MIDDLE EAST
AND CENTRAL ASIA
DEPARTMENT

# Fostering Private Sector Led Growth in MENA: A New Role for the State

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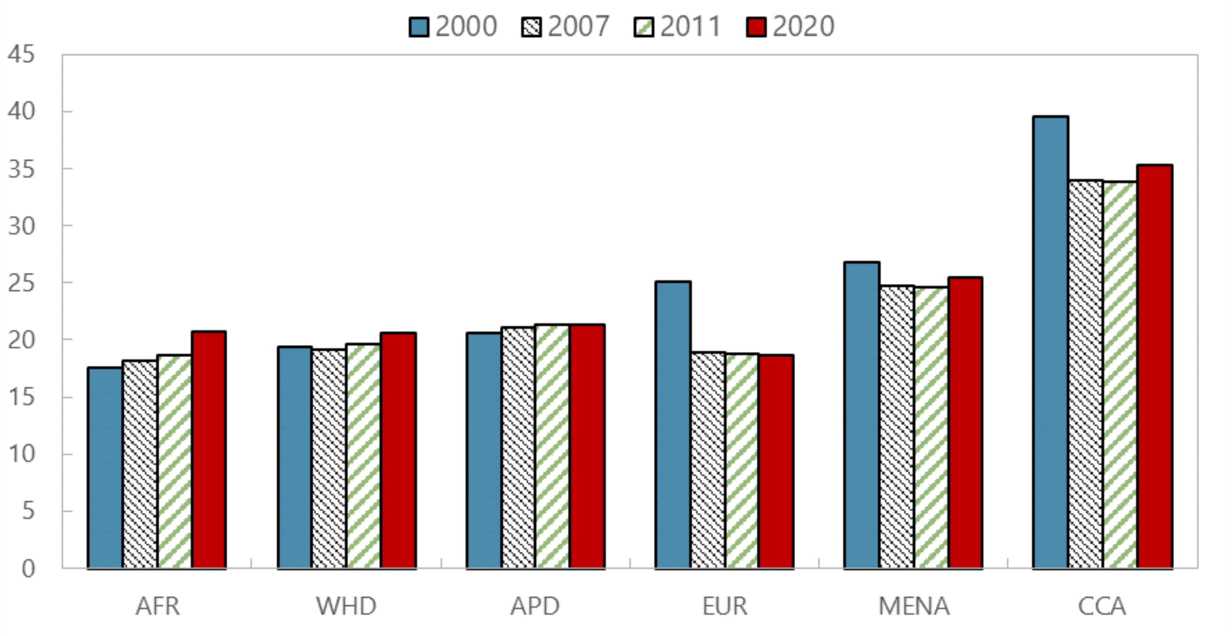
# Outline

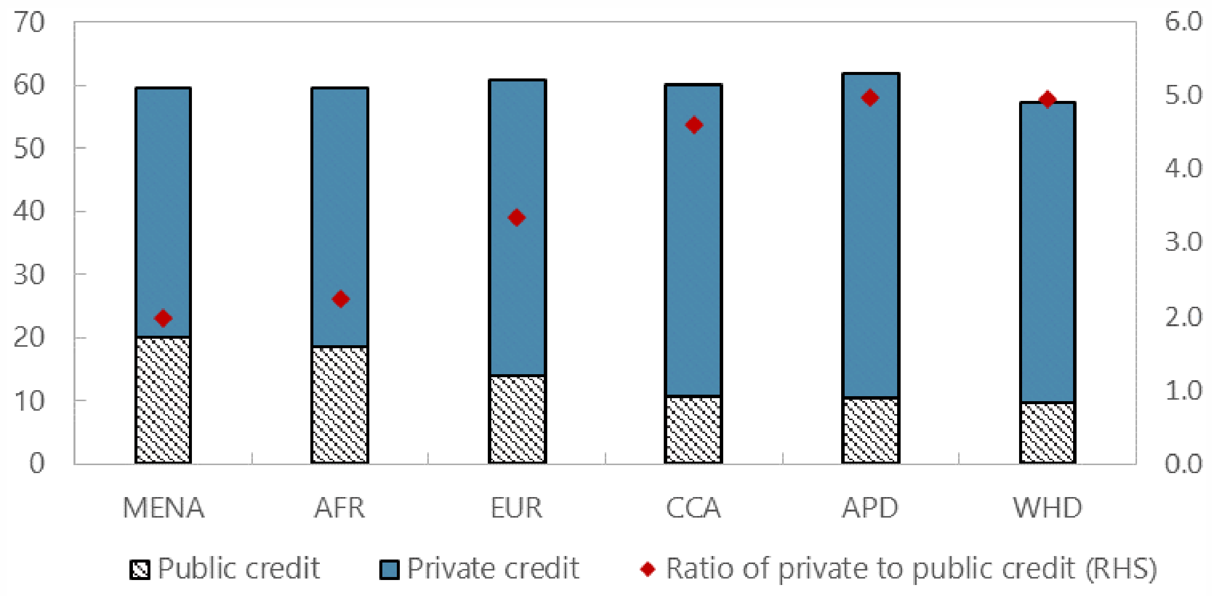
- **Background:** Large footprint of the state in MENA economies, particularly through myriad of SOEs.
- **Empirical evidence:** How do SOEs differ from private sector firms? How does SOE presence affect private sector dynamics?
- **Policy implications:** New role of the state to facilitate competition and business dynamism.

# The large state footprint in MENA has grown from development models based on state capitalism…

**Public Consumption**
(share of total)




**Bank Credit**
(percent of banking system's assets)



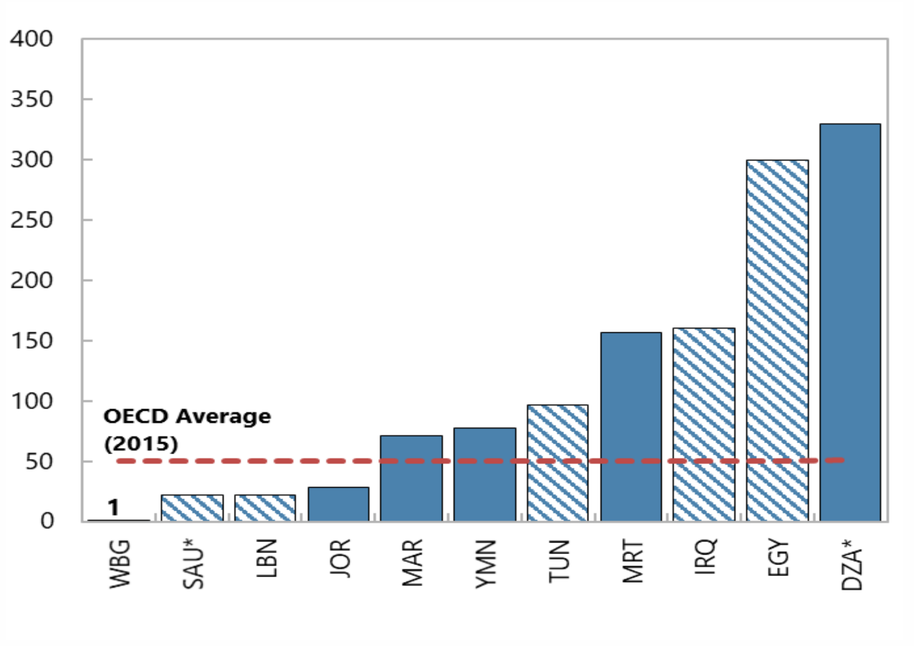

Note: AFR= Sub-Saharan Africa; WHD = Western Hemisphere; APD= Asia and Pacific; CCA = Caucasus and Central Asia.



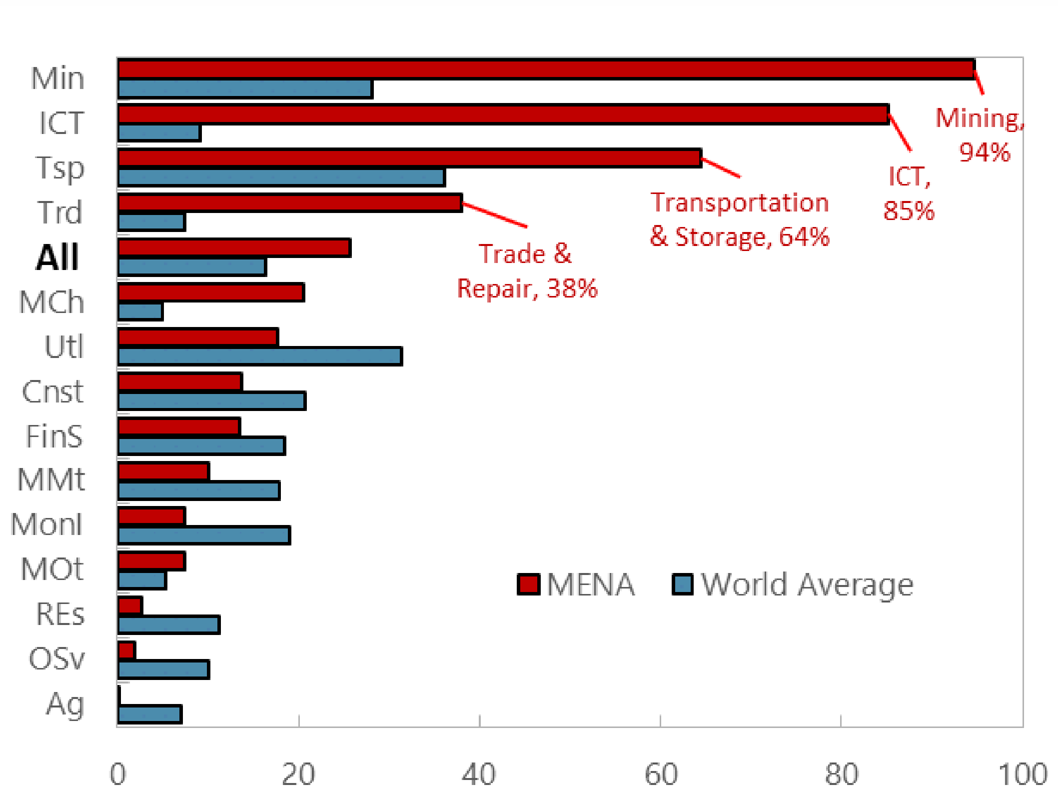
Sources: World Economic Outlook; International Financial Statistics

# ...with numerous SOEs created to support economic and social objectives...

**Number of SOEs**
(2019 or latest available)




**Sectoral Asset Share of SOEs**
(2006-2018 average)



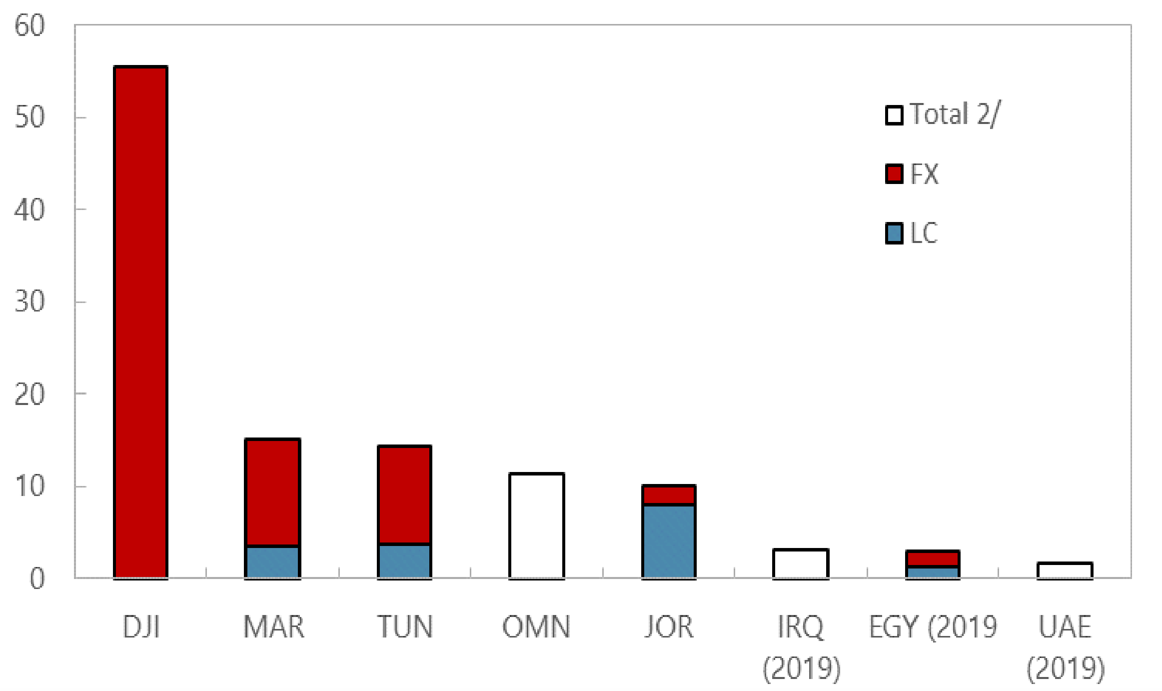

Note: Note. Ag = Agriculture; Cnst = Construction; FinS = Other Financial Services; MCh = Chemicals Manufacturing; MMt = Other Materials Manufacturing; MOt = Other Manufacturing; Min = Mining; MonI = Monetary Intermediation; OSv = Other Services; Res = Real Estate; Trd = Trade & Repair; Tsp = Transportation & Storage; Utl = Utilities & Sanitary; Whole = All sectors.



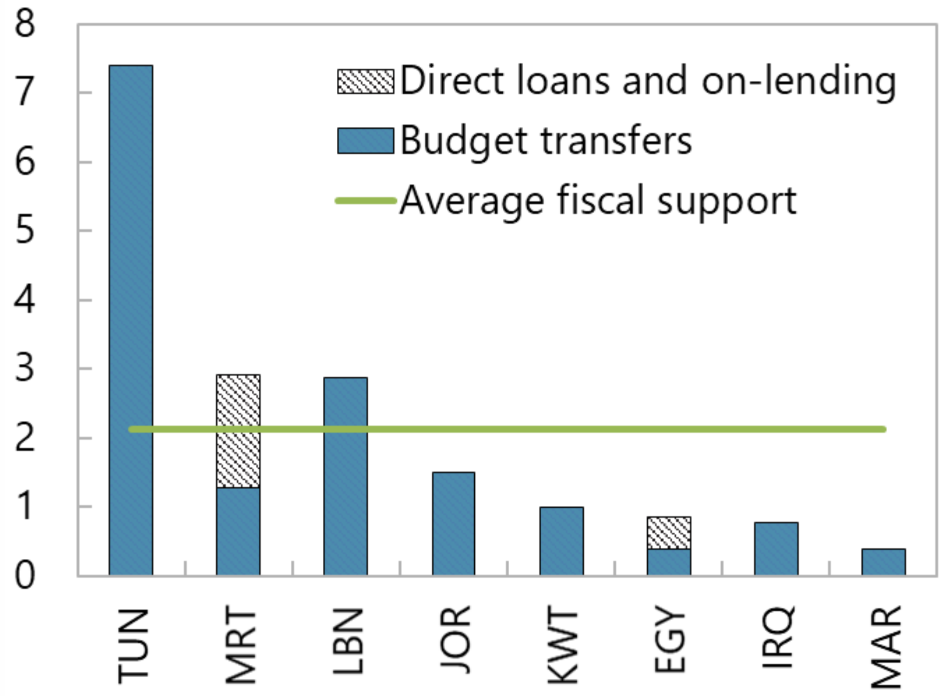
Sources: IMF (2021); Orbis.

# ...and SOEs benefitting from advantages such as fiscal support and debt guarantees.

**Stock of Government Guarantees to SOEs**
(2020, as percent of GDP)



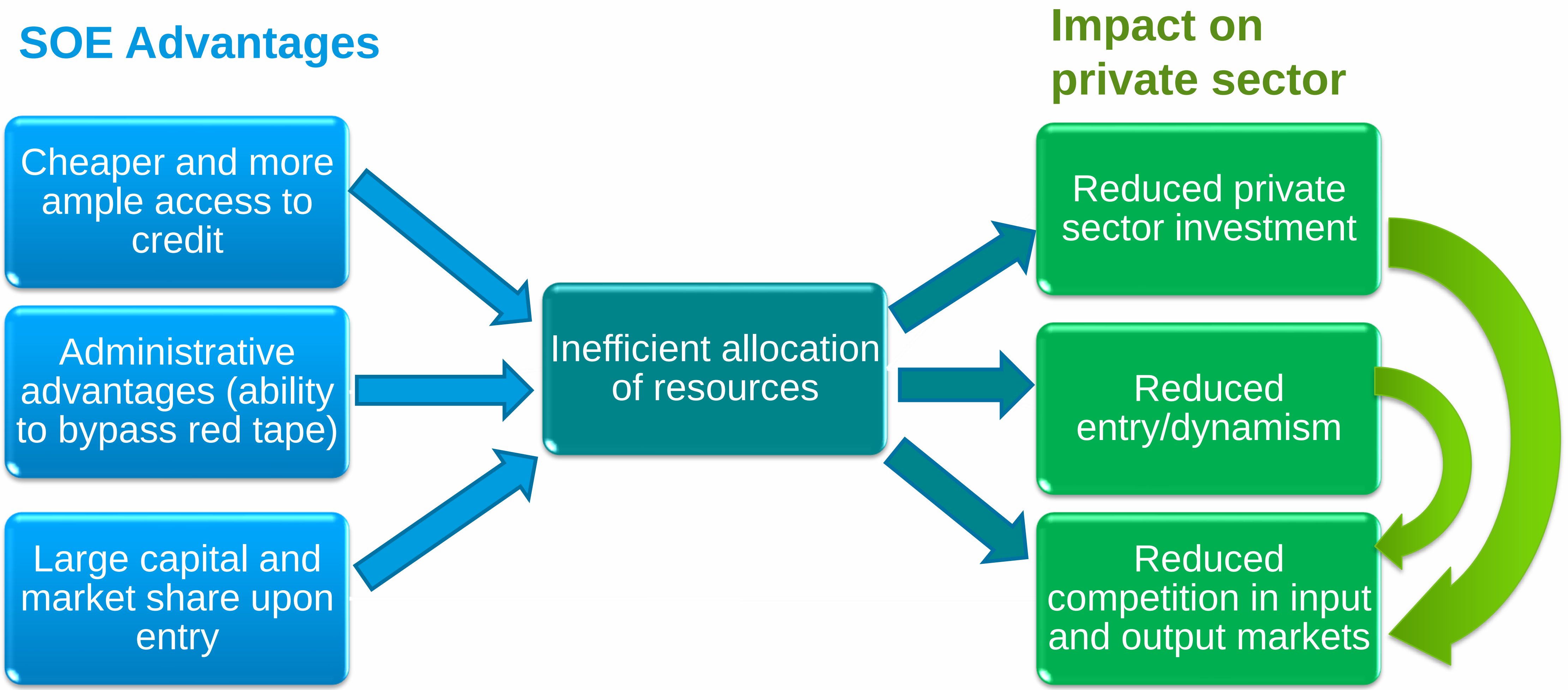

**Direct fiscal Support to SOEs**
(2019, percent of GDP)






Sources: IMF (2021)

# Advantages received by SOEs may create distortions and affect private sector development.



# The relationship between SOEs and the private sector can be assessed using firm level data.

- How do SOEs differ from private sector firms?
- How does the presence of SOEs affect competition, business dynamism, and private sector investment?

# Differences between SOEs and private sector firms suggest potential resource misallocation.

| | Firm Profitability | Imputed Interest Rate | Firm Productivity |
|---|---|---|---|
| | $RoE_{i,t}$ | $R_{i,t}$ | $RoK_{i,t}$ |
| SOE | -50.3*** | -0.31*** | -587.3*** |
| | (0.64) | (0.26) | (207.9) |
| MENA | -0.26 | -1.06 | |
| | (51.7) | (0.71) | |
| MENA x SOE | 1.632 | 0.016 | |
| | (1.83) | (0.39) | |
| Firm-level controls | ✓ | ✓ | ✓ |
| Sector-level controls | ✓ | | ✓ |
| Fixed effects | Country x Sector<br>Country x Year | Country x Sector<br>Country x Year | Country x Sector<br>Country x Year |
| Region | World | World | MENA |
| Observations | 39mn | 39mn | 53k |
| R-squared | 0.041 | 0.041 | 0.00041 |

Note: Robust standard error in parentheses. *** p<0.01, ** p<0.05, * p<0.1

Globally, SOEs are *less profitable* than private sector counterparts, and face *lower interest rate costs*.

In MENA, SOEs are also *less productive in using capital* than their private sector counterparts.

# A larger SOE presence reduces competition, business dynamism, and investment.

Larger SOE presence is associated with *higher concentration in input and output markets* in MENA, and with *reduced entry and exit* rates globally.

Larger SOE presence is also associated with *lower investment by private sector firms* in MENA.

| | Market concentration | | Business Dynamism | | Investment |
|---|---|---|---|---|---|
| | Output market $HHI_{c,s,t}$ | Input market $HHI_{c,t}$ (capital) | $Entry_{s,t}$ | $Exit_{s,t}$ | Private firms $Investment_{i,t}$ |
| $SOE\ share_{c,s,t}$ | 0.095*** | -0.038 | -0.021* | -0.011*** | -594.* |
| | (0.012) | (0.087) | (0.0038) | (0.0043) | (343.93( |
| MENA x $SOE\ share_{c,s,t}$ | 0.16*** | 0.80*** | 0.00036 | -0.015 | |
| | (51.7) | (0.14) | (0.0047) | (0.030) | |
| Firm-level controls | | | | | ✓ |
| Sector-level controls | | | ✓ | ✓ | ✓ |
| Fixed effects | Country<br>Sector<br>Year | Country<br>Year | Country<br>Sector<br>Year | Country<br>Sector<br>Year | Country x Sector<br>Country x Year |
| Region | World | World | World | World | MENA |
| Observations | 8,504 | 917 | 8,504 | 7,820 | 45k |
| R-squared | 0.408 | 0.593 | 0.035 | 0.041 | 0.0051 |

Note: SOE share represents share of sector assets owned by SOEs. Entry (exit) represent share of first in the first (last) year. Robust standard error in parentheses. *** p<0.01, ** p<0.05, * p<0.1



Sources: World Development Indicators and UNDP

# Conclusions

- **SOEs differ from private sector firms:**
  - Endowed with more capital upon entry, but grow more slowly;
  - Benefit from certain advantages, e.g., lower interest rates;
  - Less profitable and less productive.

- **SOE presence negatively affects competition and dynamism:**
  - Higher SOE market share is associated with lower competition in input and output markets, lower dynamism, and lower private investment.

- **Rolling back the state's role and allowing private sector growth can lead to greater efficiency, higher productivity, and hence the economy's ability to sustain higher growth.**

# Policy Implications

- **The state should pivot towards facilitating rather than leading business activities in the MENA region.**

- **Need for a competition policy framework that ensures competitive neutrality between SOEs and private sector firms; EU competition rules serve as potential model:**
  - Prohibit state financial support to SOEs unless justified by general economic interest (requires clear rationale for state involvement);
  - Prohibit preferential access to inputs for SOEs if it generates anticompetitive outcomes;
  - Allow granting exclusive rights for an SOE to provide a public service, but prohibit abuse of dominant position (e.g. cross-subsidization of other products or downstream margin squeezes);
  - Independent governance of SOEs necessary to consider them as separate units in competitive assessments.

# Discussion

- **How can governments limit financial support for SOEs and to reallocate resources towards private sector development (e.g., reducing bureaucratic red tape, improving infrastructure, supporting SMEs)?**

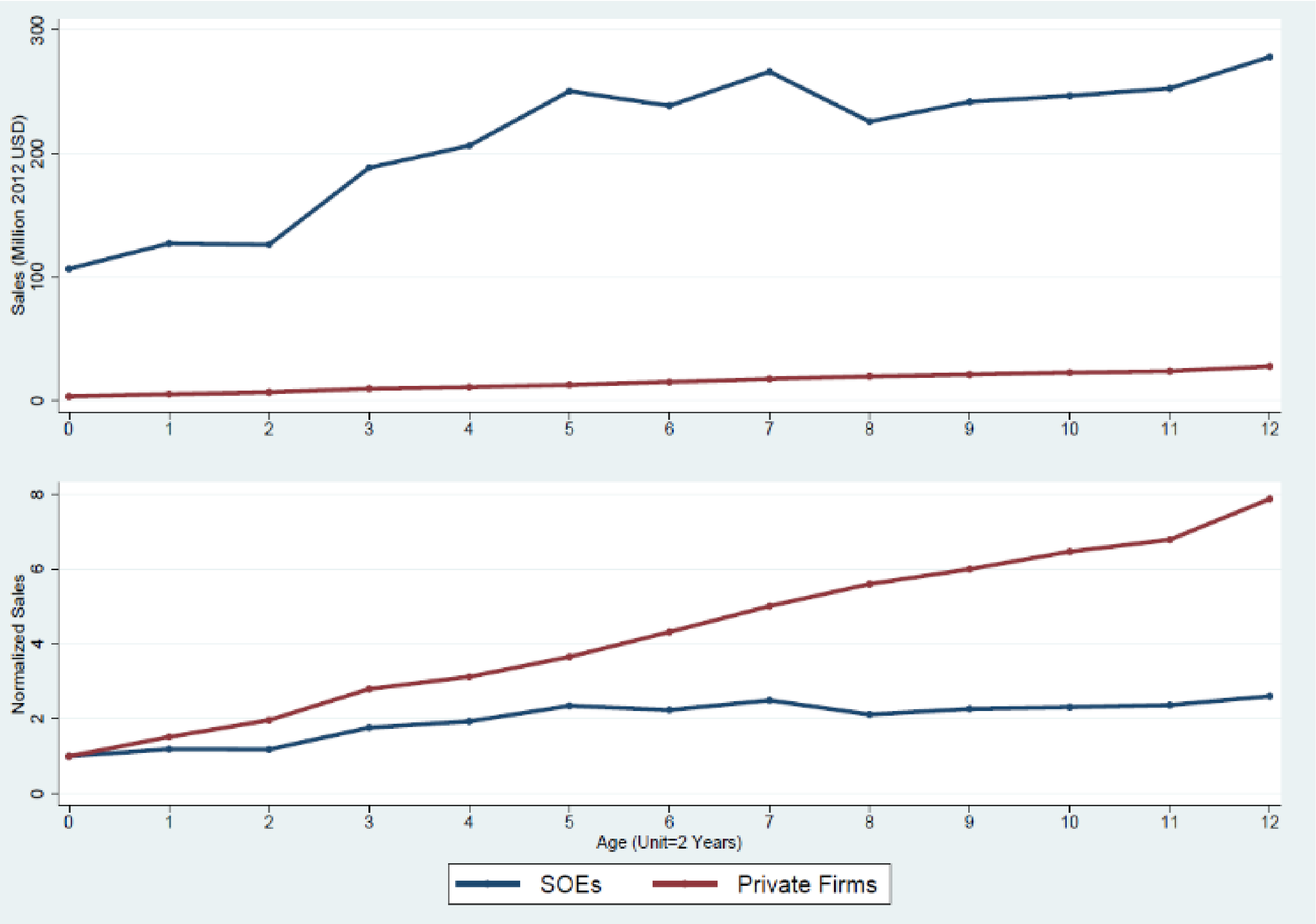
- **What steps can be taken to increase transparency and limit fiscal contingent liability risks related to the operation of SOEs (e.g., financial reporting of SOEs; separation of commercial and social objectives of SOEs)?**

- **What changes are necessary to support competition policy reform (e.g., establishing independent regulatory authorities)?**

# Thank you!

# Backup slides

# SOEs are born big but grow slowly






Sources: IMF analysis of Orbis data.

# Firm-level data used for empirical analyses

- Bureau Van Dijk’s Orbis database is one of the few harmonized cross-country firm-level datasets that include both SOEs and privately-owned firms (both listed and non-listed);
- Sample includes 74 countries in all regions including 8 countries in MENA (Morocco, Algeria, Egypt, Saudi Arabia, Oman, Iran, Kuwait, and Jordan);
- Annual data over 2006-2018;
- SOEs are identified based on the reported firm owner (firms owned by “Public authority, state, government”).