

South Africa and the Arab World: Facing Common Challenges

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Today the Arab countries of the Middle East face a challenge familiar to all South Africans: to create jobs for the large cohort of young people reaching working age. Over the next decade or so, the region may experience population growth of 150 million people—the equivalent of adding two Egypts (table 1). In demographic terms, the task is similar to that facing South Africa—only larger. Rising labor force participation by women only increases the pressure. The task is immense, and the stakes are high.

The picture is not entirely bleak, however. On the back of rising oil prices, economic performance has improved in recent years. But this windfall is felt unevenly across the Arab world, as some of the most populous states are not well-endowed in oil, and whether these prices will be sustained is an open question. In some Arab states—and not merely the oil exporters of the Persian Gulf—foreigners, not locals, account for most of the new hires over the last five years, again a phenomenon that finds its echo, albeit on a smaller scale in South Africa. This development is even more acute if one looks only at private sector employment, since nationals disproportionately enter the public sector. With a few exceptions, employment has not been growing in industries where productivity is increasing—that is, it does not appear to reflect an expansion of activity in rising dynamic sectors. Simply maintaining past performance, even the relatively good performance of the last several years, will be insufficient to generate the necessary jobs.

One method of rapidly creating a sustainable increase in employment is through an expansion of labor-intensive manufacturing or services exports. But outside the petroleum sector, the region's track record is inauspicious. Manufacturing exports are modest and, like those from South Africa, face increasing competition from China and India. Foreign investment flows have surged in recent years, but they are largely the product of intraregional petrodollar recycling. Commodity prices

rise and fall—as South Africans know—and unlike foreign investment undertaken by industrial firms, it is doubtful that these financial flows convey new technology which could accelerate productivity growth.

The Arab countries score relatively poorly on a nexus of indicators relating to cross-border economic integration and the transfer, dissemination, and application of technological knowledge and innovation. Partly this would appear to reflect weak inputs: Arab students have generally not performed well in a variety of international comparisons of educational achievement, including the most recent Trends in International Mathematics and Science Study, a quadrennial survey of achievement among eighth graders (South Africa was not a participant). In the most recent Shanghai Jiao Tong University ranking, Cairo University was the only university in the Arab world to make the top 500. As a point of comparison, South Africa placed four in the top 500 (Cape Town, Witwatersrand, KwaZulu-Natal, and Pretoria), though the South African system faces a distinct challenge with respect to inclusion.

Concerns about human capital formation are compounded by policy: Relatively weak intellectual property rights protection and state domination of the oil industry have retarded technology transfer and absorption, and local technical capacity, on which a dynamic export-oriented employment-generating industrial sector could be built, appears weak (table 2). Again, comparative data for South Africa are presented to get a sense of scale—the Arab economies generally do not score as highly as South Africa does with the notable exception of the brain drain indicator, where it is fair to say that both the Arab countries and South Africa have experienced difficulties retaining homegrown talent. It is possible that under a different set of economic policies or with institutional reforms, such as reducing the barriers to business formation or making finance more easily available to small and medium enterprises, that latent capabilities would manifest themselves, but at least under current conditions, evidence of industrial competence is muted.

This situation may partly reflect the relative absence of outside catalysts. With the exceptions of the extractive industries and tourism, where geology or special attractions like the Pyramids confer unique and irreproducible advantages, as a group, the Arab countries appear to have weak linkages to the outside world, whether measured in terms of merchandise trade, import of capital goods (which embody technological advances from abroad), cross-border investment, integration into transborder supply networks, technology licensing, and internationally recognized intellectual achievements (figure 1). In short, the neural synapses that would link the latent productive possibilities of the Arab people with the goods and services demanded in the global market appear to be weak or nonexistent. Their relative isolation from international technology inflows whether in the form of FDI or technology licenses or the use of foreign consultants has stunted productivity growth and inhibited the ability of mostly locally owned firms to enter international markets in nonoil products despite

membership in the World Trade Organization (WTO) and preferential market access through special trade agreements.

Building such links presents a formidable challenge. Unlike issues of macroeconomic policy management—where policy change can be implemented by a relatively small number of centrally placed technocrats and is subject to relatively straightforward feedback mechanisms to facilitate benchmarking progress—addressing the institutional weaknesses requires a much more prolonged and uncertain slog.

To take a simple illustrative example, the returns to a country training software engineers may not be very high in the absence of computers; conversely, building or importing computers may not have a high payoff if no one knows how to operate them, or if local conditions prevent their efficient usage. Properly measured, the social returns to education in the Arab countries may not be particularly high in the absence of complementary technology and an enabling business environment, again echoing similar multifaceted challenges faced by South Africa.

Under such circumstances the issues of prioritization and linkage are nontrivial. Today's success stories in East Asia, for example, did not get everything right from the start, and certainly have not achieved Nordic levels of probity today, much less at the start of their periods of rapid growth. It may be that strong performance in some areas compensates for weakness in others.

Successful reform is inhibited by the region's reputation as a risky business environment, due in part to deep uncertainty about the future of many of the region's political regimes. While the region's contemporary economic performance may not be distinctive, its enduring political authoritarianism is. This characteristic is linked to the reliance of some of these governments on relatively narrow ethnic, religious, or tribal constituencies, and fundamental uncertainty about political transition and the nature of successor regimes—a situation that is reminiscent of South Africa's a generation ago. The region's lack of political dynamism in the face of underlying social change, together with the increasingly religious orientation of the political opposition, paradoxically raises the possibility of abrupt transitions or regime changes. Intermittent terrorist incidents further elevate the risk premium. Such deep political uncertainty discourages behavior that involves irreversibility—from investment to a reversal of the brain drain—and creates the possibility of a self-reinforcing downward spiral.

That said, one is struck by the degree of intraregional variation in the indicators reported in table 2 as well as others reported in our book *The Arab Economies in a Changing World*. This intragroup variation is important for two reasons. First, it suggests that whatever is determining outcomes on these measures it is not deeply culturally or religiously determined. The influence of Islam or the anthropology of Arab culture may have many effects on local institutions and practices, but they cannot explain why it takes 15 times as long to enforce a contract in Egypt as it does in

Tunisia. Second, for some countries, there could be considerable gains associated with achieving “best practices” as defined by their regional comparators. For countries like Egypt or Syria just meeting the Tunisian standard could mark a real advance. They do not have to turn into Iceland.

To be clear, these issues are anything but value-free. As professional economists we often implicitly focus solely on efficiency. But there are other values that matter as well. For example, in a poll recently conducted by Zogby International in Egypt, Jordan, Lebanon, Morocco, Saudi Arabia, and the United Arab Emirates, majorities in four of the six countries supported governing business by sharia law, with pluralities in all six countries agreeing that sharia required further interpretation to enable businesses in the Muslim world to integrate into the global economy. Another poll conducted by the Pew organization found that while popular attitudes in the Middle East do not appear to be “antimarket” as some have alleged, they are not particularly supportive of the process of globalization, at least on existing terms, and South African attitudes as elicited in this survey appear consistently more supportive of free markets and integration into the global economy (table 3). Such considerations are not of mere theoretical interest: Perceived inconsistencies between WTO rules and local interpretation of sharia played an important role in delaying Saudi Arabia’s accession to that organization. The issue is how to square efficiency with the values and aspirations of local communities. The views elicited in the Zogby poll could be interpreted as forming a coherent basis for adapting the demands of globalization to local values. But the Washington Consensus it is not.

There is more than one way to skin a cat: One could imagine an alternative set of institutions and practices that would deliver the benefits yielding, to paraphrase the Chinese experience, reform with Arab characteristics. Islamic finance might represent an example. Of course, the signal extraction problem is complicated by the region’s pervasive political authoritarianism: It is not clear how the policies and practices embodied in the status quo map to the true underlying preferences of the citizenry. Yet it is important to keep in mind that ultimately it is not enough to get the policies and institutions right: what matters is accelerating the growth rates of income and employment.

The Middle East has long been a politically contested region of global significance. The demographic pressures the region faces to productively employ its young people entering the labor force raise the stakes even higher. It is not difficult to envision the region caught in a downward spiral where impoverishment, discontent, militancy, and repression feed upon one another, deterring reform and impeding growth.

Yet this is not the only possible future path. If the region’s daunting employment challenge can be successfully addressed, the region’s demographics could turn from a potential liability to a valuable asset. The Arab world could reap a demographic dividend as the new generation enters its most productive working years—a phenomenon that contributed to the outstanding performance of

East Asia over the past four decades or so. Growing prosperity, confidence, and optimism about the future could underpin movement toward greater political openness and social tolerance. The region's young demographic could then turn from a potential burden to a bonus.

South Africa faces a similar set of possibilities. To generate large numbers of jobs for its large pool of relatively unskilled labor, South Africa will have to rely on low costs relative to international competitors. In turn, this requires either continued low real wages or increased productivity to generate sufficiently low costs for either locally or foreign-owned firms to compete on world markets. Obviously, improving productivity is the more economically and politically attractive alternative. Yet generating such productivity gains is not a simple matter.

The data in table 2 and figure 1 suggest that South Africa is better positioned than the Arab world to take advantage of global technology flows. The ability to tap into international knowledge was a crucial component of the success over the past two generations of many Asian exporters such as Korea as noted in our book, *Industrial Policy in an Era of Globalization*. Although there are understandable historical reasons for a distrust of the globalization in both commodity and knowledge, with sufficient prudence, these risks can be transformed into widely beneficial increases in both employment and productivity growth. While it may be tempting to say, as do many policymakers throughout the world, that "we are not Korea," the Korea of 1960 was not the Korea of 1980 nor the nation of 2007 with high wages and low unemployment exporting automobiles, flat panel televisions, and cell phones.

Table 1 Population projections

	Total population (millions)					
	Scenario 1			Scenario 2		
	2000	2010	2020	2000	2010	2020
South Africa	45	50	53	45	49	51
Arab Region*	238	305	388	238	294	346

	Dependency ratio			Median age		
	(percent, based on scenario 2)			(years, based on scenario 2)		
	2000	2010	2020	2000	2010	2020
South Africa	0.59	0.57	0.54	23	24	26
Arab Region*	0.76	0.64	0.50	20	23	27

* Arab region includes Algeria, Bahrain, Djibouti, Egypt, Iraq, Jordan, Kuwait, Lebanon, Libya, Morocco, Oman, Qatar, Saudi Arabia, Syria, Tunisia, UAE, and Yemen. Dependency ratio and median age figures are population-weighted averages.

Sources:

UNDP (2002, 144).

Population Division of the Department of Economic and Social Affairs of the United Nations Secretariat.

Note: Scenario 1 projections are based on constant population growth; scenario 2 projections are based on UNDP estimates.

Table 2 Institutional Capacity

	Local supplier quality	Local availability of process machinery	Local availability of specialized research and training services	Intellectual property protection	Brain drain	Technology Innovation and Diffusion: Firm-level technology absorption
South Africa	79	68	81	81	43	75
Middle East						
Algeria	20	24	17	17	9	54
Bahrain	51	11	15	68	72	74
Egypt	28	56	46	54	22	58
Jordan	46	51	52	77	26	62
Kuwait	58	55	51	55	97	74
Morocco	33	54	44	39	12	39
Qatar	44	17	15	73	99	64
Tunisia	62	62	68	76	67	72
UAE	73	40	27	74	98	88

Note: Data are in percentiles (higher number is better); sample n=117; cost of importing foreign equipment sample: n=104.

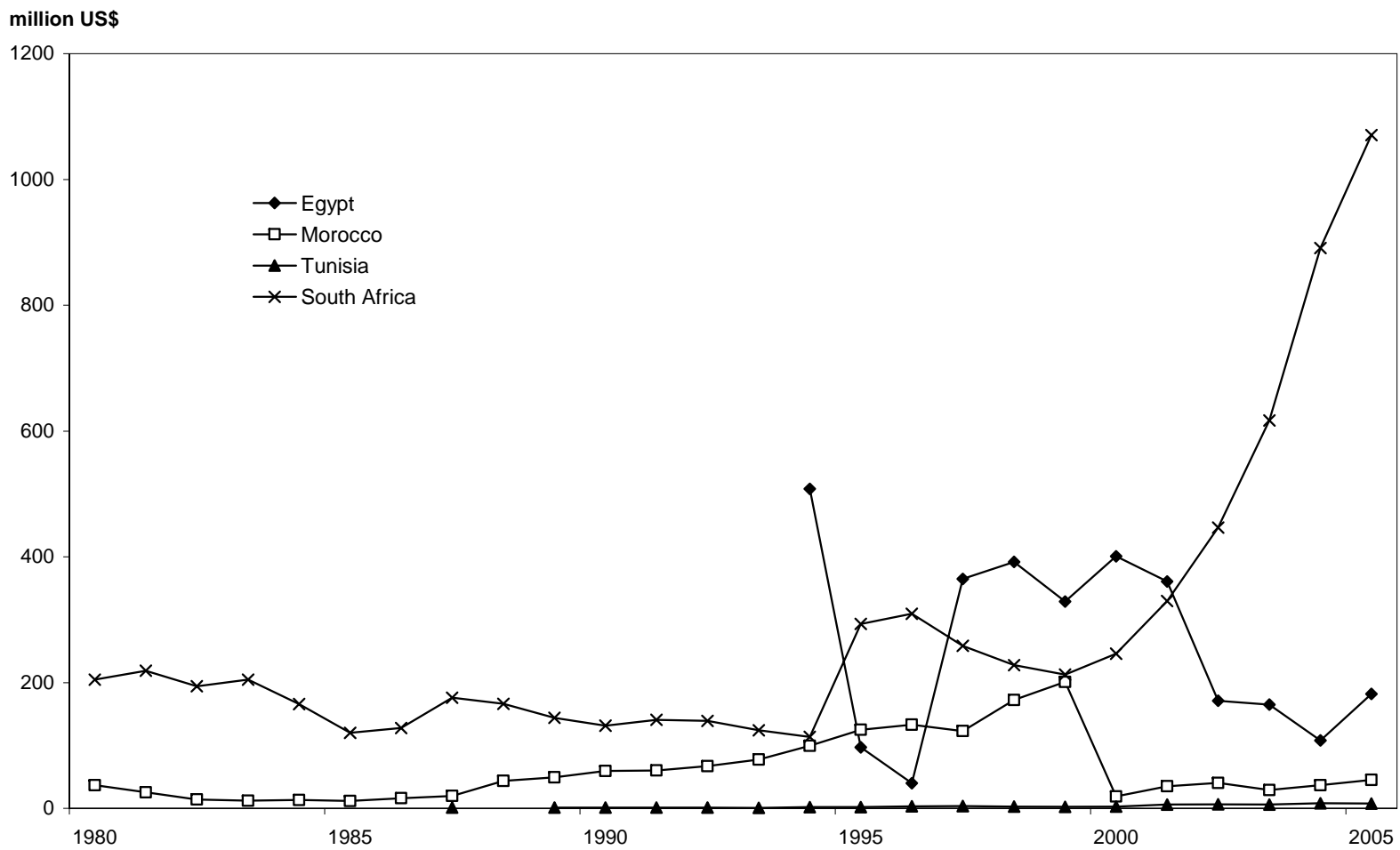
Source: World Economic Forum, Global Competitiveness Report 2005-2006; cost of importing foreign equipment: Global Competitiveness Report, 2004-2005

Table 3 Popular Attitudes

	South Africa		Arab Countries	
	Support/ Good	Not support/ Bad	Support/ Good	Not support/ Bad
Most people are better off in a free-market economy, even though some people are rich and some are poor.	73	19	58	29
Large companies from other countries have a very good/somewhat good/neutral/somewhat bad/very bad influence on the ways things are going in our country.	78	16	50	46
International organizations such as the World Bank, International Monetary Fund, and World Trade Organization have a very good...very bad influence on the way things are going in our country.	68	13	38	49
Do you think that globalization is a very good...very bad thing?	70	9	52	31
All in all, how do you feel about the world becoming more connected through greater economic trade and faster communications?	88	9	67	26

Source: Pew Global Attitudes Project (2003). Arab countries in the survey included Egypt, Jordan, Lebanon, Morocco, and Kuwait.

Figure 1 Royalties and fees for technology licensing, 1980-2005



Source: World Bank, *World Development Indicators Online* (accessed August 27th, 2007)