



# ► Productivity growth, diversification and structural change in the Arab States

February 2022

## ► Introduction

**Increasing productivity is a shared concern of ILO constituents, who view it as a catalyst for creating decent work, inclusive growth and shared prosperity.**

The report aimed at understanding the contours of a business environment conducive to productivity growth and sustainable enterprise development for decent job creation in selected Arab states. In line with the building Back Better agenda with a human-centred approach, the report strove at identifying the elements of coherent and comprehensive policy frameworks to raise productivity for a swift economic and employment recovery.

**In this research, when we refer to Arab States we include:**

- Bahrain
- Iraq
- Jordan
- Kuwait
- Lebanon
- the Occupied Palestinian Territory
- Oman
- Qatar
- Saudi Arabia
- the Syrian Arab Republic
- the United Arab Emirates
- Yemen



### ► 5 main objectives:



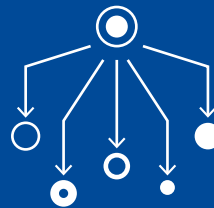
Analyse productivity trends in selected Arab states during the 1950-2019 period.



Assess the business environment and identify barriers to productivity growth.



Examine the role of management practices in business performance.

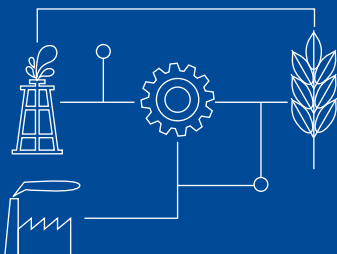


Identify challenges and opportunities for diversification and structural change.



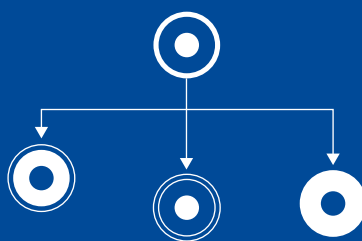
Assess whether national development plans address productivity growth.

## ► Economic structure of the Arab region



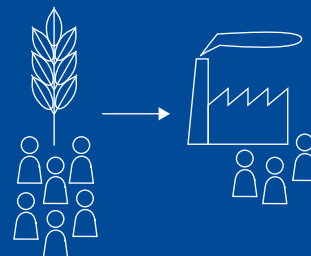
### Structural Transformation

Arab economic development has not yet led to reallocation of labour from low-productivity to high-productivity sectors. Where the economy is largely dependent on oil revenues, the economic structure tends to be less diversified, the service sector is predominant while manufacturing is marginal.



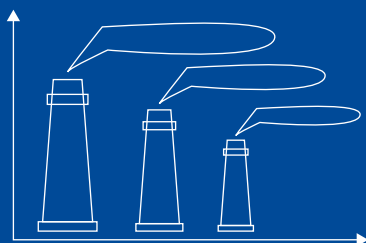
### Diversification

Diversification and the reallocation of resources from low-productivity to higher-productivity economic activities will increase aggregate productivity in the economy. Reallocation of resources through the fiscal system may play a major role in this process. Foster workforce quality and the extent to which workers' skills are adequate for high value-added economic activities and country's needs are other key factors to promote diversification and structural change.



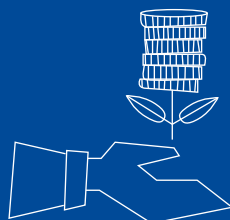
### Manufacturing

The shift in economic activity from agriculture to manufacturing is a major source of productivity increase in developing countries, whilst the shift to services will hinder productivity growth as services are less capital intensive and less open to international competition due to the non-tradable character of the sector.



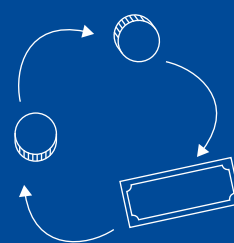
### Premature deindustrialization

The Arab economies have experienced deindustrialization and the dominance of the service sector engendered by the presence of oil revenues, without having gone through a proper experience of industrialization. This trend is detrimental in economic growth and productivity growth and leads to increases in informality.



### Investment and natural capital depletion

To secure sustained investment, growth and productivity in the long run with increased investment rates are needed to account for resource depletion and ensure an adequate physical capital stock in the future. diversification and structural change.



### Exchange rates

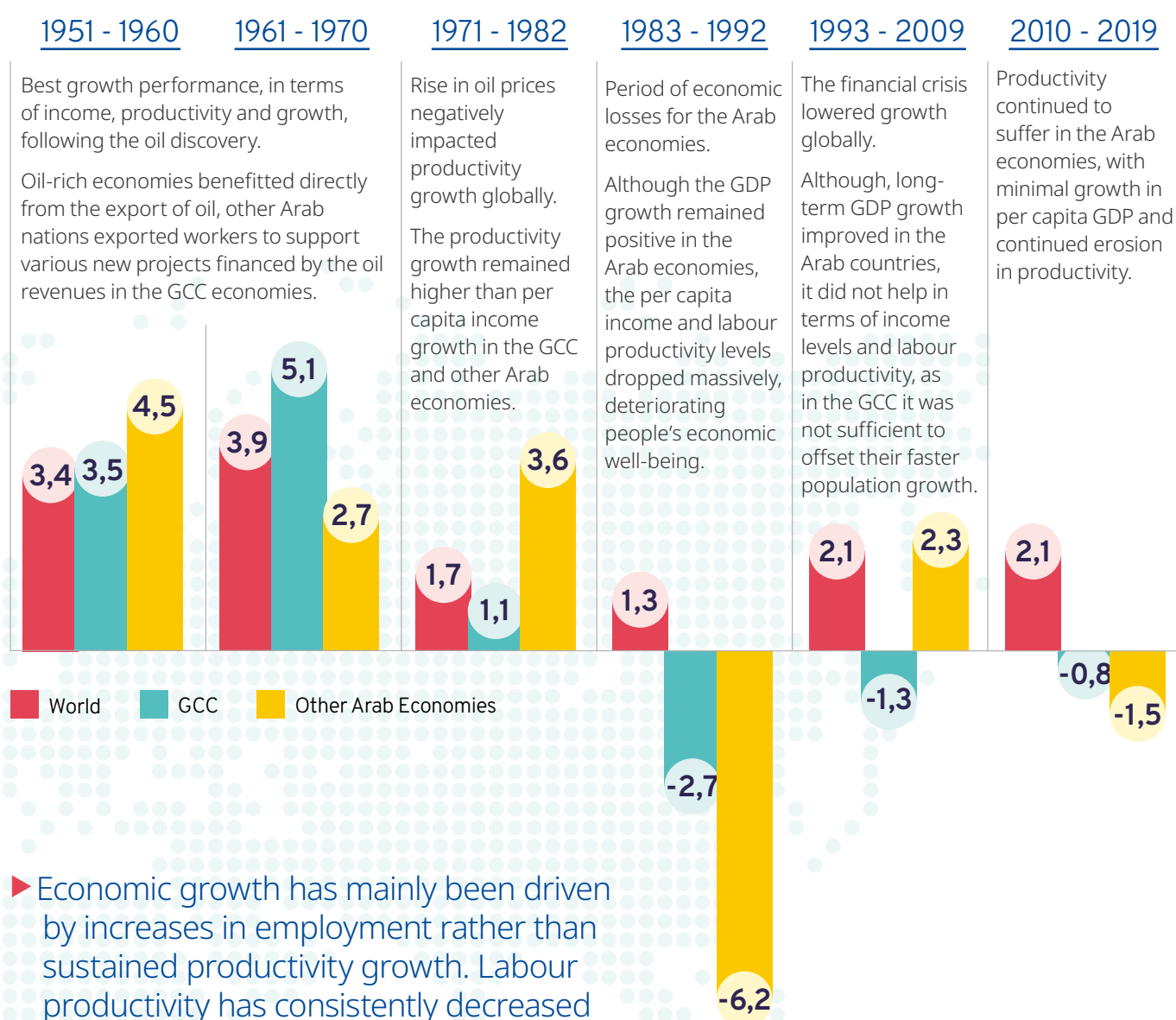
In countries of the Arab region that are heavily dependent on oil, exchange rate regimes follow a fixed exchange rate system. The fact that there is no vibrant export sector in traded goods shunts the political economy of these countries from developing group interests that would push for a more flexible exchange rate regime.

## ► Productivity trends in the Arab States in the period 1950-2019

The economic growth dynamics in the Arab region feature a high but falling income levels in the GCC's oil-rich economies and shallow yet falling levels in the other Arab nations. Productivity remains a challenge for the Arab economies since the 1980s until the present.

During the last decade, starting in 2010, the region continued to suffer from declines in productivity and witnessed a disconnect between productivity and per capita income growth, implying increasing reliance on less productive jobs.

### ► Labour productivity growth (1950-2019)



► Economic growth has mainly been driven by increases in employment rather than sustained productivity growth. Labour productivity has consistently decreased since the late 1970s while total factor productivity (TFP) has contracted since 2005. Not surprisingly, the overall labour productivity of the Region has had the worst performance worldwide.

## Alarming productivity patterns in the Arab States

When compared with other regions of the world, the Arab region is the worst performing in terms of productivity growth. This is the result of poor overall efficiency to transform inputs into output, skills gaps and mismatches, and the region's inability to translate its capital investment into productivity gains. Persistent challenges for private sector organisations to develop vibrant and competitive business models due to government interventions, and the limited achievements of diversification policies aimed at fostering a productivity-driven structural change, are other important contributing factors. This has led to a weakening in growth of per capita income relative to advanced economies, which is particularly worrying in relatively poor Arab economies.

### ► Main findings



► The oil-supported economic boom did not sustain longer, as the GCC economies seemed to have caught up in the resource curse, with no economic diversification.



► The fall in income and growth was fuelled by the region's excessive reliance on employment driven growth, tapping the cheap foreign workers. While other regions of the world combined employment growth and productivity growth to drive GDP, both the GCC and the other Arab economies hardly prioritized productivity.



► Growth in output, per capita income, and labour productivity have also been quite volatile in the Arab region, particularly in the GCC economies, as these trends relied heavily on global trends in oil prices and oil demand.



► While the fall in relative income and productivity levels in the GCC economies is largely an inevitable outcome as they move from resource-dependent economies to more diversified ones, the fall in the other Arab economies is alarming.



► The slowdown in productivity is also a function of poor overall efficiency, but what is also alarming about the region is its inability to translate its capital investment into productivity.



► The lack of a solid manufacturing sector that can absorb semi-skilled and low-skilled workers and the lack of a vibrant private sector in both the GCC and other Arab economies adds to their challenges to excel productivity growth.

► To foster a job-rich recovery with decent work opportunities, ensuring business continuity and raising productivity through innovation, **diversification** and **structural change** are of the utmost importance.

► Global call to action for a human-centred recovery from the COVID-19 crisis that is inclusive, sustainable and resilient. Adopted at the 2021 International Labour Conference

## ► Barriers to sustainable enterprise development

The ILO productivity ecosystem aims to identify and assess the main barriers to productivity growth that arise from faulty business environments (macro level), sectoral frictions and challenges (meso level), and inadequate management practices (micro level).

Business leaders in the Arab States have identified the following bottlenecks.

### The Macro level:

#### ► Political instability

#### ► Access to credit

- The institutional framework does not facilitate access to credit for investment and working capital, which mainly affects SMEs. Firms have adjusted their funding strategies to rely more on internal and recently on private equity financing.
- Firms with adequate access to credit grew (in terms of employment) and sold more products and services

#### ► Tax rates

- Arab States, with rare exceptions, does not have a particularly demanding tax system.
- Enterprises that reported tax-related obstacles as a major constraint exhibit lower productivity.

#### ► Access to electricity

- Non GCC economies spend more time in getting adequate electricity supply compared to lower-middle and upper-middle-income peers. Getting electricity is one of the most important concerns in Jordan, Iraq, Lebanon and the Occupied Palestinian Territory.

- Small and medium-sized enterprises (SMEs) employ the largest number of workers:

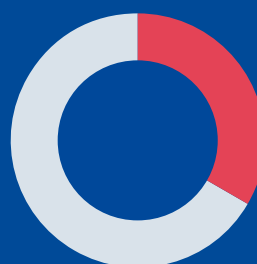
► **70%**

globally

► **97%**

in the Arab states —  
with microenterprises  
predominance

- Region's exports:



► **1/3**

of their potential

Business environment should be more conducive to importing and exporting - this could encourage the internationalization and growth of SMEs.



## ► The Meso Level (sectoral):

- Services is the main economic sector. Small enterprises are mainly working in retail while large firms in other services (e.g., finance, insurance) that exhibit higher productivity.
- There is a wage gap between large enterprises and SMEs rather than across sectors. Large enterprises tend to pay higher wages compared to SMEs.
- Larger and/or more mature (over 5 years) enterprises are more productive than microenterprises and/or young businesses.



## ► The Micro level (enterprise): Addressing structural factors at firm level

### ► Management practices

- Enterprises with more experienced managers, exhibit higher productivity.
- Enterprises that innovate and exhibit good management practices can deal with political instability in a better way.

### ► Technology adoption

- Enterprises still struggle to adopt remote work, adapt their operations to online services and incorporate digital solutions to their processes.
- Disparities in access to internet, informality and other factors affect the ability of lower-income economies to work from home and adopt digital solutions.
- Medium- and low-tech sectors have considerable room for improvement toward the technological frontier.




## Policies to enhance productivity :



- **tax policies for R&D** to encourage enterprises to spend on research and innovation;
- **productive development policies** to achieve inclusive growth, productivity increases and structural transformation;
- **gender equality** in labour participation; gap and disparities affect female income, wealth and retirement fare;
- **competition in product and labour market**;
- **linking wage growth to productivity growth**.
- **develop a coherent policy framework** to promote productivity growth as the strategic and sustainable means to raise standards of living.
- **address skills gaps and mismatches** by investing in up-skilling and re-skilling according to market's needs. Skills in high demand include technical knowledge, teamwork and collaborative skills, organization skills and attention to detail, communication and digital skills.
- **enable technology adoption** by enterprises in the short to mid-term to foster productivity growth, diversification, and business resilience.
- **upgrade management practices** to enhance productive efficiency, entrepreneurship, business performance, and working conditions.

## ► National development plans and visions in the Arab region

► What changes to national development plans the selected Arab States could take into account to **increase productivity**?



**In general:**

- Lack of productivity as the backbone of economic development to raise standards of living.
- Significant emphasis on investments in ICT.
- Significant component related to the development of human capital.
- Significant presence of the R&D component.
- No addressing the competition in product and labor market issue.
- No addressing the issue of informality and its relation to productivity.

► **Compatibility between national plans and visions with policy framework to enhance productivity**

- weak in the areas of industrial policy, social and labor institutions and gender equality.
- good in the areas of diversification, skills development and education, ICT investment, and the environment.<sup>1</sup>



<sup>1</sup> See ILO (2015) Guidelines for a just transition towards environmentally sustainable economies and societies for all. Available at [https://www.ilo.org/wcmsp5/groups/public/---ed\\_emp/--emp\\_ent/documents/publication/wcms\\_432859.pdf](https://www.ilo.org/wcmsp5/groups/public/---ed_emp/--emp_ent/documents/publication/wcms_432859.pdf).

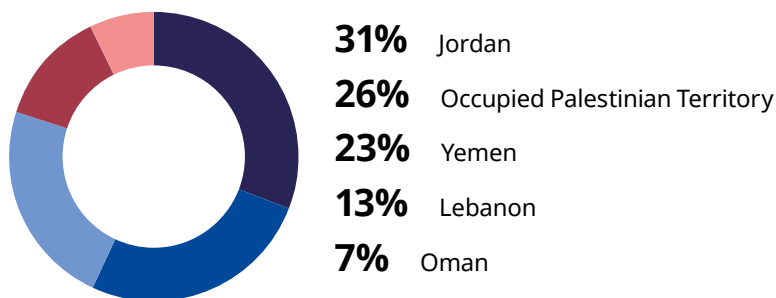


## ► Impact of COVID-19 on business

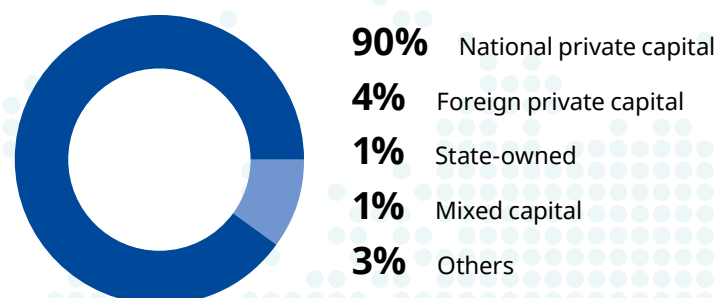
### Jordan, Lebanon, Oman, Yemen, and Occupied Palestinian Territory<sup>1</sup>

The ILO conducted an enterprise survey in selected countries in the Arab States to assess challenges and opportunities for sustainable enterprise development and economic growth amid the COVID-19 pandemic.

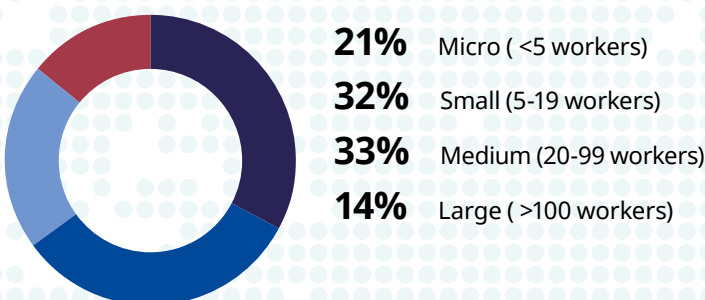
#### Survey sample by country (percentage of surveyed enterprises)



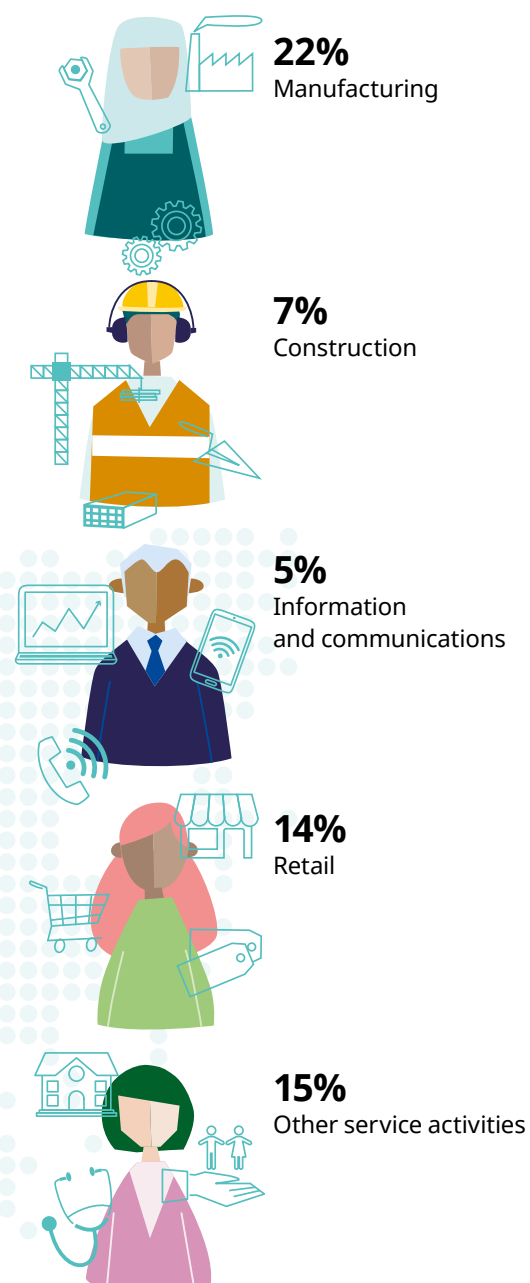
#### Type of ownership (percentage of surveyed enterprises)



#### Size of enterprises (percentage of surveyed enterprises)



#### Economic sector (percentage of surveyed enterprises)<sup>2</sup>



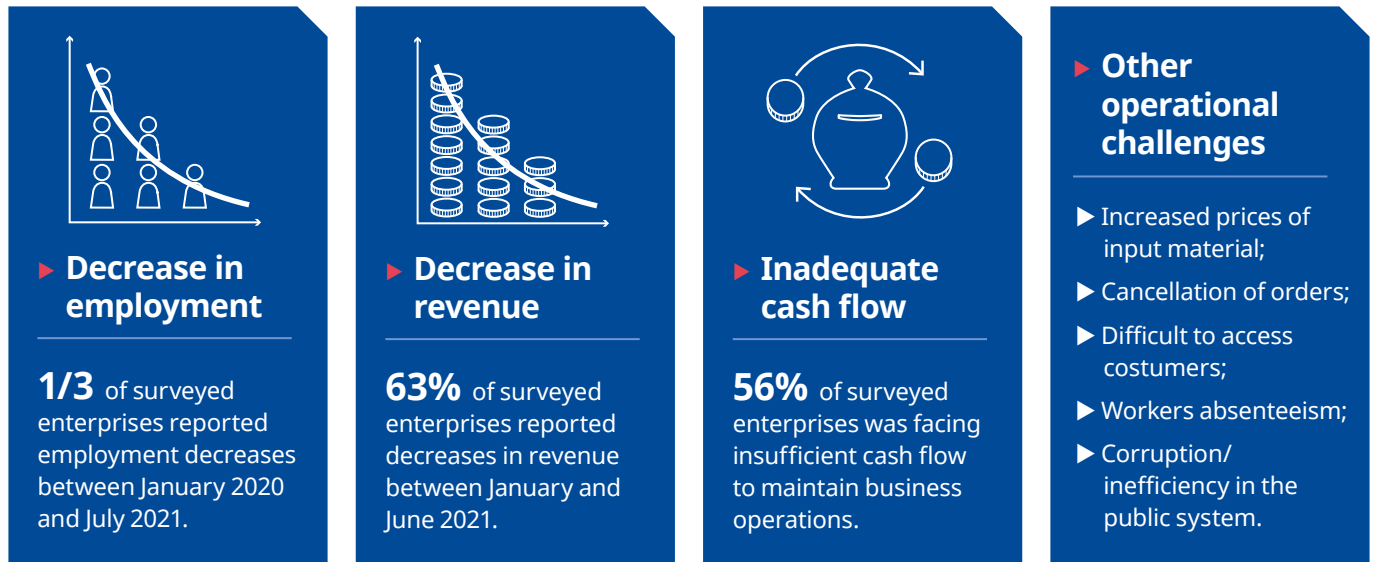
<sup>1</sup> The survey was conducted online between August and November 2021 with 586 enterprises in five countries, namely, Jordan, Lebanon, Occupied Palestinian Territory, Oman, and Yemen. Five employers and business membership organizations (EBMOs) disseminated the survey to their members.<sup>93</sup> These EBMOs are the Jordan Chamber of Industry, Association of Lebanese Industrialists, Federation of Palestinian Chambers of Commerce, Oman Chamber of Commerce and Industry, and Federation of Yemen Chambers of Commerce and Industry.

<sup>2</sup> Economic sectors accounting for less than 5 per cent of the regional sample are not displayed in this figure. These sectors include Administrative or support services; Agriculture, forestry or fishing; Arts, entertainment or recreation; Education; Financial or insurance activities; Hotels or restaurants; Human health or social work; Mining or quarrying; Professional, scientific or technical activities; Public administration or defence; Real estate activities; Supply of electricity, gas, water or waste management; and Transportation or storage services.



## Impact of COVID-19 on enterprises

The COVID-19 pandemic has exacerbated existing challenges in the Arab region including weak public institutions, economic and political instability, undiversified economies, and high unemployment.



### Operational challenges during COVID-19 (depending on the sector):

- Retail enterprises were particularly affected by inadequate cash flow to operate.
- Manufacturing enterprises reported high prices of input materials.
- Service enterprises were affected by reduction in demand due to order cancellations.
- Construction enterprises struggled with worker absenteeism.

The COVID-19 pandemic primarily impacted micro, small, and medium enterprises (MSMEs) in terms of **employment losses**.

The COVID-19 pandemic hit **revenues** of micro and small enterprises the hardest. In fact, the shares of enterprises reporting strong or medium revenue losses decreased as the enterprise became larger.

- 39% of surveyed enterprises thinks that governments **had not** adequate policies to promote innovation and technologies adoption.

Governments can encourage the adoption and development of new technologies with financial incentives (e.g., tax reductions, grants) by collaborating on such innovations, buying them and/or reducing related risk. The extent to which governments influence and encourage innovation can have major implications on enterprises' growth and productivity.

**Only 2 out of 10 enterprises agreed that governments in their respective countries had adequate policies to promote innovation and technology adoption.**



## ► Which policy framework to build forward better in the post-COVID-19 economic environment?

### Recommendations // To Governments:

1. Bring productivity growth, diversification, and structural change to the forefront of national development plans.

2. Adopt a long-term systemic approach to foster economy-wide productivity and sectoral productivity coupled with adequate productivity data collection and measurement capabilities at the national governmental level.

3. Continue diversification efforts in oil-dependent countries and broader structural change in non-oil dependent countries, through privatization and design and implementation of industrial and productive development policies.

4. Promote reforms to improve the business environment aimed at reallocating resources to the most productive sectors.

5. Fostering regional integration: attempt to integrate the region's economies by removing trade barriers and create areas where it can act as a single market. Specific measures supporting internationalization and growth of SMEs should be prioritized.

6. Develop proactive and comprehensive national employment policies making the labour market more efficient and with a focus on promotion of gender equality and female labour market participation and reduction of informality while encouraging the growth of the formal economy.

7. Invest in knowledge capital, skills development, and technologies to improve the overall efficiency of input use. Policymakers, businesses, and educational institutions devise better-coordinated skills policies to develop productivity-oriented business strategies.

8. Provide incentives to nudge and support enterprises to upgrade management practices.

9. Develop policies to promote access to credit, financial deepening and financial inclusion.



## ► Which policy framework to build forward better in the post-COVID-19 economic environment?

Recommendations // To Employers and Business membership Organizations (EBMOs):

1. Embrace **productivity growth** as a priority.

2. Develop a research agenda on productivity.

3. Track progress of employers' agenda on productivity.

4. Continue engaging in **social dialogue** to come up with innovative solutions to promote economic recovery.

5. Provide **training courses, guidance** and **practical tools** to improve essential management practices, from how to design a professional business strategy to Lean, and the like, management methodologies for continuous improvement.

6. Courses, trainings, and handbooks on **how to reduce waste** by identifying none-added-value activities, streamline processes, and eliminate poor working arrangements can be instrumental to enhance performance, productivity, innovation, and evolution

7. Assess enterprises' capability building needs to offer members training opportunities and practical services to improve productivity on a regular basis.



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