

## Rebuilding the Arab Economies: New Regional and Global Strategies

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### **Abstract**

*The Arab countries are facing one of their most difficult periods of the modern history. The popular uprisings which broke out at the beginning of 2011 in Tunisia and then spread to Egypt, Libya, Morocco, Jordan, Bahrain and Syria, reflect profound economic and social hardships, but also major uncertainties regarding the political perspectives of these countries. The political transition carried out by several Arab countries could represent an incentive for profound economic reorganization and structural change all over the region. The aim of this paper is to assess the structural economic challenges the Arab countries had been confronted with over many decades and to identify possible regional and global strategies for economic development.*

**Keywords:** Arab countries; economic development; economic integration; trade;

**JEL Classification:** O53; F63; F15; F10;

### **1. Introduction**

The popular uprisings that broke out in several Arab countries at the beginning of 2011 revealed some major problems these countries had been confronted with since many decades, although a range of reforms and policy actions had been introduced over time. Apart from the traditional reform programs based on the recommendations of the international financial institutions such as the International Monetary Fund and the World Bank, and the general perceptions of economic liberalization after years of severe protectionist measures, most of these countries did not outline a clear vision about the purpose of the reforms and their empirical implications. As a consequence, the political, economical and social dimensions of the contextual settings in these countries continued to decline, intensifying people's dissatisfaction with their current situation and posing deep uncertainties for their future.

In the wake of the Arab revolts, it is clear that these events have unevenly affected countries in the region, but they put pressure on local governments to design new developmental strategies and policies in order to overcome the stagnation of their economies. This outcome, combined with the regional diversity in economic terms, implies that a new set of regional and global strategies adapted to local specificities should be developed. Therefore, the aim of this paper is to propose some strategies for economic integration and sustainable development of Arab countries, after decades of economic isolation and widespread stagnation. The methodological approach consists of a critical evaluation of the relevant literature and on empirical data such as descriptive statistics and official documents.

## 2. The Economic Profile of the Arab Countries

The Arab world is not a monolithic structure, a unified economic entity. It includes heterogeneous economies placed at different stages of economic development and unequally endowed with hydrocarbon resources. As Table 1 shows, the region includes the state of Qatar, one of the world's richest nations with a GDP per capita of US\$76,168 in 2010 and, at the other extreme, Yemen, with the lowest GDP per capita among all Arab countries (US\$ 1,282).

Table 1. GDP/capita for selected Arab countries, 2010

Country	GDP/capita US\$
Qatar	76,168
United Arab Emirates	59,717
Kuwait	36,412
Bahrain	20,475
Oman	18,657
Saudi Arabia	16,996
Libya	11,314
Lebanon	10,044
Jordan	4,500
Algeria	4,435
Tunisia	4,200
Morocco	3,249
Syria	2,877
Egypt	2,789
Iraq	2,564
Sudan	1,705
Yemen	1,282

Source: ILO Department of Statistics, 2011

The prevalent element that binds together all Arab countries is the *Islamic religion*, the core of Islamic civilization, and “the driving force behind contemporary Arab culture and society” which profoundly influences many aspects of life, including commercial activities (Zineldin, 2002, p.42). Another common characteristic is the *Arab language* which is spoken by more than 385 million people in 22 Arab countries (World Bank, 2013).

The Arab countries are usually split into two categories: the oil-rich countries (mainly the GCC members<sup>1</sup>) and the non-oil producing countries, among which can be mentioned Egypt, Syria, Morocco and Jordan. The oil-rich countries have attempted to diversify their economies as a means of protection against oil reserves depletion as well as a buffer against oil markets fluctuations. In this respect, they invested in heavy industry, supported the agricultural sector and developed the financial services sector and tourism. Overall, these countries have made substantial progress toward economic diversification. The other group, the non-oil producing countries, rely heavily on agriculture and the industrial sector.

At present, the Arab countries are facing several structural weaknesses that hamper their ability to make the transition to sustainable and productive economies. A brief account of the most constraining issues is presented in the following paragraphs:

<sup>1</sup> Gulf Cooperation Council (GCC) includes Saudi Arabia, Bahrain, Kuwait, Oman, Qatar and United Arab Emirates; it is an intergovernmental political and economic agreement, established in 1981.

Firstly, *dependence on oil revenues* is still a dominant feature of the Arab economies. They rely heavily on the extraction-based industries that have preserved their high importance given the increased contribution to GDP. Oil and natural gas exports compound over 70% of total exports in the Arab region. As a consequence, domestic economies are frequently exposed to global oil market fluctuations.

Secondly, the dominant economic challenge the Arab countries must face on the short run is the high *unemployment* level. Some authors (Noland and Pack, 2008, p.1) asserted that, all over the region, the labour force is growing at around 3.5-4% annually and it poses significant pressure on the labour market. According to the International Labour Organization (ILO), the Arab world has the highest rate of unemployment in the world, 10.3%, compared to 6.2% the average at the global level. Still, the challenge is even greater if one takes into consideration the extremely high youth (aged 15-24) unemployment rate of 23.4% in 2010 (ILO, 2011).

Finally, the *demographic transition* is another major challenge that Arab countries need to stand up to in the short run. This implies that the labour force has been stepping up because of the modification in the age structure of the population. The demographic transition implies an unprecedented growth of young people who enter the labour market every year. A World Bank study carried out in 2007 concluded that the region needs to create around 80 million jobs between 2000 and 2020 in order to absorb the new entrants on the labour market. The Arab Human Development Report (UNDP) estimates that 30% of the region's working age population is represented by youth aged 15-24 and about 25% of them are unemployed, compared to 14% the international average (UNDP, 2010, p.13).

All these taken into account, it is obvious that immediate structural reforms are needed in order to tackle the large spectrum of issues and problems the Arab countries are presently facing. In order to accomplish their main economic challenges, these countries must acknowledge their economic reality and move forward with comprehensive structural reforms. This requires new regional and global strategies such as developing intraregional trade and finding new regional and global markets. It also requires improvements in their economic competitiveness, of the public sector governance as well as intensified strategic efforts to develop the private sector. Structural reforms are essential in order to address the need for higher and sustainable economic growth and job creation.

### **3. Remaking the Arab Economies: Regional and Global Strategies**

A range of reforms have already been introduced in many Arab countries over the latest decades, but they proved to have limited positive effects on the economic performance of these countries. The entrenched preference of the Arab governments for political and social stability prevented the efficient implementation of the economic reforms in terms of integration with the region and the world. According to a report prepared for the World Bank, the reform recommendations are not new to Arab leaders (Nabli, 2007, p. 90), but they failed in successfully implementing them, as the *social contract*<sup>2</sup> represented a more powerful force than change.

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<sup>2</sup> The *social contract* in Arab countries represent an "agreement" whereby citizens chose not to involve in the political life in exchange for some social benefits (employment in public sector, free education, health care, food subsidies etc.)

It is tempting to suggest that each Arab country should follow its own strategic plans in terms of economic reconstruction, but this would be a missed opportunity for them. Indeed, the reforms should be country-specific, but “the spillovers between countries through economic linkages, the contagion of new cycles, the interaction of people, and the sharing of aspirations, are too great to ignore the impact of one country on another” (Amin *et al.*, 2012, p.11) For example, Tunisia, which is one of the most open Arab countries was considerably affected by the decline in tourist revenues from Libya. Another example is that of the Egyptian migrants who are spread throughout the region, whose remittances link Egypt’s economic prospects to those in other Arab countries (Amin *et al.*, 2012, p.11).

### **3.1 Developing intra-regional trade**

Many regional trade agreements were established all over the world in order to foster trade among a set of countries that shared some common characteristics. The success of such initiatives varied significantly across regions. From a historical perspective, trade among Arab countries has been weak despite all the efforts undertaken to promote the trade of goods and services among these countries. As they share a common historical, religious, linguistic, social and cultural background, it has been expected a greater intra-regional trade than actually achieved by now.

In the Arab countries, as in other parts of the world, recent developments in the process of economic internationalization have presented tendencies to establish different forms of regional economic integration, all these initiatives fading away. As a consequence of the failed attempts to establish regional economic integration, there were created some forms of sub-regional economic unions. For instance, the Arab Maghreb Union (AMU) was created in 1988, a trade agreement comprising Algeria, Libya, Mauritania, Morocco and Tunisia. The Gulf Cooperation Council (GCC), set up in 1981, aimed at creating a political and economic union among countries of Arabian Peninsula. The Arab Cooperation Council (ACC) was founded in 1989 by Egypt, Iraq, Jordan and Yemen in an attempt to foster economic cooperation and integration among its members (Romagnoli and Mengoni, 2009, p.70). By far, the most successful union has been the GCC, as it produced significant trade increases among its member states. Moreover, within the region, the GCC countries have made significant progress toward creating a custom union, adopting a common value added tax (VAT), and agreeing on legislative issues. Still, there are discussions for introducing a common currency, although this issue requires the resolution of intra-GCC disputes over surveillance (Amin *et al.*, 2012, p.144).

There are some motives that can be put forward as explanations for the failure of all these integration initiatives. According to some authors (Pons *et al.*, 2003, p.37-38) most Arab countries (with the exception of the GCC states) adopted trade-related strategies aimed at protecting their industries (import duties, non-transparent trade practices and regulations), measures that eventually hampered the implementation of all these intraregional trade agreements.

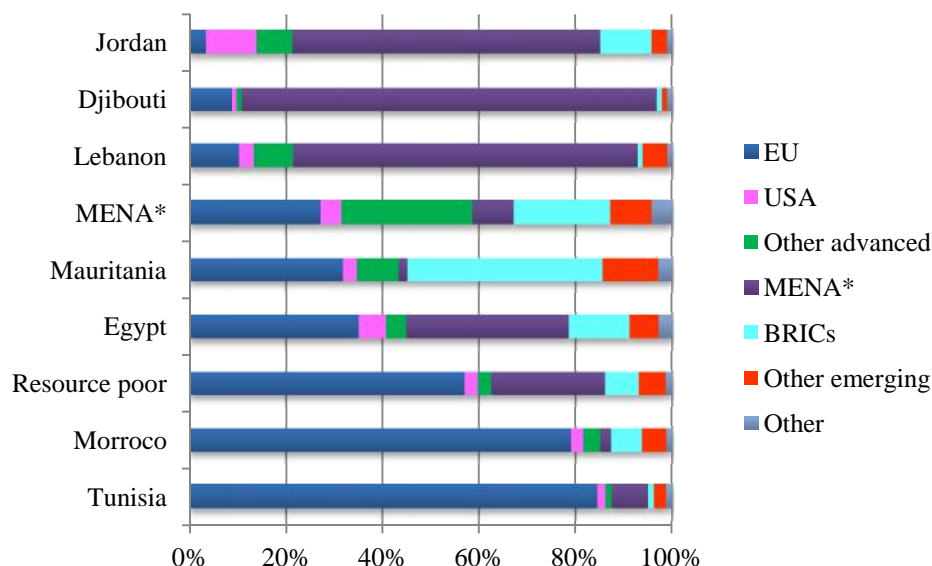
The factors that prevented the successful implementation of intraregional Arab trade could also be identified at the political level, as many frictions, mistrusts or conflicts among different Arab nations proved to hold back any discussions on economic and commercial relationships (Pons *et al.*, 2003, p.38). Finally, lack of market information and weak transportation infrastructure represent other important structural factors that hindered the effective implementation of intra-Arab trade agreements.

There is a huge potential for trade among Arab countries and this could be a source of increased investment, production and employment. In this respect, the Arab Free Trade Area Agreement (treaty signed in 1997 by 18 Arab countries, aiming to eliminate all trade barriers between them) may improve past efforts and open new opportunities for the future. But its impact may be limited by the above mentioned reasons. Moreover, the original regulations may continue to function and be enforced with deeper protectionist effects (Nabli, 2007, p.20).

Arab countries could benefit from economic integration with the region and the rest of the world. According to Zineldin (2002, p.35), one major impediment is the constant competition, rather than cooperation, that characterize the relationships among them. Therefore, they need to promote cooperation, to create strong alliances and to build up confidence among them in order to be able to reap the benefits of regional economic integration and to improve their economic competitiveness in the globalized world (Zineldin, 2002, p.35).

Export competitiveness is strongly connected to intra-regional trade. Although Arab countries have proved to have limited intra-regional trade, it is still considered an efficient tool for economic development and political stability (Abdmoula and Labaas 2010, p.17-18). In many Arab countries exports have been dominated by oil and gas, especially in GCC countries where hydrocarbon resources account for more than 90% of total commodity exports (Abdmoula and Labaas, 2010, p.9). This situation generated significant wealth in these countries and contributed to their economic development. On the contrary, the resource-scarce Arab countries, considered diversified economies, had to find different export markets. As Figure 1 presents, exports from Tunisia and Morocco are mostly directed at the European Union (EU) market (more than 70% of their commodities), while Lebanon and Jordan concentrate on other Arab countries (O'Sullivan *et al.*, 2011, p.15).

**Figure 1. Goods export destinations in selected Arab countries, 2009**



\*MENA = Middle East and North Africa (the Arab countries)

Source: OCDE Report (2011) realized by O'Sullivan, Roy and Mendez,

The small share of non-oil exports in Arab countries' GDP reveals their lack of global competitiveness and shows that it has not been taken advantage of a potential source of job creation. Only few countries such as Tunisia and Morocco have made tangible progress in penetrating the EU market, but overall, the region has lagged behind its potential. Unlocking regional trade would imply building up institutions that support regional markets by reducing cross-border transaction costs. A recent study in the field shows that the cost of complying with nontariff barriers consist of more than 10% of the total value of the goods shipped. Moreover, intraregional discrepancies in regulations, limitations of the physical movement of individuals as well as restrictions on currency convertibility have hindered Arab countries service providers to operate within the regional market (Amin *et al.*, 2012, p.145).

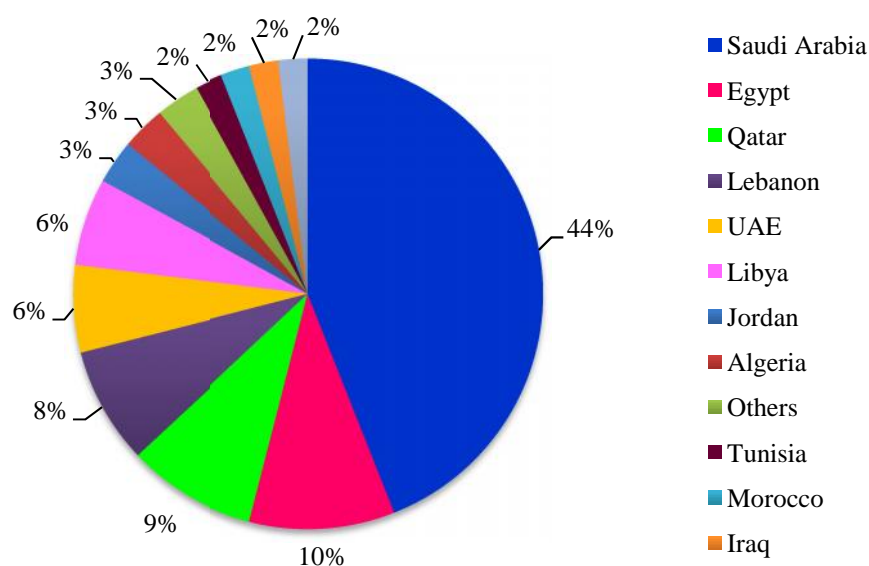
To sum up, there are significant steps to be made toward creating regional markets and developing regional economic integration so that the Arab region can move on beyond the current position where the intraregional trade is about 9% of the total Arab trade.

### 3.2 Intensifying the strategic efforts to develop the private sector

Foreign Direct Investments (FDI) constitute one of the main factors that support a country's economic development, by raising production level, creating new jobs, or by implementing new technologies, know-how and effective managerial tools.

According to a World Bank study issued in 2003, the Arab countries were less successful in attracting FDI compared to other developing countries (cited by Al Abbadi, 2009, p.55). The overall investment in the region has increased during the last decade, but the main recipients were still the rich Arab countries (GCC members). For example, the total amount of FDI in the region was estimated at around US\$64.5 billion in 2010 and two thirds going to the rich countries as Saudi Arabia which received 44% of the total FDI in the region (Figure 2). The resource-poor countries received around 25% of the total FDI inflows into the region, most of them being concentrated in Lebanon and Egypt (Arab World Competitiveness Report, 2011-2012, p.57)

**Figure 2. FDI inflows to the Arab countries, 2010**



Source: Arab World Competitiveness Report, 2011-2012

The private sector in most Arab countries is saddled with some structural problems: the Arab economies are less competitive than other regions, companies tend to be older than, for example, their counterparts in Latin America, Asia or Eastern Europe, new firms find it more difficult to enter the market and inefficient companies are less likely to exit the markets. Moreover, the dynamism and innovation which are essential to increase firm productivity are occurring at a much lower pace than in other regions (Amin *et al.*, 2012, p.107). In this context, governments in the region need to find a sustainable economic model, with the private sector playing a leading role. For this purpose, they must create a transparent business environment in which companies to be able to operate effectively.

Since the inception of the “Arab Spring”, discussions on the necessity to reform the private sector in most Arab economies intensified. Countries as Egypt, Tunisia and Libya, which have already entered the transitional process, have no other alternative for economic improvement than to develop the private sector, with a high potential for job creation, FDI attraction and growth of competitiveness. Therefore, creating a robust private sector is essential for economic development in Arab countries as the prevailing model is not sustainable in the long run.

### **3.3 Integrating with the global economy**

The Arab countries as a whole have made significant progress in the realm of trade policy, but there still exists the challenge of international competition. Besides the hydrocarbon resources (oil) and tourism, the Arab region record weak commercial connections with the rest of the world in terms of trade with goods and services, cross-border investments, technological licensing or patenting (Noland and Pack, 2007, p.301). Under these circumstances, altogether with the political reforms, from the economic perspective there is a need for stronger commercial ties with the rest of the world. Although many Arab countries have favourable access to markets, they haven't ripped all the benefits and opportunities yet. Overall, the region has a very low global market share in many export sectors, non-oil exports amounting less than 1% of world trade, the lowest share among all regions (Amin *et al.*, 2012, p.140).

There are several reasons why Arab countries should develop some consistent and coherent strategies toward the rest of the world. First of all, openness could give domestic companies the impulse to become more efficient and more creative in a competitive business environment. Secondly, reforms could be advanced and long term credibility of change could be enhanced through adherence to international agreements and understandings such as World Trade Organization (WTO) or other international institutions. Moreover, openness can help reduce the transition costs of economic reforms by attracting financial resources or other resources (Romagnoli and Mengoni, 2009, p.72).

All of the Arab states are members of the Bretton Woods system, but the real differences among them reside with respect to GATT/ WTO membership as almost half of these states are not members of the latter organization (Noland and Pack, 2007, p.211). Nonetheless, in the sphere of trade policy Arab countries have made significant progress and most of them have undertaken reforms in order to bind themselves with the WTO rules and practices.

## 4. Conclusions

As the globalization process is unfolding and the external competitive pressures are increasing, the Arab countries have to undertake comprehensive structural reforms and to apply new regional and global strategies in order to improve the competitiveness of their economies. For this purpose, the governments should focus on creating a better legal and institutional environment for enhancing the foreign direct investments, making more space for private investment in services, improving access to finance and designing new strategies for regional and global integration in order to reap the benefits of globalization. Indeed, all these strategies and policies should be exhaustive and adapted to the local characteristics, needs and potential of each country.

One pivotal element to economic development is to foster intraregional trade, as it has been weak despite all the efforts undertaken so far to stimulate trade of goods and services among these countries. For this purpose, the Arab countries need to promote cooperation among them, to build up confidence with each other and to create strong alliances to be able to achieve some synergy effects as a result of these endeavours.

FDI constitute one of the main factors that support a country's economic development, therefore Arab countries should improve competitiveness in order to attract more FDI in the region and to intensify their efforts to develop the private sector. For this purpose, a transparent business environment could improve predictability, allowing companies to operate efficiently in a competitive business environment.

All taken into account, the paper argues that the Arab countries should develop some consistent and coherent strategies toward integration into the global economy. Thus, a successful approach in the Arab region could be the creation of robust institutions to support the process of economic integration and to improve the competitiveness of their economies in order to take advantage of all the positive aspects of globalization.

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