

# **Trade Policy and Economic Integration in the Middle East and North Africa**

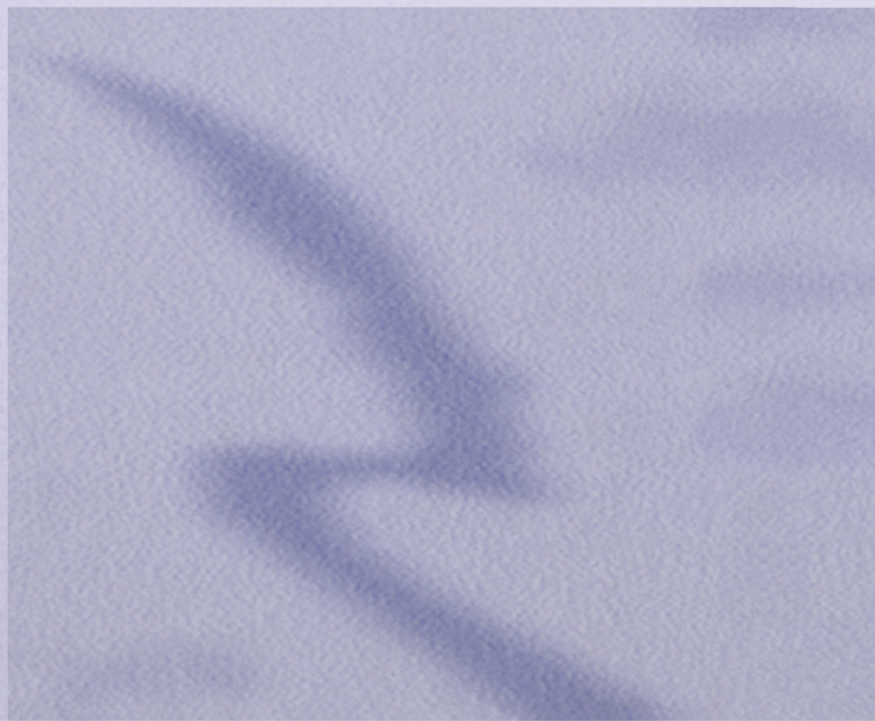
Economic boundaries in flux

*Edited by*

Hassan Hakimian and Jeffrey B. Nugent

The Political Economy of the Middle East and North Africa

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# Trade Policy and Economic Integration in the Middle East and North Africa

The recent globalization trends have revived a long-standing interest in regional integration in the countries of the Middle East and North Africa (MENA). Despite numerous attempts to encourage economic integration in MENA in the past few decades, there is broad consensus that progress has been painfully slow and the record of economic integration in this region has been largely beset by failure. This book examines the impact of recent changes in the world economy on trade policy within the MENA region and its economic relations with the rest of the world. It considers regional integration and prospects for trade blocs; trade liberalization and economic restructuring; resource endowments and employment trends; and changes in economic boundaries, especially as a result of labour migration and regional conflicts.

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# **The Political Economy of the Middle East and North Africa**

(Series editor: Hassan Hakimian)

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## **Preface and acknowledgements**

The recent globalization trends have revived a long-standing interest in regional integration in the countries of the Middle East and North Africa (MENA). Despite numerous attempts to encourage economic integration in MENA in the past few decades, there is broad consensus that progress has been painfully slow and the record of economic integration in this region has been largely beset by failure.

This book examines the impact of recent changes in the world economy on trade policy within the MENA region and its economic relations with the rest of the world. It considers regional integration and prospects for trade blocs; trade liberalization and economic restructuring; resource endowments and employment trends; and changes in economic boundaries, especially as a result of labour migration and regional conflicts.

The recent revival of regionalism in MENA countries—dubbed the ‘New Regionalism’—has been bolstered, on the one hand, by attempts at broader economic reforms and the adoption of outward-oriented economic strategies and, on the other hand, by renewed interest in economic integration with the outside world, especially with Europe. These forces have combined in recent years to set the region’s economic boundaries in flux.

This book is the result of a joint initiative by the Middle East Economic Association (MEEA) and the School of Oriental and African Studies (SOAS), University of London. To mark the twenty-fifth anniversary of MEEA’s foundation, we organized an international conference—MEEA’s first European conference—in London University in the summer of 2001. The theme of the conference was ‘Global Change and Regional Integration: The Redrawing of the Economic Boundaries in the Middle East and North Africa (MENA)’. The aim was to provide an opportunity for outstanding scholars and researchers from the region and beyond to address MENA’s economic challenges in a global setting, specifically looking at ways in which the changing patterns of trade, investment and finance, and labour flows were likely to influence the region’s economies as they entered the twenty-first century.

The works in this volume all draw from contributions to that conference and reflect closely its objective of fostering wide-ranging debate from multiple perspectives. This led to a unique gathering of researchers and experts from many countries and institutions—from the World Bank and the IMF to academics and researchers from MENA, Europe, and the United States—to share in and debate their latest research findings. The outcome

of the debate is presented in this volume in five parts examining different aspects of MENA's economic integration in a broad regional and international context.

We would like to thank the Ford Foundation's regional office in Egypt and the SOAS Research committee for providing partial financial assistance. This was essential for encouraging participation from the MENA region itself. We are grateful to SOAS for hosting the conference and to Dr Sarah Stewart and the staff of the Centre for Near and Middle East Studies at SOAS for administrative support.

The project owes a great deal to our MEEA colleagues for their support and encouragement. Among them special thanks are due to Professor Mine Cinar, MEEA's President, and other Board members, whose names we need not list here.

The completion of the book has been greatly facilitated by the dedicated editorial assistance of Marianna Volpi who went through the various chapters which had such varied styles and authorship, and tried to maintain consistency and completeness. Her contribution is highly valued.

Needless to say that the views expressed and any errors contained in individual contributions are the responsibility of the authors and not their respective institutions or any other party.

We would like to dedicate this book to the cause of peace in the region, as another war has just 'ended'. Although it is hard to remain optimistic when adversities escalate so rapidly, we remain hopeful that both the people of the Middle East shall overcome the many adversities they face and the rest of the world will finally treat the region and its people with the respect and dignity that they deserve.

Hassan Hakimian and Jeffrey B. Nugent  
August 2003

# Introduction

*Hassan Hakimian and Jeffrey B. Nugent*

Under the combined impacts of globalization and regionalization, the economic boundaries between different nations have been in considerable flux for several decades. Thanks to its long history of attempts at greater economic integration and its pivotal role in world energy supplies, the Middle East and North African (MENA) countries have been far from immune to these forces. In the Arab world, regional integration has been a frequently stated policy goal, acting as a yardstick for evaluating the achievements of post-independence nationalism. Elsewhere in the region, too, there is a rich history of attempts at economic integration. Yet, despite numerous initiatives at the regional and sub-regional levels and hundreds of bilateral agreements, there is broad consensus that progress has been painfully slow and the record of economic integration in the MENA region is largely beset by a catalogue of failures.

In recent years, two distinct trends have emerged among MENA countries. Following the failure of region-wide trading initiatives in the earlier postwar period, the first trend (in the 1980s) was to increase efforts to integrate at the sub-regional level. Indeed, the 1980s witnessed the creation of the Gulf Cooperation Council (GCC) in 1981 (involving Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates) and the Arab Maghreb Union in 1989 (involving Algeria, Libya, Mauritania, Morocco, and Tunisia).

The second trend—beginning in the 1990s—has been the gradual liberalization of MENA's trade with the rest of the world. Some of this was at the multilateral level after the completion of the Uruguay round. But, an even sharper boost to trade liberalization was the Euro-Med initiative between the European Union and the southern Mediterranean MENA countries. This initiative aims to create a free trade area in the Mediterranean region by 2010 and does not focus *per se* on intra-MENA trade.

The recent revival of regionalism both within and outside of MENA—dubbed the 'New Regionalism'—has been bolstered, on the one hand, by attempts at broader economic reforms and the adoption of outward-oriented economic strategies and, on the other, by renewed interest in economic integration with the outside world, especially with Europe.

This book examines the impact of recent changes in the world economy on trade policy within the MENA region and its economic relations with the rest of the world. It considers regional integration and prospects for trade blocs, trade liberalization and economic restructuring, resource endowments and employment trends, and changes in economic boundaries, especially as a result of labour migration and regional conflicts.

As a background to establishing how far MENA's economic boundaries have been changing in recent years, we attempt to identify the extent to which fundamental reforms

have been undertaken and to examine the impacts of these reforms and why and how the experience may or may not have met expectations.

With or without trade reforms, the products of many sectors are not traded internationally. Services have long been an example of non-traded goods but, with the increasing relative importance of agricultural subsidies and other barriers to trade in agriculture, many agricultural products have become non-traded. The goods and services produced by the informal sector are also often non-traded. Yet, the labour markets of these sectors are often extremely important as far as employment is concerned. How have trade agreements and other measures of international cooperation affected labour flows and the composition, character, and level of employment in these activities? What are the implications for future trade arrangements for MENA country labour markets? What are the challenges ahead with new trade arrangements among MENA countries and between them and the European Union and other countries?

Another issue of considerable and special importance to the region is the relationship between political and economic boundaries. The dominant view is that the relationship is complementary. In other words, attempts to liberalize political relationships between nation states are likely to increase trade and factor flows among them. In the context of the Middle East, this has led to considerable optimism that movements toward promoting peace in the Middle East such as the Oslo Accords would have the effect of freeing up economic flows between Israel and its neighbours including the Palestinian territories. Yet, reality has taken a sad toll on such overly optimistic expectations. Moreover, as several chapters in this volume demonstrate, every actual or proposed policy change (or international treaty) is likely to have economic winners as well as losers: this implies that attempts to settle international disputes may not necessarily lower domestic conflicts and result in full implementation of agreements—a simple fact of manifest relevance to the MENA region.

The theory of international economic integration generally assumes away implementation failures and the unilateral imposition of non-tariff barriers to trade of various sorts once an agreement has been reached. Yet, implementation failures have been endemic to trade and other agreements within the MENA region. How should this be taken into account? While the theory of economic integration has dealt with polarization effects, it has not dealt with asymmetries in the power to directly limit internal product and factor mobility within one or more potential trading partners such as the Israeli security actions have in the Palestinian territories. Where international disputes are incompletely resolved and asymmetries in political and/or military power exist, the result can be very unequal benefits of any actual or potential economic integration. Since trade in commodities can serve as a substitute for trade in factors of production, the freeing of trade in commodities can result in less trade in factors and hence possibly less economic integration overall. This, too, is an issue that has not been adequately treated in the theory of economic integration.

One complicating factor of special relevance to the MENA region has been the continuation—arguably aggravation—of minor and major conflicts among countries of the region, each with regional and international implications. Unlike much of the rest of the world, which seems to have benefited from the ‘peace dividend’ in the post-Cold War era, the MENA region continues to suffer from lack of democracy, wars, and various forms of external shocks ranging from economic sanctions and blockades to outright

military incursions. The Israeli-Palestinian conflict is as heated as ever and indeed has become more violent over time. As we write this introduction, the war against Iraq has just started against wild claims and raised expectations about the future of Iraq and the region at large. Yet, the prospects for resolving this conflict are as fuzzy as the logic used to justify it—not to mention the process used to trigger the war itself. With major national and regional resources tied up in such conflicts in MENA, the prospects for the region's economic and political integration appear as distant as ever.

While some of the trade and labour market policy issues discussed here are so important as to have received considerable attention in recent years, most of these have been from the standpoint of an individual author or international organization. Similarly, for the issues of conflict and power, there have been few studies interweaving conflicts and trade and other policy reforms in the MENA region and fewer still that use a number of different perspectives.

Given the complexity and controversy surrounding them, it is our belief that greater attempts must be made to represent a wider variety of viewpoints than is usually found in such work. The Middle East Economic Association is an organization of scholars representing a wide range of approaches and functional and geographic specializations. The present volume takes advantage of a number of the more relevant papers presented at the First European Conference of the Middle East Economic Association held at the School of Oriental and African Studies of the University of London in July 2001. As the reader will see, the papers represent an unusually diverse set of perspectives and viewpoints. Indeed, a wide variety of analytic models is used in these papers, ranging in complexity from descriptive case studies to relatively large-scale, regression-based gravity and real exchange rate models, linear programming (or activity analysis) models, and simulation-based computable general equilibrium models.

While much of the attention in the volume is devoted to the regional picture for MENA as a whole, the struggles of individual countries with trade strategy and reform are not neglected. Indeed, the volume includes detailed analyses of the more interesting and important case studies from the region, such as Iran, Syria, Tunisia, Turkey, Kuwait, Israel, and the Palestinian territories.

The presentation is divided into five parts. Part I consists of a single chapter by Dasgupta, Keller, and Srinivasan providing a comprehensive overview of both the extent to which MENA has engaged in economic reforms during the 1990s and their apparent effects on growth and employment. The chapter makes a serious attempt to distinguish the effects of the partial and tentative reforms from those of falling oil prices. The latter have, of course, had a generally depressing effect on growth throughout the region, even among non-oil exporting countries. The results show that those MENA countries that have achieved somewhat greater diversification away from oil and reformed earlier than the other countries of the region have performed somewhat better than the others. Among the different types of reform, the authors argue that progress has been greater on macroeconomic reforms involving inflation and exchange rates and most recently on private capital flows than on structural reforms involving product and labour markets. They also show that there has been an overall improvement in performance during the 1990s compared to the 1980s. They argue that this may be due to the modest but not negligible reforms operating through improvements in total factor productivity, at least relative to the decline in total factor productivity experienced in the preceding decade.



Part II consists of three chapters devoted to assessing the relative merits of different types of actual or projected trade and exchange rate policy reforms. One of the great debates facing the region is whether to concentrate on trade reforms designed to increase intraregional trade or those designed to increase trade with Europe and the rest of the world. To a large extent, the answer to this question depends on whether or not actual trade within the region or between MENA and the European Union is greater or less than would be expected on the basis of natural factors such as country size, distance, language differences, and factor endowments incorporated in a 'gravity' model. In contrast to some alternative estimates in the literature based on less complete data and specifications, in Chapter 2, Miniesy, Nugent, and Yousef show that intra-MENA trade is considerably smaller than would be expected on the basis of their gravity model. As a result, they show that a free trade agreement known as the Greater Arab Free Trade Agreement which would be as comprehensive, strong, and completely implemented as that within the European Union, could more than double this trade. Trade with some other regions such as the European Union is also less than would be expected but some with other regions such as the Less Developed Countries (LDCs) is larger than would be expected on the basis of the same natural factors captured by the gravity model.

Chapter 3 by Nabli and Véganzonès-Varoudakis shows that, despite the aforementioned improvements by MENA countries in dealing with inflation and macroeconomic instability and decreasing exchange rate overvaluation in the 1990s, considerable overvaluation still persists among several MENA countries. It is shown that such overvaluation decreases the competitiveness of MENA exports and domestic production and reduces its growth performance. The authors measure the extent of overvaluation (or more generally *misalignment*) by comparing the actual exchange rate with the equilibrium exchange rate predicted by their model based on data from 53 countries including ten MENA countries. They show that exports of manufactures have been adversely affected by the extent of such overvaluation.

A very different modelling approach to issues of trade arrangements with the rest of the world is presented in Chapter 4. This chapter by Bayar, Ben-Ahmed, de Boer, Diao, and Yeldan makes use of a multi-region, multi-sector, dynamic computable general equilibrium model of the world economy to focus on the long-term effects on MENA countries of various alternative policy scenarios. Although income distribution effects are suppressed by focusing in each country on a single representative consumer, the results show the sensitivity of the results to the character of liberalization. For example, the effects of trade liberalization with the European Union are likely to be much more favourable to MENA countries if the trade liberalization measures include the liberalization of the presently important non-tariff barriers and serve to bring about a more competitive environment. The authors also show that the simulations reveal the likelihood of major kinds of disequilibria such as trade deficits and unemployment, suggesting the need for MENA countries to be ready to make suitable adjustments to these disequilibria.

Part III is devoted to individual country experiences with restructuring, the price competitiveness of exports, trade strategy, and its relation to industrial development. Chapter 5 by Ghali and Mohnen represents an innovative approach to identifying comparative advantage and the relative scarcity (in social opportunity cost terms) of different types of labour and their contributions to economic growth in the Tunisian

economy. Tunisia is one of the few MENA countries to have been somewhat successful in exporting some manufactured goods. The approach used is a linear programming or activity analysis model with given constraints and objectives that is used to identify the optimal factor allocations and the 'shadow' prices of these factors both before and after the structural adjustment programme of 1986. The sectors with comparative advantage are found to be hotels and tourism, financial services, transport and communications, construction materials, glass, and food. Even though structural adjustment has moved the economy in the direction of making greater use of skilled labour, there remains excess supply for this type of labour and a negative rate of return to such education, suggesting that further policy actions are needed.

Turkey is another MENA country that has made progress in penetrating international markets in manufacturing. Indeed, Turkish exports in the manufacturing sector grew many-fold after trade and other reforms were introduced, but its exports remain quite concentrated both by country of destination and product, making these exports vulnerable to demand and policy changes of various sorts. In Chapter 6, Kotan and Sayan compare the competitiveness of Turkish exports in the manufacturing sector to the European Union with those East Asian countries that constitute its major competitors in these markets. They estimate the responsiveness of Turkey's market share to relative prices in each of several commodity groups, ranging from traditional exports such as textiles and clothing to newer non-traditional Turkish exports like electrical machinery and power-generating machinery. Their results show the degree of competitiveness of the respective markets and then use these results to evaluate the likely effects of a customs union between Turkey and the European Union.

Chapter 7 by Zonooz examines three hypothesized harmful effects of Iran's continuing reliance on oil exports combined with Import Substituting Industrialization (ISI) long after these policies have been abandoned in much of the rest of the world. The first effect examined concerns the effect of ISI on progressively raising the foreign exchange requirements for its sustenance. The second effect concerns the allegedly deleterious effect of the protection offered to support ISI industries on static allocative efficiency. The third concerns the adverse effect of oil exports cum ISI on dynamic efficiency. Evidence for all three adverse effects is presented. While already evident in the pre-Revolution period, the non-sustainability of the oil exports cum ISI strategy has been rendered even sharper by both the choice of the Revolutionary regime to lower oil exports and the international isolation that Iran has experienced during much of the post-Revolution period. Indeed, the latter has increased the extent of rent-seeking behaviour and allocative inefficiency while at the same time depriving Iran of the technology transfer and institutional evolution that would have taken place in the absence of its increasing international isolation.

Part IV consists of two chapters focusing on three of the non-traded sectors mentioned above, namely, self-employment, the informal sector, and traditional agriculture. These sectors are quite naturally strongly affected by trade strategies and market reforms of various sorts and are of special importance as far as employment is concerned. Since these sectors are also ones where females are playing relatively greater roles in the labour force around the world, the focus in both chapters in this part is on employment, the organization of work, and female labour force participation.

In Chapter 8, Charmes provides a broad overview of female labour force participation, especially in self-employment and the informal sector across the countries of the MENA region. Some distinctly different patterns are found in different sub-regions and countries. For example, Charmes finds that, while most other MENA countries have experienced rapidly increasing female labour force participation, Iran and Turkey have not. Female labour force participation rates also vary considerably across countries of the region, being especially high for the lowest income countries of the region, followed by the Mashreq countries, and being especially low for the GCC countries with the highest levels of per capita income. While as in other LDCs, self-employment and informal sector employment have been growing rapidly in most countries of the MENA region, such growth has been slow in Iran and Turkey and has actually been negative in GCC countries. Contrary to the general pattern in developing countries, the increase in informal sector employment has not been due to that sector's feminization, implying that the increased female labour force participation in MENA countries has been solely attributable to the rising share of females in formal sector employment and especially that in the public sector. Although the data are rather weak, the only component of the informal sector in which the female share seems to be rising is in home-based work or 'putting out' work. Charmes points to very different sources for the explanation of the two areas of rising female labour force participation. In the case of formal sector employment, especially that in the public sector, the rising trend seems to be due to rising educational attainment of women and affirmative action programmes of government. But, in the case of home-based informal sector employment, the driving force seems to have been globalization.

In Chapter 9, Martini, Bailey, Jones, and Goldey take advantage of detailed field studies from north-western Syria to examine the changes in the agricultural labour force and the organization of labour. Agricultural production in this region has been influenced by several important changes, rising demand for off-farm employment of males, commercialization-induced changes in cropping patterns that have had the effect of intensifying land use throughout the year, and mechanization, which has decreased the need for male labour for heavy work, allowing female labour to be substituted for male labour in many but not all tasks. The increasing specialization and differentiation of tasks has also induced different modes of labour use to emerge, some of it in groups or labour gangs.

Part V consists of three chapters that deal with the aforementioned relationships between international conflicts and integration, political and economic boundaries, and the sources of changes in economic boundaries and the problems therein. These issues are, of course, of special relevance and importance for the MENA region. Chapters 10 and 11 focus on boundary issues (Kuwait and Palestine), Chapter 12 on the economic challenges posed by genuine integration efforts (Turkey), and Chapter 13 on those posed by those integration efforts that are 'less than genuine', meaning that not all pre-conditions for genuine integration have been satisfied (Palestine).

In Chapter 10, Pfeifer discusses the effects of the 1990–1 Gulf War on the Kuwaiti economy. Historically, Kuwait's economic dilemma has revolved around the need to diversify its economy away from oil exports without losing its cultural and social integrity. Painful and costly as Iraq's invasion and occupation of Kuwait was in 1990, the crisis and subsequent liberation offered the Kuwaiti government and its people a unique

opportunity to reinvigorate their economy and to creatively redefine their external and internal economic boundaries. However, Pfeifer argues that the policies pursued in the decade after liberation neither achieved these goals nor restored sustainable economic growth. Instead, Kuwait has intensified its current and future dependence on the oil sector and on the United States, adjusting its external boundaries to accommodate this policy choice. Furthermore, it has rigidified its internal social boundaries instead of relaxing them as part of a reform that might have diversified the economy and enhanced non-state economic activities.

She further argues that the resolution of Kuwait's economic dilemma may require a paradigm shift in economic thinking, involving a fundamental redefinition of external and internal economic boundaries. Externally, a return to the model of Kuwait's more diversified pre-oil economy, and a more balanced and healthy relationship to the world economy than it has experienced during 1991–2001, may entail deeper and more extensive regional economic integration than the GCC can provide. Internally, the key to promoting development on both the demand and supply sides of the domestic growth equation, and indeed securing Kuwait's integrity, may entail the Kuwaitization of persons rather than jobs; that is, a reversal of the policy toward expatriate labour extant since the mid-1980s.

Farsakh in Chapter 11 demonstrates that, when one country has the ability to unilaterally impose non-tariff barriers to both internal and external factor mobility on its integration partner, the result can be rather catastrophic for the welfare of the partner. In particular, she demonstrates the enormous differences in effective integration between the Palestinian territories of the West Bank and Gaza Strip (WBGS) between the pre-1990 and post-1990 periods. In the former, while there was almost no progress toward political settlement, product and labour markets were both relatively open between the WBGS and Israel. The WBGS ran a trade deficit that was financed largely by its growing supply of surplus labour to the Israeli labour market. The economies of both entities grew quite rapidly. Yet, with the advent of the peace process throughout much of the 1990s, labour flows dropped off and especially recently have become extremely volatile, varying with the whims of Israeli decision-makers, border guards, and the *intifada* clashes. At a time in which Palestinians had become heavily dependent on Israel for disposing of their surplus labour, Israel prevented Palestinian workers from entering Israel and even from moving from one place to another within the WBGS. The result was an increase in the unemployment rate among Palestinian workers to over 28 per cent and a reduction in per capita WBGS GDP by some 27 per cent in 2001 alone (and reportedly even further more recently).

As indicated above, one of the major trade-liberalization initiatives facing MENA countries is the prospect of forming customs unions or even full integration with the European Union. Chapter 4 paid some attention to the implications of this for the MENA region in general in the case of agricultural trade and Chapter 2 looked at the potential trade impacts of a customs union with the European Union compared to, or in addition to, one among MENA countries. Neither of these chapters paid much attention to the several problems that MENA countries would have to address in order to take advantage of such an opportunity. In Chapter 12, however, after identifying some of the substantial benefits of full integration with the European Union, Togan identifies in considerable detail the challenges that would have to be met for Turkey to achieve its current goal of full

integration with the European Union. He argues that the greatest difficulties are likely to arise from adoption of the Common Agricultural Policy, the liberalization of services, the attainment of macroeconomic stability, and meeting the stringent environmental standards of the European Union.

Chapter 13, by Kanafani, picks up where Farsakh leaves off with regard to the relationship between the peace process and economic integration between the WBGS and Israel. Kanafani's focus is on that part of the Oslo Peace process that involves economic relations between Israel and WBGS. While many have blamed the failure of the peace process on implementation failure, Kanafani suggests that the failure was more fundamentally a design failure. For peace to succeed, he argues that the economic relations would have to foster mutual prosperity and a more fair distribution of the benefits of peace and integration. Because the political design was obscure, partial, and temporary, so too were the blueprints for economic relations. The result was a high degree of uncertainty that undermined the process. Disputes on the economic side proliferated and complicated the resolution of political disputes. The basic outcome was a failure to allow Palestinians to prosper under the arrangements. This failure is attributed to four more specific failures: (i) inability to prevent Israel from unilaterally cutting off its labour market to Palestinian workers; (ii) the absence of an independent enforcement mechanism or means of arbitrating disputes arising during implementation; (iii) a trade regime that was at the same time unnecessarily complex in its structure, imprecise, and unfair; and (iv) the absence of any mechanisms for redistributing unequal gains from integration.

Starting from their unequal levels of development, there were two mutually reinforcing flaws in the system. First, the uncertainties about product markets and the future economic prospects in the WBGS undermined the incentives for investment in the WBGS that might have attracted funds from Israel and abroad. Second, the failure to prevent Israel from closing its labour markets to Palestinian workers increased Palestinian unemployment and lowered disposable income, undermining the viability of many economic activities and causing a serious economic depression. These effects have bred resentment and desperation among the Palestinian masses. Hence, according to Kanafani, the only way for peace to be achieved is to satisfy the aforementioned prerequisites for satisfactory economic relationships.

All in all, we hope that the depth and breadth of the contributions in this volume—as outlined above—will be a welcome addition to the ongoing debates on economic development and integration in the MENA region at a time when the challenges the region faces show no sign of relenting.



**Part I**  
**Past trends and future**  
**prospects for growth in**  
**MENA**

# 1

## **Reform and elusive growth in the Middle East—what happened in the 1990s?\***

*Dipak Dasgupta, Jennifer Keller, and T.G.Srinivasan*

### **1 Introduction**

Achieving faster economic growth is a major economic objective and undertaking economic reform provides a main rationale for attaining this objective. The ‘Washington consensus’ of the early 1990s has long advocated a certain set of core reforms as essential in a rapidly globalizing world: minimum standards of macroeconomic stability, and structural reforms to foster openness and an appropriate investment environment. But since the late 1990s, questions are being asked as to whether these reforms are having their intended effects. Despite apparent reforms—albeit not to the same extent in all countries and areas—the growth performance of many developing countries and regions has often been disappointing. Countries in the Middle East and North Africa (MENA) region are no different in their experiences with reform and growth in the past decade.

The political and social implications of reforms and the expected economic growth outcomes are crucial to the success of reform efforts. This is especially critical in the MENA region because of its prevailing unemployment problem. The region’s labour force has grown by about 2.8 per cent a year in the 1990s—roughly the highest rate in the world—while job opportunities have been lagging. Although rapid labour force growth can be a ‘demographic gift’ in the right circumstances, it can also create enormous social problems in the face of lagging job opportunities. Formal unemployment rates in the region (outside of the Gulf Cooperation Council or GCC countries) now average close to 25 per cent, the second highest in the world.<sup>1</sup> In some countries—Algeria, Iran, Syria, Libya, Yemen—as much as one-third of the labour force is unemployed. Even the GCC economies, with comparatively low unemployment rates of about 5 per cent on average, have begun to experience growing unemployment among their national populations. The absence of growth combined with rapidly rising unemployment has also coincided with falling real wages in the region—as is to be expected. Consequently, the crisis of growth in the MENA region since the 1980s has translated into an ‘unemployment crisis’, which could spill over into a larger poverty crisis (which the region has so far managed to avoid in most places because of the presence of formal/informal and implicit or explicit social safety nets). Unemployment often impacts young jobseekers the most, contributing to a potentially explosive social situation. Unemployment rates for those under 25 are about twice as high as national averages in Algeria and Tunisia, and as high as two and a half to three times higher in Lebanon and Iran. But this age group is also better educated; hence,