Country Note D

The Middle East and North Africa: Performing below Potential

Earlier parts of this report highlighted that sustained growth experiences result from four functions of growth being met, and that at different moments, different functions are more relevant than others and their absence poses more binding constraints. Fulfilling only some of the functions of growth results in performance well below potential. Countries in the Middle East and Northern Africa illustrate this point: while they have succeeded in accumulating capital, both physical and human, and have also succeeded in ensuring equitable distribution, they have not sufficiently emphasized efficient allocation of resources through openness and liberalizing their domestic economies.

The 12 developing countries[1] of the Middle East and North Africa have a total population of 260 million, of which the two most populous, the Arab Republic of Egypt and the Islamic Republic of Iran, account for about half.[2] While the countries of the region vary widely in their natural resources, population density, and stage of economic and political development, they share a common history and cultural heritage. They also share a common approach to economic policies: relatively high import protection and a large role of government in the economy. Their experiences highlight the role of natural endowments in growth processes, and the role of openness and domestic liberalization.

Countries in the region have generally followed prudent macroeconomic management principles and have avoided extreme instability of the kind seen in Latin America. Inflation has been moderate and relatively stable, and Argentina-like fluctuations in output have been exceptional. But the fundamentals have in many cases weakened and the region now faces a number of serious macroeconomic vulnerabilities. In particular, contingent liabilities have been building up in many countries, from sources such as pension systems, banking sectors, public enterprises, and a variety of implicit and explicit government guarantees.

Although intraregional trade and financial flows are small, the countries in the region are tied together by large-scale labor migration. Other common characteristics include rapid gains in social indicators over the last two decades, starting from extremely low levels (table D.1). Poverty declined rapidly in the 1960s, 1970s, and 1980s, but changed little in the 1990s. Income inequality remained relatively low throughout the period. Also, in the last two decades, countries in the region experienced one of the highest labor force growth rates in the developing world. Between 1990 and 2020, the growth of the economically active population (ages 15–64) will exceed that of the economically dependent population by a much greater amount than in any other region. As experience elsewhere has shown, this rapid growth presents an opportunity, but also poses the challenge of responding to the employment expectations of an increasingly urbanized labor force.

For most of the last century, because of its oil and natural gas reserves, the world's largest, the region has been the focus of attention from industrialized superpowers. Possibly as a result of such strategic importance, armed conflicts have been frequent over the past four decades.[3]

Growth Performance

Though the region has escaped extreme instability, its high output growth of the 1960s and 1970s gave

TABLE D.1

Progress on Social Indicators, Middle East and North Africa, 1980–2000

	1980	*1985*	*1990*	*1995*	*2000*
Headcount poverty rate, %	—	16.9	17.2	15.9	—
Life expectancy, %	59	64	67	69	70
Infant mortality rate, %	83	—	42	36	32
Adult literacy rate, %	42	49	57	64	72
Secondary school enrollment, % gross	33	45	49	59	69
Literate female to literate male ratio, ages 15–24	62	69	79	86	92

Source: World Bank 2004f; Adams and Page 2003.

Note: Table shows medians of the regional social indicators. Headcount poverty rate is a simple arithmetic average, because the sample size is small: long enough series are available for only five countries: Egypt (1981–82, 1990–91, 1995–96, 1997, 1999–2000); Jordan (1986–87, 1992, 1997); Morocco (1984–85, 1990–91, 1998–99); Tunisia (1984–85, 1990–91, 1998–99); and the Islamic Republic of Iran (1986, 1990, 1994, 1998). Though not reflected in the table, in 2000 poverty rates continued to decline in the countries for which data are available (Egypt and the Islamic Republic of Iran), and rose only in Morocco. Data shown on adult literacy rate and literate female-to-male ratio do not include Djibouti and Lebanon, for which no data are available.

—. Not available.

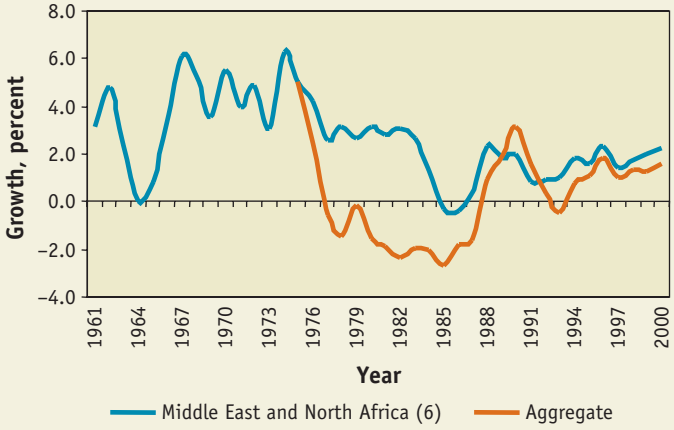
way to stagnation in the 1980s (figure D.1 and table D.2). Except for Egypt and Tunisia, the countries of the region have not grown fast enough to reduce the income gap with more advanced industrial economies (Country Note B, *Lessons from Countries That Have Sustained Their Growth*). Per capita income declined over the 1980–2000 period in several countries, including Algeria, Jordan, and virtually all of the Gulf countries.

Natural resources have not ensured economic performance (World Bank 2004f). Indeed, over the last two decades, countries without large oil resources have generally performed better than those rich in oil (tables D.3 and D.4).

Labor-abundant countries have performed better than those where labor is scarce. In particular, in the 1980s, when practically all oil-rich economies shrank as oil prices collapsed, the oil-poor, labor-abundant countries were able to sustain growth: Egypt, Morocco, and Tunisia grew annually at 2.9, 1.6, and 1.1 percent, respectively, during that decade (table D.3). Jordan was an exception: because of its dependence on remittances and financial support from oil-exporting countries, its growth in the 1980s dwindled, trailing that of resource-rich countries.

FIGURE D.1

Median and GDP-Weighted Economic Growth in the Middle East and North Africa, 1961–2000



Source: WDI.

Note: Median growth rates for samples of countries that have complete GDP series. Aggregate is growth rate for the region (regional GDP over regional population). All data are smoothed with three-year moving averages. Extending the sample of the region's countries to six more does not significantly change the results in the later decades.

The 1990s saw improvements in performance virtually everywhere, except in Saudi Arabia (whose income per capita declined to the point that the country is now classified as a developing country) and Oman. The return to peace accounted for much of the

TABLE D.2

Economic Growth in the Middle East and North Africa, 1960–2003
(median GDP per capita growth)

	1960	*1970*	*1980*	*1990*	*1990s**
6 countries	2.4	3.6	1.3	1.4	1.5
9 countries			–0.2	0.6	0.9
12 countries				1.2	1.2
All developing countries (69)	2.0	1.8	–0.5	1.3	1.0
Developing countries (78)	...	1.9	–0.3	1.0	1.0
Developing countries (93)	...	...	–0.2	1.0	0.9

Source: WDI.

Note: Different country groups correspond to the periods for which data exist for all countries. For example, there are only 6 countries in the Middle East and Northern Africa for which GDP statistics exist since 1960, 9 for which they exist since 1980, and 12 for which they exist since 1990. 1990s* means 1990s including 2001 and 2002.
6 countries: Egypt, Arab Rep. of; Morocco; Tunisia; Algeria; Syrian Arab Rep.; Oman.
9 countries: Egypt, Arab Rep. of; Morocco; Tunisia; Jordan; Algeria; Syrian Arab Rep.; Iran, Islamic Rep. of; Oman; Saudi Arabia.
12 countries: Egypt, Arab Rep. of; Morocco; Tunisia; Jordan; Lebanon; Djibouti; Algeria; Syrian Arab Rep.; Iran, Islamic Rep. of; Yemen, Rep. of; Oman; Saudi Arabia.

TABLE D.3

Three Major Middle Eastern and North African Country Groups

	Abundant labor	*Scarce labor*
Rich in resources	Algeria, Syrian Arab Rep., Iran, Islamic Rep. of, Yemen,	Oman, Saudi Arabia
Poor in resources	Egypt, Arab Rep. of, Morocco, Tunisia, Jordan, Lebanon, Djibouti	

Source: World Bank 2004f.

improvement in the Islamic Republic of Iran, after the Iran-Iraq war, and in Lebanon and Yemen, after civil conflicts. In Jordan, improvement took place as the result of ambitious reforms that opened and liberalized the economy in the 1980s, even though political uncertainties and restrictions on the country's access to external markets kept the country's growth below its potential (Khalaf Hunaidi, in World Bank 2005b).

Fulfilled and Unfulfilled Functions of Growth

Recent World Bank reports have highlighted the importance of governance reforms, to enable the countries in the region to grow faster and more equitably (World Bank 2003a–d). Middle Eastern and North African countries have benefited from public institutions that are able to maintain law and order and exert the state's authority. The energy of the bureaucracy, however, has often focused more on controlling the allocation of resources than on supporting private sector initiatives and a competitive economy. Many countries in the region have been hesitant to embrace economic openness and competition, and some analysts believe that political liberalization is needed to address governance issues and create an investment climate that is more predictable and more conducive to growth.

Middle Eastern and North African countries have generally fulfilled two of the central functions of growth: accumulation and distribution. Their investment rates have been high compared with other developing-country groups (figure D.2). The Middle East and North Africa's "social contract," with the state dominating the economy, allowed it to mobilize significant resources for investment, particularly when oil prices skyrocketed in the 1970s. Throughout the 1970s and early 1980s, investment rates in the region were comparable with those in the eight high-performing East Asian

TABLE D.4

Economic Growth in the Middle East and North Africa: Impact of Natural Resources

	1990	*1980*	*1970*	*1960*
Resource-poor with abundant labor				
Egypt, Arab Rep. of	2.3	2.9	4.4	2.9
Morocco	0.4	1.6	2.7	2.0
Tunisia	3.1	1.1	5.0	2.8
Jordan	0.6	–1.8	…	…
Lebanon	5.3	…	…	…
Djibouti	–4.0	…	…	…
Resource-rich with abundant labor				
Algeria	–0.3	–0.2	2.8	1.2
Syrian Arab Rep.	2.1	–1.1	6.4	2.0
Iran, Islamic Rep. of	2.5	–0.7	…	…
Yemen, Republic of	1.7	…	…	…
Resource-rich, labor importing				
Oman	0.6	4.7	1.2	16.2
Saudi Arabia	0.0	–5.7	7.9	…

Source: WDI.

[Use "—" for "not available" and ".." for negligible; which is it in this case?]

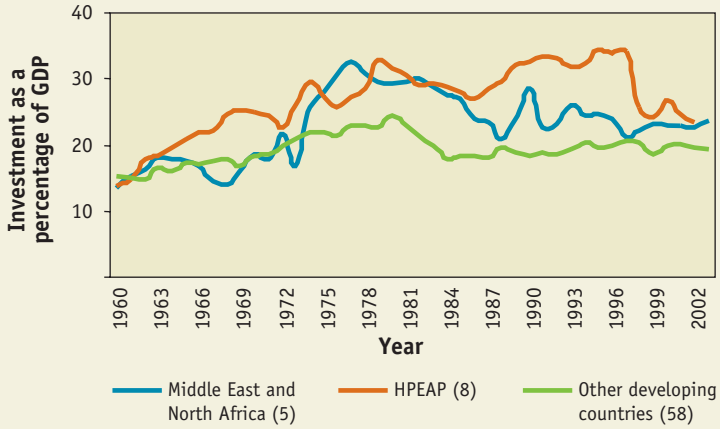
economies. Investment rates were high not only in the oil-rich countries—such as Algeria with a two-decade average of 38 percent of gross domestic product (GDP)—but also in Jordan (31 percent), Tunisia (28 percent), and Egypt (26 percent). From an international perspective, these investment rates are extremely high. Even after the collapse of oil prices, and ensuing declines in investment rates in recent years, they have been comparable to those in the high-performing East Asian economies.

Middle Eastern and North African countries have also invested large amounts in human capital. They have dramatically reduced infant mortality, raised life expectancy, and expanded school enrollment. Their literacy rates have increased significantly, including for women in countries such as Algeria, the Islamic Republic of Iran, Jordan, and Tunisia, and are now above those in many developing countries at similar levels of income.

Most governments in the Middle East and North Africa, perhaps with the exception of Morocco, have been highly redistributive. Distribution took place through a variety of programs, including provision of

FIGURE D.2

Investment in the Middle East and North Africa, 1960–2002



Source: WDI.

Note: HPEAP designates high-performing East Asian economies; Other Dev (58) is the sample of 58 countries for which data are available for this period. Extending the sample of MENA countries to six more does not significantly change the results in the later decades.

health and education, subsidies for housing and for consumption items including bread and transport, scholarships, and even jobs in the public sector. In the 1990s, however, as part of fiscal adjustment programs, many of the subsidies were phased out.

Macroeconomic stabilizations in the late 1980s reduced inflation and debt and reduced the need for external inflows. Fiscal positions were consolidated and economies recovered from recessions. But for a number of reasons growth in the region has failed to regain its pre-1979 levels.

Combined with the high investment rates in physical and human capital, the disappointing growth performance suggests that productivity growth was negative. Negative productivity growth may be the most important reason why countries in the Middle East and North Africa have performed less well than countries in, for example, East and South Asia.

There are three main reasons for the low productivity of investments in the Middle East and North Africa. First is the dominance of production by the state, which typically uses resources less efficiently than the private sector.

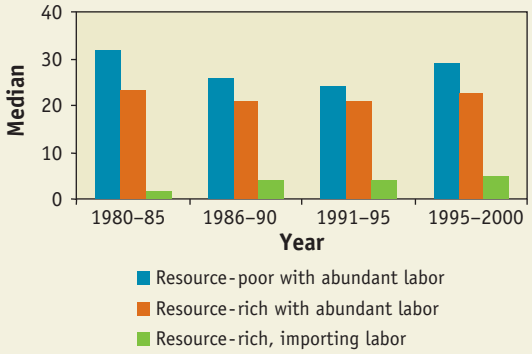
Second, the region's tariff barriers are among the highest in the world. For countries with limited domestic markets, import substitution policies quickly outlive their usefulness. In the early 1980s, the region's tariffs were quite low compared with those in other developing regions. But they have remained at these levels, while those in other regions have now been dramatically reduced. Average tariff rates in Algeria, the Islamic Republic of Iran, Jordan, Libya, Morocco, Saudi Arabia, the Syrian Arab Republic, and Tunisia have either increased somewhat or remained constant since the late 1980s (figure D.3) (Oliva 2000).[4]

Third, Middle Eastern and North African countries maintain domestic restrictions on private investments. Domestic restrictions on private investments are not always explicit and the lack of a vibrant and developing private sector is not always the result of state monopolies. Red tape, the inefficiency of the judiciary, corruption, and state capture of government regulation all work to deter private investment. And the absence of clear directions on the future evolution of policy creates uncertainty, which further limits private investment.

FIGURE D.3

Tariffs in the Middle East and North Africa, 1980–2000

(median of unweighted average tariffs)



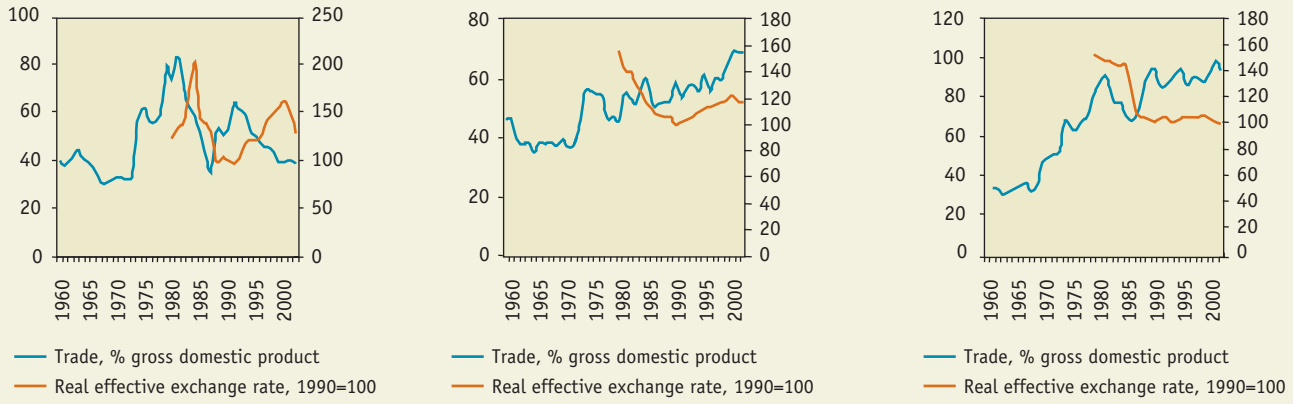
Source: World Bank, World Integrated Trade Solution database.

The low productivity of investments belies several waves of reform in the region's trade regimes. Notwithstanding the reforms, investments tended to be allocated inefficiently and as a result, the growth payoff to large investments was low.

Tunisia, Egypt, and Morocco introduced their first trade-related reforms in the 1970s (figure D.4). Tunisia was able to significantly accelerate its growth rate in the 1970s by creating export-processing zones insulated from the rest of the economy, and it continued with gradual but persistent steps to liberalize the economy (Oliva 2000). Egypt followed the route of internal liberalization first, drawing on the potential of its large internal market; the pace of reform was much slower and the approaches more sporadic. During the 1990s, trade volume rose in Tunisia but fell in Egypt. Morocco joined the General Agreement on Tariffs and Trade in 1987 and proceeded to liberalize its financial sector, privatize state-owned enterprises, and rationalize its tax system. Openness steadily increased in both Morocco and Tunisia, as did the share of manufactured goods in these countries' exports, but only in Tunisia did increased openness translate into high growth (figure D.5).

FIGURE D.4

Trade Outcomes in Egypt, Morocco, and Tunisia, 1960–2000

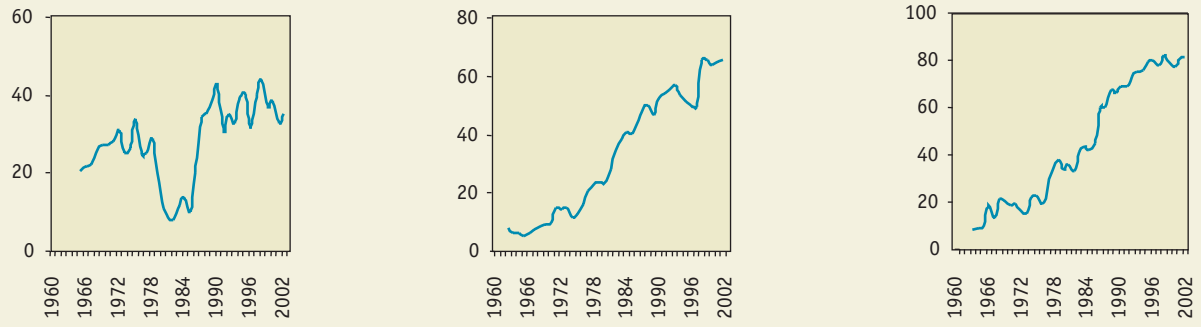


Source: WDI.

FIGURE D.5

Diversification in Egypt, Morocco, and Tunisia, 1960-2002

(manufactured exports as a percentage of exports of goods and nonfactor services)



Source: WDI.

In Lebanon and in labor-abundant and resource-rich economies—Republic of Yemen, Algeria, Syria, and the Islamic Republic of Iran—the approach to trade reform has been more gradual and haphazard. The Islamic Republic of Iran, after the Iran-Iraq war, implemented some internal liberalization that, as in Egypt, resulted in high output growth but not much international integration. In the Islamic Republic of Iran, it is difficult to disentangle the effects of liberalization from those of postwar "reconstruction," dismantling of wartime price controls, gradual and sporadic reforms, and higher oil revenues. But despite decades of state support to manufacturing, the Islamic Republic of Iran's exports remain completely undiversified and the manufacturing sector itself shows little sign of viability (Tabibian 2003). The sus-

tainability of the country's liberalization measures is unclear (Esfahani 2002).

Conclusion

The experience of developing countries in the Middle East and North Africa illustrates the importance of maintaining a balance among the different functions of growth, and that if a country succeeds in fulfilling one function, it may not achieve its full potential unless it can fulfill the other functions as well. The achievement of sustained high growth in the region will require more clarity on the future directions of policies and considerable domestic and external liberalization.

Notes

1. Algeria, Syrian Arab Republic, Islamic Republic of Iran, Republic of Yemen, Arab Republic of Egypt, Morocco, Tunisia, Jordan, Lebanon, Oman, Djibouti, Saudi Arabia.
2. The region's performance and development challenges have been analyzed in a series of World Bank reports (World Bank 2003b, 2003f, 2003j, 2003l), on which this country note draws extensively.
3. The number of conflicts is at par with that in Sub-Saharan Africa, where the number of countries is three times that in the Middle East and North Africa (World Bank 2003b, 2003f, 2003j, 2003l).
4. Tariffs increased for various reasons. Those in Saudi Arabia rose by between 8 and 12 percent a year in response to balance of payments pressures, and those in Morocco rose as the result of quota tariffication.