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GCC and The Arab Economy : Growth, Reform, and Regionalization

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Working Paper 0329

Economic Research Forum

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Abstract

This study attempts to shed some light on the analytical underpinnings of this evaluation with the aim of putting the growth performance of the region in its global context, and providing causal explanations identifying the underlying laws of motion, thus shedding light on the road ahead and what is to be done next. The analytical methods in this study utilize a variety of approaches, including the dynamic disequilibrium linkage approach, in addition to dealing with the interaction among regional development and globalization, international political economy, and regionalization trends and frameworks. It is concluded that regionalization and globalization are not substitutes but complements.

ملخص

اول الدراسة أن تلقي بعض الضوء علي الأسس التحليلية ذا التقييم بدف وضع و الأداء للمنطقة إطاره الدو ، وتقد تفس ات سببية تُعرف القوان الأساسية للحركة، وبذا تلقي الضوء علي الطريق إ الأمام وما يتع القيام به بعد ذلك. إن الأساليب التحليلية هذه الدراسة تستخدم تلف ا ناهج، ا ذلك منهج ربط أوجه الاختلال الفعالة، فضلاً عن التطرق إ التفاعل ب التنمية الإقليمية والعو ة، والاقتصاد السياسي الدو ، وا اهات الأقلمة (تقسيم البلدان إ أقاليم) وأطر عملها. و لص إ أن الأقلمة والعو ة لا يعدوا بدائل بل مكملات.

1. Introduction

An increase in GCC oil surplus after 1974, with its regional spillover, acted as the main engine of growth in the Arab economy at large. In fact, one can speak of the growth in the oil sector as having led to the establishment of an oil-based Arab regional economy and order in general. Initial assessments of the resulting Arab regional pattern of growth and performance unanimously conclude that it has been less than adequate, resulting in the region's sliding on global scales.

The paper is divided into four sections. The first tackles the process of globalization, its phases and ramifications for the Arab region. The second examines the Arab genesis of the oil-based regional order and its pattern of growth. Using a generalized linkage approach, the third part attempts to diagnose the underlying analytics of the observed pattern of growth. The last section places the Arab Region's pattern of growth in its global context with a focus on the state of international political economy and regionalization trends.

2. Stages of Globalization and the Arab Economy: A Road Map for Future Catching Up

The Arab region, by virtue of its location and geopolitical situation, has been well integrated into the world economy and continues to remain at the forefront of political events since early last century. This was particularly so after the discovery of oil, and the region's hegemony over international oil reserves and production. More recently, the outbreak of the Arab-Israeli conflict with its continuous escalation and successive cycles of war and peace underlined this position even further.

In light of this situation, any analysis of the Arab region's pace and pattern of development can hardly be carried out in isolation from its global context. Changes on the global scene and their ramifications for the region have been a mainstream factor in the process of change.

Therefore, it is warranted to begin our assessment of the region's development by briefly canvassing one of its major triggers-cum-constraints, namely today's globalization and its ramifications for the Arab regional economy.

2.1 Road Map for Arab Prospective Reforms

2.1.1 The Beginning of Internationalization

Globalization as a process of global market integration is hardly a new phenomenon. Its origins can be extended back to the turn of the last century. Furthermore, one can distinguish distinct phases in its long-term growth. In the latter part of the 19th century and spanning through the early 20th century the world witnessed a period of rapid growth and upsurge in capital movement. This was the period of the gold standard which amounted to a global currency. Great Britain was the leading economy and dominant force on the world scene. This was also the period which saw the powerful spread of European colonialism in Africa and Asia.

Growth in this period was triggered by major advances in industry, transportation and communications as well as major business organizations including the emergence of giant financial trusts, joint-stock corporations in Europe and the U.S. and the Zaibatsu in Japan. This period heralded the separation of ownership and management in business and the advent of corporate capitalism.

Lastly, towards the end of this period, the US witnessed a managerial revolution in the form of an application of the principles of “scientific” management on the basis of time-and-motion studies in management. This was a revolution that came to dominate management practices of large organizations, industry and even governments worldwide.

2.1.2 The "Multinationalization" Era

The next wave of globalization took place during the "golden era" of post World War II growth in the 1950s and 1960s. The US replaced Britain as the world capitalist leader and the US dollar became the international currency par excellence. The Bretton Woods system, the adjustable peg currency regime, as well as the GATT provided stable international monetary and trade standards. In fact, international trade, which had fallen to a low level, started to grow vigorously once again.

This period also witnessed the birth of Europe's common market and the rise of the Euro-dollar markets, with their massive liquidity and financial power. Multinational enterprises and FDI were the vehicles of growth both interms of output and trade on a global scale, thus facilitating economic liberalization and integration, particularly in Europe. This was the beginning of the birth of regional markets and the spread of regionalization.

2.2 Today's Globalization: Growth in the 1980s and 1990s

Towards the end of the 1970s, a new wave of growth and globalization had emerged once again. In he US and Europe the response to stagflation in the previous period involved massive deregulation and monetary "shock treatment," and subsequently kick-started their economic growth**.**

This period also saw the birth of another technical revolution. Advances in biotechnology and materials technology broke the cycle of technological slowdown in the previous two decades. But the most important advancement was due to the advent and rapid global diffusion of the new microelectronics-based information and communications technologies. This included the application of the microprocessor to all production processes leaving hardly any industry untouched.

This new wave of technological innovation gave a strong boost to productivity growth which had also stagnated in the MDCs in the previous period. It also gave birth to new management approaches, techniques and theories. "Flexible" production approaches and management systems started to replace the early 20th century techniques of mass production and the high degree of specialization with its tendency to isolate conception and planning from execution in the organization of work.

The innovative "flexible" production system seeks to overcome the rigidities of its predecessor which obliged large enterprises to turn to low-wage production locations "offshore" or in LDCs. It borrowed, to a certain extent, from the more flexible Japanese production techniques which allowed Japanese car manufacturers to replace and gain markets from their US counterparts, even in US markets themselves. But it also benefited from the flexible automation technologies and compatible management systems. This approach is what now constitutes the "new rules" of global competition at both the micro and macro levels.

The new production system distinguishes between large organizations and smaller businesses, enterprises that tend to form industrial districts that cluster significant numbers of relatively small independently owned firms that both compete and cooperate with one another. They constitute "network enterprises." Aside from the technological and managerial paradigm shift, the new globalization wave gave birth and was boosted by a number of watershed events and changes. These include financial liberalization and capital markets integration, the dissolution of the USSR and its adoption of an "open door" policy, and the adoption of LDCs of "outward-oriented" strategies and IMF/WB-led stabilization and structural adjustment reform programs.

The result of all this was a soaring of international capital flow (mainly private). Net capital inflows in the form of both FDI and portfolio investment increased from a trickle at the beginning of the 1980s to over a quarter of a trillion US dollars in the second half of the 1990s.

But with the emergence of the East Asian crisis and its global contagion effect, it receded and began to fall again. Needless to say, the Asian crisis negatively affected the global rates for growth of production and trade. This trend was followed and reinforced by the year 2000's global financial market crash and its aftermath. Then came the mammoth event of September 11^{th} 2001 and the sea change it brought about.

However, it should be mentioned here that this latter wave of globalization and its policy underpinnings has been characterized as a whole by macroeconomic instability and recurrent national and multinational crises. One can refer here to the crises in the mid 1990s in Mexico, to be followed by other Latin American countries such as Argentina and Brazil. These were followed by the East Asian financial crash, then by Russia, and culminated in the stock markets' collapse in the MDCs and a consequential fallout on growth in output and trade.

3. The Arab Regional Oil-based Economy, its Pattern of Growth and Prospects

3.1 Stages of Arab Regional Development

The above highlighted stages of growth of globalization likewise map the distinct characteristics of each phase, their "premium mobile" and accomplishments. In that sense, built in this survey is a bird's eye view of global economic development, technical progress and underlying systems. Accordingly, this analytical survey could be looked upon as constituting an implicit "road map" and prognosis for the space and distance that the Arab economy at large will have to cover in its efforts to catch up with the rest of the world.

As far as the initial wave of globalization, namely the "internationalization" phase, it can be skipped as far as the Arab economy is concerned since at that time the region was under colonial rule. The only thing to be mentioned here is the substantial capital flow to Egypt which contributed to building up its initial infrastructures during the colonial era.

Meanwhile, the transitional phase of the globalization march, that is, between the "internationalization" wave and today's globalization with its ups and downs in growth, witnessed the Arab countries' move to independence, and the rise of Arab nationalism and socialism. It also witnessed two Arab-Israeli wars and the rise of OPEC as a political and economic force on the global scene, which in retrospect impacted subsequent relations with the Western countries, namely Europe and the US as well as the path of regional development.

Concerning OPEC's watershed decision to cut oil supplies to "unfriendly relations" after the 1973 October War, a British historian puts it:

> The relation between the West and the third world was redefined into that of the oil consuming and oil producing nations. The action was dubbed as responsible for the quadrupling of oil prices and … plunged the industrialized nations into an era of soaring inflation, and low and volatile growth- "stagflation"… For two decades the two sides of oil producing and consuming nations were implacably opposed to each other… After the invasion of Iran by Iraq…global recession and over supply produced an oil glut and the power swung the other way to the oil consuming nations". Subsequently "reduction of dependency on OPEC oil, the entry of capitalist Russia with huge reserves into the international oil market, the switch away from heavy industry, advances in technology and energy efficiency…meant that the oil weapon could not be used in the same way again.

The other then goes on to say that:

> …with the self-deconstruction of the Soviet Union and its abandonment of socialism, the first and second worlds become one, and the third world becomes internally so marked by significant disparity so that it is no longer one either…In the situation of one world, globalization became the new way of talking about colonial-colonized relations in our time. The world was one…the west was almost everywhere. It had stopped being a region; it had become the universal system to which everyone had to submit, Willy Nilly.

The author then proceeds to draw attention to the Muslim/Arab world dissention and how others look at it by noting that:

> The Muslim World became more and more restless. The situation in Palestine the, last remaining major colony on earth, (and now in Iraq as well), deteriorated. This renewed turbulence was understood by Huntington not as a simple question of political and land rights, but as a 'clash of civilizations'…with September 11, 2001 (and President Bush's famous saying 'either with us or against us') the west was over…it became America, as multilateralism is replaced by unilateralism.[1]

Thus heralding a new phase in international political economy replacing the Bretton Woods system with the United States at the helm.

As for the consequences of the latter wave of globalization heralded by the unprecedented worldwide economic growth in the 1980s and most of the 1990s, for the Arab region, it was disappointing. While some major steps towards liberalization and stabilization took place in some parts of the Arab world, there was no move towards tackling their binding structural foundations and the region's core policy regime remained intact. There was a similar situation with regard to the Arab regional order. It is not surprising; therefore, that economic growth has hardly kept pace with population growth.

3.2 GCC and the Rise of the Arab Regional Economy:

3.2.1 The Arab Regional oil-based Model

The Arab Region's economies vary greatly in terms of population, factor endowment and levels of growth and income per capita. Most countries in the region could be classified as middle-income economies with per capita incomes ranging between $700-1200.

However, the Arab countries with GCC membership (i.e. Bahrain, Kuwait, Qatar, Oman, Saudi Arabia and the United Arab of Emirates) enjoy a significantly higher average income per capita ranging from over $25,000 for Qatar and the UAE to $6,000 for Oman. On the other hand, while the GCC member countries' economies are virtually mono-crop ones in terms of the extent of diversification of their production and export bases, the other Arab economies are slightly more diversified although most of them continue to depend mainly on primary exports. Moreover, while the GCC economies are capital exporting ones, the others suffer from capital shortage including the semi oil producers with the exception of Libya and Iraq.

The GCC member countries also differ significantly in terms of population with Saudi Arabia reaching above 22 million inhabitants while Qatar falls below the one million level. Furthermore, they differ in their oil wealth in terms of both oil reserves and production level. Saudi Arabian proven reserves are estimated to be 263 billion barrels in contrast with that of Bahrain estimated at 0.2 billion barrels. As for annual production levels, they range from 7.1 million barrels a day (2002) for Saudi Arabia to 0.2 million barrels a day for Bahrain.

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[1] "Rereading the West: A short History in Three Acts ", a lecture given by Prof J.C Young, Professor of Cultural and Critical Theory, Oxford University, at the Supreme Council of Culture, Cairo, December 2003.

It must also be pointed out here that while Qatar's crude oil reserves are only 15.2 billion barrels (2002), the country has one of the highest natural gas reserves in the world (26 billion standard cu m). Lastly, not all GCC member countries are members of OPEC. Only Kuwait, Qatar, Saudi Arabia and UAE are members while Bahrain and Oman are not. Other Arab oil-producing countries include: Algeria, Egypt, Libya, Syria, the Sudan and Yemen. Their total oil production is estimated to have reached 3.2 million barrels per day (before 2000) compared to 14.3 million barrels per day for the GCC member countries.

The GCCs' unique regional position and impact emanates from their substantial oil reserves and production capacity. At the same time, they are sparsely populated so that when their oil revenues soared suddenly after the oil price rise in 1974, it triggered a massive intraregional factor movement. It created a rising demand for labor in domestic markets on the one hand, while generating cash outflows in the opposite direction on the other.

In other words, the oil-exporting countries that are members of GCC were not the only beneficiaries of the oil boom. The windfall gains, resulting from the sharply increasing real crude oil prices, led to both higher per capita growth and investment in all Arab economies. This regional spread of oil revenues took place directly and indirectly through its regional demand for labor, remittances, other current transfers and the external financing of investment. The Eastern Arab countries were the main beneficiaries, especially Egypt, in the light of their surplus labor, proximity and sharing of the Israeli threat.

3.3 GCC: The Oil Boom and its Aftermath

The rise in oil prices after the 1973 October war set in motion an unprecedented boom in the GCC as the average price of crude oil shot up from less than $2.8 a barrel in 1972 to more than $36 in 1981. The aggregate annual merchandise export earnings of the GCC states soared from less than $10 billion to more than $163 billion.

Although imports rose dramatically as well from about $3.5 billion in 1972 to more than $52 billion in 1982, the group managed to record a sizeable current account surplus exceeding $66 billion in 1982. The great bulk of this rise in the oil sector's windfall income went to the government as revenue. Accordingly, this oil revenue soared from $4 billion in 1971 to over $96 billion in 1981. With total revenue from taxes amounting to roughly $20 billion in 1981 (mainly from taxes on foreign trade) the oil revenue then constituted 80 percent of total government revenue for the group.

However, neither the oil prices nor the export earnings were sustainable. As part of a backlash from the rest of the world (oil consumers) economizing energy use and shifting to non-oil sources, among other things, oil prices nosedived. The price of crude oil averaged less than $14 a barrel by the mid 1980s (1986). Likewise, aggregate merchandize export earnings of GCC were down to about $45 billion which amounted to less than one third of its peak level. As for government oil revenue, it also plummeted to $38.9 billion.

But most governments in the group preferred to sidestep the problem counting on their unlimited reserves and expected future income. Also, it became structurally more difficult to retrench given the extended welfare system in place. So, during the subsequent decade, government deficits averaged 5 percent or more of GDP surpassing 10 percent in some cases. Budget shortfalls were almost entirely selected in the external accounts leading to current account deficits, especially for the small surplus members.

External and domestic deficits were initially financed by drawing on the substantial foreign assets accumulated during the boom years. Some, after having depleted their assets, turned to borrowing which exposed their economies and economic policies for the first time to international scrutiny. The deficit spending also put pressure necessitating a resort to expenditure reduction. The first line of expenditure to suffer from cost cutting is, needless to say, investment and development expenditure. Concentrating on capital reduction instead of wasteful consumption jeopardized future growth.

3.4 GCC Pattern of Growth and Policy Underpinnings

Over the last 25 years one can safely distinguish between two phases of growth, one leading to the other. For the period ranging from 1975 to 1985 with the first oil shock and soaring of prices, the economy experienced rapid growth led by the crude oil exports proceeds. The external balance realized large surpluses that boosted the group's external reserves.

During this phase, member countries followed diverse strategies in utilizing their windfall oil surpluses. Small countries, with small populations and narrow markets, opted for a diversified strategy. They invested a portion of their surplus in foreign assets abroad as a means of building up an alternative source of income other than oil, and also, as an insurance policy for future generations (Kuwait), while larger member countries with a wider domestic market (Saudi Arabia) opted for utilizing its oil revenues in diversifying its domestic production base and, at the same time, building up its resources abroad in the form of short term, liquid, financial assets. The remainder followed a path combining elements of both strategies.

However, in terms of domestic policies, all members of the group invested heavily in building modern infrastructures following state of the art technology. They also developed, in different degrees depending on available resources, their petrochemical industries making their economies competitive in this regard.

In order to make their population bases share in their countries' oil wealth, they unanimously followed an elaborate welfare policy. This included subsidies to basic commodities and services including food, energy, transportation, etc. This is over and above free education, basic health services, housing finance, etc.

Added to this was a policy of government employment guarantee. This extended and costly welfare policy was financed from oil revenues. There were no income taxes except on foreign business while indirect taxes came mainly from foreign trade.

With rapidly growing populations and rising demand for expatriate labor who enjoyed welfare benefits, it was not long before those economies began to suffer from the twin deficit: the budget and trade balance deficits. At the same time, the private sectors enjoyed a very hospitable market environment. The expatriate labor cost was quite low by virtue of the low cost of living and the welfare system.

In spite of all these business privileges, including a tax haven, the price and incentive structures were not conducive to investment. The exception was domestic services (non-tradables). As for the tradable sectors, particularly manufacturing, they did not offer a competitive advantage in the light of the very low protection levels (customs duties), bottlenecks in technical know-how and heavy bureaucracy.

With regard to foreign exchange policies, on the whole they opted for tying their local currencies to the US dollar in lieu of the SDR. This was preferred so as to protect against domestic inflation triggered by a depreciating SDR. Also, this was in line given that oil prices were denominated in US dollars.

The above approach to foreign exchange policies was enforced by a monetary policy that took the exchange rate as its anchor. This served money purposes including a stable nominal exchange rate, a low inflation rate especially during periods of real exchange rate appreciation. It was also consistent with the maintenance of wealth and asset prices and facilitated capital movement.

However, tying domestic currencies to the US dollar dictated a very restricted monetary policy stance as a tool for the macro management of the domestic economy. Domestic interest rates became tied to US interest rate movements and were then left to domestic demand for liquid assets to equilibrate financial markets through changes in the banking system's foreign assets. Stability of domestic nominal exchange rates indirectly served stability in intra group exchange rates, which, in turn facilitated de facto policy coordination among members of the group. It even triggered talk of establishing an intra-group monetary union.

On the basis of the above analysis, one can detect potential contradictions between fiscal and monetary policies. An expansive fiscal policy could in due time start to put pressures on exchange rates and, through it on monetary policy, especially in the light of a large contingent expatriate labor with a strong inclination to save and transfer resources to their families abroad. But given the oil prices with their rise and fall, this issue has not yet arisen in a sufficiently stringent way.

In summary, the above portrayal of policies highlights the major characteristics of the welfare economic structure and its underlying policies after the first oil shock, which constituted phase one in the group's long term development. On the other hand, phase two was ushered by the second oil shock, namely the collapse in oil prices in the mid-1980s (1986). Since then and until the Asian crisis, the GCC economies were characterized by low-intensity activity. Real growth rates were roughly in line with the rate of population growth while economic policies adjust and average their income accounts and balance sheets with rise recurrent rise and fall of oil prices.

One must mention here that while oil prices remained subdued during this phase around a mean level of roughly $20 per barrel, output did not show any trend towards increasing. If anything, it trended down. GCC member countries of OPEC had changed strategies. They felt that acting as a trust to corner the world market did not serve any purpose. It led to their losing their market share and encouraged the substitution of alternative energy sources. Accordingly, they seem to have opted for a more accommodative policy rather than a confrontational one.

3.4.1.Regionalization Policies

In spite of the fact that all the prerequisites of integration among GCC member countries were in place, one can hardly notice any discernable move in this direction. A legal and regulatory framework liberalizing the movement of goods, factors of production and people has already been promulgated. This is over and above their almost identical cultures, proximity, common history as well as challenges, etc. Laws of gravity do not seem to be invoked here.

However, this is understandable from both an economic and political point of view. In turn, if one searches beneath the surface, members of the group still enjoy external surpluses or at least do not suffer from any sustained imbalances in this regard. They are all, relatively speaking, sparsely populated and do not suffer from net labor surplus. They are all capital exporting and have overly open economies. Their domestic markets are driven more by welfare policies than otherwise.

On the other hand, the political agenda of GCC is pressing. In the 1990s the group witnessed two intra-Arab wars, besides the feeling of overall insecurity vis-à-vis the rest of the world including some Arab neighbors given their oil wealth. Accordingly, the GCC common goal priorities are more geopolitical and security bound. This is at least for now although there are intensifying tendencies to economize the institution.

As for Arab region-wide cooperation and integration, in spite of a number of efforts and experiments over almost the last half-century, it has gone nowhere. The present effort to create an Arab free trade area is moving too slowly. Besides it has no institutional base to push it ahead at a faster pace. A major stumbling bloc standing in its way is that it is too circumscribed by being restricted to commodities. Similarity between the region's production structures, lack of competitive exportable surpluses, great disparity in levels of protection, the dependence of governments or customs duties, etc., all cluster to slowing down the movement towards effective implementation.

However, the oil price increase has served as region-wide engine of growth. It has been responsible for initiating an important vehicle of regional cooperation namely factor movement from the labor surplus economies, especially from the Arab Mashrek economies, to the labor deficit oil exporting countries of the Gulf. Aside from GCC countries, this includes Iran and Libya.

The massive labor movement that took place after 1974 was soon followed by first a trickle than an avalanche of transfers in the opposite direction in the form of labor remittances. Egypt alone had exported to the Gulf area a peak of roughly three million persons at the height of the oil boom. Their remittances had gradually become a major source of foreign exchange resources a well as of government revenues.

This source of income of non oil-rich countries in the form of net factor income from abroad was further reinforced by other current and capital transfers including official aid and direct investment. Also, it encouraged an intra-Arab popular tourist trade, which constituted another source of export income. The Mashrek Arab countries were more involved in this intra-Arab factor movement by virtue of proximity, but also because they shared with the Gulf countries the problem of insecurity caused by the Israeli conflict and the security threat it imposes.

While it is not the place here to elaborate on the contagion effect of the oil-based economies' use in the GCC, it could be safely said that it has a strong regional impulse. Egypt, for example, followed a similar pattern of macroeconomic instability and fluctuations paralleling that of the GCC member countries. Also, it exerted an influence on policies, particularly fiscal policy, which had become dependent on “rent” income as a major source of revenue. When this source of income declines, the budget deficit rises and the twin deficit situation is accentuated. Similarly given the country's parallel welfare policies, the social cost to government rises leading to a rise in public expenditure.

Accordingly, the GCC member countries' growth rates fell significantly in their second phase, sometimes turning negative. The Mashrek countries' growth rates decelerated but remained higher than GCC countries. This is by virtue of their more diversified economies.

On the whole, the oil-triggered factor movement created the semblance of an economic region. But if this is to be sustainable in the light of the slowing down oil engine of growth, it must be followed by creating a stable base and policies for a sustainable higher regionalization condition.

3.5 GCC: A new Phase of Reform and Growth in the Making: 1995 - 2005

In general one can say that the basic underlying problems and weaknesses besetting both the GCC economies and the Arab region in general continue to exist with very substantial variation in intensity from country to country. Some of the GCC member countries made significant progress towards following a market based path aimed at diversifying their economies, with an open trade system and a liberal capital flow regime. This contributed to their growth performance even when oil prices were falling.

At the same time, the continued adherence to a fixed exchange rate regime to the US dollar kept inflation at bay while an open border expatriate labor policy ensured sufficient supply of labor at competitive wages.

But due to a continued deterioration in the region's fiscal stance restoring fiscal discipline remains a major challenge. Efforts are needed to reduce the non-oil fiscal imbalance (i.e. fiscal balance after excluding oil revenue). Such an adjustment will require cutting current expenditure (basically welfare-related) while developing a modern tax system to raise its share of total revenue.

The policy reforms referred to above would provide the resources needed to tackle the chronic challenges facing the region's economies, namely high unemployment among local labor, slow growth in per capita income and a low investment level on which the expansion and production diversification depends. Not only does real investment continue to stagnate and is often sacrificed at times of low oil prices and revenue, but also the incremental capital output ratios are amongst the highest in the world which is an indicator of the low quality of investment and its skewed pattern of allocation favoring construction with high capital/output ratios.

To conclude, the above-mentioned policy inadequacies and remaining structural imbalances should not undermine the myriad achievements attained by the sub-region as a whole. The group experienced what amounts to a total transformation, both economic and social. Their infrastructures have been modernized to a level that may be said to be on par with the more developed countries. Also average income per capita has gone up to a level of over $12,000 p.a.

At the same time, the GCC served as the virtual regional engine of growth for most of the Arab countries, particularly in the Mashrek. This took place through their demand for labor surpluses coupled with substantial financial transfers (worker's remittances, aid, etc.).

In the social sphere, illiteracy among the young age groups has virtually disappeared while life expectancy has reached 74 years. What remains is more progress towards diversification, which is a sine qua non for macro stability, higher employment and sustained growth.

4. GCC: Pattern of Growth and its Underlying Laws of Motion: a Generalized Linkage Approach

The Arab economy moved, more or less, in synchrony during the last quarter century. One can generalize by saying that it was on a commodity standard, namely oil. The rise in oil prices after the first oil shock in 1973 generated huge oil surpluses to a number of GCC member countries. This served as a direct engine of growth to the producing countries and indirectly to other Arab countries and the region as a whole. The intra-regional mechanism of oil surplus regional dispersion was mainly financial transfers, public and private. However, while such transfers led to a substantial rise in expenditure, its contribution to the real economy’s sustained development was less obvious.

The size of the oil revenues’ windfalls was quite substantial by virtue of its sharp price rise. This is besides the speed and low cost of its extraction. Furthermore, given the producing countries’ sparse populations and shallow domestic markets, the oil boom had all the characteristics of a booming sector model. Its consequences on national and regional patterns of growth were deeper in comparison to other cases of booming sectors based on agricultural and mineral commodities.

There has been a growing literature (particularly in the 1980s) on booming sector economics and the “Dutch Disease”. The Dutch Disease refers to the adverse effect on Dutch manufacturing of the natural gas discovery in the 1960s. Booming sector models have also been applied to shed light on historical episodes of disequilibrium effects on other sectors and resource allocation.

This approach has been applied as well to the rise in oil prices and the windfall profit it generated. Some quip that it might be somewhat of a mixed blessing because of its long-run repercussions on other sectors including "deindustrialization". In a nutshell, the mechanism behind this goes as follows: "part of the oil revenues is spent on non-traded goods which leads to a real appreciation in their prices…This in turn draws resources out of the non-oil traded sectors into the non-traded goods producing sectors."[2]

As has been stated earlier, the performance of the GCC economies and the Arab region as a whole fell short of what everyone was hoping for. The Dutch Disease literature pointed to a particular policy weakness, namely the negative effect of the booming sector on the growth of other sectors in the economy. It referred particularly to its bias against tradable sectors leading sometimes to "deindustrialization" and impacting the trade balance negatively. However, this model of analysis does not provide answers to many dynamic questions related to strategies and processes. What strategies did the booming sector economies formulate in using their oil wealth to promote growth and development? How can we measure aspects of success or failure and their underlying causal relationships? Alternative approaches are needed.

Most other writings on the subject emphasize political and institutional factors. On the other hand, some policy makers looked at the extent to which oil revenues led to a rise in capital formation as the main criteria of success. Others focused on contributions to fostering growth of a particular sector, notably industry.

The neoclassical approach, on the other hand, emphasized long-run outcomes. The level of consumption and its distribution overtime and across groups represents the overriding criteria for assessing the use of the windfalls. It considers the level of investment relevant in the short-run, but only as far as its contribution to maximizing long-term growth and consumption.

When wealth is derived from a non-renewable resource, such as oil, its income becomes a Ricardian rent. In this case, the macroeconomic theory approach prescribes the need to determine what constitutes a sustainable level of government consumption to preserve resources for future generations. Accordingly, output levels should be decided on the basis of changes in prices with an eye on keeping wealth constant guaranteeing a "permanent income." This approach is implicitly used as a guiding principle in formulating oil production and use of its revenue in some GCC member countries whenever circumstances allow.

Each of the above-mentioned approaches and criteria is important in shedding some light on the different aspects of the pattern of utilization of the windfall surplus. However, in order to answer dynamic disequilibrium questions related to the process of growth, sequencing and underlying cause-effect logic, it is felt that a generalized linkage approach would fit the purpose more[3]. This approach is based on and extends the "Staple Thesis" approach popular in the 1960s.

Linkage theory, based on input-output relations, deemphasizes comparative advantage and equilibrium analysis, and instead attempts to discover how one thing is causally related to

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[2] S. Van Wijnbergen "The "Dutch Disease": A Disease After All". The Economic Journal, March 94, p. 41.

[3] Hirschman, Albert O.: " A Generalized Linkage Approach and Development, with special reference to staples" in Essays in Trespassing: Economics and Politics and Beyond, Cambridge University, 1981.

another. Such analysis is undertaken to discover the process of growth and use of the booming sector (staple) resources under various socioeconomic settings.

A staple, in our case oil, is supposed to generate production linkages (backward) such as processing of crude oil into petrochemicals; consumption linkages (forward) refer to import substitution where fiscal linkages represent a final demand connection. But given the case at hand and the dominant role of governments which receive all oil surpluses, the emphasis here is on the "fiscal linkage."

One of the distinguishing facts about the fiscal linkages is that it possesses more degrees of freedom in the use of the windfall surplus that is unlike the production and consumption linkages which are determined by input-output relations.

The main conclusion is that fiscal linkages represent by their very nature an "unbalanced" path to growth. In the case of small countries, the ability of governments to invest develops ahead of its capacity to tax leading to fiscal imbalances. Given the need to build up capacity to invest, the rising oil resource inflows leads to building up an extended bureaucratic machinery. Such an organization becomes difficult to dismantle or even scale down later.

The resources invested are usually allocated to building up costly infrastructures in the light of the small absorptive capacity of domestic markets. Further, with no foreign exchange constraints, it is easier to import. Some of these built infrastructure capacities may initially long outpace both demand and need.

Another major linkage is the unrealistic expenditure on social services. This, on the other hand, is considered necessary as a vehicle to distribute the windfall profits and allow the population base to share in its benefits. This facet of the fiscal linkages leads to major and lasting distortions in market price and incentive structures. It represents at present a major hurdle standing in the way of building efficient market mechanisms and the move to a post-oil regime.

The resulting rise in domestic income and expenditure leads to a sharp rise in imports. The rising cost of social welfare, infrastructural maintenance and investment, coupled with rapid population growth, ultimately puts pressure on the balance of trade and maybe at a later stage on the exchange rate. Proceeds of oil exports and declining purchasing power start to lag behind import demand.

However, one can extend this line of causality further by saying that the accumulated growth in demand, domestic absorption and technical know-how prepare the grounds for a new stage in growth. With appropriate macroeconomic policies and liberalized intraregional investment (other than in free trade areas), a basis for investment in the production sectors would have arisen. In other words, the foundation of a new pattern of growth is laid down.

That may give an indicator as well as a prescription for potential future growth. Furthermore, with growth and maturity in civil society organizations as well as the private business sector, they can serve as partners to government. This new civil society sector can play a supporting role to government in leading the way to a new transformation process towards sustained growth and macro balance. With reduced reliability on the oil sector's windfall profits, sustained growth would represent a post-oil new stage.

5. Development Theory, International Political Economy and Regionalization

5.1 Development Theory: State Centrism

Development theory has in the past evinced a bias towards state centrism in the political sense of excessive dependence on state intervention in the process of development. It was also built on a methodological assumption regarding the nation state as the main universe in which development takes place. In fact, it could be argued that the ambivalence felt by some towards the theory orientation is simply a reflection of the growing disparity between this assumption and the growing trend towards globalization, regionalization and what they entail in terms of their gradual substitution for a "world approach" which has by no means reached maturity yet.

It is obvious that nowadays any development model that assumes the existence of a "free national will" is of limited use in the present world globalization context. There is a growing need in development theory and practices to reconcile their models with the realities in the international political economy that comes to dominate the development process and its underlying policies.

At the same time, the process, patterns and sequences of national and regional economic orders towards liberalization and restructuring, require a political regime. Such an order has to be based on a coherent social order and system of norms and rules.

A market system of exchange is not in itself an order, but needs to be confined by a particular order reflecting its underlying values. Accordingly, one can in this case assume that market systems differ to the extent that their underlying social orders differ.

5.2 International Political Economy: Evolution of the World Order

The concept of a world economic order refers to the rules and norms regulating international commerce transactions. As long as one particular order is maintained, the rules are known and often widely complied with. The post Second World War order, that of the Bretton Woods, and its underlying global economic institutions, provided a stable consensual order with the US as its hegemonic power.

However, in recent years the Bretton Woods order started to give way to another order based on the dictates of practised international political economy. The new liberal (or neo-liberal) international order and political economy is primarily concerned with the market principle which is considered the "natural order". Accordingly, the role of political institutions at all levels is to facilitate the development of this natural order. Attempts to seclude oneself from this "natural order" is thus to be condemned to stagnation.

5.3 Regionalization: A Stepping Stone towards Globalization

At present the world is at a crossroads moving towards either multilateralism or a less open world economy dividing the world into major trading blocs. Multilateralism would represent a pluralist world of cooperating and mutually dependent nations. The power of the state would in this case be restricted by a multilateral system of shared norms based on international regimes.

These alternative scenarios constitute competing projects backed by social forces with varying strength. There is growing popular opinion in the MDCs that to avoid global instability the world must avoid global free trade and replace it by regional trade. That does not mean that any region is prevented from trading with the rest of the world. It means that each region is free to decide whether or not to enter in bilateral agreements with other regions.

Some political and business constituents in the MDCs are getting concerned about losing jobs to LDCs with their more competitive labor costs. Many multinational enterprises are outsourcing segments of their activities to specific locations in the LDCs. It is felt that it might in due course threaten economic stability and employment levels in the MDCs.

At the same time there is growing thought in the international arena that regionalization could serve as a necessary and advantageous stepping stone towards globalization. This notion replaced the concern about the impact of regionalization on free trade as to whether it would lead to "trade creation" or "trade diversion". De facto regionalization can thus be a bridge towards globalization by helping to strengthen the microeconomic forces that drive globalization in the region by stimulating internal competition as well as by significantly enlarging domestic markets.

6. Conclusion

In the light of the above, regionalization in the Arab world represents an important step towards globalization. Regionalization and globalization are not substitutes but complements. They reinforce each other and act as premium mobile for reform and growth.

But at the same time the road to deep regionalization passes through national reforms. Treating regionalization as a sector cannot take the region any further in the light of formidable structural impediments and lack of institutional and market bases at the national level.

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GCC Countries: Selected Economic Indicators, 2002

Country	Nominal GDP $ (million)	Nominal GDP (Per capita $[1]	Population (millions)[1]	Overall Fiscal Balance (% GDP)[2]	Total Gov Gross Debt (%GDP)	Proven Oil Reserves (Years)[3]	Central Bank Foreign Assets (Months of Imports)[4]	Current Account Balance (%GDP)
Bahrain	8506	11619	0.7	0.8	30.3	15	2.7	0.3
Kuwait	33215	15098	2.2	20.6	32.9	134	10.7	20.9
Oman	20290	7515	2.7	3.7	16	16	4.8	10
Qatar	17321	28362	0.6	5.1	58.2	15	2.7	13.8
Saudi Arabia	188960	8567	22.1	-5.3	93.8	85	12.9	4.7
UAE	71187	19613	3.6	-9.3	4.5	124	4.7	5.5
GCC	339479	11979[5]	31.9	-2.7[5]	66.65[5]	83.75	7.6	6.95

Notes: [1] Including expatriates; [2] Including investment income of government foreign assets. [3] Based on current production. [4] These figures are not an accurate reflection of the country's foreign assets position because data on government foreign assets are partial in some GCC countries. [5] Weighted average.

Sources: National authorities; and IMF staff estimates

As of August 1998, financial support towards the ERF Working Papers Series from the Commission of the European Communities (through the FEMISE Program) is gratefully acknowledged. The views expressed in the Working Papers are those of the authors and do not necessarily reflect the views of the European Commission.

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