
Introduction

The story of development in the Middle East and North Africa (MENA) region is a tale of the interplay between two forces: external factors and a rivalry of interests. Over time, large public sectors, rather than markets have evolved as the primary mechanism to manage these forces – by enhancing certainty, real or perceived and mediating interests – with both intended and unintended consequences for growth and development. The aim of this book is to assess development policy choices in the post WWII era from the vantage point of these two forces, their interaction and the institutional framework which is given at any point in time. As such, the book surveys primary challenges facing policy-makers in the region today; namely low total factor productivity growth, management of volatile oil and natural gas revenues and rising water scarcity, post-conflict development, raising private investment and diversifying exports, lowering high unemployment, improving education quality and addressing poverty incidence.

To the general public, the Middle East and North Africa region (MENA)¹ is perhaps best known for its vast oil wealth, geopolitical

¹ The countries classified as Middle East and North Africa include Algeria, Bahrain, Egypt, Iraq, Iran, Jordan, Kuwait, Lebanon, Libya, Morocco, Oman, Qatar, Saudi Arabia, Syria, Tunisia, the West Bank and Gaza, United Arab Emirates, and Yemen. World Bank data for MENA regional averages is a subset of this group and includes Djibouti although Djibouti is not included in the general discussions throughout the text. Given its small size, inclusion of Djibouti is not considered to bias the regional estimates for MENA countries in a significant way.

significance, and youthful demographics. Today, with 60% of the world's oil and more than 40% of natural gas reserves, much of it produced by sovereign entities and with less than 5% of the global population, a handful of governments within the region have become net creditors on a global scale. The region increasingly has the financial resources needed to stimulate growth entirely from within. Arab countries span an area end to end which covers more than one fifth of the globe from west to east (Drysdale and Blake, 1985a) – larger than China, Europe, the United States or Canada. People within these lands are also linked by complementarity in labor and capital, a sense of unique cultural identity and many speak a common language – Arabic which is also the language of the Qu'ran.

The region's geostrategic location has long attracted the attention of the world's great powers, with attendant consequences for uncertainty and dislocation. No other grouping of states belongs to as many geopolitical realms as the countries of the MENA region. The coastal states of North Africa for example are simultaneously African, Mediterranean, Islamic, and Arab as well as historically, economically, and politically influenced by close proximity to Europe (Drysdale and Blake, 1985b). Rapid growth in China and the East Asian economies has increasingly exerted stronger gravitational pull in terms of goods and capital flowing eastward, heightening the region's central importance as the apex of trade and commerce linking Europe, Africa and Asia. Large numbers of youth, an estimated 35% of the working population navigate multiple cultural and social affinities and identities along with significant intergenerational gaps in human experience, given the rapid pace of modernization in the post-war period.

For development practitioners, the MENA region is of even greater interest, by virtue of its unique combination of growth challenges – critical to the people in these lands – and to the global economy at large. It is home to some of the richest (Qatar) and poorest (Yemen) countries in the world – contributing to a set of regional dynamics and policy regimes which differ from other developing areas. MENA houses one of the oldest aid agencies in

the developing world and some of the largest recipients of foreign aid per capita. Intra-regional dynamism is linked to a greater extent with remittance flows and the accumulation of financial surpluses in the Gulf Cooperation Council (GCC) countries as opposed to exports.² The region is prone to shocks in the form of commodity price volatility and windfalls, climate variability and water scarcity as well as a legacy of political upheaval and wars.

Vast oil wealth and participation in the Organization of Petroleum Exporting Countries (OPEC) creates dual and related challenges for policy-makers in terms of global oil production and domestic fiscal policy. This has contributed to a global oil market in which a significant share of world oil is produced by relatively high-cost producers. At the same time, a large portion of the region's population resides in arid and semi-arid areas, where rainfall comes unpredictably for some three months every year. Per capita fresh-water availability region-wide is the lowest in the world, yet water is locked into relatively low-valued uses in agriculture – even among the high per capita income countries in the region.

The MENA region has a long history of globalization. It also relies heavily on three to four sectors to generate export potential and many economies have traditionally retained a limited range of import partners. Most of the region's export commodities are volatile in price – namely oil, natural gas, phosphates and agriculture – creating challenges for fiscal policy and exchange rate management. Non-traded goods and services have tended to predominate, leaving many industries and firms struggling to increase competitiveness in the wake of rapidly-integrating global markets. Tradable industrial output is among the lowest in the developing world. MENA's existing firms and entrepreneurs tend to be older than the average for emerging markets and there is a high concentration of family-owned firms. Financial markets remain somewhat volatile, given the lack of depth in terms of instruments and volume; the rapid growth of Islamic financial instruments in the

² The states of the Gulf Cooperation Council include Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates.

region and worldwide, has implications for further development of the region's financial markets.

A legacy of public employment guarantees has focused educational attainment and skills development on public employment potential and provided avenues of mobility for many – particularly women. At the same time, however, large numbers of government employees, along with large cohorts of first-time job seekers and lack of full adjustment in labor markets contributes to high rates of youth unemployment and perpetuates segmented labor markets. In Algeria, for example, more than 80% of the female labor force was employed by the public sector in the 1990s, while in Kuwait the majority of the private labor force consists of foreign nationals. The region's most pressing challenge – youth unemployment estimated at over 40% in some countries – affects first-time job seekers with at least a secondary education certificate – many of them women, as public hiring rates are declining and female labor force participation is rising.

Across the region, relatively high levels of social welfare prevail, in part, through the continuation of high levels of public employment and generous subsidies on food and energy together with generally wide access to social services such as education and basic health. Countries in the Middle East and North Africa region spend more on the unemployed, the disabled and the poor, than what industrialized countries did at similar levels of development. For a host of reasons, family and kinship networks also play an important economic and social role. In Jordan for example, approximately 40% of the elderly live with their children. However, the real impact of such policies and entitlements can vary significantly within countries and across groups. In Egypt, for example, poverty rates were 34% in rural Upper Egypt and 5% in metropolitan areas in the 2000s. Middle-class and upper-income families tend to benefit disproportionately from energy subsidies. There are horizontal inequalities across groups and regions, based on economic, social, political and cultural status.

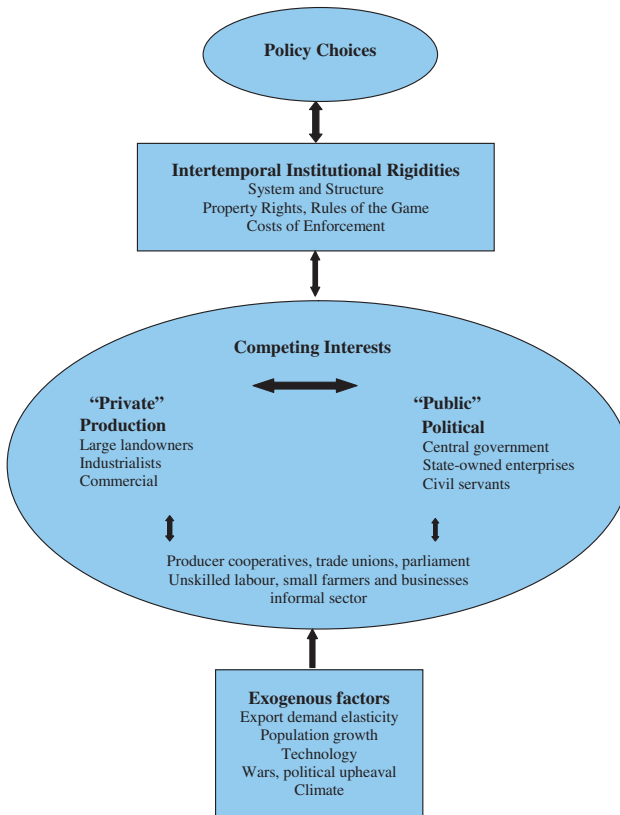
The degree and form of government intervention underlies many of these challenges, as do external forces and a rivalry of

interests which give rise to policy choices. These are linked with factors both generic to developing countries and unique to the region. Economists would identify the link between openness and demands for more protection; sociologists might highlight tendencies towards egalitarianism, social affinity and kinship, alongside a determined and competitive individualism. Historians tend to single out the region's harsh physical environment – a pervasive sense of uncertainty and the tenuousness of power – exemplified by shifting influences between an urbanized core, entrepreneurial hinterlands and cosmopolitan coastal cities. Regardless of its origins, understanding this dynamic is important for understanding growth and development in the Middle East and North Africa region – where it has been, and where it is going.

Many of the development challenges described earlier are not unique to MENA countries and the tools employed to address them can and are used in a multitude of contexts. The hope is that much will be gained in enhancing understanding of this region in terms of the continuity and modalities of how such issues are addressed.

An important aspect of this story relates to the political economy dynamic underlying policy choices. In this regard, much has been written about the role of MENA governments as large, interventionist entities with a proclivity towards redistribution according to the terms of an unwritten, yet powerful “social compact” between governments and populations (Roy, 1980; Hansen, 1991; World Bank, 1995, 2003). Others describe the dynamic in terms of the workings of the “rentier state” where the rents from oil wealth are distributed by the state, with limited accountability to the body politic through the absence of a clear link between public spending and taxation (Beblawi and Luciani, 1987; Anderson, 1987).

This survey aims for a more general and dynamic approach. It attempts to look more broadly at development policy choices in terms of the relative strengths and interplay between two central forces – competing state/government and private interests and external factors – bounded by the institutional constraints which



Source: Author. Adapted from Ekelund and Tollison (1997). *Politicized Economies: Monarchy, Monopoly and Mercantilism*. College Station, Texas A&M University Press.

Fig. 1 A Political Economy Framework for the MENA Region

are given at any point in time.³ (Figure 1) A historic account of agricultural reforms in the latter part of the 19th century sheds some light on this dynamic:

“...Whatever (external) pressure there may have been to introduce a ... system of registration, taxation or private property rights, the actual result of policy was generally a bargain between the central government, local councils and men of rural power which was clearly neither in the

³ This framework is adapted from Ekelund and Tollison (1997).

interests of efficient administration nor the most profitable development of the region's agricultural resources." (Owen, 1981).

The stylized diagram in Figure 1 is a rudimentary attempt to capture factors underlying this dynamic. It is intended to be sufficiently general to explain discrete and continuous policy outcomes as well as encompass discussion of the region's broad thrust of development policy and specific challenges. Outcomes at any point in time, can be viewed as the by-product of two main forces – a balance of competing domestic interests and external forces. This "moving equilibrium" of sorts is also influenced by institutional mechanisms such as property rights enforcement and rules of the game. A central feature of this approach is that the boundary between government/private activity is fluctuating rather than static reflecting a tenuous balance between state/government action and private entrepreneurship. In economies with high levels of government activity and where governments are players as well as rule-makers, present and future balances between governments and private actors can be highly uncertain, given that much depends on a set of unarticulated social practices and tacit assumptions beyond the control of any individual actors including policymakers (Frydman and Rapaczynski, 1994).

This approach is intended to be descriptive, not predictive. Underlying interests include commercial, industrial and government, both collective and dispersed. The impact of exogenous factors is intertwined with competition and collusion across such interests and the relative strengths of these interests working individually and/or in groups. At any given point in time, institutional constraints and costs of enforcement imply a set of costs and benefits affecting economizing behavior on the part of competing domestic interests. Over time, property rights are shifted primarily by the relative balance of these interests but also by the impact of exogenous factors such as population growth over longer periods. Government and private interests are active in a manner which is both dispersed and collective; in some MENA countries public and private distinctions also coincide historically with

specific family and ethnic groups. Mutual tensions and suspicions, together with political and economic bargains coexist between these groups, heightened at times, by ethnic and religious differences. A central outcome of this dynamic, has been protection over various segments of economic activity primarily in the form of output restraints and entry barriers. Similar to other economies, with high levels of government activity, there is a tendency for transfers of power from one cohesive group to another to be limited to synergistic mergers or anti-competitive arrangements (Frydman and Rapaczynski, 1994).

Government actors can and do allocate resources to state-owned enterprises as well as private parties and insiders – working individually as well as in groups, who pressure for more or less government intervention depending on the influence of external factors and the strength of opposing groups. Social forces and developments are also key drivers of underlying costs and benefits of the shift in government-private boundaries.

Policy outcomes resulting from this political economy framework tend to be a rather unpredictable mix of the comparative strengths between the competition of public and private interests, exogenous factors and institutional rigidities. Lack of certainty regarding the costs and benefits for winners and losers from discrete policy shifts, contributes to a general bias towards the status quo and inertia in policy-making. Furthermore, in situations where resources are dispersed across groups maintaining asymmetric information about costs of reform, the status quo tends to persist (Alesina and Drazen, 1991).

However, shifts do occur and are influenced at some intervals, by leverage gained from external resources, overlapping areas of interest, mobilizing unskilled labor and regulatory change or institutional reforms. Policies of “Infithah” or macroeconomic opening to foreign investors during the 1970s, for example, were facilitated by oil windfalls, which eased domestic pressures for continued protectionism. Some sectors were opened up for investment; others were not. However, as the growing trade protectionism of the 1980s and 1990s demonstrated, such policy shifts are neither

permanent nor irreversible. From a practical perspective, achieving economic change, either through discrete shifts or continuous modification in policy tends to be facilitated by the emergence of new and promising opportunities, multiple rounds of bargaining and consultation at various levels, inaction by opposition groups and/or more general agreement on the basis of eliminating obvious “bads.” Successful development interventions tend to exhibit all or some of these characteristics. Such changes rarely occur purely as a result of highly visible, unilateral, linear approaches and proactive advocacy by proponents on the basis of public good rationales.

Over time, the confluence of these factors has also contributed to high levels of public interventionism in MENA countries, at levels generally higher than those found in other developing areas-with significant consequences for growth performance. In this environment, interventionism also has a self-reinforcing logic. Markets can and do deliver unpredictable and, at times, undesirable outcomes, further enhancing demands for more public intervention. Over time, growth prospects are dampened by higher costs of production and service delivery, along with a higher real and perceived threshold for competitive entry into new products, technology and markets. Total factor productivity growth and living standards stagnate. Interests also become more difficult to mediate when public sectors have a stake in the game. This raises the demand for more intervention and mediation, which in turn, only heightens prospects for non-cooperative outcomes in society-at-large, and tends to perpetuate a scenario in which much problem-solving is undertaken by small groups with private information.

This Gordian Knot of tangled growth directions is the subject of this book. In Part I, Chapter 1 compares MENA countries to other middle-income regions in terms of the basic characteristics of developing economies. Within the region, there are obvious and growing differences between the governments of the Gulf Cooperation Council and the rest of the region.

Chapters 2 and 3 survey the region’s rapid growth in the 1960s and 1970s, collapse in the 1980s and moderate growth resurgence since the latter half of the 1990s. Chapters 4, 5 and 6 look more in

depth at the challenges of managing abundant oil wealth, scarce water resources and development in the post-conflict environment, respectively.

In Part II, policy issues related to the microeconomy, industrial structure and trade relations are examined. Chapter 7 reviews the strengths and weaknesses of the business environment; while Chapter 8 explores questions surrounding the region's pace of global integration. Chapter 9 reviews the challenges and opportunities for industrial restructuring.

In Part III, Chapter 10 surveys population dynamics and educational achievements, while Chapter 11 surveys the functioning of the region's labor markets and explores underlying factors contributing to high unemployment. Chapter 12 reviews social spending from the vantage point of poverty and inequality. Chapter 13 reviews the nature and effectiveness of development assistance and Chapter 14 concludes with suggestions for the future.

Two windows of opportunity have opened in recent years. A new and rising generation of leaders is emerging, with a more proactive approach to addressing underlying problems. The oil windfall of the early 2000s has also made the resolution of many of the region's challenges within reach. These two factors place MENA countries at the cusp of a historic and economic shift toward a potentially very different growth trajectory – one which more fully maximizes the region's combined resources of land, capital, and people.

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