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Young Gazelles and Aging Turtles: Resolving the Unemployment Dilemma in Arab Countries

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In a nutshell

Government efforts to reduce the chronic unemployment problem in the Arab world would benefit from focusing on supporting new/young firms that are medium to large-sized with existing investments in R&D. If these private firms are to benefit from government support (such as tax breaks, subsidies, credit facilitation, depreciation acceleration, and other forms of support), we should expect a higher policy impact on reducing unemployment in the region.

The Arab Unemployment Dilemma:

Many studies have indicated that the problem of unemployment and labor market imbalances in Arab countries is one of the major and significant factors that contributed to the state of political unrests and labor strikes which climaxed in the 2011 Arab Spring.

It is important, however, to underline that unemployment in Arab countries is a structural problem. This was evident during the period of economic reforms and recovery (the 2000s). Throughout the period 2002-2008, many MENA countries such as Egypt, Tunisia, Iran, Lebanon, Jordan, Libya, and Yemen achieved very respectable GDP growth rates (more than five percent on average). However, the overall unemployment rates were still over 10 percent and much higher among the young educated population (over 25 percent). This has prompted some economists and policy analysts to brand this period as the "jobless growth" decade. Others believe that "jobs were created," however the problem stemmed from the rapid growth of MENA's labor force and the insufficient growth of employment to absorb new and young job seekers. In any event, there is an agreement now that employment response to growth should have been above average to mitigate the unemployment problem in the region. Moreover, most of the employment growth happened in low-paying and dead-end jobs, which created a problem of "job quality" as well.

It was clear at the time that "growth" did not lead to "development." While growth is a mere increase of per capita income or "increasing the size of the pie," regardless of who gets to consume the pie, development is much more than that. Development is growth motivated by structural economic change that guarantees improvement in the standards of living of citizens. Accordingly, growth is the necessary condition to reduce unemployment, but development is the sufficient one.

Employment growth does not only depend on output growth, but also on the elasticity of employment with respect to output, that is, the employment intensity of such growth. In the 2000s, Arab countries witnessed an increase in production or growth of output without generating sustained employment growth commensurate with the high labor force increase rate due to the demographic transition effect.

As a result, high unemployment rates did not decline and have persisted. Thus, large segments of the population have been excluded from sharing the fruits of growth, and this major dilemma remains one of the chief factors in the political instability ongoing in the region until now.

Henceforth, after 2011, *"job creation in terms of quantity and quality"* is considered the number one policy recommendation by all international organizations, multilateral financial institutions, and development partners. Consequently, "creating employment" in the private sector became the top priority of all governments in the region.

In 2018, economic conditions across the region have deteriorated even further. The decline in oil prices has negatively impacted the resource-rich countries of the GCC and their labor exporting partner countries. In the latter, the problem of involuntary return migration from the GCCs added more unemployed individuals to the pool of idle workers. Syria, Libya, and Yemen are in turmoil. Civil wars in these countries have pushed around 15 million people to Jordan, Lebanon, Egypt, and Tunisia, which already suffer from high unemployment and are struggling economically; adding to the severity of the unemployment problem in the region. The Israeli occupation and the cycles of violence in Gaza caused the unemployment rate to become the highest in the world.

In addition, it is worth noting that emphasis on the private sector for job creation does not stem from ideological biases, but rather for pure objective and pragmatically justified reasons. In Arab countries with high unemployment, the public sector is suffering from either "surplus labor" or "disguised unemployment." Moreover, given the tight fiscal space in these countries, where public sector wages eat up half of its revenues, budget deficit is reaching alarming levels and public debt is increasing to unprecedented levels; leaving the private sector and private firms as the only sources of job creation.

Resolving the Dilemma:

Based on the above, any success in resolving the unemployment dilemma in Arab countries will be closely linked to understanding the environment, factors, and conditions necessary for private firms to create jobs.

The term "gazelles" is usually used to describe firms with the largest share of employment. It first appeared in a body of research in Europe in the late 1970s. Researchers at the time were trying to evaluate the impact of Small and Intermediate Enterprises on national employment in Germany and the US. However, an application of the 'gazelle firm' concept in the MENA region was recently initiated by Rijkers et al. (2014), who examined private sector job creation in Tunisia during the period 1996-2010. Shiffbauer et al. (2014) further expanded this work to seven MENA countries (Egypt, Tunisia, Morocco, Jordan, Lebanon, West Bank and Gaza, and Turkey). Both studies strongly suggest that job growth is driven by a few fast-growing firms (the gazelles) that account for a high share of job creation in MENA. While this is a significant and very important finding, what is more crucial is identifying these gazelles and their counterparts (the "turtles") in terms of their main characteristics and the environment in which they work, and to understand why these firms are creating more (or less) employment opportunities in comparison to other peer firms across the region. In this brief, we are attempting to accomplish this task.

Three groups of firms are going to be referred to here. The first group are the "gazelles": the fast-growing firms whose employment increased by more than 50 percent during the period 2009-2012. The second group are the "turtles": firms whose employment grew between one and 49 percent during the same period. The third group are firms with zero or negative growth in employment (downsizing). These firms represent seven Arab countries: Egypt, Morocco, Yemen, Tunisia, Jordan, Lebanon, and Palestine. The data analyzed are from the World Enterprise Surveys (WES) conducted by the World Bank.

The analysis of the data shows that "**turtles dominate the labor market in the Arab countries,"** while "**gazelle firms constitute a small fraction of total firms, yet they contribute significantly to job creation in the region."** The contribution of gazelles to total job creation ranges from a staggering 61 and 60 percent in the case of Palestine and Tunisia to 37 and 32 percent in Lebanon and Jordan. It is worth emphasizing that gazelles' contribution to job creation is significantly higher than the share of gazelles to total firms with positive job creation. For example, in Egypt, the contribution of gazelles to job creation exceeds 50 percent, while they only represent 23 percent of all the firms with positive job creation.

The pervasiveness of turtle firms in the MENA region with little to no contribution to job growth is a real obstacle to sustainable and inclusive development. These firms do not only represent the majority of firms in the region, but they have interesting characteristics. For example, turtles that control the private sector tend to be older (the year of construction), less innovative, have less financial/credit restrictions than their counterparts, and are smaller, on average, than gazelles. These characteristics lead to a straightforward policy implication; since turtles tend to be the more mature firms with relatively fewer financial constraints, then it is beneficial to the region if we convert the care and assistance given to these turtles, in a disproportional fashion, toward the gazelles of the region. This is especially relevant since gazelles are the ones with more financial constraints. The question now is: how can one target gazelles? In other words, what are the main characteristics of these job-creating firms?

Gazelle firms are younger relative to the other two categories. This very important characteristic is apparently universal across all the countries studied and across all the sectors examined. Thus, a major policy implication is to focus on younger firms rather than old ones. The old firms are either turtles or they are downsizing, therefore, not much employment growth will be achieved by giving government subsidies (for example), financial concessions, or tax advantages to older firms. This characteristic holds across countries and sectors as well. The average employment growth for the period 2009-2012, for young firms (age zero to five) is six times higher than the average employment growth for old firms (age higher than 11). Hence, these two characteristics combined further strengthen the policy of focusing on young firms rather than older ones.

Young gazelles are either medium size or large firms. There is evidence that size matters; among gazelles, bigger firms are better able to create jobs compared to smaller ones. As a result, young gazelles are typically not small firms; on the contrary, once controlling for age, large and medium firms seem to grow faster than small firms do. Therefore, the larger the size of the firm, the higher its probability of creating more jobs.

Young gazelles invest in Research and Development (R&D) and New Methods (NM) of production. Thus, since investment in R&D or NM is positively related to job creation, any sort of encouragement for R&D or NM spending (through capital depreciation acceleration or low-interest loans, more access to finance…etc.) might be helpful as a job creation policy.

Policy Recommendations:

The overall cumulative characteristics of gazelles (job creators) paint a very interesting picture of the Arab private sector that can provide clues for government policies aimed at stimulating job growth. **More significantly, government efforts to reduce unemployment would benefit from focusing on supporting new/young firms that are medium to large-sized with existing investments in R&D. If these firms are to benefit from government support (such as tax breaks, subsidies, credit facilitation, and other forms of support), we should expect a higher policy impact on reducing unemployment.** Moreover, these firms are the ones who need government support the most as they often face more financial constraints and a harder time establishing themselves in the market, yet they are the region's best hope in addressing its chronic unemployment problem.

Future Research Agenda:

There are a number of areas that need to be explored fully, depending on the availability of detailed data. These areas of research include many determinants that could contribute to job creation, such as labor market regulations, political activeness, access to foreign markets, practice of social responsibility, and political corruption. For instance, do politically connected firms fare better than unconnected ones? More importantly, do they prevent others firms from growing?

In addition, the dynamics of becoming a gazelle need to be studied further. Not only does the profile of a gazelle firm need to be fully drawn, the time span that takes a firm to move to the gazelle rank needs to be identified as well. Does a firm become a gazelle right after inception? How many years, on average, does a firm take to become a gazelle or a turtle? Is there a typical move from the gazelle rank to the turtle or vice versa? In addition, what is the average number of workers a firm might employ before moving to the gazelle rank? Can we ever break from the gazelle/turtle dichotomy and see a more evenly distributed (less skewed) job growth across all firms? These are all questions that might help the government target specific firms with its job creation policies.

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