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MACROECONOMIC TENDENCIES AND POLICY OPTIONS IN THE ARAB REGION

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GLOBAL INTERDEPENDENCE AND THE FUTURE OF THE MIDDLE EAST: MACROECONOMIC TENDENCIES AND POLICY OPTIONS IN THE ARAB REGION

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1. Broad macroeconomic tendencies in the Arab region

This section provides a brief critical survey of the basic macroeconomic tendencies in the Arab countries of the Mashrek and Maghreb since the mid-1970s, in order to assess the weaknesses and strengths of the performance of Arab economies and to indicate the problems and challenges ahead. An issue of great relevance in this context is the heavy reliance of Arab economies on **exogenous resources** and a variety of 'rentier' (and 'semi-rentier') revenues. This, in turn, increases the vulnerability of Arab economies to external shocks as will be discussed through this paper.

From the mid-1970s, the Arab region witnessed a period of high growth up to the mid-1980s, fuelled mainly by oil revenues in Arab oil-exporting countries and by other derivative forms of the oil rent (i.e., workers' remittances and aid flows) in Arab labour-exporting countries. Annual real GDP growth rates reached 8.5 per cent in **Mashrek** countries and 5.8 per cent in **Maghreb** countries during the period 1970-80, and 5.7 per cent and 4.7 per cent during the period 1985-90 [cf. Diwan and Squire (1992), Table 3]. By the mid-1980s, annual economic growth had decelerated markedly: 2.9 per cent for **Mashrek** countries and 1.1 per cent for **Maghreb** countries (*ibid.*). This recent deterioration in rates of economic growth is related, directly or indirectly, to conditions in the international oil market.

Nevertheless, the process of economic growth in the easy years of the 'oil boom' was basically a kind of a 'bubble economy', fuelled by the 'construction boom' and the upsurge in trade and finance activities. As a result, the performance of the main **commodity sectors** (i.e. agriculture and manufacturing industry) was rather poor during the boom years, as the food security situation deteriorated in the traditionally agricultural economies of the Arab region, and the distribution of the manufacturing value added remained heavily biased towards light agro-based industries — 'food, beverages and tobacco' and 'textiles and clothing' (see Table 1).

Paradoxically, despite the huge inflows of oil revenues during the period 1975-90, this period was marked by the heavy reliance of Arab economies on foreign finance. For the **external debt** of Arab countries reached a record high by 1990 — around $72 billion for

Table 1. **Changes in the structure of manufacturing industry in selected Arab countries (1970-90)**

(Distribution of manufacturing value-added)

(Percentages)

	Food, beverages and tobacco		Textiles and clothing		Machinery and transport equipment		Chemicals	
Country	1970	1990	1970	1990	1970	1990	1970	1990
Egypt	17	31	35	16	9	9	12	8
Sudan	39	n.a.	34	n.a.	3	n.a.	5	n.a.
Morocco	n.a.	31	n.a.	25	n.a.	6	n.a.	16
Jordan	21	26	14	7	7	4	6	15
Syria	37	24	40	31	3	6	2	15
Tunisia	29	17	18	19	4	6	13	9
Algeria	32	n.a.	20	n.a.	9	n.a.	4	n.a.
Saudi Arabia	n.a.	7	n.a.	1	n.a.	4	n.a.	39

Source: World Bank, *World Development Report 1992*, Table 6.

Mashrek countries (excluding Iraq) and $58 billion for **Maghreb** countries [Diwan and Squire (1992), Table 7]. Several countries had to reschedule their official or commercial debts several times by going to Paris and London clubs (Morocco, Egypt, Jordan), while other countries ran arrears and are almost cut-off from voluntary lending (Syria, Lebanon, Yemen[1]).

On the other hand, while the share of **gross domestic investment** in GNP attained unprecedented high levels during the period 1975-84: 30 per cent for **Mashrek** countries (excluding Iraq and Lebanon), and 35-39 per cent for **Maghreb** countries, this was accompanied by a rising share of **foreign savings** in GNP during the same period (with the exception of **Algeria**): around 20 per cent for **Mashrek** countries (excluding Iraq and Lebanon) and 12-15 per cent for Morocco and 8 per cent for Tunisia (cf. World Bank, *Regional Data Base*, 1993). This, combined with mounting external debt stocks, would place serious pressures on the balance of payments of Arab countries in the future, due to the servicing of foreign investment and external public and private debts.

Looking further ahead, there are three sets of issues placing further pressures on the Arab economies in the coming years, namely:

a) **Water shortages** are getting acute in most Arab countries. According to World Bank estimates "at least **ten** of the countries in the Middle Eastern region are presently under what is termed 'water stress', and over **half** exhibit 'absolute water scarcity' which means that the ratio of population to water exceeds minimum standards taken to be one million cubic meter of water per one thousand persons"[2]. According to the same estimates, Algeria, Jordan, Israel, Palestine, Syria, Tunisia and Yemen suffer from the spectre of **water scarcity**[3].

b) The relatively **young age structure** of the region's population (43 per cent under the age of 14 years) poses serious challenges to the provision of educational and health services[4], and increase the 'dependency ratios' within Arab societies.

c) Uncertain oil price prospects, the poor performance of manufactured exports, and the likely deterioration of the income terms of trade for most Arab countries, increases the vulnerability of Arab economies to external shocks.

2. Economic reform programmes and policy shifts

2.1 The liberalisation drive

Many Arab countries embarked on economic reform and structural adjustment programmes (ERSAP's) — Morocco (1981); Tunisia (1986); Jordan (1988); Egypt (1991) and, more recently, Algeria (1994). While insisting on the re-establishment of macro-balances, especially on the **external** and **fiscal** accounts in the short and medium term, the main thrust of these reforms covered more important areas, namely:

i) price liberalisation;
ii) trade liberalisation;
iii) financial liberalisation
iv) reform of public enterprise and privatisation.

Price liberalisation constituted the 'master piece' of the reform packages, as several Arab countries took serious steps to liberalise their domestic price systems, including through adjustments in the prices for major agricultural and for energy products[5]. **Trade liberalisation** was another key element of the new reform package, as steps have been taken to relax trade restrictions, to reform the exchange rate régime, and to reduce nominal tariffs on imports[6].

Many Arab countries have also embarked on a process of **financial liberalisation** as part of their financial sector reforms. "The reform challenges in the financial sectors of many Arab countries include three key elements: (i) rationalising the rates of return structure, thus supporting the mobilisation and allocation of loanable funds; (ii) deepening money and capital markets in the formal sector of the economy; and (iii) strengthening prudential regulation and supervision"[7].

Improving the financial intermediation process seems to be the crucial element in the derive to reform the financial sector in the Arab region. These intermediation activities extend to nonbank financial institutions (i.e. the insurance companies and the stock exchange). In fact, the market for equities in the Arab world remains very thin as market capitalisation of **traded equities**, constituted a very small fraction of the GDP of Arab economies. According to financial data relating to 1992, the ratio of market capitalisation of traded equities to GDP stood at 6.2 per cent in the case of **Egypt**, 6.6 per cent in the case of **Morocco**, 7.5 per cent in the case of **Jordan**, and 0.3 per cent in the case of **Tunisia**, as compared to **Chile** (7.8 per cent), **Mexico** (43 per cent), **Turkey** (8.9 per cent), **Pakistan** (15 per cent)[8].

As for the process of public enterprise reform and privatisation, it is still in its early stages in most Arab countries as this process has been delayed by concerns about the absorption of 'redundant labour' and "by difficulties in addressing the large financial obligations of the enterprises — obligations that not only involve direct contingent budgetary liabilities, but also affect the soundness of the domestic banking system"[9]. In brief, the current slow pace of the 'privatisation programme' in reforming Arab economies is largely due to the inherent problems relating to the **thinness** and **narrowness** of Arab financial and capital markets.

At a purely technical level, it is to be noted that a serious problem of 'sequencing' exists, as the World Bank and IMF designers of the 'privatisation component' of the ERSAP's failed to establish a correspondence — in **time** and **space** — between the **target** (privatisation) and **the instrument** (efficient financial intermediation).

Nevertheless, reaching a certain 'policy frontier', satisfying the World Bank and IMF cross-conditionality, does not mean by itself that the transition path from reform to sustainable growth would be a smooth or a sustainable one. Such 'transitional path' is likely to be plagued by a host of macro and micro problems. More precisely, while the stage has been set for private growth through stabilisation and adjustment policies, the dynamic supply response may not be forthcoming at the right **time** and with the right **magnitude**.

On the other hand, the new literature on growth makes the process of 'endogenous growth' crucially dependent on the **externalities** generated by human and physical capital accumulation. Azariadis and Drazen (1990) went as far as to show how a threshold requirement in the **externality generated by human capital accumulation** can yield multiple steady states in per capita growth[10].

2.2 Unemployment and return migration: Challenges and policy concerns

At the moment, well over 10 million people are currently unemployed in the Arab region (Diwan and Squire, 1992). The structure of **reported** unemployment is distinctive with a high proportion of the employed being new entrants to the labour force, of whom a significant portion are university and secondary school graduates. Growing unemployment in the Arab economies points to serious malfunctioning of labour markets as well as the lack of a vigorous strategy of growth and development. If Arab countries were to keep pace with the current rates of population growth and annual additions to the labour force, these countries need to create employment and income-generating opportunities for 4 million people each year (*ibid.*).

The prospects for increased out-migration are limited in the near future, and remittances are likely to fall as a share of GNP in the receiving countries. The only solution for the currently **unemployed** and for the future labour market entrants lies with the resumption of economic growth. The efficient mobilisation of workers' remittances within an export-oriented growth strategy seems crucial in this respect, in order to maximise the export-employment linkages within the national economy. Table 2 shows that Arab countries benefited from large inflows of workers' remittances which constituted a significant proportion of the GNP of these countries during the 1970s and the 1980s.

Table 2. **Workers' Remittances[a] as a share of GNP**
(Percentages)

Country	1970-74	1975-79	1980-84	1985-89	1990	1991
Algeria	4.4	1.7	0.7	1.4	2.6	3.0
Morocco	2.7	5.4	6.7	8.3	9.3	8.6
Tunisia	2.9	3.5	4.4	4.9	5.9	5.4
Maghreb countries	3.5	3.0	2.4	3.1	4.8	5.2
Egypt	1.2	8.2	12.1	10.6	13.5	13.3
Jordan	3.0	18.2	18.4	14.3	12.1	10.5
Occupied Territories	20.2	22.9	30.5	26.8	26.4	25.6
Syria	0.8	3.7	3.1	3.1	3.0	2.8
Yemen[b]	n.a.	n.a.	n.a.	6.6	21.8	10.9
Mashrek countries[c]	1.8	8.1	10.3	9.9	11.5	10.6

a. Refers to current transfers for Algeria, Morocco, Tunisia and Israel.
b. 1985-89 average refers to 1989 only.
c. Does not include Lebanon and Yemen because of lack of data.

Source: World Bank (1993).

The phenomenon of 'return migration' assumed significant dimensions by the mid-1980s in the case of Arab sending countries. The flow-back of returning Arab 'guest workers' from oil-rich States may be decomposed into two components:

a) the flow-back due to economic recession and the replacement of Arab 'contract migrants' by Asian migrants;

b) 'forced' massive flow-back due to certain political events (the end of the Iraq/Iran war, and the Iraqi invasion of Kuwait).

Given the size of the stock of the 'returnees', there is an urgent need for appropriate planning to enhance the process of absorption and reintegration of migrant workers and their dependants in the national economies. The gradual loss of 'workers' remittances' constitutes another major policy challenge, as the current situation is not likely to be sustainable in the future due to the possible decline in the share of workers' remittances in GNP in the second half of the 1990s due to the combined impact of: (a) the 'saturation effect' (i.e. the slowing-down of demand for the unskilled grades of Arab migrants workers); (b) the 'substitution effect' replacing Asian labour for Arab labour in the intermediate occupations; and (c) the 'recession effect' causing a short-fall of demand for all grades of migrant Arab labour.

In the face of these challenges, a growth strategy centred around export-oriented activities constitutes a necessity to compensate for the gradual loss of foreign currency remittances, associated with the systematic decline of the stock of Arab Mashrek 'guest workers' working in Gulf countries, and Arab Maghreb workers migrating traditionally to Europe. Thus, out-migration in the major Arab labour-exporting countries (Egypt, Yemen, Jordan, Sudan, Algeria and Morocco) should be viewed as a transitory phenomenon, stimulated mainly by the surge in oil revenues in the Arab region and by high growth in advanced Western countries. New, more reliable, and sustainable venues for growth and employment need to be thought out, bearing in mind the scale of the secular supply-side increase driven by population growth.

A dynamic policy of 'export-substitution' based on the evacuation of the traditional export lines of textiles, ready-made garments, food products and embarking on new lines of exports (e.g. leather products, light chemicals, light engineering goods, electrical products) where the Arab economies of the Mashrek and Maghreb could exhibit more adaptability and a certain measure of competition in response to a rapidly changing world economy, could yield better employment and growth returns.

Employment in the **formal business sector** is expected to make a greater contribution to aggregate employment and employment growth in future years, with the dramatic slow-down of growth in public sector employment and the saturation and overcrowdedness of the urban informal sector. The capacity of the private business sector to absorb labour, while transforming its structure towards tradables, would crucially depend on **growth impulses** stemming from the demand side (domestic or foreign).

In the longer term, effective solutions to the unemployment problem in Arab countries would have to be conceived within the framework of regional co-operation, to break-out of the constraints set by the limits of the domestic market. Such a 'regional solution' would open the way to the Arab labour-sending economies **to replace exports of its labour by exports of its products** to the neighbouring Arab countries and other regional markets.

3. The challenge of transition from reform to growth

The restoration of macroeconomic discipline and the liberalisation of the economy does not guarantee by itself growth in the medium and longer terms. It is usually claimed that successful 'structural adjustment' raises growth in the medium term, typically after a transitory period of low growth or outright recession. The mechanisms of transition from reform to growth are often neglected, or are simply based on textbook paradigms rather than on the economic realities of each Arab country. Arab countries which suffer from low real GDP growth and high levels of unemployment (especially among the educated youth and the new entrants into the labour market) badly need high-quality growth.

In fact, Arab economies do not suffer from lack of savings or investible funds, but the problem lies with the very liquid nature of the savings (deposited with the domestic or foreign banks, and invested in government financial instruments). The weak supply responses and the 'semi-rentier' behaviour of private investors (seeking high returns in the shortest possible time), and the faulty sectoral composition of private investment, constitute the main factors underlying the slow-down of GDP growth and the low employment creation in the Arab region. All these factors contribute to an inefficient pattern of allocation of national savings and to low social productivity of aggregate investment within the Arab economies.

The decline in the level of **public investment** in adjusting countries in the Arab region without any compensation on the part of **private investment** poses a problem for the process of dynamic transition from 'reform' to 'growth'. Data shown in Table 3 illustrate this point with reference to three adjusting Arab economies: Egypt, Tunisia and Morocco. As can be easily gleaned from these statistics, the decline in the levels of public investment in Egypt and Morocco was not compensated for during the adjustment period, while private investment was on the rise in a country like Iran with no ERSAP and with a lot of political problems.

Table 3. **The share of private and public investment in GDP (1980-92)**

(Percentages)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992
Egypt													
Private			9.1	6.5	5.8	6.1	6.4	6.0	6.7	10.5	9.1	8.7	7.8
Public			21.0	22.2	21.7	20.5	17.3	12.0	15.5	12.7	12.8	11.8	10.4
Iran													
Private	10.9	9.5	6.9	11.5	12.1	10.1	7.7	7.3	7.5	8.1	10.0	9.1	14.0
Public	10.4	9.4	9.5	9.0	8.3	6.6	6.0	5.2	5.1	5.1	7.2	7.8	12.1
Morocco													
Private	11.8	11.4	13.4	11.8	11.2	12.1	12.2	11.6	11.8	13.2	15.4	12.2	13.4
Public	10.4	14.5	13.9	12.6	11.9	11.0	9.1	8.6	8.7	9.6	8.4	10.1	10.7
Tunisia													
Private	13.3	14.8	15.4	14.2	13.6	12.3	10.5	9.3	9.7	10.7	11.3	9.8	10.7
Public	15.0	16.2	18.6	17.6	17.1	14.5	13.5	11.0	9.6	10.0	11.6	12.3	11.9

Source: IFC, *Trends in Private Investment in Developing Countries*, Discussion paper No. 20 (Washington, 1994), p. 42.

As a result, a vicious circle is at work: without investment, reform will not be sustainable, but investment will not be forthcoming in the presence of uncertainty as to future outcomes of the reform[11]. The ensuing costs in terms of foregone growth are substantial.

In the absence of a model of 'shared growth' in the longer term — along **Asian lines** — the liberal economic policies in the Arab region will lose credibility over time and may eventually collapse. Timely foreign aid could only smooth short-term transitional costs of reforms and adjustment (by reducing the political resistance of the most adversely affected groups), but it cannot induce growth effects and sustain liberal economic reforms on 'borrowed credibility'.

As the crisis of transition from 'reform' to 'growth' deepens, the Arab economy may witness an increasing degree of 'informalisation' of economic activities. For, with the speeding up of the growth of the modern and tradable sectors, modern formal employment of unskilled and semi-skilled labourers will be severely reduced. This leads to a higher degree of 'casualisation' of the workforce in society, with low and unstable incomes.

The 'informal sector' is usually conceived as a **sponge** for labour, taking back and releasing unskilled workers and own-account operators, as demand conditions dictate. Nonetheless, while the 'informal' part of the economy enjoys a high degree of flexibility due to a variety of mechanisms — sharing out a certain workload, rationing, etc. — the fact remains that there is a limit to the amount of 'employment creation' within the informal sector of the economy. In fact, the rate of employment creation (however casual) in the informal parts of the economy is not totally divorced from the level of activity and the level of earnings generated within the formal parts of the economy. It can be shown, in the case of a closed economy, that at any one point in time, an equilibrium configuration could be established between the amount of employment in both sections of the economy (formal and informal), which ultimately depends on the size of total earnings generated in the formal parts of the economy[12]. In brief, supply does not create its own demand (according to **Say's law**) within the confines of the informal economy. In short, in the absence of vigorous (and not lopsided) growth, the unemployment and the social crisis is likely to deepen and not to lessen.

4. The regional dimension

4.1 Macro-policy coherence and co-ordination

Prior to any derive towards regional co-operation and integration, an improvement in policy coherence and co-ordination among countries of the region is required in all areas of macroeconomic policy-making — exchange rate, credit policy, investment licensing, targeting foreign aid flows, etc. Such coherence in macro-policy rules constitutes one of the conditions for effective Arab economic integration.

The co-ordination of macroeconomic policies at the regional level would increase the externalities from national policy decisions. These co-ordination and policy coherence efforts should be directed to control and harmonise **debt** and **deficit** levels, by adopting broadly-agreed **fiscal rules**. If we take the **Maastricht Treaty** as an example, we appreciate that four conditions were laid down for admitting a country to the union[13]:

1. A consumer price **inflation rate** no more than 1.5 percentage points above the average for the three countries with the lowest inflation rates;

2. Average nominal long-term **interest rates** no more than 2 percentage points above those for the three countries with the lowest inflation rates;

3. No **exchange rate** realignment for at least two years;

4. A sustainable government financial position, defined as a general government deficit to GDP ratio of less than 3 per cent and a gross debt to GDP of less than 60 per cent.

Hence, it is clear that a certain number of 'convergence criteria' need to be respected in areas of **monetary, foreign exchange and fiscal policies** in order to enhance the process of co-ordination and integration at the regional level. Gains from macro-policy co-ordination could pave the way to a much closer co-operation and integration in **investment and growth policies.**

4.2 Regional arrangements

Globalisation and regionalisation constitute the two Central tendencies governing the world economy today. According to Charles Oman (1993), regional arrangements and regional pacts could be the outcome of one of two processes:

i) a **political process**, i.e. a *de jure* process driven by political forces leading to *de jure* regional arrangements among governments; or

ii) a *de facto* economic process driven by microeconomic forces that tend to promote *de facto* gradual regional integration via the strategies and behaviour of firms and other economic agents, even in the absence of *de jure* regional institutions.

Ultimately, a process of *de facto* regionalisation will be accompanied, as things mature, by *de jure* regional arrangements. Nonetheless, the problem in the Middle East is: which comes first? Here it is a matter of 'political feasibility', rather than pure 'economic feasibility'. In Pacific Asia, for instance, which comprises Japan, the four tigers, the ASEAN countries and China, the move towards greater regional integration remains largely a *de facto* process. A leading Asian economist (Ippei Yamazawa) argues that differences in levels of development, stages of industrialisation and differences in resource endowments militate against integration along the lines of the EEC model[14].

At the heart of the intellectual debate in the Arab region today is the advisability of regional and subregional arrangements involving Israel in a post-peace settlement era, notably a Middle Eastern Free Trade Area.

In the Middle Eastern context, the real challenge lies in how to handle contradictions and to shape potential regional arrangements to be supportive of a sustainable peace process, which is consistent with the full respect of the free will and aspirations of peoples of the region. Various documents and studies (including the EEC) emphasized the formation of a Free Trade Area in the Arab East (involving Egypt, Israel, Palestine, Jordan, Syria and Lebanon). This arrangement was viewed as a key agenda item in the post-settlement era.

On the other hand, **static** gains from closer regional co-operation and integration have invariably been secondary to the **dynamic** ones. The dominant impulse for many Arab countries to seek closer economic integration (within a Mediterranean or Middle-Eastern context) would be to attract capital and modern technology rather than to derive benefits from freer trade. At the moment, the expected pattern of flows of foreign investment could act as a powerful instrument in reinforcing the "hegemonic dominance" of Israel within the newly-suggested FTA.

A long transitional period of confidence-building is required to eliminate the roots of hundreds of years of intense conflict. Moreover, partner countries in any regional co-operative scheme need to cross a certain "threshold" of similarity in their economic and strategic objectives before any partial surrender of national autonomy. This process has to occur in a smooth and voluntary fashion, thus excluding the subordination of any country of the Arab Mashrek to exogenous rules or to the strategic preferences of another powerful regional power. For any set of "forced" regional solutions, schemes, or rules of behaviour will run the serious risk of political unacceptability and unsustainability.

A gradual and more cautious approach to economic regional co-operation in the Middle East is likely to yield more tangible and irreversible results, and would ultimately enhance the process of development, democracy and stability in the region, with the full respect of Arab's aspirations to progress, interdependence and integration.

In sum, because of fears of dominance by Israel under any FTA (i.e. MEFTA), there is an urgent need for schemes involving a high degree of economic co-operation and integration among subgroups of Arab countries *prior* to any negotiations with Israel. This approach has a concrete parallel in the case of Latin American countries. Because of fears of dominance by the United States under FTA, a Southern Cone Common market (Mercosul) among Argentina, Brazil, Uruguay and Paraguay was signed in March 1991, and a new life is also being breathed into the Andean Common Market as its members established ground rules for a free trade zone by the end of 1991 (see Fishlow and Haggard, 1992, p. 27).

Within the Arab context, the minimal action that could be developed is to build Arab regional (or subregional) co-operation out of bilateral deals without an explicit regional organization or governance structure. Such an approach would lead to a deepening of economic relations and harmonisation of macroeconomic policies among Arab countries. Whatever form such inter-Arab co-operation over trade, investment and macroeconomic policy might take, it would presumably provide a counterweight to powerful regional economies: Israel, Turkey and other Mediterranean countries. There is no reason to think that past failures in the field of inter-Arab economic co-operation and integration predetermine the failure of future attempts in this respect.

At any rate, despite the major decline in the volume of nominal oil revenues, Gulf States continue to enjoy a much more comfortable financial position than the rest of the Arab countries, as they remain largely 'surplus countries'. Hence, there is ample room for a variety of financial solidarity mechanisms between Gulf countries (as the rest of Arab oil countries — Iraq, Algeria and Libya are already in a very bad financial shape) and the non-oil countries. Among the most conceivable mechanism and instruments in this respect:

1. Buying a large portion of the external debt of non-oil countries, which is now traded on the secondary market. Such a step could help to alleviate the burdens of the debt problem in many Arab countries while offering Arab Gulf States with new and lucrative investment outlets (e.g. debt-equity swaps).

2. Establishing joint ventures with other Arab countries to foster the development of some key sectors at the regional level: industry, agriculture, services, and research and development (R&D).

Unless Gulf oil-producing countries back the development of other non-oil countries in a substantive way, there will always be disparity problems affecting the political stability of the Arab region. Investing in the development of other Arab countries (especially Egypt and the Arab Mashrek countries) constitutes the Gulf States' only 'insurance policy' for the future. The current pattern of use and recycling of petrodollars in these countries does not enhance the long-term development of the Gulf economies in the post-oil era, and leads to great frustrations and tensions in the rest of the Arab world.

A concerted regional effort of co-operation seems mandatory for the rest of the 1990s and for the opening decade of the 21st Century. The major axes of future regional co-operation may be listed as follows:

1. The joint environmental management, according to a concerted regional (and multi-country) effort.

2. Enhancing intra-regional trade flows (intra-Maghreb, intra-GCC, and intra-Arab at large). At present (1990), intra-Maghreb trade is around 2.3 per cent as compared to 17.8 per cent for the intra-ASEAN trade.

3. To rationalise labour migratory flows among Arab countries and to improve the efficiency of use of workers' remittances. For while workers' remittances as share of GDP reached high levels in many Arab countries (1990) — 15 per cent in North Yemen, 13 per cent in Jordan, 11 per cent in Egypt, and 8 per cent in Morocco — the developmental impact of such remittances remained very limited.

4. Joint regional investment venture in physical infrastructural projects, which generate dynamic externalities for all participating countries.

5. The State and the civil society: The need for a new 'social contract'

5.1 The shrinking space of 'public goods' and the de-legitimisation of the State

The provision of social services and public amenities (mainly education, primary health care, and public transport) by the State at subsidised and affordable prices was a major source of legitimisation of the State in the Arab World since the 1950s. The more recent evacuation by the State of the space of 'social goods' under the pressure of the fiscal crisis of the State budget and the new privatisation drive, leads to serious problems concerning the future balance between the State, the market, and the civil society.

The provision of the public goods and social services through the market mechanism at prices (or users' fees) hardly affordable by individuals belonging to the bottom 50 per cent of the population, leads to inequitable accessibility to these basic services. As a result, informal health and education delivery systems to the urban poor, gradually evolve through a new network of clinics and schools mainly sponsored by Islamic organisations and agencies.

Hence, the failure of the market to satisfy the basic needs of the urban poor at this very elementary level (i.e. , inequitable rationing of educational and health services) leads to a decentralised and politically-sponsored forms of provision of basic social services at the community level. These practices contribute, in turn, to a political undermining of the legitimacy of the Arab State and thus giving way to what might be termed the **'Robin Hood effect'**.

Nonetheless, the provision of other social services which requires huge amount of capital outlays (i.e., roads, public mass transit) are beyond the financial capabilities of any communal and politically-motivated collective initiatives. The State's failure in this domain will be severely felt by the poor as well as the middle segments of the population.

5.2 The need for a new national consensus-building

The Arab region is currently in the midst of "a profound crisis of political legitimisation, rooted in the marked downturn in material conditions"[15]. In fact, the socio-economic foundations underpinning the political order in the Arab region throughout the 1970s and 1980s (i.e., massive inflows of oil rent, workers' remittances, and foreign aid) are likely to change dramatically in the 1990s, thus entailing a thorough process of economic and political restructuring and rebalancing.

So far, there is no genuine mechanism to build up national consensus on major political and economic issues in most Arab countries. Under the new economic liberalisation drive in the Arab world, there is an urgent need to work out a new 'social contract' to regulate the relationship between labour and capital and to reconcile 'private' welfare with 'social' (or community) welfare.

The call for a full-fledged 'national dialogue' among various political groupings and social forces, at the country level, could open the way for a genuine process of a new national consensus-building. There is an urgent need for such new consensus-building in Algeria, Iraq, Sudan and many other politically-troubled countries. The national dialogue, once begun, could well develop into an all-party national conference leading to a new consensus based on national renewal, socio-political reforms, and a new social pact. Thus we can move away from short-term conflict resolution to the longer-range view of a sustainable consensus-building mechanism.

The major issues crucial to the process and mechanisms of the 'consensus-building' in Arab society relate primarily to packages of domestic reform, strategies of growth, and regional development. More specifically, two issues stand out:

a) How to allow for individuals to choose not only between a specific reform programme (designed by the Bank and the Fund) and the *status quo*, but also among alternative reform and growth strategies;

b) The need to assess **the distributional consequences** (gains and losses) of reform and growth packages across various social-economic groups.

Hence, new institutional structures need to be evolved in order to allow for a better process of consensus-building, thus ensuring a higher degree of political and economic stability. Most important and crucial in this respect is the 'time-lag' between the demolition of the old economic régime and reaching the new 'steady-state' in the post-reconstruction period. The real challenge lies in how to make the economic and political transitions in the Arab world credible, stable, and sustainable.

NOTES

1. cf. Diwan and Squire (1992), *Economic and Social Development in the Middle East and North Africa* (Washington: The World Bank discussion paper series).

2. cf. Diwan and Squire (1992), pp. 5-6.

3. *Ibid.*

4. *Ibid.*, p. 5.

5. cf. M. El-Erian and S. Tareq, *Economic Reform in Arab Countries*, IMF Working Paper (WP/93/39) — processed — (April 1993).

6. *ibid.*

7. *ibid.*, p. 9.

8. cf. R. Feldman and M. Kumar, *Emerging Equity Markets: Growth, Benefits and Policy Concerns*, IMF Policy Analysis Paper (Washington: March 1994), Table 1.

9. El-Erian and Tarek, *op. cit.*, p. 6.

10. cf. C. Azariadis and A. Drazen, "Threshold Externalities in Economic Development", QJE (1990), No. 105, pp. 501-26.

11. cf. Rodrik, "How Should Structural Adjustment Programs be Designed?", *World Development*, Vol. 18, No. 7 (1990), p. 936.

12. This result can be obtained under a set of simplifying assumptions. cf. Fitzgerald (1976) and Abdel-Fadil (1980).

13. cf. Charles R. Bean, "Economic and Monetary Union in Europe", *Journal of Economic Perspectives*, Vol. 6, No. 4 (Fall, 1992), p. 44.

14. cf. The *Economic Journal* (Novmeber 1992), p. 1489.

15. cf. Editors, "The Democracy Agenda in the Arab World", *Middle East Report*, January-February 1992, p. 2.

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