Overview of the Region

History and civilizing legacy are shared among the MENA countries. The region has historically always tried to maintain its inimitable geopolitical importance, having always been a booming hub of business.

The MENA province has always been very affluent, when compared to other provinces of the globe. In the tenth century, the region had the highest GDP per capita among five nation pools. The region's uniqueness remains, despite the disappearance of its dominant role. This zone has the greatest heritage bond with practically every part of the globe because it is centrally situated between three continents: Asia, Europe, and Africa.

The MENA region has the world's largest oil reserves, and its fiscal reserves are significant. The province shows dazzling potential in the sphere of renewable energy resources—especially solar energy (Müller-Steinhagen and Trieb, 2007). After gaining independence during the twentieth century, the nations have focused on industries of their own choices, health structure, and edification. During the 1970s, Most of the nations in the MENA region had an agenda to recover from the effects of colonialism on citizens' class of living, by exploiting the monetary reserves from native supplies. As the oil boom petered out in this period, so too did its economic accomplishments, despite having invested in infrastructure ventures, edification, and civic wellbeing. Economic reforms had to do with privatization and trade liberalization as the gear to progress business capabilities. Many such endeavors were found to be successful to some extent, letting these economies adjust internationally.

22 self-governing countries are included in the MENA zone, possessing a surface area of 14.8 million sq. km. This region covers 61% of the globe's known oil resources and 21 percent of the natural gas resources. Among the Organization of the Petroleum Countries (OPEC) member nations, eight are in this zone. According to World Bank (2008), the region is sparsely inhabited—relatively speaking—with nearly 38 occupants per km^2. This is due to the lowered availability of water reserves. The oil-producing nations are Saudi Arabia, UAE, Qatar, Kuwait, Oman, Libya, Bahrain, and Algeria. The employment opportunities created by the oil sector is nearly 5 percent. In these countries, there is scarcity in non-consumer and consumer supplies, which makes household fund attraction scarce. FDI, tourism, transmittals, and export play a vital part in the process of economic development of the second bunch of countries—Egypt, Lebanon, Jordan, Morocco, Syria, and Tunisia—in terms of creating more jobs. The rest of the states in the MENA region are facing grave issues in the arena of economic and community development due to the inadequacy in funds.

The minority of this country pool are successful in discovering proper approaches to adjusting the ever-varying global setting. The UAE, Oman, Tunisia, and Bahrain provide a positive approach in this

regard. In the Gulf Cooperation Council (GCC), Oman, Bahrain, and the UAE are affluent in reserves while Tunisia is affluent in having a skilled and profuse work force. These four countries constitute one-fourth of the GDP of the region even though they are comparatively less populated.

Institutions in MENA Countries

In this section, we are going to focus on several formal institutional proxies that are widely used in the literature, and examine them from the perspective of MENA countries. Specifically, we will be looking at:

- The degree of economic freedom (using data from the Heritage Foundation)
- The quality of governance (using the Worldwide Governance Indicators from the World Bank)
- The "friendliness" of the business environment (using the Doing Business Indicator from the World Bank)
- The perceptions of firms in these markets regarding the institutional environment in which they are active (using the Enterprise Surveys from the World Bank)

Heritage Foundation's Economic Freedom Index (EFI)

For several decades, the EFI has been a useful tool for policymakers to assess and improve their institutional environment in order to spur economic dynamism and, subsequently, prosperity. Scholarly work performed while using the EFI has revealed a strong connection between economic growth and several institutional features: low tax rates, limited government, a stable currency, openness to global trade and financial flows, strong private property rights, and lower regulatory burden. The EFI evaluates countries using 10 specific categories, such as property rights, freedom from corruption, and more, which are then averaged to create an overall score for each state.

Overall, the average level of economic freedom in the MENA region has remained comparable to that of previous years, with economic and political policies that hamper growth and development in the region, as suggested by the limited involvement of private enterprises and relatively high unemployment rates (Kim and Miller, 2015). Most of the MENA countries are in the "moderately free" or "mostly unfree" groupings of this index. Israel (70.5), Bahrain (73.4), United Arab Emirates (72.4), and Qatar (70.8) are the regional leaders in terms

economic freedom, while Iran (41.8) and Algeria (48.9) have the lowest scores in the region. In comparison with previous years, Israel has improved its position with 2.1 points, achieving the highest EFI score ever via improvements in management of public spending, property rights, regulatory prescriptions, as well as trade, labor, and fiscal policies. In contrast, both Algeria and Yemen have experienced significant decreases (1.9 and 1.8), further contributing to the international perception of them being "mostly unfree" countries. Some countries (Syria, Libya, and Iraq) remain uncovered by this Index as a result of ongoing violence and unrest in these nations, which suggests that the true regional average (61.6) is likely to be lower than the one reported, which is still above the world average of 60.4. The areas of most pressing concerns remain property rights (39.4), corruption (38.4), and financial (45.3) and investment freedom (44.4), while trade (74.1), monetary (73.4), and fiscal freedom (88.8) score above average. A sustained decline in the business freedom (64.0) in 11 out of 18 countries suggests the potential for more social and political unrest in the region, despite heavy subsidies for energy and food (Kim and Miller, 2015).

World Bank's Worldwide Governance Indicators (WGI)

In its simplest form, governance can be viewed as the way authority is exercised in a nation through political, economic, and institutional mechanisms. Previous work in this area associates good governance to growth and development, particularly in the medium and long run (Kaufmann and Kraay, 2003), as countries affected by misgovernance are closely associated with lower investment and economic development rates as a result of weaker private sectors (Kaufmann, 2011). To measure governance in the MENA region, we will employ the widely popular Worldwide Governance Indicators (WGI). The WGI comprises of six composite indicators covering 200 countries since 1996, and captures six broad dimensions of governance using several hundred variables from survey respondents, nongovernmental organizations, public sector organizations, and commercial business information providers worldwide (Kaufmann et al., 2010). These are:

- *Voice and accountability*
- *Political stability and absence of violence*
- *Government effectiveness*
- *Regulatory quality*
- *Rule of law*
- *Control of corruption*

On average, the WGI data suggests that governance in the Middle East and North Africa is low, and practically unchanged in the last decade or so (Figure 1.1). Only a couple of countries (Qatar and the UAE) have, on average, improved their governance scores, while for most others, their governance metrics have stayed unchanged or even deteriorated slightly over the past decade. These numbers are consistent with the general perception of mishandling and misrule perpetuated by several of the region's governments prior to the "Arab Spring," and the subsequent unrest stemming from political volatility and power voids.

Taken individually, most MENA countries have negative scores on all six dimensions considered by the WGI, and are ranked in the thirty-sixth percentile or lower worldwide—in stark contrast to the scores displayed by advanced, high-income OECD countries (Table A1.2). Among them, four countries (Israel, Oman, Qatar, and the UAE) stand out as regional leaders in terms of governance. All these countries have, on average, positive scores across most of the WGI components. Still, Israel scores negatively on political stability, while the other three performers lack in terms of voice and accountability. On the other side of the spectrum, we find many countries with high negative scores across all these dimensions, as both a result of and

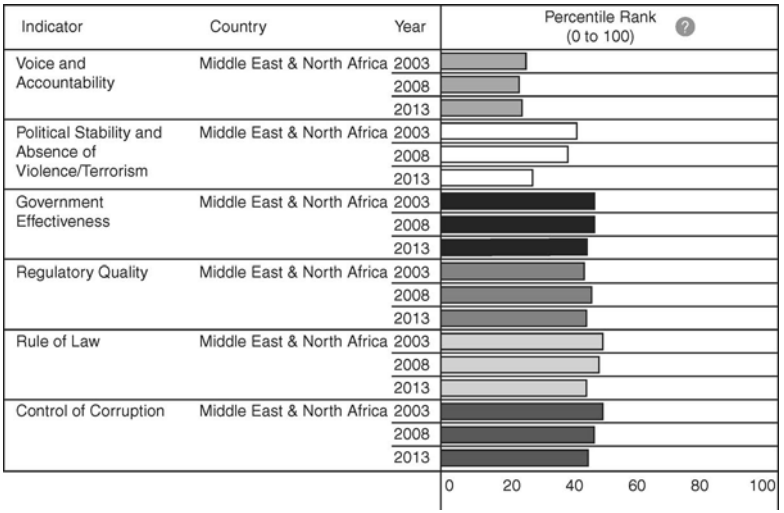

Figure 1.1 Quality of Governance in MENA countries.

Source: Kaufmann D., A. Kraay, and M. Mastruzzi (2010), The Worldwide Governance Indicators: Methodology and Analytical Issues. Available at: www.govindicators.org.

cause for continuous unrest in the region (Syria, Iraq, and Yemen) or lack of democracy (Iran). As expected, given the political and social contexts of the region, all MENA countries (except Israel) score very low (actually negative scores) on voice and accountability criteria, confirming a relative lack of freedom and participation of the citizenry in elections or expressions of opinion. Formal institutional environment (rule of law and regulatory quality) is especially strong in higher-income countries like Bahrain, Qatar, Israel, and the UAE, with few other exceptions (Jordan and West Bank/Gaza). Higher incomes are also associated with more political stability and superior governmental efficiency, while in terms of control of corruption laws and regulations, a few countries are doing extremely well (Qatar, the UAE, and Israel) while most of the region remains on the negative side, with a couple of extreme cases, such as Libya (–1.52), Syria (–1.24), or Yemen (–1.20).

The explanations for these severe governance failures focus on three key aspects. First, the lack of governments' accountability as a result of diminished democratic institutions and weak political freedom is ubiquitous. The historical deficit of democratic tradition in the region has kept many autocrats from being held accountable for the lack of major improvements in terms of economic growth, human development, or other social indicators. Moreover, the lack of free speech and free press in many instances has further amplified this failure for accountability. Second, from a purely economic perspective, many MENA countries suffer from adoption of subpar economic policies dating back to the 1950s, which have resulted in a misguided allocation of authority over natural resources. As a result, a common characteristic of the region is the presence of an overinflated public sector, in which state-owned enterprises often under perform as a result of mismanagement and the inefficient allocation of resources (Pfeifer, 1999). Finally, the presence of rampant corruption exacerbates these aforementioned risks, reducing the efficiency and transparency of governance, with significant negative consequences for growth in the region. Although the primary explanation for the prevalence and severity of corruption resides in the failure of these states, in many instances, bribes and kickbacks are deeply rooted in the cultural and social background of these countries. Hence, corruption in MENA nations takes on a very different meaning from corruption in Western societies, and ranges from being tolerated to often being considered a normal "form of democracy" (Rosen, 2006), which has been used for centuries, as a way to forge relationships in these societies.

World Bank's Doing Business Indicator (DBI)

Given the high rate of unemployment[1] (especially among young people, the highly educated, and women) and the lack of a strong private sector in many of the MENA countries, one avenue through which these countries can improve on these aspects is by facilitating the development of private business and attracting significant volumes of foreign investments. In this regard, the Doing Business Indicator from the World Bank highlights how difficult or easy it is for an entrepreneur in these countries to open and run a business, given the local institutional requirements—as measured by differences across regulatory frameworks between countries. In capturing these differences, the DBI tracks changes in regulations (mostly in terms of number of procedures, duration/time, and monetary costs associated with these steps) across ten areas, specifically:

- Starting a business (including minimum capital required to open a new business)
- Dealing with construction permits
- Getting electricity
- Registering property
- Obtaining credit (including the legal rights index strength, and credit information depth)
- Protecting investments (including the degree of disclosure needed, liability involved)
- Paying taxes (number of taxes and the bureaucratic burden of complying with and paying them)
- Trading across borders (approvals, signatures for import-export operations)
- Enforcing contracts
- Resolving insolvency issues (including the expected recovery rate of debts).

Overall, the DBI indicator provides a bird's eye view of the ease of doing business across 189 economies in the world, and is commonly used in policy analysis aimed to identify areas for regulatory improvements and targeted future reforms. Countries are assigned scores in all 10 aforementioned areas, and are subsequently ranked based on their aggregate performance across these indicators. The standing of each topic is a simple average of the percentile ranking on its component indicators. This is a useful tool for international comparisons, although it obviously faces some methodological tradeoffs (i.e., inability to measure all factors that matter for the survival and performance of the

firm; sampling of firms usually being biased toward big cities/major business hubs; the underlying conditions of the existing regulatory frameworks, which are endogenous to the business environment, etc.) that prevent it from telling the whole story regarding the comparative competitiveness of one business environment versus another.

So, how do MENA countries do in terms of ease of doing business vis-à-vis other regions? Overall, MENA countries score 107 in terms of ranking, which places them in the lowest quartile of the circulation in terms of friendliness of the business environment, thus confirming some of our previous conjectures regarding the characteristics of governments in the region and the lack of a strong private sector (Figure 1.2). Most MENA countries are in the lower half of the DBI ranking, and only few economies in the region manage to be competitive in this respect (i.e., UAE, Bahrain, Oman, Saudi Arabia, Qatar, and Tunisia). The areas with the largest regulatory deficits are in terms of obtaining credit (ranked 133 for the region), enforcing contracts (ranked 118), resolving insolvency (ranked 105), protecting investments (ranked 113), but also the effort needed to start a business (ranked 112). Historically, MENA countries have actually become worse over the last decade or so, as the "distance to the frontier" (i.e., the best practice/score in the world) in all these areas has increased, with some cases—such as starting a business—registering

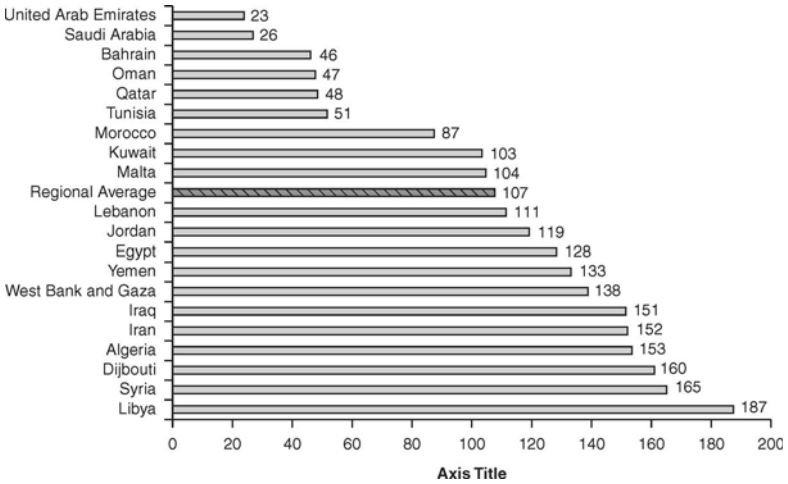

Figure 1.2 Ranking of MENA countries in terms of Ease of Doing Business (2014).
Source: Doing Business database. http://www.doingbusiness.org/.

an increase in this distance of around 30 percentage points from 2005 to 2013 (Doing Business, 2014). Some of these setbacks are driven by several countries in the region who constantly score low on many of these indicators, resulting in very low rankings, like Libya, Djibouti, or Iraq (see Table A1.3). At the opposite end of the spectrum, Saudi Arabia as well as the United Arab Emirates are the regional leaders in the majority of the categories as they continue to improve on their global rankings.

In conclusion, the weakness of the private sector in most MENA countries can be traced back to some several regulatory drawbacks as well as the limited access to credit, which subsequently constricts the number of private employment opportunities and perpetuates the usage of informal authority and corrupt practices (e.g., "wasta," or having connections) to get a public sector job or a job in a state-owned enterprise. This further spills over into the capacity of these countries to raise taxes (given that the informal sector is relatively large) and the ability to attract competitive foreign investments in the region to address the existing unemployment and achieve a better match in terms of skills and education available in these countries. However, these regulatory provisions are very dynamic, and the most recent Doing Business report summarizes some of the major reforms undertaken by these countries in terms of spurring the creation of new businesses and facilitating access to credit and development resources for new firms in these economies. More of these efforts, adapted to the particularities of these markets, are needed to spur reform and promote MENA as a friendlier and more competitive business environment for both domestic and foreign enterprises.

World Bank's Enterprise Surveys (ES)

Although these aforementioned aggregated (country-level) indicators are widely used for international comparisons, providing some useful international comparisons both within the MENA region and also between these countries and the best practices (of countries at the forefront), we know from the literature that there is great heterogeneity in terms of how firms are affected by the institutional constraints in these markets (Kinda et al., 2011). Therefore, in order to tackle this heterogeneity, in the last part of this empirical descriptive exercise of capturing formal institutional aspects in MENA, we are going to concentrate on the perceived institutional constraints experienced by firms in these countries, using firm-level numbers from the Enterprise Surveys produced by the World Bank. In this way, we are going to complement the existing macroeconomic evidence on the status quo

of formal institutions in the MENA region with some microeconomic evidence derived from these surveys. According to these sources, small and medium size enterprises (SMEs) constitute about 80 to 90 percent of the formal private sector in MENA, being responsible for 20–40 percent of the private employment and with real growth opportunities in the future, if complemented by regulatory actions regarding access to finance and streamlined legislation for operation.

Interestingly enough, when examining the aggregate responses of firms with respect to the biggest obstacles faced by firms in these economies, besides "Access to finance" which has already been discussed in previous paragraphs, other factors—pertaining to infrastructure ("Access to electricity") and institutional/political background ("Political instability")—appear even more important (see Table 1.4). More than a quarter of the firms in the MENA region (27.5%) perceive the ongoing political unrest and frequent regime changes as a major challenge to their activities, and the latest wave of violence in the region is clearly represented in these responses (Yemen 49%; West Bank and Gaza 31%; Lebanon 58%). This is almost three times higher than the world average for this indicator (10.5%). Although the majority of MENA countries appear to benefit from good (and in some cases, excellent) infrastructure, several outliers such as Djibouti (48.8%), Iraq (19.7%), and Yemen (23.7%) indicate that excessive instability and violence affects firms also via reduced and cumbersome access to important factors of production, such as electricity. Besides these general prescriptions applicable to all MENA nations, there are also strong idiosyncratic effects at the country-level that are emphasized by these surveys. For example, many enterprises in Egypt perceive informal competition to be a major obstacle to their activities (25.5%), as opposed to excessive taxation (23.2%) in Jordan or corruption in Yemen (26.6%) and Syria (14.2%).

The joint-importance of these factors is also documented by previous studies in the literature. Their results support the hypothesis that in the region, economic growth has been significantly hampered by these country-specific characteristics, as likened to other regions in the world. Thus, an improvement to the labor skill shortages faced by firms in MENA countries could increase real GDP per capita by over 0.4 percent annually (Bhattacharya and Wolde, 2010). These average elasticities of growth rates suggest that addressing all these institutional deficiencies in the region pays off significantly over the long run. Conversely, such solutions require major changes in the institutional underpinnings of these nations, such as labor market policies to improve skill level and job matching especially for private firms

(via subsidies, training, and incentive schemes), measures to improve access to finance (via specialized agencies for SMEs, public promotion measures of private credit, etc.), and investment in infrastructure (i.e., generation, transmission, and distribution of electricity, perhaps through greater public-private and foreign partnerships). Addressing some of these extremely pressing concerns will positively influence both labor productivity and technical efficiency of firms in the region, with a clear objective of improving export-capacity and diversification possibilities for many resource-driven MENA countries (Kinda et al., 2011) as a sustainable avenue for economic growth in the future.

Note

1. According to the latest numbers provided by the UN, the Middle East and North Africa show 18.8 and 24.4 percent youth unemployment (ages 15–24) respectively, compared to 13.1 percent in OECD and Europe, or 9.1 in East Asia.

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Appendix

Table A1.1 Economic Freedom scores in MENA countries (2015)

Country	World Rank	2015 Score	Change in Score from 2014	Property Rights	Freedom from Corruption	Fiscal Freedom
Algeria	157	48.9	–1.9	30.0	36.0	80.0
Bahrain	18	73.4	–1.7	60.0	48.0	99.9
Egypt	124	55.2	2.3	20.0	32.0	85.8
Iran	171	41.8	1.5	10.0	25.0	81.2
Iraq	N/A	N/A	N/A	N/A	16.0	N/A
Israel	33	70.5	2.1	75.0	61.0	61.9
Jordan	38	69.3	0.1	60.0	45.0	93.7
Kuwait	74	62.5	0.2	45.0	43.0	97.7
Lebanon	94	59.3	–0.1	20.0	28.0	91.3
Libya	N/A	N/A	N/A	10.0	15.0	95.0
Morocco	89	60.1	1.8	40.0	37.0	70.9
Oman	56	66.7	–0.7	55.0	47.0	98.5
Qatar	32	70.8	–0.4	70.0	68.0	99.7
Saudi Arabia	77	62.1	–0.1	40.0	46.0	99.7
Syria	N/A	N/A	N/A	10.0	17.0	N/A
Tunisia	107	57.7	0.4	40.0	41.0	74.3
United Arab Emirates	25	72.4	1.0	55.0	69.0	99.5
Yemen	133	53.7	–1.8	30.0	18.0	91.5

Source: Kim and Miller (2015). *Index of Economic Freedom*. http://www.heritage.org/index

Gov't Spending	Business Freedom	Labor Freedom	Monetary Freedom	Trade Freedom	Investment Freedom	Financial Freedom
38.7	66.6	50.5	71.2	60.8	25.0	30.0
73.1	72.5	83.1	74.2	78.6	65.0	80.0
68.0	65.4	53.6	67.4	70.0	50.0	40.0
93.0	57.0	51.3	48.7	41.4	0.0	10.0
43.8	57.7	74.4	73.6	N/A	N/A	N/A
47.8	72.4	67.1	81.6	88.6	80.0	70.0
70.7	59.1	74.4	80.6	79.6	70.0	60.0
61.1	58.6	64.2	74.0	76.2	55.0	50.0
70.6	54.7	60.7	72.0	75.8	60.0	60.0
37.5	46.8	66.7	71.4	80.0	5.0	20.0
61.0	68.8	33.4	81.9	78.2	70.0	60.0
44.2	68.4	76.1	76.2	76.8	65.0	60.0
71.9	70.5	71.2	79.7	81.8	45.0	50.0
61.9	65.8	72.7	68.4	76.4	40.0	50.0
N/A	57.3	49.1	N/A	N/A	0.0	20.0
70.8	81.2	69.1	74.8	61.2	35.0	30.0
85.8	74.7	83.8	83.8	82.4	40.0	50.0
59.9	54.0	57.1	68.5	77.6	50.0	30.0

Table A1.2 The quality of governance in MENA countries in comparison with OECD countries (2013)

Country \ Indicator	Voice and Accountability	Rule of Law	Regulatory Quality	Political Stability	Government Effectiveness	Control of Corruption
OECD countries	1.29	1.37	1.36	0.94	1.43	1.39
Algeria	−0.89	−0.68	−1.19	−1.17	−0.60	−0.48
Bahrain	−1.32	0.35	0.60	−1.34	0.58	0.45
Djibouti	−1.44	−0.76	−0.55	−0.12	−1.18	−0.44
Egypt, Arab Rep.	−1.04	−0.60	−0.70	−1.62	−0.89	−0.60
Iran, Islamic Rep.	−1.60	−0.98	−1.50	−1.27	−0.70	−0.68
Iraq	−1.10	−1.47	−1.26	−1.99	−1.08	−1.25
Israel	0.63	0.95	1.16	−1.09	1.22	0.84
Jordan	−0.82	0.39	0.11	−0.62	−0.11	0.09
Kuwait	−0.65	0.39	−0.09	0.14	−0.07	−0.15
Lebanon	−0.44	−0.78	−0.09	−1.69	−0.39	−0.92
Libya	−1.00	−1.36	−1.83	−1.81	−1.50	−1.52
Morocco	−0.72	−0.25	−0.17	−0.50	−0.07	−0.36
Oman	−1.00	0.56	0.47	0.48	0.21	0.08
Qatar	−0.86	1.04	0.74	1.22	1.07	1.24
Saudi Arabia	−1.82	0.26	0.08	−0.41	0.06	−0.01
Syrian Arab Republic	−1.77	−1.48	−1.61	−2.68	−1.34	−1.24
Tunisia	−0.11	−0.20	−0.35	−0.91	0.00	−0.15
United Arab Emirates	−1.03	0.64	0.78	0.92	1.17	1.29
West Bank and Gaza	−0.87	−0.44	0.15	−1.90	−0.78	−0.71
Yemen, Rep.	−1.35	−1.16	−0.74	−2.35	−1.20	−1.20

Source: The Worldwide Governance Indicators. Available at: www.govindicators.org
Note: All six WGI indexes range from −2.5 to 2.5.

Table A1.3 Summary of regulatory quality in the MENA region (2014): Ease of doing business

Indicator	Worse regional performance	Best regional performance	Regional average	Best global performance
Starting a Business (rank)	Libya (171)	UAE (37)	112	New Zeeland (1)
Procedures (number)	Algeria (14)	3 Economies* (5)	8	New Zeeland (1)
Time (days)	West Bank and Gaza (45.0)	3 Economies* (8.0)	19.9	New Zeeland (1.0)
Cost (% of income per capita)	Djibouti (184.7)	Bahrain (0.9)	28.9	Slovenia (0.0)
Paid-in Min. Capital (% of income per capita)	Bahrain (266.6)	9 Economies* (0.0)	45.4	112 Economies* (0.0)
Dealing with Construction Permits (rank)	Libya (189)	Bahrain (4)	108	Hong Kong SAR, China (1)
Procedures (number)	Kuwait (24)	Iraq (10)	16	Hong Kong SAR, China (6)
Time (days)	Iran, Islamic Rep. (320.0)	United Arab Emirates (44.0)	145.7	Singapore (26.0)
Cost (% of income per capita)	Djibouti (1,949.2)	Qatar (1.1)	283.3	Qatar (1.1)
Getting Electricity (rank)	Iran, Islamic Rep. (169)	United Arab Emirates (4)	77	Iceland (1)
Procedures (number)	3 Economies* (7)	United Arab Emirates (3)	5	10 Economies* (3)
Time (days)	Djibouti (180)	United Arab Emirates (35)	86	Germany (17)
Cost (% of income per capita)	Djibouti (7,487.0)	Qatar (4.0)	1,038.0	Japan (0.0)
Registering Property (rank)	Libya (189)	United Arab Emirates (2)	93	Georgia (1)
Procedures (number)	Algeria (10)	United Arab Emirates (2)	6	4 Economies* (1)
Time (days)	Morocco (60.0)	Saudi Arabia (8.0)	33.0	New Zealand (1.0)
Cost (% of income per capita)	Syrian Arab Republic (27.8)	Saudi Arabia (0.0)	5.9	5 Economies (0.0)
Getting Credit (rank)	Libya (186)	Saudi Arabia (55)	133	Malaysia (1)
Strength of legal rights indes (0–10)	Djibouti (2)	Saudi Arabia (5)	3	10 Economies* (10)
Depth of credit information index (0–6)	Djibouti (1)	Saudi Arabia (6)	4	31 Economies *(6)
Public registry coverage (% of adults)	Djibouti (0.3)	Oman (21.0)	11.9	Portugal (100.0)
Pribate bureau coverage (% of adults)	Egypt, Arab Rep. (19.6)	Saudi Arabia (44.3)	28.4	22 Economies (100.0)
Protecting Investors (rank)	Libya (187)	Saudi Arabia (22)	113	New Zealand (1)
Extent of disclosure index (0–10)	Malta (3)	Saudi Arabia (8)	6	10 Economies* (10)

Continued

Table A1.3 Continued

Indicator	Worse regional performance	Best regional performance	Regional average	Best global performance
Extent of director liability index (0–10)	Lebanon (1)	Saudi Arabia (8)	5	Cambodia (10)
Ease of shareholder suits index (0–10)	Djibouti (0)	Malta (8)	3	3 Economies* (10)
Strength of investor protection index (0–10)	Djibouti (2.3)	Saudi Arabia (6.7)	4.5	New Zealand (9.7)
Paying Taxes (rank)	Algeria (174)	United Arab Emirates (1)	64	United Arab Emirates (1)
Payments (number per year)	Yemen, Rep. (44)	Saudi Arabia (3)	18	Hong Kong SAR, China (3)
Time (hours per year)	Algeria (451)	United Arab Emirates (12)	220	United Arab Emirates (12)
Trading Across Borders (rank)	Iraq (179)	United Arab Emirates (4)	89	Singapore (1)
Documents to export (number)	Iraq (10)	United Arab Emirates (3)	6	Ireland (2)
Time to export (days)	Iraq (80)	United Arab Emirates (7)	20	5 Economies (6)
Cost to export (US$ per container)	Iraq (3,550)	Morocco (595)	1.127	Malaysia (450)
Documents to import (number)	Iraq (10)	United Arab Emirates (5)	8	Ireland (2)
Time to import (days)	Iraq (82)	United Arab Emirates (7)	24	Singapore (4)
Cost to import (US$ per container)	Iraq (3,650)	United Arab Emirates (615)	1.36	Singapore (440)
Enforcing Contracts (rank)	Syrian Arab Republic (179)	Iran, Islamic Rep. (51)	118	Luxembourg (1)
Time (days)	Djibouti (1,225)	Iran, Islamic Rep. (505)	658	Singapore (150)
Cost (% of claim)	Malta (35.9)	Oman (13.5)	24.6	Bhutan (0.1)
Procedures (number)	Syrian Arab Republic (55)	Yemen, Rep. (36)	44	Singapore (21)
Resolving Insolvency (rank)	3 Economies *	Bahrain (27)	105	Japan (1)
Time (years)	Djibouti (5.0)	Tunisia (1.3)	3.2	Ireland (0.4)
Cost (% of estate)	Egypt Arab Rep. (22)	Oman (4)	14	Norway (1)
Recovery rate (cents on the dollar)	Iraq (0.0)	Bahrain (67.4)	29.4	Japan (92.8)

Source: Doing Business database. http://www.doingbusiness.org/
Note: * Two or more economies share the top ranking in this indicator.

Table A1.4 The biggest obstacles to firm activities in MENA countries

Economy	Year of the survey	Access to finance	Access to land	Business licensing and permits	Corruption	Courts	Crime, theft and disorder	Customs and trade regulations	Electricity	Inadequately educated workforce	Labor regulations	Political instability	Practices of the informal sector	Tax administration	Tax rates	Transportation
All Countries		16.6	3.4	2.6	6.7	1	4.5	3.5	10.1	7.4	2.9	10.5	12.2	3.4	11.9	3.2
Middle East & North Africa		9.8	3.8	2.4	6.4	0.9	2.1	3.4	19.8	3.5	2.8	27.5	6.3	1.3	9.2	1.2
Djibouti	2013	1.9	0.8	1.8	12.6	0.7	0	3.8	48.8	6.6	1.7	1	4	1.3	12.4	2.6
Algeria	2007															
Egypt, Arab Rep.	2007	7.1	3.1	2.2	14.8	1.1	0	2.5	6.7	8.7	4.6	0	25.5	3	19.8	1.1
Egypt, Arab Rep.	2008	7.4	7.5	2.3	8.1	0.5	0.2	3	4.7	18.1	3.4	0	25.5	2	14.4	3.1
Iraq	2011	4.7	10.5	6.4	2.9	0	1.4	4.3	19.7	7	5	15.1	16.7	1.3	4.6	0.5
Jordan	2006	9.2	3.7	25.4	6.1	0.5	0.5	3.5	1.2	9.2	6	7.7	6	11.3	8.6	1.1
Jordan	2013	31.2	4.8	1.9	4.6	1.4	0.6	3.2	1.8	4.8	6	10.6	3.3	1.1	23.2	1.6
Lebanon	2009	10.6	1.3	0.5	4.8	4.5	1.1	2.1	11.6	4.2	1.3	45.2	4	0.3	5.6	2.9
Lebanon	2013	6.6	1.9	0.6	6.7	1.8	1.4	2.1	11.1	0.7	1	58	2	1.6	4.4	0.1
Morocco	2007															
Syrian Arab Republic	2009	6.6	3.2	3.2	14.2	9	0.2	9.4	11.8	12.8	7.8	0	11.2	5	4.8	0.6
West Bank and Gaza	2006	10.7	1.8	4	4	0	1.3	1.3	11.2	0.5	0.5	45.1	6.7	1.8	0.5	10.7
West Bank and Gaza	2013	9.4	3.2	3.6	3.9	0.5	1.3	6	13.4	1	2.1	31.1	10.6	2	10	2.1
Yemen, Rep.	2010	5	6.6	0.9	26.6	1.5	1.3	0.8	32.1	5.4	0.2	7.7	2.1	2.6	6.8	0.5
Yemen, Rep.	2013	4.8	1.5	0	7.9	0.8	7.8	0.7	23.7	0.8	1.3	49	1.1	0.3	0.2	0.2

Notes: This indicator refers to the percentage of firms that have identified obstacle "x" as a major constraint for their activity; this indicator is computed using data from manufacturing firms only.

Source: World Bank Enterprise surveys. http://www.enterprisesurveys.org