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Lost Chances in the Middle East

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I. Light and Shadow in Economic Development in the Middle East

On August 2, 1990, Iraq surprised the world by invading Kuwait and announcing its annexation later. The crisis disclosed one aspect of accumulated contradiction of economic development in the region as well as in the world for the last two decades. One of the main motivations of Iraq's invasion of Kuwait was to find a way out of Iraq's economic difficulties, such as accumulated external debts and limited oil export income caused by stagnant oil prices. Kuwait's oil fields and financial assets were very attractive to Iraq. Although Iraq's economic difficulties were mainly due to the huge military expenditures for the prolonged war against Iran and although she is one of the major oil-exporting countries in the world, it is to be noted that Iraq has succeeded to some extent in invoking new resentments about the widening economic gaps between the oil-rich Gulf countries and other countries in the region suffering from economic difficulties.

Throughout the 1980s the bargaining power between the oil-exporting countries and the oil-importing developed countries turned out to be favorable for the latter. For example, Saudi Arabia had to have recource to deficit budgeting since 1987. Despite this, however, some oil-exporting countries, mainly in the Gulf, managed to overcome their own temporary difficulties by depending on accumulated assets, although their capacities to give aid to other countries have declined. In this context the contrast of the rich countries with poor countries in the Middle East has soured, aggravated, and undermined mutual relations in the region through the 1980s. For instance, per capita national income of Sudan as of 1987 was only 330 U.S. dollars, while that of Kuwait was 14,300 U.S. dollars, more than 43 times higher than the former. Sudan now faces a sort of economic catastrophe as one of the LLDCs.

Another example is Jordan, which has faced increasing financial deficits because of diminishing assistance from the Arab countries in the Gulf. As one of the "frontier states" against Israel it could have expected grants as much as one billion U.S. dollars per year between 1979 and 1988, according to the resolution of the Arab Summit held in Baghdad in 1978. However, some Arab countries in the Gulf and in Magreb failed to fully implement their pledges due to declining oil export revenues. They have found difficulties in giving to other Arab countries enough aid, which they had given in the 1970s. The diminishing flow of capital from the Gulf to other countries in the Middle East is one of the new phenomena of a loosening in the economic system that was in the process of being established in the 1970s. The emerging system in 1970s was one of transmitting prosperity in the oil-exporting countries to other countries in the region through the transfer of remittances of emigrant laborers, grants and aid, and capital investment. We observe now a declining process of the system at the end of the 1970s, to be transformed and adapted to the new situation created under the pressure of depressed oil prices in the 1980s.

The Middle East has experienced drastic structural changes since the beginning of 1970s, particularly since the first oil boom at the end of 1973. The main measures of these changes were nationalization movements of oil resources by oil-producing countries and the quadrupled increase of the oil price through the oil strategy adopted by the Arab oil-exporting countries in the Middle East War in October 1973, which assured huge increases in export revenues for the oil-exporting countries in the region. Countries in the Middle East in general realized high economic growth in the 1970s. The increases of revenue thus realized not only resulted in exorbitantly huge investments in the infrastructure and industry in their economies, but also in a reorganization of the whole economic structure in the region, in such a way as to make the business cycles in the non-oil-exporting countries dependent on those of the oil-exporting countries.

The Gulf countries and Libya drew emigrant laborers on a large scale in order to overcome a labor shortage, from other Arab countries and Turkey, as well as from countries in South Asia and the Philippines. The major labor-exporting Arab countries were Egypt, Jordan, Tunisia, Morocco, Syria, and the occupied territories of the West Bank and Gaza. They accepted emigrant laborers from India, Pakistan, Bangladesh, and Sri Lanka. Remittances by the emigrant laborers, grants and aid offered by the oil-exporting countries, joint ventures and investment, and the expansion of mutual trade intensified economic relations between the Arab states in the region. During the economic boom, the dependency functioned as a tunnel through which economic prosperity expanded to labor-exporting countries. In case of the recession in the oil-exporting countries, this structural dependency aggravated the labor-exporting countries' economies in an accelerated way. This exacerbation was another kind of structural transformation in the 1980s.

At the same time, the economies of oil-exporting countries were involved more deeply in the world economy led by the developed countries, not only through the demand and supply of oil, but also through trade in general and financial activities. The so-called low-absorbing countries invested their surplus money in treasury bills, bonds, and stocks of developed countries in order to keep and increase their real values against exchange risks. The Gulf Arab countries in general linked their economic destinies to the world economy, particularly to the economies of the developed countries.

Kuwait is the most typical case in that it has given up industrialization as a guiding strategy of its economic development and decided to survive on returns of its amassed financial assets invested abroad. Other GCC countries such as Saudi Arabia, Oman, United Arab Emirates, Bahrain and Qatar turned out to be rentier states to some extent. In the case of Bahrain, it intended to become an off-shore financing center regionally as well as internationally. These options reflect specific conditions in those countries, whose populations are too small to establish self-sustaining national economies.

In the 1980s, under the pressure of stagnant oil prices, the oil-exporting countries had new difficulties with their economic management. However, the Arab Gulf countries could manage to survive various new challenges, such as deficit budgets, by depending on their past financial accumulations from the period of booms in the 1970s and in the beginning of the 1980s. On the other hand, other Arab countries, including oil-exporting ones, faced structural difficulties, such as accumulated external debts, in the new circumstances in the latter half of the 1980s. The negative impact of the oil glut took shape more conspicuously in Egypt, Sudan, Yemen, Morocco, Jordan, Tunisia, Algeria, and Turkey. They have suffered from accumulated external debts accompanied by economic recessions, increases of unemployment, and inflation. The amounts of external debts of these countries as of the end of 1980s are approximately 50 billion U.S. dollars for Egypt, 10 billion U.S. dollars for Sudan, 3 billion U.S. dollars for North Yemen, 23 billion U.S. dollars for Morocco, 8 billion U.S. dollars for Jordan, 7 billion U.S. dollars for Tunisia, 23 billion U.S. dollars for Algeria, and 33 billion U.S. dollars for Turkey, respectively. These are quite heavy burdens. Iraq may occupy an exceptional position among the countries suffering from this agony, because the major cause of Iraqi debts has been the war against Iran. However, there is no denying the fact that this is also a reflection of the accumulated effects of the continuous stagnation of oil price since the beginning of the 1980s, particularly the drastic collapse of oil prices in 1986. Iran also suffered economically from the disorders around the Revolution in 1979 and the war with Iraq that succeeded it.

II. Structural Crisis

In addition to the debts, there are other kinds of difficulties and crises that came to the fore in the 1980s. One of them is an erosion of self-sufficiency in food and a decline of agriculture in general. As shown in the Table 1 the rates of food self-sufficiency as of 1984 – 86 were very low in some countries. In the case of Kuwait,

Table 1. Food Import Dependency Selected Countries

	1979–81	1984–86
Algeria	64.5	69.1
Egypt	40.6	46.9
Israel	71.1	71.9
Jordan	91.0	97.3
Kuwait	110.9	103.9
Morroco	38.2	30.8
Saudi Arabia	89.7	78.4
Sudan	9.6	12.1
Syria	22.6	35.2
Tunisia	42.8	41.6
Turkey	1.9	5.2

Source: United Nations, Development Program (UNDP); Human Development Report, 1990, p.150.
Note: Ratio of food imports to food available for internal distribution—i.e, domestic food production plus food imports minus food exports.

the rate is more than 100%, while Saudi Arabia imported as much as 78% of its domestic consumption of food. These two countries can afford to pay for food out of their financial assets. However, Egypt, which enjoys a comparatively sufficient water supply, had to import almost half of its domestic consumption, 47%. Algeria had to import almost 70% of its food. Other Magreb countries such as Morocco and Tunisia import 31% and 42%, respectively. It is significant to notice that the economies in these countries were originally agriculture-based. In addition, Sudan was supposed to be a candidate granary with enormous potential for agricultural production with its Gezira project in the 1970s. Saudi Arabia and other Gulf countries showed considerable interest in the project and invested in it so that it would provide necessary food for other Arab countries in the future. However, despite the big flow of financial aid from the Gulf, the project failed to achieve the desired purpose. The supposed-to-be food exporting country now suffers from an insufficiency of domestic supply of food for its population and is always under the threat of mass hunger. One can point out the disappearance of subsistence economies and the prevalence of a market economy even in the rural area as one reason for the agricultural crisis.

Another explanation for the food crisis is the phenomenon called Dutch disease. The emigration of laborers and shifting of labor from agriculture to service sector deprived agriculture of necessary labor. At the same time, the socio-political structure should also be taken into account to explain the decline of agriculture.

The other problem that should be taken into consideration is the pricing policy of agricultural products. In Egypt, for example, the state had been the sole purchaser in principle of wheat, rice, cotton, etc. until the latter half of the 1980s and their prices are controlled at a low level so that the agricultural sector can be the major source for capital accumulation for other sectors, such as industry.

The strategy was inevitable to some extent because, except for the agricultural sector, there was no other economic sector that can support capital accumulation in an agricultural country like Egypt.

Other aspects of structural difficulties are urban problems, such as housing, pollution, and haphazard urbanization, including local middle-scale towns. At the same time, with the higher rate of population growth compared with developing countries in other regions, the population explosion causes serious problems, such as unemployment as well as underemployment, particularly among the younger generation.

Another new aspect to be noted is that each oil-exporting country invested its oil revenue in such a way as to establish an "independent national economy." This prompted a break-up process of the ideological basis of "Pan-Arabism." I call this phenomenon "One-countryism." The ruling circles in each country tried to attain a sort of economic legitimacy in each country as an independent entity. These activities induced non-economical double or triple investment in the Gulf as a whole without an appropriate division of labor.

III. New Orientations in the Development Strategies

In the meantime, neo-classical development strategies crept in the Middle East as the guiding principle for economic development since the middle of the 1970s at the earliest and this school's impact expanded in later years. Liberalization and decontrol measures were imported mainly through the IMF and the World Bank as alternative measures to cope with structural difficulties. Import liberalization and an export-oriented strategy was recommended as an alternative to the former prevalent principle of an import-substitution strategy. The market mechanism was emphasized as a promoter of efficiency by introducing competitiveness in the export market. In this context the inefficiency in the public sector was taken up as one of the major constraints to be solved, and various ways for privatization were recommended.

It is to be noted that various regulations and controls had existed not only in the so-called socialistic countries, such as Egypt, Syria, Algeria and Iraq, but also in the liberalism-oriented countries such as Morocco and Tunisia. Most countries had to depend on state initiatives in industrialization because of a lack of capital and entrepreneurship in the private sector. The introduction of controls and regulations was also necessitated by the expected role of the state in economic development. Furthermore, subsidies for such necessities as bread and sugar are found among the major public expenditures in most countries in the region. These subsidies are expected to function as a buffer against the probable outbreak of discontent of the general masses. The above characteristics are found in both the socialism-oriented countries and the liberalism-oriented countries.

At the introduction of liberalization measures, these state-led economic structures and their policies, in the name of Arab socialism or otherwise, began to be re-examined and re-criticized. We have to analyze whether these new experiments have succeeded in overcoming the structural economic difficulties in the region. However, it is difficult for the moment to draw a general conclusion or point out a case of success convincing enough to the governments and the people in the region. Some people refer to Turkey in the 1980s as a success story with some reservations.

The problem here is one of general or specific applicability of liberalization theory to countries in the Middle East. It is necessary to point out here that new principles are liable to be applied on an equal basis without taking into account the specific local conditions of each country. Second, the time span for getting positive results is comparatively short. Third, the socio-political factors are often overlooked or taken lightly. In this connection it is necessary to sort out causes for the economic difficulties in the region. Each economic difficulty is a combination of various factors, such as oil price stagnation as well as accumulated results of economic policies pursued by successive governments. As for the low-absorbing oil-exporting countries endowed with comparatively rich natural resources, failures in the economic policies appear more prominent.

In case of Algeria, for example, the public sector in general failed to achieve the required objective in increasing production and productivity either in agriculture or in industry. The exogenous factors, such as the decline in oil prices, might have not contributed much to the present economic crisis there. If this is true, temporary increases of oil revenues might not be sufficient to overcome the structural economic difficulties.

If the so-called socialistic economic systems were causes for economic difficulties, then we have to face a sort of process of transformation from "socialism" to a "market-oriented economy." However, the processes are full of specific difficulties and disturbances not necessarily related to "socialism." Take again the case of Algeria. Failure in realizing expected targets in raising efficiency in the public corporations despite various measures for autonomy resulted in the political and social disturbances since 1988. We cannot overlook political repercussions through these economic liberalizations. We observe new waves of disturbances oriented toward the political liberalization, which emerged in the latter half of the 1980s, such as mass revolt in Algeria in 1988 and in Jordan in 1989.

IV. Arab Socialism and Egypt

Egypt began to face new crises towards the middle of the 1980s. Although Egypt was originally a labor-exporting country even before the oil boom in the 1970s, its dependency on remittances from Egyptian emigrant laborers intensified after the middle of the 1970s. Remittance turned out to be one of the four major sources of foreign currency besides oil exports, Suez Canal fees and tourism. Egypt exported her labor to the Gulf as well as to the North Africa. The total number of workers abroad is supposed to be around two or three million. These laborers come not only from rural areas but also from urban areas. They include university professors as well as manual or agricultural laborers.

The Egyptian economy recovered rapidly after the middle of 1970s and the average growth rate of GDP (in real terms) between 1975/76 and 1980/81 was as high as 9.2%. However, the growth rate decreased to 8.0% in 1983/84, 7.4% in 1984/85, 4.8% in 1985/86, and 4.2% in 1986/87. In 1987/88 the growth rate declined to 3%.

Because of the dependency on the oil-exporting Gulf countries, the collapse of oil prices in 1986 obliged Egypt to apply for a stand-by credit from the IMF in order to overcome its balance of payment crisis. There were controversies concerning the characterization of the crisis as to whether it was only a cyclical one or of a structural nature. Negotiations started between the IMF and Egypt in the beginning of 1987. The IMF put a set of conditionalities which Egypt should follow, as other countries should.

The conditionalities included a decrease of the deficit in the national budget by cutting subsidies. As for subsidies, there are two kinds: those given directly to the necessities such as bread, sugar, and public transportation, and others given indirectly by setting lower prices compared with international prices such as gasoline.

It should be noted that these conditionalities will inevitably undermine the established framework of "socialism" in Egypt, which was formed during the Nasser period and survived even the "Infitaha" (open-door) period after the middle of 1970s. In 1974, Egypt embarked on a new economic orientation different from the previous one by encouraging foreign and private investment in wider fields. Foreign capital came in timidly. However, new joint ventures appeared on the scene mainly in tourism and banking. Import liberalization was partly introduced. "Nouveau riches" came out of quick-earning merchants, the bureaucratic bourgeoisie, and the old bourgeoisie who survived the Nasser period. At the same time the government was very cautious not to touch the basic "socialistic" structures intended to protect the welfare of the general masses, such as peasants and workers. Therefore the economic system in the "Infitaha" period was a queer combination of "socialism" and "capitalism," with the public sector playing still a very important role in the national economy.

It was not easy for Egypt to accept remedies offered by the IMF, as these remedies seemed to touch very sensitive elements of Egyptian "socialism" by undermining more radically the state-led economy, in order to transform it to a more liberalized market-oriented economy.

The major resistance against the "radical" transformations can be explained by an anxiety about the political cost, which might jeopardize the political base and the legitimacy of the government. It is ironic that various kinds of subsidies that were supposed to support the poor became indispensable all the more because of the increasing gap between the new rich and the poor after the introduciton of open-door economic policies. In January 1977 Egypt experienced a nation-wide riot when President Sadat announced a price rise for bread (eish) under pressure from the IMF. This riot impressed the government very strongly with the vulnerability of the Egyptian society. This memory is so strong that President Mubarak has to take every caution against any sign of discontent among the poor masses.

When we discuss the problem of subsidies, we have to take into account not only the reactions from the poor, but also the connections between subsidies and the public employment policies in Egypt. In the 1950s, Egypt introduced a sort of employment guarantee to graduates from universities for employment in the government or the public sector. The system worked comparatively smoothly when the number of the graduates was limited.

However, the number of graduates increased beyond the absorptive capacity of the government and the public sector later on, resulting in heavy pressure on the national budget. On the other hand, because of budgetary constraints, per capita wages of government employees declined in real terms. It has become almost impossible for government employees to survive on their wages alone. Subsidies were given a new raison-d'etre, as they contributed to some extent to cushioning their low income by giving a guarantee of minimum necessities for government employees. The social strata of government employees have covered a wide range of personnel, and it was very important for the government to obtain their support for its stability. In other words, the class of government employees has been an indispensable base for the political system in Egypt. Their support as organized labor to the regime was essential. However, these subsidies have failed, ironically, to stop the declining economic status of the government employees as a whole. Despite these subsidies government employees have found it very difficult to make both ends meet. Now it is generally observed that many government employees are engaged in second jobs besides main jobs. Now the government has to accept this fact. In other words, many of them are in the state of disguised underemployment.

Another negative aspect of this employment guarantee is over-staffing in the government offices in disregard of the required amount of labor. The enforced over-staffing deprived the government as well as the laborers of an incentive to increase productivity.

The simplification of multiple rates of exchange implies the same effects against the poor and government employees in the Egyptian context. For instance, out of multiple exchange rates there is an overvalued rate for the Egyptian pound for the export of oil as well as the import of wheat. In the latter's case, the exchange rate is another type of subsidy by supplying food with cheaper prices calculated in the Egyptian pound.

The third ocnditionality on the rationalization of interest rates was meant to improve the efficiency of enterprises, mainly in the public sector. This requirement was liable to touch another pillar of "socialism." The public sector was the symbol that represented socialism and equality. Many public sector enterprises have survived economic inefficiencies with the help of negative rates of interest, which were nothing but another sort of subsidy. Therefore, it was expected that once interest rates were raised, many enterprises in the public sector would find it almost impossible to survive in the immediate future. Taking into account the national understanding that the public sector is the guiding sector for the socialistic economic structure formulated during the Nasser regime and the fact that liquidation of the public sector has been almost a taboo in the political and ideological framework, it is only natural that any attempt to undermine the public sector should have faced formidable psychological obstacles. It took several years before President Mubarak could endorse in public, in 1988, the idea of selling out of public enterprises, even in very limited specific cases. For the moment, partial sell-out is limited only to those enterprises that are exceedingly inefficient and to those areas not related to the basic and strategic industries.

As for the public sector in Egypt, it is to be noted that the only social group that has been resisting the sell-out or break-up of the public sector is the organized labor in the public sector. In other parts of the world the bureaucracy in the government is very often one of the social groups that oppose the sell-out of public enterprises to the private sector. However, in Egypt, because of wider chances for bureaucrats in the public sector after retirement, the bureacracy is not always against privatization of the public sector. This is a specific factor in the Egyptian case.[1]

However, Egypt had to accept the above-mentioned conditionalities, such as the decrease of subsidies, to a less degree than required by the IMF. At the same time, exchange rates were simplified, from the original five or six to three, in May 1987. The agreement with the IMF paved the way for re-scheduling agreements concerning parts of external debts in the Paris Club. However, Egypt was forced to require another stand-by credit from the IMF in the end of 1988 to get another agreements for re-scheduling. The negotiations between the IMF and the Egyptian government were prolonged without coming to an agreement, as of October 1990. The major reason behind the delay is supposed to be differences of views concerning the time-schedule of implementation of the conditionalities put forward by the IMF authority. Both of them agree to the basic understanding that conditionalities should be implemented. However, Egypt insists on the necessity to implement these measures more slowly, while the IMF asserts that it is useless to carry out them bit by bit. The point is that the Egyptian government fears repercussions from general masses.

V. Morocco and Tunisia

Morocco and Tunisia are countries that were not bound by any fixed ideologies except during a short period. However, they also had to take a state-led development strategy and introduced a series of controls in prices, investment, and import. In the 1980s, under the guidance of the IMF, they took recource to an export-led growth strategy, improvement in efficiency in both the private and the public sectors, and labor intensive development. They adopted a more liberal and market oriented development strategy.

Tunisia took socialist orientated policies in the 1960s. However, it changed its orientation in the 1970s and tried to liberalize prices, investment, and import. In this connection, wages and salaries were restricted after 1983 under a certain level and since the middle of the 1980s they have been limited to levels less than the increase of the consumer price index. These measures were meant to strengthen the competitiveness of Tunisian products in the export market. Exchange rates were also depreciated to ensure international competitiveness. In the middle of the 1980s also interest rates were raised, so that they are positive in the sense that they are higher than inflation rates. Another measure is a budget outlays decrease, so that budget deficits and positions in balance of payments might be improved. The decrease in expenditures was realized through limitation of wage and salary increases and social service subsidies. The latter element includes a reduction of the number of public enterprises.

As is shown in the targets in the above, the heaviest burden is borne by the workers, including government employees. But it is feared that these measures will not expand the opportunities for the creation of new employment as expected.

VI. Lost Chances for Liberalization and Export-Oriented Strategy

In the case of Egypt, it had to tackle the liberalization of economic control, such as the unification of exchange rates and raising of interests rates, when its economy lost its advantages, such as a high rate of savings, and the inflow of a comparatively huge flow of foreign currency in the latter half of 1970s. Now Egypt is obliged to face with stringent measures. In other words, Egypt should have made use of the "golden opportunities" in the 1970s in order to implement these radical measures.

Because of economic difficulties, cutting down various subsidies in the budget is liable to face stiffer resistance from the general public. On the other hand, Egypt may not have enough time to go through an expected difficult time required to rationalize the management in the public enterprises, to increase their efficiency, and to privatise part of them.

For a country that has opted bit by bit for its export-oriented development strategy, Egypt has had to compete with others already more advanced, such as the Asian NIEs countries. If one goes to Port Said, a free zone city of Egypt on the coast of the Mediterranean Sea, that has also liberalized import of consumer goods, one will find imported commodities produced by the Asian NIEs countries and mainland China. Egyptian people come there to purchase these commodities instead of similar domestic products by paying nominal custom taxes. Latecomers would find it very difficult to compete with forerunners in the world market. This understanding could be applicable to almost all countries in the Middle East. On the other hand, the increase in income discrepancies accelerated by liberalization may slow down expansion of the demand for domestic production.

It may be that the time required for such a deep transformation of the economic structure in Egypt is longer than that envisioned by the international finance organizations. In this respect the Egyptian stance might be reasonable. We have to watch carefully the experiments carried out in Egypt as very significant ones concerning the general applicability of export-oriented development strategy. How to balance the importance of the domestic market and the export market is a controversial issue for a country that has a certain level of population and domestic market.

NOTES

1. Manabu Shimizu, Introductory Notes for the Study of Pressure Groups in Egypt, in *Pressure Groups and Economic Policies in Egypt* (edited by Manabu Shimizu), 1988, IDE, pp. 40–45.

(Additional comments)

Since the end of 1990, Egypt seems to have taken a more positive stance toward "economic reforms" such as unification of exchange rates, liberalization of interest rates, and removal of administered prices. We have to watch whether this is a breaking point from the past or not. However, there is no denying the fact that collapse of Soviet regime had at least psychological effects on the policy makers in Egypt in changing its direction.