



S E C T O R B R I E F

SOCIAL PROTECTION IN MENA

Regional Issues and Strategic Directions

The MENA region faces important economic and social risks that threaten investments in human capital and compromise the welfare of the population:

Given an incomplete agenda of structural reforms, economic growth remains weak and erratic. Several studies cite the region's worsened total factor productivity (TFP) growth as a primary reason for low economic growth (see Keller and Nabli, 2002; Dasgupta et al., 2002) and conclude that TFP growth in MENA has not been positive for the last thirty years. At the core of the problem are such factors as an unfriendly private sector business environment, public sector dominance in economic activities, underdeveloped financial sectors, and inadequate levels of human capital — a recent study found that education, by gearing students toward public sector employment, has failed to contribute to economic growth (Pritchett, 1999).

Economic growth in the region is also affected by external shocks as well as social and political instability. The lack of economic diversification and dependence on commodities has exposed many countries not only to oil-price volatility but also to trade shocks and the post-1998 global economic decline. Regional political events—including the Palestinian-Israeli conflict, September 11, and the Afghan and Iraq wars—have also imposed a toll on the countries.

Due to a rapidly growing labor force, unemployment is becoming one of the main development challenges. Driven by still-high fertility rates and increasing female labor participation rates, the labor force is projected to grow by more than four million units, on average, each year between now and 2030. This will require the creation of more than fifty million new jobs between 2002 and 2015. The labor force growth rate is expected to decline gradually from the current 3.3 percent per year to 1.8 percent only in the second half of the 2020s. In the absence of institutions that support private sector lead growth and a dynamic labor market, the unemployment rate, currently estimated at around 16%, will likely rise. The unemployment problem is more pronounced in Algeria, Egypt, Iran, and Morocco, which together account for two-thirds of the labor force in the region.

The gradual integration into the world economy brings new opportunities but at the same time new sources of risks and new constraints. International competition will impose important reallocations of resources across sectors and the restructuring of public firms. The flexibility integral to the development of product and service markets will diminish the number of “guaranteed for life” jobs. At the same time, the requisite monetary and fiscal discipline will limit expenditures in the social sectors. In addition, growth, transformations in the socioeconomic structure,

Yemen Second Social Fund Project

In May 2000, the World Bank approved a credit to Yemen in the amount of US\$75 million (56 million SDR) to support the Second Social Fund for Development Project.

The objective of the project is to improve the range of services and options available to the poorer segments of the Yemeni population through a combination of community development, capacity building, and micro-finance programs. The project will also continue to support the Yemen Social Fund for Development, which was financed by the Bank, and has proven to be a significant element in Yemen's strategy of spreading the benefits of growth and protecting the poor.

The project is expected to benefit the poor who lack access to essential services, as well as disadvantaged communities experiencing high rates of unemployment or underemployment. Project benefits would fall into three areas: 1.) Benefits would accrue directly to the poor through: (a) the creation of temporary and permanent employment; (b) greater access to essential social services; and (c) greater economic integration of women through access to health services, an improved water supply, and access to micro-finance and education services. 2) The project will improve the capacities of domestic non-governmental and local government entities to plan and implement development projects, thereby complementing the activities of the central government. 3) The project will make special efforts to assist vulnerable groups (e.g., destitute women, street children, orphans, the mentally- and physically-handicapped).

urbanization, and an increase in the share of women participating in the labor force can reduce the effectiveness of informal social protection mechanisms (.e.g., the family and/or kinship ties).

Current social protection systems are not well adapted to the current socioeconomic environment:

All countries in the region have put in place comprehensive public social protection systems that combine labor market programs, social insurance programs, and social assistance programs. The goal of these programs is to assist individuals and families in managing social risks, which can stem from man-made (unemployment, inflation) or natural sources (disease, death, adverse weather). Social protection interventions help lessen the economic effects of shocks and help promote the accumulation of human capital among the poor and vulnerable. Most social protection systems, however, are facing problems.

Labor Markets. Across the region, the public sector has been operating as an employer of last resort. This is particularly true in oil-rich countries such as Algeria, Iran, and Libya. At the same time, instead of focusing on income protection, governments have focused on job protection. The results have been rigid labor regulations that reduce incentives to hire workers, an imbalance between worker protection within and outside the firm, and a series of often ad-hoc programs such as supply-driven vocational training, limited job-search assistance, and wage subsidies that attempt to stimulate job creation.

These programs receive substantial public resources, yet their effectiveness remains in doubt. Most of these programs have continued to operate in the absence of appropriate monitoring and impact evaluation systems. Moreover, international experiences suggest that the programs cannot substitute for structural reforms that generate private sector investment and growth. Moreover, the costs of these programs, particularly if not well designed, can surpass their social benefits. In essence, in an attempt to avoid job destruction, governments have also hampered job creation and the programs as currently implemented to address unemployment have not been successful.

Social Security System. Most countries in the region have developed health insurance and pension systems. Algeria, Egypt, and Iran also have an unemployment insurance system. In general, the insurance system faces problems in terms of design that affects financial sustainability, incentives and equity.

Health insurance systems are affected by weak institutional capacity to manage, regulate, and supervise. In all cases, there is little or no information regarding utilization patterns and unit costs and it is therefore not possible to price health insurance plans. As a result, contributions to the health system are ad-hoc and often insufficient to finance generous benefits packages. At the same time, the free health care offered through the public system reduces incentives to enroll in the insurance scheme and thus impairs and reduces the contributory base. Another issue is related to inadequate payment mechanisms for providers, mostly public providers. Current practices do not generate incentives to control costs and improve the quality of care.

All countries in the region have implemented defined-benefit (DB) pensions systems that provide old-age, disability, and survivorship pensions. While most schemes still own some reserves, they are mainly managed on a pay-as-you-go basis. Pension systems tend to be fragmented, with at least one separate scheme

for public and private sector workers, with different contribution and benefit rules. This restricts the mobility of the labor force. In the majority of cases the pensions systems have been given mandates that are too large. Replacement rates for the full-career worker often surpass 80 percent of the last salary across levels of income, and minimum pensions can exceed 40 percent of the average wage. These large mandates reduce incentives to better diversify the sources of savings for retirement and simply are not affordable. Contribution rates and retirement ages are not aligned with the current levels of income replacement. Hence, despite still-favorable demographics, most systems are accumulating large implicit pension debts that threaten macroeconomic stability and have the potency to become the source of important adverse intergenerational transfers. In addition, benefit formulas and eligibility conditions do not follow best practices in the design of DB schemes. Today's regulations create incentives to strategically manipulate wages and to retire early. They also generate large variations in implicit rates of return across individuals as a function of wage histories and enrollment/retirement strategies. Hence, while distribution is taking place within the DB schemes, it is not necessarily from high- to low-income.

Social Assistance Programs such as public works, food subsidies, cash transfers, and social funds, have been used to help reduce poverty and mitigate income shocks for the poor. In MENA countries, informal mechanisms abound in rural areas, such as transfers from family and non-government sources, as formal methods of social protection seldom extend to the rural population. Migration too has played an important role as a risk-coping mechanism.

Unfortunately, social assistance programs have not been designed within the context of an integrated social protection strategy. There is little or no coordination between the various institutions involved in the implementation of these programs. Moreover, the majority are not appropriately monitored, targeted, and evaluated. Hence, it is frequent to observe duplications between programs, leakages that reduce the benefits received by the poor and vulnerable, and ineffective distribution systems. The efficiency of these programs—especially those involving subsidies—can be improved.

Various reforms in the social protection system are now being considered:

Governments and international partners recognize that prudent macroeconomic policies, better governance, and more efficient regulatory institutions are requisite elements of a global social protection strategy. It is also important to improve the effectiveness of the social protection system while involving the private sector and civil society in developing, implementing, and managing the social protection programs. Some of the necessary interventions in labor markets, social insurance systems, and social assistance programs are discussed below.

The proposed strategy regarding *active labor market programs (ALMPs)* and policies has four pillars: (i) review labor market regulations to provide more flexibility to firms while enforcing labor standards; (ii) design appropriate programs (e.g., severance packages and/or unemployment insurance and job search) to protect the income of workers transiting between jobs; (iii) rigorously assess the impact of ALMPs and gradually phase out those that are not cost-effective; and (iv) reform vocational training programs to reduce fiscal costs and to be more responsive to market demands.

Regarding *social insurance*, the focus is in the area of *pension reform*. The recommendation is to adopt an integrated vision that looks not only at the current public schemes but also at the role that occupational plans and the insurance

sector could play as sources of voluntary savings for retirement. There are many possibilities in terms of design, but in all cases the following principles will need to be respected: (i) the system should provide adequate pensions for retirement; (ii) the system should be financially self-sustainable and secure; (iii) the system should allow for a proper diversification of savings for retirement; (iv) the system should be administratively efficient; and (v) if redistribution takes place it should be transparent and progressive. A priority is to reform current defined-benefit pay-as-you-go systems to improve financial sustainability, efficiency, and equity. Necessary interventions include: (i) gradually reducing the current mandate of the schemes; (ii) integrating schemes for civil servants or at least creating “bridges” that facilitate labor mobility across sectors; (iii) bringing benefit formulas and eligibility conditions up to the standard, to reduce economic distortions and make the systems sustainable; (iv) identify mechanism to finance the current implicit debt of the systems in a transparent way; and (v) support the development of the necessary regulatory and supervisory framework to promote the emergence of voluntary private pensions.

Social Safety Nets need to be better coordinated among institutional providers and should be better targeted, monitored and evaluated. *Public works programs* can reach the poor through improved self-targeting wage-setting mechanisms. The financial sustainability of *social funds* also needs to be addressed through, for instance, a more intensive use of cost-recovery mechanisms. Further improvements in targeting *food and other subsidies* to the poor are needed, as part of a broad poverty alleviation strategy; and the role of the government in *microfinance* could be limited to define the regulatory framework as part of a country's financial sector development strategy. Countries also need to consider diversifying safety net instruments, exploring *conditional transfers* following properly evaluated pilots. Several evaluations, mainly in Latin American countries, have shown the benefits that these programs can bring to promote the accumulation of human capital among the vulnerable and poor.

At the same time, it is necessary to *mainstream vulnerable (including disabled) and disadvantaged women and children* into the broader Human Development agenda. Cross-sector strategies are needed to help achieve Education for All and to reduce child labor. Gender issues must be integrated into the policy process to ensure that women can participate in the economy and balance family responsibilities. Disability in MENA, which is emerging as a key development issue with negative impact on labor productivity, needs to be mainstreamed and the strategy should include a balanced approach among interventions that focus on prevention, mitigation, rehabilitation, and inclusion.

How the Bank Supports This Strategy

The focus in the MENA region in the area of social protection has been on the reform of *vocational training programs* (Bank operations have been developed in Algeria, Egypt, Jordan, Lebanon, Morocco, Tunisia, and Yemen) and the design of *social investment funds* (Bank operations implemented in Algeria, Egypt, Morocco, the West-Bank Gaza, and Yemen). The latter is used to mitigate shocks on the most vulnerable groups and also as compensatory mechanisms to increase the access to and the quality of basic social and infrastructure services used by the poor. A few adjustment loans have addressed *safety net* concerns.

Moreover, the Bank is engaged in addressing the critical needs of the countries in conflict, including the West-Bank Gaza and Iraq. In Iraq, the Bank is supporting the revitalization and reform of the social protection system. To this end, a workshop was held in June 2004 to discuss with senior policymakers the current situation of

the system and the priorities in terms of technical assistance. In the West-Bank Gaza, the Bank is implementing an innovative *conditional cash transfer program*.

The Bank has also expanded activities in the area of *labor markets* and *pension* reform. Regarding *labor policies*, the focus is on better understanding the functioning of labor markets and the impact of current programs. In addition, the Bank is providing capacity building for the design and implementation of impact evaluation systems for active labor market programs. A comprehensive study of the labor market in Tunisia was completed and reviews of employment strategies in selected countries are underway. The Bank also organized a workshop on impact evaluation methodologies in Casa Blanca in January 2004. To explore the linkages between labor market policies and other reforms aimed at job growth, the Bank is also organizing a regional conference on "*Job Creation and Skills Development in the Middle East and North Africa Region (MENA)*" in Cairo, Egypt, in December 2005.

On *pensions*, the Bank has launched a large program of technical assistance which covers Algeria, Bahrain, Djibouti, Egypt, Iran, Iraq, Jordan, Lebanon, Libya, Morocco, the West-Bank Gaza, Tunisia, Yemen, and Syria. Through this program the Bank is assisting the governments to evaluate the financial situation of current schemes and designing multi-year reform programs. The assistance includes training and capacity building activities in areas such as modeling of pension systems, administration, and management of public pension funds. The regional report *Pensions in the Middle East and North Africa Region: Time for Change* was published in May 2005 and presented at a regional conference on pensions in Rabat Morocco.

In addition *child labor and protection* has been an area of growing emphasis particularly through improving the understanding of the problem and aiming at mainstreaming necessary policy interventions into the broader Human Development agenda (e.g., Egypt, Jordan, Morocco, and Yemen). In addition, the emerging program on the inclusion of vulnerable youth and the disabled has made headway in the region, with strategic workshops held in the Bank in June 2003 and 2004.

All dollar figures are in US dollar equivalents.

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