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Middle East Transitions: A Long, Hard Road

Shahid Yusuf

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Middle East Transitions: A Long, Hard Road

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Prepared by Shahid Yusuf

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Abstract

Since the onset of the Arab Spring, economic uncertainty in Egypt, Jordan, Libya, Morocco, Tunisia, and Yemen (Arab Countries in Transition, ACTs) has slowed already sluggish growth; worsened unemployment, particularly of youth; undermined business confidence, affected tourist arrivals, and depressed domestic and foreign direct investment. Furthermore, political and social tensions have constrained reform efforts. Assessing policy options as presented in the voluminous literature on the Arab Spring and based on cross-country experience, this paper concludes that sustainable and inclusive growth calls for a two pronged approach: short term measures that revive growth momentum and partially allay popular concerns; complemented with efforts to adjust the public's expectations and prepare the ground for structural reforms that will deliver the desired longer tem performance.

JEL Classification Numbers: E60, J11, O1, O23, O53

Keywords: economic transition; growth; youth unemployment; institutions; education, social safety nets; SMEs; SEZs.

Mr. Yusuf is Chief Economist of the Growth Dialogue at the George Washington University Business School. He conducted this work as a consultant for the IMF's Middle East and Central Asia Department.

Author's E-Mail Address: shahid_yusuf@hotmail.com

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I. Introduction

In hindsight, it all seems inevitable.[1] Pressures were mounting in several Arab countries and it was only a matter of time before an upheaval occurred. Mohammed Bouazizi's self-immolation on December 17th 2010 provided the unexpected spark in a North African country that few thought would be the first to tip suddenly into open rebellion; but tip it did, and the passions that spilled forth proved highly contagious.[2] The subsequent outpouring of commentary on what was perhaps too hastily labeled the "Arab Spring" convincingly lists the factors that contributed to the crumbling, within a matter of weeks,[3] of seemingly well-entrenched[4] authoritarian regimes in Tunisia and Egypt,[5] the piecemeal and violent destruction of the regime in Libya, the removal of an unpopular president in Yemen, and the groundswell of protest in several other countries in the Middle East and North Africa (MENA).[6] Not only we do have plausible explanations as to why some regimes succumbed to popular protest without or with external support; the unexpected resilience of other regimes equally susceptible to the forces that brought down Ben Ali, Mubarak, and Qaddafi, has also been buttressed with plausible arguments.[7] The situation

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[1] One may well ask, as Queen Elizabeth II did in another context, 'Why did no one see this coming?' Clearly social and political 'scientists' are strong on hindsight and weak on foresight, missing all the great turning points of the past 50 years. Kenneth Pollack (2011, p. 2—3) provides a list of causes: "Economic stagnation; an educational system stuck in a pre-modern era; a democratic desert, with autocratic regimes adding to the misery of their people by tolerating, and even encouraging widespread corruption and sketchy legal systems that frightened away legitimate investors; ulcerous economic liabilities such as unemployment and underemployment among the middle class; (those seeking redress from governments) met only callous indifference, corruption and humiliation from bloated bureaucracies; 'good governance' was a bad joke in most of the Middle East; monolithic regimes (were) vast dead weights holding exploitative systems in place. Repression (acted) as a pressure cooker; No one could have predicted that the match struck by Bouazizi would ignite the entire Arab world but the kindling had been laid and was there for all to see years before." Kenneth Pollack and others, *The Arab Awakening.* Brookings. Washington DC. 2011. http://www.brookings.edu/research/books/2011/thearabawakening

[2] Amin and others (2012, p.12) note, "The fact that the Arab Spring occurred almost simultaneously throughout the Arab world has significance and suggests the existence of an Arab identity that should not be ignored."

[3] Bouazizi died on January 4th 2011, Zine al Abidine Ben Ali fled the country on January 14th 2011. Jean-Pierre Filiu, *The Arab Revolution*, Oxford University Press, Oxford. 2011.

[4] Hosni Mubarak became president in 1981, Zine al Abidine Ben Ali in 1987, and before his ouster, Ali Abdullah Saleh ruled Yemen for 33 years.

[5] According to Pollack (2011, p. 5), the swift downfall of regimes in Tunisia and Egypt can be ascribed to the relative homogeneity of their populations. The monarchies have thus far proven more durable because their legitimacy is grounded in religion, historical associations between the state and the ruling families that through marriage with the other elites have morphed into "vast clans," and because of a measure of affection for the monarchs.

[6] A timeline starting with the triggering incident in Sidi Bouzid, can be found in Deutsche Bank (2013) http://www.ilsole24ore.com/pdf2010/SoleOnLine5/_Oggetti_Correlati/Documenti/Notizie/2013/01/rapporto-detsche-bank-Arab%20Spring.pdf?uuid=ff2925e4-67e5-11e2-8e3d-9f95df31318b

[7] On the resilience of the Arab monarchies buttressed by mineral wealth, strong domestic networks and international alliances, see Gause (2013) http://www.brookings.edu/research/papers/2013/09/24-resilience-arab-monarchies-gause

throughout the region remains fragile, even as the slow-motion tragedy continues to unfold in Syria and Egypt grapples with the fallout from the removal of the government led by Mohamed Morsi.[8] Arab governments, new and old, are on notice that times have changed, that popular demands can no longer be indefinitely suppressed by force or neutralized through state largesse, and that a return to normalcy requires an enlightened approach to consensus-building through the crafting of a more inclusive political system[9] and creative economic policies. Governments are under pressure not only to make promises but also to satisfy some of the urgent demands of the populace in the near term and credibly commit to policies that are likely to lead to steady and inclusive development.

II. A Better Transition

East European and Central Asian experience with transitions involving regime change and system reform warns that these can extend over a decade or more and involve substantial hardship.[10] Not every transition has a happy ending: some countries are fortunate that the political economy of the transition process leads to a higher growth path and more equitable economic outcomes; others are unable to iterate toward a political economy 'sweet spot,' and the much-celebrated 'spring' transitions into a lengthening 'winter.'[11] For those Arab countries burdened with poverty and unemployment, a smooth, accelerated and development-enhancing transition is highly desirable, to minimize the risk of further social fracturing, political discord, and worsening economic conditions for the vast majority. The longer the delay in arriving at a viable equilibrium, which can serve as a springboard for recovery, the greater the likelihood that

[8] The removal of a democratically elected government – the fifth to be toppled thus far - has heightened uncertainties and aroused fears that the military and the old elites will become entrenched once again setting the stage for a drawn out confrontation with the Muslim Brotherhood and its allies. Parallels are being drawn with the past experience of Algeria and Turkey as well as Egypt's own earlier relations with the Brotherhood. http://whynationsfail.com/blog/?currentPage=2; http://www.project-syndicate.org/commentary/lessons-for-egypt-s-next-government-by-ishac-diwan-and-hedi-larbi-d9809302217098700c9a8ce8; http://www.project-syndicate.org/commentary/democracy-in-egypt-requires-reinstating-mohamed-morsi-by-jeffrey-d--sachs; http://www.project-syndicate.org/commentary/democracy-in-egypt-requires-reinstating-mohamed-morsi-by-jeffrey-d--sachs

[9] An inclusive approach will be needed to calm the situation in Egypt, post June 30th 2013 and in order for government to address vital economic issues. See Wittes (2013) http://www.brookings.edu/blogs/up-front/posts/2013/07/04-egypt-revolutionary-coup-morsi-wittes; and Hamid (2013) http://www.brookings.edu/research/opinions/2013/07/04-egypt-democracy-morsi-islamist-hamid

[10] In an editorial questioning whether the Arab Spring had failed, the Economist (July 13th, 2013, p.11) notes, "Political change is a long game. The transition from communism for instance, looks easy in retrospect. Yet three years after the fall of the Berlin Wall, Europe was overrun by criminal mafias; extremist politicians were prominent in Poland, Slovakia and the Baltics; the Balkans were about to degenerate into war and there was fighting in Georgia".

[11] There is the widespread though still arguably premature fear that winter is hard on the heels of the Arab Spring. http://www.economist.com/news/briefing/21571144-two-years-after-its-revolution-egypt-again-crisis-how-did-it-get-there; http://www.economist.com/node/18332630

states will weaken and drift towards failure and effective policy- making will be put on hold.[12] For the rest of the world, a turbulent and economically stagnant Middle East is an entirely unwelcome prospect. It could result in a decline in energy supplies; spark regional conflicts that could easily escalate; and trigger large-scale migration, with the already ongoing transfer of populations from Iraq and, more recently, Syria to neighboring countries, providing a mere foretaste.

Politicians and decision-makers in six Arab countries (Egypt, Jordan, Libya, Morocco, Tunisia and Yemen) in transition (ACTs) either because of regime change or in order to ward off a domestic convulsion, are hungry for politics and policies that will steer them towards a development path more fruitful than the one they have followed thus far.[13] Their demand challenges the international community to come forward with a set of proposals that is tailored to their circumstances; that can be implemented systematically despite limited available political capital and weakened organizational capabilities; and that take into account the current state and uncertain future prospects of the global economy. There is no paucity of lessons from the past experience of Eastern Europe, East Asia, and MENA countries themselves, but the relevance of some of these at this particular juncture is questionable. The transition process in MENA is unlike the transition in Eastern Europe: this is not a case of tight Communist Party control and virtually all-encompassing state ownership being displaced by democratic politics, market institutions, and widening private ownership; market institutions are already embedded in Arab economies and the private sector accounts for the lion's share of GDP. The characteristics, drivers, and pace of East Asian development during the last quarter of the 20th century, the reference point for so many all-purpose policy nostrums, were also, in some respects, unique. The timing was propitious as globalization was gaining momentum; the focus on export-oriented manufacturing generated jobs and growth; investment in human capital through investments in education and in improving healthcare complemented spending on productive facilities; and the balance struck between state guidance and private initiative proved to be felicitous. Despite these differences, as one probe deeper, cross-regional experience provides useful pointers that could supplement, shape, and strengthen policy initiatives that are being debated in the ACTs.

Once it became apparent that a number of Arab countries were shifting political tracks and would need to introduce economic policies that responded to the concerns of the public, international agencies and think tanks, mainly in Western countries, went into overdrive. The result is an abundance of reports and monographs that analyze the causes, antecedents, and

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[12] Obaid (2013) presents six conditions responsible for the effective functioning of states and is of the view that several of the ACTs may not satisfy these and court state failure.
http://belfercenter.ksg.harvard.edu/files/The%20Long%20Hot%20Arab%20Summer.pdf

[13] Sharqieh (2013) maintains that Tunisia's institutions— military and civil—and the initiatives of the various players thus far suggest that it could serve as a provisional beacon, however dim, for the other countries.
http://www.foreignaffairs.com/articles/139938/ibrahim-sharqieh/tunisias-lessons-for-the-middle-east

historical determinants of the Arab uprisings,[14] and the factors constraining development. These studies offered a host of policy suggestions for unlocking the potential of the Arab countries. Inevitably there is significant overlap in findings as to the causes, identification of the problems needing to be tackled, and in the policies advanced. Inevitably also, some of the advice is generic, such as the longstanding call to strengthen governance, to improve the efficacy of local institutions, and to root out corruption.

The purpose of this paper is to briefly examine and assess the factors leading to the upheavals in the ACTs, and to synthesize as well as discuss the key measures being proposed which are of relevance to all six of the countries, although it is noted, where appropriate, that differences among countries will require some adaptation of policy measures. The fact that the six countries confront similar problems and imperatives simplifies the task. It is beyond the scope of this paper to exhaustively survey the literature, which by now is vast and growing,[15] or to attempt to break new empirical ground. The paper also does not attempt to wade into the socio-politics of the Arab uprisings, except minimally as needed to set the stage, delineate the problems, and define solutions.

Thus Section 2 briefly reviews the accumulating problems and emerging economic pressures that brought matters to a head in Tunisia, Egypt, Libya, and Yemen and which are worrisome concerns in Morocco and Jordan, two monarchies that have weathered the storms but which cannot ignore the anger that pervades the neighboring countries and simmers also in their own. Section 3 presents selected lessons on policy initiatives from East Asia and Eastern Europe that contributed to a quickening of growth and of the transition process and could inform the actions of Arab countries. Section 4 summarizes the salient characteristics of the six economies, underlining the commonalities and differences. Based on the cross-country policy insights and the findings derived from studies of the six ACTs, section 5 focuses on feasible short-term policy actions that could produce some 'quick wins' and help create the trust and the space needed to build durable political coalitions and to win support for a longer-term development strategy that will deliver the sought-after results. Section 6 covers the deeper, structural policy issues that will take many years to resolve, but, if neglected, will either lengthen the process of transition or—what is worse—lock countries into low-level equilibrium traps. Section 7 concludes with some observations on global developments that make durable reforms more urgent while raising the odds against which Arab countries must contend.

[14] http://www.wilsoncenter.org/event/historical-perspective-the-arab-spring

[15] As of end 2013, typing in Arab Spring pulled up nearly 2,800 titles in Amazon.

III. Roots of Discontent

A multitude of factors stretching back in time contributed to the spread of mass protests and the upsurge of violence, which became widespread and turned deadly in Libya and now in Syria.[16] However, five fundamental developments are responsible for its forcefulness: a youth bulge that has resulted in high rates of unemployment among those in the 15–25 age group and weakening employment prospects for those in higher age brackets as well; stagnating real wages; widening and increasingly visible income disparities[17] combined with a sense among even the educated youth that the income divide between the favored few and the rest is becoming unbridgeable; feelings of insecurity exacerbated by the great recession and fears that capitalism plus globalization presage regular spells of turbulence in the years ahead; and a deepening awareness of political and economic realities elsewhere in the world, arising from the spread of modern communications, overseas travel, and contact with foreign visitors, together with a feeling of empowerment derived from collective identity and the capacity to mobilize engendered by social media. Compounding the frustration caused by these developments were two additional factors: the tight control over the expression of "voice" exercised by authoritarian regimes through a vast, intrusive, and corrupt state apparatus;[18] and the rampant cronyism practiced by those in power that was in large part responsible for the concentration of wealth.[19] With the leadership failing over decades to provide a developmental vision that could instill hope and win commitment, regime legitimacy eroded and public alienation worsened, with the young seeing a darkening future and no opportunities for "exiting."

East Asian countries also faced a youth bulge in the 1980s and 1990s; but they were able to extract a growth dividend from the increased supply of educated labor, the energies, and entrepreneurship of the youthful workforce, higher savings from a reduction in the dependency ratio and the investment of domestic savings, supplemented by foreign capital in productive

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[16] See Daniel Byman and others (2011), *The Arab Awakening*, Brookings Institution, Washington DC 2011; Adeed Dawisha, *The Second Arab Awakening*, Norton, New York, 2013. Magdi Amin and others (2012) op. cit. On earlier awakenings and the historical and cultural factors (including tribal and ethnic divisions in countries such as Yemen and Libya) explaining developments in the Middle East, see Jeremy Salt. *The Unmaking of the Middle East*, University of California Press, Berkeley, 2008. Timur Kuran, *The Long Divergence*, Princeton University Press, Princeton NJ. 2010. Kuran (2013) http://econ.duke.edu/uploads/media_items/philosophy-social-criticism-2013-kuran-0191453713477350.original.pdf; and Dan Diner. *Lost in the Sacred*, Princeton University Press, Princeton NJ, 2009.

[17] As in Tunisia, Egypt, and Morocco. See African Development Bank (2012) http://www.afdb.org/fileadmin/uploads/afdb/Documents/Publications/Jobs%20and%20Justice%20-%20EN.PDF

[18] Even where governments tolerated "talking shops" where the chattering classes could air their views and frustrations, decision-making remained firmly centralized. Newspapers and TV stations were either controlled by the state or by wealthy entrepreneurs beholden to the authorities.

[19] Albert Hirschman succinctly categorized the options for citizens subject to repression and narrowing opportunities as *Voice, Exit and Loyalty*. Harvard University Press, Cambridge, MA, 1970.

assets that generated employment.[20] Similarly, some of the most successful East Asian economies endured many years of harsh dictatorial rule that was hospitable to crony capitalism, but the restiveness of the population was checked by rising and shared prosperity. East Asian regimes were able to survive external shocks and internal crises because leaders offered a compelling vision of economic progress and consistently delivered results, a rising tide that lifted all boats. The visible reality of rapid growth year after year; of near-full employment; of improving social services; of tolerable income disparities; and of rising stature and respect among the community of nations, maintained the implicit social contract as well as a belief in the accountability of government, and allowed for a grudging acceptance of corruption so long as it did not burden daily life or significantly compromise economic performance.[21]
Weak economic growth is surely not the principal cause of turmoil and regime change in MENA; however, low to moderate rates of growth over two decades in the face of rapid increases in the size of labor forces dashed the expectations of a generation that sees progress elsewhere, expects more, and is angry at a state that mismanages and fails to deliver. Between 1990 and 2000, MENA economies averaged a GDP growth rate of 3.8 percent per annum; between 2000 and 2010 they averaged 4.7 percent per annum, well below the low- and middle-income country average of 6.4 percent and the 9.4 percent achieved by East Asian countries.[22]
Higher growth will not be a panacea for the ACTs, but if growth does not quicken in the near term and remain strong well into the future, the core issues —employment, poverty, social services, fiscal imbalances, quality of life, and longer-term prospects for the young —cannot be adequately addressed.[23] Faster growth is a necessary but not a sufficient condition for a return to stability and the achieving of inclusive development that in time may begin to heal the corrosive sectarian and tribal divisions that have emerged in several countries.[24] But it can be convincingly argued that growth is the necessary condition deserving primacy— because there are no sufficient conditions that can restore normalcy and effectively harness the explosive energies released by the Spring that will continue to be fed by the expanding army of young and disaffected people. An acceleration of growth requires action on a number of fronts as well as an enabling global environment. These are discussed in section 3 below.

[20] Bloom, Canning, and Sevilla (2001); Bloom and Williamson (1998): http://www.econ.yale.edu/~nordhaus/Resources/bloometal_pop_w8685.pdf; http://wber.oxfordjournals.org/content/12/3/419.abstract

[21] In contrast, the middle classes in Egypt and Tunisia threw in their lot with the rebellious young.

[22] Over the period extending from 1966 to 2011, MENA countries averaged per capita growth rates of 2.1 percent per annum compared with 1.73 percent for Latin American countries, 0.65 percent for countries in Sub-Saharan Africa, and 6.15 percent per annum growth in East Asia.

[23] Dollar, Kleineberg and Kraay (2013) reaffirm the poverty-reducing role of growth. http://elibrary.worldbank.org/doi/book/10.1596/1813-9450-6568

[24] From an analysis of 90 transition episodes, Freund and Jaud (2013) conclude that the more rapid the transition to stability, the larger the longer-term growth dividend— about 1 percentage point per annum. http://www.voxeu.org/article/growth-effects-democratisation-new-evidence. Getting the transition right is also stressed by Magdi Amin and others: *After the Spring*, Oxford University Press, New York, 2012.

IV. Sourcing Growth

The sources of growth can be analyzed from three different points of view: supply-side; sectoral; and with reference to the degree of outward orientation.

Growth decomposition divides sources into investment (capital accumulation), increase in labor supply and human capital, and gains in total factor productivity (TFP). Although capital has remained the principal driver of growth in all countries, in some— especially the advanced ones—it is being overtaken by TFP; in the long run, it is assumed that increasing productivity will be the primary source of growth, with innovation the main ingredient.[25] For low- and middle-income countries, investment in plant, equipment, and infrastructure that embodies newer technologies is the most reliable indicator of growth potential. However, the quality of human capital can play a significant role[26] during the catching-up phase: a transfer of technology— soft and hard—promoted by a deepening stock of human capital and intangibles and investment in R&D, can increase the contribution of TFP. China and Korea derived 3 percent and more of their growth from TFP. MENA countries have done very poorly in this respect. During 1960–2000[27] the contribution of TFP to GDP growth was among the world's lowest, and there was little improvement during 1990–98: most of the growth was derived from capital; growth from TFP was negative in Morocco and Jordan, low in Tunisia, and only a little better in Egypt.[28] More recent data in the World Bank report show improved TFP scores during 1990–2009 for Tunisia and Egypt (p.17). Higher growth requires working on all three registers: measures that raise the rate of investment in productive assets promise the quickest returns, while the quality of human capital plus the accumulation of R&D capital and innovation capabilities provide a stimulus after a gestation lag of perhaps a decade or more. The quick win is from investment in the right places and the maximizing of productivity, in part by narrowing the wide differentials in productivity among firms in the very same industry.[29] Noland and Pack

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[25] Based on a sample of 122 countries, Jorgenson and Vu estimate that capital (including ICT capital) contributed 57 percent of growth during 1989–95 as against 12 percent by TFP; during 2004–08, for the same sample, the contribution had declined to 41 percent from capital as against 37 percent from TFP. Jorgenson and Vu (2011) http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1912362

[26] Hanushek and Woessmann (2010) http://www.cepr.org/meets/wkcn/9/979/papers/hanushek_woessmann.pdf; and Hanushek and Woessmann (2008) http://hanushek.stanford.edu/publications/role-cognitive-skills-economic-development

[27] http://www.worldbank.org/en/news/press-release/2013/06/04/transforming-arab-economies-towards-knowledge-innovation-driven-development-strategies. (p.16)

[28] See Abu-Qarn and Abu-Bader (2007) http://www.relooney.info/SI_Governance/Governance-Economic-Growth_71.pdf; and Noland and Pack (2007, pp. 96–97); Paul Rivlin, *Arab Economies in the Twenty-first Century,* Cambridge University Press, New York, 2009. p. 179. Saudi Arabia experienced a 2.2 percent annual decline in TFP between 2002 and 2011, with labor productivity falling annually by 1.3 percent. Keller and Nabli (2007) estimate that TFP growth in MENA was negative during the 1970s and 1980s and through much of the 1990s. https://openknowledge.worldbank.org/handle/10986/6914

[29] Syverson (2004) http://ideas.repec.org/p/nbr/nberwo/10501.html; Syverson (2011) http://faculty.chicagobooth.edu/chad.syverson/research/productivitysurvey.pdf

(2007, pp. 97–98) maintain that for the Arab economies to raise growth in the short term will require a reduction in consumption: "…from this perspective the value of accelerated TFP growth resides not only in the free economic resource it offers, forestalling the need to suppress consumption, but also by extension it relieves some of the pressure on the political system to choose among competing demands for scarce resources."

Composition of Growth by Sector: The sectoral dimension is taking on a greater significance as a consequence of technological change. Until fairly recently, growth was synonymous with industrialization:[30] in virtually all of the upper-middle- and high-income economies, manufacturing was the leading sector and a major source of employment, both direct and indirect, with indirect employment in supporting services becoming more important as we come closer to the present. Whether manufacturing can be the driver it was in the past for late-starting 21st-century middle-income countries, is now an open question. Because of large increases in productivity, the share of manufacturing in GDP has been in retreat in all industrialized countries and is now below 20 percent, even in Germany and Japan. East Asian economies such as Korea, Taiwan (China), Malaysia, and Thailand continue to source more than a quarter of their GDP from manufacturing, and China derives almost a third of GDP from that sector; however, the share of manufacturing appears to have crested and is likely to decline. A shrinking contribution to GDP is paralleled with higher capital and reduced labor coefficients in the manufacturing sector, the result of labor displacing technological change[31] and the lower relative cost of capital in a number of the industrializing countries and worldwide over the past decade. The stagnating share of manufacturing GDP in India (at close to 17 percent) underscores a possible new normal for middle-income countries, in which case the industrializing strategies that worked in East Asia may not produce comparable results for MENA countries in the coming decades. The industrial scale, acquired competitive advantage and global market presence in virtually all merchandise commodity groups of early industrializers in East Asia, most notably China,[32] also raises entry barriers for newcomers looking to diversify, reap scale economies, increase domestic value added, and enlarge export shares—the path taken by East Asian tiger economies from the 1970s onwards.

If manufacturing is surrendering its lead role, then, by default, services must serve as the principal driver of growth and the source of employment. Very briefly, in the preceding decade, India seemed to be shaping up as a model of rapid services-based growth, but no longer. Undoubtedly, there are services offering considerable scope for innovation and productivity

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[30] UNIDO (2009) http://www.unido.org/fileadmin/user_media/Publications/IDR_2009_print.PDF; and with reference to Malaysia, Rasiah (1996) http://www.emeraldinsight.com/bibliographic_databases.htm?id=1204879

[31] The so-called "race against the machine" which is displacing workers in manufacturing as well as in services, is empirically highlighted by Brynjolfsson and McAfee http://www.nytimes.com/2011/10/24/technology/economists-see-more-jobs-for-machines-not-people.html?_r=0

[32] Yusuf and Nabeshima (2010) http://publications.worldbank.org/index.php?main_page=product_info&products_id=23742

gains; but, on average, services with the largest labor coefficients (many of which are in the non-tradable category) have tended to register minimal increases in productivity, which is one reason why the services sector in spite of its size, has not served as a growth engine for successful developers. Digital technologies that have already transformed the higher-end services (mainly tradable) such as finance, engineering, logistics, and insurance, could also increase the productivity of retail, education, security, and health services for example—though such a technological makeover would reduce employment intensity perhaps substantially in the long run—but whether these could adequately substitute for a robust industrial sector is uncertain.

There is an additional dimension to the sectoral story that deserves mention: the role of medium-sized and large firms.[33] The economic fortunes of East Asian economies and fast-growing European ones are closely tied to those of a relatively small number of firms producing mainly tradables and actively engaged in international trade. Such firms, generally no more than 2 percent of the total number in any country, are the most competitive, innovative, and productive. These firms consciously pursue a global marketing strategy, and the most ambitious seek to establish a dominant share in their chosen niche. This ambition accounts for the achievement of lead firms in Germany, Finland, Korea, Taiwan (China), China, and other iconic industrializers. The economic strides made by these countries are inseparable from the prowess of the globally oriented and innovative firms in their midst. Middle Eastern countries can count few, if any, such firms, and filling this gap must be an integral part of a growth strategy.[34]

Demand-side Growth: Complementing the above is the demand-side explanation of growth: consumption, investment, and net exports. For more than a decade, transitioning countries, such as Egypt, Jordan, Morocco, and Yemen, have relied on domestic consumption to propel growth. For small and mid-sized economies seeking to accelerate growth with the help of productivity gains and innovation, this is not a viable strategy. A diversifying bundle of exports that benefit from economies of scale and learning and induce innovation will need to contribute possibly up to a third of annual growth. Diversification is vital also for resource dependent-countries, such as Libya and Yemen, that are cushioned by oil exports but need to develop a base of tradable goods and services to create employment, to initially supplement energy exports, and to eventually supplant the latter as resources are depleted.[35] A large and thriving tradable sector is at the heart of every successful growth story. Both exports and imports are key: imports no less

[33] The SMEs that grow into mid-sized and large firms are the ones that create numerous and stable jobs—not the more numerous and often short-lived small fry.

[34] The Boston Consulting Group has identified 40 leading African "Challengers" the majority of which are providers of financial (25), mining (20) and telecommunications services (15). Only 15 companies are from Morocco, Tunisia, and Egypt; financial, logistics and construction firms are dominant. http://www.bcg.com/documents/file44610.pdf

[35] Non-oil exports accounted to only 1.9 percent of Yemen's GDP in 2011, down from 5.7 percent in 2009. World Bank (2012) https://openknowledge.worldbank.org/handle/10986/11979

than exports serve to raise productivity by transferring technology, putting competitive pressure on domestic firms, and providing exporters with the inputs they need produce and to process for global markets. A sizable share of the manufactured exports of low- and middle-income countries, e.g. Tunisia and Jordan, is comprised of processed or assembled commodities with a large import component. It is well known that Chinese manufacturers add just 2 percent of domestic value to the iPhone in the form of labor for assembly,[36] and while this might be an extreme case, the local value added through CTM (cut, trim, make) of garments, and from the assembly of consumer electronics, of footwear and other similar goods, can be minimal. Hence low import barriers, streamlined customs and clearance procedures, and efficient transport logistics can be advantageous for enlarging the scale of the export economy.

The relationship between exporting, increased productivity, and aggregate GDP growth is mixed, with causation difficult to pin down. A body of research suggests that more productive firms are likelier to enter the export market, and there is learning from exporting that further augments productivity and prompts innovation. Profitable exporters attract resources, and as the sector grows relative to other segments of the economy, it can help raise the growth rate.[37] Moreover, there is some evidence suggesting that exporters, whether domestic firms or multinational corporations, give rise to spillovers generally of the vertical, intra-industry kind that have broader economy-wide effects. On balance, the attractiveness of export-led growth is undimmed; however, achieving outcomes on a par with East Asia's is far more difficult: the minimum threshold of performance (cost, quality, packaging, delivery, labor standards, adoption of ISO standards such as 9000 and 14000 etc.) that firms must meet is higher, and because trade in a variety of entry-level products is conducted through regional buyer-driven value chains. Firms must find ways of hooking on to these chains, but these are conduits for highly commodified products such as garments, footwear, consumer electricals, auto parts and metal products with very narrow profit margins that constrain domestic value added and offer limited opportunities for local firms to grow. For firms in MENA, chains centered on Europe

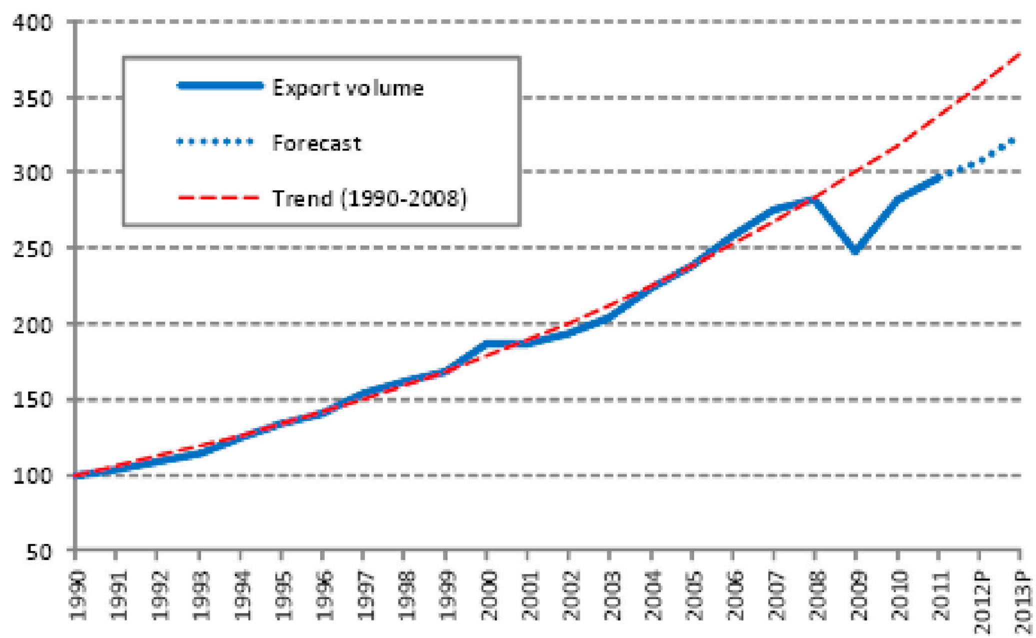
[36] Kraemer, Linden and Dedrick (2011) http://pcic.merage.uci.edu/papers/2011/Value_iPad_iPhone.pdf

[37] The literature on this topic is voluminous, albeit less than conclusive. See Bernard and Jensen (1999) http://web.mit.edu/ipc/publications/pdf/exptfp40.pdf; Fabling and Sanderson (2010) http://www.rbnz.govt.nz/research/discusspapers/dp10_07.pdf; Sharma and Mishra (2011) http://www.tandfonline.com/doi/abs/10.1080/02692171.2011.557046#preview; Alvarez and Lopez (2008) find that spillovers can be an important source of productivity gains, including horizontal ones. http://www.captura.uchile.cl/bitstream/handle/2250/6624/Alvarez_Roberto.pdf?sequence=1; Dumont and others (2010) also point to spillover effects. http://www.ecb.int/home/pdf/research/compnet/Dumont_Merlevede_Piette_Rayp_2010.pdf?76b34b47dfd6d4f642b13ae3b9589265; also Fernandez and Isgut (2005) give empirical credence to the learning from exporting of new entrants and firms exporting to advanced countries which presumably challenge them to perform to higher standards. http://elibrary.worldbank.org/content/workingpaper/10.1596/1813-9450-3544; Winters (2004) surveys the literature on trade liberalization and productivity growth, and tentatively concludes that the effect of the former on the latter is positive. This finding is further reinforced by Wacziarg and Welch (2003) http://www.nber.org/papers/w10152; http://www.cer.ethz.ch/resec/teaching/seminar_aussenwirtschaft_wt_04_05/winters_EJ.pdf;

are a natural choice because of market proximity, but Europe's economic troubles, which are likely to persist, will make it much more difficult to launch new export-led virtuous spirals.

Global Context: A stagnating Europe, a slow-growing United States, and increasingly sluggish BRICS (with even China now resigned to growth in the 5–7 percent range norm of the Southeast Asian economies) suspend a question over future rates of growth in world trade, and raise the worrisome possibility of an upsurge of murky protectionism (Figure 1).[38] Could recent moves presage a halt to further globalization and possibly even a partial reversal? Probably not, but with major countries struggling to correct imbalances, and with austerity the policy watchword for a number of governments as well as the rallying cry for many influential economists, there is good reason to believe that the growth of trade will be less brisk well into the middle of the decade.

Figure 1: Volume of World Merchandise Trade 1990-2013
Indices 1990 = 100



Source: WTO

Out of necessity, because the options are so few, transitioning economies—particularly Morocco, Tunisia, and Jordan—will need to emphasize industrial development and look to trade as a means of accelerating growth while narrowing current account imbalances. But export-led

[38] Evenett and Wemilinger (2009) http://www.unescap.org/tid/publication/tipub2587_chap1.pdf; Baccheta and Beverelli (2012) http://www.voxeu.org/article/trade-barriers-beyond-tariffs-facts-and-challenges. World merchandise trade averaged a 6 percent growth rate between 1990 and 2008, dipped sharply in 2009, and rebounded in 2010 only to slow to 5 percent in 2011 and 2.0 percent in 2012. It rose marginally to 2.5 percent in 2013. http://www.wto.org/english/news_e/pres12_e/pr658_e.htm; http://www.reuters.com/article/2013/09/09/us-trade-growth-idUSBRE9880HQ20130909

growth, spearheaded by the manufacturing sector, will require policy ingenuity, a good deal of entrepreneurial initiative by domestic firms, and an increasing focus on faster-growing Asian markets[39] if it is to move the needle non-trivially. Making a significant dent in the unemployment problem will be harder still.

Three other growth-promoting – or growth-inhibiting – factors have received considerable attention in the literature. The role of institutions has acquired prominence thanks in part to the recent work of Daron Acemoglu and James Robinson[40] and Dani Rodrik,[41] and is now a hardy perennial. The resource curse is a second. The salience of the state sector is a third.

Institutions for Growth. Briefly, there can be no denying that a host of institutions (e.g., legal institutions governing property rights and contracts) influence market functioning and the investment climate. However, the growth literature offers few concrete and broadly applicable suggestions for "strengthening" specific institutions so as to deliver higher rates of growth over the medium term.[42] Moreover, as Pritchett and Werker have demonstrated, institutions are weakly associated with growth accelerations.[43] Using the Quality of Government Institutions (QOG) indicator that aggregates the rule of law, bureaucratic quality, and control over corruption, they demonstrate that rich countries have a high quality of government, but the relationship between a change in the level of QOG and growth over a 20-year period is very weak. Countries with the same level of governance have experienced widely varying rates of growth, and rapidly growing countries differ markedly in their rankings e.g. Indonesia (0.15) and Singapore (0.9). Furthermore they find that there is no relationship between QOG and growth between 1984 and 2004 for their sample of countries; or between the pace of growth and improvement in component institutional variables. [44]

Whether long-standing institutions are responsible for slow growth in MENA is open to question. Timur Kuran (2013, p.2)[45] is among those arguing that certain traditional institutions derived from Islamic law might have "hindered political development by limiting checks and balances, preventing the formation of organized and durable opposition movements, and keeping civil society weak. These include Islam's original tax system which failed to protect property rights; the waqf, whose rigidities hampered the development of civil society; and the

[39] Most buyer-driven supply chains remain oriented towards European Union, North American, and Japanese markets, although in time this could change with China creating its own global value chains.

[40] Acemoglu, Johnson and Robinson (2005) http://economics.mit.edu/files/4469

[41] Rodrik, Subramanian and Trebbi (2002) http://www.nber.org/papers/w9305

[42] Keefer and Knack (1995) http://mpra.ub.uni-muenchen.de/23118/

[43] Khan (2007) has also shown that the level of institutions does a poor job of predicting growth. http://eprints.soas.ac.uk/9921/

[44] Pritchett and Werker (2012) http://www.hbs.edu/faculty/Pages/item.aspx?num=44065

[45] http://philpapers.org/rec/KURTPC

region's private commercial enterprises, whose small scale and short lives prevented the development of private coalitions capable of bargaining effectively with the state." According to Kuran, these are some of the reasons why the uprisings have not produced strong leaders or compelling ideologies that would provide a narrative to shape, temper, and channel the energies released by the "Spring." Such evidence may be convincing for social scientists who believe in the power of institutions, and are convinced that institutions, which emerged centuries ago, continue to exert a profound effect; others looking at the East Asian experience in particular, are less convinced that institutions can cast such a long shadow.

Resource Booms and Curse. Prior to 1970, the economic performance of countries with oil wealth differed little from that of others. However, after 1973 the huge increase in oil revenues changed the political and economic dynamic in the affected emerging economies and was the beginning of an oil/resource-related malaise that has afflicted a number of countries. The well-documented manifestations of this so-called "curse" are lock-in effects that are difficult to undo. Among the ACTs, Libya is the most susceptible, though other countries derive substantial earnings from the export of phosphates and/or petroleum products.[46]

The majority of middle-income and developing countries have, on balance, been unable to build the capacity to transparently account for and manage the flow of resource-based revenues in the face of shocks, or to minimize corruption and efficiently allocate these revenues with reference to both current and future needs. On average, oil/mineral rich countries have grown at rates comparable to those of their peers; however, they have underperformed consistently in relation to the capital at their disposal.[47] In part this can be ascribed to currency appreciation and lavish domestic spending on nontradables, which distorts prices and diverts resources away from manufacturing, agriculture, and tradable services.[48] This in turn is responsible for less learning by doing and, consequently, for fewer gains in productivity. Moreover, petroleum extraction and mining activities generate minimal industrial spillovers and domestic linkages. Other factors have contributed also to the weak overall performance. Natural resource–endowed developing economies have tended to be more authoritarian, with governments using natural resource rents, low taxation, and redistributive policies to buy off or otherwise suppress

[46] The UNDP's (UNDP 2011) Arab Development Challenges Report 2011, views "the oil curse as the origin of the Arab rentier state's autocracy, technological backwardness and economic fragility and social injustice."(p.7). https://openknowledge.worldbank.org/handle/10986/11979

[47] Torvik (2010) finds that growth is negatively correlated with resource abundance; others also conclude that even if the short-term effects of a resource boom are positive, the long run effects are not (Collier and Goderis 2007). Rent-seeking can also lead to a dismantling of "good institutions" that get in the way of rampant exploitation as for instance of timber in Indonesia. www.oxrep.oxfordjournals.org/content/25/2/241.short; economics.ouls.ox.ac.uk/13218/1/2007-15text.pdf

[48] See van der Ploeg (2011) http://www.aeaweb.org/articles.php?doi=10.1257/jel.49.2.366 ; and Frankel (2011) for surveys of the resource curse literature. http://www.nber.org/papers/w15836

opposition to their policies and neutralize voices calling for democracy;[49] more secretive in disclosing the magnitude and the disposition of revenues thereby increasing the susceptibility to corruption— when rent seeking becomes more lucrative than conducting productive businesses, there are fewer entrepreneurs wanting to run firms (Torvik, 2010); more prone to domestic unrest, insurgencies, and civil wars; more likely to squander funds on productivity-subtracting white elephant[50] projects and to persist with dysfunctional economic policies because resource revenues soften budget impact; and less likely to attract non-resource, export-diversifying FDI.[51] Michael Ross (2012) and Christa Brunnschweiler (2009)[52] draw attention to other growth-retarding tendencies associated with resource abundance: reduced human capital formation and fewer opportunities for women. Ross (2012, p.12–13) states that "governments spend in ways that discourage women from joining the labor force and oil production crowds out industries that would otherwise hire women as well as opening pathways towards greater economic and political rights," lowering fertility rates and boosting per capita income growth.

With preventive measures, resource-rich countries can minimize the risk of exchange rate appreciation, smooth revenue volatility, and reduce rent-seeking activities and the losses from corruption (e.g., through the distribution of revenues to the public or their transparent sequestration in sovereign wealth funds). These measures, however, are far from guaranteeing industrial diversification and rapid growth in the future. Furthermore, none of the recipes indicates how societies exposed to the resource curse can initiate the peaceful cultivation of democratic institutions[53] and a robust civil society in the absence of enabling political traditions and in the face of resistance from authoritarian governments reluctant to cede power.

The impact of the state sector. The share of GDP accounted for by the state sector and the contribution of public enterprises to productive/tradable activities is a third factor with a bearing on productivity and growth. The relation is generally inverse and in transitioning countries – but not only in transitioning countries – a shrinking of the state sector and a privatization of viable state enterprises and a shuttering of the rest is to the net benefit of the economy in the medium term. A vast literature analyzing the consequences of privatization concludes, with some equivocation, that the efficiency of resource use increases and the inhibiting effect on entry is

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[49] Ross (2009, 2012) http://www.sscnet.ucla.edu/polisci/faculty/ross/Oil%20and%20Democracy%20Revisited.pdf; http://www.sscnet.ucla.edu/polisci/faculty/ross/The%20Big%20Oil%20Change%20-%20APSA%20version.pdf

[50] Its origin is a gift from the King of Thailand that saddled the recipient with an animal that needed to be fed but would do not work.

[51] Poelhekke and van der Ploeg (2012) ideas.repec.org/p/dnb/dnbwpp/266.html

[52] Michael Ross. *The Oil Curse*. Princeton University Press. Princeton NJ. 2012. http://ideas.repec.org/p/oxf/oxcrwp/029.html

[53] Acemoglu and Robinson (2012) offer few clues as to how a country that is in the grip of political systems supporting extractive institutions and practices can dissolve entrenched rent-seeking coalitions, thereby eliminating obstacles to political activity that will lead to innovation and growth-friendly inclusive institutions. http://blogs.the-american-interest.com/fukuyama/2012/03/26/acemoglu-and-robinson-on-why-nations-fail/

reduced.[54] Reform can reinforce the stimulus from other initiatives. In all six ACTs fuel and/or food subsidies have crowded out other productive expenditures, distorted consumption, in some cases exacerbating budgetary and current account deficits, and disproportionately benefitted consumers in higher income brackets.[55] A gradual reduction of these subsidies— a politically explosive issue— is unavoidable and has started in some cases, but targeted, means-tested transfers still need to be replace them. Whether governments will be willing to grasp this nettle is another matter, but eventually they must; and the sooner they do, the greater the likelihood of their economies reaping a growth dividend.

How One Transitioning East Asian Country Accelerated Growth. The parallels between China and the ACTs are not apparent at first glance, but China's success at emerging from the post-1989 doldrums and igniting a second round of rapid growth following Deng Xiaoping's Southern Tour in January 1992[56] offers some useful clues. China's initial "reform and opening," starting in 1979, imparted a degree of growth momentum; however, this could easily have petered out with reformers on the defensive following the Tiananmen incident. What revived and sustained double-digit growth rates[57] from the mid-1990s onwards were a series of bold policy actions. Seven initiatives,[58] introduced between 1993 and 2001, played a pivotal role:

- Official recognition of the importance of the private sector and of the entrepreneurs that had driven the growth of China's extraordinarily dynamic township and village enterprise (TVE) sector that essentially laid the groundwork of the country's new outward-oriented market-led economy;

- Decentralizing fiscal reforms that presented subnational governments to pursue local development by encouraging entrepreneurship and the emergence of local manufacturing enterprises some of which eventually grew into major firms;

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[54] A survey of the literature can be found in Yusuf, Nabeshima, and Perkins (2006) http://www.sup.org/book.cgi?id=10140

[55] Governments in the MENA region devote 8 percent of their budgetary resources to untargeted subsidies, of which only a third or less assist the bottom 40 percent of the population. Subsidies amounted to 10.4 percent of Egypt's GDP and consumed almost 43 percent of the government revenues. Following the uprisings, governments have further ramped up subsidies to mollify the population, with the result that in Morocco, they rose from 3.6 percent of GDP in 2010 to 6.1 percent in 2011. During the same period they rose by 200 percent in Jordan and 68 percent in Tunisia. http://www.ilsole24ore.com/pdf2010/SoleOnLine5/_Oggetti_Correlati/Documenti/Notizie/2013/01/rapporto-detsche-bank-Arab%20Spring.pdf?uuid=ff2925e4-67e5-11e2-8e3d-9f95df31318b; Ahmed (2013, p. 11). http://www.imf.org/external/pubs/ft/fandd/2013/03/ahmed.htm.

[56] http://www.wsws.org/en/articles/2012/11/deng-n27.html.

[57] Growth led by the manufacturing sector and reinforced by rising investment in infrastructure, housing and commercial real estate, was primarily responsible for creating productive jobs and sharply reducing poverty.

[58] China's one-child policy introduced in 1979, may have contributed to higher household savings by reducing dependency rates, raising women's labor force participation, and inducing households to save for old age and quality education for a single offspring.

- The corporatization, privatization, or dissolution of the majority of state-owned and collective enterprises, and a shedding of the vast state-supported workforce;

- A first round of civil service reforms that introduced and extended competitive hiring, performance evaluation etc. that improved the quality and implementation capacity of the civil service and also of the judiciary and the procuratorate.[59]

- Steps towards WTO membership and the formal entry in 2001.

- A pegging of the renminbi to a depreciating dollar post 2001.[60]

- The systematic building of technological capabilities and of an innovation system backed by determined efforts to improve the quality of education, increase spending on R&D, and promote innovation by enterprises.

- The launch of a longer-term program to create urban, energy, and transport infrastructures to support an advanced industrial economy and to supplement, via linkages, the growth impulse generated by the expanding manufacturing sector.

Some of these, such as the official endorsement of the private sector, fiscal reform, entry into the WTO and exchange rate management, began quickening the tempo of economic activity (or exports) almost immediately. Civil service and state enterprise reform began yielding results within a few years and the innovation system bore fruit in less than a decade. Together they resulted in a growth acceleration that has persisted for more than two decades.

Both the domestic politico-economic circumstances of the ACTs and the global environment they now face and will in the near term, are quite different from China's, but the steps China took to revive its becalmed economy are both suggestive and inspiring. They suggest the kind of radical and farsighted policies that the Arab countries need to put into effect; they are inspiring because they provide proof that long-running growth acceleration is not an impossibility.

V. Transitioning Countries: An Economic Snapshot

If a revival of economic growth is a necessary step to expediting the transition to a better equilibrium, the indicators identified above can help highlight the areas deserving policy attention, and these indicators can also reveal the shared characteristics of the ACTs.[61]

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[59] Burns (2007) http://www.oecd.org/gov/budgeting/44526166.pdf

[60] Lardy and Borst (2013) http://www.piie.com/publications/pb/pb13-2.pdf

[61] Detailed accounts of Arab economic development can be found in Marcus Noland and Howard Pack, *The Arab Economies in a Changing World*, Peterson Institute, Washington, DC, 2007; Paul Rivlin, *Arab Economies in the Twenty-First Century*, Cambridge University Press, New York, 2009 and Khalid Ikram, *The Egyptian Economy, 1952–2000*, Routledge, New York, 2006.

Of the six ACTs, Yemen is in the low middle-income category, and Libya, because of its oil resources, is classified as a high-income country. The other four fall squarely in the middle income range, extending from $2,892 (per capita GDP, Egypt) to $4,788 (Jordan) with non-income human development rankings extending from 10 for Morocco in 1990–2010 to 53 for Jordan. All six countries averaged a growth rate of more than 4 percent per annum between 2000 and 2010, with Yemen just managing a 4.1 percent rate and Jordan at the upper end with 6.7 percent. Only Jordan exceeded the low and middle-income average rate of 6.4 percent and none approached the East Asian average of 9.4 percent (biased upward by China). It is notable that only three of the ACT countries (Egypt, Jordan and Libya) grew faster than the Sub-Saharan average of 5 percent, though four beat the average growth for MENA (4.7 percent per annum).

Egypt (population 85 million in 2010) is by far the most populous; Libya and Jordan, both with populations of approximately 6.5 million the least. Morocco, Yemen, and Tunisia lie in between with populations of 32 million, 24 million, and 10 million respectively. When compared with the populations of East Asian economies, Egypt's population is a little smaller than that of Vietnam, and Yemen's is almost equal to that of Taiwan (China). Singapore with 5.3 million people falls not too far short of Jordan and Libya. The point to be noted is that each of the countries is, in principle, large enough to develop a fairly broad industrial base but probably too small to grow rapidly without the pull exerted by exports.

In four of the ACTs, population growth rates are high—a factor that could exacerbate the unemployment problem if economic performance does not pick up. Egypt's population is expanding at a 1.9 percent rate, Yemen and Jordan are tied at 2.9 percent and Libya is in between at 2 percent. Only Morocco (1.2 percent) and Tunisia (0.9 percent) are in a safer zone. In comparison, populations of East Asian countries as a group are rising by 0.6 percent per annum.

The jobs issue comes into sharp relief when these rates—even the lower ones—are juxtaposed with the youthfulness of the population and the unemployment figures. Between 42.5 percent (Tunisia) and 66 percent of the populations of these countries are under 25 years old, three clustered in the 48–51 percent band (Morocco, Libya, and Egypt), and Jordan much higher at 59 percent. Youth unemployment, even given the low participation rates of women,[62] is an immensely serious matter. In 2011, Tunisia recorded a youth unemployment rate of 42 percent.[63] Figures for the other countries are less current and range from 22 percent in

[62] Two-thirds of women did not participate in the labor force during the past decade (according to some estimates only 22 percent of women in the MENA region participated in the workforce as against 70 percent in East Asia). This gap is of itself a matter of grave concern, entailing a diminution of growth potential and a waste of valuable human capital.

[63] Unemployment in Tunisia has been swollen by the return of migrants from Libya. https://openknowledge.worldbank.org/handle/10986/11979 ; p.10.

Morocco (2009) to 25 percent in Egypt (2007) and even higher in Yemen.[64] However, these probably underestimate the rates prevailing in 2013. High fertility rates during the 1980s, will sustain the rapid growth of the labor force well into the future, and although the share of the youthful population peaked in 2010, the absolute numbers in MENA will increase by a further 12 million through 2025. Hence even maintaining unemployment rates at current levels will require the creation of millions of additional jobs.[65]

Employment elasticities computed by Steven Kapsos (2005) shed light on what employment generation on this scale entails with respect to growth. For the period 1991–2003, the global employment elasticity for youth was 0.06 (a decline from the 0.11 during 1995–9). In other words, employment increased by 0.06 percent for every 1 percent of GDP growth. According to Kapsos' estimates (2005, p. 9), if the increase in the youth labor force between 2003 and 2015 is 0.5 percent per annum, then with an elasticity of 0.06, the world economy would need to grow by 10 percent per annum to keep youth employment constant.[66] In fact, the average global growth during 2003–12 has not exceeded 3.0 percent per annum, which partly accounts for the worsening situation for young people in Europe and MENA. Sectoral elasticities with respect to GDP growth illuminate the structural changes that are afoot and reinforce the point made above as to the contribution of industry to employment. Globally, for the 1991–2003 period, the elasticities for agriculture, industry, and services were 0.24, 0.21 and 0.61 respectively. However, they were lower in comparator eastern and central European countries and in East Asia. In the former, the industry and services elasticities were 0.09 and 0.47 respectively; in East Asia the labor elasticity of industry was just 0.06, although for services it was 0.5.

Labor elasticities for the Middle East differ markedly and suggest that structural change and technological catching up has been much slower. Elasticities are higher for both agriculture (2.06 vs. 0.88) and industry (1.1 vs. 0.45) in the Middle East as against North Africa and approximately the same for services (0.8 vs. 0.77). According to a World Bank update, the average employment labor elasticities for 2000–08 were 0.78 for the entire MENA region, and ranging between 0.5 for Tunisia and Morocco, 0.6 for Jordan, and a loosely estimated 1.0 for Egypt.[67] Clearly, in MENA all three sectors have gone against trends elsewhere in absorbing labor, but the cost has been stagnant or declining productivity, rising labor unit costs, slower technological catching up, and weaker competitiveness compared with East Asia and Eastern

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[64] Youth unemployment also tends to be more volatile. http://siteresources.worldbank.org/NEWSARABIC/Resources/EDP_Spring_2012_MENA.pdf

[65] See Mirkin (2013) http://www.arab-hdr.org/publications/other/ahdrps/AHDR%20ENG%20Arab%20Spring%20Mirkinv3.pdf

[66] ACTs grew by a little over 1 percent in 2011 and by 2.5 percent in 2012; the forecast for 2013–14 calls for growth to slowly rise to 4 percent with Libya and Yemen in the lead and Egypt trailing behind.

[67] http://www.worldbank.org/en/news/press-release/2013/06/04/transforming-arab-economies-towards-knowledge-innovation-driven-development-strategies (p.21)

Europe.[68] That MENA countries create more employment for every 1 percent of GDP growth (or value added) is not necessarily comforting news. Anecdotal evidence indicates that firms and public bodies have an excess of workers; in order to enhance efficiency and shave costs, they would need to trim the numbers employed. Moreover, if the transition economies are to make a success of export-led growth, they will need to assimilate the latest technologies — which are increasingly capital intensive —and to be far more selective in their hiring practices, emphasizing quality and skills over quantity. In other words, the kind of structural change that could improve competitiveness and raise the growth rate will entail a shedding of the overhang of the underemployed in the business and public sectors[69] and the incorporating of advanced technologies (those embodied in equipment and others that are embodied in management), organization, and work practices. If the transition process is to result in greater competitiveness, in part induced by reforms that improve the flexibility of labor markets, labor elasticities in all three sectors might be more tightly squeezed, possibly to East Asian levels or lower, a development that can only be squared with reduced unemployment if growth is close to or in the low double-digit range. A growth acceleration (that efficiently absorbs the labor overhang) comparable to what China achieved in the 1990s calls for a sharp increase in the shares of investment in GDP and in exports, and an increase also in the shares of productive sectors, preferably manufacturing; however, the future of tradable services is also promising. It should be noted, though, that these developments, were they to occur, would make a substantial dent in unemployment if young people are willing to take on jobs in manufacturing and in new services, something they, especially those with tertiary education, have hitherto been reluctant to do.[70]

Investment rates in the ACTs vary widely: they were adequate or high in Tunisia, Libya, and Morocco (26, 28, and 35 percent in 2010, respectively), however, they are low or unusually low in Egypt, Jordan, and Yemen (19, 15, and 12 percent in 2010)[71] and have declined since 2000, substantially in Jordan and Yemen.[72] The first three countries have to focus on improving

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[68] Among the ACTs included in the WEF's Global Competitiveness Index 2012–13, Jordan was ranked 64th, Morocco 70th, Egypt, 107th and Libya 113th. All of the leading East Asian and Southeast Asian economies were in the top 38. Among the Arab countries, Qatar occupies the top slot, followed by Saudi Arabia and the United Arab Emirates. All the ACTs are ranked lower, with Yemen at the bottom of the list. http://www.weforum.org/reports/arab-world-competitiveness-report-2013 (pp. 9-10).

[69] Amin and others (2012, p.21) op.cit. state that the public sector has been key to the survival of many MENA governments because it is a vehicle for creating employment, extending patronage, and distributing rents. Employment by the public sector accounted for 29 percent of the total number of jobs in MENA, 42 percent of non-agricultural jobs in Jordan, and 70 percent in Egypt. Deutsche Bank (2013) http://www.ilsole24ore.com/pdf2010/SoleOnLine5/_Oggetti_Correlati/Documenti/Notizie/2013/01/rapporto-detsche-bank-Arab%20Spring.pdf?uuid=ff2925e4-67e5-11e2-8e3d-9f95df31318b

[70] In its 2013 report, the ILO holds out little hope that unemployment will decline in the next five years. http://www.ilo.org/global/research/global-reports/global-employment-trends/2013/lang--en/index.htm

[71] All data from WDI 2012 Table 4.8

[72] Capital formation as a percent of GDP in East Asia averaged 41 percent, somewhat biased upward by China's unusually high rate.

allocative efficiency and raising productivity; the latter three are unlikely to realize the needed growth acceleration absent investment rates in the 25+ percent range combined with efficient allocation. All need to redouble their efforts at technological catching-up and the cultivation of incremental innovation.

Share of manufactures in GDP, and export shares of merchandise exports and knowledge-intensive business services (KIBS)[73] provide an additional fix on growth potential from gains in TFP and demand pull. The manufacturing sector has increased its share in just one of the six ACTs: in Jordan it has risen from 16 percent in 2000 to 19 percent in 2010. It has a tiny 4–6 percent share in Libya and Yemen; it has remained stable at 18 percent in Tunisia; and it has accounted for a diminishing share of GDP in Egypt (down from 17 percent to 15 percent), and in Morocco (down from 17 percent to 15 percent).[74]

Exports as a share of GDP and the export mix are a window into the degree of openness and the scope for export-led growth. In this regard, Egypt is the laggard, with an export to GDP ratio of 21 percent; only Yemen has experienced a decline from 41 percent in 2000 to 30 percent in 2010. Libya, an oil exporter, leads the pack with a 67 percent rate; the others range from 33 percent in Morocco to 49 percent in Tunisia, with Jordan falling in between at 45 percent. Except for Egypt, all countries are above the global average of 28 percent and three exceed the East Asian average of 37 percent. But they fall short of the rates for Malaysia, Thailand, and Vietnam: 97, 71, and 78 percent respectively.

Predictably, Libya and Yemen are at the bottom of the list with negligible merchandise exports, and their exports of KIBS are also trivial. For these two countries diversification is a desirable longer-term objective; however, accelerating growth on the strength of non-fuel exports will be a considerable challenge. The other four countries are better positioned, with Egypt again trailing with a 43 percent share of manufactures in total exports,[75] and low and declining share of KIBS since 2000. Morocco, Jordan, and Tunisia are in a more comfortable situation, with merchandise exports to total exports between 66 percent and 76 percent. None of these countries export insurance, financial services, or engineering services, and they have yet to establish a foothold in the market for global construction services. Morocco and Tunisia have modest exports of other KIBS; both have managed to increase the volume of exports by a sizable margin. Jordan has suffered a major decline. The global average for merchandise exports was 69 percent and for KIBS was 45 percent; East Asia was above the average for merchandise

[73] KIBS includes insurance and financial services and computer, information, communications, and other commercial services. All data are from World Bank's World Development Indicators 2012.

[74] The small size of the industrial sector is highlighted in the report of the African Development Bank (2012). http://www.afdb.org/fileadmin/uploads/afdb/Documents/Publications/Jobs%20and%20Justice%20-%20EN.PDF

[75] Only Tunisia has a level of per capita exports that is close to East Asian levels. In Egypt it is less than $100 and those of Morocco are 60 percent of the average for developing countries. http://www.afdb.org/fileadmin/uploads/afdb/Documents/Publications/Jobs%20and%20Justice%20-%20EN.PDF

exports (79 percent) and about level with regard to the export share of KIBS (43 percent). Morocco, Jordan, and Tunisia have built up export-oriented manufacturing capabilities and now need to diversify and to increase domestic value added. They also need to strengthen the KIBS sector. Egypt is farther behind and must try harder.

Except in Tunisia where the weighted mean tariff rate was 16 percent, the rates in the ACTs were below 10 percent. Jordan had the lowest rate (5.2 percent). Tunisia, Morocco and Egypt have each improved their World Bank Logistics Performance Index[76] ranking since 2007, and in 2012, ranked 41st, 50th and 57th respectively. Yemen was a little lower in 63rd place, with Jordan and Libya far behind (102nd and 137th from a total of 155 countries). Further gains would surely be helpful for all six ACTs, and reducing import lead times would facilitate participation in regional value chains.

VI. Accelerating Growth: Short-term Measures

Confronted by an impatient population and antagonistic former elites ready to transfer their liquid assets overseas (if they have not done so already), the newly installed governments— or interim governments—of transitioning Arab economies do not have the luxury of time. They need to demonstrate their readiness to take concrete policy steps that can produce quick results in the current less-than-propitious global environment, and to follow these steps with additional measures based on new economic strategies (crystallized from the many reports that have been produced to date) that build upon these early initiatives so as to sustain the tempo of development over the longer run. The shorter-term initiatives are outlined below; those that will take longer to put into effect are discussed in the next section.

Undoubtedly, political stability[77] and actions that will begin the process of correcting macroeconomic imbalances, as in Egypt, are part and parcel of growth-enhancing policies. A recent World Bank report stated that "employment miracles" require a combination of macro stabilization, flexible business and trade regulations, improved governance, and the time it takes to enforce contracts and start a business.[78] Progress in these spheres would take the edge off the uncertainties that beset the ACTs and that are dampening private investment and inducing capital flight. In particular, managing of political differences, a degree of tolerance for the articulation of dissent, willingness to compromise, and proactive efforts by governments to forge a consensus with major stakeholders on developmental objectives will be critical to the

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[76] http://siteresources.worldbank.org/TRADE/Resources/239070-1336654966193/LPI_2012_final.pdf#page=11

[77] This progress may require more than 'controlled democracy' or 'theocracy' that new regimes have been prepared to offer; furthermore, instituting a 'just rule of law' in conjunction with constitutional and electoral reforms in societies riven with dissent will be no easy matter. http://www.brookings.edu/research/opinions/2013/02/11-arab-awakening-democracy-mbaku. Amin and others (2012, p.49) op.cit.

[78] World Bank (2012) http://siteresources.worldbank.org/NEWSARABIC/Resources/EDP_Spring_2012_MENA.pdf

acceleration of growth. In the four ACTs that have experienced uprisings and the two that have dodged them thus far, the framing and implementation of sound economic policies is predicated on political understandings that will make it possible to administer the needed economic medicine in the immediate future and in measured doses during the balance of the decade.[79]

Employment-generating growth is the only way of broadly satisfying the expectations of the various interest groups in the ACTs and their external creditors. But such growth should narrow rather than enlarge fiscal and external imbalances, which means that it should ideally be led by tradable sectors and begin contributing to foreign exchange earnings. Absorbing more youth into the public sector and/or raising the salaries of public employees—as Egypt, Tunisia and Morocco have done—can temporarily placate the restive workforce; however, such actions involve long term fiscal costs as they cannot easily be undone, they negatively impact productivity, and they further distort the expectations of young graduates for whom a 'tenured' public sector job with benefits is life's driving ambition— and they affect wage costs in other sectors as well. In addition to macroeconomic policies tourism, trade promotion, SME development, and infrastructure could be targeted for short-term action. Longer-term policies could target improvements in the business environment; state enterprise reform and private sector development; 21st-century industrial policies; entrepreneurship; and an upgrading of education and training.

Tourism. For countries that derive large earnings from the labor-intensive tourism sector, Egypt, Jordan, Morocco, Tunisia, and to a lesser extent Yemen, this is a sector that can initiate a revival and help persuade foreigners that ACTs are on the mend. Globally, earnings from tourism climbed to $1.3 trillion in 2012 and arrivals rose to 1.035 billion (from 528 million in 1995) and tourism is estimated to have increased by 5 percent in 2013.[80] Earnings from tourism have been rising (albeit slowly) in Morocco but took a dive in the other countries. In MENA as a whole, tourist arrivals fell from 58 million in 2010 to 52 million in 2012, though receipts remained almost constant. Economic conditions in the European Union and in North America are weighing on tourism; nonetheless, the ACTs can seek to increase tourist traffic beyond 2013 and beyond (benefitting from an apparent rebound in tourism to MENA) and to increase their share of global tourist arrivals[81] by allaying the security concerns of tourists. This should be accomplished not through harsh police measures but through negotiation that underscores the

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[79] The necessity of concurrent political and economic reforms is emphasized by Muasher (2013) http://www.imf.org/external/pubs/ft/fandd/2013/03/muasher.htm; and by some contributors to Wilson Center (2012) http://www.wilsoncenter.org/publication/has-the-arab-spring-lived-to-expectations

[80] http://www2.unwto.org. Tourism accounts for 6 percent of global exports, one in 11 jobs and 9 percent of GDP. http://www.ibtimes.com/surprise-europe-drives-global-tourism-growth-over-first-8-months-2013-1435172

[81] The share of the Middle East is 4.4 percent of the global total. http://dtxtq4w60xqpw.cloudfront.net/sites/all/files/pdf/unwto_highlights13_en_lr.pdf; http://www2.unwto.org/en/press-release/2013-10-17/international-tourism-rise-boosted-strong-performance-europe-0

mutual interest of all parties in the health of tourism—and in FDI, both in the hospitality sector and in urban services more generally.
Internal measures deserve primacy and will be the ultimate arbiters of success, however, as they progress, these measures need to be combined with a major marketing campaign not only in traditional markets in the European Union and North America, but also in South Asia and East Asia. The campaign should reassure visitors of the return to normalcy throughout the region, offer quality services, greater variety of entertainment, and a better experience overall. MENA tourist destinations have much to learn from the hospitality sector in Southeast Asia about moving up the tourism value chain,[82] especially with regard to training so as to raise the quality of services and of the tourist infrastructure. The economic spread effects from a resurgence of tourism would immediately take some of the edge off the economic concerns of the average household.

Export Promotion. More tourist traffic, preferably of the long-stay, higher-end sort, is only a part of the answer to the near-term economic woes.[83] Stimulating trade more broadly would boost growth in both the short and the long term. Piecemeal reforms since the 1980s have mainly benefitted "industries with static comparative advantage, particularly those linked with petroleum. The increased intensity of trade has not been indicative of a successful integration into the global economy" (UNDP 2011, p.35). Growth of merchandise exports and diversification away from resource-based and textile exports[84] should be a priority, starting with the small number of firms that are engaged in trade, the reallocation of resources favoring successful exporters,[85] and with the nurturing of new entrants. The initial focus necessarily must be on known and large markets that can produce "big hits."[86] Search (or discovery), ISO certification, effective use of websites and e-mail, and product diversification and upgrading can facilitate market widening or entry. Successful exporting also hinges on firms' continuous reshuffling of product portfolios. East Asian experience and, more recently, India's, would also

[82] The upgrading of the tourism workforce and other elements of the value chain are the subject of Christian and others (2011) http://www.cggc.duke.edu/pdfs/2011-11-11_CGGC_Ex.Summary_Tourism-Global-Value-Chain.pdf

[83] Hausmann and Bustos also note that tourism by itself cannot be a source of the needed dynamism (p.21) http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/Comparative%20Study%20on%20Export%20Policies%20in%20Egypt%20Morocco%20Tunisia%20and%20South%20Korea.pdf

[84] Tunisia and Morocco have begun to diversify, although domestic value added in medium-tech industries remains low. They need to press ahead and others need to catch-up, Libya and Yemen being among the least diversified economies among the ACTs (UNDP 2011, pp. 35–36).

[85] Melitz and Trefler (2012) http://scholar.harvard.edu/files/melitz/files/jep_final.pdf

[86] Research by Easterly and Reshef (2010) points to the disproportionate share of export earnings from a few *big hits*[86](sizable exports of specific products to individual markets). That is, a few major exports to a small number of countries can account for the bulk of earnings. The composition of the *big hits* changes repeatedly over time (often as a result of 'discovery' or chance as with the exports of Nile perch fillets from Uganda to the UK) and it is very hard to determine a priori which products could prove to be major successes. Hence the continuous search for new products that could yield the next big hit. http://www.nber.org/papers/w16597.pdf

suggest that rising exports are associated with an export mix increasingly weighted with more sophisticated manufactures, incorporating greater domestic value added combined with a range of supporting marketing, technical, after-sales, and IT services.[87] In other words, attractive products are those with several value-adding rungs to their quality and technology ladders, and it is such products that deserve the most attention and incentives from the government. That MENA countries have been unsuccessful in diversifying away from low tech to more sophisticated manufactured exports associated with higher rates of growth has been highlighted by a number of studies, and most recently by a report on export performance produced by the AfDB (2012).[88] But as Lederman and Maloney have pointed out, the product space analysis pioneered by Hausmann and others offers limited guidance as to what products MENA countries might "strategically bet upon" (p. 59) if they attempt to diversify with the help of government intervention to coordinate and to lead the effort (Elbadawi and Gelb 2010, p. 16). It is easy enough to identify machinery, electronics, chemicals, and pharmaceuticals as the sophisticated industries to pursue but difficult to make these into growth drivers. Lederman and Maloney (2012, p. 105)[89] stress the "lack of robust empirical indicators to help select products for special treatment and the overwhelming evidence of heterogeneity within goods should shift the debate to understanding how countries can produce whatever it is they produce in ways that more effectively drive economic development." Instead of targeted (vertical) industrial policies of the kind employed by Korea in the 1970s, horizontal (so-called soft) policies that utilize a variety of incentive measures to develop export activities have more to recommend them (on this see below). [90]

From among the menu of feasible export-promoting policies, all of which were implemented by the East Asian tigers with varying degrees of success, the following remain of relevance for ACTs, albeit for the ones with merchandise exports to sell, which excludes Libya and Yemen:

- Exchange rate policies that advantaged exporters through a degree of undervaluation unlike the real exchange overvaluation that a number of MENA countries have permitted, in the process undermining their export competitiveness;

- Export subsidies, insurance, and guarantees;

[87] The success of several of the East Asian economies hinged on the presence of MNCs that established local assembly platforms and exported back initially to their home countries and, later, worldwide.

[88] http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/Comparative%20Study%20on%20Export%20Policies%20in%20Egypt%20Morocco%20Tunisia%20and%20South%20Korea.pdf; Elbadawi and Gelb (2010) http://www.erf.org.eg/cms.php?id=NEW_publication_details_reports&publication_id=1304

[89] Daniel Lederman and William Maloney, (2012) *Does What You Export Matter?* http://elibrary.worldbank.org/content/book/9780821384916

[90] Aiginger (2011) http://www.voxeu.org/article/inefficiency-industrial-and-innovation-policy-france; Harrison and Rodriguez Clare (2010) http://www.voxeu.org/article/hard-soft-industrial-policies-developing-countries; Veuglers and others (2009) http://www.voxeu.org/article/kick-starting-green-innovation-machine.

- Reduction of trade barriers and trade facilitation procedures, and WTO/EPA-related capacity building; and
- Soft infrastructure: overseas market intelligence, standards, metrology, statistics.

These are being utilized to varying degrees and the issue now is one of fine-tuning so as to further reduce the transaction costs. Export credits and insurance (guarantee) schemes at below market rates (e.g., Brazil's PROEX[91] and FINAMEX schemes), are WTO-compatible and not deemed to be subsidies if above cost. Other incentives in this category include tax concessions on earnings and profits, subsidies for nontraditional exports, including subsidies for incremental exports and duty drawback provisions on imported materials and capital goods, including goods for export processing zones. These can be tied to domestic value added, or to export performance (e.g., Brazil's Fiscal Benefits for Special Export Program, BEFIEX[92]). Subsidizing freight and transshipment fees to export markets is also an option (Laird 1997)[93].

Trade barriers between countries in MENA are the highest in the world; as a consequence less than 6 percent of trade is intraregional.[94] Both tariff and non-tariff barriers need to be scaled down.[95] Improving trade facilitation could lead to a 20 percent gain in exports for the non-resource exporting MENA countries.[96] Facilitation involves the simplification of the customs requirements, rules, and procedures impinging upon exporters, and upgrading their logistics competence, tracking and tracing, and timeliness. The fewer the efficiency-reducing levies on logistics providers[97] and customs requirements to be observed, forms to be filled, clearances to be sought and inspections to be undergone, the lower the transaction costs for exporters, who in any case are taking substantial risks in venturing overseas. Singapore and Korea demonstrated that a streamlined, preferably one stop computerized system lowers the hurdles for exporters and can encourage more firms to enter world markets. Morocco has shown a large improvement in this respect through investment in port infrastructure and in weeding out obstructive procedures. Over the medium term, ACTs could help small exporters and new entrants grapple

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[91] For details on PROEX, See http://brasmari.com/brazil/?p=260; and WTO 1999 www.worldtradelaw.net/reports/wtoab/**brazil**-aircraft(ab).pdf . These have partially offset Brazil's high real interest rates.

[92] See http://www.wto.org/english/tratop_e/tpr_e/tp47_e.htm

[93] See WTO (2011) for details on the rules governing export incentives: http://www.intracen.org/Export-Promotion-and-the-WTO-A-Brief-Guide/

[94] See Richter (2012) http://ideas.repec.org/p/wsr/pbrief/y2012i014.html

[95] http://www.afdb.org/fileadmin/uploads/afdb/Documents/Publications/Jobs%20and%20Justice%20-%20EN.PDF ; According to the WEF report, Jordan would benefit from a reduction of trade barriers. Internationally it is in 104th place, and with respect to regulatory barriers impeding FDI, Jordan is ranked 70th. http://www.weforum.org/reports/arab-world-competitiveness-report-2013

[96] Hufbauer, Vieiro and Wilson (2010) http://www.voxeu.org/article/trade-facilitation-matters

[97] Noland and Pack (2007, pp.107-8) describe some of the impediments faced by logistics suppliers.

with the sheer variety and complexity of rules governing trade through capacity building in WTO and country-specific rules and a concurrent improvement in organizational capabilities. For exporters of food products, as in Morocco for example, storage and dedicated cold chains would reduce spoilage and offer sound investment opportunities.

Exporters must navigate a thicket of standards and certification procedures that differ among countries. A sound metrological system is a great asset for all producers, but especially for exporters, because it helps them meet standards and reduces transaction costs. As technology levels have risen and computerization has become pervasive, industrial extension, again by both public and private providers, is helping companies to assimilate and adapt technologies, to search out new technologies, and to upgrade production processes and products. Many smaller companies cannot afford the latest and most sophisticated testing equipment or to set up their own lab facilities. For such companies, and these comprise the majority of exporters, shared lab facilities and testing equipment are vital assets, whether at special-purpose facilities or universities. Early efforts at expanding these could provide exporting with an additional impetus.

Increased assistance from state overseas marketing agencies in identifying international market opportunities and gathering relevant market intelligence would be a considerable benefit especially for smaller companies; and in a world where production networks orchestrate a large share of trade, closer association with intermediaries could lift export shares in key markets. The role of intermediaries (such as Li and Fung[98] and the Japanese trading companies) in trade is frequently overlooked and underrated:[99] in fact a quarter of all exporters in the world are intermediaries, and these are responsible for a quarter of the trade of countries such as Malawi and Paraguay, and lesser shares of countries such as China (9 percent). The attraction of intermediaries is that they have lower fixed costs and can offer firms attractive rates for distribution and marketing.[100]

Assisting small and medium-sized enterprises. The vast majority of firms in the ACTs are small and medium-sized enterprises (SMEs).[101] They are the principal employers and the source of future regional and global "challengers" from the ACTs.[102] The growth of SMEs has been hindered by limited access to credit – a worldwide problem – and to technical, training, and

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[98] http://www.lifung.com/eng/global/home.php

[99] With major buyers preferring to deal directly with larger suppliers, the role of "integrators" and trading companies might be on a decline.

[100] See Bernard, Grazzi and Tomasi 2012. http://ideas.repec.org/p/trn/utwpde/1016.html

[101] Amin and others (2012, p.108) op.cit.

[102] Analysis of data from 99 countries shows that firms employing less than 100 workers are the largest source of jobs and employment overall (Ayyagari, Demirguc-Kunt, and Maksimovic 2011).

business services, and by a constrictive regulatory environment.[103] Tackling the many ills besetting the SME sectors in the ACTs is a longer-term project. In the near term, credit and industrial extension might enable existing firms to increase output and employment, diversify, and upgrade.[104] Whether this will accelerate growth is uncertain – although the proliferation of small IT firms in Jordan many providing online services, is a promising development.[105] Microeconomic and cross-country research suggests that SMEs are net job creators in low-income countries, but micro-enterprises might contribute little in this respect. The contribution of SMEs to net job creation in middle- and high-income countries is less easy to establish. Moreover, SMEs are low on the scale of labor productivity and innovativeness, and although SME activity is correlated with growth it does not *cause* growth.[106]

The experience of other industrializing countries, as well as of the ACTs, suggests that specialized public financial institutions created to serve SMEs and the use of directed credit have yielded meager results. SMEs perforce rely for a good chunk of their financing on own resources and those of friends and family. This is the case also in the United States and East Asia. Informal finance is an important source of financing. The problem in ACTs and virtually everywhere is that commercial banks, while supplying a portion of the working capital to the larger SMEs and some collateral-based lending, service too small a portion of the remaining needs of SMEs (while lending excessively to large firms [Amin and others 2012, p.109]).[107] Moreover, they are easily discouraged by downturns and by uncertainties such as those plaguing the ACTs currently, even though SMEs are responsible for a small fraction of nonperforming loans.

Banks typically cite insufficient collateral and/or its registration and enforcement, information asymmetry (services offered by credit bureaus are still in their infancy), the associated risk, and high transaction costs as the primary reasons for their reluctance to lend to smaller firms and for

[103] A major OECD report also makes the case for a stronger regulatory, legal, and competitive environment and attention to the provision of skills and finances. http://www.oecd-ilibrary.org/industry-and-services/new-entrepreneurs-and-high-performance-enterprises-in-the-middle-east-and-north-africa_9789264179196-en

[104] The EBRD's T2T initiative has generated a wealth of suggestions on how to assist SMEs. http://www.ebrd.com/downloads/research/economics/t2t/cairo_report_1.pdf

[105] Economist (July 13th, 2013, p. 55-57) http://www.economist.com/news/business/21581737-clusters-internet-firms-are-popping-up-all-over-region-start-up-spring

[106] See Beck, Demirguc-Kunt, and Levine (2005) http://ideas.repec.org/p/nbr/nberwo/11224.html; and Demirguc-Kunt (2011) http://blogs.worldbank.org/allaboutfinance/generating-jobs-in-developing-countries-a-big-role-for-small-firms. Haltiwanger and others (2010) and http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1666157; and the Economist (2013) http://www.economist.com/news/finance-and-economics/21579808-fate-large-firms-helps-explain-economic-volatility-goliaths also underscore the role of growing and large firms as against SMEs that mark time.

[107] Venture capital (and private equity), especially public funds, have a weak track record in virtually all industrializing countries; neither such funds nor angel investors are likely to make much of a contribution to the growth of the real sector in the ACTs in the medium term.

their preference for safer assets. If those are the principal constraints, solutions do exist; these include: improving credit scoring systems (already being introduced) using the latest information technologies (which includes integrating credit information into the credit risk assessment process, and using credit registration services); risk self-assessment by SMEs; optimal pricing schemes; loan guarantees and covenants; creation of special support units for high-risk customers; new products tailored for SMEs and training of bank staff to segment and deal with SME clients; and cooperating with SME organizations and providers of business development services to not just reduce risks but also to combine financial with nonfinancial services. SMEs can also improve their own access to credit by improving management and planning skills that put accounting, financial records, and human resource management on a sound footing, as well as by strengthening financial literacy.

For SMEs in MENA, Sharia-compliant Islamic finance[108] has emerged as an additional and arguably more accessible source of funding.[109] It offers a number of advantages because banks engaged in Islamic practices rely on leasing, partnership instruments, and trade-based contracts. By encouraging banks to behave more responsibly, internalize more stringent ethical values, and prioritize socially responsible lending, Islamic banking has the potential of involving banks more directly with the SME/real sector while requiring them to abide by prudential rules. Islamic banking is a growth sector in MENA, but it has yet to make an impact on SME development, a lacuna that deserves policy attention.

Business development services offer additional means of increasing the growth, profitability, and export orientation of firms. SMEs have a more difficult time entering overseas markets, and their success is frequently dependent on networking, good contacts, and links with multinational corporations. Services providers that assist with marketing, certification, business intelligence, and contacts can make a valuable contribution,[110] though an oversupply of such providers may sow confusion, waste resources, and make it harder for SMEs to access the services they require.

Infrastructure and housing shortages affect all of the ACTs, to varying degrees, and investment in these is generally the shortest route to a revival of economic activity,[111] to bolstering the efficiency of critical supply chains, to increasing employment for the semi-skilled and unskilled, to meeting demand for housing in crowded cities, and to raising productivity.[112] Power (and

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[108] This is derived from *fiqh muamalat* and requires exclusion of *riba* (interest payments), avoidance of *haram* activities, and efforts at minimizing *gharar* (ambiguity of contracts).

[109] http://www.sbp.org.pk/ibd/pdf/Handbook-%28iSME%29.pdf

[110] See also Ferro (2011) http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1750747

[111] Dethier and Moore (2012) survey the evidence, which is less than rock solid. http://ideas.repec.org/p/ags/ubzefd/123305.html

[112] UNDP (2011) op.cit.

water) shortages are a severe constraint for Yemen, and cramp development in Egypt and Jordan as well. Inadequate ICT infrastructure hampers firms in all of the ACTs and impedes new entry into higher-tech activities.[113] With the oil producers taking the lead, MENA countries have invested on average more than 6 percent of GDP in infrastructure over the past 25 years[114] and construction activities have accounted for 30 percent of jobs created since 2000.[115] Overall, employment in infrastructure and construction absorbs between 11 percent (Egypt, Yemen) and 25 percent (Morocco) of the workforce in the ACTs. Ianchovichina and others (2012) estimate that every $1 billion spent on infrastructure gives rise to 110,000 jobs in the oil-importing countries and 49,000 in the oil-exporting ones. Furthermore, an 8.7 percent increase in the infrastructure stock adds 1 percent to the growth of GDP, though much depends upon design, targeting, and governance. For those ACTs that are less hamstrung by budget constraints— and all are wrestling with fiscal deficits ranging from nearly 5 percent in Yemen to 11 percent in Egypt—investment in economically viable "shovel-ready" projects could be one major element of a policy package to enhance short-run growth and employment. Raising the effectiveness of the ICT infrastructure, so as to improve networked readiness, would promote growth in the short and long term.

VII. Longer-Term Reforms for Rapid, Inclusive Development

The policies proposed above, if speedily implemented, could accelerate growth rates in ACTs, even with an initially unchanged business environment, so long as governments can muster a consensus on the urgency of the growth issue. A growth spurt, if achieved, would need to be sustained through a complementary set of policies.

Assuming that investment will remain the principal driver of growth for the foreseeable future for the ACTs, raising the level of investment in manufacturing and tradable services would be good for productivity, innovation, trade and, of course, employment. In order to achieve results, each of the countries will need to adopt a multi-pronged approach suitably tailored to their individual circumstances.

A body of research suggests that *a better "business environment*" is positively related to investment and growth (which is integral to the horizontal industrial policies referred to earlier

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[113] The WEF's Networked Readiness Index for 144 countries puts Jordan in 47th place, but all of the others are much lower down the scale: Egypt 80th, Morocco 89th, and Libya and Yemen near the bottom at 132nd and 139th. http://www3.weforum.org/docs/GITR/2013/GITR_Chapter1.1_2013.pdf. All of the ACT have fewer than 50 Internet users per 100 people with Libya counting just 5.7 in 2010. WDI

[114] Annual public investment in OECD countries from 2001 to 2011 averaged 3.3 percent of GDP.

[115] Ianchovichina and others (2012) http://ideas.repec.org/p/wbk/wbrwps/6164.html. In several MENA, e.g., the Gulf States and Jordan, most of the jobs went to immigrant workers; this was not the case in North Africa.

and below).[116] Such an environment facilitates the entry and exit of firms; makes it easier to acquire construction contracts, licenses, and permits; is conducive to the enforcement of contracts and the resolving of insolvency procedures; and is one in which essential public services are efficiently priced and readily available. Improving the business environment is not a game changer; countries such as China, India, Turkey, Indonesia and Brazil that receive relatively low rankings on the World Bank's Doing Business Survey have managed to perform in spite of hindrances to starting a business or obtaining permits and having to cope with weak legal infrastructures. Similarly, Saudi Arabia has climbed the Doing Business rankings without a commensurate improvement in the rate of entry, productivity, and private investment. Nevertheless, the ACTs can doubtless only gain from lowering the hurdles faced by existing firms and prospective entrants. Among the six, Tunisia leads with a 2013 rating of 50 (well ahead of China and India) followed by Morocco (97),[117] Jordan (106) and Egypt (109).[118] Prior to 2010, Egypt introduced reforms that began improving the business climate and need to be resumed; others need to redouble their own efforts because these are closely watched metrics and they influence investor sentiments domestically and worldwide.

International experience, and in particular the experience of East Asian economies, suggests that progress on the business environment must be complemented by equally vigorous actions along three other axes: *state owned enterprise reform and private sector development; market-compatible industrial policies; and entrepreneurship*. The lesson from China and some of its neighbors is that growth and employment generation really took off when a combination of institutional reforms and industrial policies enabled the private sector to gain traction. *A curbing, corporatizing, and/or downsizing of the public sector* not only releases human and financial resources; it also lowers entry barriers into industries dominated by state-owned enterprises (SOEs). In addition it raises the level of competition, including competitive pressure on SOEs. ACTs face a dual challenge: they need to scale back the role of public enterprises (including those run by the military), and they also need to curb the market power of the quasi-public entities owned or controlled by regime insiders and friendly business allies. The closed oligopolistic nature of industrial economies in Egypt, Morocco, and Jordan is inimical to competitiveness and dynamism. Regime change in Egypt, Tunisia, and Libya and the mood favoring reform in Jordan, Morocco, and Yemen provide an opportunity to revise the rules of the industrial game and to create more open and competitive industrial and financial sectors

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[116] Dethier, Hirn and Straub (2008) http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2008/12/05/000158349_20081205165155/Rendered/PDF/WPS4792.pdf

[117] Morocco has taken a number of steps to improve the business environment by sharply reducing the corporate tax, introducing electronic filing of corporate taxes, and setting up a one-stop office for obtaining permission construction permits (p.20). http://www.weforum.org/reports/arab-world-competitiveness-report-2013

[118] Egypt is experiencing a decline in competitiveness because the quality of institutions, legal protections, and corporate governance are all deteriorating. (p.24). http://www.weforum.org/reports/arab-world-competitiveness-report-2013

hospitable to new entry and to the growth of small firms.[119] Such action would reinforce the advantages stemming from a pruning of regulations burdening businesses.

Broad-gauged industrial policies (IP) that are now deemed acceptable by the European Union can impart additional impetus to the efforts aimed at raising private investment and attracting new players, whether domestic or foreign, into the industrial arena. ACTs must welcome both. The industrial policy variants now coming into vogue embrace support for competitive subsectors; these subsectors are being buoyed by a widening of comparative advantage (aided by FDI as in Tunisia and Jordan) and are demonstrating their prowess via expanding domestic market shares and/or exports. This approach to IP includes measures to strengthen the research infrastructure and to build a triple-helical innovation system,[120] with special attention to research universities and advanced training in the sciences. They incorporate some vestiges of the traditional industrial polices, in that they maintain that 'competitive winners' and firms testing the edges of new technologies can receive doses of supportive credit from public venture–type institutions, even as they establish a foothold in international markets or work through the gestational phase of a potentially disruptive technology.[121] Furthermore, the new IP also has a place for government procurement as a frequently necessary corollary to the maturing of a new technology (e.g., renewable energy) as it moves down the cost curve with the help of learning, debugging, scaling up, and incremental innovation.[122]

The new IP is tolerant of networked cluster development: "Third Italy" is one form it takes, Cambridge, UK, another.[123] A review of successful clusters suggests that, aside from luck and serendipitous occurrences, anchor firms (Lockheed and Fairchild in Silicon Valley), research universities (MIT/Harvard in Boston) and special economic zones (SEZs) (Shenzhen, Penang, Hsinchu Park) can serve as nuclei around which many small firms aggregate.[124] A possible route to cluster formation in the ACTs leads through SEZs/EPZs (export processing zone): policymakers influenced by the experience of China and the Southeast Asian economies believe

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[119] al-Nashif and Tzannatos (2013) observe that privatization in Arab countries during the 1990s did not lead to a revitalized private sector that produced sufficient gains for the middle class because it was not backed by other reforms. Handing over state enterprises to private operators only resulted in privately owned oligopolies. http://www.imf.org/external/pubs/ft/fandd/2013/03/

[120] Leydesdorf and Meyer (2006) http://arxiv.org/ftp/arxiv/papers/0911/0911.3407.pdf

[121] The current thinking on industrial policy can be gauged from Aiginger (2007) http://karl.aiginger.wifo.ac.at/fileadmin/files_aiginger/publications/2007/aiginger_fin.pdf; Aghion and others (2011) http://www.bruegel.org/publications/publication-detail/publication/566-rethinking-industrial-policy/; http://www.nber.org/papers/w18048; Aggarwal and Evenett (2012) http://basc.berkeley.edu/pdf/Aggarwal%20Evenett%20Oxrep%202012.pdf

[122] Aggarwal and Evenett (2012). Op.cit.

[123] http://www.rri.wvu.edu/WebBook/Norton/nortonupdate/neoflows1.htm; Yusuf, Nabeshima and Yamashita (2008) https://openknowledge.worldbank.org/handle/10986/6429

[124] Humphrey and Schmitz (1995) http://www.unido.org/fileadmin/media/documents/pdf/SME_Cluster/Humphrey.pdf

that SEZs can help jumpstart industrialization by attracting MNCs, spurring startup activity, and, most importantly, creating jobs for low-skilled workers.[125] [126] Egypt has nine free-trade zones;[127] SEZs have been established in Tunisia and Morocco, and Qualified Free Trade Zones in Jordan.[128] Whether these can grow clusters remains to be seen.

The qualifying industrial zone (QIZ) in Jordan has contributed to exports however; the majority of jobs have gone to immigrants. The Tangier free trade zone, established in 1999, has augmented Morocco's exports,[129] but the zones in Tunisia and Egypt have yet to prove their worth. The return on public investment in infrastructure, and their net contribution to industrialization and employment have proven difficult to establish, there being a dearth of systematic analysis of performance to guide policymaking (Farole 2011).[130] The preferred treatment of export industries in SEZs creates distortions in other sectors of the economy, and there is scant evidence to suggest that they increase net investment in manufacturing activities. Furthermore, the technological spillovers and linkages from firms in the zones to the rest of the economy have tended to be minimal. Now that their numbers are so large, new zones must compete for FDI; most attract little, if any. With the progressive liberalization of trade and the adoption of WTO disciplines by most countries, the growth potential of SEZs has weakened.[131] Nevertheless, the zones/parks are here to stay, so it is desirable to explore ways of increasing their growth potential, linkages, and spillovers.

Farole (2011)[132] and the Facility for Investment Climate Advisory Services (FIAS, 2008) offer a number of guidelines to enhance the potential of SEZs to demonstrate the efficacy of selected policy instruments, catalyze the development of tradables, and give rise to industrial demonstration effects. Assuming that a politically validated policy framework is in place, a good location and adequate infrastructure are necessary conditions. Private participation can improve the quality of zone management, and a well-defined legal framework, together with

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[125] Kusago and Tzannatos (1998) cite this as one of the main benefits of EPZs.

[126] As of 2006, there were 3500 zones in 130 countries. In India alone there were 114 SEZs operating as of October 2010, and a further 500 had been approved.

[127] http://www.gafinet.org/English/Pages/FreeZones.aspx

[128] http://www.oecdobserver.org/news/fullstory.php/aid/3101/Free_zones:_Benefits_and_costs.html

[129] Hufbauer and Brunel http://www.piie.com/publications/chapters_preview/4334/11iie4334.pdf

[130] African EPZs have had a negligible impact on the continent's unemployment problem. http://www.fdiintelligence.com/Archive/EPZs-in-Africa?ct=true

[131] The telling experience with the hundreds of SEZs sanctioned in India since the SEZ Act in 2006, argues for caution in going down the zone route. http://www.business-standard.com/india/news/mahesh-vyas-sezs-aren%5Ct-delivering-time-to-scrapscheme/361692/

[132] Farole (2011) http://publications.worldbank.org/index.php?main_page=product_info&products_id=24016; http://www.voxeu.org/article/special-economic-zones-what-have-we-learned

proper land titling can minimize some common problems encountered by firms. Tax and other incentives can contribute, but their effects are limited and tend to fade over time.

International experience—in particular East Asian experience—makes a good case for government intervention in late-starting countries to promote industrial diversification and technological advancement, and to correct market failures; however, as Khan (2007, p.17)[133] rightly points out, "growth-enhancing governance of IP depends upon a number of institutional and political factors that enable the effective implementation of the underlying growth enhancing strategies (i.e.) agencies involved in monitoring and enforcement are sufficiently centralized to be able to internalize all the costs and benefits of implementing the strategy. This is to ensure that failing industries or sectors are not able to offer inducements to monitoring agencies to allow them to continue to receive their rents without delivering performance. (Equally) important is the political requirement that the governance agencies are able to enforce difficult decisions about rent and resource withdrawal from non-performing sectors and firms when required. This in turn requires a compatibility of the required governance tasks with the internal power structure of the country." It should be added that East Asian and European agencies that competently planned and conducted industrial/innovation policies relied on the expertise and competence of their well-trained staff, recruited through meritocratic selection procedures and motivated by both financial and nonfinancial incentives.[134] Bloated and inefficient bureaucracies will need overhauling before they can tackle the failure-prone task of framing and managing 21st-century industrial/innovation policies.

Entrepreneurship. Macro stability, institutional reforms, and incentives bolstered by industrial policies can only succeed if there is an entrepreneurial response from the private sector. The supply of entrepreneurship determines how many new firms are started-up, how fast existing firms grow and enter export markets, and whether new ideas and technologies are harnessed and transferred into the marketplace. In the ACTs, the best and the brightest have either gravitated to the public sector; led secure, government-supported private oligopolies; or emigrated abroad. By all accounts, graduates from educational institutions in ACTs are not well prepared for a life of entrepreneurship. They prefer to eschew risk and wait for secure, stable public sector employment. There are few true entrepreneurial role models; schools give little effort to instilling the venture ethic; and authoritarian states have long neglected the cultivating of entrepreneurial mores and sought instead to ensnare elites by bestowing resource rents and offering comfortable public sector jobs. As Ismail Serageldin (citied in Noland and Pack (2007) op.cit. p.94) rightly observed, "a generation has grown up within a dependency culture that is ill-suited to cope with the expected increasing exposure to market pressures. That generation lacks achievement motivation, vision of opportunities, sense of discipline, work ethic

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[133] http://www.un.org/esa/desa/papers/2007/wp54_2007.pdf

[134] Arezki and Quintyn (2013, p.44) find that better-educated civil servants are less corruptible, better at public financial management and increasing tax effort, and more supportive of the private sector. http://www.imf.org/external/pubs/ft/fandd/2013/03/arezki.htm

commitment and self-esteem that one generation passes on to another (to motivate a) progressive society." It is not surprising therefore, that the MENA region has the lowest "firm density entry rates in the world, suggesting a lack of entrepreneurship, with a rate almost four times lower than in Europe and Central Asia." (Deutsche Bank 2013, op.cit. p.9). Moreover, most startup activity is in the form of microenterprises in the informal sector, serving the domestic market, and that is where most of the new jobs are being created.[135]

The relationship between entrepreneurship and growth, and the role entrepreneurs play in transferring knowledge from universities and research entities to the marketplace, are well documented.[136] As Singapore has discovered, instilling entrepreneurial animal spirits through training is a slow process, which must be reinforced by changes in attitudes and mindsets, and through the availability of alternative opportunities. A downsizing of the public sector that begins redirecting the energies of talented young people into the business sector, both to start up new firms and to serve as "venture labor,"[137] will be the first step. The emergence of role models and how these affect attitudes will probably be decisive in the long run.

Labor Market Reforms. Labor market rigidities and distortions introduced by minimum wage laws, unionization, social security contributions, rules governing layoffs, and severance pay, the wage leadership role of the public sector, and institutions discouraging female participation and discriminating against the hiring of women—who perform far better than males on standardized international test scores and on average have higher academic qualifications[138]— are seen as depressing employment in the formal sector to varying degrees. Agenor and others (2004)[139] maintain that a piecemeal approach to reform is unlikely to deliver results because of general equilibrium effects on private investment (of increased government borrowing to finance tax cuts). Instead, a package of labor reforms that includes cuts in payroll taxes on unskilled workers, wage subsidies, and a scaling-back of employment in the public sector would need to be complemented with financial sector reforms, privatization, and measures to increase private sector investment. The significance of these labor market rigidities varies among the ACTs: unionization rates are low in Morocco and Tunisia and only moderate in Egypt; minimum wage

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[135] Amin and others (2012, op.cit. p. 39) state that 60 percent of the jobs in Arab countries are in the informal sector, as much as a quarter of all output is produced informally, and two-thirds of the workers lack pensions. (p.19) http://siteresources.worldbank.org/NEWSARABIC/Resources/EDP_Spring_2012_MENA.pdf

[136] See Carree and Thurik for a competent review. http://people.few.eur.nl/thurik/Research/Articles/The%20impact%20of%20entrepreneurship%20on%20economic%20growth%20-%20thurik%20chapter.pdf; Audretsch (2007) highlights the "conduit of ideas" function. http://relooney.fatcow.com/OREP-Solow_2.pdf; also Becker and Hvide (2013) http://www.voxeu.org/article/do-entrepreneurs-matter

[137] Gina Neff. *Venture Labor*. MIT Press. Cambridge MA. 2012.

[138] http://www.economist.com/blogs/pomegranate/2013/07/special-report-arab-spring; Arab countries top the world in the ratio of women in low quality jobs. Economist Special Report, The Arab Spring. July 13th 2013.

[139] http://papers.ssrn.com/sol3/papers.cfm?abstract_id=610373

regulations are adhered to mainly in the public sector and by large private employers; and the protection afforded by rules governing hiring and firing only applies to a minority of workers in the formal sector. Informal sector wages in all these countries are flexible. Chipping away at the rigidities, especially those created by the public sector, is desirable but politically challenging. Other reforms—also supported by the IFIs—may be quicker to produce results. These include workfare programs paying less than the market wage for work on infrastructure projects, e.g., in Yemen; social fund–based programs supporting community-driven cash-for-work activities in remote areas; and active labor market programs e.g., in Tunisia that provide small income assistance subsidies for job seekers or targeted subsidies for skilled graduates, placement services, market information systems, and, in some cases, micro-credit for entrepreneurs.[140]

The research on active labor market programs in OECD countries offers qualified support for certain kinds of initiatives. Wage subsidies, job assistance programs, and private sector–led on-the-job training have demonstrated results. Public sector employment programs and remedial training programs aimed at youth and older workers have been far less effective; those attempting to assist young people have been the least effectual.[141]

Increasing women's participation and access to jobs, and ensuring wage parity would boost human capital and growth over the longer term. But in addition to changes in social mores and attitudes of families, husbands, and employers, these call for a redrafting of laws governing women's rights and autonomy, access to courts, and against gender discrimination. Moreover a fair enforcement of rights must accompany legislation.

Education and Training. Arguably the most widely touted solution to the unemployment problem of the ACT is reform of the education and vocational training systems that will raise quality and reduce the skill mismatches in labor markets.[142] This is a solution being proposed for all other countries, including advanced ones. As noted earlier, raising the quality of education (through a focus on student learning outcomes, early childhood education,[143] presence of teachers in classes, teacher education and training, classroom furniture, lessening the reliance on rote learning and memorization, "teaching to university entrance tests," motivating learning

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[140] World Bank (2011) http://econpapers.repec.org/paper/wbkwboper/10897.htm ; Restructuring of Libya's financial sector will be needed to promote private sector investment and job creation. http://www.weforum.org/reports/arab-world-competitiveness-report-2013 (p.26).

[141] Kluve (2007) http://ideas.repec.org/p/iza/izadps/dp2018.html; Card and others (2009) http://ftp.iza.org/dp4002.pdf; RWI (2005) http://www.rwi-essen.de/media/content/pages/publikationen/rwi-projektberichte/PB_ALMP.pdf; Heckman and others (1999) http://ideas.repec.org/h/eee/labchp/3-31.html

[142] See ILO, Youth Employment Crisis, 2012. http://www.ilo.org/wcmsp5/groups/public/---ed_emp/---ed_emp_msu/documents/publication/wcms_181269.pdf ; Navtej Dhillon and others (2009) http://www.brookings.edu/~/media/Research/Files/Reports/2009/5/middle%20east%20youth%20dhillon/05_middle_east_youth_dhillon_ch4.PDF

[143] http://www.worldbank.org/en/news/press-release/2013/06/04/transforming-arab-economies-towards-knowledge-innovation-driven-development-strategies

environments and the engagement of parents and communities)[144] [145] imparted in the MENA countries would be growth-supporting, except that how this is to be achieved remains an extremely vexed question.[146] Even more intractable is the issue of vocational training that is unattractive for students because it is considered to be of lower status and with a low payoff.[147] MENA countries must certainly devote attention and resources (they have invested more in education and in vocational training than comparable East Asian and Latin countries—about 5 percent of GDP on average) to educational outcomes, however, during the next 10 years, the main challenge will be to employ the current youth cohort i.e., the educated and marginally educated in the 15–25 age range, and overcoming the distaste for any other than comfortable white-collar (public sector) jobs offering good benefits and pensions, and for the vocational training widely seen as a dead end, with few employment prospects, for those who do not fare well in 'high stakes' exams.[148]

A shortage of educated people is not a bottleneck; the MENA countries have relatively high rates of primary and secondary enrollment (72 percent in 2010 vs. 76 percent in East Asia) and

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[144] Salehi Isfahani and others (2012) stress inequality of access and family background as factors hindering educational outcomes. These will be tough obstacles to overcome. http://filebox.vt.edu/users/salehi/achievement.pdf

[145] According to international test scores, secondary school students from the participating ACTs performed poorly in math, science, and reading. See Amin and others (2012, op.cit.p.60); and Navtej Dhillon and others (2009) http://www.brookings.edu/~/media/Research/Files/Reports/2009/5/middle%20east%20youth%20dhillon/05_middle_east_youth_dhillon_ch1.PDF ; the PISA reading and Math scores (2009) for Jordan and Tunisia were 405 and 387 and 404 and 371 respectively, either below or slightly above the lowest cutoffs. Jordan is one of the countries singled out by the WEF 2013 as having a stronger educational system relative to others in the Region. The 2011 TIMSS scores for 4th and 8th graders in Mathematics ranked Tunisia, Morocco and Yemen at or near the bottom of the 4th grade list with scores of 359, 335 and 248 respectively – far below the 500 center point. 8th grade students from Jordan and Morocco also performed poorly with scores of 406 and 371 respectively. http://timssandpirls.bc.edu/timss2011/downloads/T11_IR_M_Chapter1.pdf; Science 4th graders from Tunisia, Morocco and Yemen were at the very bottom; however, 8th graders from Jordan and Tunisia did a bit better with scores of 449 and 439 respectively but Moroccan students scored just 376. http://timssandpirls.bc.edu/timss2011/downloads/T11_IR_S_Chapter1.pdf; *The Economist* (July 13th, 2013, The Arab Spring, p.10) observes that "in the Trends in International Mathematics and Science Study (TIMSS) tests, Arab countries made up nine of the bottom 10 out of 63 participating countries". The World Bank report on *Transforming the Arab Economies* (2013, p.33) observes, with typical understatement, "The education report card for the Arab countries paints a picture that is far from rosy." http://www.worldbank.org/en/news/press-release/2013/06/04/transforming-arab-economies-towards-knowledge-innovation-driven-development-strategies; Low scores and the small absolute numbers of those with high scores could be a severe drag on economic performance, according to the findings of Pritchett and Viarengo (2010) http://www.voxeu.org/article/producing-superstars-economic-world-cup-new-evidence-mexico

[146] See the meager recommendations that emerge from the review by Glewwe and others (2012) of a mountain of research. http://www.nber.org/papers/w17554.

[147] Navtej Dhillon and others (2009) http://www.brookings.edu/~/media/Research/Files/Reports/2009/5/middle%20east%20youth%20dhillon/05_middle_east_youth_dhillon_ch2.PDF

[148] http://www.brookings.edu/research/reports/2009/05/middle-east-youth-dhillon

an adult literacy rate of 76 percent.[149] Preference for public sector jobs induces young people to engage in long periods of job search (average search period for those between the ages of 20 and 24 in Egypt is 34 months); the demand from the private sector is soft because businesses are growing slowly and "signals from the private sector for the skills it is willing to reward are weak"(Amin and others 2012, op.cit. p.69); moreover, "signals from the private sector are drowned out by strong public sector signals" (Dhillon and others 2009, p. 18).[150] As in most other countries, businesses are reluctant to undertake the training that is a commonplace in the Northern European countries and instead are looking to the government to pick up the tab; technical vocational education and training (TVET) is of low quality, subject to dysfunctional administrative fragmentation (the 1,237 centers in Egypt are affiliated to 27 ministries), unresponsive to employer needs (because the centers are not working with employers to design curricula and practical training opportunities), poorly regarded and unable to attract good students from middle-class families; school-to-work transition programs are few, and still largely ineffective; and technological change in the ACTs has been such that the need for higher-order skills is modest at best. In this situation, the advantages of increasing the supply of skills (if that were possible) are debatable. As Noland and Pack (2007, op.cit. p.179) state, "more education (and training) absent true demand rather than politically dictated demand will create more of a problem with unemployed and underemployed graduates." Only an acceleration of growth, as proposed above, will begin to make a dent in unemployment and signal what sort of skills can be absorbed. Supply push, through increased expenditure on training to correct possibly illusory mismatches, will do no good.

Labor market institutions in the ACTs, as well as education and training systems, need overhauling; however, as noted above, this is a project that will span a decade or more and will require parallel changes in institutions and attitudes. There are no quick wins here; but delay in embarking on reform would be costly and perpetuate the current problems.

Knowledge-based Growth: Whether some of the MENA countries join the ranks of knowledge economies will depend upon their success at resolving human capital, business environment, and institutional issues.[151] Although market size, investment in higher education,[152] and opportunities to develop green energy satisfy some of the preconditions of a knowledge economy,[153] MENA countries have a lot of catching up to do, as is apparent from the data

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[149] Jordan counts a large pool of engineers— 80,000 in all— and can potentially draw upon an educated diaspora numbering one half million. http://www.weforum.org/reports/arab-world-competitiveness-report-2013 p.19.

[150] http://www.brookings.edu/research/reports/2009/05/middle-east-youth-dhillon

[151] The GCC countries have made good progress in building up the ICT infrastructure but the human capital deficit remains to be filled. Kumar and Welsum (2013) http://www.rand.org/pubs/research_reports/RR188.html

[152] More in the GCC countries than in the ACTs.

[153] See EIU (2011) http://www.managementthinking.eiu.com/sites/default/files/downloads/EIU-ATIC_Report1_Web.pdf

presented in a number of recent publications.[154] The CMI/World Bank/EIB report on *Transforming the Arab Economies* (2013)[155] provides detailed statistics on indicators: for example, only 22.6 percent of students pursue degrees in science and engineering; publications in science and technology journals are relatively sparse; the Knowledge Economy Index scores of MENA countries have declined since 2000; only a single university from the region, the University of Alexandria, is included in the Times Higher Education Supplement (THES) list of top 400 universities. In the light of the above, the recommendations of the CMI/WB/EIB report are eminently sensible (p.49): ambitious policy reforms tempered with realism; confidence-building change that first gathers low-hanging fruit; building a new economic model and social contract; regional integration and more active collaboration with the international community.

Social Safety Nets. To ameliorate the hardships caused by unemployment, and to contain poverty, ACTs have relied upon a number of safety net programs that for some are becoming fiscally burdensome. Energy and food subsidies and other (exclusive) income transfers eat up much of the resources channeled into safety net programs: subsidies average 7 percent of GDP in MENA countries.[156] Only 0.7 percent of GDP remains for other programs and as a consequence, two-thirds of those in the lowest quintile are unable to access non-subsidy social safety net programs, and leakages from these programs further dilute the benefits for the poorest.[157] Increasingly tight budgetary constraints have made it more difficult to defer reforms, and some governments have started them, though they are painfully aware that a trimming of subsidies could be politically explosive. When it comes, a number of recommendations, if implemented, could make safety nets across the ACTs more reliable, equitable, and effective. Making safety nets less regressive, improving information systems, consolidating many scattered/overlapping schemes, greater transparency, better means testing and targeting, and expanding of successful programs[158] are some of the easier wins that have been advocated for years. In conjunction with other reforms, these could also contribute to the flexibility of labor markets by making it easier to hire and fire workers. To realize the full returns from these reforms, however, ACTs will also need to increase the awareness of the poor as to the scope and coverage of the programs and how the benefits are distributed.[159] Every country needs to strengthen the apparatus for administering safety net programs and developing delivery methods that minimize leakages and the transaction costs of servicing the targeted recipients: these

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[154] Ofek (2011) http://www.thenewatlantis.com/publications/why-the-arabic-world-turned-away-from-science; http://physicstoday.org/journals/doc/PHTOAD-ft/vol_60/iss_8/49_1.shtml?bypassSSO=1; http://www.arab-hdr.org/publications/other/ahdr/ahdr2003e.pdf

[155] http://www.worldbank.org/en/news/press-release/2013/06/04/transforming-arab-economies-towards-knowledge-innovation-driven-development-strategies

[156] IMF (2012) http://www.imf.org/external/pubs/ft/survey/so/2012/car051412b.htm

[157] Exclusion of women and the disabled worsens the regressivity. http://carnegieendowment.org/2012/10/03/social-safety-nets-in-middle-east-and-north-africa/e4tt

[158] These include Morocco's conditional cash transfer program, Tayssir, and Yemen's Social Welfare Fund.

[159] IMF (2012) http://www.imf.org/external/pubs/ft/survey/so/2012/car051412b.htm

methods could include using mobile communication devices, smart cards, and the existing network of bank branches.[160]

VIII. CONCLUDING OBSERVATIONS

Economists are practitioners of a dismal science but they are optimists at heart.[161] Arab countries in transition face strong headwinds but these also increase the likelihood that they might be readier to introduce and implement tough reforms. A sluggish global economy and weakened European economies are a drag on trade. Civil war in Syria and intra-regional tensions[162] are compounding uncertainties for investors in the MENA region. Despite progress in the political transition, finding common ground remains difficult for the political and religious factions contending uncompromisingly for political advantage. Despite progress in the political transition, finding common ground remains difficult for political and religious factions that are contending for political advantage. There is a grave risk that the cooler heads will be ignored and hotter ones will prevail, making the reforms proposed above, and others related to macroeconomic issues, well-nigh impossible to satisfactorily introduce.

Nevertheless, it is possible that Morocco, Tunisia, Egypt, and Jordan will maintain or arrive at political outcomes sufficiently workable that they can implement the complex and painful macroeconomic, institutional and sectoral policies that, to varying degrees, all need to implement. Whether Libya will evade the resource curse and begin the process of economic diversification is a longer shot, and for Yemen transitioning to a viable development path will require tough policy decisions and a dose of luck. When faced with adversity, countries are capable of surprising feats of resilience, and some countries in the MENA region may yet surprise us all with a short transition to a higher growth rate.

However, as these countries forge ahead, and their immediate problems are partially resolved, they will need to come to grips with others of a less tractable nature: climate change and associated desertification, water shortages, coastal inundation and intrusion of saline water; rising relative prices of minerals and grain (Egypt is the world's largest importer of wheat); and because of technological change, a shrinking of the relative share of manufacturing (in GDP and employment) putting the burden on services to create good jobs, innovation, and increases in productivity.

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[160] See World Bank (2013) https://publications.worldbank.org/index.php?main_page=product_info&products_id=24505

[161] As *The Economist* (2013, July 13th, p.11) observes, "The Arab Spring was always better describes as an awakening: the real revolution is not so much in the street as in the mind. Those who say that the Arab Spring has failed ignore the long winter before and its impact on people's lives."

[162] *Financial Times*, Cracking –Up, November 27th 2013.

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