

The Arab Economies in the Face of Crisis: Assessment and Perspectives since the Tunisian Revolution

El Mouhoub Mouhoud

Professor of Economics

Paris Dauphine University

The sudden changes experienced by Southern and Eastern Mediterranean Countries surprised all observers. The surprise was even greater since these countries had relatively better withstood the crisis than the ensemble of other world regions. Behind the appearances and good macroeconomic performances, all the countries in the region suffered the same symptoms, thus explaining the unexpected spread of the revolutions and the demands for democracy. These economies are characterised by a polarisation into just a few sectors, some of the weakest employment rates in the world, a rentier management of resources and corruption conducted and organised by the clan oligarchies in power, with or without military involvement. And above all, the considerable rise in educational levels since decolonisation has resulted in underemployment of graduates and abnormally high qualified labour expatriation rates.

This article analyses the nature of the economic systems in these countries, the similarities in their internal and external functioning and new regional perspectives on the horizon since the Arab revolutions.

Apparent Resilience to the Crisis and Good Macroeconomic Performances

The countries in the region weathered the 2008 global subprime crisis. First of all, the Maghreb countries and Egypt were poorly integrated into international financial markets, which allowed them to considerably limit the financial spread of the crisis.

The crisis was transmitted via three channels, however: a decline in migrant remittances, a drop in export revenues and rising prices, particularly of staple foods. In any case, the hardships were more limited in oil and gas-exporting countries, whose foreign exchange reserves allowed direct intervention on the price of staple foods, among other things, and the maintenance of public expenditure. Governments with financial capacity maintained prices of foodstuffs via direct subsidies, created youth jobs in the administration or fostered consumer credit operations and entrepreneurial projects.

After the second half of the 2000s, governments learned to manage the crises by implementing effective countercyclical policies nearly across the board that proved more or less successful: extension of fiscal incentives to investment, magnitude of interest rate reduction needed to maintain economic activity, etc. (Abdih et al, 2010). Although Egypt's macroeconomic policy was not marked by effectiveness, its performance in the sphere of governance was noted in World Bank ratings.

Tunisia, Algeria, Morocco, Oman and Saudi Arabia were thus rated among the ten countries in the world having experienced the greatest increase in human development index from 1970 to 2010.¹ Rapid progress made by countries in the region in health and education were highlighted. Life expectancy in Northern Africa went from 51 to 71 years of age between 1970 and 2010. The percentage of children being schooled went from 37% to 70% in the same period in Northern Africa. The lower birth rates in Arab countries went hand in hand with marriages at a later age and women's increased, though still low, labour force participation rate (Kateb, 2010). On average, the populations of Arab countries experienced an annual growth rate of approximately 1 to 2%, whereas the

¹ In 1970, Tunisia had a lower life expectancy than Congo and Morocco, and a child schooling rate lower than Malawi.

working age population rose by 3% each year, the employment demand by 4% and the number of university graduates by 6 to 8% (Fargues, 2011).

The Shared Scourges of Arab Countries

In the majority of Arab countries, there is a series of similarities or shared scourges that would explain the simultaneous spread of revolutionary change under diverse forms in all of them:² a polarisation of Arab economies in few sectors, rentier management of resources (including non-natural resources), extremely low employment rates associated with abnormally high expatriation rates of qualified labour and systems of corruption and predation that have grown worse. A last point in common deserves particular attention: a single external pact between Arab States and Western powers that delayed these (r)evolutions.

Polarisation of the Economy Excludes Qualified Labour

The countries in the region share the same defect: a very low diversification of the economy, which is concentrated in three or four sectors associated with the primary industries or low-added-value manufacturing industries.

Algeria, whose foreign revenue continues to depend 98% on oil and natural gas, has even experienced a decline in the manufacturing sector while agriculture has been sacrificed. The rentier nature of the regional economy is often associated with the existence of a large oil and gas industry with revenue more or less redistributed throughout the remainder of the economy. In fact, such an approach is not enough to characterise the Algerian production system. The latter is based on the coexistence of three key sectors that have very weak real links between them but that are financially related.

The public mono-export sector (oil and gas) originates nearly all foreign revenue. Contributing a third of the GDP, originating two thirds of the budgetary revenues and 98% of export revenue, this sector is a supplier of liquidities, in particular during periods when oil prices are on the rise. It powers import sec-

tors in consumer and capital goods (for the hydrocarbon and petrochemical industries), in part through the public banking system.

The countries in the region share the same defect: a very low diversification of the economy

The import sector supplies an international business sector that includes a small amount of processing (food processing industry) and assembly (electric, electronic, textile) activities. This sector accounts for a large part of informal activity and imports are financed partially through informal exchange rates and through national networks in developed countries, primarily France. Short and medium-term bank loans serve as support to import activity. Formal activity and the informal sector are thus closely inter-related. This second import sector spills over into a third sector: services, petty trade, construction and non-tradable goods in general. The desired diversification of the productive system is having trouble getting under way. We are even witnessing a decline in manufacturing to benefit the mining – phosphate and iron – and the construction and public works sectors.

The dependence of the Algerian economy on exports and volatile oil and gas revenues causes periods of excess liquidity. Symmetrically, as revenues shrink, liquidity constraints cause cash flow problems for banks.

The Libyan economy resembles the Algerian economy on a smaller scale: oil revenues account for nearly all foreign currency inflows and over half of the GDP. Its low population and oil revenue make Libya the country with the highest GDP per inhabitant on the African continent. This, however, says nothing of the distribution of this wealth between the Libyans on the one hand and the clans that continue to structure the country on the other. The 2000s were marked by a very high GDP growth rate.

The Tunisian economy, which benefits less from natural resources than its Libyan or Algerian neighbours, likewise has an economy structurally concentrated in certain sectors. Coastal mass tourism – intensive in low qualified labour or qualified (educated) but un-

² For a more in-depth analysis of the nature of these rentier States, see E.M. MOUHOUD (2012) "Political Economy of Arab Revolutions: Analysis and Prospects for North-African Countries," *Mondes en Développement*, Vol. 40-2012/2 - No. 158

deremployed and underpaid labour – represents a majority of the added value. The export sectors handling subcontracted garment assembly segments in the textile and clothing industry have had very little secondary effects on the rest of the economy, nor product recovery effects on capital goods and intermediate goods. In business support services (IT, call centres, etc.), the same path has been taken, using the classic advantages in terms of wage costs without professionalisation of manpower or using over-qualified university graduates.

There is also a small amount of agriculture and non-tradable services, whereas there are no direct investments from these countries due to their limited domestic markets. Delocalisation has most often taken place in the form of assembly subcontracting by European SMEs.

The Moroccan economy is somewhat more diversified than the others. Nonetheless, it is structurally dependent on certain natural resources, volatile agricultural revenue and migrant remittances, which continue to represent nearly 10% of Morocco's GDP.

The Egyptian economy focuses essentially on mass tourism, oil, metals and agriculture. Tourism is the premiere activity responsible for foreign exchange inflows, followed by migrant remittances. Political shocks and uncertainties have rendered these revenues volatile and fragile.

All in all, sectoral and spatial polarisations of the economy and overall performance can go hand in hand and, obviously, conceal the real shortcomings of the economies in the region.

Low Employment Rates, Graduate Elite Adrift

In all Southern and Eastern Mediterranean economies, the elevated unemployment levels, in particular among youth, the low participation of youth and women in the labour market (although on the rise in the case of women) together with the existence of a significant informal sector result in one of the lowest formal employment rates in the world (less than 40%).

At the same time, we are witnessing a considerable growth in the number of graduates from institutions of higher education and enrolment rates in universities and other institutions of higher learning. This massification of higher education is a response to

the frustrated demand for education by populations during the colonial period. Decolonisation and the populations' aspiration to an education combined with demographic growth were automatically accompanied by a rise in the secondary and higher education enrolment rates. But the crisis, which struck the non-oil exporting countries harder than the others, has led to a drop in expenditure on education and a crisis of the educational system. The annual increase in the number of students has reached 10 – 15% in Algeria, Morocco and Syria.

There are actually two categories of elite in the Arab countries. The first category of elite, limited in number, consists of people associated with the ruling class, whose families send their children to foreign schools and universities in order to gain access to qualified jobs.

The second category, comprising the mass of higher education graduates, generally from poor or middle-class families, makes up the majority. The mass unemployment among these young graduates, even those having taken selective courses of study, is even greater for youth from small cities or rural areas, where the labour market is greatly limited, and where they cannot have access even to the underemployment offered in urban centres due to the exorbitant cost of housing. As if under house arrest, they find themselves under the material and moral control of their parents.

Abnormally High Qualified Worker Expatriation Rates

In the case of Arab economies, a more marked brain drain can be observed than in other comparable regions in terms of per capita income. The expatriation rate of people with a higher education degree is greater than 10%, as compared to 8.3% in Latin America and 7.1% in East Asia. The main flows linked to highly qualified labour migration come from Northern Africa, and more precisely, from Algeria, Morocco and Tunisia to France and Belgium, and more recently also to Spain and Italy. North America is increasingly attracting the most highly qualified. The "new migrants" of the 1990s and 2000s – young men and women qualified as "*Harragas*"³ – seem to feel little attachment to their countries of origin and do not express the desire to return (Miotti, 2010).

³ A term of Maghreb Arab origin meaning "those who burn" (i.e. their papers, referring to their identity documents).

The Tunisian revolution has consolidated the rupture of this implicit internal pact according to which the political elite had a protected place on the qualified labour market and the educated elite stemming from the poor and middle classes were relegated to underemployment and a difficult home situation or expatriation, at times combined with underemployment abroad.

Corruption and Drain on Economies

Institutional stagnation and widespread corruption erode “capabilities”, to cite Amartya Sen, as well as trust. This ends up reducing efficiency and detracting from the productivity of work. There is a corruption ceiling attained by these countries beyond which their efficiency to produce trust insofar as a social practice substituting Rule of Law disappears, replaced by aspects of erosion of trust and “capabilities.” Monetary poverty is limited by remittances (sent by émigrés) and the organisation of social networks through family solidarity and government support in the form of keeping staple product prices low or granting employment with the Administration. But the implicit social contract that underlies this solidarity fosters clientelist practices that tend to tie individuals to the owners of the portions of political or administrative power. Finally, progress on formal regulations is blocked and traditional operating practices continue to prevail (Ould-Aoudia, 2006). In fact, an external pact has long delayed the changes underway. Throughout the 1990s, this pact tied the ruling classes in the Southern and Eastern Mediterranean to EU States, first and foremost France.

Implosion of the System of Euro-Mediterranean Relations

The Arab revolutions have caused an implosion of the internal social contract among the elite, but also of the external pact between Arab States and Western powers. The States in the region all – bilaterally and not cooperatively – signed trade liberalisation agreements with the European Union that were unfavourable to them. Neither agricultural products nor trade in services were included in the agreements,

which were limited to manufactured goods for which Southern Mediterranean countries had low export capacities. The motivation for these States generally lay in the search for legitimisation of international policy at the risk of economically losing in an asymmetrical free trade agreement to their detriment.⁴

The decrease in export revenue, associated with the absence of competitiveness of their manufactured products on European markets on the one hand, and the maintenance of barriers against agricultural products on the other, could only be compensated by revenue from tourism, migrant remittances and direct foreign investment, too low in any case. In exchange for the EU's political recognition, encouraged de facto through the signature of these agreements, Southern States committed to conduct a repressive emigration policy against their citizens and those of Sub-Saharan Africa in transit through these countries. The commitment of signing countries to readmit their citizens when they are deported from Europe and restrict the right of their citizens to emigrate in exchange for marginal development aid clearly means that Europe is delegating its policy of repressing immigration to Southern Mediterranean States, in particular the Maghreb.

Clearly, neither the European Commission through the European Neighbourhood Policy (ENP), nor France through the embryonic Union for the Mediterranean (UfM), can continue in the logic of legitimising the ruling classes of Southern Mediterranean States. At the same time, regional processes already underway in the South may be accelerated.

New Regional South-South Perspectives

The transaction costs at the borders of the different Middle East and North African (MENA) countries are higher than between each of them and the EU. Due to high tariff and non-tariff barriers between the MENA countries, the markets in the region are greatly fragmented and bilaterally oriented towards Europe. The low diversification of Maghreb partner countries can be ascribed in part to an absence of the will to build a real regional market, despite the implementation of the Greater Arab Free Trade Area (GAFTA) agreement, whose effects are analysed

⁴ In the case of enlargement agreements with the Central and Eastern European Countries (CEECs), there was a clear advantage to the benefit of the CEECs, which kept a certain number of barriers to EU countries while the latter committed from the outset to fully open their borders to the former.

below. Intra-regional trade represented but 10% of the commerce in MENA countries in 2007. However, the situation differs greatly from one country to another: Syria, Lebanon and even Jordan send over half of their exports to countries in the region. For seven other States, in contrast, in particular in the Eastern Mediterranean, only 10% to 20% of their overall exports go to countries in the region.

For all others, and especially Maghreb countries, the proportion of exports to the MENA region does not surpass 8% of their overall exports. Trade volumes between MENA countries are significantly lower than what one would expect from their economic, cultural and geographical characteristics. According to recent estimates, these countries carry out 86% less trade than their characteristics would allow (Bhattacharya, 2009).

This market compartmentalisation in MENA countries explains to a great extent the low inflow of direct foreign investment (FDI) apart from oil and gas. Stagnation induced by economic policy or structural factors curbs trade and economic growth in general, which should be two to three points higher than its current level.

Therefore, the GAFTA free trade agreement, concluded by 14 Arab countries at the Cairo Arab Summit in 1996⁵ and currently including 17 of the 22 Arab countries, has already produced interesting effects. From 1997 to 2009, GAFTA markedly increased intra-regional trade (after deducting the effects of trade diversion); indeed, by 26.6% (Abedini, 2008). Yet non-tariff barriers between the Member States remain significant (evaluated at 30% in tariff equivalent). Trade in services and the free circulation of skilled labour at the regional level should reinforce this integration agreement.

Also worth considering is the new geopolitical space opened by Turkey's "eviction" from the prospects of integration into the EU. Since EU governments proposed substituting an Association Agreement for the prospect of accession to the EU, Turkey has re-deployed its geostrategic efforts in the region. Moreover, its economically advanced situation and technology and work productivity levels, higher than the average in Southern European countries, could allow Turkey to play the role of relay country contributing foreign direct investment and technologies ap-

propriate to a regional zone sharing institutions and with a common religion. Finally, regional integration led by Turkey could help the Arab Maghreb Union, which always runs up against the political difficulties of the Algeria-Morocco pair, to overcome its "stand-by" situation.

Already a strong demand for trade with Turkey can be observed in the Maghreb countries, even if the Turkish supply is still below its potential. Although Turkish trade remains focused towards Europe, its direct investment in the services sector, construction and industry is on the rise in the Maghreb. Entrepreneurs in these countries identify with their Turkish counterparts, whose technological and managerial offer is perceived as better adapted to local needs. Finally, with the current crisis of the European Monetary Union, a more integrated North-South Mediterranean area could result from the double process of divergence between Southern European countries and those of the core euro zone on the one hand, and the growing role that Turkey will play in the regional dynamic in the Southern Mediterranean on the other hand. Also, the current period of political changes throughout the region (Tunisia, Egypt, Libya) and the acceleration of reform in the other countries, independent of the institutional nature of the political regimes to be established, is propitious to the acceleration of regional construction that would also allow renegotiation of the free trade agreement with the EU on a new basis.

Conclusion

The new perspectives of regional integration between Southern and Eastern Mediterranean Countries, including Turkey, should be the basis for re-examination and re-evaluation of EU Association Agreements on a multilateral basis within the framework of the European Neighbourhood Policy. Southern countries should renegotiate with the EU the content of the free trade agreement but in a multilateral and not bilateral manner. Issues such as the free circulation of skilled labour, the liberation of services sector trade and taking into account agricultural interests of countries in the region should be on the negotiating table.

⁵ United Arab Emirates, Egypt, Kuwait, Saudi Arabia, Syria, Tunisia, Morocco, Sudan, Oman, Qatar, Lebanon, Iraq, Bahrain and Libya, later joined by Jordan, Palestine, Yemen and Algeria. Completion was planned for 01-01-2007 at the latest, but the Amman Arab Summit of 2001 accelerated the period of application to arrive at zero tariffs by 01/01/2005.

In a post-revolutionary perspective, MENA countries should develop regional integration, relying on the GAFTA. Together, they should renegotiate the free trade agreement with the EU, demanding both the opening of EU agricultural markets and temporary asymmetry to the benefit of MENA countries.

Clauses should be included relating to the participation of Southern Mediterranean countries in EU research and innovation programmes (calls for proposals). Likewise, rentier behaviour should be banished on the qualified labour market, systematically developing calls for proposals for each qualified opening and justifying each recruitment by indicating the CVs of both the selected and the rejected candidates on the public or private employer's website.

It is important that businesses and governments in Southern countries negotiate co-contracting or OEM (Original Equipment Services) contracts adapted to services stipulating the use of local managers in the co-contracting subsidiaries (they should not accept being subcontractors and relegating graduates to positions in call centres). The education policy should make better use of technical subjects and social sciences directed towards the professional services sector as a whole.

A policy of collective services adapted to territorial needs should ensure complete access to transport and telecommunications infrastructures. Public infrastructures should be financed on a clear basis using subscription operations eliminating full State subsidisation, which is a source of clientelism and corruption as well as low durability.

These proposals, which can be elaborated upon, are a response to the challenges of Arab economies in transition towards democracy. They do not exclude additional measures more specifically targeting industry and other sectors of the economy.

Bibliography

- ABEDINI J., PÉRIDY N. "The Greater Arab Free Trade Area (GAFTA): An Estimation of Trade Effects," *Journal of Economic Integration*, 23(4): 848-872, 2008
- ABDIH Y., LOPEZ-MURPHY P., Agustin ROITMAN, and Ratna SAHAY, "The Cyclicity of Fiscal Policy in the Middle East and Central Asia: Is the Current Crisis Different?" *IMF Working Paper*, WP/10/68, 2010.
- BHATTACHARYA Rinaet and WOLDE Hirut. "Constraints on Growth in the MENA Region," *International Monetary Fund Working Paper*, 2009.
- DUPUCH S., MOUHOUD E.M., TALAHITE F. "L'Union européenne et ses voisins méditerranéens : les perspectives d'intégration," *revue Economie Internationale*, No. 97, CEPPII, 2004.
- FARGUES Philippe. *Voice after Exit: Revolution and Migration in the Arab World*, www.migrationinformation.org, consulted on 12/05/2011
- KATEB Kamel. "Transition démographique en Algérie et marché du travail," *Confluences Méditerranée* 72, April 2010.
- MIOTTI L., MOUHOUD E. M., & J. OUDINET. "Determinants and Uses of Remittances to Southern and Eastern Mediterranean Countries: Insights from a New Survey," *Development Working Papers* 288, Centro Studi Luca d'Agliano, University of Milan, revised 30 April 2010.
- MORIYAMA Kenji. "The Spillover Effects of the Global Crisis on Economic Activity in MENA Emerging Market Countries — An Analysis Using the Financial Stress Index," *IMF Working Paper* WP/10/8, 2010.
- OULD AOUDIA Jacques. *Croissance et Réformes dans les pays arabes méditerranéens*, Notes et Documents n°28, Paris: Agence française de développement, 2006.
- TOCQUEVILLE Alexis (de). "L'ancien régime et la Révolution," Vol. 4: *Œuvres complètes*, M. Lévy, 1866, 7th edition (1st edition 1856), 446 p.