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June 12, 2007

ARAB ECONOMIES FACE MASSIVE BULGE IN LABOR FORCE AND REQUIRE RENEWED GLOBALIZATION TO RESPOND

Washington—The Arab world faces a demographic imperative—a possible 150 million person increase in population, equivalent to two Egypts, over the next decade or so. If this daunting challenge can be successfully addressed, the region could look forward to a “demographic dividend” as a new generation enters its most productive working years. A new book from the Peterson Institute, *The Arab Economies in a Changing World*, finds that growing prosperity, confidence, and optimism about the future could underpin movement toward greater political openness and social tolerance.

There is no guarantee that this positive vision will become a reality. An alternative outcome is a vicious circle in which impoverishment, discontent, militancy, and repression feed upon one another, deterring reform and impeding growth. The fact that neither scenario can be dismissed underscores the extraordinary salience of this book for today’s global geopolitical as well as economic development debate.

To generate an increase in employment of the required magnitude requires duplication of the “miracle” economies of Korea and Taiwan—an expansion of labor-intensive manufacturing or services exports, often in conjunction with foreign investors or local entrepreneurs who integrate into global supply networks. But outside of the energy sector, the region’s track record in integrating into the world economy has been inauspicious. The Arab world risks being left behind at precisely the moment it needs to accelerate job growth.

Substantial intraregional variation in achievement along many of the relevant benchmarks suggests that these outcomes are not determined by intrinsic cultural factors. Islam is not in any simple sense an obstacle to growth. The Arab region’s growth performance has not been that different from comparable developing countries. Two Islamic nations, Indonesia and Malaysia, have been among the more successful developing countries in recent years.

These simple observations are confirmed by ground-breaking statistical analysis that shows that adherence to Islam cannot explain variations in growth or productivity either across countries or within multiethnic and multireligious states. The influence of Islam or the anthropology of Arab culture may have many effects on local institutions and practices but they cannot explain why it takes 15 times as long to enforce a contract in Egypt as it does in Tunisia. Significant improvements in economic outcomes could be achieved by simply matching the best practices established within the region.

Progress is inhibited by two factors, one institutional and the other political. Outside of the extractive industries and tourism, where geology or special attractions like the Pyramids confer unique and irreproducible advantages, the Arab countries as a group score poorly on a nexus of indicators relating to cross-border economic integration and the transfer, dissemination, and application of technological knowledge and innovation. In 2004, exports of manufactured products from the eight largest Arab countries were slightly greater than half those of Turkey, a nation with a fraction of the total population of the eight countries. Over the period 2000–2004, the cumulative inflow of foreign direct investment to the eight was 15 percent of Brazil's despite the much lower population of Brazil. As a group, the Arab countries do not make heavy use of technology licensing agreements with other countries or foreign business consultants. Few products from the Arab countries can be found on the shelves of Wal-Mart or Old Navy. Nor do consumers or businesses phoning call centers encounter voices in Cairo rather than Bangalore or Manila.

Building such links presents a formidable challenge. Unlike issues of monetary and fiscal policy, where policy change can be implemented by a relatively small number of centrally placed technocrats, addressing the institutional weaknesses that slow economic growth requires a much more prolonged and politically and socially uncertain path. The hesitancy to reform stems from concerns more fundamental than mere special interest politics, however. While the region's contemporary economic performance may not be distinctive, its enduring political authoritarianism is. This lack of political dynamism in the face of underlying social change, together with the increasingly religious orientation of the political opposition, paradoxically raises the possibility of abrupt transitions. Such deep political uncertainty discourages behavior that

involves irreversibility—from investment to a reversal of the brain drain—and creates the possibility of a self-reinforcing downward spiral.

A primary problem of the countries analyzed is the absence of a demonstrated international competitiveness in either manufacturing or services. Partly this reflects the maintenance over a long period of an orientation to protected domestic markets. The Arab countries exhibit unusually high tariff rates compared with other developing countries. While these countries have made progress, by lowering tariff and nontariff barriers, they remain among the highest in the world. As these are lowered further, the nations may be able to take advantage of many existing international trade agreements with the United States and Europe. The international community should increase these agreements with the Arab countries.

The United States should renew its emphasis on multilateral coordination. The Arab world needs institutional reform and capacity building. The United States can provide technical assistance and support bilaterally but it ought also use the whole panoply of international institutions including the World Trade Organization, International Monetary Fund, and World Bank. The impact of these international institutions is incremental and they do not have magic bullets in their policy advice. However, some of their recommendations, ranging from desirable education reforms to alterations in the regulations facing business, are important. In supporting them the United States, and other nations, can buy an option on reform: maintaining contact and a local knowledge base in anticipation of the day when the host government will be ready to move forward.

The Middle East has long been a politically contested region of global significance. The demographic pressures the region faces to productively employ its young people entering the labor force raise the stakes even higher. If the region's employment challenge can be successfully addressed, the Arab world could reap a demographic dividend as the new 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. The region's young demographic could then turn from a potential liability to a bonus.

The Arab Economies in a Changing World

by Marcus Noland and Howard Pack

ISBN paper 978-0-88132-393-1

June 2007 • 365 pp. • \$24.95

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