INTERNAL SUSTAINABILITY AND ECONOMIC GROWTH IN THE ARAB STATES

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1. Introduction

The Arab states as a group are popularly referred to as the "Arab World". The term "Arab World" is a political designation rather than an economic grouping, despite the fact that economic integration, and unity, has always been an inspiration of various political movements in the region. As a political grouping the term finds its expression in the League of Arab States (LAS) that was established in 1945. In the context of LAS, which is modelled on the UN organizational structure, a lot of perceived economic aspirations of ordinary Arabs are expressed and articulated, but not necessarily implemented. Due to various historical reasons the Arab countries have failed to use the LAS framework to forge an economic integration scheme that could have distinguished them as a distinct economic group.

Perhaps one of the reasons why the Arab economic group did not materialize is the fact that the Arab World is characterized by a lot of economic diversity. To highlight this economic diversity it may be useful to follow the Economic Research Forum (ERF: 1998) and group the Arab countries into four broad categories: mixed oil producers (MOP) including Algeria, Libya and Iraq; Gulf Cooperation Council (GCC) including Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and UAE; diversified economies (DE) including Egypt, Jordan, Morocco, Lebanon, Syria, and Tunisia; and, primary producers (PP) including Comoros, Mauritania, Sudan, Djibouti and Yemen [The classification of Comoros, Libya and Djbouti is not that clean. Palestine is not included for obvious conceptual reasons; though in some documents the West Bank and Gaza Strip is included as an Arab economy]. In 1998 the total population of the Arab World is estimated as 258 million (4.4% of the population of the world). It is with the sustainability and economic growth potential of this group of countries that this paper is concerned.

The question of sustainability has recently been associated with environmental

management. According to the famous Brundtland Commission sustainable development is defined as "development that meets the needs of the present without compromising the ability of future generations to meet their own needs". As rightly pointed out by Haq (1995: 78) such a definition begs more questions than it answers. He argues, correctly, that what needs to be sustained is human life and that sustaining the physical environment is a means, not an end, to sustaining human life. Formulating an operational framework for sustainable human development he argues that if the basic "concept is sustainable human development, each generation must meet its needs without incurring debts it cannot repay. That means avoiding the accumulation of environmental debts (by polluting or exhausting natural resources) as well as financial debts (through unsustainable borrowing), social debts (by neglecting to invest in human development) and demographic debts (by permitting unchecked population growth and urbanization). All these debts rob our children".

On the basis of the above broader view of sustainability, the concept of sustainable development "would immediately focus on the nature and quality of economic growth and avoid the sterile debate over zero growth. Growth is essential, but sustainable development requires that it be different. It must become more respectful of the physical environment. And it must translate into human lives". On such an understanding, therefore, the issue of the sustainability and growth of Arab countries are closely linked and can be looked at by considering the major propositions of the theory of economic growth regarding the major factors explaining long-run economic performance of countries. In this respect we note that modern empirical growth theory (see, for example, Romer 1986; Lucas 1988; Barro 1997; Sala-i-Martin 1997) has identified at least sixty-two statistically significant explanatory variables influencing the growth performance of different economies. Of these sixty-two, three explanatory variables have consistently been reported as significant in all studies. These three variables are in the nature of initial conditions. They include initial real per capita income (reflecting the stage of development of the country and capturing the idea of convergence over long periods of time); initial life expectancy at birth (reflecting the health dimension of the human capital of the country); and initial primary school enrolment ratio (reflecting the education dimension of human capital).

A recent rigorous robustness analysis conducted on the remaining 59 variables, and taking account of the above three initial conditions, found only 22 variables to be robustly significant in explaining differences in growth performance between countries (Sala-i-Martin 1997). Seventeen of these are deemed relevant and can be grouped into six broad categories of regional, political, market distortions, investment, production structure, and openness (trade policy) variables. Another variable that has come out as an important explanatory variable is colonial experience.

The most important qualitative results of this literature can be summarized as follows. (a) There are three regional variables, two of which are regional dummies for Latin America and Sub-Saharan Africa, and both of which are negatively related to growth. The third is an "absolute latitude" variable, which shows that the farther away from the equator a country is, the better is its growth performance. (b) The political variables are six: the "rule of law", "political rights" and "civil liberties" (positively related to growth); the "number of revolutions", "military coups" and "war" (negatively related to

growth). (c) The market distortions and economic organisation category include two market distortion variables, both of which are bad for growth. These are the "real exchange rate distortions" and "the standard deviation of the black market premium". The third variable, "degree of capitalism", is positively related to growth. (d) The investment variables include "equipment investment" and "non-equipment investment", both of which are positively related to growth. It is reported, however, that the influence of non-equipment investment on growth is only about one-fourth that of equipment investment. (e) There are two production structure variables: the "fraction of primary products in total exports", negatively related to growth, and "the fraction of GDP in mining", positively related to growth. (f) An openness variable reflects trade policy and includes one variable, "the number of years an economy has been open between 1950 and 1990", which is positively related to growth.

Given the established methodology of cross-country regressions of growth performance, it is perhaps important to note that out of these 17 robustly significant variables, the three variables of the "regional group" and colonial experience are exogenous in nature. Of the remaining 13 variables, ten are in the nature of initial conditions: the six variables of the "political group", the two investment variables, and the two variables of the "production structure" group. The remaining variables are policy related. We hasten to note at this juncture that the above analysis has shown that a number of conventional variables perceived to be important did not survive the robustness test. These include such variables as "various measures of government spending", "various measures of financial sophistication", "the inflation rate or its variance", "various measures of scale such as total area or total labour force", "outward orientation", "tariff restrictions", "the black market premium" and "the ethno-linguistic fractionalisation". Obviously, a large number of these are policy variables and some of them are formulated in such a way as to have a non-linear relationship to growth and as such were not adequately captured by the analysis.

Consistent with the above analysis it has recently been argued that the fundamentals for long-run growth are investment in physical capital and human resources. "These are, in turn, made possible by physical infrastructure, macroeconomic stability, the rule of law and solid institutions. The role of trade policy in economic growth is largely auxiliary and of an enabling nature: extremes of export taxation and import restrictions can surely suffocate nascent economic activity, but an open trade regime on its own will not set an economy on a sustained growth path" (Rodrik 1999:105).

Further, a recent set of theoretical literature argues that greater initial inequality in the distribution of income and wealth is likely to be detrimental to long-run growth. One theoretical explanation for this is couched in terms of the consequences of imperfect capital markets on agents' investment behaviour resulting in lower productivity and efficiency losses. Under this theoretical construct, the poor are seen as being credit constrained to pursue investment in education and hence in human capital formation. Similarly, political economy models have shown that initial inequality is likely to increase voter support for inefficient redistributive policies resulting in efficiency losses and lower growth. In this respect it is also important to note that from a long-run development and transformation perspective, determining the initial inequality levels would depend on which side of the inequality-development relation (the well known

Kuznets curve) an economy finds itself (see Kuznets (1955)). As is well known, the Kuznets curve is a long-run relationship between the level of development and inequality, which shows that at initial stages of development, inequality will tend to rise before it declines. Despite a lot of controversy surrounding the existence of this relationship recent empirical work, using high quality data sets, has confirmed its existence (see, for example, Ali and Elbadawi 1999; Barro 1999).

From the above, rather brief and selective, review of the recent advances in the literature on the fundamental determinants of long-run growth, it is perhaps clear that there is a core set of initial conditions that is likely to determine the growth performance of Arab countries and hence their sustainability. Given the wide multiplicity of what constitutes initial conditions and the diversity of the region, we identify income and its growth (section 2), inequality and poverty (section 3), economic structure (section 4), investment (section 5), institutions (section 6), and technological capacity (section 7) as the most critical set of variables for the internal sustainability of the Arab states. The paper concludes by offering some final remarks (section 9).

2. Income Levels and Income Growth

Initial income refers to the level of income, however measured, that obtains at some reference point in time. Due to data limitations we look at the level of income in 1998, the latest year for which reliable region-wide GDP data are available. We hasten to note that by looking at the level of income of the region the point of departure here is that such an investigation will enable us to appropriately appreciate the position of the region compared to the world. Table (1) below provides a summary of the distribution of population and income in the Arab world among the four sub-groups of the region.

Country	Population (million)	GDP	
		Current Prices (billion US$)	Per Capita (US$)
MOP	52.3 (20.3)	124.8 (21.2)	2386
GCC	29.3 (11.4)	231.5 (39.4)	7901
DE	118.0 (45.8)	162.5 (27.7)	1377
PP	57.8 (22.5)	68.7 (11.7)	1189
Arab Countries (Total or Average)	257.4 (100.0)	587.5 (100.0)	2282
S. Deviation	**15.4**	**33.5**	**5223.4**

Source: Own compilation from ERF (2000).

Table 1. Income and Population of Arab Countries: 1998

Consider first the income of the region. In 1998 the Arab world produced goods and services worth US$587.5 billion at current prices. This amounts to a per capita income of US$ 2282 per annum or US$190 per month. This average hides significant variations among countries and sub-groups. At the country level, per capita GDP varies between a high of US$ 17222 (nearly US$1435 per month) for United Arab Emirates to a low of US$325 (or about US$ 27 per month) for Yemen. At the sub-regional level, the highest

GDP is recorded for GCC at US$ 231.5 billion and a per capita income of US$ 7901, followed by that of MOP with a GDP of US$ 124.8 billion and a per capita income of US$ 2386. DE ranks third with a GDP of US$ 162.5 billion and a per capita income of US$1377, while PP has the lowest GDP at US$ 68.7 billion and a per capita income of US$ 1189. Thus the table confirms the diversity of the Arab world in terms of both the level of total income and the level of per capita income, a diversity captured by international classification of the various countries of the region such as the classification adopted by the World Bank in terms of low-income, middle income and high income groups.

To properly appreciate the economic size of the Arab world in the world economy a comparison with a set of selected countries is undertaken. Available information shows that Spain, with a population of 39 million, has a GDP of US$ 552 billion nearly equal to that of the Arab world, while Italy's 58 million people have a GDP 0f US$ 1171, nearly twice that of the Arab region. The 9 million Swedes produce goods and services worth US$227 billion nearly three times more than the 58 million people of the Arab primary producers. Finally, the 46 million South Koreans produce a GDP of US$ 298 billion twice as much as the 52 million Arabs of the mixed oil producers..

Further comparisons are also worth noting. Thus, for example, the GDP of the Arab world contrasts very unflatteringly with the value of the goods and services produced by the largest multinational corporations in the world. Available information shows that the four largest multinationals in the world in terms of sales revenue (General Motors, Ford Motor Company, Mitsui & Company, Royal Dutch/Shell) had total revenue of US$ 593 billion in 1997 more than the GDP of the Arab world. The sixth ranked company (Itochu Corporation of Japan) had sales revenue of US$118 billion in 1997, greater than the GDP of the eight primary producers of the Arab economies of US$ 68.7 billion (UNCTAD, 1999). Thus, despite its oil wealth, and its population share of 4.4% in world population, the Arab world could be seen as a marginal grouping in the context of the world economy.

Having noted the above, we now turn to look at the growth performance of this group of countries. In this respect we note that it is now generally accepted that the post-war period up until 1973 was the golden era for economic growth in the world. The Arab economies shared in this growth, where some of the countries experienced unprecedented rates of economic expansion. In historical perspective, the year 1973 marks the first oil price shock, which unleashed an era of massive economic dislocation for non-oil exporting developing countries.

For a sample of 50 developing countries, for which data is available, it is shown that per capita incomes increased at annual rates in excess of 2.1 percent over the period 1960-1973. There were no fewer than 42 developing countries whose economies grew at rates exceeding 2.5 percent per capita per annum. For these countries per capita income could have doubled in about 28 years. The sample included 4 Arab countries, Oman, Mauritania, Egypt and Iraq. Oman topped the list of the fastest growing developing countries, with a per capita GDP growth of 10.5 over the period 1960-1973 (see Rodrik 1999: 68-71). Per capita growth rates for Mauritania (2.9%; with a doubling time of about 24 years), Egypt (2.7%; with a doubling time of about 26 years) and Iraq (2.6%;

with a doubling time of about 27 years) were quite respectable.

Following Rodrik's 1973 periodization, we compiled the evidence for various samples of Arab countries for which data is available over the period 1960-1998. As table (2) shows, over the period 1960-1973 the sample included ten countries. Two Arab countries experienced fast growth where per capita income increased by an average rate in excess of 5 percent per annum. This sub-sample of fast growers included Oman and Saudi Arabia with per capita income growth rates of 13.6 percent and 7.65 respectively. In addition, three countries recorded growth rates in excess of 2.5 percent but less than 5 percent. These included Tunisia (4.26 percent) and Syrian Arab Republic and Mauritania both recording per capita growth rates of 3.05 percent. Two countries recorded negative per capita growth: Kuwait (-4.47 percent) and Sudan (-1.18 percent). The overall growth rate of the Arab countries averaged 2.60 percent with a standard deviation of 4.83 percentage points.

Range of Real Per Capita Growth Rate (per cent)	**1960-1973**	**1974-1984**	**1985-1994**	**1995-1998**
Above 5.0	2	3	1	1
2.5-5.0	3	3	1	3
1.5-2.5	3	1	2	2
0.5-1.5	0	1	3	3
0.0-0.5	0	0	2	0
Below 0.0	2	4	6	6
Total # of Countries	**10**	**12**	**15**	**15**
Average Growth Rate (Per cent)	**2.6**	**-0.3**	**-0.09**	**0.59**
Standard Deviation (Percentage Points)	**4.83**	**4.30**	**2.63**	**3.07**
Source: Computed from World Bank (2000)				
World Bank (2000), World Development Indicators on CD-ROM				

Table 2: Distribution of Arab countries on the basis of Real per capita Growth rates (Number of countries)

Following 1973, however, the dismal growth performance decades started. Despite the various attempts at explaining this dismal performance, it is generally accepted that the turbulence that beset the world economy following 1973 was the major dislocating factor. According to Rodrik (1999) the turbulence included the abandonment of the Bretton Woods system of fixed exchange rates, two major oil shocks, other commodity boom and bust cycles and the interest shock of the 1980s. In the wake of these and other shocks, out of 12 Arab countries for which the data is available, the period 1974-1984 saw three Arab countries with per capita growth rate in excess of 5 percent. Of the two fastest growing Arab economies during the period prior to 1973, it was only Oman with the real per capita income growth rate of 6.17 percent that maintained its performance over the period 1974-1984. The other fast growers over this period were Jordan (7.25 percent) and Egypt (5.45 percent). The distribution of countries in table (2)shows that the number of Arab countries that grew in excess of 2.5 percent but less than 5 percent remained the same though only two countries maintained the same range of growth rate

over this and the previous periods: Syria and Tunisia. However, the number of Arab countries that grew in excess of 1.5 percent but less than 2.5 percent declined from three to one. It was Morocco that registered real per capita growth rate of 2.32 percent for the 1974-1984 period as compared to 1.93 percent of the period prior to 1973. At the other extreme, the number of Arab countries that registered negative growth increased from 2 to 4. The overall growth of the region averaged only negative 0.30 percent with a standard deviation of 4.30 percentage points.

For a sample of 15 Arab countries over the period 1985-1994, only Kuwait distinguished itself as a fast grower with an average growth rate of per capita income of 6.03 percent per annum. The number of countries growing at negative rates during the 1985-94 decade increased to 6: United Arab Emirates (-3.96 percent), Algeria (-2.22 percent), Saudi Arabia (-1.52 percent), Comoros (-1.48 percent), Jordan (-1.39 percent) and Mauritania (-1.15 percent). The overall growth of the region was negative 0.09 percent with a standard deviation of 2.63 percentage points.

As is now generally acknowledged, the second half of the 1990s witnessed a rather hesitant economic recovery in the region. Table (2) records that the number of countries growing in excess of 2.5 percent but less than 5 percent increased from one to three while the number of countries that registered positive growth rate but less than 0.5 percent decreased from two to zero in the 1995-1998 period. It was only Sudan that distinguished itself as the fastest growing Arab country over this period as compared to 0.12 percent growth rate it registered in the previous period. The number of countries that registered negative growth rate during this period also remained six of which four were carried forward from the previous period: Comoros, Saudi Arabia, United Arab Emirates and Jordan. The overall growth of the region rebounded to positive levels averaging 0.59 percent with a standard deviation of 3.07 percentage points [Similar results, using decadal averages, see Makdisi et al (2000). They also note the relatively high volatility of growth in the region].

The cumulative effect of all the above growth patterns is that at the end of 1998 there were 3 Arab countries, out of a sample of 9 countries, with real per capita incomes less than that of 1973. The per capita income deficit varies between countries. The ratio of 1998 per capita income to that of 1973 is less than 50 percent in the United Arab Emirates (38 percent). A ratio greater than 50 percent but less than 90 percent is recorded for Saudi Arabia (67 percent) and Mauritania (88 percent). The remaining countries have a ratio of 100 percent or more: Algeria (111 percent), Egypt (238 percent), Morocco (157 percent), Syria and Tunisia (185 percent) and Sudan (151 percent). At the end of 1998 the average real per capita income in the region (measured in 1995 constant prices) amounted to $1981 (with a standard deviation of $4247) compared to $1710 in 1973 (with a standard deviation of $14173).

An interesting question at this juncture is what would have happened to the level of income if the pre-1973 growth rates were maintained during the post 1973 period. If each country were able to maintain its 1960-1973 per capita growth rate over the past 25 years, the average per capita income of the region would have been $3248. Countries, of course, would have performed differently given their initial growth rates, but averaging over countries it can be shown that the real cost to the region of low growth over the

period 1973-1994 amounted to $285.3 billion at the end of 1998.

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