




DEVELOPMENT CHALLENGES FOR THE ARAB REGION:

A HUMAN DEVELOPMENT APPROACH

Volume 1



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Regional Bureau for Arab States (RBAS)
One United Nations Plaza
New York, NY 10017
League of Arab States
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Cairo, Egypt

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The analysis and policy recommendations of this Report do not necessarily reflect the views of the League of Arab States or of the United Nations Development Programme, its Executive Board or its Member States. The Report is the work of an independent team of authors sponsored by the United Nations Development Programme Poverty Thematic Trust Fund, and the Technical Committee Ministerial Council of Arab Development and Social Affairs.

This work was originally published in English. In the case of any discrepancies, the original language shall govern.

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Foreword

On the 29th of March 2007, the Summit of the League of Arab States called for a Special Arab Summit to be exclusively devoted to the discussion of economic, developmental and social issues. The motivation for holding such a specialized Arab Summit is a widely shared consensus view that emphasis on developmental issues could substantially enhance Arab cooperation in a historical phase dominated by some politically divisive issues. Moreover, there is recognition among Arab policy makers that the region is passing through a critical era with threats not only to its national security, but also to its social and economic security.

This report, commissioned by the LAS Development and Social Affairs Ministerial Council, in preparation for the Arab Economic Summit, is the result of twelve months of collaboration between the LAS, UNDP, and a group of leading regional experts. The report is divided in two volumes; the first and more comprehensive volume addresses a wide range of social and economic development challenges from a human development perspective. The second volume focuses on the food security challenge per se. Each volume begins with a review of development-related stylized facts which set the stage for the identification of the challenges and hence policy directions.

As far as the development facts are concerned, the report confirms that there are many reasons for concern: low, volatile, poor progress on poverty reduction since the 1990s; high rates of extreme poverty in LDCs coupled with sharply deteriorating standards of living. Particularly in countries stricken by domestic conflicts; high and rising unemployment; high dependence on food imports; poor performance in industry and agriculture; and increasing water scarcity.

Stemming from these stylized facts, the report identifies six major development challenges. The challenges involved are: reforming education and institutions; creating over fifty million jobs at decent wages by 2020; sustaining and financing a pro-poor growth process; reforming the educational systems; diversifying the

sources of economic growth; and significantly raising agriculture production to address low food security (particularly in LDCs) and food sovereignty (region-wide) under increasingly limited and binding water resource constraints.

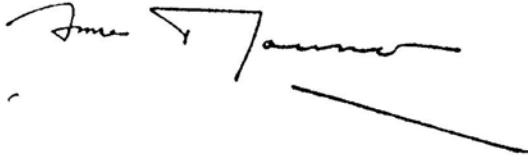
Although the authors refrain from detailed policy prescriptions, they provide several policy directions and insights. The main conclusion is that Arab countries need a new development model that is anchored mainly to poverty reduction and the MDGs. Another principal policy recommendation is for stronger policy action to address short-term needs of the LDCs, particularly the scale up of humanitarian assistance for them. In the absence of this, the authors argue that these countries could be faced with a generation of physically and mentally stunted individuals as a result of prolonged lack of access to sufficient nutrition. Moreover, as argued by the authors, the recent decline in commodity and fuel prices, while important for the short- and medium-term outlook, does not affect the seriousness of the long-term food security challenge nor does it change the fact that Arab governments have lacked the appropriate policies to address their food security and food sovereignty challenges with home-grown countermeasures and practical solutions. To this end, the report presents Arab decision makers with a menu of policy options on how to move beyond temporary band-aid solutions in order to address the long-term food security issues, which are also intricately tied to issues of agricultural development.

Despite the enormity of those challenges, the report is generally optimistic. The authors repeatedly make the case that the main goals of poverty reduction, economic diversification, employment generation, and increased food security and sovereignty are attainable. This region is already equipped with all it needs. We have the availability of arable land. We have the financial and material wealth. We have a large labor force hungry for decent employment. We have both historic and indigenous industrial and agricultural knowledge, and modern technologies can be easily deployed to overcome water scarcity problems and raise

manufacturing productivity. And we have much to lose if we do not transform our region's productive sectors, and their related policies, accordingly. However, as the authors note, the

attainment of these development goals hinges to a large extent on whether or not there will be a higher and more concerted level of regional cooperation.

Amre Moussa



Secretary General
of the League of Arab States

Amat Al Alim Alsoswa



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List of Acronyms

AHDR	Arab Human Development Report
AITHDEG	Arab Initiative on Trade Human Development and Economic Governance
ALO	Arab Labor Organization
AMDGR	Arab Millennium Development Goals Report
API	Arab Planning Institute
BDP	Bureau of Development policy
DE	Diversified Economies
DRDI	Domestic Resources Available for Development and Investment
ECA	Economic Commission for Africa
ERF	Economic Research Forum
ESCWA	Economic and Social Commission for Western Asia
EU	European Union
FAO	Food and Agriculture Organization
FTA	Free Trade Agreement
FHH	Female-Headed Households
GAFTA	General Arab Free Trade Agreement
GCC	Gulf Cooperation Council
GDP	Gross Domestic Product
GPI	Gender Parity Index
HDI	Human Development Index
HIES	Household Income and Expenditure Survey
HPI	Human Poverty Index
IAOS	International Association for Official Statistics
ICORS	Incremental Capital Output Ratios
IFIs	International Financial Institutions
IFPRI	International Food Policy Research Institute
ILO	International Labor Organization
IMF	International Monetary Fund
IPRs	Intellectual Property Rights
IRIN	Integrated Regional Information Network
KSA	Kingdom of Saudi Arabia
LAS	League of Arab States
LDC	Least Developed Country
MDGs	Millennium Development Goals
MENA	Middle East and North Africa
MERCOSUR	Mercado Común del Sur
MHH	Male-Headed Households
MIC	Middle Income Country
MOE	Mixed Oil Economies
MTID	Markets Trade and Institutions Division (of IFPRI)
NAFTA	North American Free Trade Agreement

NAMA	Non-Agriculture Market Access Association
NSO	National Statistics Office
ODA	Official Development Assistance
OE	Oil Economies
OECD	Organization for Economic Cooperation and Development
OLS	Ordinary Least Squares
OPT	Occupied Palestinian Territory
PCBS	Palestinian Central Bureau of Statistics
PCE	Private Consumption Expenditure
PEE	Primary Export Economies
PPP	Purchasing Power Parity
R&D	Research and Development
RBAS	Regional Bureau for Arab States
RCC	Regional Cairo Center
SSA	Sub-Saharan Africa
TIMSS	Trends in International Mathematics and Science Study
UAE	United Arab Emirates
UNAMI	United Nations Assistance Mission for Iraq
UNCTAD	United Nations Commission for Trade and Development
UNDP	United Nations Development Program
USCBO	US Congressional Budget Office
WDI	World Development Indicators
WTO	World Trade Organization

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1 ■ Introduction

On the 29th of March 2007, the Summit of the League of Arab States called for a Special Arab Summit to be exclusively devoted to the discussion of economic, developmental, and social issues. Though stated very briefly, the motivation for holding such a specialized Arab Summit included a deeply felt concern that perhaps an emphasis on developmental issues could substantially enhance Arab collaboration and cooperation which have been dominated by politically divisive issues in the past.

We note at the outset that in the last two decades, a major reorientation of the development debate has taken place. We interpret the outcome of this debate and ensuing initiatives as signifying a return to the application of the basic ideas of the human development and Keynesian schools and, as such, a retraction from the growth-focused agenda of neoclassical economists which reigned over mainstream development thought and practice in most developing countries during the earlier decade of the 1980s.⁽¹⁾ Significant among these initiatives is the UN Millennium Declaration embodying the UN Millennium Development Goals (MDGs) adopted in September 2000. By adopting the MDGs the world community reasserted the centrality of human development and poverty reduction as the overarching objective of development policy in the developing world.

It can easily be argued that the adoption of the MDGs also reflects an emerging consensus that “development can be seen as a process of expanding the real freedoms that people enjoy” (Sen, 1999: 3). The philosophical foundations of this freedom approach to development require judging the welfare of individuals not in terms of the utility of goods and services, or in terms of primary goods, but in terms of “substantive capabilities to choose a life one has reason to value”. Capability is thus the substantive freedom to achieve various lifestyles.

The freedom approach to development offers a broader understanding of what is meant by development compared to other approaches that identify development with increases in per capita

income, industrialization, technological advance, or social modernization. The richness of this broader approach to development is best captured in terms of five instrumental freedoms that have immediate policy relevance: *political freedoms*, including “the political entitlements associated with democracies in the broadest sense”; *economic facilities*, in the sense of the “opportunities that individuals respectively enjoy to utilize economic resources for the purpose of consumption, or production, or exchange”; *social opportunities* in the sense of “the arrangements that society makes for education, healthcare and so on”; *transparency guarantees* in the sense of “the freedom to deal with one another under guarantees of disclosure and lucidity”; and, *protective security* in the sense of the provision of a “social safety net for preventing the (vulnerable sections of society) from being reduced to abject misery, and in some cases even starvation and death”. These “instrumental freedoms tend to the general capability of a person to live more freely, but they also serve to complement one another” (Sen, 1999: 38).

Development achievement on the basis of this broader approach is now being measured, and regularly reported, by the now famous Human Development Index (HDI), and the Human Poverty Index (HPI) developed by the UNDP. Capabilities included in these two measures are: the ability to live longer; the ability to read and write and to have access to available information; and, the ability to have a decent standard of living.

Arab human development, as analyzed through the lens of Sen’s *Development as Freedom* intellectual paradigm, has received much attention, particularly since the publication of the Arab Human Development Report in 2002. However, while the AHDR excels in describing three major developmental deficits in Arab countries; political freedom, women’s empowerment, and knowledge, it pays little attention to the impact of macroeconomic (and particularly fiscal) policies on these deficits. Furthermore, it merely scratches the surface of other major developmental deficits: food security, distribution of income and social exclusion, a fragile and oil-led pattern of economic growth, high and rising unemployment, dismal trade and industrial performance, high income

(1) For a recent survey of the state of development economics thought see a number of contributions in Meier and Stiglitz (2001).

poverty in LDCs and within some regions of the MICs (particularly rural regions) and very poor progress towards the achievement of MDG1. This report attempts to fill those important gaps by integrating into the traditional UNDP human development approach more economic analyses to address these issues.

In addition to the AHDR, development achievements of the Arab countries have recently been addressed in a series of inter-related reports by the World Bank (2004-a-d) and the World Bank (2007)⁽²⁾. The issue is addressed by the former in the context of the *social contract* that was ruling in the region during the period 1940-1970. The fundamental feature of the Arab social contract, according to the World Bank, is that it was interventionist and redistributive in nature. Accordingly, the major features of the Arab social contracts are succinctly summarized in the World Bank (2004) as follows:

- a preference for redistribution and equity in economic and social policy;
- a preference for states over markets in managing national economies; the adoption of import-substitution industrialization and the protection of local markets from global competition;
- reliance on state planning in determining economic priorities;
- an encompassing vision of the role of the state in the provision of welfare and social services; and
- a vision of the political arena as an expression of the organic unity of the nation rather than as a site of political contest or the aggregation of conflicting preferences.

It is admitted, rather grudgingly, that the social contracts in the Arab countries, despite various problems and setbacks, delivered “unprecedented levels of economic growth and social development. Between 1965 and 1985 MENA’s economic growth rates were among the highest in the world, averaging 3.7 percent per capita a year. The social contract also meant low levels of poverty and income inequality. The social payoffs from these policies have been enormous, with dramatic reductions in mortality and increases in life expectancy, school enrollment rates, and literacy levels” (World Bank (2004-a: 2)⁽³⁾.

(2) As a sub-region of the Middle East and North Africa (MENA) region.

(3) For the growth record of Arab countries over the period 1960-2000, see Elbadawi (2005: 296, Table1), and Makdissi et al (2003). For information on mortality rates, life expectancy, school enrollment, and literacy levels see the various issues of the Human Development Reports of the UNDP.

Significantly, the World Bank (2004-a: 2-3) goes on to observe a trade-off between the developmental achievements of these contracts and political freedoms. It is noted that large segments of the population benefited from the redistributive mechanisms of the social contract: “from 1960 through the 1980s, these social groups emerged as prominent winners in the political economies created by the interventionist-redistributive social contract. The welfare gains also helped to cement an “authoritarian bargain”, with citizens trading restrictions on political participation in exchange for economic security and the public provision of social services, welfare, and other benefits” (World Bank (2004-a: 3).

In a rather rare admission, the World Bank (2004-a: 3) notes that the inability to continue with the redistributive policies in the Arab countries was primarily caused by outside events: “declining oil prices, shrinking demand for migrant labor, and reduced remittance flows” In response to the economic crisis, governments in the Arab countries, like most governments in less developed countries, opted for the adoption of adjustment policies largely on the advice of the World Bank and the IMF: “across the region governments cut subsidies, reduced public expenditure, and reformed exchange rate regimes (...) [adopted economic reforms] also included: privatization of state-owned enterprises, fiscal reform and trade liberalization, deregulation, and strengthening the institutional foundations for a market-led economy”.

The above package of economic reform policies is, of course, what is known as the Washington Consensus; it is also known in political science parlance as the neo-liberal orthodoxy. From the perspective of those who believe in this orthodoxy, all that developing countries need to do to enhance economic growth, and hence reduce poverty, is to get their policies right in the sense of adopting the above noted measures. Accumulating evidence over the two decades of the 1980s and 1990s, however, shows that a large number of countries that adopted the Washington Consensus policies did not see growth. On the contrary, the most sustained result of such policies was a noticeable negative impact on the social dimension: education, health, nutrition, employment, and distribution of income.

Appreciating such results from a broad development perspective calls for a revisiting of the development strategies in almost all developing countries,

with the Arab countries being no exception. Such a process requires looking at the stylized facts that describe pattern and trends in economic and human development in various countries in order to answer, *inter alia*, the following questions:

1. What are the main features of Arab economic growth over the past three decades and the main factors influencing it? Are poor institutions and weak governance structures the main impediments to Arab economic growth? Has investment in education and human capital significantly influenced Arab growth?
2. What has happened to unemployment, MDGs (and particularly poverty) in Arab countries over the past two decades, and what is the order of magnitude of growth and investment resources required to address them? Is there enough domestic and regional fiscal space to support the development expenditure required to meet these challenges?
3. How has income and wealth inequality changed in Arab countries in the aftermath of economic liberalization? Are interventionist macroeconomic policies a good vehicle to the re-distribution of income to the poor?
4. Have external trade and financial liberalization policies reliably produced higher economic growth, greater poverty reduction, and more human development in Arab States? Is industrial development on the East Asia model the panacea for economic

diversification, employment, growth, and human development? Can it be achieved under present conditions and policy constraints?

5. If the attainment of a high and sustainable level of economic and human development is taken as an end goal, how should current macroeconomic and sectoral policy stances of Arab countries be reconfigured? What is the ideal mix for the role of the state versus the private sector in promoting Arab economic and human development?

With these questions in mind, the report is structured as follows: Section 2 reviews conceptual and methodological preliminaries in order to discuss further some pre-analytical stances and establish a common understanding on measuring development achievements in the Arab region. Section 3 identifies a number of salient features of the Arab development over the past three decades with emphasis on its diversity in terms of population, income levels, and human and economic development indicators. The idea is to pave the way for identifying the development challenges facing the region, which are discussed in section 4. In section 5 we offer policy recommendations corresponding to the identified challenges. Section 6 ends this report with a number of concluding remarks which could be taken as reflecting on the possible way ahead.

2 ■ Conceptual and Methodological Preliminaries

To be consistent with the broader definition of development as a process of expanding the real freedoms that people enjoy, the measurement of development achievements by the Human Development Index (HDI) and the Human Poverty Index (HPI), and taking into account the already agreed upon indicators of progress towards achieving the MDGs, we note in what follows a few conceptual and methodological preliminaries that should help appreciate the identified stylized facts in the next section.

As noted in the introduction, this report critically examines development facts and challenges in Arab countries with the aim of offering remedial medium and long-term policy perspectives, including on macroeconomic policies. It targets, primarily, an audience of policy makers. Conceptually, the emphasis is on human development rather than growth and distributional issues are assumed to play a major role.

We also acknowledge that, conceptually, the relationship between institutions, economic policies and human development is rather complex and thinking about it involves several levels of abstraction: empirical; historical; theoretical; political; and ideological. The focus here is on the empirical level per se but with minor excursions to the political and historical levels at times.

The emphasis on distribution and equity implies that the report generally adopts a 'heterodox' stance. Indeed, we believe that there is much potential for the Capability approach and the heterodox economic approach to fruitfully complement each other as they share a common fundamental feature: their elaboration of a conception of a human agent embedded in a social structure, going beyond the atomistic account of human agency that pervades mainstream and neoclassical economics. However, while the heterodox traditions have been mainly concerned with socio-economic theories, the Capability approach focused on analyzing poverty, well-being, and advantage. But the Capability approach lacks a more substantive account of socio-economic mechanisms through which well-being and advantage can be fostered, in the same way that the heterodox approach could be fruitfully informed by the capability perspective on

well-being and advantage. Hence, our major pre-analytical stance is that there is much scope for complementary integration between the Capability approach and heterodox economics. They are merely pitched at different levels of abstraction.

Within the Heterodox school, one approach to address the complex set of issues that arise from the question is presented by Structuralist economists. Although, they do not give a general or definitive answer to this question (and in any case it would be quite impossible to do so), what makes their analytical framework more interesting and relevant to Arab countries is that it is derived from the premise that economic structures and initial conditions in developing countries differ radically from those which prevail in developed economies. It follows that the process of economic development in the former is quite different from that in the latter. It also follows that a policy stance which advocates a unified set of policies is bound to be over simplistic and quite dangerous. In this respect, the orientation of our economic analysis is Structuralist in the sense that arguments for a causal relation between say openness (liberalization) and economic growth or between growth and poverty reduction are believed to be meaningless outside a country's historical and institutional context, especially its dynamics of growth, distribution and structural change. This pre analytical vision we owe to Lance Taylor, a prominent architect of Structuralist macroeconomic thought.

Two policy-related stances derived from the Structuralist framework are particularly relevant to the analyses and policy recommendations contained within this report. First, an economy's institutions and distributional relationships across its productive sectors and social groups play essential roles in determining macro behavior (Taylor, 2004). Thus, changes in income inequality may have a strong impact on growth and poverty reduction. Second, under the conditions of generalized or mass poverty (as in the case of Arab LDCs) and high and rising unemployment (as in the case of most other Arab countries), social safety nets, employment oriented social funds for development and other redistributive social welfare schemes are not sufficient. Under such conditions, more intrusive

state-led macroeconomic management is required to enlarge public investment and create a wider fiscal space for development expenditure which is crucial for accelerated job creation and poverty reduction.

Those stances are also consistent with what we know from early reform experiences. Taylor (1988) summarizes the empirical findings of stabilization episodes in 18 countries. One main conclusion that emerges is that stabilization programs, which are designed to concentrate on reducing the fiscal deficit, often set off a contractionary multiplier output response (instead of slowing price increases as they are often meant to do).⁽⁴⁾ More recently, Neo-liberal reform programmes and proposals have increasingly been subjected to close scrutiny.⁽⁵⁾ A large body of literature analyses their results on the ground. The effects of trade liberalization on growth and welfare have received preferred attention in this regard. Analysis of the links between trade and growth, has not produced clear cut conclusions (e.g. Rodrik and Rodriguez, 2000; Abu-Ismael, 2005; Oxfam 2002; Hallack and Levinshon, 2008) and it would be fair to conclude that the early statements by Taylor (1994), Taylor and Ocampo (1998) and McCulloch, Winters & Cirera (2001) that liberalized trade alone has not yet been unambiguously and universally linked to subsequent economic growth, still holds valid today. Moreover, the link between economic growth and poverty reduction is at its best very tenuous (Vos, 2007 for a review of empirical studies). It is increasingly recognized that there is no automatic and predetermined relationship between economic growth and employment, which is the principal link through which growth is transmitted to the poor, and that not all growth is employment intensive (UNDP & ILO 2007, Kakwani, Prakash & Son 2000). Also, the analysis of trade liberalization and productivity growth in developing countries has shown mixed results (Das, 2002). The fact is that we know that trade liberalization might be good for growth, but we are not quite clear on who wins and losses, or on how free trade affects poverty (Cockburn 2004).

The experience of the Latin American countries is particularly relevant for Arab countries. As the best students seem to have gotten the worst grades,

(4) For an elaborate representation see Lance Taylor's (1988), *Variety of Stabilization Experiences: Toward Sensible Macroeconomics in The Third World*, Oxford University Press.

(5) Among many others for a recent suggestive contribution refer to Kosul-Wright and Rayment (2007). It has to be recognized also that the World Bank (2005) has re-assessed with a critical view the outcomes of the reforms it proposed and pushed for during more than a decade. A mea culpa can also be found in Kuczynski and Williamson (2003).

Latin American economies have been particularly instrumental in exposing the weakness of the neo-liberal prescriptions and in promoting the search for alternative policy options. Latin America has ridden the wave of macroeconomic discipline, economic reforms and trade liberalization of the Washington Consensus for the last 20 years. With the minimization of government intervention under neo-liberalism, Latin American countries abolished many of their prior industrial policies, ranging from the drastic decline in tariff protection, to the elimination of subsidies, to a shrinking range of action of development banks, if those persisted at all.⁽⁶⁾ After all these years of neo-liberal reforms, most South American economies have returned to a comparative advantage based on primary products in agriculture and mining, while the exports of most Central American countries have come to be dominated by assembled labor-intensive products (e.g. Reinhardt and Wilson 2000). Even Chile, upheld in many contexts as Latin America's development success story, has not succeeded in creating a technologically more advanced structure of production during the 1990s (Albala-Bertrand 2006).

Several other influential studies have shown that liberalization or '*good economic policies*', as defined by the World Bank and the IMF, have no statistically significant benefits for poverty reduction.⁽⁷⁾ Indeed, in recent years, many more people have been questioning the positive association between liberal economic policies and growth.⁽⁸⁾ For developing countries, Easterly (2003) established that the proposition is based on the assumption that countries are starting with extremely bad policies – implying that countries starting from moderate

(6) While some industrial policies persisted, e.g. the support of the automobile industry in the MERCOSUR, it was only in the second half of the 1990s that targeted policies re-emerged in some countries. Nearly all of them have been in the form of fiscal incentives and loans to sectors other than manufacturing (Peres, 2006).

(7) See, for example, P-R. Agenor (1998), "Stabilization Policies, Poverty and the Labor Market", IMF, Washington D.C.; Ali, A.A.G., (2002), "Macroeconomic Policies and Poverty Reduction", AERC, Nairobi; Demery, L., and L. Squire, (1996), "Macroeconomic Adjustment and Poverty in Africa: An Emerging Picture", World Bank Research Observer, Vol. 11, No. 1; and Christiaensen, L., Demery, L., and S. Paternostro, (2003), "Macro and Micro Perspectives of Growth and Poverty in Africa", World Bank Economic Review, Vol. 7, No. 3; and Dollar, D., and A. Kraay, (Growth is Good for the Poor, Journal of Economic Growth, Vol. 7, No. 1).

(8) Acemoglu, D., Johnson, S., Robinson, J., and Y. Thaicharoen, (2003), "Institutional Causes, Macroeconomic Symptoms: Volatility, Crises and Growth", Journal of Monetary Economics, Vol. 50, No. 1; Easterly, W., and R. Levine, (2003), "Tropics, Germs and Crops: How Endowments Influence Economic Development", Journal of Monetary Economics, Vol. 50, No. 1; Rodrik, D., Subramanian, A., and F. Trebbi, (2004), "Institutions Rule: The Primacy of Institutions over Geography and Integration in Economic Development", Journal of Economic Growth, Vol. 9, No. 2.

values for the policy indicators are not likely to see any improvements.⁽⁹⁾ Moreover, Ali (2004), using the Easterly specification among others, shows for a sample of 8 reforming Arab countries over the period 1960-2000 that conventional policy variables either had no effect on the growth rate of real per capita GDP or that they actually reduced growth. The situation is different however, for the 'investment rate', defined as the ratio of investment to GDP. A number of researchers have found this to be a statistically significant determinant of the growth rate.⁽¹⁰⁾ Accordingly, if Arab governments want to use growth as a channel for poverty reduction they would do better to focus on investment, including public investment. Recent UNDP-led reports on macroeconomics and poverty in a number of developing countries, including, from the Arab region, Syria, Yemen, and Sudan also reached the same conclusion.

The fact that public investment - and especially public infrastructure investment spending - has been declining (as a share of GDP) in the developing world over the past two decades, and during the 80s in particular, has been well documented. The phenomenon has affected certain countries or regions and specific sectors more than others, but a general trend is clearly observable, with pronounced declines in public investment spending occurring during the 1980s in particular (Roy, Heuty and Letouze, 2007).

These declines are particularly pronounced in low-income countries which embark on the development process with a historically low stock of public and infrastructure assets. As Roy, Heuty and Letouze point out, Latin America has been the region most affected by declining public investment. However, similar trends are observable in East Asia, the Middle East and West Africa, and Sub-Saharan Africa (SSA). Many Structural Adjustment Programs of the 80s and 90s were also underpinned by the presumption that the private sector would compensate for the drop in public investment spending in key areas such as infrastructure provisioning. However,

recent research shows that the private sector did not compensate for the drop in public investment as it was hoped (IMF, 2004).

In the trade arena, since the early 1990s, Arab countries have significantly opened their economies to trade, investment, and capital flows. In the realm of trade policy, tariffs have been significantly reduced and most non-tariff barriers eliminated or significantly reduced (Table A.5). Moreover, effective tariff rates are, on average, 25 to 50 percent less than applied rates due to preferential treatments embodied in domestic policies and/or bilateral and multilateral Free Trade Agreements. Not surprisingly, indicators such as trade to GDP ratios and shares of duties and other taxes on imports to total tax revenues are either comparable to other developing regions, including Asian countries, or significantly less.

However, those reforms did not reflect positively on trade performance. The region's overall share in world trade remains insignificant (6.0 and 3.2 percent in 2006 for exports and imports, respectively). Moreover, trade in the Arab region is still typically characterized by highly concentrated exports and relatively diversified imports. Exports are dominated by primary products and low value-added goods, mainly fuels, which have low returns to domestic factors of production, particularly labor, and relatively low contribution to employment generation.

These stories suggest that the dynamic effects expected from trade liberalization do not necessarily materialize in all developing countries at all times. This should not be surprising as latecomers in the development process, with rare exceptions, have caught up with some form of protectionist measures and active government intervention. This issue is stressed on the literature pointing out to the flaws of neo-liberal prescriptions (e.g. Chang 2005, Rodrik 2004, and Amsden 2001). The implication is that without macroeconomic policies that create (or restore) the fiscal space required to enlarge development expenditure, many developing countries, including Arab, will simply not be able to attain human development goals such as the MDGs. This begs the question of which economic policies are more suitable for an expanded fiscal space for human development. As noted in the introduction, this is one of the central questions we aim to address in this report (though not necessarily provide a detailed answer for, as this would be a futile endeavor given the high level of diversity among Arab countries).

(9) Easterly, W., (2003), National Policies and Economic Growth: A Reappraisal", Working Paper No. 27, Center for Global Development, www.cgdev.org. The range for moderate values used by Easterly are as follows: inflation rate and black market premium in the closed interval [-.05, 0.35]; budget deficit as a ratio of GDP [-0.12, 0.02]; overvaluation index [-0.4, 0.65] with index above zero indicating overvaluation; and trade (exports plus imports) as a ratio of GDP less than 1.2.

(10) For such results see, among others, Ali, A.A.G., (2004), "Do Macroeconomic Policies Affect the Growth Rates of Developing Countries?"; Experts Group Meetings' Series, No. 10, Arab Planning Institute, Kuwait (in Arabic).

Against these important pre-analytical conceptual stances, we turn our attention to the more mundane methodological preliminaries. Starting from the premise of poverty reduction as the overarching objective of development in developing countries, it seems reasonable to note that the two fundamental determinants of consumption poverty are the mean per capita consumption expenditure in a society (where consumption expenditure proxies the standard of living in developing countries), the poverty line (i.e. the level of consumption expenditure per capita below which an individual is deemed poor), and the distribution of consumption expenditure in society (as represented by the famous Lorenz Curve or any of its summary measures such as the famous Gini coefficient).

Under the above money-metric approach to the measurement of poverty, the poverty line is usually composed of two components: a food component, and a non-food component. The sum of the two gives rise to the overall poverty line. The food component is usually calculated on the basis of WHO-FAO recommended dietary requirements of calories and protein intake for a normal functioning in a given environment. Given such a methodology, it can easily be argued that the poverty line represents, in a real sense, the cost of survival in a given society. The poverty line in real terms can be held constant over time and across countries as has been the practice in the specialized literature dealing with poverty comparisons at the world level (e.g. the famous one and two dollars a day per person poverty line). A more sensible approach, which is gaining a lot of acceptance, is to allow poverty line to be related to the standard of living for the various countries.⁽¹¹⁾

Given a poverty line, mean consumption expenditure and information on the distribution of consumption expenditure, poverty can be measured using various indexes. Without getting involved in technical details we note that the most famous money-metric measures of poverty are the head-count ratio (which is the ratio of those with consumption expenditure below the poverty line to total population), and the poverty-gap ratio (which measures the relative distance of the consumption expenditure of the poor from the poverty line). The head-count ratio measures the spread, or incidence, of poverty,

while the poverty-gap ratio measures the depth of poverty. These two measures, and indeed all relevant poverty measures, are expected on a priori grounds to decline (increase) as per capita consumption expenditure (poverty line) increases (decreases), holding the distribution constant; and to increase as the degree of inequality increases, holding the mean consumption expenditure and the poverty line constant. These are the partial responses of the poverty measures to their fundamental determinants.

Given the above, and without loss in generality, we hasten to note that the first MDG is expressed as reducing the spread, or incidence, of poverty by half by the year 2015 starting from the 1990 level of incidence. To monitor progress in achieving this goal requires looking at the determinants of the change in poverty over time. Once again without getting involved in technical details it can be shown that such a change will have two components: an economic growth component (which is a multiplicative term of the partial response of the head-count ratio with respect to consumption expenditure and the per capita growth rate of real consumption expenditure); and a distribution component (which is a multiplicative term of the partial response of the head-count ratio to the Gini coefficient and the rate of change of the Gini coefficient). From this MDG perspective, therefore, the relevant stylized facts that need to be identified for the Arab countries should include (a) the spread of money-metric poverty, inclusive of the partial sensitivity of the head-count measure with respect to the fundamental determinants; (b) the salient features of the growth process; (c) the nutritional standards underlying the poverty line (inclusive of issues of food security); and (d) the degree of inequality in the distribution of consumption expenditure.

As noted in the introduction, the remaining MDGs can easily be interpreted in terms of human poverty as measured by the Human Poverty Index (HPI) of the UNDP. It is worth recalling that the HPI is an attempt to operationalize the broad definition of development which in its turn is based on the capability approach to welfare. Under the capability approach "poverty means that opportunities and choices most basic to human development are denied". Thus HPI concentrates on deprivation in three essential elements of human life already reflected in the HDI: longevity, knowledge, and decent living. Three indices are chosen to represent human poverty in a composite index: (i) an index of deprivation

(11) For the vast literature on the calculation of the poverty line see, for example, M. Ravallion, S. Chen and P. Sangraula, (2008), "Dollar a Day Revisited"; WPS4620, www.worldbank.org, and the references cited therein.

relating to survival meaning the vulnerability to death at a relatively early age; and is measured by the percentage of people expected to die before age 40; (ii) an index of deprivation with respect to knowledge meaning exclusion from the world of reading and communication; and is measured by the percentage of adults who are illiterate; and (iii) an index of deprivation from a decent standard of living (overall economic provisioning) which is composed of two sub-indicators for measurement purposes: This is measured by a composite of two variables: the percentage of people without sustainable access to a safe water source (with weight 0.5) and the percentage of children who are underweight for age (with a weight of 0.5). The three indices of deprivation (i.e. (i) – (iii)) are combined into a composite index allowing for possible substitution between them.

Given the above method of constructing the HPI measure it is perhaps not surprising to note that an increase in any of the three component indexes will be expected to increase the HPI. We hasten to note that the method used for constructing the HPI does not preclude extending the measure to include deprivation from enjoying a status of gainful employment. Such an additional dimension can be represented by the unemployment rate. Thus, from a development policy perspective use can be made of the HPI for the purposes of identifying the stylized facts. A more detailed accounting for the stylized facts, however, should appropriately take into account the details with respect to the component indicators and sub-indicators.

Having noted the above, it is important to observe that though the MDGs did not include a specific goal regarding institutions, in general, or governance institutions, in particular, nonetheless the monitoring indicators used under the third MDG refer to such institutions albeit from the perspective of women empowerment in the sense of expanding the freedoms that women enjoy in society. More fundamentally, and as noted in the introduction, it needs to be recalled that one of the instrumental freedoms identified to have direct policy relevance in the context of the process of development is that of political freedoms. Other instrumental freedoms embody a substantial institutional content, and institutions are now acknowledged to be one of the most important determinants of long-term economic growth of nations. From a technical point of view the most widely used definition of institutions is that they are the rules of the game that govern the interactions, and transactions, in a society.

Recent research proposed a method for constructing aggregate institutional and governance indicators that incorporate more directly relevant measures of institutional quality (see, for example, Kaufmann et al. (2007)). The method is based on a compilation of a large data set from 30 specialized agencies that monitor various aspects of institutions of governance covering up to 212 countries and territories all over the world. Defining governance as “the traditions and institutions by which authority in a country is exercised”, the major aspects of governance are identified to include: (a) the process by which governments are selected, monitored, and replaced; (b) the capacity of the government to effectively formulate and implement sound policies; and (c) the respect of citizens, and the state, for the institutions that govern economic and social interaction.

The chosen indicators are organized in six clusters: two clusters under each of the three major aspects of governance noted above. The governance process has two clusters called “voice and accountability” and “political instability and violence”; the capacity of the government has two clusters called “government effectiveness” and “regulatory burden”; and the respect for the rule of law has two clusters called “rule of law” and “graft” (i.e. corruption).

The data from the various sources was reprocessed so that higher values correspond to better outcomes (e.g. stronger rule of law and less corruption). Moreover, each indicator is rescaled by subtracting the minimum possible and dividing by the difference between the maximum and minimum score so that each indicator is on a scale from zero to one⁽¹²⁾. Using an econometric model to organize the data from the various sources, and with an appropriate choice of measurement units, a standardization procedure is followed such that the estimate of the distribution of each governance indicator has a mean of zero and a standard deviation of one and the value of the governance indicator would range from about -2.5 to about 2.5, where higher values correspond to better outcomes. Thus, from a development perspective, use can be made of a composite institutional, or governance, indicator to assess the development achievements of Arab countries. We hasten to note in this respect

(12) This has become a common method to standardize indicators. Thus, if we denote an indicator by I and its normalized value by I^* then the normalized value is given by the following: $I^* = [I - I_{min}] / [I_{max} - I_{min}]$.

that such indicator has already been used in the pioneering UNDP (2002), Arab Human Development Report: Creating Opportunities for the Future Generations; New York.

For a systematic analysis of development achievement in the region there appeared a number of ways of classifying the countries of the region in a number of fairly similar categories using different classification devices.⁽¹³⁾ In this report, following ERF (1998), we group the countries of the region into four broad categories: Mixed Oil Economies (MOE: Algeria and Libya); Oil Economies (OE), which include the countries of the Gulf Cooperation Council of Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and UAE; Diversified

Economies (DE: Egypt, Jordan, Lebanon, Morocco, Syria, and Tunisia); and Primary Export Economies (PEE: Comoros, Djibouti, Mauritania, Sudan, and Yemen).

Finally, the reader should be alerted up front that this report will not be dealing extensively with special case or conflict countries, particularly Palestine, Somalia, and Iraq. This is not to underestimate the impact of conflict on human development and MDGs. To the contrary, we believe the issue is too important to be handled superficially in a region where five countries (Iraq, Palestine, Lebanon, Somalia, and Sudan) are still burdened by armed conflict and internal civil tensions. It therefore warrants special attention beyond the scope of this report.

(13) For example, one common classification used by the World Bank distinguishes between Arab countries according to their endowment of natural and human resources as follows: resource rich, labor importing countries (Bahrain, Kuwait, Libya, Oman, Qatar, Saudi Arabia, and UAE); resource rich, labor abundant countries (Algeria, Sudan, Syria, and Yemen); and, resource poor, labor abundant countries (Djibouti, Egypt, Jordan, Lebanon, Morocco, and Tunisia). It is also common in UN and World Bank reports to divide Arab countries based on income per capita. The high income group comprises of Bahrain, Kuwait, Qatar, Saudi Arabia, Oman, and UAE; the middle income group includes Lebanon, Libya, Algeria, Egypt, Iraq, OPT, Jordan, Morocco, Syria, and Tunisia; and a low income group which includes Yemen, Comoros, Mauritania, Somalia, Djibouti, and Sudan. A third classification adopted by the Arab MDG Report (ESCWA, 2006 and 2007) is a mainly geographic one which groups the countries into one of four sub-regional classifications: GCC (Saudi Arabia, Bahrain, Kuwait, Qatar, Oman, and UAE); Mashreq (Egypt, Jordan, Iraq, Syria, Lebanon, and OPT); Maghreb (Morocco, Algeria, Tunisia, and Libya) and LDCs (Sudan, Yemen, Djibouti, Somalia, Comoros, and Mauritania). However, as there are five Arab countries that are either in conflict or suffer high political instability (Lebanon, OPT, Somalia, Sudan, Iraq, and Yemen) it is not uncommon to witness this additional sub-regional category of conflict countries featured in UN regional publications.

3 ■ Development ‘Stylized Facts’

Any sensible discussion of development challenges in the Arab region should begin with an objective assessment of the basic facts. In social sciences, this is tantamount to establishing the so called “stylized facts”. A stylized fact is a simplified presentation of an empirical finding. While results in statistics can only be shown to be highly probable, in a stylized fact, they are presented as true. They are a means to represent complicated statistical findings in an easy way. A stylized fact is thus a broad generalization, which although essentially true may have inaccuracies in the detail. The stylized facts presented below on social and economic development and inequality in the Arab Region are therefore observations that should be widely understood as empirical truths, to which theories must fit and towards which policies should be responsive.

In what follows we present stylized facts on economic structures, human development and MDGs, institutions, economic growth, poverty (both income and human), income inequality, education, and trade and industry.

3.1. Diverse Economic Structures, Human and Natural Resource Endowments and Mixed Performance on Human Development and MDGs

The diversity among Arab countries and sub-regions in terms of economic structures and human and natural resource endowments noted earlier is evident from the data in Table 1, which shows the projected 2008 distribution of population and GDP (adjusted for PPP). The table shows that DE accounted for 51% of population and about 34% of GDP; MOE accounted for 13% of population and 14% of GDP; PEE accounted for 22% of population and only 6.3% of GDP; while OE accounted for only 13% of population and about 45.9% of GDP. Intra-Arab diversity is also captured by differences in per capita GDP. Not surprisingly, OE ranks top on this scale with a per capita GDP of about US\$27.7 thousand, followed by MOE (US\$8.3). DE ranks third with a per capita GDP of US\$5.3 thousand while PEE’s per capita GDP amounted to only US\$2.2 thousand.

Table 1: Population and GDP per capita in Arab Countries (2008, projections)*

Country Group	Total Population (million)	Population Share (%)	GDP (PPP US\$ billion)	GDP Share (%)	Per Capita GDP (PPP US\$)
DE (6)	156.4	51.5	833.3	34.2	5328.0
MOE (2)	39.9	13.1	331.7	13.6	8313.3
OE (6)	40.2	13.2	1117	45.9	27786.1
PEE (4)	67.1	22.1	152.8	6.3	2277.2
Total	303.6	100	2434.8	100	8019.8

Source: IMF (2008) and CIA World Factbook .

* For country level data see Annex Table A.9.

Within each group, per capita Private Consumption Expenditure (PCE) also varies.⁽¹⁴⁾ Thus, for example, in 2005, for OE the highest PCE per capita is recorded for United Arab Emirates (US\$43 per person per day) while the lowest is recorded for Saudi Arabia (US\$9.9 per person per day). In the MOE the highest PCE is recorded for Libya (US\$6 per person per day), while the lowest is recorded for Algeria (US\$2.9 per person per day). The DE group also records a wide

variation with five countries having an average PCE that varies between a high of US\$13 per person per day for Lebanon and a low of US\$2.5 per person per day for Egypt. In the PEE group of countries private consumption expenditure per person per day varies from a high of US\$2.1 for Djibouti to a low of US\$1.1 for Mauritania. Using the above information on PCE per capita, the indicative international poverty lines of one and two dollars per person per day, and pending further information on the distribution of PCE in the various countries, it is reasonable to expect that

(14) League of Arab States et al (2007: annex tables 2.5, p. 237; and 2.7, p. 239).

poverty, appropriately defined, should be expected to pose a development problem in all of the Arab countries of the DE group, the PEE group, and possibly Algeria in the MOE group (Table A.1).

In addition to the above conventional economic performance indicators, the broad definition of development as the expansion of the freedom that people enjoy requires looking at development achievements in terms of the Human Development Index (HDI). The latest available information on this indicator is available for 2005 in UNDP

(2007: 229-232, Table 1). It will be recalled that the HDI is composed of three sub-indexes: life expectancy at birth (health proxy), adult literacy rates and combined enrolment ratio (knowledge proxy), and GDP per capita (standard of living proxy). The HDI for 2005 was calculated for 177 countries and regions. The best performing country was Iceland with an HDI of 0.969; while the worst performing country was Sierra Leone, with an HDI of 0.336. Given these benchmarks, the most recent human development performance of the Arab countries is given in Table 2.

Table 2: Human Development Performance in Arab Countries in 2005*

Country Group	Total Population (million)	Population Share (%)	Life Expectancy at Birth (years)	Adult Literacy Rate	Combined Gross Enrolment Ratio (%)	GDP per Capita (PPP US\$)	Human Development Index (HDI)
DE (6)	140.2	51.1	71.1	69.2	71.3	4672	0.70
MOE (2)	39.2	14.3	72.0	72.2	77.0	7588	0.74
OE (6)	34.1	12.4	73.7	84.6	73.5	18212	0.82
PEE (4)	60.9	22.2	59.1	58.0	43.9	1682	0.52
Total (18)	274.4	100.0	68.9	69.1	66.3	6104	0.68

Source: Human Development Report (2007).

*For country level data see Annex Table A.10

The table clearly shows that seven Arab countries, comprising the six GCC countries in addition to Libya, achieved high human development status in 2005 with a value for the HDI of 0.8 or more. These seven countries account for about 15% of the population; the remaining eleven countries all achieved medium human development status (i.e. an HDI of 0.5 but less than 0.8). Thus, in 2005 none of the Arab countries were included in the low human development category. Compared to the human development performance around the world, where about 8% of the population lives in countries with low human development status, this is indeed a credible performance. We hasten to note, however, that the average HDI for the Arab countries is lower than that for the world: simple average for high human development is 0.847 for the Arab countries versus 0.897; and simple average for the medium human development is 0.649 for the Arab countries versus 0.698.

Without getting involved in details it is perhaps important to note that until recently only four Arab countries were included in the high human development category (Kuwait, Bahrain, Qatar, and UAE; i.e. only 20% of the GCC population and about 2.5% of the Arab population). The four Arab countries of PEE group were included in the

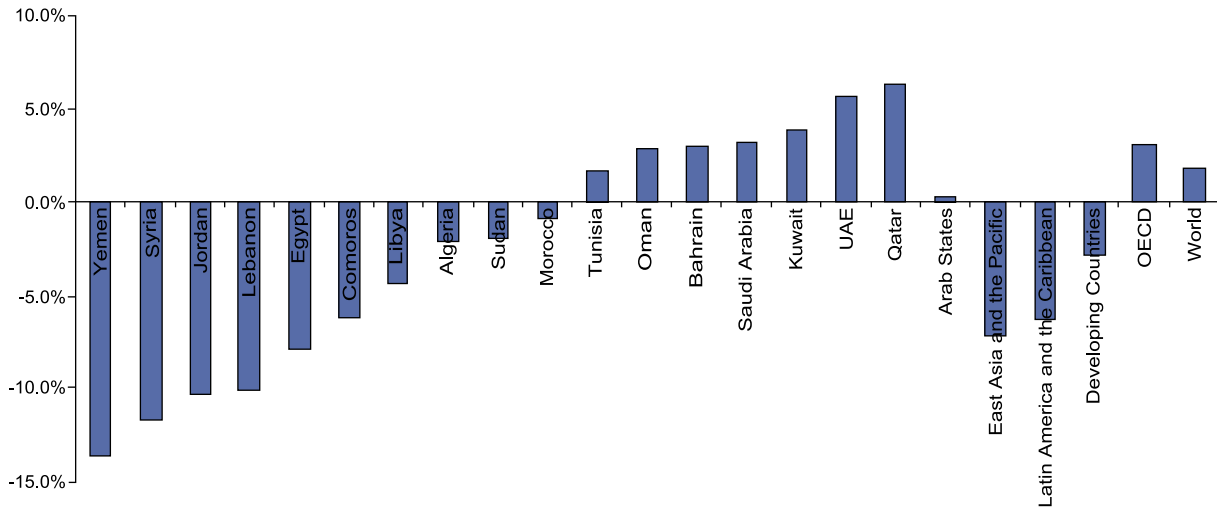
low human development category (a population weight of 22.2% of the Arab population). A solid core of medium human development included the countries of diversified group in addition to Algeria, Libya, Oman, and Saudi Arabia. The recent upward transitions of the Arab countries could be explained in terms of the recent oil price increases.

At the level of the details of the capability indicators included in the HDI, it is also important to note that a weakest link is represented by the knowledge variables: the adult literacy rate and the combined gross enrolment ratio for the conventional schooling levels (primary, secondary, and tertiary). Illiteracy rates are highest in the PEE group of Arab countries where an overall average of 42% of the population 15 years and older are illiterate. Around 30% of this population group is illiterate in the diversified group of countries, and about 31% for the Arab world as a whole. Similarly, the combined school enrolment ratio in the rich GCC group of countries is still relatively low, at about 74%, and is almost equal to that of the group of diversified economies. In the primary export economies the enrolment ratio is only about 44%. Overall, the weighted average enrolment ratio for the Arab countries is about 66%.

Arab countries also exhibit diversity in terms of human development achievement when compared to their level of income. This is shown in Figure 1, which plots the difference between the GDP and the Human Development Index (HDI). As shown in the graph, for the group of Arab countries included in the sample, the HDI is very close to the GDP Index (0.699 and

0.702, respectively). Still, country data reveal large discrepancies. The OE group and Tunisia have a positive score. This implies a lower level of human development than would be expected given the GDP level. All other Arab countries recorded a negative score suggesting vice versa. The countries with the lowest score were Yemen, Syria, Jordan, and Lebanon, respectively.

Figure 1: GDP Index Minus the HDI



Source: Human Development Report (2007).

Finally, the Arab region continues to be characterized by sharp disparities not only in terms of levels of economic and human development, but also in terms of progress made towards the achievement of the internationally agreed upon human development goals, including the MDGs. As shown in Annex Figure A.1, Arab countries have demonstrated progress in many MDG-related fields, including significant strides in health and education. But the picture is quite diverse across the sub-regions. While the high-income OE countries have demonstrated the most advanced strides in that progress, the least developed countries (PEEs) including Comoros, Djibouti, Mauritania, Sudan, Somalia, and Yemen, in addition to Iraq and OPT, will likely fail to meet most of those goals by the year 2015. As noted earlier, these conflicts have induced, and continue to produce, extremely high direct and indirect costs. Over half of the Iraqi and Palestinian population is estimated to be living in poverty.⁽¹⁵⁾ Likewise, a significant proportion of the population in Sudan is also expected to live in extreme poverty. School enrolment rates have

dropped by over 6 percentage points since 1990 in Iraq and by over 16 percentage points since 1999 in Palestine (particularly due to separation walls and the abundance of check points and road blocks).⁽¹⁶⁾ The negative impact of these conflicts also extends to neighboring countries (particularly Syria) and the region as whole through the influx of refugees, reduced private investment, and pressure on public infrastructure (ESCWA, 2007).

To summarize, judged by a narrow concept of development (as measured by GDP per capita), the Arab region displays a huge diversity among its countries. However, assessed on the basis of a broader definition of development (as measured by HDI), the region seems to have recorded a credible development performance with none of its countries belonging to the low human development category. On the other hand, while the OE countries seem to be on-track in achieving most of the MDG targets, the PEEs and conflict-ridden Iraq and Palestine lag significantly behind, making it unlikely that they will be able to meet the majority of the targets by 2015.

(15) UNAMI Human Rights Report (January – March 2007) p. 20 and Palestinian Central Bureau of Statistics (PCBS), 2005.

(16) ESCWA (2007).

3.2. Weak Institutional Framework:

Despite their economic diversity, Arab countries are characterized by weak institutions, in general, and weak governance institutions in particular (see, for example, UNDP, 2003); World Bank, 2004; Noland and Pack, 2007; and Nabli, 2007). To appreciate this, and without loss in generality, use can be made of Kaufmann et al (2006) most recent results on governance indicators. As noted in section (II) these indicators are

reported for the period 1996-2006. We may look at the end points, recalling that institutions evolve very slowly over time and noting that the average quality of institutions at the level of the world would be represented by a score of zero for any governance category: voice and accountability; political stability; government effectiveness; regulatory quality; rule of law; and control of corruption. The simple average of these six clusters can be used as an overall index of the quality of institutions.

Table 3: Quality of Institution in the Arab Countries in 1996*

Country Group	Voice and Accountability	Political Stability	Government Effectiveness	Regulatory Quality	Rule of Law	Control of Corruption	Average
DE (6)	-0.97	-0.78	0.02	0.07	0.00	-0.04	-0.29
MOE (2)	-1.32	-2.33	-0.50	-1.09	-1.22	-0.47	-1.16
OE (6)	-1.40	-0.23	-0.07	-0.14	0.53	-0.21	-0.25
PEE (4)	-1.54	-1.88	-1.07	-1.34	-1.40	-0.78	-1.34
Average (18)	-1.21	-1.18	-0.31	-0.43	-0.42	-0.28	-0.63

Source: Kaufmann (2005).

*For country level data see Annex Table A.11.

For 1996, Table 3 reports the details of the results for the Arab countries classified by economic groups. The overall average governance index for the Arab countries as a group is -0.63 implying that as a group these countries had a below average quality of institutions in 1996. As the table shows, the overall average index for each of the six governance dimensions is negative indicating that as a group the Arab countries suffered from below average quality of institutions. But, of course, there are differences among groups of countries, as well as among countries within groups.

The table clearly shows that all Arab economic groups have had an overall below average quality of institutions: diversified economies (DE; with an overall average index of -0.29); mixed oil economies (MOE; with an overall average index of -1.16); GCC oil economies (OE; with an overall index of -0.25); and primary export economies (PEE; with an overall average index of -1.34).

Further details show that for all institutional dimensions the MOE and PEE groups suffered from below average quality of institutions. Rather surprisingly, the GCC countries also suffer from below average institutions in all dimensions except for the rule of law. The DE group enjoyed above average quality of institutions for the two dimensions of government effectiveness and regulatory quality, and attained just average quality of in the rule of law dimension.

Ten years later, the picture of weak institutional structure of the Arab countries as a group remained almost unchanged. The overall average index of institutions is -0.61 in 2006, the latest year for which we have results. Table 4 reports the details. Compared to 1996 there seems to have been no improvement in the overall quality of institutions, indicating the persistence of below average quality of institutions. However, there are significant changes within the groups.

Table 4: Quality of Institution in the Arab Countries in 2006*

Country Group	Voice and Accountability	Political Stability	Government Effectiveness	Regulatory Quality	Rule of Law	Control of Corruption	Average
DE (6)	-1.02	-0.68	-0.31	-0.30	-0.05	-0.05	-0.46
MOE (2)	-1.00	-0.71	-0.43	-0.74	-0.65	-0.47	-0.67
OE (6)	-1.17	-0.27	-0.02	0.21	0.35	0.40	-0.09
PEE (4)	-1.46	-1.78	-1.04	-0.93	-1.15	-0.90	-1.21
Average (18)	-1.13	-0.88	-0.45	-0.44	-0.33	-0.24	-0.61

Source: Kaufmann (2005).

*For country level data see Annex Table A.12.

As the table shows, over the period under consideration, the overall quality of institutions deteriorated for the DE group (with an overall index of -0.46), but improved for all other sub-regions, albeit the overall index for each subregion indicating below average institutions. It is also significant to note that in both years the OE countries recorded a below average quality of institutions for the voice and accountability dimension of governance. In this dimension, therefore, all Arab countries seem to be almost the same. The voice and accountability dimension, it will be recalled, deals with the process by which governments are selected, monitored and as such is closely related to the concept of democratic governance. This is not surprising in view of the recurrent result in the specialized literature regarding the existence of a democratic deficit in the Arab countries (see, for example, Nolan and Pack, 2007; Nabli, 2007; and Elbadawi, Makdissi and Milante, 2008).

3.3 Low, Volatile and Oil-Led Growth

Growth in Arab countries has been historically driven by oil and oil-related revenues, either directly through fuels exports, as in all GCCs, Algeria, Libya, more recently Sudan and to a lesser extent Yemen, or indirectly through transport and delivery of oil and oil-related goods and services, workers' remittances, intra-regional public and private expenditure (including both

consumption and investment) and foreign aid, as in Egypt, Lebanon and Jordan. This rendered long-run economic growth in Arab countries to be volatile and subject to international oil market dynamics and geopolitical factors.

Table 5 compiles the evidence on the volatility of long-run real per capita GDP growth over the period 1961-2000, and the most recent medium-term period 2000-2006. The table reports the coefficient of variation for the available time series reported in the World Development Indicators of the World Bank. For the country groups we report the weighted averages for the coefficient of variation, using nominal 2005 GDP shares. The results show that long-term growth is clearly volatile for the Arab region. The coefficient of variation of the growth rate for 14 out of the 18 countries in the sample is in excess of one indicating the volatility of the long- and medium-term growth process in these countries. The highest volatility is recorded for Djibouti, Lebanon, Kuwait, Libya, and Algeria. Thus volatility characterizes all groups. Countries with less volatility are Yemen, Egypt, and Tunisia (see Annex Table A.13). Per capita GDP growth has generally tended to be less volatile since 2000. This is due to the fact that the first period (1961-2000) is much longer than the second period (2000-2006) and witnessed huge fluctuations in oil prices and revenues.

Table 5: Volatile Economic Growth: Coefficient of Variation of Real Per Capita GDP Growth (1961-2006)*

Period	Diversified Economies	Mixed Oil Economies	Oil Economies	Primary Export Economies	All Countries
1961-2006	3.0	6.2	5.22	4.1	4.6
2000-2006	0.9	1.6	1.22	1.3	1.3

Source: Author's calculations based on World Development Indicators.

*For country level data see Annex Table A.13.

To substantiate the hypothesis of oil-led growth, it is sufficient to note that fuels exports constituted 80, 92, and 90 percent of merchandise exports of the OE, MOE and PEE, respectively. DE countries are notably performing better on this front, with a manufacturing share of 51 percent of merchandise exports, during the same year. Jordan and Tunisia are considered to be the top performers in terms of growth of manufacturing exports, led by textile exports. High-technology exports and exports of machinery and transport equipments constitute, on average, 1 to 3 percent of total manufactured exports for most Arab countries, except for UAE

and Morocco, around 7 percent and Jordan and Tunisia, 5 percent.⁽¹⁷⁾

Oil-led growth also reflects, in large part, the poor performance of productive sectors, particularly the industrial sector. One of the most alarming developmental stylized facts for Arab countries is that they have transformed very rapidly, over a span of less than forty years, from agriculture-based to service-based economies. By the year 2004, the services value added share in GDP exceeded 50 percent in all Arab countries, with the exception of Algeria and Saudi Arabia (35 and 37 percent,

(17) UNCTAD online database, 2008.

respectively), and well above 70 percent in Jordan, Lebanon, and OPT. Furthermore, the services and non-tradables (particularly construction activities)

absorb over 50 percent of total employment in all Arab countries, with the exception of Morocco (around 43 percent of total employment).

Table 6: Manufacturing to GDP shares in Arab Countries (1966-2006)

Country group	1966	1976	1986	1996	2006
MOE (1)	14%	9%	16%	9%	5%
DE (6)	15%	13%	15%	14%	13%
OE (4)	3%	3%	8%	7%	7%
PEE (5)	8%	7%	8%	7%	5%

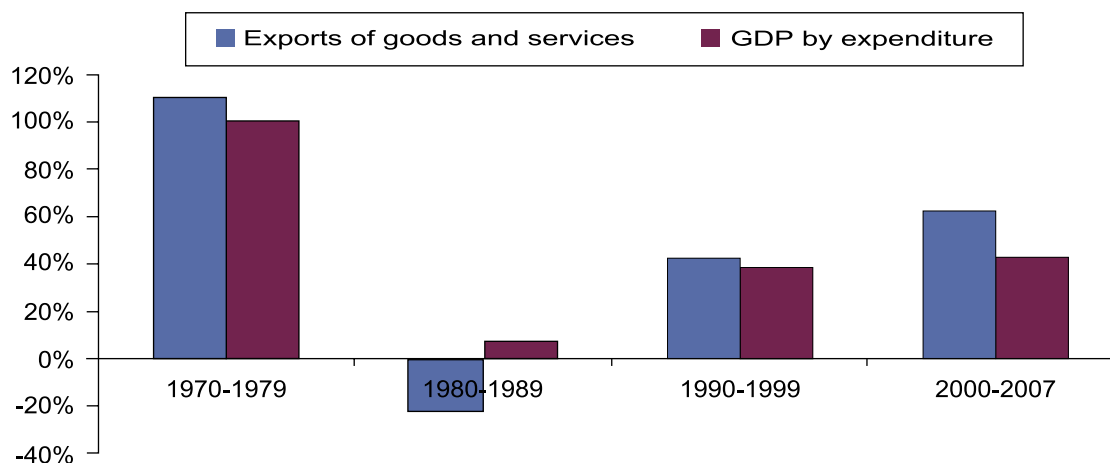
Source: WDI on line database (2008) and UNIDO (2007).

As shown in Table 6, Arab countries with a relatively diversified economic base in the 1960s such as Syria, Egypt, Morocco, Algeria, and Tunisia have all experienced deindustrialization to one extent or another, as revealed by declining manufacturing shares of value added and employment, over the last three decades. Table 6 shows the decline in the share of the manufacturing value added in GDP over the last three decades in Arab MOE, DE and PEE countries and modest progress in OE countries (due mainly to the petro-chemical industries), which started with a very poor industrial base in 1960s. Correspondingly, services have grown steadily to dominate Arab economies since the 1970s (Annex Table A.2).

Finally, aside from petrochemical industries in GCCs, traditional industries, such as textile and clothing and food processing, still dominate manufacturing sector structures, particularly in DE countries. High-tech industries are virtually nonexistent. It would be safe to argue therefore that one ramification of oil-led growth is that Arab countries have experienced a phase of stunted industrialization as characterized by the following main features:

1. Obsolete technology, lack of adequate expenditure on R&D and an industrial labor force that has extremely low productivity.
2. The weakness of long-run strategic planning, in terms of the overall macro-economy in general and the industrial sector in particular, which manifested in the absence of clear and well-specified roadmap for the industrial sector with an eye on foreign trade.
3. An overall shortage of investment and misallocation of finance and credit away from the manufacturing factors.
4. A private sector that is biased towards low-risk services and trade activities and low value added traditional manufacturing activities in the absence of incentive structures and monitoring systems that encourage the private sector to engage in high value added, productive, and competitive manufacturing activities.
5. Inadequate infrastructure particularly in information, communication, and transportation.
6. Excessive dependency on resource based industries.

Figure 2: Arab Exports and GDP Growth (average annual percentage changes for periods in constant 1990 US\$)



Source: Authors' calculations based on data from UN Statistical Databases.

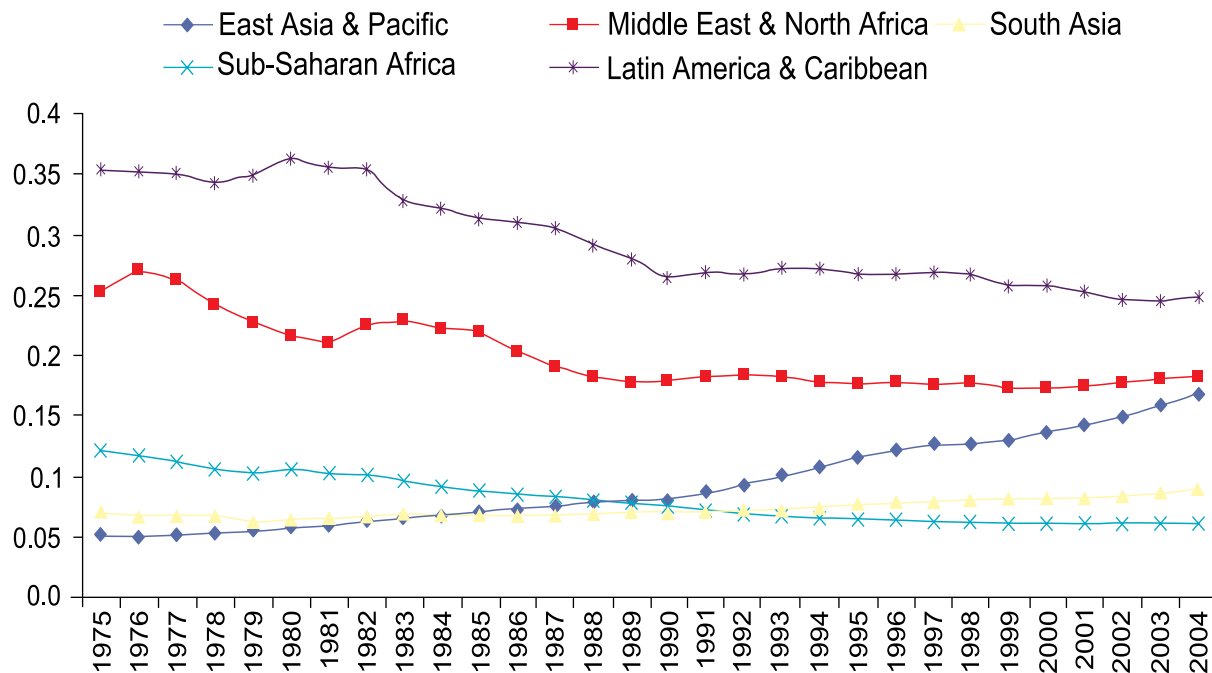
Oil-led growth is also revealed in the growth and balance of payments data. Figure 2 plots GDP and exports (goods and services) growth over four time periods since 1970. The highest growth rate in exports and growth is recorded for the 1970s where both nearly doubled (in constant US\$). The high correlation between GDP growth and exports over the four periods is also easy to observe and is quite striking. The figure also shows that GDP barely grew in constant prices during the 1980s (which suggests a large decline in per capita GDP).

In fact, it is worthy to note that real GDP per capita for the region grew by 6.4 percent only over the entire 24 year period (from 1980 to 2004).⁽¹⁸⁾ This held down the growth in average real per capita

GDP for the region, which rose by 168 US\$ only (from US\$2600 to US\$2768). Not unexpectedly, the GCC countries witnessed a sharp decline in real income (35 percent). However, it is also worthy to note that this period also coincided with the implementation of economic liberalization programs in most Arab countries.

Growth performance has picked up significantly since the early 2000s due to the rebound in oil prices. Over the period from 2001 to 2006, GDP and GDP per capita growth of the OE group grew by 36.3 and 24 percent, respectively. The PEE group achieved the second highest GDP growth after the OE (32.3 percent) but their rapid population growth held back the rise in per capita income to 14.1 percent only.

Figure 3: Growth of GDP per capita (constant 2000 PPP US\$) by Developing Region (share of OECD) (1975-2004)



Source: World Bank, World Development Indicators.

To sum, the Arab region did not utilize the window of opportunity provided by oil revenues nor did it perform better than other developing countries in catching up with rich countries. This is depicted in Figure 3 which plots PPP adjusted GDP per capita for five developing regions (as the ratio of GDP per capita for OECD). As the figure shows, over the period from 1975 to 2004, only East Asia (and to a lesser extent South Asia) was successful in 'catching up' with the OECD.

3.4 High and Rising Unemployment Particularly among Youth:

The presence of large informal labor markets and other problematic labor market outcomes experienced by most Arab countries, such as high unemployment, particularly amongst the youth, and low returns to education, are all well established stylized facts.⁽¹⁹⁾ According to ILO's most recent Global Employment Trend

(18) Authors' estimates based on World Bank data (World Development Indicators, 2007).

(19) See for example UNDP (2004).

Brief (2007), the overall unemployment rate in Arab countries was approximately 13.0 and 12.2 percent in 2005 and 2006, respectively, while for the world at large it was measured at 6.3 percent. Furthermore, ILO (2007) also reports that the Arab region has one of the lowest employment-to-population ratios (47.3 percent in 2006, up from 47.0 in 2005). It also has the lowest labor force participation rate (53.9 percent in 2006 and 53.6 percent in 2005) worldwide (ILO, 2007: 3). The aggregate unemployment rate for the region has 'hovered around the 12 percent mark for at least the past decade' (ILO, 2004-5: 56). This stands in sharp contrast with other regions, notably East and South Asia, where the unemployment rate stood at 6.1 and 3.8 percent, respectively in 2005. However, overall unemployment varies considerably across the region, ranging from 1 percent in Qatar, to 32 percent in the West Bank and Gaza.

The Arab region also confronts very high labor force growth (averaging around 3.7 percent annually during the period from 2000 to 2005).⁽²⁰⁾ That is more than 4 million new entrants to the labor market every year. Meanwhile, it has the lowest participation rate in the world (47 percent in 2006), particularly of woman, and the youngest labor force in the world (excluding Sub-Saharan Africa). The region is also still dependent on public employment. Available data show that public employment accounted for 33 percent of total employment in the region, exceeding 50 percent in middle income Arab countries such as Egypt and Syria (ILO, 2005). However, the growth of public sector employment has been slowing down significantly since the mid 1990s in most countries. Consequently, the private sector's contribution to job creation has exceeded the public sector's contribution, considerably, over the last decade. (World Bank, 2007: 72-79).

In analyzing Arab labor markets there is a need to distinguish between the labor markets in the Gulf Cooperation Council (GCC) countries and other Arab country groups (see, for example, ERF,

2000). The labor market in the non-GCC countries is found to be the more problematic of the two from the perspective of unemployment. Thus, according to the ERF (2000: 111-114) analysis three major features of the labor markets in non-GCC Arab countries were identified: relatively high unemployment rates; declining real wages; and the predominance of the government sector in total employment.

With the exception of Saudi Arabia, unemployment rates in the other GCC countries have been characteristically low, typically below 5% of the respective labor force. Thus, for example, the World Bank (2007: Table A.28: 129) reports that unemployment rates for 2004 were 1.9% for Bahrain, 1.7% for Kuwait, 2.1% for Qatar, and 3% for UAE. The unemployment rate for Saudi Arabia is reported as 7% of the labor force. Despite these low unemployment rates at the level of the economy the unemployment of nationals has recently become a source of concern for policy makers.

Despite well known unemployment data problems, there is evidence to suggest that during the period since 1980 to the present unemployment rates remained relatively high and exhibited increasing trends in most of the Arab countries for which time series data is available. These countries are Algeria, Egypt, Jordan, Morocco, Tunisia, and Syria.⁽²¹⁾ In 2005 the total labor force of these countries amounted to 67.5 million representing about 57% of the total Arab labor force (LAS et al, 2007).

Available time series evidence shows that the average unemployment rate for the 1980s decade ranged from a high of 16.5% in Algeria to a low of 4.8% in Syria. Morocco's unemployment rate was second highest (14.2%), followed by that of Tunisia (13.6%), Egypt (7.6%), and Jordan (6.2%). The weighted average unemployment rate for this group of Arab countries for the 1980s is 10.6%, where the labor force weights for 2005 are used. For the 1990s decade, the average unemployment rate for Algeria remained the highest at 25.3%, followed by that for Morocco (18%), with both Jordan and Tunisia recording the third highest average unemployment rate of 15.5%, followed by Egypt (9.6%), and Syria (8.1%). The weighted average unemployment rate for the 1990s decade is 14.5%. Thus, over these

(20) According to the LAS et al (2007: 291 and 302) total labor force in the Arab countries amounted to about 119 million workers in 2005 (labor force/population ratio of 0.382 and a total population of about 312 million). Over the period 1995-2005 labor force was growing at an annual average rate of 3.4 percent compared to a population growth rate of 2.3 percent per annum. The annual rate of growth of labor force varied from a high of 6.6 percent for Saudi Arabia to a low of 1.8 percent in Qatar. Thus for the Arab countries as a group, total labor force is expected to become 141 million workers in 2010 and about 167 million workers by 2020.

(21) The time series on unemployment in the Arab countries is compiled by Belkacem Laabas of the Arab Planning Institute in Kuwait. A recent compilation for Syria is taken from the State Planning Commission of Syria.

two decades the unemployment rate did indeed increase for all countries under consideration. Similarly, though slightly fragmentary, preliminary evidence for the 2000s decade indicate that the weighted average unemployment rate increased to 15.5% from its average in the 1990s decade.

The annual growth rates of the unemployment rate, over the period since 1980 and up to 2002 or the most recent year available, ranged from a high of 6.6 percent for Jordan to a low of 0.8 percent for Tunisia. Algeria's unemployment growth rate amounted to 2.8 percent, followed by that for Syria (2.4 percent), and Egypt (2.2 percent). The weighted average growth rate unemployment rate for the region (using 2005 number of unemployed) is about 1.8 percent.⁽²²⁾ Likewise, the estimated rates of growth of employment, for the five countries for which time series data is available over the period 1980-2002, are all negative and statistically significant, except for Morocco.

The 1990s earmarked the beginning of a “demographic transition” in many countries of the region, due to the slow down in fertility relative to the 1970s and 80s when the region experienced the highest rates of population growth in the world. As a consequence of the demographic transition and the increasing participation of women in the labor force, especially educated women, the region's labor supply has grown quite rapidly. On the other hand, faltering growth since the 1980s as educational attainments continued to expand led to a widening mismatch between labor supply and demand, especially with regard to educated labor. For example, in Egypt the proportion of labor force with secondary education or above accounts for only 42%, but they constitute about 80% of the unemployed; and for Algeria and Morocco this category, respectively, accounts for 38 and 30% of the unemployed, which is about twice their respective shares in the labor force (El Badawi and Loayza, 2008).

Unemployment rates in Arab countries are also conjectured to have an inverted u-shaped relationship with the level of education such that unemployment is highest for those who hold intermediate level of education compared to

those with lower, as well as those with higher, levels of education (see, for example, Shaaban et al, 1995). It is conceded, however, that this relationship is not robust. Indeed the World Bank (2007: 48, table 2.5) provides recent evidence for 2006 for Algeria, Egypt, Jordan, and Morocco that does not support the above proposition. Except for Jordan, this evidence shows that indeed the unemployment rate is lower for those with low level of education (6.6% of the labor force in Algeria for those with no education; 1.4% for those with less than secondary education in Egypt; and 5.2% for those with no diplomas in Morocco). The Jordanian unemployment rate for those with less than secondary education is reported as 14.2% (higher than that for those with secondary and intermediate levels of education of 12.1%). In all four countries, however, the unemployment rate for those with higher education is higher than, or equal to, those with intermediate levels: 19.3% (compared to the same rate for secondary) in Algeria; 13.7% (compared to 13.5%) in Egypt; 17.7% (compared to 12.1%) for Jordan; and 26.8% (compared to 20.5%) in Morocco.

The unemployment rates in the Arab countries are also observed to have a clear gender dimension with the female unemployment rates higher than those for males. The most recent evidence is provided for 2006 by the World Bank (2007-a: 46, Table 2.4). According to the evidence, female unemployment rate was 21.3% (compared to 19.8% for males) for Algeria; 18.6% (compared to 4.7%) for Egypt; 25.9% (compared to 12.8%) for Jordan; 24.8% (compared to 16.3%) for Morocco; 28.3% (compared to 9%) for Syria; and 17.2% (compared to 12.9%) for Tunisia. Evidence also suggests an overall pattern of stagnation of formal urban employment and the expansion of the informal sector. El Badawi and Loayza (2008), present several indicators related to overall informal activity. Their results indicate that there seems to be much heterogeneity across Arab countries. However, for some countries (e.g., Iraq, Syria, Mauritania, and Sudan) it is comparable to the most informal countries in the world.

Despite the increase in female participation in absolute terms over the last decade, female unemployment rates are still significantly higher than those of their male counterparts in all age groups (World Bank, 2007; ILO, 2007). Furthermore, female employment is still largely concentrated in agriculture, household and personal services (such as child care), education,

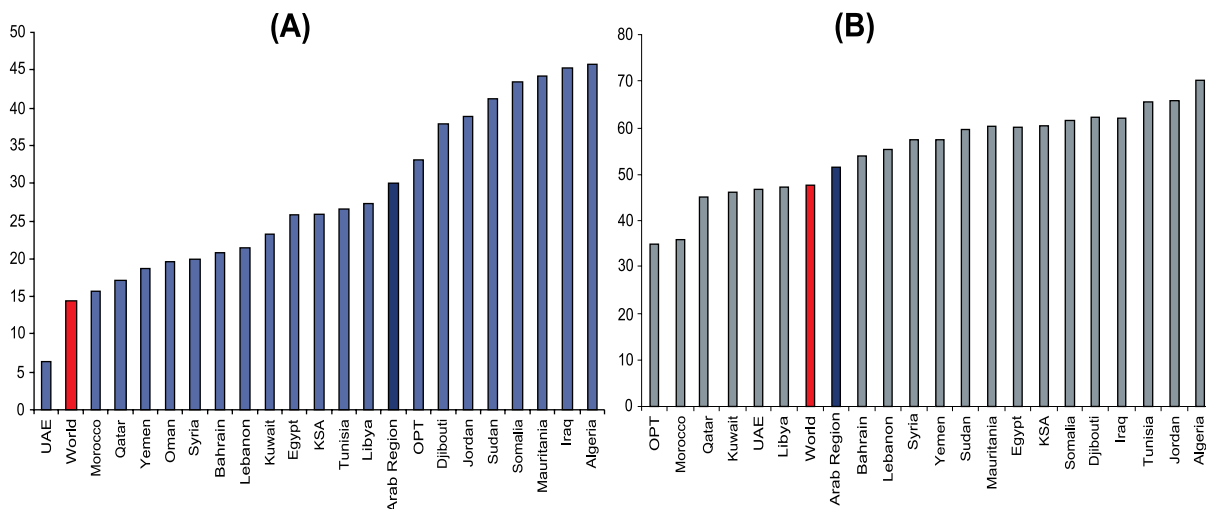
(22) The time trend coefficient for Algeria is 0.0279 (with a t-value of 7.2 and an R-squared of 0.69), that for Egypt is 0.0223 (with a t-value of 3.9 and an R-squared of 0.4), that for Jordan is 0.0655 (with a t-value of 6.2 and an R-squared of 0.63), that for Morocco is 0.0082 (with a t-value of 1.4 and an R-Squared of 0.08), that for Syria is 0.024 (with a t-value of 6.2; and an R-squared of 0.52), and that for Tunisia is 0.0082 (with a t-value of 6.3 and an R-squared of 0.65).

and public services. In 2003, 39 percent of female workers in Egypt were in agriculture, 22 percent in education, and 13 percent in public services. During the same year, 34 percent of females in the Occupied Palestinian Territories (OPT) worked in the agricultural sector and 28 percent in education. Meanwhile, in 2002, 45, 53 and 42 percent of females in Saudi Arabia, Qatar and UAE worked in household and personal services, while 42, 22 and 17 percent worked in education, respectively. Furthermore, 2005 data in Morocco records that the agricultural sector absorbs 61 percent of females. Such patterns of employment reinforce to a great extent the traditional division of labor. More importantly, it deprives Arab societies from productive and innovative capacities that could be gained from a broader female access to and participation in labor markets.⁽²³⁾

As expected, youth unemployment rates vary among Arab countries. A compilation by ALO for the year 2005 show that these rates vary from a high of about 46 percent for Algeria to a low of 6.3

percent for UAE (Figure 4. A). With the exception of UAE, this time around even high income Arab countries suffer from double digit youth unemployment rates: Bahrain (27%); Saudi Arabia (26%); Qatar (17%); and Kuwait (23%). Relatively high youth unemployment rates are recorded for the middle income Arab countries: Jordan (39%); Tunisia (27%); Syria (20%); Oman (20%); Lebanon (21%); Libya (27%); Egypt (26%); and Morocco (16%). The low income Arab countries also report relatively high youth unemployment rates, Yemen (over 29% in 2006), Sudan (41%), Djibouti (38%), and Mauritania (44%).⁽²⁴⁾ Not surprisingly the youth unemployment rate in the Arab region is the highest in the globe. Estimates reported by the ILO put the latter for the Middle East and North Africa at 25.7 percent in 2003, which is also the highest in the world and 77.8 percent higher than the world average.⁽²⁵⁾ As a result, the share of youth among the total unemployed population exceeds 50 percent for most Arab countries, reaching nearly 70 percent in Algeria (Figure 4.B).

Figure 4: Unemployment rate among Arab Youth (A) and their Share in Total Unemployment (B) (%) in 2005/2006



Source: compiled from ALO (2008)

Be the above as it may, the third distinguishing feature of Arab labor markets, this time inclusive of GCC labor markets, is the preponderance of public sector employment. While admittedly this feature lost a lot of its quantitative importance due to the repeated implementation of structural adjustment programs by a large number of countries, it nonetheless continues to feature in the current literature on the subject.

Once again, and rather surprisingly, up-to-date information is conspicuously lacking on this score. The latest, not necessarily the best or most reliable, evidence is provided by the World Bank (2007-b: 226, Table 7.6). According to this evidence, excluding

(23) Figures are based on data reported by national sources and ILO (2007) database. The data on youth unemployment for Yemen was reported by the latest Country Common Assessment (2005)

(24) Similar results are reported by the World Bank (2007-a: 47, figure 2.13) which reports youth unemployment rates of about 46% in Algeria, 54% in Egypt, 66% in Jordan, 33% in Morocco, and 41% in Tunisia.

(25) International Labor Office, Global Employment Trends for Youth, International Labor Office, Geneva 2004, p. 8.

GCC countries, public sector employment as a share of total employment in 2000 ranged from a low of 10% for Morocco to a high of 44% for Jordan. Algeria and Egypt reported a share of 29% each while the share in Tunisia was 22%. These shares are considered high compared to a world average share of 18% (excluding China).⁽²⁶⁾

Structural changes undergone by Arab countries have rendered the services sector to be the largest employer, providing jobs for nearly two thirds of the labor force in the Arab region. It also absorbs the majority of female workers. However, despite its high growth rate, services have failed to completely absorb the rapidly increasing labor force, in addition to labor shifts from productive sectors which resulted in high unemployment. The agriculture sector is still a major source of employment in Arab LDCs, providing approximately 50 percent of total employment in Yemen, Sudan, and Mauritania. It also absorbs around 27, 21, and 36 percent of total labor force in Egypt, Algeria, and Morocco, respectively.

Thus, agriculture and services sectors have been the major sources of employment creation in the region over the last three decades and are expected to play the most crucial role in employment generation in the future, unless

significant structural and policy changes take place, aiming at enhancing the contribution of the manufacturing sector to employment generation.

3.5 Limited Progress on Income Poverty Reduction since 1990 and Medium Levels of Income Inequality

Despite the diversity in income levels, the volatility of real per capita growth, and the relatively high unemployment rates, the Arab region is known to have low rates of incidence of income poverty. The most recent evidence supporting such a conclusion is reported in Chen and Ravallion (2008). As usual with such highly aggregated analysis the Arab countries are subsumed under the Middle East and North Africa region. Fortunately, out of eight countries used for defining the region, 7 are Arab.⁽²⁷⁾ Thus, without major loss in precision we could take the results for the MENA region as representing those for the Arab region. We also note that five of the seven Arab countries belong to the Arab middle income group while only two belong to the low income group.⁽²⁸⁾ Taking into account the relative population, GDP, and weight of the Arab middle income group, we believe the more relevant results are those based on the international poverty line of US\$2 per person per day.⁽²⁹⁾ In Table 7 we report these results as well as those for the 1.25 and 2.5 US\$ per day.

Table 7: Incidence of Poverty in the MENA Region: Headcount Ratios in Percentage and Number of Poor in Millions

Poverty Line (US\$ per person per day)	1981	1990	1996	2005
1.25	8.6 (14.9)	5.4 (12.2)	5.3 (13.7)	4.6 (14.0)
2.00	28.7 (49.7)	22.0 (49.6)	22.3 (57.4)	19.0 (58.0)
2.50	31.0 (71.7)	27.9 (76.1)	29.4 (89.9)	24.1 (94.3)

Source: Chen and Ravallion (2008: 32-35).

The table shows that in 2005 about 19% of the MENA population was living below the international poverty line of US\$2 per person per day. Recalling that this estimate is based on information for the Arab middle and low income groups, and recalling that the population of this group represents about 88.2% of the total population of the Arab countries not in conflict, it can be concluded that in 2005 about 48.6 million Arabs were living under conditions of income poverty. It is also worthy to note that the number of poor increases over time regardless of the choice of the poverty line.

(26) The respective shares in the oil producing countries are reported as: 93% in Kuwait, 79% in Saudi Arabia, 66% in Libya, and 28% in Bahrain. For international comparison the OECD average share is reported as 14% while that of Latin America and the Caribbean is 13%. Excluding China (with a share of 36%), East Asia and the Pacific are reported to have an average share of 5%.

(27) Household survey information used come from Algeria, Djibouti, Egypt, Jordan, Morocco, Tunisia, and Yemen.

(28) It is perhaps obvious to note that given the per capita income levels reported for the Arab high income countries in Table (1) we should not expect any incidence of income poverty in this group of countries, possibly with the exception of Saudi Arabia using a national poverty line. For such rich countries the European convention is to set the poverty line at 0.5 of average income. This will work out as US\$38 per person per day as an average for the group.

(29) Evidence to highlight the inappropriateness of the 1 dollar a day line can be derived based on the data provided by the World Bank itself. When analyzing the headcount poverty rates for three regions (MENA, ECA, and Latin America) as a ratio of the global poverty rate derived based on the three new international poverty lines (1, 2, and 2.5 dollars per day), it can be shown that both the ranking of the MENA region as well as the gap between its rate of poverty incidence and the global poverty rate deteriorates significantly (relative to other developing regions) as the value of the poverty line increases. This confirms that the incidence of poverty is more sensitive to the choice of poverty line in MENA region than in other developing regions. It also strongly suggests that the one dollar a day (whether based on the new or old PPPs) is particularly inappropriate for this region.

However, the above poverty estimates for the US\$2.0 a day line only adequately reflects the reality of extreme poverty incidence in Arab countries (defined here as share of the population

under the lower national poverty line).⁽³⁰⁾ To clarify, our population weighted estimates of extreme poverty for the country groups (excluding OE) and individual countries are shown in Table 8.

Table 8: Incidence of Extreme Poverty in a Sample of Arab Countries*

Country Group	Survey Year	Poverty Incidence (%)	Number of Poor (million)	Survey Year	Poverty Incidence (%)	Number of Poor (million)
DE (6)	1991-1999	14.7	18.4	2000-2005	16.8	22.8
MOE (1)	1995	14.1	4.1	2000	12.1	3.8
PEE (2)	1996-1998	41.3	8.0	2000-2006	36.2	8.1
Overall Average		17.9	30.5		18.4	34.7

Source: Authors estimates based on data reported in WDI (2006) CD-Rom and World Bank and UNDP Poverty Assessment Reports for Syria, Lebanon, and Yemen.

*For country level data see Annex Table A.14

The table shows that in the 1990s extreme poverty affected on average 17.9% of the population of the sample which is consistent with the international 2 dollar per day. Not surprisingly, high incidence is reported for the primary export countries with an average of about 41% of their population falling below the extreme poverty line. In the remaining two groups the incidence of extreme poverty in the 1990s was moderate with a head-count ratio of less than 15%. The total number of the extremely poor in the sample of countries is about 31 million people. Applying the overall average head-count ratio obtained from the sample to the population of the Arab countries in 1995 (i.e. the mid-point population of the 1990s) it is an easy matter to check that the total number of the extreme poor in that year was 46 million people. The table also shows that extreme poverty in the Arab region recorded an increase over time -from an overall average head-count ratio of 17.9% to 18.4% in the 2000s- despite the fact that most Arab countries in the sample achieved poverty reduction.

The incidence of extreme poverty increased in diversified economies sub-group but declined in the other two sub-groups. As a result of these trends, the total number of the poor in the population of the sample increased from about 31 million in the 1990s to about 35 million in the 2000s. Using the overall average head-count ratio and the population of the Arab countries in 2003, the total number of the extreme poor in that year was around 55 million people. However, as the population of the other Arab countries which were excluded from the analysis for lack of data and where extreme poverty affects the majority of the population such as Sudan, Somalia, Comoros, Occupied Palestinian Territories, and Iraq is higher than the population of the more

affluent countries such as Libya and the GCCs, the actual rate of extreme poverty for the region may be higher by 3-5 percent than that reported above. Extrapolating this rate to the Arab 2005 population yields an estimate of approximately 65 million extremely poor individuals.

If this is the picture with regards to extreme poverty, then it would be reasonable to expect that overall poverty in the region is significantly higher. Indeed, evidence based on the most recent household budget surveys in four Arab countries shows that the poverty rates, using appropriately defined upper national poverty lines, range from a low of approximately 27-30% of the population in Lebanon and Syria to a high of about 58% of the population in Yemen with that for Egypt being about 39% of the population. The weighted average of these head-count ratios is about 41% of the Arab population, which is more than double the rate based on the 2.0 dollar per day and lower national poverty lines. The fact that one poverty measure can be almost ten times the order of magnitude of another (as in the case between the 1.25 dollar per day and the latter overall poverty based on upper national poverty lines) illustrates how crucial it is to clearly define what is being measured (food poverty, extreme poverty, or overall poverty).

Three other stylized facts related to the income poverty and the characteristics of the Arab poor are worth noting. First, among the countries for which data are available, rural residents are

(30) The analysis in this section is based on the most recent results on country poverty diagnosis or assessments reports of World Bank/UNDP. For all countries, the cost of basic needs approach to the estimation of poverty lines is used, where the food baskets reflect the consumption pattern of the poor and the non-food component is derived by Engel curves.

poorer and are lagging behind in poverty reduction. Almost one person out of four persons in Egypt and Morocco is poor in rural areas compared to one out of ten in urban areas. Poverty rates in Yemen are significantly higher in rural areas. Although the rural population in the seven countries under investigation (Algeria, Syria, Egypt, Yemen, Morocco, Jordan, and Tunisia) represents 53 percent of the total population, 74 percent of the poor live in rural areas. Furthermore, in most countries, the urban-rural gap has widened (Annex Table A.3). It is also worthy to note that poor rural households typically are agricultural wage workers or with small landholdings.

Second, income poverty has a strong gender dimension. The share of households headed by women ranged from 10 percent of households in Jordan to 18.8 percent in Yemen. Although household surveys show that there is little difference in poverty measures between female-headed households (FHH) and male-headed households (MHH), some selected sub-groups of FHH have a higher incidence of poverty than corresponding male headed households. For example, in Egypt, Syria, and Lebanon households headed by widows with more than three children are over-represented among the poor (In Lebanon their share among the poor is five times their population share and eight times the corresponding share among better-off households); in Egypt, FHHs with more than three children have the highest risk to poverty in both urban and rural areas, 31 percent and 57 percent respectively. Moreover, the risk to illiteracy of children living in poor female headed households is the highest in rural areas. In Jordan separated women are the most vulnerable of all FHH and MHH groups. The implication is that poverty level differs much among households, when the gender of the household head is combined with marital status and number of children.

Third, two broad growth patterns characterize the differences in poverty outcomes among countries. In Egypt (1999-2004) and Morocco (1991-1999), poverty increased mainly because of slow growth which led to a decline in per capita consumption. However, in Egypt, the positive effect of reduced inequality in expenditure hampered the negative impact of declined per capita expenditure on poverty, while deterioration in inequality in Morocco aggravated increases in poverty. Declining poverty in Syria and Yemen was also mainly driven by positive

per capita expenditure growth, but changes in inequality worked in the opposite direction. In both countries growth was not pro poor and hence growth was coupled with deterioration in inequality despite the decline in poverty over the period from 1996/8-2004/5.

Thus, income poverty trends in Arab countries underscore an important role for distributional change. However, the strength of its impact on poverty reduction varies significantly across countries. Table A.4 in the annex tables, shows the elasticities of poverty with respect to mean consumption and income distribution classified by poverty measures. It reveals that poverty trends are more responsive for medium-income countries since the respective elasticities were found to be higher for this group than those of low income group.⁽³¹⁾ The elasticities also show that urban areas have the higher elasticities compared to rural areas.

The most recent compilation of the state of income inequality, as measured by the Gini coefficient, is provided in Ferreira and Ravallion (2008).⁽³²⁾ The information is provided for 130 countries.⁽³³⁾ For each country the Gini coefficient is reported for two survey years: one in the 1990s, or just before that decade, and the other in the 2000s. However, not all countries have two entries. Out of the total number of countries in the compilation 98 had household surveys conducted in the 1990s and prior to 2000, while 84 had household surveys conducted in the year 2000 or more recent years. Further we note that for some countries the Gini coefficients are based on income distribution while for other they are based on consumption expenditure. In what follows we appropriately adjust the information available.

(31) This pattern may be interpreted as the mirror image of Kuznet's inverted U for income distribution since at low level of development attempts at poverty reduction are not very effective, become more successful as income level increases and less successful for higher levels of income.

(32) It will be recalled that the Gini coefficient is a measure of inequality based on the Lorenz curve which gives a non-linear relationship between the cumulative share of population and the corresponding cumulative share of consumption expenditure or income, where individuals are arrayed from the poorest to the richest. The Gini coefficient ranges from unity for the case of complete inequality (i.e. only one individual getting 100 percent of expenditure) to zero for the case of complete equality (i.e. every individual getting average expenditure).

(33) Nine Arab countries are included in this compilation: Algeria (with a survey for 1995); Egypt (1995); Jordan (1992 and 2002); Kuwait (1998); Lebanon (1995); Mauritania (1993); Morocco (1998); Tunisia (1995); and Yemen (1992). In addition, we also include the Gini for Syria for 2003, (from El-Laithy and Abu-Isma'il (2006).

To appreciate the state of inequality in the Arab region we first establish a benchmark at the level of the world. To look at the inequality in the distribution of consumption expenditure at the level of the world we converted the reported Gini coefficients based on the distribution of income by subtracting 6.6 percentage points to obtain the Gini coefficients corresponding to the distribution of consumption expenditure (for the advice to undertake such an adjustment see Deininger and Squire, 1996, and Li, Squire, and Zou, 1998).

In the 1990s the lowest recorded degree of inequality in the world was that of the Slovak Republic (a Gini coefficient of 0.129 in 1992) while the highest degree of inequality was recorded for Lesotho (a Gini coefficient of 0.631 in 1995). The overall average degree of inequality in the world was 40.6 percent, with a standard deviation of 10.6 percentage points. In the 2000s the lowest degree of inequality is recorded for Sweden (a Gini coefficient of 18.4 percent for 2000);⁽³⁴⁾ while the highest degree of inequality, a Gini coefficient of 53.6 percent, is recorded for Bolivia (for 2002). The overall average degree of inequality in the world is 37.57 percent, with a standard deviation of 8.91 percentage points. Thus, over the decade (roughly speaking) inequality in the world declined and its dispersion also declined.

To focus on the current state of inequality in the Arab region use will be made of the results for the 2000s. Using the above two descriptive statistics, together with the population for 2005, we can derive the distribution of the degree of inequality in the world as comprising low inequality for countries with a Gini coefficient of less than

0.3311 (i.e. mean inequality minus half a standard deviation); medium inequality countries with a Gini coefficient of 0.3311 but less than 0.4202 (i.e. with a range equal to one standard deviation- n); and high inequality countries with a Gini coefficient of 0.4202 or above. Over these inequality ranges the 2005 population of the sample of countries was such that about 11% of the population was living in low inequality countries; about 40% were living in medium inequality countries; while 49% were living in high inequality countries.

With the above inequality benchmark we can now look at the current state of inequality in the Arab countries. For the eleven Arab countries we have information on the distribution of consumption expenditure for the year 2000, or the closest year thereof, the Lorenz reading of the available information (i.e. in terms of the income expenditure shares of the various quintile groups) is given in Table 9. Of these eleven Arab countries, there are seven for which the Gini coefficient information is available for the year 2000, or more recent years: 0.32 for Egypt (for 2004/05); 0.408 for Tunisia (for 2000); 0.360 for Lebanon (for 2005); 0.359 for Jordan (for 2002); 0.391 for Mauritania (for 2000); 0.375 for Syria (for 2004); and 0.366 for Yemen (for 2005). It is worthy to note therefore that most Arab countries in the sample enjoy a moderate degree of inequality compared by global benchmarks. Moreover, the simple average Gini coefficient for the eleven countries in the sample is 0.365, confirming that the Arab countries seem to enjoy a medium degree of inequality. Such a result should be understood as the cumulative achievement of the social contracts that ruled in the Arab countries since independence.

Table 9: The Distribution of Consumption Expenditure in Arab Countries (percent)

Country	Lowest 20%	Second Lowest 20%	Third Lowest 20%	Fourth Lowest 20%	Highest 20%	Gini (most recent)	Gini (earlier survey)	% change
Low Inequality								
Egypt (2004/05)	8.9	12.7	16	20.8	41.6	32	34.5 (1995)	-7.8%
Oman (1999/00)	5.1	9.2	14.7	23.5	47.5	30.3	-	-
Medium Inequality								
Algeria (1995)	7.8	11.7	15.9	21.6	43	35.3	40.14 (1988)	-13.7%
Jordan (2002/03)	6.7	10.8	14.9	21.3	46.3	35.9	36.4 (1996)	-1.4%
Kuwait (1999/00)	5.9	10.5	15.6	22.7	45.3	39.1	-	-
Lebanon (2004/05)	7.07	11.41	15.81	22.17	43.55	36	-	-
Mauritania (2000)	6.2	10.8	15.5	21.9	45.6	39.1	-	-
Morocco (1998/99)	6.5	10.6	14.8	21.3	46.8	39.7	39.2 (1990)	1.3%
Syria (2004/5)	7.2	11.1	15	21.4	45.3	37.5	33.7 (1996)	10.1%
Tunisia (2000)	6	10.3	14.8	21.7	47.2	40.8	41.6 (1995)	-2.0%
Yemen (2005/06)	7.5	11.5	15.5	21	44.5	36.6	34.5 (1998)	5.7%

Source: World Bank (2005) and UNDP Poverty Reports for Yemen and Lebanon (2006, 2007).

(34) For the 1990s, decade the average Gini at the level of the world was 0.4076 with a standard deviation of 0.1031. The lowest degree of inequality of 0.129 was recorded for the Slovak Republic (for 1992), while the highest degree of inequality of 0.677 was recorded for Namibia (for 1993).

As in the case of poverty, data limitations does not easily allow for an accurate time-series comparative analysis of changes in income inequality for the Arab region. Data in Table 9 indicates that, in the last decade, income inequality rose in Morocco, Syria, and Yemen and fell in Tunisia, Algeria, Jordan, and Egypt. The countries experiencing the largest increase in inequality were Syria, followed by Yemen. Algeria experienced the largest decline in inequality, with the Gini falling by 13.7 percent over the period from 1988 to 1995. Egypt also witnessed significant reduction in inequality within a span of five years. The other countries experienced relatively small changes in inequality, involving less than a 1 percent annual change in the Gini.

3.6 Rapidly Declining Human Poverty

Having noted the above on income poverty we now look at human poverty. Table 10 reports the human poverty index for 14 Arab countries based on the most recent available data. Four of the Arab countries, accounting for about 6% of the 2005 total population of the sample of Arab countries for which HPI is calculated (Jordan, Qatar, UAE, and Lebanon) have a low incidence of human poverty (i.e. an HPI value of less than 10);

five countries, accounting for about 56% of the Arab population have a medium incidence of human poverty (Syria, Tunisia, Egypt, Algeria, and Djibouti) and a high incidence is recorded for 5 countries (Comoros, Morocco, Sudan, Yemen, and Mauritania), accounting for 38% of the total population of the Arab countries.

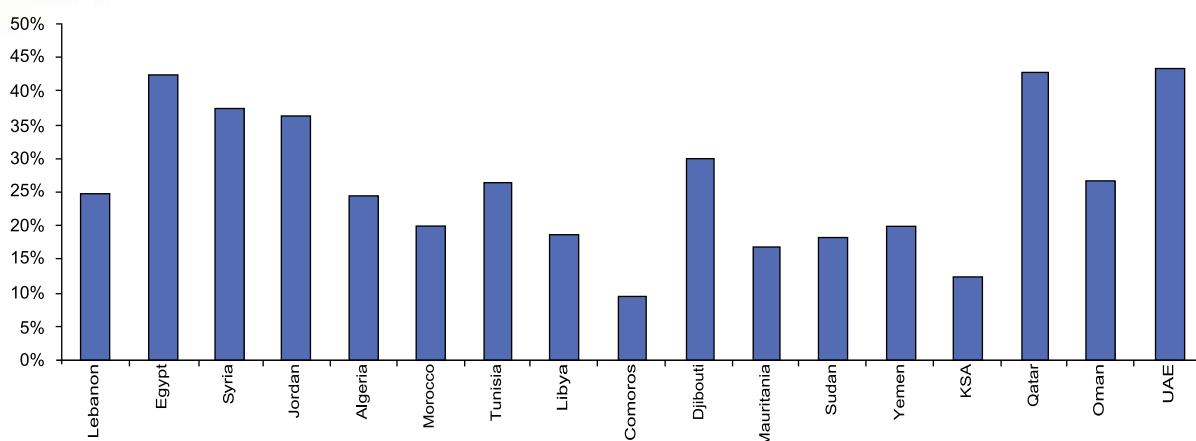
The details of the table show that, for the high human poverty Arab countries, the components express themselves in relatively high probability of not surviving to the age of 40 years (ranging from a low of 8% of cohorts to a high of 26%); a relatively high incidence of adult illiteracy rates (ranging from a low of 39% of the population of age 15 years and older to a high of about 49%); a relatively high degree of deprivation from access to safe water reaching to the extent of 47% of the population without access (with a low of 14% of the population so deprived); and a relatively high incidence of malnutrition as expressed in the percentage of children underweight for age. This percentage of children ranges from a low of 10% to a high of 46%. As far as trends are concerned, at the sub-regional level, the region-wide HPI stood at 23.5 in 2007 (declining by almost one third, from a value of 33 in 1996-1998), which implies that Human Poverty in the region is at a relatively medium level.

Table 10: Incidence of Human Poverty in the Arab Countries (2005)

Country	Value of HPI	Probability of not Surviving to 40 (% of cohort)	Adult Illiteracy Rate (% age 15 and older)	Population without Access to Safe Water (%)	Children Underweight for Age (%)
Low HPI					
Jordan	6.9	6.4	8.9	3	4
Qatar	7.8	3.7	11.0	0	6
UAE	8.4	2.1	11.3	0	14
Lebanon	8.5	6.3	-	0	4
Medium HPI					
Syria	13.6	4.6	19.2	7	7
Tunisia	17.9	4.6	25.7	7	4
Egypt	20.0	7.5	28.6	2	6
Algeria	21.5	7.7	30.1	15	10
Djibouti	28.5	28.6	-	27	27
High HPI					
Comoros	31.3	15.3	-	14	25
Morocco	33.4	8.2	47.7	19	10
Sudan	34.4	26.1	39.1	30	41
Yemen	38.0	18.6	45.9	33	46
Mauritania	39.2	14.6	48.8	47	32

Source: UNDP Human Development Report (2007).

Figure 5: Decline in Human Poverty Rates by Country (%): 1996-2007



Source: UNDP, HDR (1996-1998 and 2007).

This conspicuous decline is not surprising given the progress made in all countries of the region. In fact, Egypt, Syria, Jordan, Oman, Djibouti, Qatar, and UAE all scored a percentage decline of 25% or above over the decade from 1996-98 to 2007 (Figure 5). However, comparing Arab countries with other developing countries shows that Arab countries could have achieved better performance in terms of HPI with the existing level of GDP and even with their level of human development. To clarify, it is worthy to make a comparison between the United Arab Emirates and Chili, which had an HDI rank of 39 and 40, respectively. However, in terms of their HPI, the UAE is more than double that of Chili. This is true for most other countries except Jordan, Lebanon, and Syria. The higher than expected HPI in Arab countries compared to other countries with similar HDI resulted mainly from

high adult illiteracy rates and to some extent from high malnutrition (underweight for age).

3.7 Facets of Inequity and Low Quality in Education:

Compared to other regions, the Arab region has invested heavily in education since the 1960s. According to the World Bank (2008), the region invested about 5 percent of GDP and 20 percent of government budgets in education over the past 40 years (Table 11) which is understandable given the extremely low base of educational coverage in the 1960s and 1970s. As a result, and in the context of the Arab social contracts noted in the introduction there is evidence to suggest that Arab countries have been successful in achieving respectable rates of expansion in education at all levels since the 1960s.

Table 11: Average of Public Expenditure in Education as a Percentage of GDP, 1965–2003*

	1965–74	1975–84	1985–94	1995–2003
Mean for Arab countries (18 countries)	4.3	4.6	5.0	5.3
Mean China, Indonesia, Korea, Malaysia, Philippines and Thailand	2.6	3.3	3.1	3.6
Mean for Argentina, Brazil, Chile, Mexico and Peru	3.0	3.4	3.2	3.9

Source: World Bank (2008).

*For country level data see Annex Table A.15.

Such evidence is usually summarized in terms of the average years of schooling for population 15 years and older, a measure of human capital, which is available for a sample of seven Arab countries (Algeria, Bahrain, Egypt, Jordan, Kuwait, Sudan, Syria, and Tunisia). The evidence shows that as a group, the Arab countries managed to increase the average years of schooling from about 1.1 years in 1960 to about 4.8 in 2000;

thus recording an annual rate of increase of 4.2 percent, the highest rate among all regions of the developing world.⁽³⁵⁾

(35) A ninth Arab country for which data is available is Iraq, which is not included in this analysis due to its special circumstances since 2003. By 2000 all countries in the sample, except for Sudan, achieved the 4 years of schooling threshold beyond which increasing returns to scale for human capital begin to accrue. For further details see Ali (2002).

Despite these achievements, however, there remains a lot of inequality of opportunity in access to education; and, repeated concerns are expressed regarding the quality of education. Both aspects are closely related to labor market outcomes of high and increasing unemployment noted above.

Measuring educational inequality, however, is not an easy task. Fortunately, recent methodological advances enabled the calculation of education Gini coefficients in a large sample of countries for which required information on the distribution of population by years of schooling is available. The World Bank (2005: Table A4, 284-285) reports education Gini coefficients for a world sample of 111 countries.⁽³⁶⁾ The average education Gini coefficient at the level of the world is 36.83 percent with a standard deviation of 22.4 percentage points and a median of 30 percent. The maximum education Gini coefficient is 90 percent, recorded for Burkina Faso in 1999, while the minimum is 10 percent recorded for Slovenia in 1999. The distribution of countries is skewed towards low inequality with 64 countries, representing about 58% of the sample, having an education Gini less than the overall average of the world sample.

Four Arab countries are included in the world sample: Egypt (for the year 2000; with an education Gini of 0.51); Jordan (2002; and 0.21); Morocco (1992; and 0.74); and Yemen (1999; and 0.73). To appropriately appreciate the extent of education inequality in the Arab countries we calculated the education Gini for the sample of seven Arab countries for the year 2000, the most recent year for which the relevant details are available. Using 2005 population weights, our results show that the overall average educational Gini coefficient for the Arab world is about 0.59 (i.e. 59 percent). This is almost one standard deviation above the mean of the world. Using the benchmark results for the world, and given the skewed nature of the distribution for the educational Gini coefficients, it is perhaps safe to conclude that there remains a lot of ground to cover in terms of equalizing educational opportunities in the Arab countries.

Increasing education inequality in Arab countries is further supported by additional data on the percentage of enrollment by poor versus non-poor and rural versus urban populations in primary and

secondary education. The data, reported in the World Bank report, are derived from household surveys in the second half of the 1990s. These data are available for only seven Arab countries and over time only for Yemen, Egypt, and Morocco. Nevertheless, they reveal that non-poor and students who live in urban areas tend to have higher access to education at both levels than the poor and those who live in rural areas. The only exception is Algeria, where the data show almost equal access by both groups across geographical locations for primary education (Annex Table A.5).

Another dimension of equity of access to education is the MDG indicator of the Gender Parity Index (GPI) defined as the gross enrolment rate for females divided by that for males. Evidence reviewed earlier suggests that most of the Arab countries achieved respectable results on this score.

Measuring the quality of education is even more problematic than that of equity. The World Bank (2007-b: 175-176) argues that such measurement can be approached from two perspectives: fundamental quality (meaning “how many students have attained the basic skills to successfully complete their courses of instruction and productively participate in the national labor market, polity, and society?”); and excellence (meaning “how many students from a particular country have entered into world class research universities; or how many national universities produce world class research or technicians/professional?”).

Despite the importance of the perspective of excellence in measuring the quality of education, the World Bank (2007-b: 176) opted for measuring the quality of education from the perspective of fundamental quality. A composite measure of two indicators is used: literacy rate in the population and the results of the international test scores for mathematics and science.⁽³⁷⁾

There is evidence to show that Arab countries have achieved great progress in terms of adult literacy rates since the 1960s. By 2005, and as can be seen from Table 2 above, adult literacy rates varied from a low of 51% of the population aged 15 years and older, recorded for Mauritania, to a high of 93% for Kuwait. The weighted average for the Arab countries is 69% which, despite the progress over time, leaves a fairly large gap to be covered in this fundamental area of quality of education. Needless to note that there is a

(36) See Thomas, Wang and Fan (2000) for the methodology of calculating Gini coefficients for education.

(37) This is usually based on the Trends in International Mathematics and Science Study (TIMSS) rounds.

lot of diversity among Arab sub-regions, and between the countries within the sub-regions. The best performing sub-region is that of GCC oil economies (with an average literacy rate of about 85%), followed by the mixed oil group (72%), the diversified economies group (about 69%), and the primary export economies (58%).

As regards the test scores in mathematics and science study, it should be noted that a report on TIMSS in Arab countries is now prepared by UNDP TIMSS regional office. The latest available results are for 2003.⁽³⁸⁾ Two sets of students were targeted for the 2003 TIMSS study: a sample of fourth grade students with an average age of 9 years, and a sample of eighth grade students of average age of 13 years. Excluding Palestine, 8 Arab countries participated in study at the eighth grade level and only three at the fourth grade level. In what follows we will note the results for the eighth grade. We also note that of the 8 Arab countries, six are the members of the diversified group of Arab economies and two belong to the GCC oil producing and exporting group of Arab economies, namely Bahrain and Saudi Arabia.

Without getting involved into technical details, Table 12 summarizes the evidence on Arab countries where figures between brackets are standard errors. For benchmarking purposes it is perhaps important to note that the best performing country in both fields of study in 2003 was Singapore with average scores of 605 in mathematics and 578 in science, and the international average scores were respectively 467 and 474. From the table it is easy to check that average scores in mathematic and science in the Arab countries are respectively 394 and 417, both well below the international average scores noted above.

The table also shows that Lebanon ranked first among Arab countries in mathematics with an average score of 433, below the international average score. In contrast the best performing Arab country in science, i.e. Jordan, scored an average of 475 points above the international average score, while the rest of the Arab countries achieved country averages significantly lower than the international benchmark.

Table 12: Average Achievement of Arab Students in TIMSS 2003

Country	Number of Students	Average Age of Students Sample	Number of Schools	Average Score in Mathematics	Average Score in Science
Bahrain	4199	14.1	67	401 (3.1)	438 (1.8)
Egypt	7095	14.4	217	406 (3.5)	421 (3.9)
Jordan	4489	13.9	140	424 (4.1)	475 (1.8)
Lebanon	3814	14.6	152	433 (3.1)	393 (4.3)
Morocco	2943	15.2	131	387 (2.5)	396 (2.5)
Saudi Arabia	4295	14.1	155	332 (4.6)	398 (4.0)
Syria	4895	14.0	134	358 (3.7)	411 (3.7)
Tunisia	4931	14.8	150	410 (2.2)	404 (2.1)

Source: UNDP (2004).

To sum, Arab countries invested heavily in education over the past forty years and as such achieved significant progress in enrolment and illiteracy rates. However, these improvements are compromised in part by the high inequality in access to education and low utilization of its accumulated human capital. The link between human capital accumulation, employment, economic growth, and poverty reduction in the region

is weak. In this respect, as noted by the World Bank (2008), there seems to be a big difference in the path taken by the region compared with the approaches used in East Asia and Latin America where education expansion occurred in response to growing demand and the emergence of new and dynamic sectors. In the majority of Arab countries, expansion took place without a corresponding increase in new job opportunities.

(38) The results for 2007 round have not been published as yet.

4 ■ Development Challenges

Given the above stylized facts, it seems reasonable to suggest that there are five major development challenges facing the countries of the region up to 2015. All these five challenges are closely related to the five instrumental freedoms identified in the freedom approach to development. As such, therefore, these challenges are closely related in the sense that the successful overcoming of each one of them helps in relaxing the constraint imposed by the others on the development process. The challenges involved are: reforming institutions; creating employment opportunities; sustaining and financing a pro-poor growth process; reforming the educational systems; and diversifying the sources of economic growth via a revival of industrialization programs to mitigate the negative effects of oil price shocks and globalization.

We hasten to note that our analysis of the development challenges is not a comprehensive one as such an undertaking lies beyond the scope and mandate of this report. Our aim therefore is to focus on the broader and pivotal development challenges. For example, no one can underestimate the importance of raising the saving and investment rates in non-oil surplus economies; reforming health and social security systems; improving capabilities in the field of scientific research and technological development; stimulating collective development efforts and regional cooperation; improving the use of surplus oil income and safeguarding Arab funds against losses such as those incurred in the current global financial/economic crisis and extending the national policy space which has been severely curtailed by excessive extraneous constraints. However, we believe that most of these are sub-challenges already subsumed within the confines of the broader five challenges identified above. Research and development and technological advancement, for example, are highly related to the challenge of reforming education and promoting industrial development. Likewise, raising savings and investments in non-oil economies is a necessary prerequisite for expanding domestic fiscal space, which, in turn, is necessary for the achievement of all the challenges. Closer Arab cooperation and better utilization of oil revenues are also subsumed within the economic diversification and globalization challenge. Finally,

reforming health and social security and income and wealth redistribution are an integral component of any pro-poor growth process.

In analyzing development challenges facing the Arab region we subscribe to the thrust of the UNDP's (2002) Policy Note on "The Role of Economic Policies in Poverty Reduction". The policy note maintains, correctly in our view, that if countries are to reach the target by 2015 of halving extreme income poverty (the primary poverty goal of the Millennium Declaration), rapid growth is certainly essential. However, if growth is also more equitable—so that the incomes of the poor grow faster than average—countries have a much better chance of reaching the target. Hence, a strategy of such "equity-based" growth will need to be rapid enough to significantly improve the 'absolute' condition of the poor and equitable enough to improve their 'relative' position—either by achieving greater equity at the start of the growth process (such as through universalizing coverage of education and health services) or by decreasing unacceptably high inequality over time (such as through pushing up wages by generating widespread employment among low-skilled workers).

In the process of meeting the identified development challenges we will assume that governments in the region can appropriately undertake all types of measures to stabilize their respective macroeconomic environments; as indeed they have done in the past, albeit from a narrow production efficiency perspective. We take it that the current state of our knowledge has amply demonstrated that there exists no robust causal relationship between what was termed "good" economic policies and economic growth. It will be recalled in this respect that a country is said to have a good economic policy if it maintains low inflation, low budget deficits and an open trade regime. Apart from the overall skepticism expressed on the nature of the techniques used to demonstrate the existence of such a relationship, as amply demonstrated in Rodrik (2005), it is now abundantly clear that there exists upper (and lower) limits for the policy indicators that can be chosen by countries without endangering their respective growth processes (see, for example, Easterly (2005: 30). Extreme values of macroeconomic policy indicators would

be: an inflation rate, and a black market premium, each in excess of 35 percent; real overvaluation of more than 68 percent; budget deficits greater than 12% of GDP; broad money to GDP ratio of more than 100 percent; and, trade to GDP ratio of more than 120 percent. Countries starting with non-extreme policy stances are unlikely to witness improvements in their growth performance.⁽³⁹⁾

Such conclusion is held to be consistent with the view that most of the income and growth differences among countries are accounted for by the technological residual which “reflects deep-seated institutions that are not very amenable to change in the short run” (Easterly, 2005: 42).

In addition to the above observations about the association between policy and growth, it is worth noting that recent analysis of long time series of growth for a large number of countries has shown that modern growth performance has passed through a time break separating two growth periods irrespective of the policy stance of countries and their level of development. The years of the break separate a high growth period (postwar period up to the mid-1970s) from a low growth period (from 1970s to the present).

In the context of such studies, it is found that steady state growth is a feature of advanced countries while volatile growth characterizes the process in developing countries. The “rule of growth in developing countries is that anything can happen, and often does. The instability of growth rates makes talk of the growth rate almost meaningless. Moreover, the enormous volatility

of growth around its trend (however defined) means that even over periods as long as a decade, growth can be dominated by shocks and recovery” (Pritchett, 2000: 247).

4.1 Institutional Reform and Governance

The stylized facts about the quality of institutions in the Arab countries amply demonstrate the imperative of institutional reforms. Without loss in generality we may use the average for each governance indicator over the ten years period to identify the direction of the required reforms.⁽⁴⁰⁾ To appreciate the nature of the required reforms we use the aggregative average of each indicator for the two years 1996 and 2006 and calculate the difference (i.e. change in the indicator). Positive differences indicate improvements in the governance dimension while negative differences indicate deterioration. We compare these changes with the large changes reported by Kaufmann et al (2007: 32-44, Table 6) for the world. In this respect we hasten to note that Kaufmann et al (2007: 22) conclude that “we do not have as yet any convincing evidence of significant improvements in governance worldwide”.

The experience of the Arab countries over the period 1996-2006 confirms the above general conclusion and as such points to the need for institutional reforms as a pre-requisite to affecting the expansion of the real freedoms that Arab people enjoy. Table 13 presents a summary of the evidence.

Table 13: Directions of Institutional Reforms in the Arab Countries as a Group

Indicator	Average 1996	Average 2006	Change	Average Change (number of countries)
Voice and Accountability	-1.07	-0.99	0.08	0.91 (9 countries)
Political Stability	-0.54	-0.42	0.12	1.32 (10 countries)
Government Effectiveness	-0.07	-0.22	-0.15*	0.79 (6 countries)
Regulatory Quality	-0.25	-0.17	0.08	1.09 (4 countries)
Rule of Law	-0.20	-0.07	0.13	0.83 (7 countries)
Control of Corruption	-0.25	-0.07	0.18	0.72 (2 countries)
Institutional Indicator	-0.40	-0.32	0.08	

Source: Authors' estimates.

(39) As is usual these results are based on cross-country regressions between per capita growth rate and policy variables to explore the nature of the association. Easterly (2005: 42) concludes that “I find that the associations seem to depend on extreme values of the policy variables, that the results are not very robust to different econometric methods or introducing initial income, and that the levels regression does not show any effect of policies after controlling for institutions”.

It is clear from the table that though the Arab countries as a group recorded improvements in five out of the six governance dimensions, such improvement was very marginal compared

(40) For a different approach to identifying the direction of institutional reforms in the Arab countries see UNDP (2005).

to the largest improvements recorded at the level of the world. As far as government effectiveness is concerned the Arab countries recorded a fairly large deterioration. This is

perhaps counter intuitive, but it signals that the Arab countries should accord this dimension a special priority in their institutional reform programs.

Table 14: Directions of Institutional Reforms in Arab Countries: Change in Governance Indicator 1996 and 2006*

Country /Country Group	Voice and Accountability	Political Stability	Government Effectiveness	Regulatory Quality	Rule of Law	Control of Corruption	Average Change
DE (6)	-0.11	-0.24	-0.31	-0.27	0.01	0.02	-0.16
MOE (2)	0.15	1.78	0.10	0.40	0.56	0.03	0.51
OE (6)	0.31	0.20	-0.01	0.32	0.12	0.64	0.26
PEE (4)	-0.02	-0.28	-0.22	0.04	0.11	-0.15	-0.09
Average (18)	0.08	0.12	-0.15	0.08	0.13	0.18	-0.08

Source: Authors' estimates.

*For country level data see Annex Table A.16.

But other dimensions also indicate the need for urgent action, given the marginality of the recorded improvement over the ten years period under consideration. Thus, for example, the improvement in regulatory quality is about 7% of the largest improvement recorded at the level of the world; that in voice and accountability and in political stability is each about 9% of the average largest improvement recorded around the world; that in the rule of law is about 16%, while that in the control of corruption is about 25% of the largest improvements recorded around the world. There is, of course, variability in the reported changes in governance indicators across sub-regions as well as across countries within each sub-region. Using tables (3) and (4), and after calculating the changes that occurred, Table 14 summarizes the results.

It is perhaps clear that the institutional reform challenge for the group of diversified economies (DE) resides in "political stability", "government effectiveness", and "regulatory quality", where deterioration is recorded over the ten years under consideration. The remaining dimensions reported an improvement over time albeit very marginal compared to the average large improvements reported for the world. Thus, for this group of Arab countries improvements in the remaining dimensions of governance should be included in the institutional reform programs.

The results for the mixed oil economies (MOE) group indicate a rather different challenge. For all governance indicators, this group recorded noticeable improvement over time; albeit marginal for all indicators compared to world large improvements except for "political stability", where the change was higher than the average the world average. The obvious explanation for

this is that each of the two groups of countries involved started in 1996 with very low achievements on this score.

The GCC oil economies (OE) recorded improvements in five of the six governance indicators; the exception being "government effectiveness" which recorded deterioration. All recorded changes were relatively low compared to the experience around the world with the exception of the "control of corruption" dimension where the achievement was about 89% of the average large improvement in the world. Despite these credible achievements, however, the original scores show that all GCC countries face the challenge of launching reforms in the dimension of "voice and accountability", where each country recorded below average quality of institutions in this dimension. A second priority of institutional reforms would need to go for enhancing "government effectiveness".

The primary export economies (PEE) recorded improvements in the two dimensions of the "regulatory quality" and "rule of law", albeit slightly marginal in magnitude. The other four dimensions recorded deterioration over time. Recalling that the level of all average indicators for this group were below the average quality of institutions around the world, it seems obvious that the action on institutional reforms in this group of countries would need to be both deep and sustained over time.

4.2 Generating Employment

Growth in the Arab region has failed glaringly to generate adequate rewarding employment opportunities to the extent that prompted some experts to coin the term "jobless growth" as an

adjective for growth in the Arab region. The bias towards low productivity investment associated with oil-led growth resulted in a much smaller number of jobs being created than needed to close the unemployment gap. Available data also warns of high unemployment and underemployment rates in the region.⁽⁴¹⁾ Youth unemployment exacerbates the situation. In addition, there is ample evidence that underemployment, because of less working hours per week and irregular work, is a widespread socio-economic ailment in the region. Evidence also suggests an overall pattern of stagnation of formal urban employment and the expansion of the informal sector.

The 1990s also earmarked the beginning of a “demographic transition” in many countries of the region, due to the slow down in fertility relative to the 1970s and 80s when the region experienced the highest rates of population growth in the world. As a consequence of the demographic transition, and the increasing participation of women in the labor force, especially educated women, the region’s labor supply has grown quite rapidly. On the other hand, faltering growth since the 1980s as educational attainments continue to expand led to a widening mismatch between labor supply and demand, especially with regard to educated labor. For example, despite that in Egypt the proportion of labor force with secondary education or above accounts for only 42%, they constitute about 80% of the unemployed; and for Algeria and Morocco this category, respectively, accounts for 38 and 30% of the unemployed, which is about twice their respective shares in the labor force (World Bank, 2008). Growth and employment patterns during the 1980s and the 1990s are thus a clear manifestation of the lack of vigorous employment generating growth in the Arab economies. Empirical analysis of growth and employment indicate a weak link between real growth of GDP and employment generation. Such weak link is manifested into a weak statistical relationship between the real growth of GDP and growth of employment over the period 2000-2005. Notwithstanding data limitations, the elasticity of employment generation with respect to real growth has been below unity during the

(41) Scarcity of data for countries of the region prevented the formation of reliable estimates of unemployment for the Arab region as a whole and for its sub-regions used in this report. For this reason, information on unemployment in the Middle East and North Africa and ESCWA will be used as proxy variables. While Middle East and North Africa (MENA) includes two non Arab countries, ESCWA comprises solely Arab ones, although only 13 of them.

period 2000-05 (see Annex Tables A.6 and A.7). The inelastic response of employment to real growth is indicative of the low capacity to generate employment resulting in “jobless growth”.

As a result of the low capacity of the formal economic sectors to generate employment, the ‘informal sector’ has become a “dumping ground” for the ‘surplus’ urban workforce, composed mostly of unskilled and unprotected laborers. Underemployment due to reduced working hours constitutes another challenge. It is estimated to be 31 percent in Iraq, excluding the Kurdish Autonomous Governorates, for the year 2004⁽⁴²⁾, and 25.1 percent in Yemen, in the year 2000. In Syria, results of the 2003 survey suggest that 52 percent of the workforce, equivalent to 49.5 percent of the employed, is underemployed (Islam and Abdel Fadil, 2005: 153).

Given these stylized fact about the relatively high, and increasing, unemployment rate in the Arab countries it is also obvious that Arab countries as a group face the challenge of creating employment opportunities in a sustained manner. Indeed, the World Bank (2004-a, and 2007) considers the creation of jobs in the Arab countries as the most important development challenge for the coming two decades. To appreciate the nature of the challenge facing Arab countries, taking into consideration the paucity of data on labor markets, we may look at the number of jobs that need to be created over the medium-run up to 2020. To do this we rely on the most recent unemployment rates reported in the stylized facts, the rate of growth of labor force over the period 1995-2000. Assuming that countries adopt the objective of keeping the unemployment rate constant by 2020, the question is how many new jobs need to be created.

Table 15 reports our results in this respect. According to the table, the challenge for the Arab countries as a group is to create about 51 million new jobs by 2020. This is a much higher estimate than that reported in the World Bank (2007- b: 223) of 34 million jobs. The table also shows the details of this challenge for country groups for the medium-term (creating about 15 million jobs by 2010 and 32 million jobs by 2015). More detailed country level estimates are also provided in Annex Table A.17.

(42) Central Organization for Statistics and Information Technology, Results of the Employment and Unemployment First Half - 2004, Ministry of Planning and Development Cooperation, Baghdad 2004.

Table 15: The Employment Challenge: Projected Number of New Jobs Required*

Country Group	2005 Labor Force (millions)	2005 Unemployment Rate (%)	2005 Employment (millions)	2010 New Jobs (million)	2015 New Jobs (millions)	2020 New Jobs (millions)
DE (6)	48.3	11.82	42.59	6.55	14.16	21.78
MOE (2)	15.5	15.61	13.08	2.26	4.92	7.56
OE (6)	13.7	4.53	13.08	3.37	7.73	12.08
PEE (4)	22.8	18.68	18.54	2.85	6.17	9.49
Total (18)	100.3	12.97	87.29	15.03	32.98	50.91

Source: Authors' estimates.

*For country level data see Annex Table A.17.

As is well known, creating new jobs can be accomplished through enhancing the growth processes in the Arab countries. This approach to the employment challenge usually uses the elasticity of employment with respect to GDP: that is, the percentage change in employment as a result of a one percent increase in GDP. Though not theoretically robust, and according to the World Bank (2007-b: 223) economic "growth is considered capital intensive when the employment elasticity is less than 0.4 and labor intensive when the elasticity is greater than 0.8". To further explore the nature of the challenge facing the Arab countries on the employment-growth nexus, we looked at the employment expansion in a sample of Arab countries we already considered under the stylized facts. We calculated the rate of employment creation over the period of 1980-2005 using the UN rates for population growth. We also calculated the GDP rate for these countries over the same period.

Three observations regarding the challenge are warranted. The first has to do with the rate of

growth of employment in the Arab countries over the last three decades. The results show that none of the Arab countries in the sample recorded an employment growth rate approximating 3.2 percent per annum over the period under consideration. Only Jordan recorded a relatively high employment growth rate. The second observation has to do with the nature of the growth process in the Arab countries. Looking at the elasticity column it is clear that none of the Arab countries in the sample was able to establish a "labor intensive" growth process over the past three decades or so as is clearly seen from the values of the employment growth elasticity all being less than 0.8. Indeed, it seems that almost all of the growth processes were capital intensive or bordering on being so. The third observation has to do with the required GDP growth rates to keep the unemployment rate constant, assuming that the required annual employment growth rate is 3.2 percent. The annual average required GDP growth rate for the sample as a whole is about 7.6 percent: varying from a high of 10.0 percent for Tunisia to a low of 5.1 percent for Jordan (Table 16).

Table 16: Required Rate of Growth to Meet the Employment Challenge

Country	Annual Change in the Employment Rate (%)	Population Growth Rate (%)	Annual Rate of Growth of Employment (%)	Real GDP Growth Rate (%)	Employment Elasticity	Required Rate of GDP Growth (%)
Algeria	-0.75	2.23	1.48	3.71	0.40	8.00
Egypt	-0.18	2.05	1.87	6.05	0.45	7.11
Jordan	-0.59	3.65	3.06	4.86	0.63	5.08
Morocco	0.00	1.78	1.78	4.02	0.44	7.27
Syria	-0.42	2.98	2.56	5.69	0.45	7.11
Tunisia	-0.14	1.79	1.65	5.15	0.32	10.00
Average	-0.35	2.41	2.06	4.91	0.42	7.62

Source: Authors' estimates.

Comparing these required rates of real GDP growth with the recent record of high economic growth over the period 2000-2006 clearly shows the nature of the challenge facing Arab countries. According to the World Bank (2007-a: 102,

Table A.1) the average annual rate of growth of real GDP over the above period was highest in Jordan (6.7 percent), followed by that for Egypt and Tunisia (4.9 percent), followed by that for Morocco (4.3 percent), Syria (4.2 percent),

and Algeria (4 percent).⁽⁴³⁾ The overall simple average for the sample of Arab countries is 4.8 percent. Clearly, the pace of growth as well as the accompanying choice of technology must diverge considerably from their historical patterns if the region is to meet the employment challenge.

Given the relatively high unemployment rate, and its tendency to increase over time in most Arab countries, and taking into account the pressures of the global market on policy makers, there is now a move in policy circles for designing macroeconomic policies that can initiate and sustain a high level of employment without sacrificing increased productivity. According to Bhaduri (2005:14) “domestic demand-led expansion is the cornerstone of this employment strategy”. An employment guarantee scheme at the minimum wage, financed to the extent necessary by an expansionary budgetary policy of the government, might be required to break the inertia of continuing serious unemployment”. The implication of such a strategy run counter to the neo-liberal advocacy of reforming labor market policies and institutions with the aim of increasing the flexibility of labor markets. In this respect the Commission on Growth and Development (2008: 45) notes that “rules and institutions exist to safeguard the rights of labor, defending workers against exploitation, abuse, underage employment, and unsafe working conditions. In some countries, these rights are protected by unions or government regulations. But in others, no such protections are in place. The Commission feels strongly that these rights should not be sacrificed to achieve other economic objectives, including growth.”⁽⁴⁴⁾

4.3 Sustaining and Financing Pro-poor Growth:

Our stylized facts highlight four main features of Arab growth over the past three decades: a relatively low rate of growth of GDP per capita (since 1980), high volatility, almost full dependence on oil exports and ineffectiveness as a tool for poverty reduction (since 1990). Within these

confines, and given the overarching objective of development as poverty reduction, there is an emerging concern that it is the pro-poor nature of growth that represents a challenge to developing countries in general, with the Arab countries not being an exemption in this regard. Also, it appeared that the region has effectively used the enormous resources triggered by the oil price hikes in the 1970s to considerably advance its standing in terms of the social development agenda. Compared to other regions, the people of the Arab world had realized enormous social benefits. Such gains were made possible by massive investment in education and health and also through direct and generous transfers to large segments of the population (World Bank, 1995).

Though there are a number of definitions of what is meant by pro-poor economic growth, it is perhaps reasonable to suggest that the most intuitive one is that due to Son and Kakwani (2006: 2): pro-poor growth is “growth that benefits the poor proportionately more than the non-poor. When there is a negative growth rate, growth is defined as pro-poor if the loss from the growth is proportionately less for the poor than for the non-poor”. A new measure for measuring pro-poor growth is suggested which is the difference between the observed “growth rate of the mean income of the whole society” and “the rate of change in inequality”. Son and Kakwani (2006: 4) note that “if inequality decreases (increases) in a period, then the pro-poor growth rate will be greater (less) than the actual growth rate of the mean income. Thus, there will be a gain or a loss in growth rate due to changes in inequality. Growth will be pro-poor if there is a gain in growth rate and anti-poor if there is a loss in growth rate”.⁽⁴⁵⁾

The above definition of pro-poor growth alerts policy makers to the fact that in designing their growth-oriented policies in the context of development, they should pay special attention to the distributional implications of such policies. This, of course, is a major challenge to all developing countries including Arab countries where poverty is a serious development problem. We hasten to note that it can be shown that even for GCC countries, where poverty is not a serious development issue, reducing the percentage of those with low consumption (or income) over time depends crucially on the state of inequality in the distribution of consumption expenditure. This is true both for the level, as well as the change over

(43) Our own calculations for the average growth rates of real GDP in the sample over the period 2000-2006 are similar to that of the World Bank: Jordan (5.9 percent); Egypt (4.7 percent); Tunisia (4.6 percent); Algeria (2.3 percent); and Morocco (2.3 percent).

(44) Bhaduri, A., (2005), “Macroeconomic Policies for Higher Employment in the Era of Globalization”; Employment Strategy Paper No. 11, www.ilo.org; and The Commission on Growth and Development, (2008), *The Growth Report: Strategies for Sustained Growth and Inclusive Development*; www.growth-commission.org

(45) The new measure is based on the generalized Lorenz curve defined as the product of mean income and the Lorenz curve.

time, of the percentage of low income individuals and families.⁽⁴⁶⁾ For non-GCC Arab countries, where poverty is a major development problem, there is evidence to suggest that some of the observed medium-term growth processes (e.g. over five years or more) that took place in them were not pro-poor.

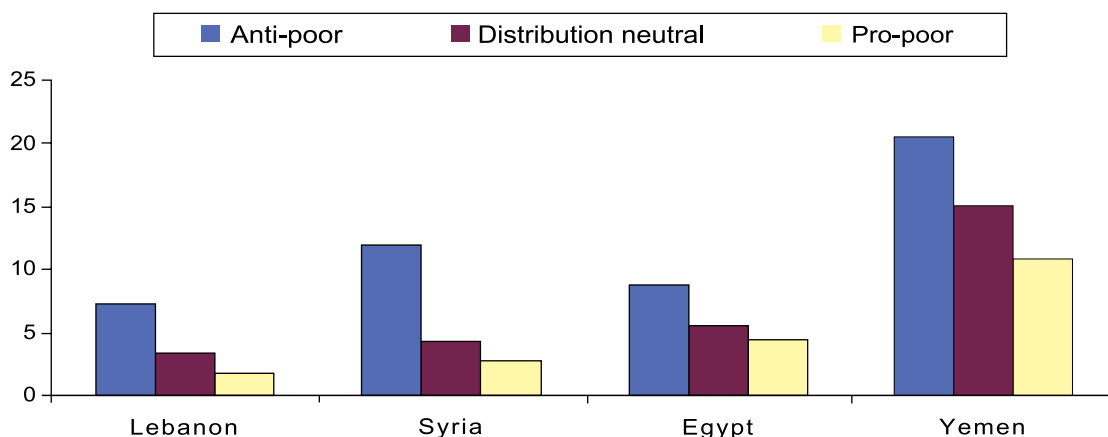
According to Son and Kakwani (2006) pro-poor growth processes have taken place in each of Algeria (1990-2001); Egypt (1987-1990); Jordan (1990-1993); Mauritania (1987-1996); Morocco (1984-1987); Tunisia (1987-1990 and 1999-2001); and Yemen (1993-1996). Our estimates shown in Annex Table A.8 indicate that the growth processes in Morocco (1991-1999), Syria (1997-2004), and Yemen (1998-2005) were anti-poor, while that of Algeria was neutral. The challenge for the Arab countries concerned is to learn from and replicate the pro-poor growth episodes.

To this end, the challenge facing Arab countries is not only to achieve higher growth -this is no doubt necessary for rapid poverty reduction- but also to transmit growth more effectively and more rapidly into poverty reduction by effectively deploying redistributive policies. The fact that poverty-distribution elasticities are relatively high for most countries in the region also implies that small shocks in income distribution may

have far reaching effects on the incidence of poverty. It is supported by the findings of several recent UNDP reports which tried to estimate the cost of poverty reduction under various income distribution scenarios.⁽⁴⁷⁾ Following a simple methodology proposed by Kakwani and Son (2005) the reports derived the cost of halving extreme poverty rates in four Arab countries relying on poverty growth elasticities derived from the most recent HIESs and applying incremental capital output ratios (ICORS) derived from national accounts. Although not a very useful or reliable tool for planning sectorial public investment, this approach is useful to determine the order of magnitude of public resources required to meet the cost of poverty reduction.⁽⁴⁸⁾

The results for four Arab countries (Egypt, Lebanon, Syria, and Yemen) are shown in Figure 6. The figure shows that the annual resource gap required to halve extreme poverty (defined here as the rate of population below the lower poverty line) between 2005 and 2015 varies significantly depending on whether growth is accompanied by an improvement (pro-poor) or deterioration (anti-poor) in income distribution. As expected, the average resource gap for Yemen (15% for the distribution neutral scenario) is significantly higher than for Egypt, Syria, and Lebanon (3-5% for the distribution neutral scenario).

Figure 6: Average Annual Gap between Savings and Investment (% of GDP) required to Halve Poverty by 2015 in Egypt, Syria, Yemen and Lebanon under Alternative Growth Scenarios



Source: Authors' estimates based on UNDP and World Bank Poverty Assessments (2005-2008)

(46) From a technical point of view this can be shown by formulating the percentage of low income individuals in a general format of a poverty measure as depending on the mean income of society as a ratio of the mandated minimum income (just like the poverty line) and the degree of the inequality in the distribution of income or consumption expenditure. Now the mandated minimum income level is usually defined as a ratio of mean income (irrespective of the value of the ratio). By appropriately inserting this in the formula we will find that the percentage of low income individuals is a function solely of the degree of inequality.

(47) See for example Abu-Ismaïl (2006) and Kakwani, Son, Abu-Ismaïl and Roberts (2006) and UNDP (2008).

(48) It should be emphasized that the estimates are highly dependent on the accuracy of the growth and distribution elasticities, which are not always reliable.

An interesting result emerges when extrapolating those results to Arab countries. Assuming that the average resource gap for Yemen applies for other LDCs and that the population weighted average for Egypt, Syria, and Lebanon applies for other Arab MICs, the gap per capita required to halve extreme poverty between 2005 and 2015 is estimated at only 2 percent of the Arab GDP in 2006 if growth is pro-poor. However, the required gap rises to 4 percent of the region's GDP if growth

is anti-poor. Those financing requirements, although relatively low when measured in terms of region-wide GDP, are still relatively high in terms of sub-regional income for MICs and LDCs. However, they also clearly indicate that the challenge is not difficult to surmount for the region as a whole. To emphasize this point, the Domestic Resources Available for Development and Investment (DRDI) (defined here as GDP minus private consumption) is a useful indicator to examine the size of this fiscal space.⁽⁴⁹⁾

Table 17: Domestic Resources Available for Development and Investment (DRDI)*

Country group	DRDI					Non-Oil DRDI				
	1970-1980	1980-1990	1990-2000	2000-2007	1970-2007	1970-1980	1980-1990	1990-2000	2000-2007	1970-2007
Oil Rich (9)	68%	59%	53%	63%	61%	16%	22%	18%	14%	17%
Oil Poor (12)	28%	24%	25%	28%	26%	23%	18%	18%	18%	19%

Source: Authors calculations based on data from the UN statistical database.

*For country level data see Annex Table A.18.

Table 17 shows the trends in DRDI and non-oil DRDI as a share of GDP since 1970 for Arab countries which are divided across two categories depending on whether or not the country has been a significant net oil exporter throughout the past two decades (thus for example Egypt, Sudan, and Yemen are included in the oil poor category). For comparison, the average value of DRDI for other (non-LDC) developing countries is over 30 percent. As the table shows, GDP in major oil exporting Arab countries has been amply sufficient to cater to development expenditure since DRDI typically hovers between half to two thirds of GDP. However, this fiscal space dwindled sharply in the 1990s when compared to the 1970s before picking up again in the 2000s.

Oil poor countries are more fiscally constrained as indicated by their much lower DRDI. The effect of structural adjustment programs and lower oil prices is also shown in the decline of the DRDI during the 1980s and 1990s compared to the average in the 1970s. When DRDI is calculated based on the non-oil GDP, the picture is reversed and oil-rich economies are observed to have less fiscal space for development expenditure than oil poor countries. However, fiscal space also drops significantly for the latter (from 26% to 19%) confirming that both groups are vulnerable to suffer from adverse impact of an oil shock.

4.4 Reforming Educational Systems

The stylized fact on education shows that despite the vast expansion in education at all levels by almost all Arab countries since 1960, there still remain major challenges regarding access to education and the quality of education provided. Moreover, the human development achievements of the Arab countries since 1975, though impressive by world standards, have been negatively affected by the education component of the Human Development Index (HDI). These facts clearly point in the direction of the existence of an educational reform challenge facing almost all Arab countries.

Apart from the technological relationship between education and economic performance, a well established empirical regularity for long-term economic growth, it is now widely recognized that education is an important vehicle for improved equity in various societies. One obvious requirement for enhancing the role of education in the development process is to devote to it an increased share of public resources.

There is now increased awareness around the world that while a number of developing countries may be well poised to achieve the MDG

(49) DRDI is also a very useful measure of the nature and extent of structural fragility caused by earlier described oil-led growth if it is measured as a share of non-oil GDP.

on universal primary education, “the majority of youth are not reaching even minimal competency levels, let alone the competence demanded in a globalized environment (...) While all countries’ education systems are expanding quantitatively, nearly all are failing in their fundamental purpose” (Filmer, Hasan and Pritchett, 2006). Minimal competency levels in education include adequate knowledge, skills, attitudes, values, and behavior needed to function in the economic, social, and political spheres of modern society.

One approach to reforming the Arab educational systems is for each country (or set of countries) to define a Millennium Learning Goal based on the “notion of cohort based assessment of the level of all children of a given age”, in and out of school. The learning goal requires defining a realistic set of low and high competencies as targets for learning. Existing curricula do include universally acknowledged minimum competencies such as functional literacy, command of basic numerical reasoning, and understanding of basic notions of science. The challenge is to recognize that some of these curricula are over-ambitious, over complicated, unnecessarily broad, and possibly not linked to the specific competencies desired by the original design. A second step in the reform process is to agree on a regular mechanism for measuring the desired competencies from schooling. This is an additional mechanism to the established national examination systems.

Another approach to reforming the educational systems is proposed in the recent World Bank (2007- b) report on education in the region. This report specifically notes that past educational reform efforts in the Arab countries have not produced the desired education outcomes. A framework for reform is proposed that have three building blocks of: engineering requirements (meaning physical resources devoted to the educational system; efforts in curriculum development and teaching; and mobilization of resources to finance and administer the system); incentives aligned with outcomes (meaning adequate evaluation and monitoring of schools, motivation for teachers and administrators including financial rewards; and a system for dissemination of information about schools); and public accountability (meaning the ability of various stake holders in the educational system to influence the formation of objectives, policies, and resource allocation at national and local levels). It is conceded that some Arab countries

have experimented with all three building blocks of the framework but the challenge that remains is that they should be implemented in concert.

4.5 Economic Diversification and Globalization

As argued earlier, Arab countries have transformed rapidly since the 1970s into service based economies. In 2007, the share of services in GDP exceeded 50 percent in almost all Arab countries (increasing from an average of 40.9 for the period from 1970 to 1979 to 51.8 for the period from 200-2007). Correspondingly, the manufacturing sector has performed rather poorly in most Arab countries. Even the more diversified middle income economies such as Syria, Egypt, and Morocco experienced significant deindustrialization, with declining manufacturing shares of value added and employment.

These stylized facts point to a major challenge: Arab countries, particularly oil-exporters, need to diversify out of oil-led growth into industrial export-led growth on the South East Asia model, Indonesia, or Malaysia. However, this may prove to be difficult given the earlier observed dynamics of stunted industrialization and its main ramification in the form of very low industrial output ratios for the Arab region.⁽⁵⁰⁾ In addition, the replication of the Asian export-oriented model by Arab countries has to overcome major challenges which are extremely difficult to surmount when compared to the difficulties confronting Asian countries in the wake of their industrialization programs three decades ago:

One major industrialization challenge facing Arab countries is that a Korean policy mix based on protecting the local market and giving incentives to selected sectors to promote manufactured export-led growth is no longer a feasible option since all these strategies are now severely restricted under the WTO and other trade agreements (Abu-Ismaïl et al, 2005). Second, manufacturing export-led growth is not easily transferable. This is because leading firms in global production networks outsource lower value-added activities, retaining control over production in the higher value-added areas of their “core competency”. These areas are often characterized by higher technological and skill requirements, but they are also commonly

(50) Abu-Ismaïl (2006) for example shows that the Arab region recorded the lowest industrial to primary export ratio during the period from 1992-2000 compared to any other region except Sub-Saharan African.

oligopolistic and subject to significant barriers to entry. Competition at the lower value added level can be so intense as to make it difficult to raise profits and wages (Milberg, 2002). In other words, export-led growth is an exclusive phenomenon, which will be more difficult to replicate as more and more countries shift outwards.

On the other hand, any country's competitive advantage is determined by innovation rather than factor endowments and by the ability to diversify up the value chain and not get stuck at a particular static comparative advantage (Paus and Shapiro 2007). The technological and knowledge race is fierce and countries that are able to master new technologies and innovation will have competitive advantage at the expense of the rest. In this regard the Arab region, as vividly illustrated by the AHDR (2003), lags behind. Moreover, the entry of China, India, and the ex-Soviet Union onto the global capitalist stage is perhaps one of the most significant changes in today's global economy. These countries, by joining the global system of production and consumption have contributed 1.47 billion workers to the global factor pool. The resulting doubling of the global labor force alters the range of possibilities for other developing countries, including Arab countries, (Freeman, 2005).⁽⁵¹⁾ Wages in many developing countries, in comparison with China, are relatively too high for countries to compete any longer in the production of unskilled-labor-intensive products; and productivity is often relatively too low to compete successfully with more technologically advanced countries, including China and India, in the production of highly skill-intensive goods and services.⁽⁵²⁾ At the same time, as noted by Karshenas (2001), the past experience of development in the region seems to have locked in social institutions and skill patterns that are inappropriate in the context of the new technological realities and the prevailing trends in the global economy. As a result, Arab countries are facing daunting challenges not only with respect

to increasing their participation in the world economy but also with respect to maintaining a share of their own domestic markets.

Trade liberalization may also have a significant negative impact on tax revenues in Arab countries. Tosun (2005) documents the shift to regressive consumption taxes by developing countries, including Arab countries, in response to the fall in tariff revenues associated with trade liberalization. He points out that, unlike most developing countries, simulation and econometric results record relatively higher welfare loss due to such shift for Arab countries, which, in turn, is the result of their relatively higher contribution to the structure of fiscal revenues. Such findings pose a warning signal for fiscal impacts that will be transmitted to the poor as well as the fiscal capacity to take necessary measures for the achieving of MDGs, particularly MDG 1.

Given these constraints, the challenge for Arab countries is to deal with globalization in a selective way and open up their economies gradually in line with the development of their productive forces and competitiveness. In this respect, regional integration is an important pre-requisite to global integration. Arab intra-regional trade remains insignificant (around 10 percent of total trade), compared to other regional groups in the world, despite the establishment of the GAFTA in 1997, two sub-regional FTAs that brought about the establishment of the GCC and the UMA in 1981 and 1989, respectively, Aghadir and several bilateral FTAs (Table 18). Moreover, oil constitutes around 70 percent of overall regional trade. Finally, it is interesting to note from the flow of trade data provided by UNCTAD that Arab-South trade and intra-Arab trade is more concentrated in manufactured goods than in Arab-North trade. Nearly 70 percent of manufactured exports of Arab countries are absorbed by intra-regional trade.

(51) Freeman estimates that the entry of China, India, and the former Soviet block into the global economy cut the global capital/labor ratio by just 55 to 60 percent what it otherwise would have been, thus transforming the structure of the global economy.

(52) Ten years ago, Adrian Wood (1996) was one of the first to call attention to Latin America's dilemma of being caught in the middle between countries with much lower wages on the one hand and countries with much higher productivity on the other.

Table 18: Intra-Regional Trade for Arab Countries and other Regional Trade Groups

Group	Intra-regional trade as a percentage of total trade						
	1999	2000	2001	2002	2003	2004	2005
Arab Countries	8%	7%	8%	10%	10%	10%	10%
UMA	3%	3%	3%	3%	3%	3%	2%
Euro Zone	51%	49%	50%	50%	51%	51%	52%
UEMOA	12%	11%	11%	11%	11%	11%	12%
ASEAN	22%	23%	22%	23%	22%	22%	24%
CIS	28%	28%	26%	26%	27%	23%	22%
CACM	12%	12%	12%	11%	11%	11%	11%
CARICOM	11%	10%	11%	9%	9%	10%	11%
FTAA	52%	53%	52%	52%	51%	50%	52%
LAIA	13%	13%	13%	12%	13%	14%	15%
MERCUSOR	20%	20%	18%	14%	15%	15%	14%

Source: UNCTAD 2007 Database and Arab Monetary Fund (AMF) Statistical Online Database.

Finally, our discussion of the globalization challenge thus far has been limited to industrialization and commodity trade. However, another major challenge arising from globalization is that Arab countries are becoming increasingly

vulnerable to suffer the negative impacts of financial liberalization and integration with the global financial system. The impact of the current global financial crisis on Arab stock markets and wealth funds is a valid case in point.

5. Policy Directions from a Human Development perspective

This report has taken a long-term assessment of the trajectory of economic and human development in Arab countries over the past few decades. It illustrates, in many facets, how Arab countries have failed to trigger rapid (or sustainable) economic growth, to generate employment and a sustained reduction of poverty. The reason why the Arab countries have not been able to enter into a path of sustainable economic growth and poverty reduction is a matter of analysis and debate. The contending views in this respect reflect the broader world wide ongoing debate spurred by the unfulfilled promises of conventional economic wisdom that prevailed during the 1980s and first half of the 1990s. What is now under discussion is the road ahead for the region. Should the region insist on the same path of so called 'economic reform'? The answer given by the stylized facts is clear. Development challenges will not be overcome by a continuation of existing policies and institutions. It is also clear that Arab countries, individually and collectively, should be able to revisit their earlier social contracts with a view of achieving "development as freedom".

However, before dwelling on policy directions to this end, it is important to clarify two issues. First, we do not pretend to have the answers or detailed policy prescriptions to address these major challenges. This would run contrary to the gist of our critique of structural adjustment policies (and in any case, we would not be able to do so in the scope of this study). Therefore, our policy directions should not be misinterpreted as policy prescriptions.

Second, we believe the developmental failure of Arab countries with respect to poverty, growth, and employment is not primarily due to governance related factors. Rather, it is due to the wrong kind of vision. This is an important clarification since, given the failure of so called market based reforms to achieve their objectives of higher growth and human development, neo-liberalism has migrated from "market fundamentalism" to "institutional fundamentalism". From this perspective, the problems affecting the Arab region are perceived to respond mainly to the lack of reforms which in turn has deterred its integration into the global

economy; and accordingly the solution is further and more accelerated economic and political reforms aimed at unleashing market forces, minimizing the role of the state in the economy, further trade liberalization, and consolidating democratic governance (e.g. Dasgupta, Keller and Sinivasan, 2002; Keller and Nabli, 2002; Abed, 2003; Sekkat and Vaganzones-Varoudakis, 2004; and World Bank, 2007).⁽⁵³⁾ Accordingly, a new set of broad reforms relating to institutions and governance are now suggested as the definitive solution to Arab countries.

Historical evidence also suggests poor Arab growth performance is caused by more than red tape or investors' weak trust. It persists despite consistent tariff reforms and a complex regime of free trade agreements (e.g. WTO, EU associations, co-terminus regional and bilateral trade agreements) which have resulted in noticeable reduction of tariff barriers to exports from Arab countries.⁽⁵⁴⁾ Weak growth cannot be blamed on poor institutions or centralized state-led planning administrations any longer as it persists despite the abandonment of state-led development models and reform of several regulatory frameworks to promote private sector investment. As repeatedly argued earlier, in the Arab context, which is closely tied to oil market dynamics, an economic development agenda reduced to effective government alone is not enough; the sort of economic development required to address the aforementioned challenges goes beyond the scope of effective administration and transparent public finance management.

We suggest, based on earlier facts and challenges, that an alternative Arab developmental approach should be anchored in three pillars: diversified economic growth, employment generation, and poverty reduction. This vision, it should be emphasized, distances itself both from market fundamentalists and from apostles of statism

(53) The common explanation of the disappointing growth and employment results in the region in the light of the structural reforms undertaken is the slow pace of reform in comparison to other regions, and the lack of a commensurate supply response, low rates and slow growth of private investment, due to the lack of credibility and the gradual and slow pace of the reforms and an adverse private investment climate in part resulting from the systems of governance that pervade the region.

(54) ESCWA Millennium Development Goals in the Arab Region 2007: A Youth Lens. pp. 59-60.

and interventionism. No doubt a large dose of imaginative realism in policy-making will be necessary to derive an appropriate balance between states and markets in accordance with the conditions prevailing in each country.

Regarding the first pillar, we believe that the policy direction required to address the globalization and economic diversification problem leaves most Arab countries with little choice but to return to productive sectors. As we shall be devoting a separate volume to the issue of food security and agriculture, the focus here is on industrial policy, which is discussed in Section 5.1. It should be noted at the outset that promoting a revival of industrial policies is not tantamount to advocating the earlier import substitution policies, where there is a low level of challenge and high level of support in the form of protection from foreign competition (although it should be recognized that these programmes had achieved many successes particularly during the 1960s). Our vision is that any industrial policy mix should encompass a high level challenge (that will come any way from the exposure to market forces embodied in trade agreements) but may also include state enforced parameters, and high support by means other than just trade protection. Clearly we do not (and in any case cannot in the context of this work) present an exhaustive list of the arguments in favor of such policies at the regional or national levels. Again, the main objective is to introduce policy directions not on pure economic grounds but on the basis of human development considerations.

We also assert that linking productive growth to poverty reduction must involve generating widespread employment at decent wages. Besides its economic implications, the employment problem can be easily identified as the most politically volatile socioeconomic issue facing the region during the short- and medium-terms. The challenge, as argued earlier, is not only to create employment, but also to provide decent and productive jobs to all the working-age population. Policy directions to this end are discussed in Section 5.2.

Finally, to address the poverty challenge, macroeconomic policies can have as much impact as—if not more than—targeted anti-poverty programmes. But the question is: what makes growth more pro-poor? The general answer given here is that three conditions should be created: **a concentration of growth in economic sectors**

that can directly benefit the poor; an enabling environment that promotes their employment; and real incomes and enhancement of their basic human capabilities. Using these criteria, as argued in Section 5.3, macroeconomic policies can certainly influence whether growth is pro-poor, but such policies cannot be a substitute for an equitable distribution of productive assets. Provided that measures are taken to help secure the poor's access to productive assets, such as land, housing, and equipment for micro-enterprises, employing macroeconomic policies to then help raise the returns to these assets is considered the most useful approach.

5.1 Reviving the non-oil industrial base

Acknowledgement of industrial policies as a core component of an alternative development vision is grounded not only on the assessment of the outcome of the neo-liberal reforms implemented during the last two decades by Arab countries, but also on a revived and revitalized discussion of the sources of success of the emerging Asian economies. It is also grounded on the realization that the new challenges imposed on developing countries, including Arab countries, by the new realities of globalization, call upon for an urgent change in the overall development policy. We shall first briefly review these issues and then discuss the foundations supporting the case for industrial policies in Arab countries.

It is pertinent to note that we concede to the notion that “macroeconomic populism” needs to be avoided if development is to take place; the state has to manage the economy in a responsible manner, assure access to and the quality of health and education, and provide the basic economic infrastructure; the private sector should be the engine of growth, therefore an overall business-friendly environment is necessary for development; and governance capabilities count. These issues are not under discussion. In this context, the role of the state and the issue of governance have been brought up to the centre stage of the Arab development debate; and the new realities brought in by globalization, have revived and revitalized the long ongoing debate surrounding the issue of active “*industrial policies*” and the economic growth and sustainable development.

The perspective presented by the authors of this report is grounded in the realization that market forces acting alone are not capable of lifting Arab

countries into a higher road of development. Intervention is needed to assure sustainable long-term increases in productivity, for creating jobs at a rate in accordance to the pressing needs of developing countries, while raising the standards of living of the majority of the population that is needed for the social and political stability required for sustaining democratic governance. The basic tenet of this approach is that state intervention in the economy is necessary if developing countries are to escape from their present situation and initiate an accelerated process of convergence with the developed world.

Structuralist recipes basically argue for an alternative approach to development which differs from the neo-liberal prescriptions in some significant ways. A convergent view of an alternative policy package is gradually emerging proposing, among other: (i) development-friendly macroeconomic management aiming at minimizing growth variability and financial volatility, and assuring competitive exchange and interest rates through market-based management mechanisms; (ii) active industrial policies supporting domestic productive sectors addressing market failure and realizing positive externalities; (iii) emphasis on equity and distributive and targeted pro-poor policies in contrast to the “trickle-down effects” notion embedded in neo-liberalism; (iv) a pro-active fiscal policy which identifies sources and agency for resources to finance developmental programmes expanding the available fiscal space, and the utilization of fiscal policy to smooth the economic cycles. These policies have to be complemented with an environment-friendly approach which does not opt for short-term economic gains at the expense of long-term environmental degradation. (Abugattas and Paus 2007).

Contrary to the neo-liberal vision, there is no presumption on a “one-size-fits-all” policy that developing countries should pursue.⁽⁵⁵⁾ This approach duly recognizes that country-specific considerations would be necessary to determine the exact nature of the policies, and the relative importance and role of each of its constituent elements. Therefore there is no blueprint of “good policies” that countries could readily adopt. Arab countries need to devise and implement the optimum policy mix and the specific instruments that would unleash all their potential. The choice of policies has to respond to the unique

(55) This has been recognized by the World Bank (2005). However, this realization has not been translated in practice to its recommendations to developing countries.

individual country circumstances, and success will depend both on the combination of policies and on the efficacy of their implementation. The need to develop specific governance capabilities to effectively implement development policies is also recognized as an important condition for success (Khan 2007).

However, the profound changes taking place in the world economy as a result of globalization impose a sense of urgency on Arab countries to accelerate their leap on to a high road to development. The fast moving technological change is constantly raising the technological frontier demanding significant efforts from developing countries in catching up with the technological leaders in order to achieve levels of productivity and competitiveness that will allow them to be effective participants in the global economy and reap benefits from globalization. The most dynamic sectors in the world economy and trade are high-technology goods and services. It has been widely acknowledged in the literature that developing countries’ specialization in commodities and unskilled-labor-intensive products, which might lead to “immiserising growth”, is the low road to development. A high road to development will not be feasible unless Arab countries adopt policies where the expansion of indigenous technological capacities is at the core of achieving structural change and competitive advantages in higher value-added goods and services. This calls for the expansion of *knowledge-based assets* that will lead to increased investment and productivity growth.⁽⁵⁶⁾

An early argument in favor of state intervention is that of “infant industry” or dynamic comparative advantage arguments. Simply stated, it highlights the fact that firms or industries learn by doing and move in time down the cost curve until reaching international competitive levels. Confronting competition from foreign producers that have already moved down the cost curve will impede these activities from developing in Arab countries. Therefore, support is needed to allow firms time to transit to higher levels of competitiveness.⁽⁵⁷⁾

(56) According to Amsden (2001) knowledge-based assets comprise a set of managerial and a technological skill allowing a firm to produce a product at above prevailing market prices or below market costs and determining a country’s long-term growth.

(57) There are important qualifications to the infant industry argument. First, that the reduction in costs over time should compensate for the higher costs during the period of assistance; second, assistance should be linked to performance by the recipient; and third, the appropriate support should be granted aiming to the factors that creates knowledge or learning by the firms.

This line of argument is generally not disputed. What has been questioned is the choice of instruments to allow firms to become competitive (e.g. among other, subsidies, financial instruments, government procurement practices, and technological support).

One main argument against industrial policies comes from the reservation about the ability of developing countries to manage anything but the most liberal policy configurations. This argument rests in the weakness of the state institutions. It is not that such policies are not adequate, but it is argued that their implementation is beyond the capacity of the state in most developing countries. Except for the successful Asian countries, the argument goes; other developing countries do not have what it takes to pursue active industrial policies (e.g. World Bank, 1993; Winters 2003; Krueger 1997; Noland and Pack 2003; among others). There is a serious flaw in this argument as those who question the capacity of the state in developing countries to implement these policies, bet at the same time on the same bureaucratic cadres being able to implement and administer the complex reforms, and the institutions and regulatory frameworks they advocate for (IPRs regimes, competition policy, national innovation systems, among other). If there is capacity to implement the reforms there is capacity to administer industrial policies.

The formulation and assessment of industrial policies in Arab countries cannot be done in the abstract; they have to be context-specific within the realm of possibilities, recognizing the degrees of freedom that countries effectively have to implement within the existing international and domestic constraints. This brings us to an assessment of the "industrial policy space" available for Arab countries for implementing industrial policies. Industrial policy space can be defined by a number of different external and internal constraints.

In order to assess the available policy space at least two different dimensions have to be considered. One corresponds to the constraints on policy space resulting from the adoption by countries of international binding and enforceable commitments. Another dimension is the effects of globalization, or increasing economic interdependence, in undermining national sovereignty and therefore limiting policy options. In the first case policy space is relinquished as an act, at least in principle, in the exercise of national sovereignty, while the latter limits policy space as a result of the new emerging

market realities and of the behavior of external private actors. It is furthermore recognized that diversity rather than universality is the principal feature of Arab countries' current development realities; and that policy space is not invariant across time. This is particularly relevant in the Arab region where heterogeneity is high.

Notwithstanding this diversity, one essential and generally applicable component for the recovery and expansion of private manufacturing investment is public investment in infrastructure. This is also particularly important for export-led manufacturing growth. The other is the strengthening of the financial sector and the provision of cheap credit for private firms. One way to provide stable, long-term finance to particular sectors is through the creation of development banks. Development banks can be public institutions as in Brazil, Korea, and Japan or privately owned as in Germany (Chang and Grabel, 2004). Development banks, hence, serve as the financial counterpart of industrial policy. Further, an initial favouring of the latter group of banks, as part of the industrial policy strategy seems to be indicated, and to have been historically relevant for successful late industrializers. These two policy objectives, the improvement of infrastructure and the provision of stable and reliable credit are essential pillars for national and regional industrial development prospects.

Consistent with our earlier views, one should also disengage from a 'one-size-fits-all' strategy in view of the diverse nature of the various economies and their specific historical circumstances. Urging all to focus on an industrial led strategy is not our objective. Also, given the history of the region, the public sector will probably have a significant role to play in the medium-term, especially in promoting investment. The focus should be on the twin goals of attaining efficiency and enhancing the employment-friendly nature of industrial development.

Finally, given the enormous globalization challenge, it would be useful for policy-makers to focus their energy and attention in the medium-term on tapping the growth potential that resides within the region and enhance regional integration first. During the last boom in oil prices, closer regional integration was fostered. A new opportunity has been created with the latest oil price boom (which may not last given the reaction of the oil market to the US-led global financial crisis). The goal of crafting a business and employment-friendly national environment

should be complemented by the need to provide a business and employment-friendly regional environment. This will produce the momentum for domestic demand to be boosted by buoyant regional demand and thus disseminate the fruits of the growth process across the various Arab economies with salutary implications for sustainable reductions in poverty within the various nation-states.

5.2 Creating sustainable employment

The current 'reform' agenda in the Arab region as advocated by the IFIs seek to resolve the employment problems of demand-constrained economies by emphasising the need to remove supply-side bottlenecks. This necessitates the need to jettison a state-led development model that served the region so well in the 1960s and 1970s in favour of a strategy that emphasises the need to improve the investment climate in order to harness private investment. This is supposed to complement a strategy of full-scale globalisation that will entail deeper integration with the world economy.

However, this report has already highlighted many of the limitations of such a strategy. Moreover, it does not hold in a situation where there is large and increasing unemployment since the essence of the problem, as argued earlier, lies in the nature of oil-led growth. Judicious alternatives include prudent and creative public investment policies within the context of a strategy of regionalisation rather than uncritical globalisation, strengthening of labor institutions, implementation of 'pro-active' labor market policies and social protection measures. In what follows we outline policy directions to this end.

1. Demographic pressures have compounded labor market woes, but the outlook is not bleak

An important stance in shaping national and regional employment policies must take into account the fact that Arab countries have experienced the fastest labor force growth in the world and, given sluggish economic conditions, this has often outpaced employment growth. Yet, the outlook is not as grim as it is sometimes portrayed. The entry of young people into the labor force can spark greater demand for housing. This in turn will increase demand for labor-intensive construction activities. There has been an unfortunate tendency to focus on luxury

housing in the region, thus leading to the neglect of augmenting housing stock for the mainstream population. Moreover, demographic pressure, while formidable at this stage, will ease over time. This means that the demographic burden of today will become the demographic dividend of tomorrow as young, educated, and productive people enter the work-force over this decade and the next. But the dividend will not be automatically realized. One would need appropriate policy interventions, most notably ensuring that young people receive the necessary education and training to meet the skill requirements of the 21st century.

2. Intra-regional labor migration has provided positive labor market outcomes and these outcomes should be consolidated through policy coordination at the regional level

Intra-regional labor migration has played an important role in influencing labor market outcomes. It has highlighted the complementarities that exist among labor-exporting Arab countries and the oil-rich labor-importing Gulf States. The first oil boom ushered an era of relatively free labor movements as oil revenues in the Gulf states financed an investment boom causing labor shortages across the skill spectrum. In meeting such labor shortages, the Gulf States also contributed to the employment needs of labor-surplus economies in the region. A corollary of this large-scale labor movement was that it provided massive financial flows in the form of remittances that flowed into the labor-exporting economies both in the Maghreb and Mashreq sub-regions. Such remittances had a major impact on the living standards of the recipients in the labor-exporting countries. Unfortunately, intra-regional labor movements have been caught in boom-bust cycles, with the emergence of a restrictive immigration policy in the Gulf States following the collapse in oil prices in the mid-1980s. This was exacerbated by geo-political circumstances, such as the first Gulf war. The Gulf States have followed a 'job nationalization' policy and a policy of substitution of Arab labor with cheaper and more docile, Asian labor. There is a case for a renewed commitment to relatively free labor movements within the Arab region. This renewed commitment should be seen as a part of a putative global development agenda that seeks to reap the benefits of a well-designed and well-regulated 'guest workers scheme'. Such a scheme should draw on the synergies that exist among the economies in the region and that simultaneously seeks to balance the interests of both labor-importing and labor-exporting countries.

3. The role of institutional and labor market rigidities in influencing employment outcomes have been exaggerated

There is a good deal of evidence of employment protection legislation across Arab countries, but they vary in extent and scope. Some of the Gulf states do not display *de jure* rigidity to the same extent that some Maghreb economies do. In any case, *de jure* inflexibility often coexists with *de facto* flexibility as reflected in volatile real wage movements and employment elasticities that are high by international standards. Islam and Chowdhury (2006) also argue that there is no systematic association between a survey-based employment rigidity index and unemployment rates at the regional level.

4. Uncritical advocacy of 'downsizing' the public sector is counterproductive

There is little doubt that the public sector in Arab countries is large by international standards, but the notion that the public sector is merely a source of unproductive employment is an ideologically driven proposition. Public sector employment has played an important role in social protection when there was no other alternative. One good example is the case of OPT after the closure where there was a significant expansion in public employment to confront the impact of the closure on employment. It should also be noted that public sector employment generation has contributed to the bulk of employment generation in most Arab countries during the state led era of the 1960s and 1970s. One major reason for the increase in unemployment is that private sector did not live up to the task of absorbing the supply of labor market entrants. As Arab economies grow to rely more heavily on the private sector, there is a need for a well designed and fiscally sustainable unemployment benefits regime.

5. Social norms sustain gender inequality but there are promising signs of progress

As noted, the Arab states are also characterized by a distinct gender dimension to their labor market performance. They have the lowest share of females in the work-force in the world; female unemployment is higher than their male counterpart; gender wage disparities are significant. Such traits of the labor markets in Arab countries display the imprint of social norms that, either implicitly or explicitly, condones gender segregation in the work-force

and encourages females to concentrate on child-bearing and child-rearing activities. Such attitudes have probably played a part in delaying the demographic transition in the region and thus contributed to supply pressures in the labor market. On the other hand, social norms are not immutable. They evolve over time. There are promising signs that gender disparities are being tackled in the Arab states in schooling and that, in the future, women can play their essential role as productive citizens at par with their male counterparts.

6. The labor market-poverty linkage is significant and the creation of productive employment opportunities essential for poverty reduction

The Arab states have the highest unemployment rate in the world, but they also have relatively medium income poverty rates. Evidence also reveals that vulnerability in the Arab region is very high due to the shallow nature of poverty. This implies that the use of social protection mechanisms to protect individuals and households should be an important part of the policy toolkit of Arab governments. National poverty lines also show that in a number of Arab states poverty went up in the 1990s. This is consistent with stagnation and slow growth in that period. The behavior of real wages also show evidence of significant declines in the 1990s to a point where real wages in the manufacturing sector in 1998 in a sample of Arab countries were merely 70 percent of the 1990 level. Hence, the potency of the labor market-poverty linkage is amply demonstrated by these co-movements in the incidence of poverty and real wages.

7. Unemployment Benefits Schemes

Unemployment benefits schemes are rare in Arab countries, although there is a keen interest among policy makers in designing such a scheme to suit local circumstances. It is important to realise that, in the absence of an appropriate unemployment insurance scheme, some Arab governments have relied heavily on what is a 'second best' option, namely, prohibitive anti-firing legislation. Indeed, even firms facing bankruptcy are not allowed to adjust their work force by making workers redundant. This legislation has understandably been highly contentious. It has also been ineffective, especially in the more informal segments of the economy where compliance and enforcement are difficult.

There has, however, been a general reluctance to adopt unemployment benefits schemes in developing countries.⁽⁵⁸⁾ Various objections against unemployment benefits schemes may be made. For example, one could argue that they are fiscally unaffordable for developing economies. Despite the reservations against unemployment benefits, there has been some resurgence of interest in exploring their applicability to developing economies in the wake of the Asian crisis. An ILO study has argued the case for introducing unemployment insurance schemes in East Asian economies.⁽⁵⁹⁾ Estimates suggest that 'an average required contribution rate of between 0.3 to 0.4 percent of payroll between 1991 to 2000 would have been sufficient to provide all insured job losers over this period, including during the current crisis, with 12 months of benefits'.⁽⁶⁰⁾ Another independent study claims that 'most of the Asian economies (...) should be able to operate (an unemployment insurance programme) with OECD generosity utilising an average payroll tax rate of 1.0 percent'.⁽⁶¹⁾ These are useful findings and should inspire Arab policy makers to seriously consider the view that an unemployment benefits scheme is fiscally affordable. Whatever the future shape of an unemployment benefits scheme in Arab countries may be, it will leave out a large fraction of the workforce in the informal sector, and those in self-employment and in rural areas. Hence, discussions of alternative forms of employment protection are necessary.

8. Public Works

Public works have been, and are, quite common in many developing countries. The initiative is in its infancy in most Arab countries. Guidelines now exist on good design features that can make a public works program operate effectively in a developing country context.⁽⁶²⁾ These features include the need to set wages at a level no higher than the market determined rate for unskilled manual workers. Another possibility is to set wages at a small multiple (say 50 percent) of the prevailing

(58) Vroman, V (1999) 'Unemployment and unemployment protection in three groups of countries', Social Protection Discussion Paper No. 9911, Washington DC, World Bank

(59) Lee, E. (1998, chapter 4) *The Asian financial crisis: the challenge for social policy*, Geneva: ILO

(60) The calculations assume that the coverage of the scheme would be the same as existing social security provisions and would provide 12 months benefit at a replacement rate of 50 percent of previous earnings.

(61) Vroman, W. (op.cit:37).

(62) See Ravallion, M. (1998) 'Appraising Workfare Programs', Working Paper No. 1955, (Washington DC), The World Bank,

poverty line. One advantage of such a deliberate policy of low wages is that it causes the program to become 'self-targeting', that is, it is likely to attract only those who need work at such a wage rate. This economizes on the need to impose elaborate eligibility criteria for screening out poor from non-poor individuals. The projects should try to target poor areas and should strive to create assets that are of value to poor communities. Where the non-poor groups are likely to be significant beneficiaries of such created assets, co-financing should be mandatory and should be ploughed back into the budgets of public works projects. There is the issue, as in the case of unemployment benefits scheme, of the fiscal affordability of social protection initiatives such as public works. The available evidence suggests that 'costs of safety nets need not be large even if they reach a large number of beneficiaries'.⁽⁶³⁾ Typically, the costs of operating public works programs are well below 1 percent of GDP, while social safety net expenditures represent a modest proportion of the budget.⁽⁶⁴⁾

9. Microfinance

Microfinance schemes are in their infancy in most Arab countries. The social funds have played a role in their inception by acting as a provider of microfinance services. UNDP has also played a major role in setting up microfinance projects. The potential demand for microfinance services is significant. However, the primary constraint in the development of a robust microfinance sector is the 'large supply of subsidised credit'.⁽⁶⁵⁾ In most countries, double-digit rates are the norm. Another point worthy of consideration in dealing with the development of the microfinance sector in Arab countries is the lack of a coherent legal and regulatory framework.

10. Wage policy

To start with, it is important to ask whether the prevailing minimum wage is set at a reasonable level. In most Arab countries, the minimum wage is set at a particularly modest level (in some

(63) Lustig, N. (2000:17) 'Crises and the Poor: Socially Responsible Macroeconomics', February, Washington D.C.: InterAmerican Development Bank

(64) The Mexican Progress costs about 0.2 percent of GDP with 2 million households as beneficiaries. The Tregear program in Argentina reaches 350,000 individuals and costs a quarter of one percent of GDP. In Indonesia, safety net operations cost about 2 percent of the central government's budget (Lustig, op.cit).

(65) Burjoree and Bransama (ibid:6).

countries it is almost identical to the poverty line). In addition, there is the issue of the degree of enforceability and the trade-offs that are inevitably unleashed by such policy initiatives. As in the case of general wage increases, the minimum wage in Arab countries – as in other economies at similar stages of development – can be readily enforced in the public sector and, to a lesser degree, in the organised private sector. Those who need it most, the working poor in the informal sector, will probably gain least because of the institutional constraints that dilute the compliance of minimum wage policy.

What, then, should be the appropriate stance of wage policy? Certainly, the government has an obligation to protect the living standards of workers. One way that can be done is to ensure that cost-of-living increases are reflected in the prevailing wage setting mechanism. Yet, one is struck by the paucity of published data on nominal wages and prices. A credible approach to wage policy has to build on timely production of wages and prices at appropriate levels of aggregation. Such information in turn has to be widely disseminated and shared with both workers and employers.

It is also worth noting that the ILO convention in this sphere does not assume minimum wage policy as the 'first best' option. When the convention was initially developed, it was assumed that appropriate labor institutions that would seek to protect and enhance the living standards of workers would take a long time to develop in developing countries. Thus, a government-led minimum wage policy was seen an imperfect substitute for the lack of a genuinely representative collective bargaining system that would support the wage setting mechanism. Such a system in turn has to draw on a core set of labor rights that can facilitate the development of robust labor market institutions. There is another important way in which the minimum wage can be an important ingredient of both labor market and poverty reduction policies. One possibility is to make it indicative rather than mandatory and convert it into a policy advocacy tool. Given that the minimum wage is reported regularly, and given that the government has the capacity to adjust it frequently, it represents a ready-made tool to monitor the conditions of the working poor. Poverty lines are infrequently published because they are tied to household income and expenditure surveys. In many Arab countries, such surveys are implemented every five

years. Furthermore, the construction of poverty lines often creates controversy. Given such constraints on the construction and availability of poverty lines, the minimum wage can serve as an effective substitute, especially in terms of monitoring the living standards of workers. This, in turn, can serve as an important input in the policy dialogue between the government and the broader community.

5.3 Pro-Poor Macroeconomic Policies

Our approach to 'pro-poor growth' strategies stems from UNDP's 2002 Policy Note: "The Role of Economic Policies in Poverty Reduction" (UNDP 2002). The policy note maintains that if countries are to reach the target by 2015 of halving extreme income poverty (the primary poverty goal of the Millennium Declaration), rapid growth is certainly essential. However, if growth is also more equitable—so that the incomes of the poor grow faster than average—countries have a much better chance of reaching the target. Hence, a strategy of such "equity-based" growth will need to be rapid enough to significantly improve the 'absolute' condition of the poor and equitable enough to improve their 'relative' position—either by achieving greater equity at the start of the growth process (such as through universalizing coverage of education and health services) or by decreasing unacceptably high inequality over time (such as through pushing up wages by generating widespread employment among low-skilled workers).

From this angle, orthodox economic policies are inadequate for the purpose of poverty reduction and achieving MDGs because they focus inordinately on short-term stabilization, undercutting the long-term basis for economic growth and ignoring the redistributive effects of growth policies. However, even economic growth is not a meaningful end in itself. What is important is whether growth is translated into human development—and into the reduction of poverty in particular. Macroeconomic policies can also have an important effect on reducing inequality, but it is unwise to rely on them alone to carry out redistributive measures. Much of the impact of policies depends, for instance, on social institutions such as the system of land holdings or corporate ownership.

In general, there has been an over-emphasis in the Arab region on economic growth as the main determinant of poverty reduction. This approach has assumed that the functioning

of market mechanisms, undistorted and unfettered by governmental intervention, would solve the poverty problem. But such an approach ignores the constraints imposed by inequality in the distribution of income, wealth and human development. Inequality not only makes it more difficult to reduce poverty, but, according to recent evidence, also reduces economic growth itself. A general rule is that a high rate of GDP growth may be necessary for poverty reduction, but it is not necessarily sufficient. Such growth must be translated into increases in personal income in those sectors of the economy where the poor are concentrated.

It is possible for inequality to increase at the same time that poverty is reduced, but poverty could be curtailed much more quickly if inequality were diminished by channeling more resources to the poor. Under certain circumstances there need be no trade-off between equity and growth. Boosting the current consumption of the poor at the expense of investment might restrict growth, but investing in the poor need not do so. Therefore, a central policy issue becomes how to ensure that investment in the poor is growth enhancing or at least growth-compatible. To this end, two general inter-related sets of policies are needed: i) redistributing assets to the poor, such as land and human capital, and ii) using macroeconomic policies to help raise the returns to these assets. In what follows we give some policy directions to this end.

With respect to the former, “equity-based” growth can be achieved through a variety of strategies. The choice depends in part on each country’s initial conditions. In general, if growth is to significantly reduce poverty in the short- and medium-terms, it should have a pattern that directs resources disproportionately to the sectors in which the poor work (such as small-scale agriculture and small and medium enterprises), the areas in which they live (such as underdeveloped regions) or the factors of production that they possess (such as unskilled labor or undeveloped land). A strategy that posed such an immediate objective would be strongly equity-driven in its early stages and tend to be bottom-up in its impact—directly reaching the poor where they are to be found. Although employment might be generated, the rise of real incomes might be slower than optimal. Nevertheless, the character of whatever growth is achieved would decidedly improve the relative position of poor households.

The longer-term objective of all development, of course, is to move the workforce, poor workers in particular, out of low-productivity sectors, poorly resourced regions and low-skilled employment. In most cases, this would imply moving poor workers out of agriculture and into industry and more modern services. Some growth strategies emphasize this objective in the medium-term, and tend to downplay equity until growth accelerates.

This alternative approach assumes that if industry is able to grow rapidly enough and generates employment broadly enough, poverty will be reduced as a result of pulling poor workers into higher-productivity, higher-paid jobs. In the past, import-substitution strategies have succeeded in achieving this effect in some countries in the Arab Region, as well as other developing regions. In this realm, South-East Asian countries stand out demonstrating the greatest success of export-oriented import-substitution industrialization. Nowadays, as noted earlier, such strategies are more difficult to achieve.

Finally, much of the focus of traditional pro-poor fiscal analysis has been on expenditure switching policies that alter the pattern of government spending in favor of pro-poor public goods. However, budget re-allocations are not sufficient to have a substantial impact on poverty when the distribution of productive assets is highly unequal (as is arguably the case for many Arab countries). In these circumstances, policies that directly redistribute assets, such as land reform, are essential initiatives.

Turning now to the second pillar of macroeconomic policies, it is important to note that any future pro-poor macroeconomic strategy would need to incorporate a renewed commitment to public investment as a core vehicle for rejuvenating growth. The primary constraints appear to be both ideological and fiscal. The former is concerned about the ‘crowding out’ effects of public investment; the latter is driven by the fear that fiscal expansion will inevitably be inflationary. The ‘crowding out’ thesis overlooks the complementarities between private and public investment. The fears of inflation appear exaggerated. Indeed, inflation-aversion among monetary authorities has, in some cases during the mid 1990s, imposed punitive real interest rates [in excess of 15 percent]. This, in itself, is a major deterrent to investment and is thus anti-growth in nature. While pursuing a policy of positive real interest rates makes economic

sense, imposing a punitive real interest rate regime in a context of sluggish growth makes little economic and commercial sense.

Furthermore, if the function of fiscal policy in Arab countries is to achieve the maximum potential and sustainable growth rate, and redistribute income at the margin in order to increase the elasticity of poverty reduction with respect to growth, then public investment is the key to these goals, since it increases capacity, and can be designed to do so in a way that biases income gains to the poor. This report thus emphasizes the importance of improving public resource mobilization rather than viewing public sector resource mobilization as a 'burden' on private initiative.

In order to finance greater investment, reliance primarily on domestic resource mobilization is recommended. Depending on official development assistance or inflows of private capital to jump-start growth is considered ill advised. Some resources can be mobilized by tilting public expenditures more towards productive investment—in human capital as well as in physical and natural capital. Public policies can also create an environment more conducive to broad-based private investment, through either more favorable macroeconomic policies or more equitable redistribution of assets. With greater opportunities for investment, people save more and/or work more to expand their asset base. The potential for domestic resource mobilization in the region is high given the low tax rates.

Fostering investment opportunities among the poor is another major policy recommendation. This is based on the unconventional view that the poor are fully capable of saving—and also of building up their productive assets through greater application of labor—if they are afforded the profitable opportunities to do so. Given a correct mix of public policies, there need be no inherent trade-off between equity and growth. An examination of the development experience of East Asian economies supports this formerly heterodox view. In fact, it is now more generally believed that a high degree of inequality—particularly in the distribution of assets—in fact impedes growth.

Following the heterodox stance, if fiscal expansion generates government deficits, these deficits do not necessarily have a strong impact on increasing inflation and that inflation does not necessarily dampen growth. If properly designed

and well targeted, public investment, such as labor-intensive public works, can in fact help lower the need for capital imports. Growth also serves to raise the share of savings in gross domestic product, which can then be used to finance the additional investment.

Much of the focus of traditional pro-poor fiscal analysis has been on expenditure switching policies that alter the pattern of government spending in favor of pro-poor public goods. However, as argued by Roy (2005), budget re-allocations are not sufficient to have a substantial impact on poverty when the distribution of productive assets is highly unequal (as is arguably the case for many Arab countries). In these circumstances, policies that directly redistribute assets, such as land reform or construction of low-income housing, are essential initiatives.

Turning to monetary policies, the second important pillar of macroeconomic policies, evidence suggests that with the growth in oil income, there has been substantial growth in bank deposits in Arab countries, especially in oil producing countries. Between 2002 and 2006, bank deposits rose in real terms by an average of 15% a year. However, this deposit growth has not been matched by growth in credit to the business sector. The growth in credit has been concentrated mostly in consumer spending and housing. Banks are also financing investments in soaring stock market. Additionally, bank credits remain concentrated among a select minority, and few private businesses can access finance (World Bank, 2006: 50). As a result, little of the region's recent and dramatic increase in assets is channeled into productive investment.

Therefore, the Arab countries must address the disconnection between the growth in bank deposits and the real economy. This requires (a) specialized credit schemes for small- and medium-sized enterprises and the agriculture sector, and (b) lowering of interest rates. Specialized credit schemes are often criticized for inefficiency and rent-seeking. However, evidence from elsewhere show that cost of market failures in the financial sector as reflected in the high collateral and urban and speculative bias of bank loans is much higher than the loss from rent-seeking and inefficiency (see Chowdhury, 2005). Moreover, in some Arab countries, the real interest rate is clearly too exorbitant. For example, according to the *World Development Indicators 2005*, the real interest rate in Algeria in 2004 was 28.3% and in

UAE, Syria, and Morocco, it was 18.4%, 10.6% and 9.9%, respectively. Such high real interest rates are the result of obsessions with very low inflation rate. But an expansionary fiscal and credit policy-mix is unlikely to lead to debilitating inflation, particularly as the inflation rate is expected to decline with the plunge in international oil and food prices. Furthermore, empirical evidence on the inflation-growth relationship overwhelmingly shows that moderate inflation (in the range of 10-12%) does not adversely affect economic growth.

Finally, in the context of regional poverty reduction, it is clear that special attention should be devoted to LDCs. The development paralysis experienced by LDCs in the Arab region can be turned around and a virtuous cycle of self-sustaining, inclusive growth started, through adoption of a judicious mix of mutually reinforcing positive actions in the economic, social, environmental, and political spheres. However, such a transformation requires a developmental compact between the Arab LDCs and their more fortunate brothers. Fortunately, estimates of the cost of poverty reduction show that the financing burden on oil-rich Arab countries will be relatively marginal compared to the availability of resources.

In this regard, high unemployment in LDCs can be tackled through a combination of increased access of nationals of these countries to jobs

in GCC countries and increased inflow of Arab investments into labor absorbing activities in these countries (the case of Yemen and the GCC is an obvious example). The quality of the labor force can be improved through greater attention to demand driven vocational and technical training, as well as the quality of public education. These can be promoted through greater ODA from Arab funds and governments as well as improved opportunities for on the job training in other Arab countries, through instituting some systems of short-term apprenticeships or contract labor. Emphasizing female and youth employment, particularly in ventures established within LDCs, would also assist in reducing gender disparities and provide greater voice to these marginalized population groups in societal decision making processes. Additional ODA from Arab countries can also assist the LDCs to move more quickly towards meeting the MDG targets and, as a result, promote more sustained progress on human development. This should improve the quality of labor that could potentially work for Arab investors as well as reduce the rate of population increase in these countries, thus decreasing the potential number of migrants from these countries that would have no choice but to seek economic opportunities in other Arab countries, with all that this entails for social stability in the host countries.

6 ■ Concluding Remarks

We conclude this report with two remarks. The first relates to development achievements and failures in the context of our earlier discussion on the social contract. As this report shows, the development record of Arab countries over the past three decades has been a mixture of both success and failure. There are two main successes. First, for the vast majority of Arab countries, human deprivation has declined significantly and human development indicators have shown significant improvement for the region as a whole. Those achievements are also reflected in the trends on the front of MDGs, in particular, the health and education goals. Second, the region still maintains relatively low-to medium-levels of income poverty and income inequality, which is remarkable given the extent of economic liberalization witnessed over the past two decades.

On the other hand, the facts evidently show that there were many more development failures than successes. First, the increased structural fragility of Arab economies is an evident ramification of the process of oil-led growth. Economic growth itself has been, for the larger part of the past three decades, erratic and low. Correspondingly, the performance of productive sectors (and manufacturing in particular) has been poor. Second, this growth model has had adverse spillovers on the labor market and Arab countries now face the highest unemployment rates (particularly amongst the youth) worldwide. Third, despite the significant oil revenues and abundance of wealth, the region as a whole has failed to reduce income poverty since the 1990s. A fourth development failure is the fact that Arab LDCs are still lagging far behind on poverty and MDGs and it is doubtful that any of them will be able to achieve these goals by 2015. Fifth, Arab countries have failed glaringly to improve the quality of their education systems and institutions. Sixth, despite moderate levels of income inequality, it is evident that social exclusion, particularly in middle income countries, has risen over the past two decades in most Arab countries where the inequality in wealth has deteriorated significantly more than the deterioration in income. Finally, any assessment of development failures in the region would not be complete without including

major setbacks in the state of food security and agriculture (which is the subject of our second volume) and the state of development in conflict countries such as OPT, Sudan, Somalia, and Iraq (which lies outside the scope of this report).

No doubt, the discussion on development progress cannot be isolated from the earlier discussion on the social contract enacted in Arab countries. This discussion is also closely tied to the above mentioned institutional and governance failures since the common feature that runs across most Arab countries is the weak mutual accountability lines between the state and citizens due to the independence most Arab States enjoy from their own citizens by virtue of access to either income from oil exports, foreign aid or some combination thereof. Thus, the articulation of an Arab social contract whereby the citizen accepts limitations on voice and accountability in return for certain benefits provided by the State is only made possible by the access of the State to a source of revenue other than direct taxes to fund its operations. Alongside the limitation in voice and accountability there is also an alarming trend of the convergence of political power with concentrated economic wealth. The most striking trend in this direction is the flagrant presence of businessmen in the political arena, e.g. in Egypt, Lebanon, Jordan, and Morocco.

In essence, the fundamental feature of the Arab social contract has allowed many Arab states to continue following a non-developmental path. Other successful developing economies, including the East Asian countries did not have this luxury and therefore by and large turned themselves into developmental states (but of course there was an array of other supporting policy related and historical conditions). This does not in any sense reduce the relevance of the difficulty Arab countries would have in following an export driven path to development given the changed international context. But the main challenge is not about adopting a development path based on self sufficiency or integration into the global market but rather of moving from a non-developmental to a developmental state. This frame of reference can also explain why some positive strides made in the more diversified Arab countries

(notably Egypt and Syria) in the 1960s were not sustained as in the case of East Asian countries, India, and Brazil. Perhaps, the greater reliance on national resources and the consequent strengthening of the mutual accountability of state and citizen in the region shall be triggered by the expected reduced oil incomes and ODA flows over the next few years.

Our second remark in this concluding section relates to the nexus between Arab development challenges and regional integration. The relevant question, we argue, is whether there is a strong regional dimension to these five challenges? The answer presented by the data and analyses in this report is unequivocal. Deeper and more inclusive intra-Arab economic cooperation and integration that goes far beyond free trade of goods and services, seems to be not the best way, rather the only way for equitable and inclusive growth, sustainable development and MDGs achievement in an era during which regionalization, evidently, comes ahead of globalization. Such intra-regional integration and cooperation has to be manifested into: a region-wide system of knowledge sharing, production, and dissemination; intra-regional public and foreign investments, and aid directed towards developmental projects as well as high-tech and high value-added industries rather than low-value added industries and services; a well developed network of intra-regional transport and communication; a region-wide unemployment and poverty reduction strategy; and a strong and pro-active common position in international commitments negotiations.

No doubt this will entail revamping existing Arab institutions, including the LAS, to be better equipped to face the challenges and the creation of new regional bodies particularly in the area of regional strategic socio-economic decision making. To this end, there is a dire need for the establishment of a regional decision support center on development policy that can harness the capacity and expertise of Arab scholars and governments and direct their efforts towards the formulation a new region-wide development vision. Arab countries have tried to assert their strategic objectives myopically and have failed to engage in the long-term strategic planning

necessary to increase the odds of accomplishing their objectives. The goal of creating such a center involved in long-term economic and strategic planning should be a priority of Arab governments. While they may disagree on the pace of economic/political reform and many other issues, Arab governments should have long-term incentives that are aligned.

For this center to be effective there are two pre-conditions. First, there is a need to enhance the collaboration and synergies with international organizations, civil society, and the various regional and national research and development institutions. The poor institutional capacities in the areas of employment and macroeconomic policy formulation, poverty measurement and monitoring render such an initiative as key to the formulation of effective national and regional poverty reduction strategies. Likewise, South-South cooperation and cross -fertilization of experiences and collaboration with development institutions in other regions, such as East Asia and Latin America, can be very fruitful.

Second, there is an urgent need to enhance and upgrade the capacities of Arab countries in the areas of data and information collection. Developing the region's own capacity to review and monitor its progress towards a development pattern that increases social cohesion, social capital and political legitimacy, is becoming a necessity amidst a plethora of outside reporting about the region. The region should capture the spirit of the Paris Declaration which calls for alignment to national processes by enhancing its own capacity to monitor itself in a rigorous manner that captures societal perceptions, not only the official understanding thereof, going beyond external experts' and investors' perceptions.

Finally, for regional plans and initiatives to be effective, they should have a financing mechanism. Hence, the role and capacity of regional development funding institutions, such as the Arab Monetary Fund and the Islamic Development Bank, need to be further enhanced as well as realigned with a regional developmental vision that aims towards inclusive growth and human development.

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Annex Tables

Table A.1: Private Consumption Expenditure in Arab Countries (2005)

Country /Country Group	Per Capita GDP (US\$)	Private Consumption Expenditure (PCE: US\$ billion)	Per Capita PCE (US\$)
Egypt	1254.9	64.1	897.2
Jordan	2311.1	10.4	1885.6
Lebanon	5653.9	18.2	4655.6
Morocco	1895.7	33.4	1073.6
Syria	1528.5	19.0	1039.7
Tunisia	2895.5	18.3	1830
DE	1711.0	163.4	1165.5
Algeria	3125.7	34.8	1056.1
Libya	6788.3	13.9	2199.0
MOE	3714.8	48.7	1239.9
Bahrain	19228.6	4.9	6990
Kuwait	28906.2	25.3	8722.1
Oman	12333.6	10.8	4331.6
Qatar	53078.8	7.7	9672.5
Saudi Arabia	13651.0	83.5	3612.8
UAE	32581.2	64.8	15792.4
OE	23413.5	197.0	5777.1
Djibouti	885.0	0.6	752.5
Mauritania	619.0	1.3	417.0
Sudan	936.6	25.3	714.5
Yemen	794.6	10.9	500.7
PEE	870.3	38.1	625.6
Total	4509.1	447.2	1628.1

Source: League of Arab States et al (2007: annex tables 2.5, p. 237; and 2.7, p. 239).

Table A.2: Arab GDP structure by Economic Sector (1974-2006)

	1974				2006			
	Agric.	Oil and Const.	Services	Manuf.	Agric.	Oil and Const.	Services	Manuf.
Algeria	7%	49%	35%	9%	7%	50%	38%	5%
Libya	2%	66%	30%	2%	2%	62%	34%	2%
MOE	6%	54%	34%	7%	5%	55%	36%	4%
Egypt	30%	8%	44%	18%	14%	20%	51%	15%
Jordan	16%	11%	65%	8%	3%	13%	67%	17%
Lebanon					7%	11%	70%	12%
Morocco	21%	19%	44%	16%	16%	9%	59%	16%
Syria	20%	6%	54%	20%	18%	16%	51%	15%
Tunisia	19%	17%	54%	10%	11%	10%	62%	17%
DE	25%	12%	47%	16%	11%	16%	56%	15%
Kuwait	0%	81%	15%	4%	0%	50%	47%	3%
Oman	3%	83%	14%	0%	3%	47%	42%	8%
KSA	1%	79%	15%	5%	3%	57%	32%	8%
UAE	1%	68%	27%	4%	2%	46%	42%	10%
OE	1%	78%	17%	5%	2%	52%	37%	8%
Djibouti				6%	4%	14%	80%	2%
Mauritania	36%	20%	31%	13%	13%	36%	41%	10%
Sudan	44%	8%	42%	6%	32%	22%	41%	5%

Source: UNCTAD online databases.

Table A.3: Poverty Measures in Urban and Rural Areas for selected Arab Countries

	Urban		Rural		National		Gini
Year	Headcount Index (%)	Poverty Gap (%)	Headcount Index (%)	Poverty Gap (%)	Headcount Index (%)	Poverty Gap (%)	
Tunisia							
1990	3.3	0.7	14.8	3.2	7.9	1.7	40
1995	3.2	0.7	15.8	3.1	8.1	1.6	42
2000	1.7		8.3		4.1		41
Egypt							
1990/91					24.18	6.54	
1995/96					19.4	3.4	34,5
1999/00	9.21	1.72	22.07	3.86	16.7	3	36.1
2004-05	10.1	1.8	26.8	5.0	19.6	3.6	32.1
Morocco							
1990/9 1	7.6	1.5	18	3.8	13.1	2.7	39.3
1998/99	12	2.5	27.2	6.7	19	4.4	39.5
Jordan							
1992	12.4	3.1	21.1	5.1	14.4	3.6	40
1997	19.7	4.8	27	7.2	21.3	5.3	36.9
2002	12.9	2.9	18.7	4.7	14.2	3.3	36
Syria							
1997	12.64	2.33	15.98	3.47	14.26	2.88	33.7
2003-04	8.70	1.57	14.18	2.70	11.39	2.13	37.4
Yemen							
1998	32.29	8.67	42.49	13.11	40.13	12.09	34.50
2005-06	20.70	4.48	40.09	10.60	34.78	8.93	36.60
Algeria							
1995	9		19		14.1		
2000	10.3		14.7		12.1		

Source: UNDP and World Bank Poverty Assessments reports.

Table A.4: Growth and Income Distribution Elasticities

		Growth	Income distribution
Egypt	P0	3.1	2.8
	P1	4.1	5.7
	P2	4.7	8.2
Syria	P0	3.0	4.2
	P1		
	P2		
Yemen	P0	1.8	1.0
	P1	2.5	3.0
	P2	3.2	4.9
Lebanon	P0	3.5	6.8
	P1	4.8	12.2
	P2	5.7	16.9
Morocco	P0	2.7	
	P1	3.3	
	P2	3.6	

Source: Poverty Assessments reports of relevant Countries.

Table A.5: Enrolment Rates for Poor and non Poor

Country/Survey Year/Educational Level			Urban		Rural	
			Poor	Non poor	Poor	Non poor
Algeria	1995	primary	96.0	95.0	89.0	89.0
		secondary	77.0	82.0	59.0	66.0
Egypt	1995	6–15	89.5	98.0	92.9	95.6
		15–19	66.0	83.9	67.2	74.7
	1999	6–15	95.8	98.5	93.5	96.7
		15–19	72.4	84.9	64.7	72.9
	2005	6-15	88	96	84	93
		16-18	47.5	67.9	45	60
Morocco	1990	7–15	70.7	84.1	34.3	43.2
	1998	7–15	69.4	87.2	36.4	49.8
Tunisia	2000	6–18	79.4	82.2	67.0	70.7
Yemen	1998	10–14	83.0	92.1	59.6	62.0
	2005-6	6-14	75	83	57	65
		15-17	55	72	43	45
Syria	2004	6-15	84	91	87	90
		16-18	37	58	43	52
Lebanon	2005	5-9	97	99	-	-
		10-14	93	98	-	-
		15-19	58	78	-	-

Source: World Bank (2008) and UNDP Poverty Assessment reports in Syria (2004), Yemen (2008) and Lebanon (2008).

Table A.6: Annual Employment Elasticity with respect to Real Growth

Country	2000-2001	2001-2002	2002-2003	2003-2004	2004-2005
MOE					
Algeria	0.07	0.06	0.06	0.11	0.05
DE					
Egypt	0.01	0.02	0.02	0.03	0.03
Jordan	0.02	0.03	0.05	0.06	0.02
Morocco	0.01	0.02	0.03	0.06	0.03
Tunisia	0.04	0.03	0.03	0.03	0.02
OE					
Bahrain	0.42	0.17	0.04	0.68	0.33
Kuwait	-1.42	0.83	0.30	0.54	2.15
Saudi Arabia	6.24	15.08	0.45	1.22	0.34
United Arab Emirates	1.04	1.97	0.74	0.89	..
OE (non-fuel GDP)					
Bahrain	0.21	0.17	0.05	3.30	0.23
Kuwait	0.48	0.24	0.22	0.97	1.55
Saudi Arabia	0.56	10.13	1.24	-1.50	0.64
United Arab Emirates	1.08	1.05	1.01	2.02	3.36

Source: Authors' calculations based on data reported by national statistical agencies, World Bank, ILO and IMF.

Table A.7 Regression Results for the Employment and Real Growth ⁽⁶⁶⁾

	<i>Linear Estimation</i>				<i>Non-Linear Estimation</i>			
Country	Coefficient	Std. Error	R2	Adjusted R2	Coefficient	Std. Error	R2	Adjusted R2
MOE								
Algeria	1.4	0.3	-0.3	-0.3	0.8	0.1	-0.3	-0.3
DE								
Morocco	0.5	0.2	-0.5	-0.5	1.2	0.2	-0.5	-0.5
Tunisia	0.6	0.1	-1.0	-1.0	1.1	0.1	-2.0	-2.0
Egypt	0.6	0.1	-0.3	-0.3	1.2	0.1	-0.4	-0.4
Jordan	0.7	0.2	-0.4	-0.4	1.1	0.1	-0.6	-0.6
OE								
Bahrain	0.2	0.1	-1.2	-1.2	1.5	0.2	-0.4	-0.4
Kuwait	0.5	0.3	-0.6	-0.6	1.0	0.2	-1.5	-1.5
Saudi Arabia	0.6	0.2	-0.4	-0.4	1.1	0.1	-1.6	-1.6
United Arab Emirates	0.8	0.3	-11.5	-11.5	0.8	0.1	-16.2	-16.2
OE (non-fuel GDP)								
Bahrain	0.2	0.1	-1.0	-1.0	1.3	0.3	-3.0	-3.0
Kuwait	0.5	0.2	-0.4	-0.4	1.2	0.2	-1.3	-1.3
Saudi Arabia	0.1	0.5	-4.0	-4.0	0.8	0.1	-9.2	-9.2
United Arab Emirates	1.1	0.2	-2.4	-2.4	0.8	0.1	-3.4	-3.4

Source: Authors' calculations based on data reported by national statistical agencies, World Bank, ILO and IMF.

(66) It is observed that assuming a linear relationship in standard OLS-regression produces low elasticity and high standard errors, while using non-linear regression methods produced significantly higher elasticity and lower standard errors in the magnitude of 50-75 percent. Statistical robustness measures are also considerably higher using non-linear regressions. Nonetheless, one must interpret such statistical evidence with caution in light of data limitations. Granted, there can be a lag effect between real growth and employment growth. Nonetheless, the long-term trend over the last two decades confirms the systematic decline in the capacities to generate employment inline with economic growth in most Arab countries.

Table A.8: The Nature of the Growth Processes in a Sample of Arab Countries

Country	Survey Years	Actual GDP per Capita Growth Rate (%)	Initial Gini Coefficient (%)	Terminal Gini Coefficient (%)	Effective Per Capita GDP Growth Rate (%)	Nature of the Growth Process
Algeria	1988-95	-1.3	40.1	35.3	0	Neutral
Egypt	1996-05	2.8	34.5	32	3.6	Pro-poor
Jordan	1997-02	0.7	36.4	35.9	1	Pro-poor
Morocco	1991-99	0.9	39.2	39.7	0.7	Anti-poor
Mauritania	1988-00	1.8	43.0	39.1	2.6	Pro-poor
Syria	1997-04	0.5	33.7	37.5	-1	Anti-poor
Tunisia	1995-00	2.7	41.6	40.8	3.1	Pro-poor
Yemen	1998-05	2.3	34.5	36.6	1.6	Anti-poor

Authors' estimates based on data in UNDP and World Bank poverty assessments.

Table A.9: Projected Population and GDP per capita in Arab Countries (2008)

Country Group	Total Population (million)	Population Share (%)	GDP (US\$ billion)	GDP Share (%)	Per Capita GDP (US\$)
Syria	19.7	6.5%	92.8	3.8%	4711
Egypt	81.7	26.9%	443.1	18.2%	5424
Jordan	6.2	2.0%	30.3	1.2%	4887
Lebanon	3.9	1.3%	45.8	1.9%	11744
Morocco	34.3	11.3%	138.2	5.7%	4029
Tunisia	10.3	3.4%	83.1	3.4%	8068
DE	156.1	51.5%	833.3	34.2%	5338
Algeria	33.7	11.1%	241.1	9.9%	7154
Libya	6.1	2.0%	90.6	3.7%	14852
MOE	39.9	13.2%	331.7	13.6%	8313
Bahrain	0.7	0.2%	26.5	1.1%	37324
Kuwait	2.6	0.9%	141	5.8%	54231
Oman	3.3	1.1%	67.7	2.8%	20515
Qatar	0.8	0.3%	95.1	3.9%	115976
Saudi Arabia	28.1	9.3%	600	24.6%	21352
United Arab Emirates	4.6	1.5%	186.2	7.6%	40478
OE	40.2	13.3%	1116.5	45.9%	27774
Djibouti	0.5	0.2%	1.9	0.1%	3800
Mauritania	3.3	1.1%	6.4	0.3%	1939
Sudan	40.2	13.3%	89.3	3.7%	2221
Yemen	23.0	7.6%	55.2	2.3%	2400
PEE	67.1	22.1%	152.8	6.3%	2277
Total	303.3	100.0%	2,434	100.0%	8026

Source: IMF (2008) and CIA World Factbook.

Table A.10: Human Development Performance in Arab Countries in 2005

Country / Country Group	Total Population (million)	Population Share (%)	Life Expectancy at Birth (years)	Adult Literacy Rate	Combined Gross Enrolment Ratio (%)	GDP per Capita (PPP US\$)	Human Development Index (HDI)
Egypt	71.4	26.0	70.7	71.4	76.9	4337	0.708
Jordan	5.5	2.0	71.9	91.1	78.1	5530	0.773
Lebanon	3.9	1.4	71.5	--	84.6	5584	0.772
Morocco	31.1	11.3	70.4	52.3	58.5	4555	0.646
Syria	18.3	6.7	73.6	80.8	64.8	3808	0.724
Tunisia	10.0	3.6	73.5	74.3	76.3	8371	0.766
DE	140.2	51.1	71.1	69.2	71.3	4672	0.703
Algeria	32.9	12.0	71.7	69.9	73.7	7062	0.733
Libya	6.3	2.3	73.4	84.2	94.1	10335	0.818
MOE	39.2	14.3	72.0	72.2	77.0	7588	0.747
Bahrain	0.7	0.2	75.2	86.5	86.1	21482	0.866
Kuwait	2.9	1.1	77.3	93.3	74.9	26321	0.891
Oman	2.5	0.9	75.0	81.4	67.1	15602	0.814
Qatar	0.8	0.3	75.0	89.0	77.7	27664	0.875
Saudi Arabia	23.1	8.4	72.2	82.9	76.0	15711	0.812
UAE	4.1	1.5	78.3	88.7	59.9	25514	0.868
OE	34.1	12.4	73.7	84.6	73.5	18212	0.828
Djibouti	0.8	0.3	53.9	--	25.3	2178	0.516
Mauritania	3.0	1.1	63.2	51.2	45.6	2234	0.550
Sudan	35.4	12.9	57.4	60.9	37.3	2083	0.526
Yemen	21.7	7.9	61.5	54.1	55.2	930	0.508
PEE	60.9	22.2	59.1	58.0	43.9	1682	0.521
Total	274.4	100.0	68.9	69.1	66.3	6104	0.684

Source: Human Development Report (2007).

Table A.11: Quality of Institution in the Arab Countries in 1996

Country / Country Group	Voice and Accountability	Political Stability	Government Effectiveness	Regulatory Quality	Rule of Law	Control of Corruption	Average
Egypt	-1.03	-1.07	0.00	0.17	0.08	0.06	-0.30
Jordan	-0.39	0.17	0.22	0.27	0.42	-0.15	0.09
Lebanon	-0.45	-0.52	0.21	0.08	-0.22	-0.23	-0.19
Morocco	-0.65	-0.61	-0.05	0.22	0.12	0.22	-0.13
Syria	-1.66	-0.82	-0.15	-0.91	-0.49	-0.79	-0.80
Tunisia	-0.82	0.15	0.51	0.55	-0.20	-0.10	0.02
DE	-0.97	-0.78	0.02	0.07	0.00	-0.04	-0.29
Algeria	-1.23	-2.44	-0.40	-0.89	-1.21	-0.37	-1.09
Libya	-1.81	-1.77	-1.02	-2.13	-1.29	-0.97	-1.50
MOE	-1.32	-2.33	-0.50	-1.09	-1.22	-0.47	-1.16
Bahrain	-1.24	-0.83	0.43	0.56	0.16	0.02	-0.15
Kuwait	-0.53	0.00	0.35	-0.01	0.74	0.61	0.19
Oman	-1.03	0.47	0.86	0.13	0.87	0.06	0.23
Qatar	-1.05	0.33	0.49	0.38	0.10	-0.12	0.02
Saudi Arabia	-1.65	-0.52	-0.34	-0.35	0.44	-0.42	-0.47
UAE	-0.98	0.74	0.42	0.58	0.83	0.13	0.29
OE	-1.40	-0.23	-0.07	-0.14	0.53	-0.21	-0.25
Djibouti	-0.82	0.21	-0.98	-0.06	-0.24	-0.75	-0.44
Mauritania	-0.94	0.56	0.20	-0.69	-0.88	-0.23	-0.33
Sudan	-1.97	-2.58	-1.49	-1.98	-1.63	-1.13	-1.80
Yemen	-0.94	-1.15	-0.55	-0.44	-1.15	-0.29	-0.75
PEE	-1.54	-1.88	-1.07	-1.34	-1.40	-0.78	-1.34
Overall Avg.	-1.21	-1.18	-0.31	-0.43	-0.42	-0.28	-0.63

Source: Kaufmann (2005).

Table A.12: Quality of Institution in the Arab Countries in 2006

Country / Country Group	Voice and Accountability	Political Stability	Government Effectiveness	Regulatory Quality	Rule of Law	Control of Corruption	Average
Egypt	-1.08	-0.87	-0.41	-0.44	0.00	-0.41	-0.54
Jordan	-0.62	-0.53	0.19	0.41	0.45	0.38	0.05
Lebanon	-0.51	-1.76	-0.45	-0.09	-0.49	-0.57	-0.65
Morocco	-0.63	-0.31	0.02	-0.15	-0.03	-0.06	-0.19
Syria	-1.64	-0.88	-1.03	-1.24	-0.55	-0.66	-1.00
Tunisia	-1.15	0.21	0.55	0.23	0.38	0.20	0.07
DE	-1.02	-0.68	-0.31	-0.30	-0.05	-0.05	-0.46
Algeria	-0.83	-0.89	-0.35	-0.61	-0.63	-0.39	-0.62
Libya	-1.90	0.24	-0.86	-1.40	-0.74	-0.89	-0.93
MOE	-1.00	-0.71	-0.43	-0.74	-0.65	-0.47	-0.67
Bahrain	-0.71	-0.42	0.35	0.72	0.62	0.58	0.19
Kuwait	-0.36	0.28	0.28	0.51	0.75	0.67	0.36
Oman	-0.77	0.66	0.48	0.75	0.71	0.71	0.42
Qatar	-0.57	0.86	0.53	0.45	0.93	0.83	0.51
Saudi Arabia	-1.42	-0.65	-0.28	-0.02	0.17	0.18	-0.34
UAE	-0.78	0.68	0.78	0.80	0.67	1.16	0.55
OE	-1.17	-0.27	-0.02	0.21	0.35	0.40	-0.09
Djibouti	-0.99	-0.20	-1.01	-0.93	-0.80	-0.67	-0.77
Mauritania	-0.95	-0.29	-0.64	-0.24	-0.43	-0.60	-0.53
Sudan	-1.76	-2.18	-1.14	-1.15	-1.33	-1.12	-1.45
Yemen	-1.06	-1.40	-0.93	-0.68	-0.98	-0.60	-0.94
OE	-1.46	-1.78	-1.04	-0.93	-1.15	-0.90	-1.21
Overall Avg.	-1.13	-0.88	-0.45	-0.44	-0.33	-0.24	-0.61

Source: Kaufmann (2005).

Table A.13: Volatile Real GDP Growth (1961-2000) and (2000-2006)

Country/Region	Coefficient of Variation for GDP Growth: 1961-2000	Coefficient of Variation for GDP Growth: 2000-2006	Coefficient of Variation for GDP Per Capita: 1961-2000	Coefficient of Variation for GDP Per Capita: 2000-2006
Egypt	0.57	0.31	0.95	0.53
Jordan	1.27	0.25	3.63	0.45
Lebanon	3.68	0.82	6.53	1.32
Morocco	1.16	0.51	2.50	0.67
Syria	1.49	0.36	3.27	1.03
Tunisia	0.70	0.31	1.19	0.42
DE	[1.48]	[0.40]	[3.02]	[0.90]
Algeria	2.29	0.40	7.17	0.61
Libya	2.26	0.96	5.16	2.54
MOE	[2.28]	[0.54]	[6.17]	[1.58]
Bahrain	1.45	0.21	11.32	0.35
Kuwait	3.35	0.65	2.15	1.41
Oman	1.62	0.44	2.52	0.50
Saudi Arabia	1.64	0.68	7.28	1.52
UAE	1.82	0.44	2.85	1.62
OE	[1.98]	[0.60]	[5.22]	[1.22]
Djibouti	1.56	0.49	0.57	2.20
Mauritania	1.74	0.73	6.15	1.88
Sudan	1.69	0.31	7.43	0.42
Yemen	0.56	0.15	2.03	0.62
PEE	[1.39]	[0.20]	[4.05]	[1.28]
Total	[1.88]	[0.54]	[4.62]	[1.25]

Source: Author's calculations based on World Development Indicators.

Table A.14: Incidence of Extreme Poverty in a Sample of Arab Countries

Country / Country Group	Survey Year	Poverty Incidence (%)	Number of Poor (million)	Survey Year	Poverty Incidence (%)	Number of Poor (million)
Egypt	1999	16.7	10.6	2005	19.6	13.7
Jordan	1997	15	0.7	2002	14.2	0.7
Lebanon	1997	10	0.4	2005	7.97	0.3
Morocco	1991	13.1	3.7	1999	19	5.6
Syria	1997	14.3	2.2	2004	11.7	2.1
Tunisia	1995	8.1	0.8	2000	4.1	0.4
DE		14.7	18.4		16.8	22.8
Algeria	1995	14.1	4.1	2000	12.1	3.8
MOE		14.1	4.1		12.1	3.8
Mauritania	1996	50.0	1.2	2000	46.0	1.3
Yemen	1998	40.1	6.8	2006	34.8	6.8
PEE		41.3	8.0		36.2	8.1
Overall Average		17.9	30.5		18.4	34.7

Source: own estimates based on data reported in WDI (2006) CD-Rom and World Bank and UNDP Poverty Assessment Reports for Syria, Lebanon and Yemen.

Table A.15: Average of Public Expenditure in Education as a Percentage of GDP, 1965–2003

	1965–74	1975–84	1985–94	1995–2003
Algeria	6.2	6.1	7.2	6.1
Bahrain	-	3.3	4.1	3.6
Djibouti	-		3.3	5.7
Egypt	4.7	5.4	4.8	5.6
Iraq	-	4.4	4.4	-
Jordan	3.2	5.2	6.1	6.4
Kuwait	-	4.1	7.1	6.3
Lebanon	-	-	2.0	2.9
Libya	-	5.2	8.4	-
Morocco	3.4	6.3	5.6	5.9
Oman	-	2.1	3.6	3.9
Qatar	-	3.6	4.0	-
Saudi Arabia	3.6	6.7	7.2	6.3
Syria	3.3	5.4	4.3	3.2
Tunisia	6.2	5.2	5.9	6.8
UAE	-	1.3	2.0	1.7
OPT	-	-	-	9.5
Yemen	-	-	5.6	5.8
Mean	4.3	4.6	5.0	5.3
China	1	2.4	2.3	2.3
Indonesia	2.6	2.1	1.1	1.2
Korea	2.7	3.6	3.8	3.9
Malaysia	4.1	6.1	5.5	6.2
Philippines	-	1.8	2.4	3.4
Thailand	2.8	3.6	3.6	4.8
Mean	2.6	3.3	3.1	3.6
Argentina	1.9	2.1	2.2	4.1
Brazil	-	3.3	4.1	3.6
Chile	4	4.6	3.0	3.7
Mexico	2.3	4.3	3.7	5.0
Peru	3.7	3.0	3.1	3.1
Mean	3.0	3.4	3.2	3.9

Source: World Bank (2008).

Table A.16: Directions of Institutional Reforms in Arab Countries: Change in Governance Indicator 1996 and 2006

Country / Country Group	Voice and Accountability	Political Stability	Government Effectiveness	Regulatory Quality	Rule of Law	Control of Corruption	Average Change
Egypt	-0.05	0.20	-0.41	-0.61	-0.08	-0.47	-0.24
Jordan	-0.23	-0.70	-0.03	0.14	0.03	0.53	-0.04
Lebanon	-0.06	-1.24	-0.66	-0.17	-0.27	-0.34	-0.46
Morocco	0.02	0.30	0.07	-0.37	-0.15	-0.28	-0.06
Syria	0.02	-0.06	-0.88	-0.33	-0.06	0.13	-0.2
Tunisia	-0.33	0.06	0.04	-0.32	0.58	0.30	0.05
DE	-0.11	-0.24	-0.31	-0.27	0.01	0.02	-0.16
Algeria	0.40	1.55	-0.05	0.28	0.58	-0.02	0.47
Libya	-0.09	2.01	0.16	0.73	0.55	0.08	0.57
MOE	0.15	1.78	0.10	0.40	0.56	0.03	0.51
Bahrain	0.53	0.41	-0.08	0.16	0.42	0.56	0.34
Kuwait	0.17	0.28	-0.07	0.52	0.01	0.06	0.17
Oman	0.26	0.19	-0.38	0.62	-0.16	0.65	0.19
Qatar	0.48	0.53	0.04	0.07	0.82	0.95	0.49
Saudi Arabia	0.23	-0.13	0.06	0.33	-0.27	0.60	0.13
UAE	0.20	-0.06	0.36	0.22	-0.16	1.03	0.26
OE	0.31	0.20	-0.01	0.32	0.12	0.64	0.26
Djibouti	-0.17	-0.41	-0.03	-0.87	-0.56	0.08	-0.33
Mauritania	-0.01	-0.85	-0.84	0.45	0.45	-0.37	-0.20
Sudan	0.21	0.40	0.35	0.83	-0.55	0.01	0.35
Yemen	-0.12	-0.25	-0.38	0.24	0.65	-0.31	-0.19
PEE	-0.02	-0.28	-0.22	0.04	0.11	-0.15	-0.09
Average	0.08	0.12	-0.15	0.08	0.13	0.18	-0.08

Table A.17: The Employment Challenge: Projected Number of New Jobs Required

Country / Country Group	2005 Labor Force (million)	2005 Unemployment Rate (%)	2005 Employment (millions)	2010 New Jobs (million)	2015 New Jobs (millions)	2020 New Jobs (millions)
Egypt	22.5	10.7	20.09	2.91	6.25	9.59
Jordan	1.9	14.8	1.62	0.43	0.97	1.51
Lebanon	1.4	8.2	1.29	0.21	0.44	0.68
Morocco	11.3	15.7	9.53	1.19	2.53	3.87
Syria	7.4	8.08	6.80	1.39	3.07	4.75
Tunisia	3.8	14.2	3.26	0.42	0.90	1.38
DE	48.3	11.82	42.59	6.55	14.16	21.78
Algeria	13.2	15.3	11.18	1.96	4.26	6.55
Libya	2.3	17.2	1.9	0.30	0.66	1.01
MOE	15.5	15.61	13.08	2.26	4.92	7.56
Bahrain	0.3	3.4	0.29	0.04	0.10	0.15
Kuwait	1.5	1.7	1.50	0.39	0.89	1.38
Oman	0.9	7.5	0.83	0.16	0.35	0.53
Qatar	0.5	2.0	0.49	0.04	0.09	0.14
Saudi Arabia	7.8	6.1	7.33	2.42	5.63	8.85
UAE	2.7	2.3	2.64	0.32	0.67	1.03
OE	13.7	4.53	13.08	3.37	7.73	12.08
Djibouti	0.4	50.0	0.20	0.02	0.05	0.08
Mauritania	1.4	22.0	1.09	0.15	0.33	0.50
Sudan	15.1	18.5	12.31	1.72	3.69	5.65
Yemen	5.9	16.3	4.94	0.96	2.11	3.26
PEE	22.8	18.68	18.54	2.85	6.17	9.49
Total	100.3	12.97	87.29	15.03	32.98	50.91

Source: Authors' estimates.

Table A.18: Domestic Resources Available for Development and Investment (DRDI)

	DRDI					Non-Oil DRDI				
	1970-1980	1980-1990	1990-2000	2000-2007	1970-2007	1970-1980	1980-1990	1990-2000	2000-2007	1970-2007
Algeria	48%	49%	48%	62%	52%	20%	24%	19%	21%	21%
Bahrain	33%	45%	47%	60%	46%	4%	20%	27%	33%	21%
Iraq	85%	76%	54%	60%	69%	38%	51%	8%	-26%	18%
Kuwait	72%	53%	49%	62%	59%	6%	10%	13%	14%	11%
Libya	72%	56%	43%	60%	58%	15%	13%	8%	0%	9%
Oman	64%	58%	52%	59%	58%	10%	8%	10%	13%	10%
Qatar	79%	75%	73%	83%	77%	14%	31%	33%	24%	25%
KSA	76%	55%	56%	68%	64%	19%	21%	23%	26%	22%
UAE	85%	68%	54%	52%	65%	19%	21%	18%	18%	19%
Oil Rich	68%	59%	53%	63%	61%	16%	22%	18%	14%	17%
Syria	32%	31%	30%	37%	33%	23%	21%	16%	13%	18%
Egypt	40%	35%	25%	26%	32%	34%	26%	15%	13%	22%
Yemen	na	26%	24%	35%	29%	Na	14%	6%	2%	7%
Sudan	20%	14%	18%	26%	20%	18%	13%	16%	17%	16%
Tunisia	37%	38%	38%	37%	38%	30%	29%	33%	32%	31%
Morocco	35%	37%	38%	42%	38%	28%	31%	32%	37%	32%
Mauritania	42%	26%	25%	30%	30%	23%	16%	13%	17%	17%
Comoros	21%	24%	15%	5%	16%	20%	23%	14%	4%	15%
Djibouti	28%	28%	31%	32%	30%	25%	24%	26%	27%	25%
Lebanon	12%	-1%	-3%	14%	6%	9%	-6%	-7%	13%	2%
Jordan	23%	22%	28%	20%	23%	20%	16%	22%	15%	18%
Somalia	19%	14%	28%	28%	22%	18%	13%	27%	27%	21%
Oil Poor	28%	24%	25%	28%	26%	23%	18%	18%	18%	19%

Source: Authors calculations based on data from the UN statistical database.

Figure A.1: The Status of MDG Achievement in Arab Countries⁽⁶⁷⁾

	Egy.	Iraq	Jor.	Leb.	Syr.	Lib.	Mor.	Alg.	Tun.	KSA	Kuw.	Bah.	UAE	Som.	Sud.	Djib.	Yem.
GOAL 2 (Overall) Ensure that all boys and girls complete a full course of primary schooling																	
GOAL 3 (Overall) Eliminate gender disparity in primary and secondary education preferably by 2005, and at all levels by 2015																	
GOAL 4 (Overall) Reduce by two thirds the mortality rate among children under five																	
GOAL 5 (Overall) Reduce by three quarters the maternal mortality ratio																	
GOAL 6 (Overall) Target 7: Halt and begin to reverse the spread of HIV/AIDS																	
Target 8: Halt and begin to reverse the incidence of malaria and other major diseases																	
GOAL 7 (Overall) Target 9: Reverse loss of environmental resources																	
Target 10: Reduce by half the proportion of people without sustainable access to safe drinking water																	
Target 11: Achieve significant improvement in lives of at least 100 million slum dwellers, by 2020																	

■ Goal already achieved
■ Very likely to achieve goal (approximately 50% or more progress so far)
■ Possible to achieve if some changes are made (e.g. policy changes)
■ Unlikely to achieve Goal (less than 25% of progress so far)
■ Insufficient information
 Not Reported

Source: www.mdgmonitor.org

(67) Progress towards Goal 1 is not included as it is reviewed extensively in section 3.5. Five Arab countries (Mauritania, Comoros, Oman, Occupied Palestinian Territory, Qatar), were not included due to lack of data.