

# BUILDING FORWARD BETTER IN THE MIDDLE EAST AND NORTH AFRICA: A MEDIUM-TERM PERSPECTIVE

Jihad Azour

*The strong and coordinated policy actions to save lives and support the recovery in Middle East and North Africa (MENA) region will hopefully put the health crisis behind us in a few years.*

Meanwhile, this crisis has posed major challenges to the region's economies that have embarked on a long and divergent path to recovery and highlighted the limitations of the current growth model. But it also provides a rare opportunity in the quest to move to a new development model to enhance growth and accelerate the transition toward a more sustainable and inclusive path. Will policymakers use this transitional moment to tackle the region's deep-seated vulnerabilities, address transformational challenges, and leverage accelerating global trends? This will help define the trajectory for the next five years in the MENA region.

A few risks have emerged from the crisis as the region's pre-existing vulnerabilities are being exacerbated by the pandemic:

- **Public financing pressures.** The crisis has led to a widening of deficits in MENA countries, which together with the economic contraction, has inflicted a sizable increase in debt and financing needs. About one-half of MENA countries are expected to have their debt levels above 70% of GDP over the medium term. Public gross financing needs will remain elevated, likely exceeding \$900 billion in 2021–22, compared to less than \$600 billion during 2018–19. Countries that rely on external financing could be more susceptible to global financial volatilities, and those heavily financed by domestic banks could risk crowding out private sector credit, hindering growth prospects.

- **Economic scarring.** The region's large exposure to the battered services sector (particularly tourism), limited ability to work remotely, and weaker corporate balance sheets will have lingering adverse effects on job growth, especially in lower-income countries. Lack of diversification and a dynamic private sector in many countries make job creation even more challenging. Consequently, economic scarring is a significant risk. According to the IMF's April 2021 projections, medium-term real output in the MENA region is expected to remain about 5 percentage points below the pre-crisis trend.
- **Rising inequality.** The crisis has worsened youth unemployment and female labor force participation across the region, while weaknesses in social protection systems and high levels of informality have added to the risk of rising inequality. In past crises, informality had a cushioning effect by allowing workers to transition to informal employment rather than becoming unemployed. That cushioning effect, however, was largely absent during the current crisis, as many sectors with high levels of informality, particularly non-tradable services, were severely affected by lockdown measures.

On the positive side, many countries have demonstrated their ability to swiftly adopt strong and innovative policy measures in response to the crisis. A good example is to deploy digital solutions to enhance the efficiency of social protection systems and expand their coverage, including to reach informal workers (e.g., Egypt, Morocco, and the UAE). Such adaptability and innovation will be critical in the coming years to leverage accelerating trends in digitalization and efforts to build a greener global economy. These trends will provide opportunities for new investment and creation of high-quality jobs in emerging sectors.

While strategies for advancement may differ between countries and situations in the region, MENA economies need to focus on the following priority areas, with sequencing tailored to country-specific conditions:

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- **Addressing macro-financial vulnerabilities** will require growth-friendly medium-term fiscal adjustment plans in effect now. Measures to improve spending efficiency and broaden the tax base will help channel additional resources to invest in the future and strengthen the social compact. Debt management strategies should proactively mitigate financing risks, taking advantage of current favorable conditions, while seeking to further strengthen financial sector and expand domestic capital markets.
- **Rethink the role of the state and foster a dynamic private sector.** State interventions during the pandemic have helped mitigate the health and social impact of the crisis. The public sector's role in these areas needs reinforcing. In parallel, an overhaul of state-owned enterprises, together with competition, regulatory, and labor reforms, will be critical to allowing the resource reallocation needed to bolster a more dynamic private sector and diversified economies. These efforts should also be supported by reforms to improve governance in the region.
- **Enhance social protection and invest in youth and women.** Further efforts can build on the progress made during the crisis to strengthen well-targeted social safety nets, including to

protect informal workers. Financial innovation and digitalization offer new possibilities to accelerate formalization and inclusion. Facilitating access of women and youth to formal employment and investing in education will help tap into the region's most important asset: a large, young, and tech-savvy population.

- **Leverage emerging global trends and benefit from regional coordination.** Adapting to climate change creates an opportunity for green investments and job creation. Accelerating digitalization could open another source of growth, especially for countries with more technologically advanced populations. A key factor of success will be regional cooperation to create a larger market and to set common standards. The Saudi Green Initiative is an important first step, and more is needed to build a consensus around a road map to a digital and greener future.

With shared commitment to this reform agenda among MENA countries and concrete measures starting now, we will look back to 2021 as the moment when economic transformation truly took hold and a brighter future was forged.

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