Boosting Competitiveness in the MENA Region: Industrial Policy vs. Structural Reforms

19 January 2026

Industrial Policy and Productivity in Arab Economies: The Role of AFESD

Mahmoud Sami Nabi

الصندوق العربي للإنماء الاقتصادي والاجتماعي
ARAB FUND FOR ECONOMIC AND SOCIAL DEVELOPMENT

OUTLINE

1. Why Industrial Policy (IP) and Why it Matters for Arab Countries (AC) ?
2. Rethinking IP and its Relationship with Reforms
3. The Catalyst Role of AFESD in Supporting Industrial Policy and Reforms in AC

Disclaimer: The views expressed in this presentation are those of the author and do not necessarily reflect the views of the Arab Fund for Economic and Social Development (AFESD).

1. Why Industrial Policy and Why it Matters for Arab countries ?

Industrial policy (IP)

- IP Refers to **government policies aiming to alter the sectoral structure of production** toward sectors believed to offer **better prospects for economic growth** (Djankov and Goldberg, 2020).

- IP is about **restructuring the economy in ways that improve its productivity and long-run growth potential** (Rodrik, 2004).

Why it Matters Today for Arab Countries ?

- Many economies are characterized with production structures dominated by *low value-added activities* and/or *limited diversification (*)*.

  - **Low economic complexity** → concentration in low value-added or upstream activities.
  - **Moderate GVC participation, with low domestic value addition.**
  - **Digital, energy and environmental transitions lag global benchmarks.**
  - **Uneven AI readiness and skills diffusion.**

  >> Productivity growth has often remained weak and volatile, even in the presence of macroeconomic reforms.

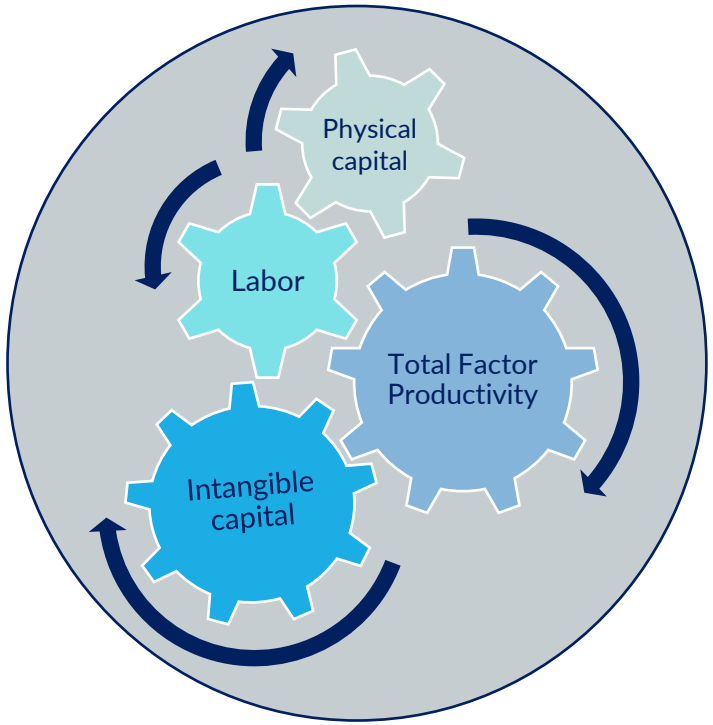
(*) See the multiple indices in Appendix 2.

Total Factor Productivity (TFP) is the dominant factor accounting for the difference in development levels.

- **Human capital** (quality of education)
- **Market efficiency**
- **Infrastructure**
- **Innovation**
- **Institutions**

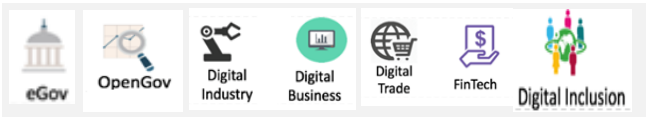
(*)

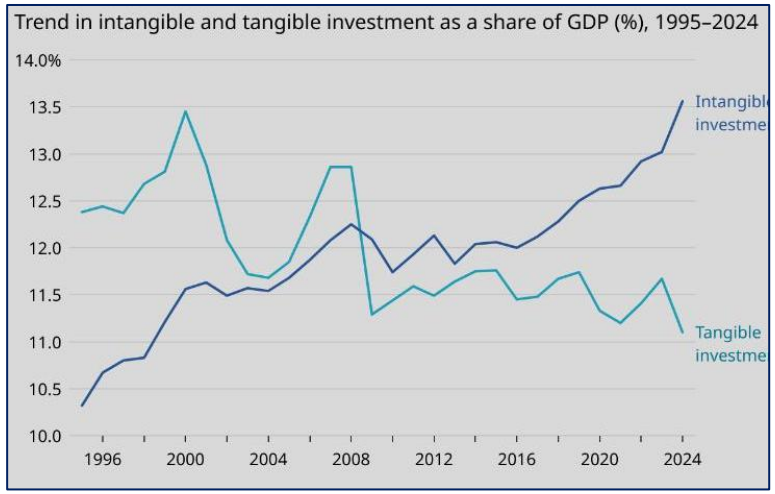
(*) Kim and Loayza (2019), Makdisi, Fattah, and Limam (2007)



- The digital economy accounts for around 4–10% of GDP in Arab countries (higher in the GCC and lower in middle-income and fragile economies), well below global benchmarks, reflecting gaps in adoption, skills, and digital-industrial integration.

Shifting the economic structure from traditional sectors to high value-added, digital and sustainable activities.





Source: World Intangible Investment Highlights 2025

- Over the past decade, the digital economy has grown **about 2.5× faster than the rest of the economy.**
- Rapid adoption of ICT and digital services; ICT sectors expanded by **~7.6% in 2023**, well above average GDP growth.

~15% of global GDP in 2024 (≈ **USD 16 trillion** out of USD 108 trillion).

>> key engine of global growth and structural transformation

Sources: World Bank (2025); OECD (2024); UN (2023).

Economic Rationale for Industrial policy (*)

- **Shifting the economic structure from traditional sectors to high value-added, digital and sustainable activities is not automatic**, even in economies that follow sound macroeconomic policies and market-friendly reforms.

- **Markets fail to discover new activities:** *prices do not reveal profitability in presence of uncertainty, first-mover risk and coordination failures* (required simultaneous investments across multiple sectors, Infrastructure (power, water, logistics), Regulation and standards, Marketing and reputation building, Upstream and downstream suppliers).

- **Private actors will under-invest:** high fixed costs complementary services, uncertain demand and disruption of supply chains, lower returns to experimentation compared to social returns.

>> Relying on markets alone is insufficient and there is a need for strategic public action.

(*) Rodrik (2004, 2008)

2. Rethinking Industrial Policy (IP) and Its Relationship with Reforms

IP should not be viewed as "State versus market" but it as "State and market, with discipline" (*)

Old view of IP

- Sector protection
- Permanent support
- Weak accountability

>> >> >>

Modern view

*IP: **a dynamic, collaborative process between public and private actors focusing on** export diversification, knowledge accumulation, and upgrading to higher value-added activities, not firm-by-firm support and not blanket subsidies.*

State's Dual Role:

Promotion

- Encourage experimentation, Learn from success and failure and Enable new activities.
- Reduce uncertainty and Share early-stage risk.
- Coordinate skills, complementary investments, and regulation.

+

Discipline

- Competition.
- Export and performance benchmarks.
- Exit and sunset clauses.

(*) Aghion et al. (2015), Fanelli (2014), Hausmann and Rodrik (2003), Nabi (2019), Rodrik (2008, 2022).

Reforms that Make Industrial Policy Effective (*)

Institutional efficiency *(Coordination, discipline, and accountability)*
Continuous state–private sector dialogue
Clear mandates and accountability of stakeholders
Monitoring, evaluation, and learning loops

Develop the ecosystem *(Productivity, learning, and scale through firms and networks)*
Technology adoption and skills upgrading
SME scale-up
Trade exposure and better integration into the GVC
Clusters and ecosystems

Regulations *(Competition, entry–exit, and dynamic reallocation)*
Relaxing binding constraints to firm growth
Sunset rules
Competition policy
Entry–exit and insolvency

(*) Evans (1995) and World Bank (2020).

3. The Catalytic Role of AFESD in Industrial Policy and Reforms in Arab Countries

Constraints facing the implementation of IP in Arab countries …

Even with good design of the IP and the reforms:

- Limited fiscal space.
- Limited ability to absorb concentrated risk.
- Infrastructure bottlenecks.
- Policy reversals across cycles.
- Fragmented markets and Infrastructure, especially regionally.

… and how DFIs can support

- Share early-stage and scale-up risk with the state.
- Finance complementary infrastructure critical to new activities.
- Extend policy horizons beyond political cycles.
- Anchor credibility for reforms and experimentation.
- Enable regional coordination and public goods.

Overview of the Arab Fund

- The Arab Fund is a regional financial institution based in Kuwait, established in 1968 when Arab States endorsed a proposal submitted by the State of Kuwait. The Arab Fund commenced its activities in 1974. It is owned by 22 member countries.

- Mandate: *Promote regional integration, advance socio-economic development, and improve infrastructure services across the Arab Region*.

  - Providing loans, grants and technical assistance to public and private sectors (*).
  - Aligning with Arab countries development goals and national priorities.

(*) See the details of AFESD activities in Appendix 1.

خمسون عاماً في خدمة التنمية العربية

The role of AFESD in supporting the IP in Arab countries

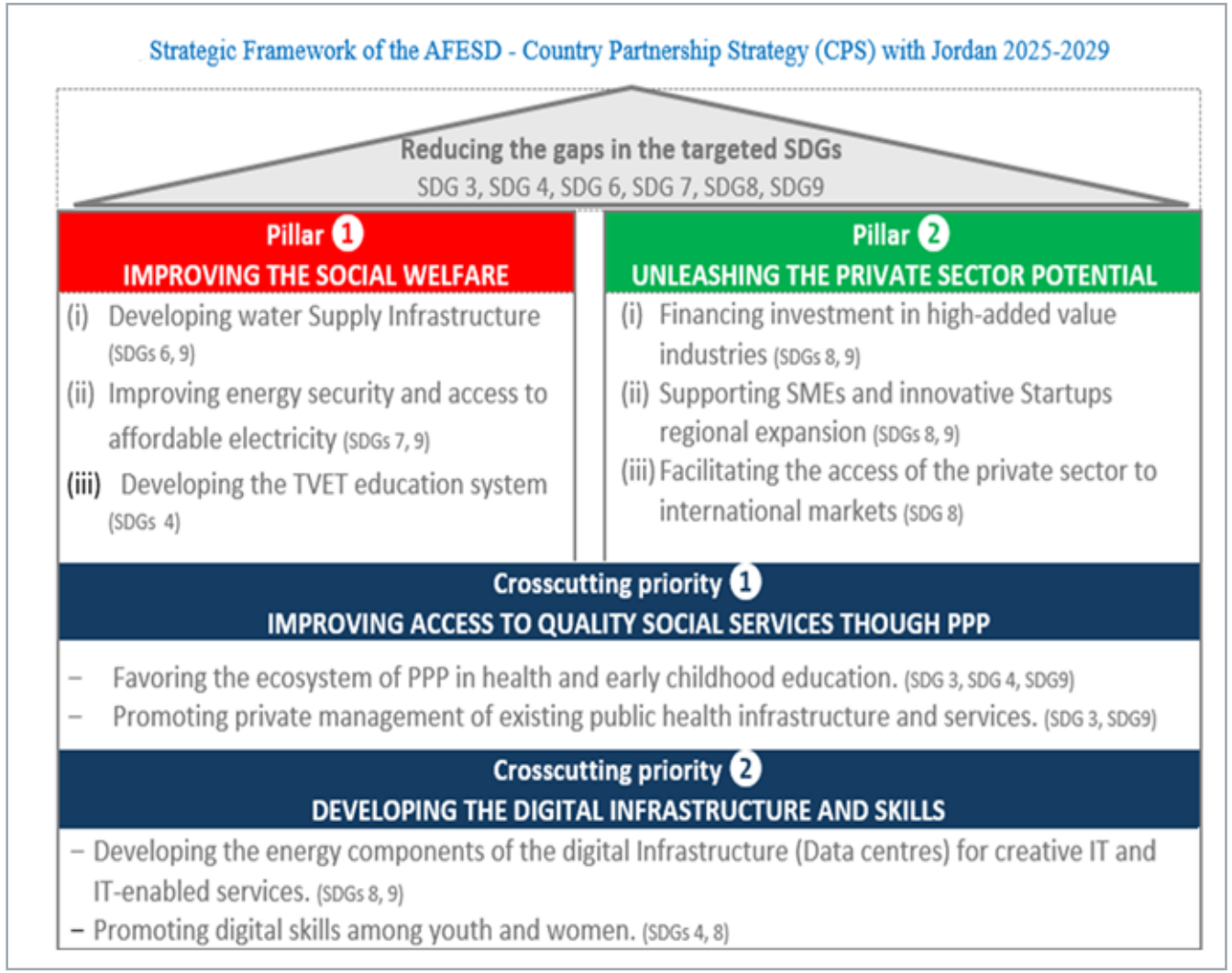
AFESD does not design industrial policy, but it enables its member countries to promote new activities while reinforcing reforms and market discipline.

- **Productive infrastructure finance**
  Energy, transport, logistics, water, digital infrastructure.

- **Support to firms scaling and upgrading**
  > Patient capital aligned with clusters and value chains.
  > De-risking + crowding-in: use guarantees, risk-sharing, co-financing with DFIs/ACG partners, and project preparation to convert “plans” into bankable pipelines.
  > Enable demand (procurement, PPP frameworks, anchor tenants, export readiness) where private investment is hesitant.

- **Institutional support**
  Policy dialogue, knowledge production and dissemination, capacity building.
- **Regional scale**
  Cross-border projects and coordination.
- **Stability**
  Long-term engagement beyond political and commodity cycles.

- The CPS responds to the country's urgent need for securing water supply, improving the quality and access to social services and creating high quality jobs by boosting the private sector-led growth, while contributing to reducing the gaps in 6 SDGs :



Source: AFESD (2025)

Bibliography

- **Abdelmoula, W. (2024).** Economic Diversification in Arab Countries and the Need for New Industrial Policies. Policy Brief No 04-2024, Arab Planning Institute https://portal.arab-api.org/Files/Publications/PDF/806/806_2342024.pdf
- **AFESD (2025).** Country Partnership Strategy, Jordan 2025-2029, https://www.arabfund.org/wp-content/uploads/2025/04/CPS-Jordan-2025-2029.pdf
- **AFESD (2023).** Contributions of the Arab Fund for Economic and Social Development in satisfying Arab development needs and achieving SDGs" in A Better World, Volume 9 edited by the Human Development Forum. https://www.arabfund.org/wp-content/uploads/2023/12/AFESD-SDG-Contribution.pdf
- **AMF, AFESD, LAS, & OAPEC (2023, 2024, 2025).** "Joint Arab Economic Report," https://www.arabfund.org/agreement-of-afesd-establishment/jae-annual-reports/
- **Baquie, S., Huang, Y., Jaumotte, F., Kim, J., Parente, R. M., & Pienknagura, S. (2025).** Firm dynamics, selection, and productivity: Evidence from developing and advanced economies. IMF Staff Discussion Note, SDN/2025/002.
- **Djankov, S. & Goldberg, P. K. (2020).** Industrial Policy: Lessons from Experience. World Bank Policy Research Working Paper No. 9063, Washington, DC.
- **Fanelli, J. M. (2014).** Industrial policy, structural change, and macroeconomic consistency. ECLAC / Development Studies.
- **Hausmann, R., & Rodrik, D. (2003).** Economic development as self-discovery. Journal of Development Economics, 72(2), 603–633. https://doi.org/10.1016/S0304-3878(03)00124-X
- **Hsieh, C.-T., & Klenow, P. J. (2009).** Misallocation and manufacturing TFP in China and India. Quarterly Journal of Economics, 124(4), 1403–1448. https://doi.org/10.1162/qjec.2009.124.4.1403
- **Hulten, C. R., & Isaksson, A. (2007).** Why development levels differ: The sources of differential economic growth in a panel of high- and low-income countries. NBER Working Paper No. 13469. National Bureau of Economic Research.
- **Kim, Y. E., & Loayza, N. V. (2019).** Productivity growth: Patterns and determinants across the world. World Bank Policy Research Working Paper No. 8852. World Bank.
- **Makdisi, S., Fattah, B., & Limam, I.** (2007). *Determinants of growth in the MENA countries*. In J. B. Nugent & M. H. Pesaran (Eds.), *Explaining growth in the Middle East.* Amsterdam: Elsevier.
- **Nabi, M.S. (2019).** Moving towards a knowledge-based economy. In: Making the Tunisian Resurgence. Palgrave Macmillan, Singapore. https://doi.org/10.1007/978-981-13-3771-0_8
- **Nabi, M.S., W. Suleiman, A. Bahtishi, M. Romdhani, & H. Al-Rashid (2023).** " Towards Shaping a New Generation of Contributions by the Arab Fund to the Education Sector ". Policy paper No 2023/01. https://www.arabfund.org/wp-content/uploads/2024/10/2024_10_1_08_52_35_Study-2023-01.pdf
- **OECD (2023).** Development finance institutions: Their role in industrial transformation and private capital mobilisation. OECD Development Co-operation Working Paper. Paris: OECD Publishing.
- **OECD (2024).** OECD Digital Economy Outlook 2024. Paris: OECD Publishing.
- **Prasad A., Subramani K., Refass S., Saidi N., Salem F., & Shepherd B**. (2025). Global Economic Diversification Index 2025. Dubai: Mohammed bin Rashid School of Government. www.EconomicDiversification.com
- **Rodrik, D. (2004).** Industrial policy for the twenty-first century. CEPR Discussion Paper No. 4767.
- **Rodrik, D. (2008).** Normalizing industrial policy. Commission on Growth and Development, Working Paper No. 3. World Bank.
- **Maria Rossotto, C. (2018).** Digital Platforms : A Policy Framework for Developing Countries, Network Industries Quarterly, Vol. 20, N ° 2, June 2018. https://www.network-industries.org/wp-content/uploads/2019/07/Digital-Platforms-A-Policy-Framework-for-Developing-Countries.pdf
- **Schwab, K., & Porter, M. E. (2008).** The global competitiveness report 2008–2009. Geneva: World Economic Forum.
- **Suh, J., & Chen, D. H. C. (2007).** Korea as a knowledge economy: Evolutionary process and lessons learned. World Bank Institute Development Studies. Washington, DC: World Bank.
- **UNCTAD (2023).** Digital Economy Report. UN Conference on Trade and Development (UNCTAD).
- **UNIDO (2025).** UNIDO in Action: Focus on the Arab Region. Vienna: UNIDO
- **World Bank. (2020).** The innovation paradox: Developing-country capabilities and the unrealized promise of technological catch-up. Washington, DC: World Bank.
- **World Bank (2025).** Global Digital Economy Report 2025. Washington, DC: World Bank Group.

Thank you

Appendix 1. *Products and Programs of AFESD*

KWD 11.35 billion
(USD 37.1 billion) >> **600 projects in 17 MCs**

Public Sector Financing
705

Badir Fund

Finance and Support (TA) to SMEs
Since 2009 >> USD 1.6 billion
55 Loans in 12 MCs
>> 124,921 projects + 584,278 jobs

Private Sector Financing
Since 2001 >> 22 Loans
KWD 116.4 million (USD 380.6 million
>> **18 projects in 8 MCs**

Private Sector Financing

Equity participation
KWD 43.5 million
(USD 142.2 million)

Grants
1367 initiatives

~5% of annual net profits
Grant ≤ KD 300,000
(Public sector + ONG):
KWD 278.5 million (USD 910.7 million)

Urgent Programme to Palestine

10% of annual net profits
KWD 225.8 million
(USD 738.3 million)
>>
Health, education, social services, economic empowerment
Resilience of Al-Quds Al-Sharif
+
Supporting Resilience of Jerusalem
KWD 29.7 million
(USD 97.1 million)

Fellowship Program

Financing opportunities
Since 1997 >> **197 awardees.**

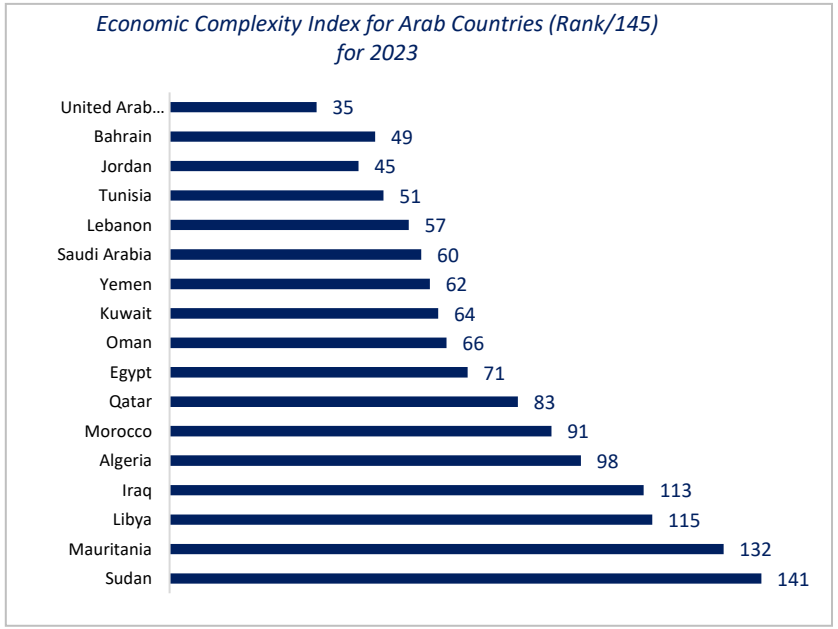
Capital

2025:
KWD 2.9 billion
(USD 9.5 billion)

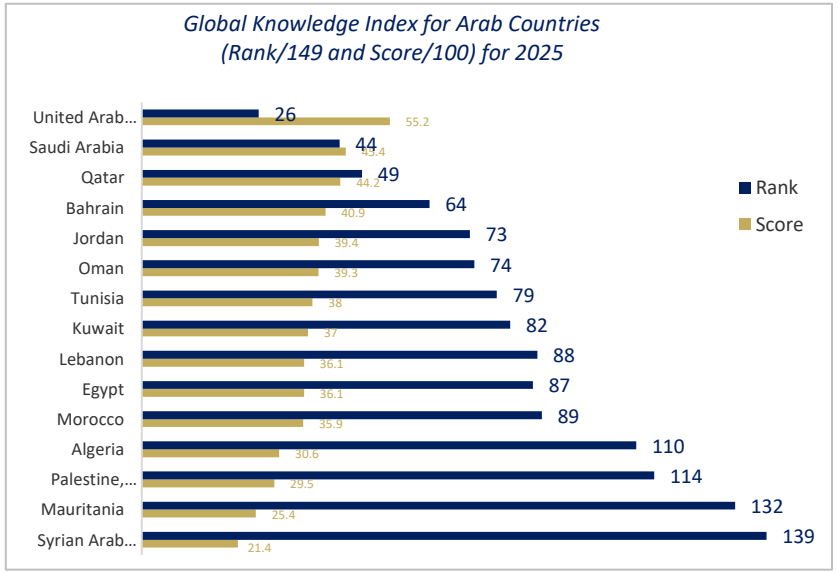
1972:
KWD 15.4 million
(USD 50.4 million)

Appendix 2.

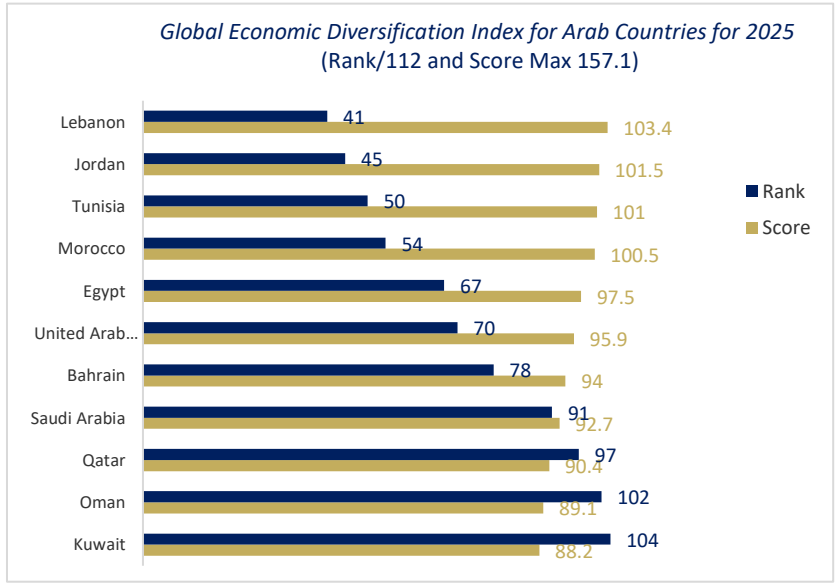
Comparative Positioning of Arab Countries across Selected International Indices



Source: The Atlas of Economic Complexity



Source: Global Knowledge Index 2025 Portal



Source: Prasad et al. (2025)

- Integration into global value chains is *moderate in scale but limited in quality, with low domestic value addition and constrained upgrading*.

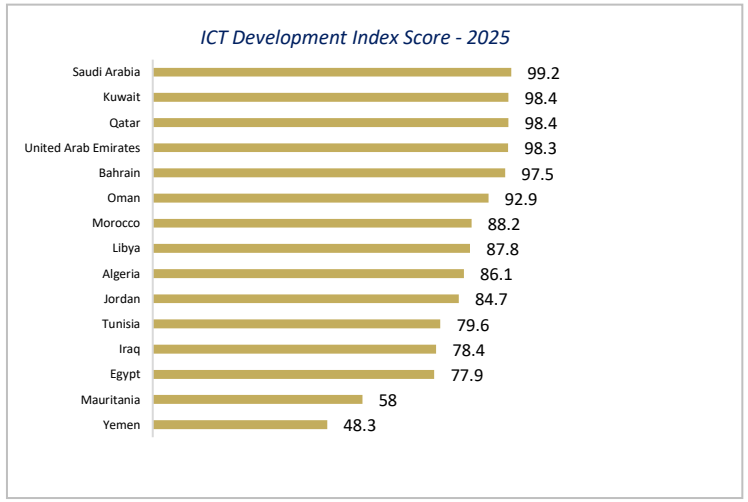
- Participation to GVCs according to three dominant models:
  - **Upstream Resource-Based Integration**: Concentration in extractive sectors, and linkages to downstream manufacturing and services are limited.
  - **Backward integration**: Relying heavily on imported intermediate inputs for export-oriented manufacturing (automotive, electronics, textiles, agrifood) with limited domestic technological content and weak spillovers to local SMEs.
  - **Marginal integration**: Limited to primary commodities, logistics, or re-exports, with weak industrial and institutional foundations.

Indicators of Arab Countries Participation in Global Value Chain (GVC)

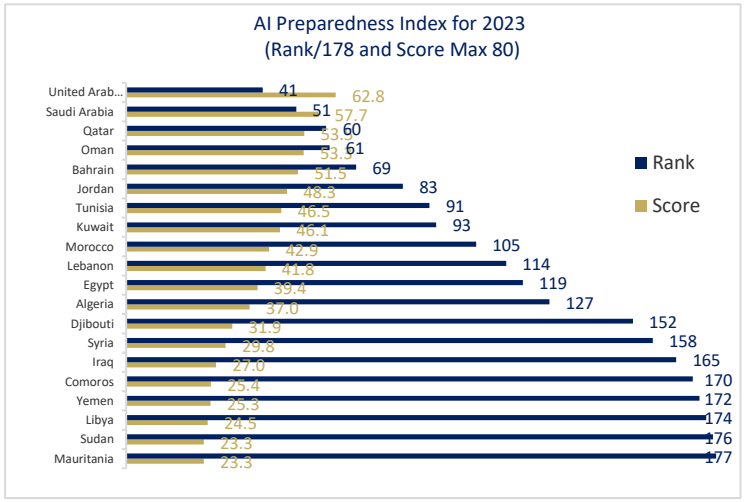
Country	Backward GVC Participation (%)	Forward GVC Participation (%)	Total GVC Participation (%)	GVC Profile
Saudi Arabia	25	40	65	Upstream commodity supplier
United Arab Emirates	35	30	65	Logistics & services hub
Qatar	20	45	68	Upstream energy supplier
Algeria	25	35	60	Energy-dominated GVC
Kuwait	20	40	60	Upstream commodity supplier
Morocco	45	15	60	Manufacturing assembly platform
Oman	30	30	60	Mixed upstream & processing
Tunisia	50	10	60	Manufacturing assembly platform
Egypt	35	20	55	Diversified manufacturing & energy
Iraq	15	40	55	Upstream oil supplier
Jordan	40	15	55	Selective manufacturing GVCs
Djibouti	35	10	45	Logistics-based GVC entry
Lebanon	35	10	45	Limited GVC integration
Sudan	25	15	40	Primary commodities
Yemen	20	10	30	Marginal GVC integration

Source: World Integrated Trade Solution (WITS). https://wits.worldbank.org/

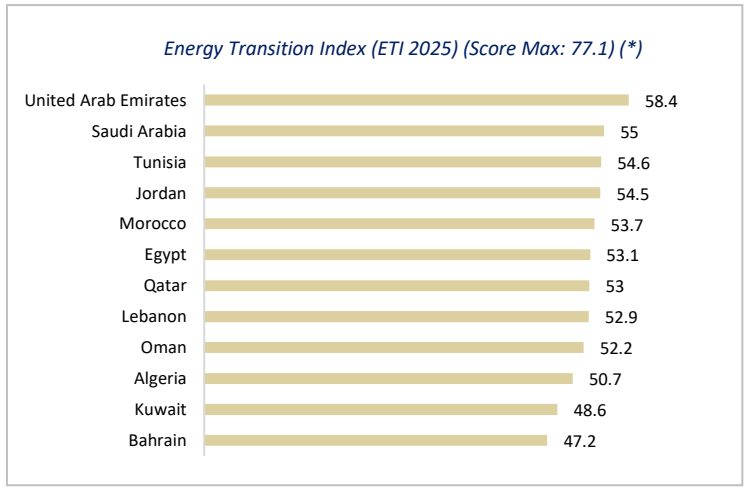
- Progress in the *digital, energy, and environmentally sustainable transitions*—key drivers of productivity, resilience, and competitiveness—*has been uneven and often insufficient*.



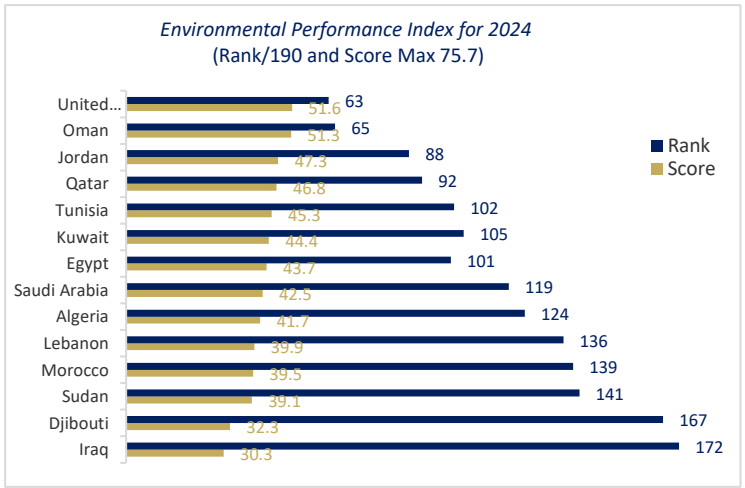
Source: ITU Data Hub



Source: IMF AI Preparedness Index (AIPI) x 100
Average AIPI score : 48.2 for middle income countries



Source: World Economic Forum
(*) Energy systems performance and transition readiness



Source: 2024 Environmental Performance Index (EPI) global results — Yale Center for Environmental Law & Policy and Columbia University