Growth and Convergence in the Arab Region

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Frustration, and even rage, over poor socio-economic and political conditions had been building up in the Arab World over several decades before the revolutions of 2010-11. By the spring of 2011, Arab youth and the rest of the world were euphoric; the old autocratic and seemingly sclerotic regimes in Egypt, Tunisia and Yemen had fallen, and were hopefully being replaced by more open, democratic and progressive systems. Two monarchies, Jordan and Morocco, were also undergoing gradual democratic transitions, and their kings appeared open to shifting part of their powers to elected parliaments. Everything seemed to be going very well at the time of the G-7 meetings in Deauville, where the world's richest nations promised substantial economic aid to support the political transitions in those five countries.

However, the euphoria was short-lived, and most people today try to avoid using the term "Arab Spring" when talking about the revolutions that led to the overthrow of presidents Ben-Ali, Mubarak and Saleh, and to constitutional reforms in Jordan and Morocco. More than three years after the revolutions, the Arab transition to democracy appears to be sinking in the desert's quicksand. And, the economies of the five so-called Arab Countries in Transition (ACTs) are not doing much better. Demands for more bread and greater social justice are far from being met. The situation beyond the five ACTs is even worse, as weak nation states (e.g., Syria) descend into chaos and civil strife. In hindsight, the euphoria of the spring of 2011 was clearly unjustified.

But does this mean that today's pessimism is justified? Probably not. A successful transition to democracy requires building institutions (free press, political parties, independent judiciary, and the like) as well as a change in culture (acceptance of the other, respect for diversity, etc.), and that is a long-term process. The experiences of countries like Turkey and Brazil seem to indicate that it is a process that could take decades rather than months or even years. Hence, a more optimistic narrative could stress the fact that in 2010-11 Arabs clearly expressed their yearning for democracy, and that a process of institution building and culture change that will unavoidably lead to more open and democratic societies has already started. Such a narrative would also stress the need for patience and a long-term vision.[1]

Democratic transitions are made easier by economic growth and expanding opportunities. With this in mind, I present here an analysis of the growth experience of the ACTs since 1980. I show that those five countries have been growing fast enough to start converging towards OECD income levels, but at an extremely slow pace, especially when compared to emerging economies like India and China. I then try to explain this slow convergence by looking at: (1) the quality of economic institutions; (2) levels of physical investment; (3) investment in people and skills; and (4) the rate of economic transformation toward higher productivity sectors.

Convergence or Divergence?

Are the ACT income levels converging? It depends. If one compares to U.S. income levels, then they have been converging since the late 1990s but at a snail's pace. On the other hand, if one compares to India and especially to China, then it is divergence, big time!

Table 1 shows the ratio of per capita GDP (in PPP dollars) in the ACTs to U.S. per capita GDP, and it also includes three of the BRICS (Brazil, China, and India) for comparison.[2] The table shows that the 1980s and part of the 1990s was a period of divergence for most countries, including the ACTs.[3] The ratio for Brazil fell from 37 percent, in 1980, to 28 percent in 1990 and 24 percent in 2000. India remained stagnant in the 1980s at 5 percent of U.S. GDP. During the same period per capita GDP in Jordan, Morocco and Tunisia fell relative to the U.S., while Egypt's per capita GDP remained more or less unchanged moving from 17 to 18 percent of U.S. levels. China is a clear exception to this trend as the ratio of Chinese to U.S. per capita GDP doubled from 2 to 4 percent in the 1980s and doubled again in the 1990s to 8 percent.

TABLE 1: RATIO OF PER CAPITA GDP TO US PER CAPITA GDP, IN PPP DOLLARS (PERCENT)

	1980	1990	2000	2010	2013
Brazil	37%	28%	24%	28%	28%
China	2%	4%	8%	19%	22%
India	5%	5%	6%	9%	10%
Egypt	17%	18%	18%	22%	21%
Jordan	29%	18%	17%	23%	22%
Morocco	12%	11%	10%	13%	14%
Tunisia	17%	15%	16%	21%	21%
Yemen	N/A	9%	8%	9%	7%

Source: World Economic Outlook and author's calculations.

The situation began to change in the 1990s and especially the 2000s as most emerging and developing economies, including the ACTs, started converging towards OECD income levels. Egypt's and Jordan's GDP per capita, which were 18 percent of U.S. GDP in 1990 rose to 22 and 23 percent, respectively. During the same period Morocco moved from 11 percent to 13 percent of U.S. GDP and Tunisia moved from 15 to 21 percent. However, those rates of convergence are very slow. At those rates Jordan would catch up with the U.S. somewhere around 2060, Tunisia would catch up around 2070, Morocco around 2080, and Egypt around 2090. Yemen shows virtually no convergence. Moreover, political upheaval after 2010 has led to a slowdown in the ACTs, implying slower convergence, and even an outright return to divergence in Egypt, Jordan and Yemen.

Emerging economies, especially India and China, have been growing at much faster rates, and therefore converging much faster to OECD levels. This also means that the ACTs are rapidly losing ground compared with those economies. Table 2 presents the evolution of the ratio of ACT GDP per capita in PPP terms to that of India. In 1980 Jordan's GDP per capita was 647 percent that of India and Tunisia's was 374 percent; by 2013 those ratios had fallen to 214 percent and 202 percent, respectively. At this rate India's per capita GDP will surpass that of nearly all ACTs before the end of the century. The comparison with China (Table 3) is even more dramatic. In 1980 Egypt's GDP per capita was more than seven times that of China, whereas now it is 10 percent lower in PPP terms. Today, Yemen's GDP per capita is about one-third that of China. It is hard to believe that in 1990 Yemen had a GDP per capita that was more than double that of China.

TABLE 2: RATIO OF PER CAPITA GDP TO INDIA'S PER CAPITA GDP IN PPP (PERCENT)

	1980	1990	2000	2010	2013
Egypt	374%	350%	308%	228%	199%
Jordan	647%	362%	289%	238%	214%
Morocco	271%	228%	171%	139%	135%
Tunisia	374%	297%	288%	226%	202%
Yemen	N/A	179%	147%	93%	70%

Source: World Economic Outlook and author's calculations.

TABLE 3: RATIO OF PER CAPITA GDP TO CHINA'S PER CAPITA GDP IN PPP (PERCENT)

	1980	1990	2000	2010	2013
Egypt	707%	441%	225%	116%	92%
Jordan	1223%	455%	212%	121%	98%
Morocco	513%	287%	126%	71%	62%
Tunisia	706%	374%	211%	115%	93%
Yemen	N/A	225%	108%	47%	32%

Source: World Economic Outlook and author's calculations.

Why did the revolts occur in 2010 even though ACT economies were growing and converging (although slowly) to OECD levels? There are two possible explanations. The first explanation is that the Arab revolutions of 2010-11 may have been about political rights and not about economics. According to most opinion polls, a huge majority of Arabs (between 70 and 90 percent depending on the poll and the country) believe that democracy is the best form of government. Hence, it may be that as their economic situation improved, Arabs (especially youth) started demanding more civil and political rights and they revolted to obtain them. The second explanation is based on the argument that economic growth in the Arab world has not been sufficiently inclusive. The middle class, and particularly educated youth, have benefitted very little from growth. They watched politically connected businessmen make huge fortunes through government-provided privileges,[4] while they remained unemployed or working for low wages in the informal sector. Moreover, the global food crisis of 2007-8 led to a huge increase in food prices and a big decline in welfare. According to PEW Research Center data, the proportion of Egyptians satisfied with the country's economic situation fell from 53 percent in 2007 to 20 percent in 2010 (right before the revolution) while the proportion of satisfied Jordanians fell from 44 to 30 percent during the same period. Thus, according to this view, growing inequality and increasing economic pressures on the middle class were the main causes of the revolutions.

The rates of convergence and the calculations of catch-up time presented in this section are very sensitive to the assumed GDP growth rates. The analysis presented here implies that if the ACTs continue growing at the same rates as the average for the period 1990-2010, while emerging economies like Brazil and China and OECD countries like the U.S. also continue growing as they have been over the last two decades, then the ACTs will lag behind the rest of the world for a very long time. But those growth rates are not cast in stone. ACTs can start growing faster by increasing their investments in efficient economic institutions as well as physical and human capital, and by accelerating the transformation of their economies in favor of higher productivity activities.[5]

Economic Institutions

Acemoglu and Robinson (2012) argue that the main (or even only) explanation for different economic outcomes among countries is different institutions. Inclusive institutions lead to the creation of inclusive markets that support growth and equality of opportunity. On the other hand, extractive institutions stifle entrepreneurship and creativity, and thus lead to low growth and high inequality. In their discussion of Egypt, the authors state that "Egypt is poor precisely because it has been ruled by a narrow elite that has organized society for their own benefit at the expense of the vast mass of the people. Political power has been narrowly concentrated, and was used to create great wealth for those who possess it."

This conclusion is supported by the analysis in a recent World Bank report that used data on "politically connected" firms in Mubarak's Egypt and Ben Ali's Tunisia.[6] It argues that privileges arising from closed deals between business and politics favor a few connected firms, but prevent the emergence of job-creating competition. Industrial policies were tailor-made to support certain firms. They limited market entry and distorted competition. According to the report, this explains why within-sector productivity growth in Arab countries lags behind the rest of the developing world. The report concludes that the region's relatively slow growth is due, at least in part, to the links between politics and business, and the ensuing distortive policies.

Table 4 shows the percentile rank of the ACTs in 2010[7] on the six dimensions of governance that are measured by the Worldwide Governance Indicators project. The two dimensions where all five countries fall in the bottom half of the countries covered by this project are: voice and accountability, and political stability. Of course, Yemen appears to be an outlier, scoring very low on all indicators,

TABLE 4: GOVERNANCE SCORES FOR 2010 (PERCENTILE RANK)

	Voice & Accountability	Political Stability	Government Effectiveness	Regulatory Quality	Rule of Law	Control of Corruption
Egypt	13.7	19.3	43.1	46.9	51.2	34.3
Jordan	27.5	34.4	59.3	57.4	61.1	60.9
Morocco	28.9	33.0	50.7	51.2	50.2	53.3
Tunisia	10.0	44.3	63.2	53.1	59.7	54.8
Yemen	10.9	1.9	14.3	30.1	13.3	10.0

Source: Worldwide Governance Indicators.

and Egypt scores generally lower than Jordan, Morocco and Tunisia, particularly on regulatory quality and control of corruption.

The work of Acemoglu and Robinson and of the World Bank,[8] as well as the data of the Worldwide Governance Indicators, appear to provide a prima facie case for the ACTs to focus on building inclusive economic institutions that provide greater voice for citizens. This could include building an institutional framework for dialogue and citizen participation in economic planning and policymaking, as suggested by Handoussa (2010) and Sakamoto (2013). It could also include reviewing the legal framework governing civil society organizations to make it more supportive of their operations, as suggested by Kharas and Abdou (2012).

Physical Capital

In addition to institutions, economic growth usually requires the accumulation of physical capital, whether as infrastructure or as new buildings, factories, machinery and equipment. Table 5 shows the evolution of the ratio of investment to GDP in the ACTs and three comparator countries. Two points are worth noting. First, ACT investment rates are comparable to those of Brazil but much lower than those of India, which invests about a third of GDP, and especially China, which invests nearly half of GDP. Second, on average, ACT investment rates seem to be stagnating or declining (with the notable exception of Morocco) while investment rates in China and India (but not Brazil) have been increasing.

TABLE 5: GROSS FIXED CAPITAL FORMATION (PERCENT OF GDP)

	1980	1990	2000	2010	2013
Brazil	23.00	20.00	18.00	20.00	18.00
China	35.00	36.00	35.00	48.00	49.00
India	18.00	25.00	24.00	37.00	30.00
Egypt	28.00	29.00	20.00	19.00	14.00
Jordan	37.00	31.00	22.00	24.00	28.00
Morocco	24.00	25.00	26.00	35.00	
Tunisia	29.00	27.00	26.00	24.00	
Yemen		12.00	19.00		

Source: World Development Indicators.

In order to catch up with the emerging economies, the ACTs will probably need to raise their investment rates. This would require an increase in both public and private investment. Government budgets are severely constrained in the ACTs. In 2013 the budget deficits in Egypt and in Jordan were about 14 percent of GDP. It was 8 percent of GDP in Yemen and 6 percent of GDP in both Morocco and Tunisia.[9] Hence, increases in public investment could not be achieved through increases in expenditure levels; it could only come from expenditure reallocation. Price subsidies, especially for energy products, are an important expenditure item in most countries, reaching as much as 7 percent of GDP in Egypt, for example. Nearly all ACTs are gradually eliminating those subsidies, which should create more fiscal space for much needed investment expenditures.

Public investment that improves the quality of infrastructure would encourage greater private sector

investment, through a "crowding-in effect." But the ACTs also need to improve the business climate and encourage the development of competitive private activities. This is where institutional reforms could have a direct impact on investment. Experience in some ACTs indicates that simply reforming the rules on the books may not have an impact, because the reforms may be poorly implemented or not implemented at all.[10] It is important that the institutions responsible for implementing the regulatory framework affecting the private sector be reformed to become more inclusive (so that the private sector has a say on how regulations are implemented) and accountable (so that the institution is judged on its results and the quality of service it provides).

Investing in People

Economic growth and development is ultimately about people. People drive the growth process and they benefit from its results. Hence education and the accumulation of human capital are central to economic growth. Arabs generally seem to value education and their governments have invested heavily in the sector with good quantitative results. Today there are 3.1 million less children out of school in the Arab world than in 2002, and more children are finishing primary school than ever before.

The problem seems not to be the quantity of education but rather its quality. International test scores show that too many Arab children are in school, but fail to acquire basic skills. At the primary level, 91 percent of Yemeni students, 74 percent of Moroccan students and 65 percent of Tunisian students fail basic numeracy tests. At the lower secondary level, 64 percent of Moroccan students and 39 percent of Tunisian students fail basic numeracy tests.[11]

The contents and quality of the curricula are also problematic. Arab education systems rely too heavily on rote learning and do not teach children "21st century skills" like critical thinking, innovation, problem-solving and teamwork. Many Arab students end up with a diploma but without the skills required by a modern labor market, which may help explain the chronically high level of youth unemployment in the region.

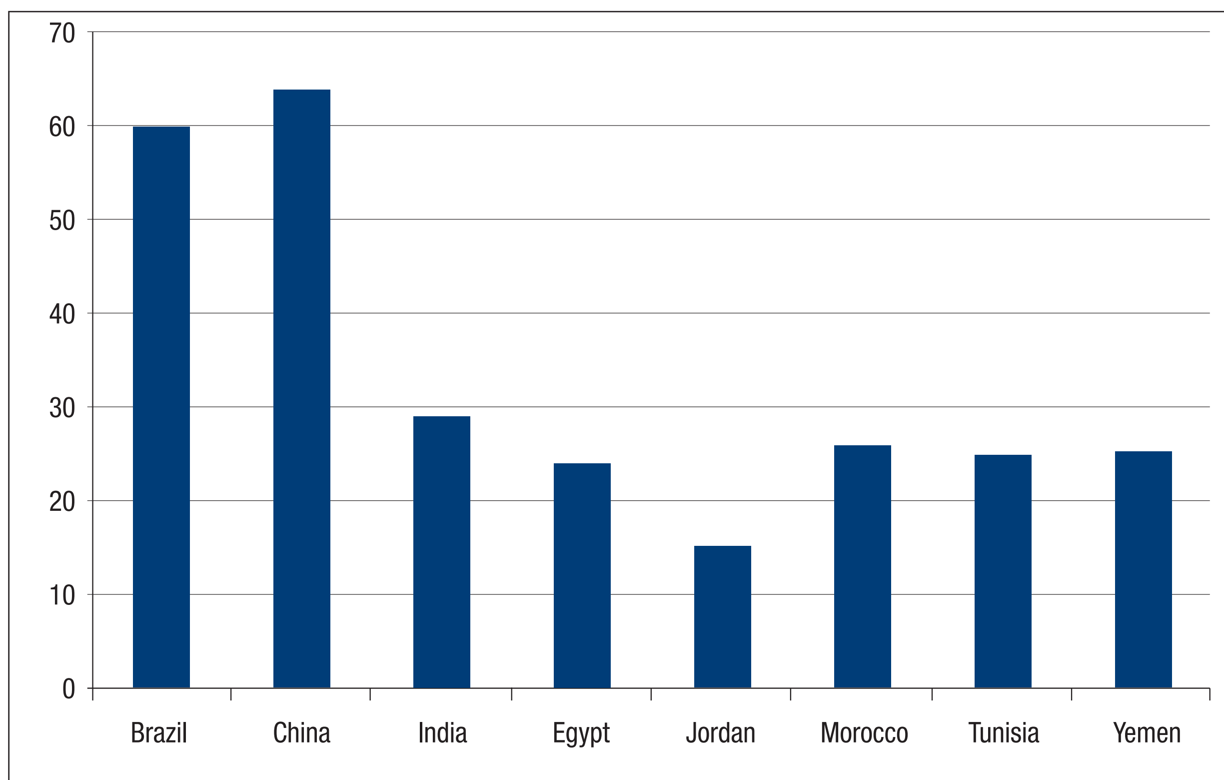
Gender-based discrimination is a very serious problem in the Arab world. Gender differences in education are minor, and even in some ACTs (e.g., Tunisia) more young women complete university education than young men. However, most Arab women seem to stay at home after completing their education. Figure 1 shows that female labor force participation rates in the ACTs range from 15 percent in Jordan to 26 percent in Morocco. This should be compared to 64 percent in China and 60 percent in Brazil. Even India, where there is traditionally a low female participation rate of around 29 percent, does better than any Arab country. Arab female labor force participation rates are the lowest in the world. This is obviously a social as well as a human rights issue. But it is also an economic issue. Arab countries are expending scarce resources educating women, it is therefore important that those women actually work and contribute to their countries' economic and social development.

It seems clear that in order to achieve rapid growth and convergence the ACTs need to resolve the problems with their education systems and deal with gender biases in the labor market. Education reform to improve the quality of curricula and of teachers is probably necessary, as are labor market reforms that encourage the hiring of women and make the workplace more female friendly. Governments cannot resolve those problems on their own. They need the active support and participation of the private sector as well as worker, teacher and student associations.

Economic Transformation

Rodrik (2013) argues that labor productivity in the formal manufacturing sector in emerging and developing economies converges to that of advanced economies, regardless of levels of education and institutional development. This means that the

FIGURE 1: FEMALE LABOR FORCE PARTICIPATION RATES IN 2012 (PERCENT)



Source: World Development Indicators.

convergence process can be accelerated by a shift of resources from low productivity and low growth sectors into manufacturing. The analysis in World Bank (2014) shows that labor productivity in formal manufacturing in MENA countries is converging to that of advanced countries at the same rate as that of other developing nations.

However, this convergence of the formal manufacturing sector did not lead to overall convergence of the economy because of the sector's very small and declining share of the region's labor force. The proportion of overall labor engaged in formal manufacturing is only 7 percent in Egypt and Jordan and 5 percent in Morocco. Moreover, this share has been declining since the mid-1990s.

This situation seems to call for the adoption of the type of heterodox policies advocated by Rodrik (2013). That is, ACTs may consider direct government interventions to provide special incentives for the private sector to invest in formal manufacturing, and for existing formal manufacturers to expand their operations.

Looking at the five ACTs, I argue that faster growth and more rapid convergence to the OECD and the emerging economies can be achieved through more investment in inclusive institutions, as well as in physical and human capital. The process could be further accelerated through specific interventions that encourage shifting resources towards higher productivity formal manufacturing.

It sometimes feels like the rest of the world (including South Asia and sub-Saharan Africa) is rushing toward a brave new era of economic abundance, technological innovation, political freedom and cultural diversity, while the Arab world remains stuck somewhere in the mid-20th century. In this short note I have tried to make the point that this does not need to be the case.

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Endnotes

1. Amin et al. (2012) for a more detailed presentation of this argument.
2. The analysis was also done using per capita GDP in nominal terms and GNI in nominal as well as in PPP terms. The conclusions do not change.
3. For more see Pritchett (1997)
4. World Bank (2014) for evidence on the privileges accorded to politically-connected firms.
5. Rodrick (2013) for a more detailed discussion of the determinants of economic growth.
6. World Bank (2014)
7. I selected 2010 to get a picture of the situation before the revolutions.
8. In addition to World Bank (2014) which focused on the issue of privileges, World Bank (2003) carries out an analysis of governance in MENA and concludes on the need for enhancing inclusiveness and accountability.
9. Fiscal data is from IMF (2014).
10. For an example from Egypt see Ghanem (2013).
11. The data and arguments in this section are from Steer, Ghanem and Jalbout (2014). Also note that international test scores are not available for Egypt and Jordan.