

## ONE

### Introduction

This book examines the relationship between demographic growth and economic development in Egypt, Iraq, Jordan, Morocco, the Palestinian Territories, Saudi Arabia, Syria, and Tunisia. It shows that, despite a slow-down in demographic growth, the labor force is increasing rapidly because of the change in the age structure of the population. This is known as *demographic transition*, a phenomenon that has enhanced economic growth in other parts of the world. In the Arab world, however, many of the opportunities presented by demographic transition are being lost, which results in serious threats to the political stability of the region.

The main reason for this situation is that the region has missed out on the Industrial Revolution that has spread through Europe, North America, East and Southeast Asia, and now to India since the nineteenth century. Demographic growth, albeit at a decelerating rate, and the change in population age structure against a background of slow job creation is a major cause of political instability and even terrorism. This poses severe challenges for all Arab countries, despite the differences between their economies. This book goes beyond the conventional analysis of demand and supply to ask two closely related questions. The first is why did governments act so slowly in response to the problem of unemployment, given the danger that it poses for social and political stability? The second question is why has the response been similar in very different economies? Answers are provided using new literature in economics and economic history. The book also examines the role of oil in retarding economic development and especially the way in which it strengthens the state and its relations with the governments of oil-consuming states. It also examines two countries that have suffered conflict: Iraq and the Palestinian Territories. The book places the effects of conflict and occupation into their historical context and shows both the similarities and differences between these economies and those of other Arab states.

States in conflict usually fail to produce good data and are, therefore, omitted from much of the economic literature. Conflict within Arab states and sometimes between them is endemic and the economic and socioeconomic conditions of those states need examination even if the data are weak.

Chapter 2 outlines the main demographic and economic trends in the region. Demographic growth has slowed and demographic transition has increased the share of the population that is of working age. It then looks at the labor market, with population viewed as the supply side and economic development as the source of demand. Economic performance has not been strong enough to significantly reduce unemployment. The reliance of many economies on different kinds of rental incomes and the weaknesses of the industrialization process are analyzed in order to explain the pattern of economic growth.

Chapter 3 evaluates the explanations of Arab economic performance. It analyzes the characteristics that Arab economies have in common and puts forth explanations for the persistence of policies despite serious economic problems. It covers the explanations for weak economic performance given in the Arab Human Development Reports and by others in and outside the region. These have increasingly blamed such factors as discrimination against women, poor education, and the lack of political freedom. They do not, however, explain why Arab countries remain in this situation. The answer is found in the way in which these countries have developed, and new literature in economics and economic history is used to explore these developments. This covers the role of geography and the resource base, culture and religion, and institutions. The weakness of the middle class, a group that has played a key role in the politics and economics of other regions, is central to understanding the predicament of Arab states. The role of Islam is highly controversial: Although economists and economic historians have been much more willing than many other Middle East scholars to examine its effects, there is no consensus.

Chapter 4 compares the economic development of Arab countries to that of East Asia and Latin America, with emphasis on industrialization. It shows how basic conditions varied between the regions and how these were much more successfully built upon in East Asia than in the Middle East and South America. It also shows that as a result of oil income and cautious capital account policies in the poorer countries of the Arab world, financial crises accompanied by debilitating capital outflows were avoided. This is despite the fact that a huge amount of Arab capital has left the region.

Chapter 5 is about Egypt, a political and cultural leader in the Arab world, with the largest population. Egypt faces huge problems, many of

which derive from demographic growth. This presents challenges in terms of the provision of social services and infrastructure. The labor force is growing rapidly and there are high levels of hidden and open unemployment. This chapter examines the effects of education on fertility and the role of women in the labor force. Despite many reforms, Egypt's main productive sectors – agriculture and industry – suffer many constraints and have not provided increases in productive employment on the scale hoped for. Many of the problems are due to the unwillingness of the government to complete the reform process in the widest sense. Egypt has, however, grasped a prickly nettle by overcoming internal opposition to the creation of Qualified Industrial Zones (QIZs), designed to export to the United States with limited Israeli content, thus securing hundreds of millions of dollars of manufactured exports and thousands of jobs. Egypt is important because of its size and importance as a cultural leader in the Arab world. It permits free debate about economic issues, although those debates have seldom influenced the decisions taken. The economic success or failure of Egypt is a matter of concern for the region as a whole as well as for many outside the Middle East.

Chapter 6 provides a historical perspective on Iraq's current economic problems. For many years it has played a major role in the region and has fought three wars. The Ba'ath regime was the most totalitarian in the Arab world and it squandered the country's human and natural resources on an unprecedented scale. As a result, it is often excluded from the analysis of the region. Despite the huge destruction, Iraq has economic potential and it will play an important role in the future. It shows how, since the 1950s, Iraq has favored the oil sector at the expense of others. This is done through an analysis of how oil revenues were invested and how, until 1980, huge volumes of funds were unused. From 1980 until the present, Iraq sustained massive losses that have caused extensive damage to the economy and to the welfare of the population. U.S. policy proposals, partly implemented after 2003, are scrutinized and it is suggested that they repeat some of the errors of previous Ba'athist policies.

Chapter 7 analyzes demographic and economic developments in Jordan. It suffers from high rates of unemployment but also imports labor. The economic reform program designed to tackle underlying structural problems is then examined. Jordan has gone further than most Arab states in trying to change its economy, especially its foreign economic relations. In this connection the creation of QIZs is analyzed. These have come to rely on cheap, imported labor and show some of the problems of industrialization in a developing economy. The chapter also looks at the history and

development of entrepreneurship in Jordan. In many respects, the economic policies of Jordan have been brave: there have been large and successful investments in human capital and attempts to industrialize using Western economic models in the face of huge demographic, social, and other challenges. Success has been limited and this – together with the country's geo-political importance – justifies the examination of its economic development.

Chapter 8 shows that Morocco introduced many reforms but these have not cured its huge socioeconomic problems. It has done much that the International Monetary Fund (IMF) and the World Bank demanded and as a result its financial position has improved and it has avoided balance of payments and foreign debt problems. Morocco was also one of the first countries in the Middle East to experience demographic transition and now benefits from slower population growth. Economic performance has been less satisfactory: economic growth remains very unstable, excessively influenced by fluctuations in the harvest due to the vagaries of the weather. Despite large-scale emigration, Morocco has very high levels of unemployment, especially among young people. It also suffers from mass poverty. The international environment has not been helpful: most exports go to Europe and face increasing competition. The private sector's room for maneuver is limited by the royal palace as well as by other weaknesses and this has limited industrialization and foreign investment, with the notable exception of tourism. Morocco demonstrates how difficult the implementation of economic reforms is even in the context of a relatively free debate within the country and a much freer political system than prevails in most other countries in the region.

The Arab Human Development Reports and many other studies in the Arab world have blamed the conflict between Israel and the Palestinians for the lack of economic development in the region as a whole. Without subscribing to the causation implied, Palestine is important in itself and because of the effects of conflict. Chapter 9 shows how the creation of a healthy economy in a future independent Palestinian state was affected by Israeli policies after 1967. The refusal to permit or encourage industrialization was the most serious blow because it left the Palestinians dependent on other sources of employment. With the deepening of conflict with Israel, the Israeli labor market was closed and the Palestinians suffered huge losses. The creation of the Palestinian Authority in the mid-1990s was also a profound disappointment. It granted monopolies to those close to the leadership and replicated the corruption prevalent in other Arab countries. The result was the alienation of much of the population, the exit of much of the West

Bank middle class to Jordan, and the rise of the fundamentalist Hamas that rejected attempts to reach a peace agreement with Israel. The Second *Intifada* resulted in major loss of life and massive destruction. Despite, or perhaps because of this, the population has grown faster than nearly anywhere else in the world, contributing to a large fall in per capita income.

Chapter 10 examines the paradox of why Saudi Arabia – a country with huge oil resources – suffers from high unemployment. This has been accompanied by the import of millions of workers from abroad. The kingdom's problems stem from the policies developed during the oil boom of the 1970s. First, it adopted a pro-natal policy that resulted in rapid demographic growth. Second, it increased the size of the civil service to supply services to the population and to provide employment. Third, it did little to develop technical, technological, and scientific education. The public service often offered higher pay than the private sector and the latter increasingly relied on imported labor. Saudis therefore preferred to work in the public sector. After oil prices fell in the mid-1980s, the government could only maintain the public sector by large-scale borrowing. Investment was cut and the economy went into crisis. Since then the financial position has improved immensely. However, the education system still fails to sufficiently train Saudis for work in the private sector and many of those who have a technological or scientific education leave because of the stifling political system. In this environment, fundamentalism and terrorism have increased. Many, though not all, of the issues faced by the Saudis have been present in the development of the other, smaller Gulf States. It therefore serves as the example of oil-based development.

Chapter 11 analyzes the Syrian economy. It has the richest agricultural sector in the Arab world, oil and gas, and magnificent tourist attractions. Despite both this and its dominance over Lebanon for many years, the Syrian economy is one of the most backward in the region. Syria suffers from rapid population growth, even faster labor force growth, and high unemployment. Its industrial sector is underdeveloped and is held back by extensive government intervention and by the lack of a modern banking system. The country is isolated from the international economy: it is now among the most inward-looking countries in the Arab world. Oil production has declined and oil revenues are falling, leaving the government with even less room to maneuver. Despite cutbacks in military spending, Syria maintains a large army and the conflict with Israel is central to all considerations in Damascus. The Ba'ath regime in Syria is much less violent than that in Iraq and so Syria has suffered much less conflict. Despite this, the extreme centralism and incompetence of the economic system have had

huge negative effects. Syria also presents an interesting parallel to Tunisia. In 1960, the two countries had similar-sized populations and economies. The paths that they have followed, measured by growth of national income per capita, have been quite different and the reasons for this are explored here.

Chapter 12 deals with Tunisia, the most industrialized economy in the Arab world. It has experienced years of economic growth as well as the advantages of demographic transition. Major efforts were made to improve the efficiency of agriculture so that it would not be exposed to the effects of the drought, and these have had considerable success. They have also helped to limit the pace of urbanization. The labor force is growing at 2.5 percent a year, more than twice the rate of growth of the population and this is one of the main reasons why unemployment, especially among the young, is high. Tunisia seems unable to break through a glass barrier to faster and higher technology industrialization. One of the reasons is the tight hold that the government has on the entrepreneurial class and its apparent unwillingness to devolve power.

Chapter 13 presents conclusions as to the causes of Arab economic problems. Based on the ideas outlined in Chapter 3, I put forward the concept of an “Arab equilibrium” and suggest that the current balance of power is one that opposes change, despite the dangers posed by unemployment and even terrorism. This is reinforced by the region’s relations with the rest of the world that are dominated by the sale of oil and gas that is government-owned and permit rents to play a major role in the political economy of the region.

## TWO

### Demography and Economics

During the last twenty-five years, all of the countries examined in this book have experienced significant declines in their demographic growth rates. This is mainly the result of a fall in fertility rates that started in North Africa and later spread to the rest of the Middle East. Despite the demographic slowdown, the rates of growth in most of the countries remain high by international standards and the absolute increases of the population in all of them are large. In 2000–05, the population of eighteen Arab states rose by more than six million a year or about 2.2 percent annually (see Table 2.1). One of the consequences of demographic change has been the creation of a large young population of reproductive age. Another is a rapidly growing labor force. None of this is expected to change in the next twenty years. Although the population of working age has grown, so has the size of the dependent population and as a result the pressure for public sector spending on social services such as education, health, and welfare has increased, often beyond the financial abilities of governments.<sup>1</sup> In the non-oil states and those with small oil incomes, taxation was the main source of funding for government spending and was usually under pressure. This was particularly true during periods of recession and when stabilization programs were being introduced. In the oil-rich states, the problems were much less acute, but they have occurred during periods of low oil revenues.

Demographic growth, insofar as it is the main cause of increase in the labor force, can also be thought of as a supply factor. The task of the labor market is to balance the supply of labor with demand. When there is an

<sup>1</sup> Williamson Jeffrey G. and Tarik M. Youssef. “Demographic Transitions and Economic Performance in the Middle East and North Africa,” in Sirageldin, Ismail (ed.), *Human Capital: Population Economic in the Middle East*. London and New York: I.B. Tauris, 2002. 22.

Table 2.1. *Demographic transition in the Arab world, 1970–2015 (millions)*

	1970	2000	2015 (forecast)	Annual growth rate 1970–2000 (%)	Annual growth rate 2000–2015 (%)
Arab population	122	281	385	2.82	2.12
aged 0–14	55	107	129	2.24	1.25
aged 15–64	63	164	240	3.24	2.57
age 65+	4	10	16		
aged 15–64/total*	51.6	58.4	62.4	0.41	0.44

\* The demographic gift is growth rate of the working population minus that of the total population.  
*Source:* Dhonte, Pierre, Bhattacharya, Rina, and Yousef, Tarik. (2000). “Demographic Transition in the Middle East – Implications for Growth, Employment, and Housing,” IMF Working Paper No. 00/41, <http://www.imf.org/external/pubs/ft/wp/2000/wp0041.pdf>.

excess supply, then unemployment results. To understand conditions in the labor market that led to very high rates of unemployment in all Arab states (some 15 percent in 2000 and nearly 11 percent in 2005), it is necessary to look at the sources of demand for labor. These depend on the structure and growth of the economy. In all of the countries examined here and in all other Arab states, the generation of employment has been weak. This was partly because of unstable or low economic growth rates, but even when growth rates were fast, the pattern of growth was such that employment growth was limited. The main reason is that the region has largely missed out on the process of industrialization, which has transformed much of the world economy. Industrialization also transforms societies and their politics, generating new interest groups – both capitalists and workers – that have interests in pro-growth economic policies. Here again, the Arab states have, to a considerable extent, missed out on a process that is much more than economic but that has profound economic effects. The weakness of the industrialization process was in part because of government policies: both in countries that espoused Arab socialism and in those that did not, governments have played, and continue to play, a dominant economic role. It is also reflected in the weakness of the private sector, an important theme in this book.

The eight countries analyzed here are fairly representative of the Arab world. They include states in the Mashreq and the Maghreb, oil and non-oil as well as low-oil economies. Among them are those in varying states of war and those at peace, some with low and others with higher income per capita, monarchies and republics.

Between 1960 and 1985, Arab economies grew by an average of 2.5 percent annually, which permitted major improvements in human development



indices. Although the growth of per capita income was very low, the benefits of growth were spread throughout society as a result of socialist policies in some countries and welfare policies in both socialist and nonsocialist states. The remittances earned by millions who went from the poorer states to the oil states to work flowed home with beneficial effects on income levels and distribution. These factors helped to reduce poverty levels; as a result, in 1990 only 5.6 percent of the Middle East population lived on less than one dollar a day, compared with 14.7 percent in East Asia and 28.8 percent in Latin America.

In the mid-1980s, oil prices slumped, incomes fell, and economic growth decelerated; so did remittances and the demand for labor in the oil-rich states. This had a ripple effect throughout the region. Since the mid-1980s, poverty has increased and, as will be shown, the region has been unable to take advantage of the “demographic gift” of an expanding supply of educated labor. In 1985–94, growth slumped to –1.1 percent a year and as a result, per capita incomes fell significantly. Furthermore, the volatility of growth increased. In the period 1995–2000, there was a modest recovery to 0.3 percent.<sup>2</sup> In the period 2000–05, there was an improvement mainly as a result of higher oil prices. The growth record since the mid-1980s has meant that poverty and unemployment have risen. There was also an increase in the number of people suffering undernourishment, from an average of 21.7 million in 1990–92 to 24.7 million in 2000–02, an increase of 14 percent.<sup>3</sup> This increase suggests that income inequality rose and that the ability and/or willingness of governments to maintain welfare levels declined. It also reflects the enormous pressure on the economy of demographic growth.

The Arab economies share three closely related features. The first is a deep and prolonged employment crisis. The second is the very limited development of the manufacturing sector and of industry in general. The third is the major role played by rental incomes. These are examined in this chapter.

### Population Growth

The underlying supply-side reason for the employment crisis is demographic, specifically the very rapid rates of population growth that prevailed in the 1970s and 1980s. Population growth in the Middle East is the fastest in the world, despite the deceleration of recent years. In the second half

<sup>2</sup> Elbadawi, Ibrahim A. “Reviving Growth in the Arab World.” *Economic Development and Cultural Change* 54 (2006). 293–326.

<sup>3</sup> Calculated from FAO, *The State of Food and Agriculture 2005*. <http://www.fao.org>.151.

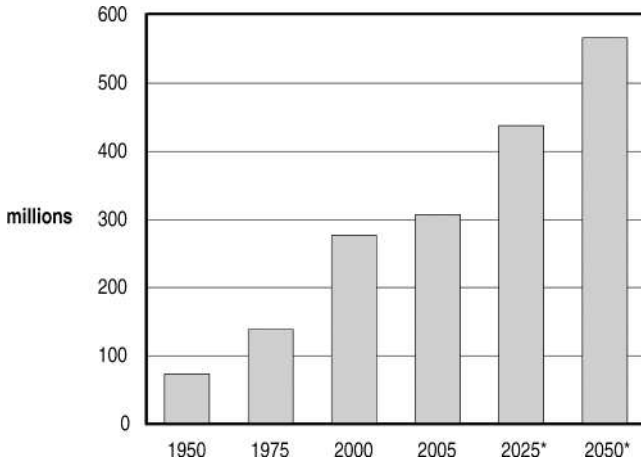


Figure 2.1. The Arab Population, 1950–2050 (millions). *Source:* Population Division of the Department of Economic and Social Affairs of the United Nations Secretariat, “World Population Prospects: The 2004 Revision and World Urbanization Prospects: The 2003 Revision, Medium Variant,” <http://esa.un.org/unpp>.

\* forecasts

of the twentieth century, demographic transition – the progression from a population with short life spans and large families to one in which people live longer and have smaller families – in the Middle East was marked by a decline in mortality that preceded the fall in fertility. In 1950, the total population of 18 Arab states was 73 million. By 1975, it had risen by 97 percent to 144 million and by 2005 it had reached 307 million (see Figure 2.1). The rate of population growth accelerated from 2.5 percent a year in 1950–75 to 2.75 percent in 1975–2000, whereas world rates fell from 1.9 percent to 1.6 percent during the same period.<sup>4</sup>

During the late 1970s, the crude birthrate averaged 42 per 1,000, resulting in 6 million births a year while the crude death rate was 12.2 per 1,000, resulting in 1.8 million deaths a year. As a result, the population rose by more than 4 million annually. In 2005, birthrates were estimated at 26 per 1,000 in North Africa and 27 per 1,000 in West Asia; crude death rates were 6 per 1,000 and 7 per 1,000, respectively.<sup>5</sup> Death rates in the Middle East and North Africa (MENA) fell because of improvements in health. Relatively

<sup>4</sup> Population Division of the Department of Economic and Social Affairs of the United Nations Secretariat. *World Population Prospects: The 2004 Revision and World Urbanization Prospects: The 2003 Revision, Medium Variant*. <http://esa.un.org/unpp>.

<sup>5</sup> Population Reference Bureau. *World Data Sheet 2005*. <http://www.prb.org>.