

Strategic Insight

Economic Stress and Instability in the Arab World

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Although many of the generating forces behind the instability, violence, and anger within the Arab world^[1] may not be economic in nature^[2], general and particular economic stagnancy and instability over the last couple of decades has not helped to cool the ferment of the region. If anything, declining real incomes, declining real wages, inequalities of income, wealth and opportunities, underemployment and unemployment, poverty, housing stress, slow diversification of the economies, continuing low levels of industrialization, high levels of actual illiteracy and the crises of quality in education, economic corruption and repression, demographic stresses, and more have magnified festering political and social problems.

The average per capita income in the Arab world is about \$2100-2300.^[3] There are about 240 million persons in the region. Total GDP might be on the order of \$504-552 billion, which is roughly 1.8 to 2 times the gross state product of Massachusetts. Even the countries that Americans presume to be wealthy are really not as strong economically as one would think. The per capita GDP of Saudi Arabia is about \$10,000. That is below the poverty line in the United States for a family of four. The country with the highest per capita income is the UAE with about \$19,000 per year. This is not exactly an impressive sum to the ears of an American. So if there is so much oil wealth, why is the per capita income so small? Too many people have too little, and too few have much may be part of the answer for some Arab countries. There is poverty in the Gulf Cooperation Council (GCC). There is also massive wealth. Also, for those who like to point to the GCC countries as bastions of wealth, one should remember that 90% of the Arab population resides outside of the GCC. There is inequality within these countries, and most certainly across these countries—and more than just in income.

In a country like Egypt, the income inequality numbers look fairly good until you really think about them. A huge majority of the people in Egypt are scraping by in grinding economic circumstances. When one takes away the income of the wealthy (1-2% of the population) and the middle class (maybe 3-4% of the population), one could conclude that the average income of Egyptians is under \$1000 per year—even if the data shows the average GDP per capita to be about \$1300. Middle class in many Arab countries means making between \$600 and \$2000 per year. Middle class income in a country like Yemen, a country with about \$350 per capita GDP, would be the equivalent of a monthly car payment in the United States. Algeria may be one of the most unequal countries in the region, as would be Mauritania. Both are fairly poor by western standards. Algeria has a per capita income of about \$2300. Mauritania's is about \$400-450. Small wealthy cliques pretty much run the economies of these two countries.

Anyone who has visited the region long enough can see the stark wealth and income differences, and the anger and hopelessness of some of the unemployed, the poor within such wealth. (Most of the poor in the Arab world are working poor.)

Possibly as much as \$600-800 billion in Arab money is invested outside of the region, mostly in the Organization for Economic Cooperation and Development (OECD) and a lot in the United States. Imagine how much better off the Arabs would be if this money came back? This \$600-800 billion is greater than the GDP of the Arab world. The inequality data seem to not include this outside wealth, or the income generated from it. Most of these monies came out of the GCC, but there could be as much as \$40-60 billion out of Egypt.

Foreign investment in the Arab world, outside of oil and gas, is miniscule in comparison to such investments that have been pouring into Asia. Per capita foreign direct investment is the lowest for any region in the world outside of sub-Saharan Africa. Only about 3% of all Foreign Direct Investment (FDI) goes to the Arab world. The Arab world's percentage of overall world trade has declined by almost 35% since 1980 to just 3%. Most of this is oil and gas.

Manufacturing exports, a source of employment generation and income stabilization, are miniscule compared to exports of oil and gas. Total manufacturing exports of the region are far less than they could be. Manufacturing exports from Israel, population 6 million, are about \$24 billion per year. Manufacturing exports from Turkey, population about 67 million, are about \$25 billion. Total Arab world (population 240 million) manufacturing exports are about \$19 billion. Some countries, like Tunisia and Egypt have made strides recently, particularly Tunisia, in manufacturing exports. But they have not come far enough. Trade reforms have made some progress, but more slowly than elsewhere. Structural reforms have gone slower than expected or hoped for by many.

On the other hand, there have been great relative successes, especially in countries like Oman, Syria, and Tunisia, in improvements in human development indicators like life expectancy, maternal mortality, child mortality, access to sanitation and health care, daily supplies of various nutrients, and others over the last three decades. However, within the human development index list of the United Nations Development Program (UNDP) only four Arab countries land in the high human development category: Bahrain, Kuwait, UAE, and Qatar. Israel is way ahead on the scale compared to any Arab state.

Most of the Arab states have a negative number for the difference between per capital income rank and the Human Development Index (HDI) rank. In other words, their income rankings are much higher than their human development scores. Those with the largest differences in those scores are Saudi Arabia, Oman, Algeria, Djibouti, and Qatar. There seems to be a disconnection between wealth and human development. On economic and political freedom scores the Arab world also does not fare well. One wonders whether this could be part of the explanation for the disconnection between GDP and human development.

For most of the Arab countries their real per capita incomes have either stagnated or declined compared to the 1980s. Real wages in many of the countries have declined over the last two decades. Productivity per worker has on average declined in most Arab states since the 1980s. Real wages have declined often because of the pressures on them due to increasing unemployment.

Unemployment has increased in many of the Arab countries in recent years. It continues to increase. The labor force growth rates will far outrun the growths in employment in many of these countries for the near future at least. Unemployment for the entire group of countries is about 15%. Combined unemployment and underemployment could be as high as 20-25%. In some countries the unemployment rates are truly stunning: Algeria, 30%; Iraq, before the war, was possibly 50%, after the war and until recently it could be in the 80-90% range; the West Bank and Gaza could be as high as 35-50% and in some areas as much as 75%. First time job seekers have the worst of it. About 80% of the unemployed in Egypt are first time job seekers. Real wages have declined in almost all occupations in Egypt since 1980.

Even in countries like Saudi Arabia, where millions of workers have been imported, there are increasing unemployment and underemployment rates amongst Saudis. There is, most importantly, an increasing unemployment rate amongst the educated and college graduates.

Even though the population growth rates have declined in many of these countries, the labor force growth rates remain high, often in the 2.3-3% per year levels. These labor force growth rates are expected to continue for the next decade as the 0-14 year olds, in many of these countries about 30-40% of their populations, start seriously looking for long-term employment. What they may find is long-term unemployment, underemployment and frustration, unless some serious changes are made. This rising tide of job seekers could be a source of significant instability and violence in the future.

Egypt, for example, has about 1.2 million new Egyptians each year. It needs to produce about 750,000 jobs per year. It is only producing about 350,000 per year.

Throughout the Arab world, many graduates from universities find it extremely difficult to find jobs that fit their education and training. There is much frustration amongst many graduates in Egypt, for example, where it is not difficult to find MA engineering graduates driving taxis, and graduates in business having their first job, if they are lucky, as bank tellers.

A lot of potential unemployment and underemployment has been absorbed by the informal sectors of many Arab states. One wonders how much more it can absorb without pushing real earnings down even further. Unless there are significant changes in the way things are being done in places like Egypt, Algeria, Jordan, Morocco and Yemen, we may be looking at an economic catastrophe sometime within the next 15 or so years. The fact that some of the Arab states have a "capital bias" built into their policies of structural reform and development hurts employment prospects even more so.

Clearly, most of the generation of employment for the next few decades will have to be from the Arab countries themselves. Otherwise, they will be dealing with an extremely explosive situation. Even in the GCC, where population growth rates have been staying high, like in Saudi Arabia with its population growth rate of about 3% per year (one of the highest in the region), where will these people work? The highest population growth rate is in the Occupied Territories. The employment problems they will face over the next couple of decades could be terrifying. There is hope that new industries might also be started, such as in auto parts and other intermediate goods, to supply factories in the EU, for example. There is also hope in the demographic transition in the EU. The EU will need workers as its population ages in the next decades. Arabs could fill in the gap. But there will likely be competition from other groups as well. There is also a growing anti-immigrant sentiment in the EU. The GCC states will hardly be a source for employment like they were in the 1970s and early 1980s.

About 50% of all persons in the Arab world are illiterate. Women and girls fare the worst. They also are often the first to leave school and the least likely to gain any significant education. One wonders how the children learn when the mothers are illiterate or poorly educated. To be fair, there have been some great improvements in literacy rates over the last couple of decades. However, when one considers how real incomes have been in decline for most people in the Arab world for the last couple of decades, it seems that the region is an outlier in showing that the return to increased years of education is negative, or, at best, a wash. Also, when one considers that often literacy in the region is defined as attending four years of elementary school, or being able to write one's name, then one wonders what we are really talking about.

There is a huge problem with the quality of education in the region. There may be more students, and a greater percentage of persons in each age group attending school, but many in the region question what they are learning, how they are learning, and what sort of labor force and what kind of citizens are being produced from these schools.

There is a wide range of variability of quality and quantity of education in the Arab world. One can conclude, however, that many of the education systems are in need of serious overhaul.

Many point to the fact that the Arab world puts a competitively large proportion of their GDPs toward education. But their GDPs are small. Expenditures per student are far below those to be found in the EU, the United States or places like Singapore. Public expenditure on education in real terms in the Arab world has declined since 1980. It is the only region where this has happened.

R&D expenditures as a percentage of GDP are the lowest outside of sub-Saharan Africa. International patenting, and scientific and engineering publications are well behind most regions in per capita terms. There are many persons working in R&D, science and engineering, but there is something stopping them from reaching their massive potential. Some of the best and brightest of the Arab world have also fled to "greener pastures" via the "brain drain". The Arabs are also not cooperating much in science, technology and R&D. Here is yet another loss for their people. Repressive states and elites can also contribute to a low level of production of new ideas and inventions.

Housing is another issue of concern. There are significant deficits in housing in many of the Arab states. Algeria, Morocco and Egypt may have some of the most severe deficits. Iraq and the Occupied Territories, after the recent attacks and demolitions, may be in the worst shape. Many people in the region live in hovels or squatter settlements. Many do not have their properties registered, and hence cannot use them for collateral for credit—a driving force of the OECD. There is no viable mortgage market in many of these states. Often the way to purchase a house is to put 40-50% of the price of the house as a down payment, and pay the rest within the year. Mortgage markets are developing in some of the countries, but not fast enough to keep up with the demand for housing.

If one were to take an optimistic track, within these housing shortages could be a possibly great opportunity to reduce unemployment in the region. If the mortgage markets, housing and construction markets are freed up (for most of these countries these are run by the State monopolies of private oligopolies), and the tariffs on imported construction supplies are dropped, and the employment markets in construction are made more efficient, then this could be a great industry to absorb some of the new workers. They need houses. They build the houses. Supply and demand works.

Poverty seems to be on the increase in the region. Many studies point to increases in poverty in Morocco, Jordan, Yemen, Egypt and Algeria over the past decade. These are potentially brittle countries, and potentially pivotal countries for extremism and violence. Again, it is important to look at definitions. Extreme poverty in the region is often defined as living on \$1 or less a day. Just plain poverty is defined as living on \$2 or less a day. Now that may seem extreme for an American, but for many Arabs that is the way life is. About 100 million Arabs are significantly impoverished. About 14% of Arabs live under \$1 a day according to some sources. Some observers suggest it could be as much as 20+%. Possibly about 22-30% of the Arab world lives on less than \$2 a day. \$1 a day works out to \$365 per year, or about the GDP per capita of Yemen. \$2 a day works out to \$730 per year, which is probably not far from the per capita income of the Gaza strip during a good year, or the income of an average unskilled to semi-skilled working person in the urban areas of Egypt and Algeria.

About 50% of the poor are in rural areas. About 42% of Arabs live in rural areas. Most of the illiterates and otherwise poorly educated are found in the rural areas. Most development and anti-poverty schemes in the region focus on the urban areas. Some of the countries, like Egypt, Morocco, Algeria, and Yemen, have found extremist elements developed in these relatively neglected rural areas. Chronic, and sometimes worsening, rural poverty has also contributed to the rapid urbanization of many Arab states, and the many stresses and strains that go along with rapid urbanization in relatively poor countries, with fairly low levels of urban employment production. The rural poor often just become the urban poor—with dashed hopes. Some think that this rapid urbanization and the continuing poverty and hopelessness of the new arrivals in the cities has led to some rather easier recruiting for the extremists in some places.

Two decades of poor growth in the Arab world have added to the miseries of the poor. Economic growth is the best way to beat poverty in the long run. It had been possible for a while to alleviate some of the potential poverty with remittance incomes. Aid flows have also declined to the Arab countries over the last few years.

The oil booms, the peace process, the modernization programs, Arab socialism, attempts at economic liberalization, urbanization, attempts at industrialization, often feeble attempts at democratization, and more were all sources of hope for the people of the Arab world. In most cases these hopes have been dashed and shattered. For some of the youth in the region the peaceful ways do not seem to work. This is a region that has had its share of violence. If only the youth knew how much this violence, and the trillions that went into military expenditures for these wars and conflicts—and for other reasons—has costs the Arabs. Past violence has sapped the Arabs of trillions of dollars of potential income and wealth.

So what might the future hold? That is really up to the Arabs, their governments, and those who care about the region. There will be a large increase in the number of people seeking jobs in a mostly stagnant economic region. Millions more will need housing. Millions more will need schooling, and quality schooling. There will likely be increasing water and land stress. If the political and economic crises in the region continue to fester, and continuing economic stagnation remains a magnifier of these issues, then more, and, possibly more serious, trouble is to come. The multiple failures of the region open up a vacuum for the extremists. The Arabs, a great people, deserve better than what they have gotten so far—and far better than the cold and dangerous, and most likely economically more destitute, world that the extremists are offering up.

A key point to remember when considering the tough policy choices ahead is: prosperous and free people have no use for extremists.

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References

1. The Arab world is defined here as the Middle East and North Africa minus Turkey and Iran.
2. There are certainly enough factors: the situation in Iraq, the plight of the Palestinians, the relative economic failure of the Arabs compared to Israel, domestic repression, a sometimes constant sense of Arab powerlessness and humiliation on the world stage in many arenas, perceived and actual injustices domestically and internationally, and more. This is a place of ferment.
3. Data on some issues in the Arab world are difficult to find, and when some of the data are found, the quality of the data sometimes remains an open question. Also, many of the Arab governments thrive on secrecy and trying to hide from the world the truths about their countries. The data in this paper should be considered as indicative only. More household survey and much better data collection needs to be done before the picture of the region becomes clearer. The IMF and others are working with some of the Arab countries on this, but that may take some time