

International Economics Policy Briefs

Islam, Globalization, and Economic Performance in the Middle East

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The Middle East is a demographic time bomb. According to the United Nations Development Program's (UNDP) *Arab Human Development Report 2002*, the population of the Arab region is expected to increase by around 25 percent between 2000 and 2010 and by 50 to 60 percent by 2020—or by perhaps 150 million people, a figure equivalent to more than two Egypts. Even under the UNDP's more conservative scenario, Bahrain, Kuwait, Qatar, and the United Arab Emirates will be the only

Arab countries in 2020 with median ages above 30.

These figures suggest that the region as a whole will experience labor force growth of more than 3 percent for the next 15 years or so. On current trends, according to an Arab League report, unemployment in the region could rise from 15 million to 50 million over this period. Under plausible assumptions about the rate of productivity growth and required investment levels, the economies of the region will have to maintain investment rates on the order of 30 percent of GDP and income growth of 5 to 6 percent a year to absorb all this labor. This is a very tall order. And recent history is not reassuring.

Fragmentary data from the 1950s and more comprehensive data from the 1960s indicate that, measured in terms of either per capita income growth or total factor productivity growth (in essence how much economic bang one gets for the buck), the performance of the countries of the Middle East was not markedly different from that of other developing countries—it was better than sub-Saharan Africa (the other region most profoundly marked by weak states and arbitrary boundaries), worse than East Asia, and comparable to Latin America or South Asia.

This pattern had changed by the 1980s, following a decade that witnessed an acceleration of inflation globally, the collapse of the Bretton Woods system of fixed exchange rates, two oil shocks, and a deceleration of income and productivity growth rates worldwide. The experience in the Middle East differed considerably among countries, with those relying on oil production rather than a more diversified economy suffering the worst. During the 1980s, the region as a whole actually experienced

negative growth in per capita income, though Egypt, Morocco, and Tunisia were notable exceptions. And while per capita incomes once again began rising in the 1990s, it was at rates markedly slower than that experienced by Latin America and South Asia, not to mention East Asia.

Yet the implications of not achieving rapid growth to absorb the rising number of entrants to the labor force could be dire. In the Zogby (2002) poll of Arab attitudes, Saudi males stand out as uniquely dissatisfied and pessimistic about their children's future. Presumably these feelings are rooted in the reality of dwindling employment prospects, the 40 percent decline in per capita income from its peak in 1982, and the lack of political voice. Dissatisfaction and pessimism about the future are mildly correlated with age, education attainment, and internet access. The youngest, most advantaged sections of society have the bleakest appraisal of the future. It goes without saying that 15 of the 19 September 11 hijackers were Saudi males.

Islam Is Not the Issue

Recent years have seen a revival of the neo-Weberian attribution of economic prosperity to religious thought. In this new rendition, instead of Calvinism acting as an agent of economic advance, Islam is recast as an inhibitor of it. For example, in one of the world's most widely circulated series of economic working papers, three professors at prominent US and European institutions characterize Islam as being negatively associated "with attitudes that are conducive to growth," and on the basis of their analysis of the World Values Survey data, they assert that among adherents to the world's major religions, Muslims are the most "antimarket" (Guiso, Sapienza, and Zingales 2002). Popular commentaries are less nuanced.

This notion, of course, has some surface plausibility: Muslims around the world often reside in poor countries such as Bangladesh and Pakistan (though many also live in Indonesia and Malaysia, largely Muslim nations with much higher income levels and growth rates). Islam is associated with distinct practices such as the prohibition on *riba* (the charging of interest) or the injunction to observe *zakat* (the paying of alms), which could serve as the causal links between theological belief and economic performance. Yet attempts to rigorously assess the impact of these unique practices suggest that they have little, if any, impact on the accumulation and allocation of capital (Kuran, forthcoming).

Likewise, research has generally failed to uncover links between Islam and economic performance in the context of conventional growth models that

emphasize factors such as macroeconomic stability and educational attainment. When one introduces into these standard growth models explanatory variables such as the Muslim population share, one does not obtain robust statistical results (Noland 2003). If anything, Islam appears to promote growth. This result is obtained whether one examines fairly large cross-sections of countries over decades, a smaller group of countries for most of the 20th century, or subnational jurisdictions within multiethnic, multi-religious countries with substantial Muslim populations.

These results hold even if one allows the size of the Muslim population to indirectly impact economic performance, for example, by affecting educational attainment or the degree of political stabil-

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ity. Muslim countries do not appear to systematically deviate from the norm in any observable way. Statistically speaking, the economic performance of Muslim countries is what economic fundamentals would suggest.

Popular Attitudes and Successful Globalization

If not Islam, then what explains the relative underperformance of the Middle East in recent decades? A litany of indicators documents the weakness of the region's linkages to the world economy: Import tariffs average over 20 percent, most of the larger countries in the region are not members of the World Trade Organization (WTO), the region's share of world exports has fallen steadily, and the region as a whole attracts roughly as much foreign direct investment (FDI) as Sweden.

It is almost impossible to imagine the region generating the rapid employment growth necessary to absorb new entrants to the labor force without a big expansion of international trade. Other countries such as South Korea or Taiwan, which achieved sustained periods of growth at this rate, did so in

the context of an outward-oriented development strategy. In the early 1960s, the level of per capita income in Egypt, South Korea, and Taiwan was virtually identical, but the latter two quickly pulled ahead leaving Egypt a generation behind. Twenty-five years ago, each of the Asian countries already achieved exports of manufactures *ten times that of Egypt today*. And although Egypt has a population more than South Korea's and Taiwan's combined, the Asian countries export more manufactures in two days than Egypt does in an entire year.

Although it is theoretically possible that the authorities could manage domestic aggregate demand in such a way as to generate balanced growth of this magnitude for a decade or more, it is highly unlikely in practice. The domestic economy almost invariably will develop bottlenecks if the authorities try to push it down a balanced growth path that rapidly for that sustained a period. The problem is particularly acute if the small size of the domestic market hampers firms. It is difficult to imagine a large economy like Egypt successfully pulling this off; it is virtually impossible to conceive of a smaller economy like Syria or Tunisia doing so.

In one sense, the comparison with South Korea and Taiwan may be unfair—one can argue that the contemporaneous level of income in the 1950s or 1960s in these countries reflected wartime disruption of the late 1940s and early 1950s and that underlying social capacity was actually quite high. Unlike Egypt, the Asian countries in a sense were in the process of converging back to their long-run development trajectory rather than blazing new trails (Noland and Pack 2003).

Yet similar though less dramatic comparisons could be drawn with other countries. Today, taking the level of physical capital, human capital, arable land, and labor into account, the most relevant comparators to Egypt and Jordan may be countries such as the Philippines, Costa Rica, and Bangladesh. Even tiny Costa Rica, with a population roughly 5 percent of Egypt, exports more than twice as many manufactures as Egypt or Jordan. And Egypt and the other countries of the region will not be able to pick and choose their competitors. Whatever the lessons of history, they will have to compete against large, formidable rivals such as China and India in world markets.

Yet it is unlikely that the Middle East will be able to compete successfully against China or India on the basis of low wages, as wage levels in most Middle Eastern countries are already multiples of those in the Asian giants. The possible competitive advantage of the Middle East instead lies in its proximity to Europe and the ability to service the European market in a more timely fashion than competitors

in Asia, Latin America, or sub-Saharan Africa. This means integrating into cross-border supply chains in which a premium is put on reliability, flexibility, and fast delivery. But as noted in a recent World Bank (2003) publication, the nations of the region are conspicuously absent from international production networks.

This close integration with producers beyond the region requires cross-border investment and frequent physical contact, which immediately raises issues relating to political risk broadly defined to include not only expropriation but also the physical security of both facilities and personnel. In the extractive sector, geology largely determines the location of production; if the marginal cost of extraction

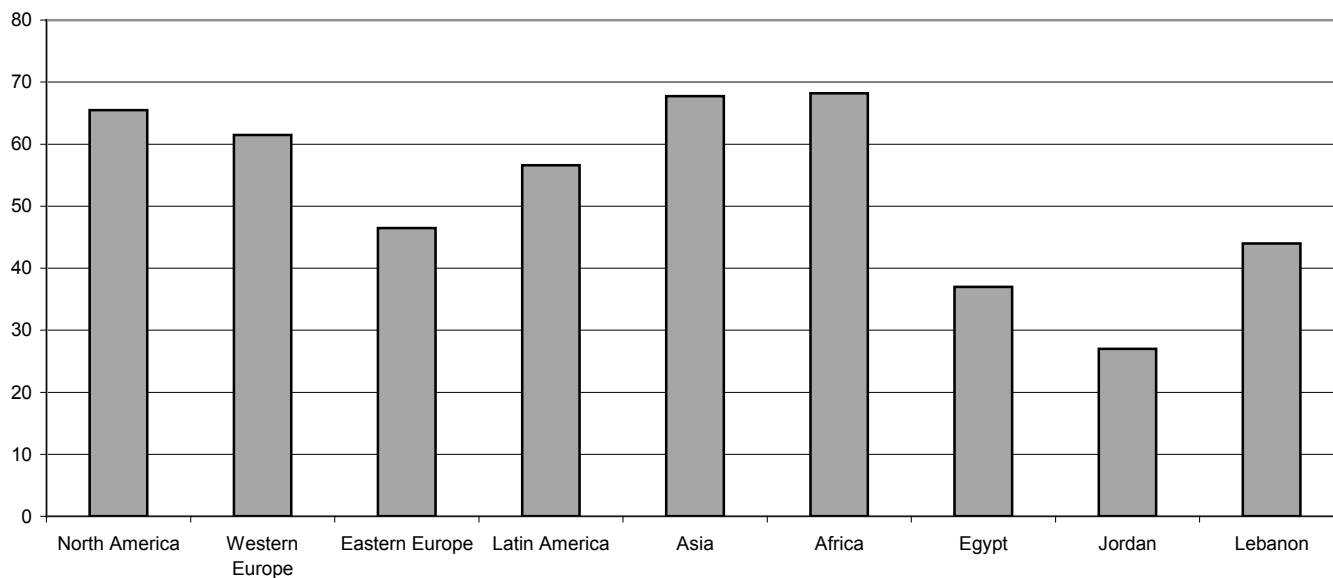
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is sufficiently low relative to the world price, someone will run the risk of producing from that location (though the case of Sudan should stand as a warning that the simple existence of mineral deposits is not a sufficient condition for this to hold).

The same does not hold for manufacturing or back-office type service-sector activities that are not location-specific. In this regard, the Middle East must compete against alternative locations in Asia, Africa, and Latin America, and security risk could potentially prove to be a binding constraint. While the attacks against "offshoring" of American white-collar jobs have mounted, the targets of concern have been countries such as India, China, the Philippines, and Mexico—not Syria or Egypt. (In this regard prospects might be better for the former French colonies of the Maghreb, once the process of outsourcing white-collar tasks begins in earnest in Francophone Europe.) Although there have been occasional attacks against foreign businesses, such as the ones in Saudi Arabia in May 2004, and foreign tourists, most notably at Luxor in 1997, to date this does not appear to be a major problem.

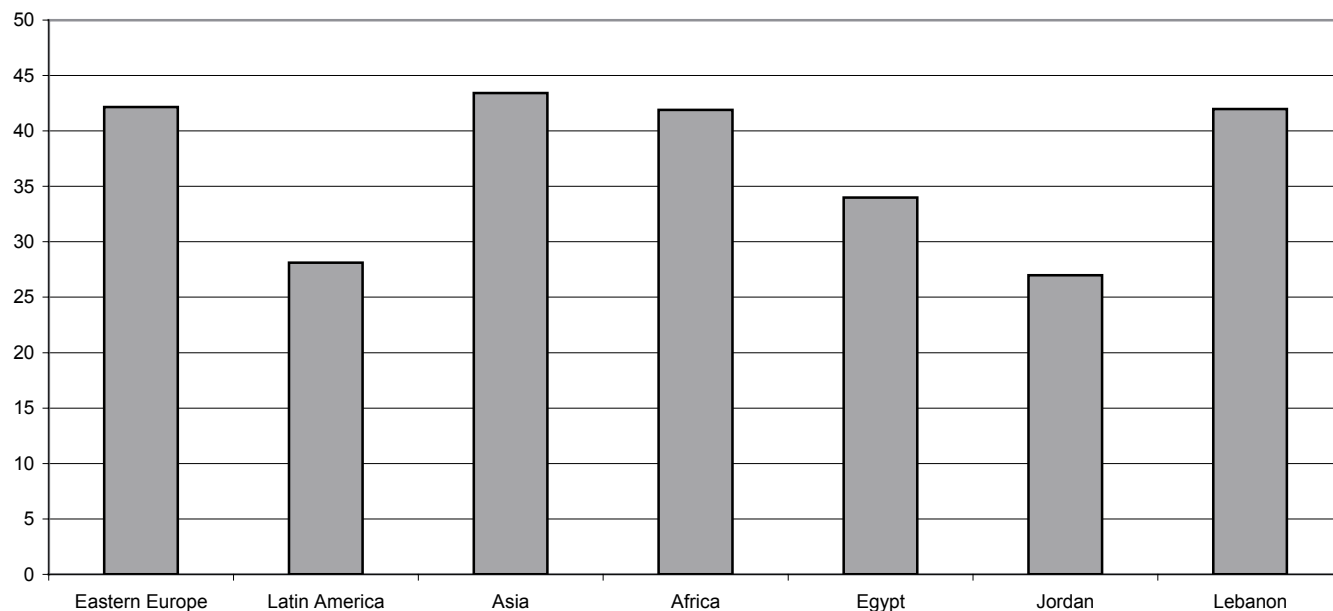
Less dramatic than terrorist attacks, though perhaps more important for economic development, are public attitudes toward foreigners and globalization. The 2003 Pew Global Attitudes survey revealed a significant level of discomfort with globalization

Figure 1: Percent that responded “globalization is good”



Source: Pew Research Center for the People and the Press, *Pew Global Attitudes Project*, 2002 and 2003.

Figure 2: Percent responding that closing large inefficient factories is “hardship but necessary”



Note: This question was not asked in North America, Western Europe, or Japan.

Source: Pew Research Center for the People and the Press, *Pew Global Attitudes Project*, 2002 and 2003.

in the Middle East. As indicated in figure 1, the percentage responding that globalization is good in three Middle Eastern countries is considerably less than in other regions of the world surveyed. Three of the many questions posed in the Pew poll have particularly high correlations with measures of risk in economic exchange, especially FDI that involves a local physical presence. The regional pattern of responses to three issues—the necessity of closing large, inefficient factories; the need to protect their way of life against foreign influence; and the desirability of societal acceptance of homosexuality—are displayed in figures 2 through 4.¹ Relative to most respondents in the rest of the world, the Arabs were less willing to close inefficient factories, more committed to protecting the local way of life, and less tolerant of homosexuality. The picture that emerges from the pattern of responses to the full set of Pew survey questions is of local populations that are relatively averse to change, instead favoring the maintenance of existing economic and social arrangements—especially if the forces of change are regarded as emanating from foreign or nontraditional sources.

Controlling for economic fundamentals such as the level of per capita income, macroeconomic stability, and corporate taxes across a broad sample of countries, these responses have some explanatory power with respect to measures of interest such as the level of inward FDI, sovereign debt ratings, and local entrepreneurship. Although the precise channels of causality are ill defined, it is plausible that the attitudes manifested in the survey responses are underpinning behaviors and practices that may impede successful globalization. The question about closing of factories could be interpreted as a straightforward question about the priority placed on efficiency. The questions about protecting against foreign influence and accepting homosexuality could be interpreted as capturing the extent of entry barriers to human capital from nontraditional sources.

The cross-national correlation of attitudes toward homosexuality and foreign influences echoes the finding that the homosexual population share was the single best predictor of high-technology industry activity across US metropolitan areas (Florida 2002). In turn, the highest demographic correlate with the gay population share across US metropolitan areas was the foreign-born share, which could be interpreted as an indicator of acceptance

of foreign cultural influences. Florida interpreted openness to homosexuals and immigrants as good indicators of low entry barriers to human capital, important to spurring creativity and prosperity. Presumably one aspect of this is relative freedom of fear from harassment or attack.

So, for example, in a statistical sense if Egyptian attitudes toward foreign influence were at the mean level of those in least xenophobic countries surveyed from Latin America, Eastern Europe, sub-Saharan Africa, South and West Asia, and East Asia (Peru, Ukraine, Angola, Uzbekistan, and China, respec-

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tively)—an ambitious but attainable standard—one would expect FDI in Egypt to be almost 90 percent higher than it is. Likewise, if Jordan's attitudes toward homosexuality mimicked those in the most tolerant countries surveyed from Latin America, Eastern Europe, sub-Saharan Africa, South and West Asia, and East Asia (Argentina, the Czech Republic, South Africa, Turkey, and the Philippines, respectively), one would expect FDI in Jordan to double.

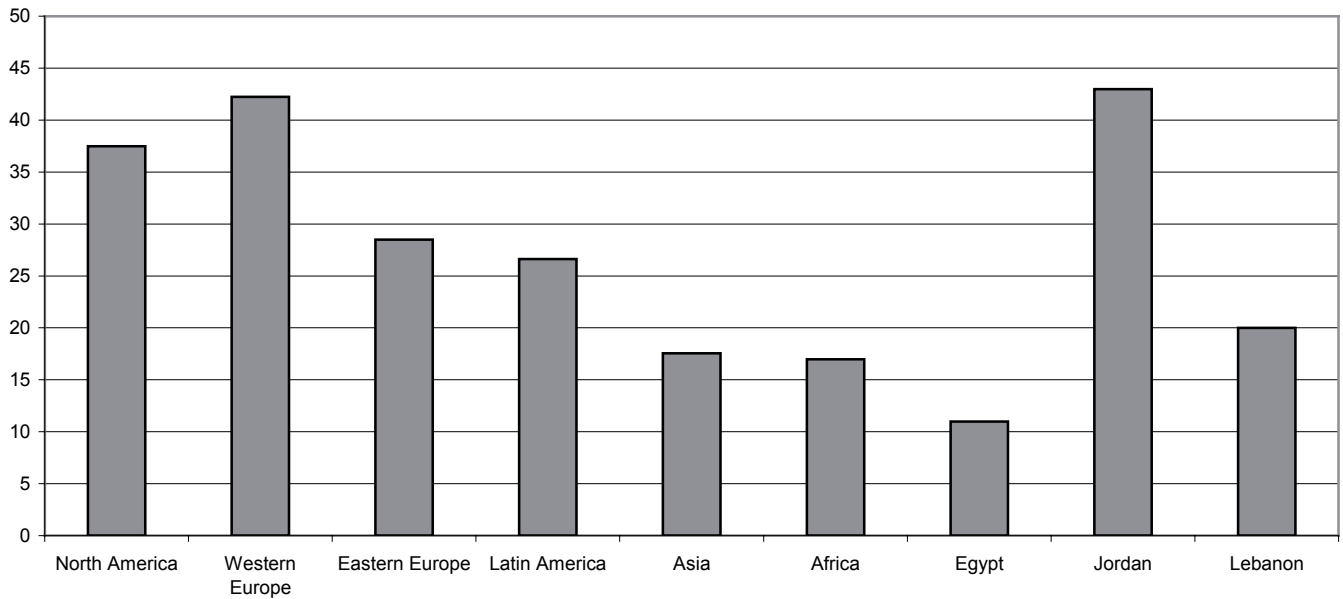
From this perspective, the attitudes revealed in the Pew survey are not auspicious. In a narrow sense, they reveal support for the inward-oriented development strategy, which has been a relative failure; at the same time, they may signal more profound levels of insecurity that may make successful globalization problematic. Given Egypt's labor abundance and proximity to Europe, an obvious potential market niche would be in the production of high-end garments, yet fashion designers are known for their flamboyance if nothing else, and wholesale fashion buyers may rank second only to MTV producers in their capacity to outrage traditional moral authorities. It is not clear that European fashion houses and societies grappling with deep issues of self-definition are necessarily a good fit.

Islam May Be Part of the Issue

The 2003 Pew survey also examined attitudes toward Islam and political life in a number of pre-

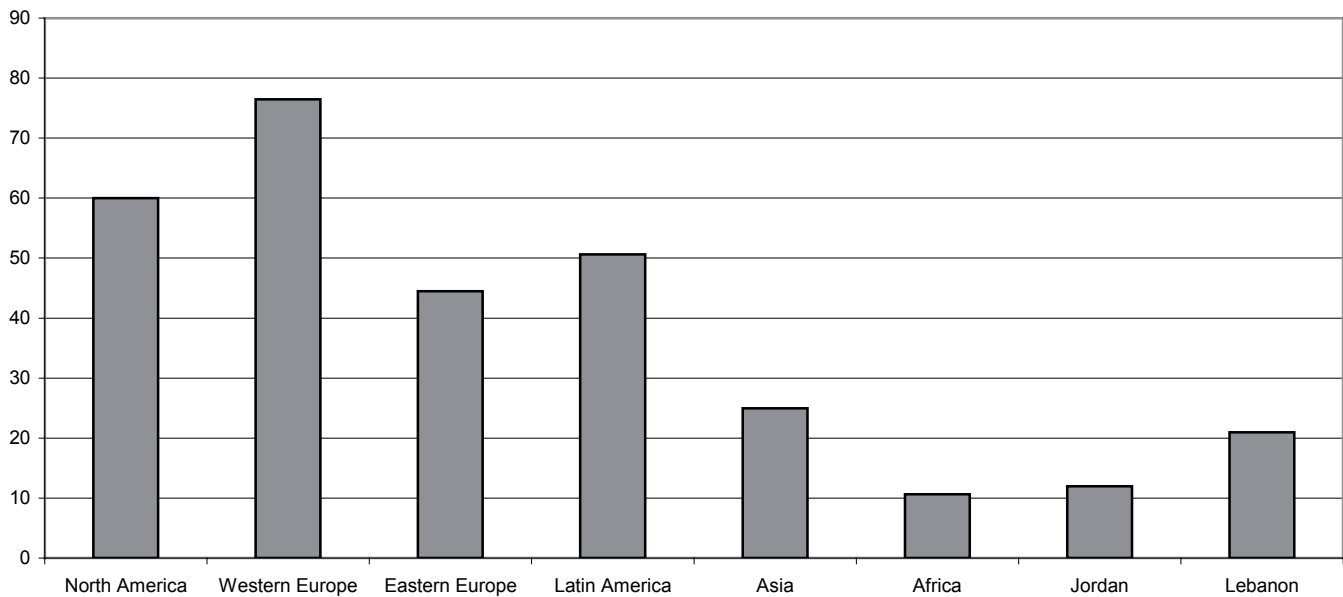
¹ The country samples in figures 1 through 4 differ slightly from figure to figure. Respondents in North America, Western Europe, and Japan were not asked about closing factories. The pollsters were not permitted to ask the question about homosexuality in Egypt.

Figure 3: Percent that disagreed that the way of life “needs to be protected against foreign influence”



Source: Pew Research Center for the People and the Press, *Pew Global Attitudes Project*, 2002 and 2003.

Figure 4: Percent that agreed that “homosexuality should be accepted by society”



Note: This question was not permitted in Egypt.

Source: Pew Research Center for the People and the Press, *Pew Global Attitudes Project*, 2002 and 2003.

dominantly Muslim countries as well as several countries with large Muslim minorities, such as Nigeria and Tanzania. The poll revealed ubiquitous feelings of solidarity with coreligionists in the *umma* (Muslim community) and widespread support among Muslims surveyed for the notion that Islam was under threat, though the perceived sources of threat were multiple and predominately reflected local concerns.

In this regard, concerns manifested through Islam may simply be one symptom of more complex social processes. Islam may matter—not in the simple sense that belief in Allah dooms one to a low personal saving rate or that Islamic banking systems handicap financial efficiency—but rather in a more subtle way. Today there are Muslim communities in the Middle East that are relatively discomfited by aspects of ongoing social change. To the extent that adherence to Islam is a significant component of personal and communal identity, Islamic teachings will be one prism through which these developments are evaluated. This pattern of apprehension may be reinforced if Islam itself is regarded as being part of this contested terrain.

Yet the centrality of religious belief in this formative process should not be overstated. As revealed in the Zogby poll, religious orientation is generally only a secondary or tertiary source of personal identity in most Arab countries in the Middle East—rather Arab ethnicity is the primary identifier. It is almost surely the case that feelings toward foreigners or homosexuals are derived from some admixture of religious teachings and prevailing cultural norms. Religious beliefs are but one input in a complex reaction to globalization.

Conclusions

Broadly speaking, the long-run economic performance of the Middle East does not appear to be unusually bad or good when viewed in comparison with other developing countries, and the concern expressed in some quarters about the impact of Islam on economic development would appear unwarranted. That said there are very serious reasons for concern.

For reasons not fully understood, performance has slipped over the past quarter century or so relative to a broad set of comparators. This concern is made particularly acute by two ongoing developments, one external and the other internal. The ex-

ternal source of concern is that the successful ongoing globalization of China, India, and smaller rivals is creating a more competitive global economic environment in which the Middle East has to operate. The global marketplace simply embodies increasingly stringent competitive pressures and less tolerance of substandard policies and practices than 20 or even 10 years ago.

The internal pressure comes from demographics. The Middle East has commenced a period in which the bulge generation created by the process of demographic transition is entering the labor force, and the imperative is to create jobs. It is almost impossible to imagine the sustained generation of employment opportunities on the needed scale without a successful process of globalization and cross-border economic integration.

This immediately raises difficult issues of sovereignty and cultural identity and with them the obvious possibilities for self-reinforcing processes. The degree of insecurity in both its economic and cultural dimensions presumably relates to actual economic performance, embodying possibilities of both virtuous and vicious circles. In this regard, the recent experiences of Saudi Arabia could be read as a cautionary tale: weak economic performance leading to pessimism about the future, possibly counterproductive policy interventions, and bouts of political extremism.

The good news is that to the extent that the Zogby poll accurately gauged regional attitudes, Saudi Arabia is the extreme case. Moreover, with fertility now dropping, the region may be well through the process of demographic transition, and as the size of the cohorts entering adulthood begins to shrink, there will be a concomitant diminution in the problems that all societies face socializing young adult males. This process of absorbing a rapidly growing labor force, while prolonged, is self-terminating and not without end.

Indeed, should the region manage to successfully surmount this challenge, it can look forward to a complementary period of “demographic dividend” as this generation enters its most productive working years—a phenomenon that contributed to the outstanding performance of East Asia over the past four decades or so. If the Middle East is able to cash in on this dividend, future pundits may praise the disciplined “Islamic ethic” as a contributor to development just as erroneously as they condemn it as an obstacle to growth today.

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