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## Unleashing Economic Reforms in the Arab World

Interview with Augusto Lopez-Claros, Chief Economist and Director, Global Competitiveness Network, World Economic Forum, at Summit in Sharm el Sheik, Egypt, 20 May 2006.

Interviewer: Samantha Tonkin

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### ***According to The Arab World Competitiveness Report, the Middle East is at a crossroads. What is at stake?***

There is a burgeoning unemployment problem in the region which needs to be urgently addressed. The numbers are well known but it is useful to restate them: the labour force in the Middle East and North Africa region is growing extremely quickly. It is projected to rise from some 100 million at the beginning of this decade to close to 200 million within the next 20 years. Just to maintain unemployment rates at present levels—already the world’s highest—tens of millions of jobs will need to be created. Of course, to actually bring unemployment rates down to more sustainable levels, job creation will have to be more ambitious, in excess of a 100 million new jobs by 2020-2025. This is a huge challenge for policymakers and the business community.

There are several aspects to this problem and why job creation will remain at the top of the reform agenda in coming years. First, there is the issue of the sustainability of extremely high unemployment, both from a social and political perspective. Civil society in most parts of the world—and the Arab countries are no exception—have much higher expectations today than 20 or 30 years ago with respect to their governments and their ability to deliver good quality services, job opportunities, basic levels of competence in macroeconomic management. Where governments fail to deliver they are either voted out of office or there is a significant rise in social tensions and frustration. A poorly performing job market is a key source of such tensions because the desire—particularly among the young—to feel productive and useful, to be imbued with a sense of social purpose is extremely strong. I think governments in the region are aware of this and you see a number of countries making concerted efforts to tackle these problems. But I would argue that the scale of the response has not been sufficient and for this reason the challenge remains. Of course much is at stake: the region’s ability to successfully adjust to the swift pace of change in the global economy, social and political stability and, ultimately, sustaining human welfare.

### ***And so what are the critical steps at the top of the Arab economic reform agenda?***

I think there are several. First, there needs to be a realization that the problem of job creation will not be solved in a sustainable way without a major shift in the orientation of economic policies and the values that have sustained them during the past two decades. A new model is needed that shifts the sources of growth in the region from an undue emphasis on the oil sector to non-oil industries, from state-dominated activities to those entailing a much larger private orientation, ideally involving the nourishing of

competitive export-oriented activities. One key component of this shift will have to be a major boost to trade and investment, well beyond the initial efforts made by a few countries in the region in the context of free trade bilateral deals or efforts by several others to join the WTO. The region as a whole remains unduly dependent on the energy sector, both for budget revenues and as a source of foreign exchange in the balance of payments. The risk here is not so much that energy prices might drop sharply thereby endangering the economic outlook—most agree that such a scenario is unlikely in the near term—but rather that the preponderance of the energy sector within many of the larger economies in the region is retarding the development of a more diversified economic structure, better able to provide jobs and facilitate the integration of these economies to the global economy in areas other than pumping oil and loading it into tankers.

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Basing a long-term development agenda on high oil prices is not a sustainable strategy. Growing competition in world markets and the emergence of highly competitive economies in the Far East and in central and Eastern Europe risks leaving countries in the Arab world behind, with stagnant or falling levels of per capita income. It is, of course, encouraging to see that some governments are making attempts at diversification and are increasingly realizing that it is essential to empower people through education and training, to facilitate the growth of new industries. But these attempts must intensify and be more broad-based; the region's demographics demand a more proactive approach that brings together government, the business community and civil society in a process of consultation aimed at confronting these challenges. Much has been written about the low levels of intra-regional trade and foreign direct investment. It is pointed out that non-oil merchandise exports still account for a relatively small share of GDP, much less, in any case, than in the more successful East Asian economies or even Latin America, while inflows of FDI are some 5 times smaller than the levels seen in a large number of emerging markets. But, instead of being depressed about these numbers policymakers must see them as an opportunity: it means that the scope for gains in trade and investment through liberalization are huge and that tapping into some of this potential will be where the millions of jobs will come from.

***Are governments using the unexpected budgetary resources following the oil driven boom to push forward reforms, or are tough decisions now on hold?***

As you know, there is an interesting literature on the "curse" of natural resources. One aspect of this debate has focussed on the impact of high oil (or other commodity) revenues on the exchange rate and the resulting appreciation that ends up undermining the growth of the manufacturing sector. But the other line of argument has to do with the creation of a sense of complacency among policymakers because the terms of trade have improved, the short-term economic outlook has become brighter and, thus, the pressure to move on economic and institutional reforms gradually disappears, falling victim to political cycles, the venality of politicians, and so on. Indeed, the most successful economies of the past 3 decades—Korea, Singapore, Taiwan, Ireland, New Zealand, Chile and some of the central and Eastern European "tigers", Japan if

we talk about the post War period—are either countries with poor natural resource endowments or a basic endowment which a combination of good policies, including investment in education, and coherent governance have turned into an engine of growth. I do not wish to say that “tough decisions are now on hold.” What is perhaps lacking—with a few exceptions—is a sense that time is not on our side, that countries that stand still fall behind and that we do not have the luxury to postpone urgent reforms.

***How can the private sector and civil society maintain pressure on governments to plan for the long term, taking into account the needs of the region's youth?***

I think that the private sector needs to take a much more proactive role in lobbying the government for better policies and improvements in the policy environment. Often the emphasis has been on securing privileges, maintaining access to those in authority, and ensuring the status quo. We have learned, however, that successful economic development strategies have much to do with the role of government and the exercise of political authority in a society for the management of its resources. It matters a great deal whether governments are accountable to their respective populations. Investors seem to care enormously whether judges and courts are reasonably independent or whether they are up for sale. Do governments show favouritism in their decisions or are they fairly even-handed in their relations with the private sector? Are public resources being allocated to public health and education or rather to wasteful projects or unproductive expenditures? On all of these issues there is much to do in the Arab world and the private sector should play a catalytic role in alerting the government about institutional and policy shortcomings and in co-opting them into a pro-reform mode.

***The World Economic Forum's Gender Gap report found that women in Egypt are furthest behind men in terms of economic equality, and four Islamic countries are ranked at the bottom of the survey. What implications does this have for the economic prosperity of the Arab world and what can be done?***

Governments in the region have done much to boost spending in education in recent years and much of this has benefited young girls and women. Notwithstanding these efforts, female labour force participation rates remain by far the lowest in the world and thus the region is not yet benefiting from the potential returns to these investments. Progress has also been slow in fully empowering women to be active participants in the political process and, thereby, contribute to shift some of the attitudes which have relegated them, in many countries, to second class citizens. Improving competitiveness has much to do with enhancing the efficiency of resource use. But this important economic principle does not refer to financial or material resources only but, increasingly to our most valuable resource: human capital. As countries in the region work to bring women into the mainstream of their societies—in the workplace, in parliament, in the company Board room and in all other areas of human endeavor—we will see a remarkable increase in the ability of these societies to find creative solutions to intractable problems. This is not dogma: this has been the objective experience of countries which have empowered women.

