



# Using human capabilities: recapturing economic growth and reducing human poverty

*Building and using human capabilities effectively represent the engine of sustainable growth and poverty reduction. At the same time, economic growth (or lack of it) influences prospects for enhancing human development, of which persistent poverty is the antithesis. Thus, achieving sustained and equitable economic growth is intimately connected with both the process and the goals of human development. This chapter continues the discussion of the use of human capabilities in the region by reviewing the record with respect to growth, unemployment and poverty and proposing a way forward for Arab countries. It begins by examining the pattern of economic growth in the region in the last three decades, observing that sensitivity to oil markets, the low efficiency of physical capital and poor labour productivity resulted in fluctuating performance and, during the 1980s, a period of quasi-stagnation. It next considers the interrelationships between growth, average income levels, income distribution and inequality, unemployment and poverty. In doing so, it illustrates and discusses an apparent anomaly between the relatively low levels of extreme poverty in Arab countries compared to other regions and some indications of widening income disparity. After characterizing the extent, main causes and different forms of unemployment in Arab countries, it suggests that renewed growth is a necessary, although not a sufficient, condition to meet the challenge of full employment, fully use human capabilities and overcome poverty. The latter part of the chapter proposes specific policy measures towards these ends, based on mobilizing the full human and economic potential of the region.*

## ECONOMIC GROWTH

### GENERAL TRENDS

GDP in all Arab countries combined stood at \$531.2 billion in 1999—less than that of a single European country, Spain, (\$595.5 billion). Over the period 1975–1998, real GDP in the Arab world<sup>1</sup> (in the geographically selective sense adopted here) rose from \$256.7 billion in 1975 to \$445.7 billion in 1998 in constant prices. The average annual rate of growth over the period as a whole was 3.3 per cent.

At first glance, this result seems respectable, slightly above the world average (2.9 per cent). The countries of East Asia and the Pacific (EAP) and South Asia (SA) have done better, with averages of 7.4 per cent and 5.2 per cent, respectively, but the region has outperformed Latin America and the Caribbean (LAC) and sub-Saharan Africa (SSA), with rates of 3 per cent and 1 per cent, respectively.

However, the period average masks wide variations by sub-period. Arab countries saw very strong growth during the second half of the 1970s: 8.6 per cent (1975–1980), followed by a very sharp drop between 1982 and 1990 (0.7 per cent)—the so-called lost decade—and then a return to more modest averages (3.3 per cent) between 1990 and 1998. Figure 6.1 illustrates the pattern over time and shows that the overall trend was downward over the period as a whole.

Moreover, several time cycles can be distinguished within sub-periods, each with an average duration of three to four years, with very

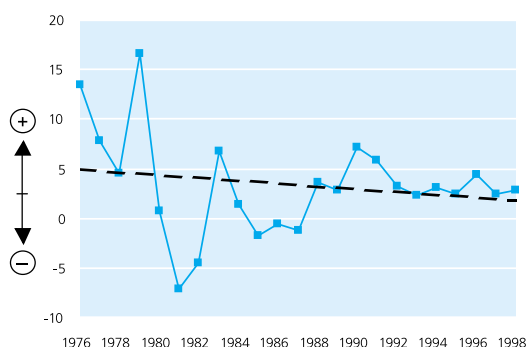
*GDP in all Arab countries combined stood at \$531.2 billion in 1999—less than that of a single European country, Spain, (\$595.5 billion).*

<sup>1</sup> The analysis presented, covering the entire period considered, does not include six Arab countries that account for a little less than 15 per cent of the population of Arab countries and about 20 per cent of the GDP of all Arab countries. Data are not available for these six countries as follows: for the Libyan Arab Jamahiriya, Qatar and Somalia during the period 1975–1998; for Lebanon and Yemen during the period 1975–1989; and for Iraq since 1990. Scattered data could be found for these countries at different points in time and from different sources. Three sub-periods were chosen for the analysis over time: 1975–1980, 1980–1990 and 1990–1998. The Arab countries were classified into three subgroups according to the level of income per capita: high-, middle-, and low-income. For comparisons with other regions of the world, the following four regions of developing countries were adopted: East Asia and the Pacific (EAP), Latin American and the Caribbean (LAC), South Asia (SA), and sub-Saharan Africa (SSA).

sharp variations in the late 1970s and 1980s but less dramatic fluctuations in the 1990s. This irregular, saw-tooth pattern of growth has consequences for material welfare, especially that of vulnerable populations, and for human development in general.

The fluctuating economic growth pattern

Figure 6-1  
Annual growth rate in GDP (1995 US\$),  
the Arab world, 1976-1998



*The fluctuating economic growth pattern in the Arab world reflects mainly movements in the oil market on which it strongly depends.*

Figure 6-2  
Annual growth rate in GDP and oil price (1995 prices),  
the Arab world, 1976-1998

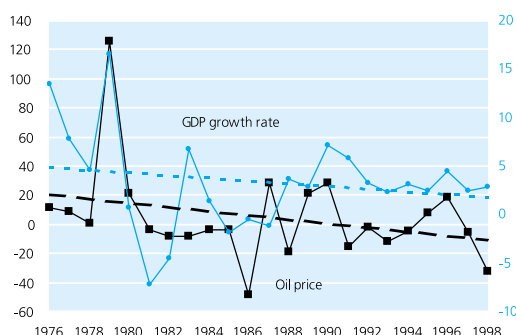
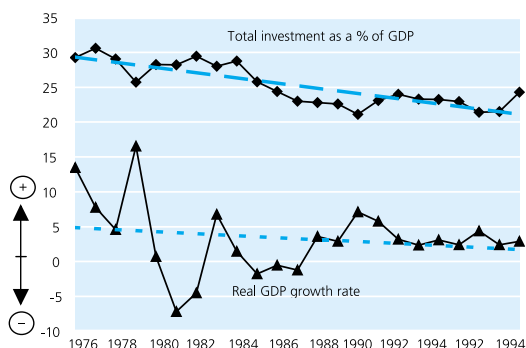


Figure 6-3  
Real GDP growth rate and total investment (as a % of GDP):  
Arab countries, 1976-1998



in the Arab world reflects mainly movements in the oil market on which it strongly depends. Throughout the period as a whole, long-run trends present a parallel picture of decline (figure 6.2), and fluctuations around the trend show distinct similarities up to the early 1990s, after which both the oil price and GDP growth fluctuated less and the connection between the two weakened.

The second factor that explains the irregular and highly fluctuating nature of economic growth is the pattern of agricultural production—although sharp variations in agricultural output have had less effect on the GDP growth rate since 1993. Thus, growth in the 1990s, while still sensitive to oil and agriculture, became less irregular.

#### FACTOR PRODUCTIVITY

##### Physical capital formation and efficiency

Between 1975 and 1998, the rate of gross investment (gross fixed-capital formation relative to GDP) was, on average, 24.6 per cent despite negligible foreign direct investment (FDI) over the period (box 6.1). The long-term trend for investment is similar to the long-term decline in GDP growth (figure 6.3). Averages by sub-period show a steady reduction: 27.3 per cent for 1975-1980, 25.1 per cent for 1980-1990 and 21.9 per cent for 1990-1998.

The contribution of investment to growth depends not only on the rate of investment but also on the efficiency with which it is used. The correlation between the rate of economic growth and investment efficiency is quite strong and significant on a world scale, as can be seen in figure 6.4, where the Arab world as a whole (the AW symbol in the chart), lies in the lower-left quarter of the graph, indicating relatively low levels of both investment efficiency<sup>2</sup> and growth.

Thus, despite a quite strong capital-accumulation effort, the Arab world shows weak investment efficiency (in terms of the productivity of physical capital) associated with a rather weak level of growth.<sup>3</sup> It should be

<sup>2</sup> Knowing that the rate of growth is, by definition, equal to the product of the rate of investment and marginal productivity (average) of capital, the latter, which encompasses the efficiency of physical capital, becomes equal to the rate of growth divided by the investment rate.

<sup>3</sup> East Asia and the Pacific, Egypt, Jordan, the Syrian Arab Republic, Tunisia and the United Arab Emirates exhibit a rather balanced relationship between the two factors as opposed to Latin America and the Caribbean, sub-Saharan Africa, Djibouti, Morocco and Saudi Arabia, where relatively weak growth is associated with a relatively weak rate of investment efficiency.

noted, however, that a significant component of investment by Arab countries during the last quarter century was in infrastructure, generally urgently needed, occasionally superfluous, but normally not yielding quick direct returns. More generally, however, a restoration of strong growth cannot be expected to materialize without significant improvement in the efficiency of gross investment in fixed capital.<sup>4</sup>

### Labour productivity

In addition to the low efficiency of investment, growth in Arab countries has been seriously hampered by low and declining labour productivity. Low productivity is a major challenge for the region. According to World Bank data (1998/1999 World Development Report), GNP per worker<sup>5</sup> in all Arab countries combined was less than half that of two comparator developing countries: Argentina and the Republic of Korea.<sup>6</sup> Dividing Arab countries into three groups (each of which accounts for about one third of the Arab work force) according to the share of oil in GNP sharpens this picture. In the first group of nine Arab countries that are richest in oil resources, productivity barely exceeds half the level in the two comparator countries; for the middle group with respect to oil's share in GDP (Egypt, the Syrian Arab Republic and Tunisia), productivity is less than one sixth of the comparators'; in the oil-poor Arab countries (Djibouti, Jordan, Lebanon, Mauritania, Morocco, Somalia, Sudan and Yemen) it is less than one tenth. This result suggests that excluding the effect of oil revenues might reduce productivity estimates for Arab economies to a greater extent than the simple overall comparison given above.

More important than measures of the level of productivity, however, are measures of changes in it over time. World Bank estimates of total factor productivity in the Middle East and North Africa (MENA) region showed a steady decline (-0.2 per cent a year) from 1960

<sup>4</sup> Efficiency varies between Arab countries. It is relatively high and associated with higher-than-average growth in Egypt, Jordan, Oman and the Syrian Arab Republic. The opposite situation prevails in Algeria, Djibouti, Mauritania and Saudi Arabia.

<sup>5</sup> As a preliminary indicator of productivity, dictated by the availability of newer data from one main source. Since the estimate of the labour force in developing countries is incomplete owing to the exclusion of women and children, especially in non-formal economic activity, it is expected that assessing productivity by this method would result in an overestimate.

<sup>6</sup> The GNP of the Republic of Korea outstrips that of all Arab countries combined (although the population of that country is less than one fifth of the total Arab population).

<sup>7</sup> A better reflection of productivity than GNP.

#### BOX 6.1

### Foreign direct investment

The contribution of foreign direct investment (FDI) to accumulation in the Arab world was only approximately 0.8 per cent on average during 1975–1998. It was around 0.7 per cent during 1975 and 1990, and it has since increased to a bare 1 per cent. For the East Asia and the Pacific, the comparable figure was around 1.7 per cent and 1 per cent, respectively, over the entire period.

The share of the Arab world in total net flow of FDI barely comes to 1 per cent over the period, with a

steady reduction by sub-period: 2.6 per cent for 1975–1980, 1.3 per cent for 1980–1990 and 0.7 per cent for 1990–1998. The Arab world remains comparatively cut off from financial globalization although some countries such as Egypt (which receives more than half the net flow of FDI to the Arab world), Morocco and Tunisia have recently seen their share of FDI grow while remaining generally weak.

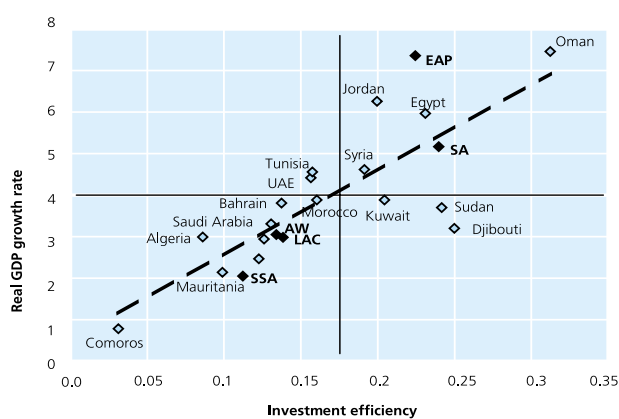
to 1990, compared to rapid acceleration in other parts of the world (World Bank, 1995: 4).

Data from the 1998/1999 World Development Report permit comparisons of GDP per worker<sup>7</sup> in nine Arab countries with that in faster-growing developing countries during the periods 1980–1990 and 1990–1997. On this basis, annual productivity is estimated to have risen by 15 per cent in China, 8 per cent in the Republic of Korea, and 6 per cent in India but only 4 per cent in the Arab countries.

Low levels of growth and productivity can be partly explained by the fact that Arab countries lag behind faster-growing developing countries in a key human-capabilities variable discussed in chapter 4: years of education. A comparison with the three Asian Tigers is revealing. In 1960, per capita output in Arab

*Growth in Arab countries has been seriously hampered by low and declining labour productivity.*

Figure 6-4  
Real GDP growth rate and investment efficiency,  
Arab countries and selected world regions



*Real per capita income for the period 1975–1998 as a whole grew very slowly, by around 0.5 per cent a year—in effect, a situation of quasi-stagnation.*

countries was higher than that of the three Tigers. The latter were, however, more advanced in terms of years of education, with a difference in educational attainment of around three years.<sup>8</sup> Over the period 1960–1992, the difference in educational attainment actually doubled, to 6 years. Not surprisingly, GNP per worker in Arab countries dropped to less than half of that in the Republic of Korea.

At the sectoral level, the United Nations Industrial Development Organization (UNIDO) provides comparative data for the industrial sector. Industrial labour productivity in the region (proxied by the organization's North Africa and West Asia region) was estimated in the early 1990s to be roughly the same as in 1970 (when it had been close to European and Japanese levels). In the face of rising productivity elsewhere, this has meant a significant relative decline. According to UNIDO (Industry and Development: Global Report, 1992/1993), Arab industrial labour productivity per worker fell as a percentage of the North American level in constant 1985 dollars from 32 per cent in 1970 to 25 per cent in 1980 and 19 per cent in 1990. It is noteworthy that the decline took place after the oil boom, which started in 1974, after an investment of \$2,000 billion in gross fixed-capital formation by 1992 and after a massive expansion in educational systems at all levels (Zahlan, 1994:107–108).

*TRENDS IN PER CAPITA INCOME (REAL GDP PER CAPITA)*

As noted earlier, the Arab world did achieve an average growth of real GDP of 3.3 per cent

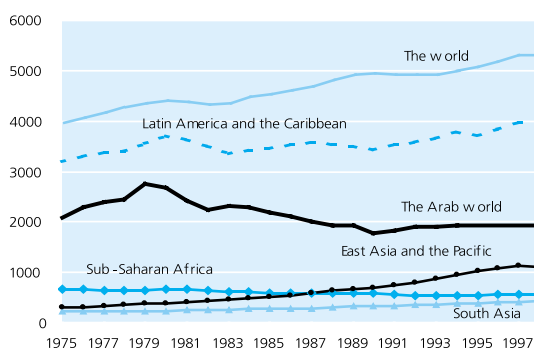
over the period 1975–1998. However, the impact of growth on the welfare of the population is related to the rate of growth of the latter, as noted in chapter 3—and population growth was very high (2.8 per cent) on average during the past quarter century although it gradually fell off over time (3.1 per cent for 1975–1980, 3 per cent for 1980–1990 and 2.6 per cent for 1990–1998).

While the relationship between real GDP growth and population growth is complex, for the geographically selective set of Arab countries discussed here, it has meant that real per capita income for the period 1975–1998 as a whole grew very slowly, by around 0.5 per cent a year—in effect, a situation of quasi-stagnation. Meanwhile, the global average increase was more than 1.3 per cent a year, implying a relative deterioration in the average standard of living in the Arab region compared to the rest of the world. In regional terms, only sub-Saharan Africa did worse than the Arab countries; over the past quarter century, having seen an actual fall in real GDP per capita. Latin American and Caribbean countries saw a modest average improvement of 1 per cent while South Asia averaged a 3-per cent rate; the best performer, East Asia and the Pacific, achieved 5.9 per cent growth.

With respect to sub-periods, Arab GDP per capita grew strongly between 1975 and 1980, from \$1,845 to \$2,300, an average annual rate of increase of 5.6 per cent. Between 1980 and 1990, growth collapsed, with a negative rate of 2.3 per cent a year, exemplifying the sharp deterioration of economic and social conditions in the Arab world during that decade. By 1990, GDP per capita stood at \$1,500; it improved slightly during the decade, reaching \$1,653 in 1997, an annual rate of increase of 0.7 per cent.

As with other variables, regional averages mask sharp differences by sub-groups of countries. The best-off group, the Gulf countries, suffered the greatest deterioration. Their GDP per capita, which grew at an average rate of 3 per cent between 1975 and 1980, turned sharply negative between 1980 and 1990 (-4.4 per cent) and remained negative (-1.7 per cent) between 1990 and 1998. The resulting rate for the quarter century as a whole is a neg-

Figure 6-5  
Real GDP per capita,  
the Arab world and selected regions, 1975–1998



<sup>8</sup> Based on a comparison of mean years of education in a group of Arab countries which includes almost three-quarters of the total Arab population, according to population figures in the early 1990s.

ative -1.8 per cent. Low-income Arab countries did a little better but still had a negative rate of growth of GDP per capita over the period as a whole (-0.1 per cent), reflecting a deterioration between 1980 and 1990 (-1.4 per cent), followed by an improvement since 1990 (+1.9 per cent). Only middle-income countries registered a slight improvement throughout the period (+0.9 per cent), with a strong increase in 1975–1980 (5.8 per cent), followed by a decline (-2.2 per cent) in 1980–1990 and a relative improvement (+1.5 per cent) in 1990–1998.

Out of the selected countries discussed here, seven have known a relatively significant improvement in average income: Egypt, Jordan, Morocco, Oman, Sudan, Syrian Arab Republic and Tunisia. Countries suffering declines included Comoros, Djibouti, Iraq (1975–1990), Kuwait, Mauritania, Saudi Arabia, United Arab Emirates and Yemen. Algeria and Bahrain saw effective stagnation.

### Real GDP per capita (PPP)

Meaningful international comparisons of real GDP per capita need to be based on purchasing power parity (PPP). Figure 6.7 provides selected regional data on this basis, using OECD countries as the comparator. In 1975, real PPP GDP per capita in the Arab world (in the geographically selective sense used in this chapter) was 21.3 per cent, barely more than one fifth of the OECD level. By 1998, the real PPP income of the average Arab citizen had fallen to 13.9 per cent, or one seventh, of that of the average OECD citizen.

The figure graphically illustrates the pattern of brief initial Arab convergence in real PPP incomes with those of the OECD countries, followed by a long deterioration into increasing divergence. By contrast, East Asia and Pacific countries moved from a ratio of about 1:20 in 1975 to about 1:7 in 1998. South Asia, despite a heavy demographic burden, achieved some degree of modest convergence. Countries in Latin America and the Caribbean (and sub-Saharan Africa) suffered a deterioration of their relative position and substantial divergence from OECD averages.

Among Arab countries, only Egypt and to a lesser degree Jordan and Tunisia had a tendency towards convergence with OECD

Figure 6-6  
Real GDP per capita by levels of income, the Arab world, 1975-1998

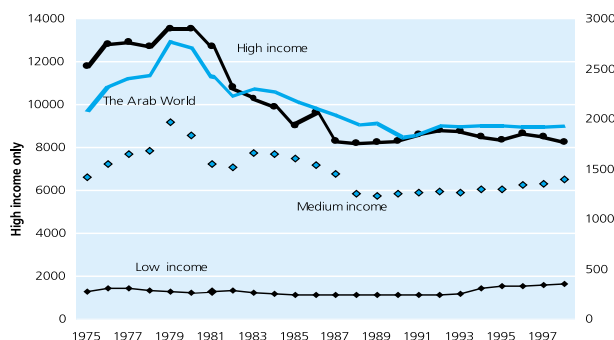


Figure 6-7  
Real GDP per capita (PPPS), the Arab world and selected regions, 1975-1998 (OECD=100)

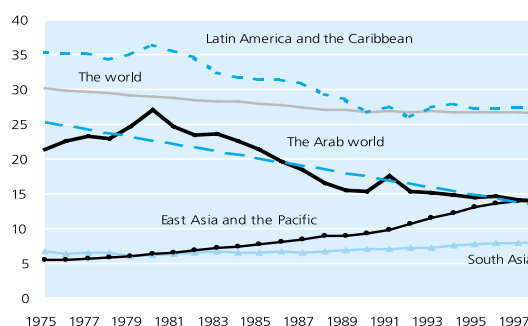
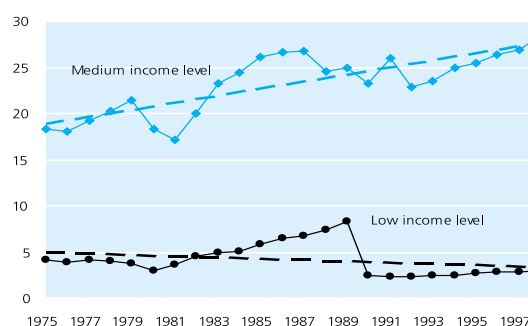


Figure 6-8  
Real GDP per capita (PPPS), the Arab world and selected regions, 1975-1998 (OECD=100)



countries. All other countries, without exception, moved in the opposite direction.

### Income convergence within the Arab region

Within the Arab world, the middle-income group has shown substantial convergence with the high-income (Gulf) countries. Figure 6.8, which equates the latter group's average income with 100, shows middle-income countries reducing the gap by 10 points, from 18.3 per cent in 1975 to 28.3 per cent in 1998. On the other hand, low-income countries, after having reduced the difference midway through the period, were actually in a slightly worse situation at its end than they were at its beginning, moving from a very low 4.11 per

*By 1998, the real PPP income of the average Arab citizen had fallen to 13.9 per cent, or one seventh of that of the average OECD citizen.*

cent in 1975 to only 3 per cent in 1998. This suggests that the pattern for the region as a whole is one of inter-country divergence rather than convergence.

#### INCOME DISTRIBUTION AND POVERTY

Income is the main determinant of the standard of living of an individual or a household and, at the macro level, of a population. Income distribution is a determinant of how a nation's wealth is shared among its citizens; it is thus an important indicator of inequalities in society.

Analysis of poverty and income-inequality issues in the Arab region is frustrated by lack of comprehensive and comparable data sets as well as by the reluctance of some official sources to share primary survey data with researchers. Moreover, United Nations agencies that try to collect and analyse poverty data often have different geographical coverage. Data for the World Bank's Middle East and North Africa (MENA) region, for example, do not include three Gulf countries classified as "high income" (Kuwait, Qatar and United Arab Emirates), or Comoros, Djibouti, Mauritania, Somalia or Sudan (all included in the Bank's sub-Saharan Africa region), and data are included on a non-Arab country, the Islamic Republic of Iran. ESCWA, on the other hand, covers the Asia-based Arab countries while the Africa-based ones are covered under the Economic Commission for Africa (ECA). Finally, the availability of reliable information is also limited by irregular patterns of data collection and publication at the level of the individual Arab country.

Nevertheless, attempts have been made to study income distribution patterns and policies in the Arab region and what they show about poverty. While acknowledging the difficulty of assessing poverty in the absence of good data on income distribution, recent studies have offered careful analyses and interesting, if not always identical, conclusions.

In their joint paper on poverty reduction in the World Bank's MENA region, 1970-2000,<sup>9</sup> Richard J. Adams, Jr. and John Page

show that the MENA countries have had the lowest regional incidence of extreme poverty in recent years, with less than 2.5 per cent of the population living on or below the \$1/day income level for dire poverty adopted for the Millennium Development Goals. They suggest that this has been due to essentially egalitarian income-distribution practices and to the ability of the region's poor to capitalize on periods of economic growth, particularly between 1970 and 1985.

On income distribution, their calculations suggest that the developing countries of the MENA region now have, on average, one of the most equal income distributions in the world, with an average Gini coefficient of 0.364 for the period 1995-1999, and that the average coefficient has been falling over time.<sup>10</sup> They attribute this to the relatively high share of income accruing to the bottom quintile of income distribution and its increasing rate over time, with the result that the MENA average income share going to this quintile over time is 7.2 per cent, the same as that of OECD and East Asia and Pacific countries.<sup>11</sup> The authors underline in particular the role of (a) migration and remittances, which "disproportionately benefited those at the bottom of the income ladder, either directly through transfers to poorer households or indirectly through their impact on the labor market"; and (b) government jobs, which cushioned the poor, especially in rural areas, from unemployment.

A UNDP analysis of the ratio of the income share of the richest to the poorest population groups in seven Arab countries for which data were obtained<sup>12</sup> confirms this picture of relatively low ratios of wealth to poverty by international standards and generally low inequality as measured by Gini coefficients. For example, by comparison with the richest/poorest 10 per cent ratios for Arab countries shown in table 6.1, Mexico's is 24.6, Kenya's is 19.3 and Turkey's is 14.2.

However, an ESCWA study on "Inflation in the ESCWA Region: Causes and Effects", published in 1999, offers a less positive picture, suggesting that income inequalities in

<sup>9</sup> Richard Adams, Jr. and John Page, "Holding the Line: Poverty Reduction in the Middle East and North Africa, 1970-2000", August 2001.

<sup>10</sup> Adams and Page, table 2.

<sup>11</sup> Adams and Page, table 4.

<sup>12</sup> HDR 2001.

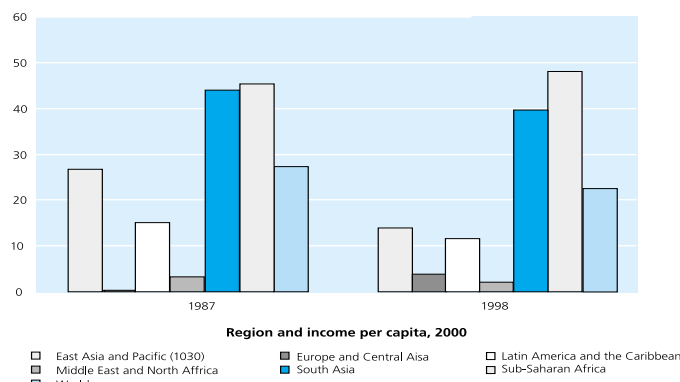
*MENA countries have had the lowest regional incidence of extreme poverty in recent years.*

Egypt, Iraq and Jordan increased in the last two decades. It estimates that in Egypt, between 1980/1981 and 1990/1991, the income share of the richest rose from 27 per cent to 28 per cent in urban areas and from 21 per cent to 28 per cent in rural areas. In Jordan, the share of the poorest 20 per cent decreased from 7.3 per cent in 1986/1987 to 6 per cent in 1992. In Iraq, the value of the Gini coefficient increased from 0.370 in 1993 to 0.508 in 1998. Implying that the gap between the higher and the lower income group had widened. The rural-urban divide is exemplified by Yemen, where the study shows that, in 1992, rural household income was less than two thirds (64 per cent) of that of urban residents.<sup>13</sup> Adams and Page also present a more nuanced picture from more detailed case studies of Egypt, Jordan, Morocco and Tunisia, with poverty during the 1990s falling in the latter two countries but rising in the former two. They conclude that "the mixed results from the country studies emphasize the diversity of contemporary experience with poverty reduction in MENA".

Could absolute poverty remain low while conventional measures of inequality rise? This question raises issues about the extent to which currently available data present the whole picture about income distribution in the region and, specifically, whether extreme poverty is alleviated by factors that are not captured in official reporting. Two such factors are briefly discussed below.

First, the Arab countries are marked by an unusually strong, cohesive system of social responsibility under which families provide sustenance to each other during hard times and income is redistributed through religious and charitable arrangements. The dual Islamic practices of *zakat* and *sadaqa* encourage the better-off to donate a percentage of their wealth to the poor. Under the *zakat*, the percentage is set at 2.5 per cent of annual cash earnings; the *sadaqa* is less rigid and more liberal with respect to the amount of sustenance provided, which can range from very minor to substantial sums. Charitable organizations have sprung up in all Arab countries to identify the poor, and to receive and distribute funds. There are no known figures for the vol-

Figure 6-9  
Incidence of poverty in the developing world, using international standards of \$ per day, 1987-1998



ume of support involved, but it can be assumed to be enormous—and it may be that this parallel system of income is enabling large segments of the Arab population to escape visible poverty and need.

Second, many Arab countries provide subsidies, mainly to military and non-military government employees, that allow beneficiaries to obtain consumer goods and perishables at below-market prices. The value of subsidies to

TABLE 6.1  
Income ratios of the richest to the poorest, selected Arab countries

Country	Richest 10% to Poorest 10% <sup>a</sup>	Richest 20% to Poorest 20% <sup>a</sup>	Gini index <sup>b</sup>
Jordan - 1997	9.1	5.9	36.4
Tunisia - 1995	13.8	8.5	41.7
Algeria - 1995	9.6	6.1	35.3
Egypt - 1995	5.7	4.0	28.9
Morocco - 1998-99	11.7	7.2	39.5
Yemen - 1998	8.6	5.6	33.4
Mauritania - 1995	11.2	6.9	37.3

a. Data show the ratio of income or consumption share of the richest group to that of the poorest.

b. The Gini index measures inequality over the entire distribution of income or consumption.

A value of 0 represents perfect equality, and a value of 100, perfect inequality.

households is not readily calculated. Meanwhile, although beneficial to those who can take advantage of it, the system of subsidies does little to help the work force in the private sector or the self-employed in the organized or informal sector. In effect, subsidy regimes mask the real need for an equitable income-distribution policy that takes into account the interests of all workers.

These two factors may be playing a major role, in addition to more official mechanisms, in improving income distribution and lowering extreme poverty. Such phenomena merit

*Subsidy regimes mask the real need for an equitable income-distribution policy.*

<sup>13</sup> ESCWA, "Inflation in the ESCWA Region: Causes and Effects", 1999.

more rigorous scrutiny through regular household surveys to measure unconventional sources of income and subsidies.

## THE CHALLENGE OF FULL EMPLOYMENT

### *PATTERNS AND CAUSES OF UNEMPLOYMENT*

As growth has either fallen or risen at slow immiserising rates in recent years, unemployment has been on the increase in almost all Arab countries. As with income distribution, consistent and comparable data on employment trends are hard to find; estimates of joblessness vary widely and come from a range of different sources (table 24, Statistical Annex). Thus a unified treatment of the topic on a region-wide basis is difficult, but it can safely be assumed that most countries suffer from double-digit unemployment and that regional hot spots, such as Algeria, Iraq and the occupied Palestinian territory, suffer from much higher rates (table 24 and Nader Fergany, 1998:480). Even in cases where official figures are considered to be underestimates (Nader Fergany, 1995), there is no disagreement that unemployment is a huge challenge.

While slow or negative growth has affected employment across the region, other factors have had differential effects in different groupings of countries.<sup>14</sup>

- Gulf countries feature segmented labour markets with differential wages for nationals and non-nationals and among non-nationals as well. In the private sector, since nationals are generally unwilling to work at the same wage levels as non-nationals, employers tend to prefer expatriate labour, mostly male, unless prompted by national legislation enforcing the employment of a quota of nationals. Governments, on the other hand, have tended to absorb nationals in public-service employment for women, this has been of particular significance.<sup>15</sup> However, sluggish economic growth at 1.2 per cent and rapid population growth at 3.4 per cent during the period 1980-2000 have reduced governments' capacities to

expand public-sector job opportunities via substantial new public investment, creating a rising problem of open unemployment of nationals in a number of these economies.

- Middle-income countries have been affected, to different degrees, by declines in labour exports to Gulf countries, which traditionally provided them with an employment cushion. This has coincided with the implementation of stabilization and structural-adjustment programmes by many of these countries. The short-term contractions resulting from such programmes along with the decline in labour exports have had a serious effect on employment in middle-income Arab countries. Over the long term, while the labour-export employment cushion may continue ameliorating domestic rates of unemployment and extreme poverty for perhaps another decade or so, signs of labour-market saturation in the Gulf indicate that exports of labour services from middle-income countries will face greater challenges and yield lower returns. The prospects for greater emigration to other destinations have been reduced since September 2001, with the probability of more stringent regulations being introduced by Europe and the United States. Declining prospects for remunerative emigration will be reflected in lower remittances to middle-income countries, creating strains on domestic economies and potentially adversely affecting poverty and perhaps reducing investment and consumption unless major international and national development programmes are put in place to accelerate productive investment and to reinvigorate growth.

- Countries affected by wars, protracted civil conflict, political instability, sanctions and occupation have experienced multiple shocks to stability that have exacerbated unemployment and poverty. Algeria, Djibouti, Iraq, Lebanon, the occupied Palestinian territory, Somalia and Sudan, for example, illustrate this point. In addition to hyperinflation and massive currency devaluations, factors such as conflict-torn governance structures, social fragmentation, destruction of productive assets and infrastructure, border closures

*Most (Arab) countries suffer from double-digit unemployment.*

<sup>14</sup> This section on factors constraining employment is drawn from "Growth and Decline in Arab Economies: A Stock-Taking Study", Fadhil Madhi, 2001.

<sup>15</sup> As stated in CAWTAR 2001: "Of relevance here is the fact that expansion of the public sector became an important channel via which Arab women have entered the labour market." Ibid.:55.

and sanctions have all taken their toll on economic development and employment. As their economies have stagnated or declined, most of those affected have witnessed out-migration of agricultural workers and qualified labour along with mass unemployment, especially among the young. As in other Arab countries, migrant workers' remittances, while instrumental in buffering households against poverty, remain vulnerable to volatile oil markets and other external shocks.

In some cases, government policy mixes that have insufficiently emphasized agricultural development while favouring capital-intensive industrialization have created legacies of instability by prompting large-scale urban migration that has turned cities into centres of discontent as population, youth unemployment and poverty have increased over time.

More generally, there are important institutional impediments to employment generation in Arab countries. For example, labour markets are traditional, severely segmented and dysfunctional; labour-market intermediation, through employment exchanges, for example, is ineffective. Structural-adjustment packages have also played a role by paying insufficient attention to reforms that build competitive, efficient labour markets, an essential requirement for growth. This omission is sometimes glossed over by the claim that labour-market rigidities and high labour costs deter employers from hiring. An integrated labour-market reform package would certainly need to involve a degree of flexibility that improves efficiency while ensuring workers' rights and social cohesion. However, greater flexibility alone cannot bear the entire weight of employment-generation policy and might have adverse, unintended consequences by straining labour relations while hardly bringing Arab economies closer to full employment.

Reinvigorating growth that will generate productive, remunerative job opportunities provides the surest way forward. Yet to do this on a scale sufficient to reduce unemployment significantly and combat poverty effectively will require a complex policy package that goes far beyond, for example, labour codes that lead to a more flexible labour market, and addresses unemployment in its various forms.

### **The different faces of unemployment**

Unemployment (underutilization of available labour) is often viewed narrowly in terms of open unemployment (in which job seekers cannot find work at all). This is not the only, or even the most pervasive, aspect of the underutilization of available labour in less developed countries. Understanding underemployment is also critical. Standard treatments of this subject, however, tend to stress visible underemployment (in which an employed person works less than a fixed time) and often fail to consider invisible underemployment, in which an employed person functions at low productivity, under-uses his or her capabilities, or earns less than enough to satisfy a defined set of basic needs. Each of these features of invisible underemployment is important. The first underpins low productivity at the level of the economy as a whole. The second results from poor articulation between the education and employment systems (noted in chapter 4) and reflects waste of resources. The third defines one sense of poverty. The concept is complex and its measurement problematic, but its importance cannot be overstated.

More generally, workers in less developed countries normally work under conditions that detract from their well-being. Hence, the unemployment problem in these countries needs to focus on aspects of the quality of employment—including humane working conditions, absence of discrimination, participation in decision-making and freedom of association (ensuring, among other things, the rights of unionization and collective bargaining)—as well as the simple availability of job opportunities.

Thus, full employment in this Report is taken to mean good jobs for all those available for work. This means jobs that are productive, in which the individual uses skills and fulfils his or her potential, under conditions consonant with human dignity, and through which enough is earned to avoid poverty and degradation.

### *UNEMPLOYMENT AND POVERTY*

In a strict economic sense, unemployment

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caused by stagnant or negative growth leads to poverty. However, poverty also aggravates unemployment. This is especially true with respect to the broad definition used in this Report. As explained in chapter 1, within the human-development paradigm, poverty is defined as a deprivation of human capability, of essential opportunities and choices needed for the well-being of an individual, a household or a community.

Thus, just as unemployment is not only about joblessness, poverty is not only about low income or expenditure, or even the failure to meet basic needs; most importantly, it is also about lack of human capability. From this perspective, poverty is almost synonymous with powerlessness. Powerlessness does manifest itself in income-expenditure deficiency and inadequate satisfaction of basic needs, but most critically, it denotes lack of access to, and control over, assets: human, physical, financial and social. This closes the vicious circle whereby poverty and unemployment reinforce each another.

On the level of the Arab region as a whole, many factors interact to shape this deprivation of human capability. Most fundamental is that of inadequate access to quality education. As noted in chapter 4, despite quantitative expansion in education, illiteracy is still high. As also noted earlier, the region's level of mean years of schooling is far below the level achieved in East Asia. The UNDP global Human Development Report illustrates the fact that, although Arab countries have made important strides in education, gaps remain by comparison with global averages. Thus, for example, they have an adult literacy rate of 62 per cent compared to a global average of 79 per cent; a combined school enrolment ratio of 60 per cent compared to 64 per cent; and average years of schooling of 5.2 compared to 6.7 years. In addition, the poor are deprived of education at higher-than-average rates, thus reducing their chances of good employment. Their access to the means of building human capabilities is also limited by the poor quality of health care, as noted in chapter 3. Finally, shortfalls in human capabilities also include the dearth of skills in the region, driven by the

absence of a dynamic system of training, re-training and lifelong learning linked to the needs of labour markets and the demands of rapid economic transformation (chapter 4).

The poor also suffer from limited and in many ways diminishing access to physical assets, particularly land in rural areas, and financial assets. Furthermore, the poor are effectively excluded from social and political institutions, a key dimension of their powerlessness. The lack of effective, integrated support to small and micro enterprises is symbolic of these problems. This neglect also flies in the face of the fact that private economic activity in Arab countries, even in non-agricultural enterprises,<sup>16</sup> is overwhelmingly small-scale. Moreover, small/informal economic activity has proved relatively successful in job creation. Nevertheless, support for small and micro-enterprises is weak.

The challenge of attacking unemployment and poverty by creating productive and gainful jobs for today's openly unemployed plus those newly entering the labour force is enormous, but it is also critical for Arab countries (especially in environments where formal safety nets are ineffective)—and it must be addressed now because otherwise, the problem will only worsen. Assuming that new labour-market entrants create a modest annual increase in the labour force of 2-3 per cent a year, 50 million new jobs will be needed by 2010. If current rates of unemployment persist, the size of unemployment will almost double by then, to about 25 million. If unemployment is to be reduced to a manageable level by the year 2010, a minimum of five million jobs will have to be created every year.

## THE WAY FORWARD

### *REVITALIZING ECONOMIC GROWTH*

This chapter has illustrated the weak growth performance of Arab countries over most of the past two decades and it has suggested that reinvigorating economic growth is essential if unemployment and poverty are to be sustainably reduced. Stimulating growth requires ac-

<sup>16</sup> Of 1.595 million private non-agricultural establishments in Egypt in 1996, 93 per cent employed less than 5 workers and 98 per cent (i.e., 1.566 million) employed less than 10. Establishments employing fewer than 5 workers accounted for nearly two thirds of employment (64 per cent) and those employing fewer than 10, for 77 per cent.

tion on multiple fronts, with individual country circumstances determining the appropriate combination of measures in each case. However, two key catalysts will be needed in all cases: mobilizing the private sector within an enabling, socially responsible policy and regulatory environment, and using the full productive capacities and human capital of all citizens. These are the keys to competitive economies based on high value-added and sustainable production.

### **Creating an enabling environment for the private sector**

The private sector needs incentives conducive to its growth and willingness to invest and take risk. The fact that the public sector can no longer be relied on to generate large numbers of new jobs makes it all the more urgent to encourage the private sector to grow, to open opportunities, and to expand markets and networks.

Governments have a central role to play in creating a positive enabling environment for private sector growth. For example, fiscal policies need to focus on the consolidation of public finances, efficient and equitable mechanisms for the allocation of public expenditure, and the provision of adequate room for private initiative—in short, sound macroeconomic policies. More attention needs to be given to strengthening central banks and financial services and, in other areas, to economic incentives, efficient infrastructure, effective import/export facilities to enhance private investment, and to aspects of good governance such as reduced red tape and an effective rule of law that commands citizens' assent and trust.

Governance issues will be discussed in more detail in the next chapter, but it is important to note here that good governance practices play a key role in revitalizing private-sector-led economic growth. With respect to the rule of law, an equitable, well-functioning legal system, including an efficient and effective judiciary, is critical in the economic as well as the social sphere. Other aspects of good governance needed to establish stability and trust among private-sector partners in development include a strong commitment to pub-

lic accountability; a regulatory system that is fair, transparent, effective and evenhandedly enforced (for example, in attacking public and private monopolies); and appropriate legislation (including, for example, protection of intellectual property rights).

Public-sector reform has become a major focus of attention in a number of Arab countries. Reforms need to be designed in terms of providing incentive structures to encourage private-sector investment and growth. In this respect, high transaction costs and unclear bureaucratic regulations and procedures are severe handicaps. Reform also needs to be undertaken from within, with the goal of motivating efficient public service through better incentive systems and organizational structures. Most critically of all, reform needs to focus on moving governments away from doing the work of the private sector and freeing them to concentrate on fostering free, open and competitive markets, which in turn create efficient mechanisms for economic exchange between buyers and sellers, producers and consumers, employers and workers, creditors and borrowers. The rewards of such reforms will be expanded participation by private firms in building the economy through innovation and entrepreneurship.

### *GENERATING AND USING KNOWLEDGE EFFECTIVELY*

A theme running throughout this Report has been that the Arab region's existing and potential human capabilities represent an inadequately tapped asset. Strengthening and using these capabilities are as important for private-sector-led growth as they are for the overarching goals of human development. For example, a dependable, qualified work force is essential for ensuring competitiveness, attracting investors, and meeting the needs of a demanding private sector, both national and transnational. In the case of foreign direct investment (FDI), one of the main engines of globalization and a critical force for the transfer and development of new technologies,<sup>17</sup> the host country must be able to offer not only the right policy mix and supporting services but also competitive workforce skills and fixed

*Governments have a central role to play in creating a positive enabling environment for private sector growth.*

<sup>17</sup> See, for example, Sanjaya Lall, "Harnessing Technology for Human Development", background paper, HDR 2001, UNDP.

### Partnerships with the private sector: breaking new ground in Morocco

A major financial and industrial holding in Morocco, BMCE Foundation, was established in 1995 by the President of the BMCE Bank to accomplish two specific missions: to fight illiteracy and preserve the environment.

#### **medersat.com: A New Alliance to Promote Schooling in Rural Areas of Morocco**

Displaying great foresight and social responsibility, BMCE Bank, through its Foundation, has launched a project "medersat.com", to build 1,001 rural community schools by 2010. The project is a concrete response to royal orientations establishing education and training as top national priorities. UNDP is a project partner.

This new partnership, the first of its kind in Morocco and the Arab region, shows that the private sector can emerge as a full-fledged stakeholder in the community development efforts of a nation.

The objective of medersat.com, built around the concept of the "school of life", is to promote schooling through integrated community development in the most disadvantaged rural areas of the country.

The Foundation undertakes the construction of rural community schools

in a manner suited to the environment in each region. In order to preserve the local architectural heritage and the environment, medersat.com draws on knowledgeable construction enterprises and local materials as well as on labour and youth from the communities where schools are built on donated land.

medersat.com, "your school" in Arabic, is for children, parents and teachers and the community as a whole. The introduction of information technology as a medium helps medersat.com to build a new generation of students in rural areas while respecting the students' culture and mother tongues, whether Arabic or Berber.

Strategic alliances have been established with the Ministry of Education, integrating recommendations from the National Charter on Education and Training, and with foreign institutions such as the Sorbonne to capitalize on international expertise in illiteracy and training.

The backbone of medersat.com is the integrated community-development approach based on a successful UNDP pilot project in education linked to sustainable development activities.

that promotes dynamic development and positive change. An environment for encouraging both knowledge acquisition and its efficient use through entrepreneurship can be provided by economic incentives supported by a strong institutional regime conducive to innovation and knowledge use.

Another source of knowledge for growth is the Arab expatriates, a dynamic component of knowledge networks outside the region where over 88 per cent of total R&D originates. These expatriates have gained a rich, varied experience working abroad and can provide technical know-how, innovative ideas and investment opportunities. Partnerships and knowledge transfer can be encouraged through targeted policies that provide financial incentives to attract both knowledge and follow-on economic investments. Developing Arab communities of learners to cross-fertilize experiences, technologies and methodologies will stimulate the economy and provide for a development environment receptive to innovation.

In addition to supporting private-sector development and the deployment of knowledge, broadly defined, as discussed above, Arab governments and societies might also consider some or all of the items discussed below when formulating strategies for revitalizing dynamic growth.

#### **Region-wide economic integration**

Most Arab economies are simply too small to be able individually to achieve rapid industrialization or diversified growth. A natural response to these limitations would be to pursue Arab regional economic and trade arrangements. Economic cooperation and freer trade among partner countries would provide mutual gains resulting from the internal and external economies of larger markets, from augmented bargaining strengths, from the pooling of resources, from inter- and intra-industry specialization, and from freer mobility of resources.

Regional economic integration is a powerful option. It can stimulate the economies of the region to work together, thereby positioning them better to participate effectively in the global economy. The Arab Free Trade Area (AFTA), which has a target date for comple-

assets.

The role of education and training strategies will be critical in this respect. These strategies need to achieve a better match than often exists today between the outputs of the education system and changing labour-market needs. To do this, the public sector needs to provide for quality educational facilities and curricula that meet job requirements in the market; it also needs to provide the regulatory environment and standards to permit private-sector facilities to fill key gaps through vocational training, on-the-job training and the development of other work-related skills.

Both growth and human-development will be enhanced if Arab countries take advantage of their intellectual capital to generate and apply knowledge. Acquiring knowledge through research centres, think tanks and consulting firms is only the beginning. Stimulating knowledge-driven growth depends on the productive application and use of knowledge

*Both growth and human-development will be enhanced if Arab countries take advantage of their intellectual capital to generate and apply knowledge.*

tion in 2008, is a step in the right direction. As more Arab countries sign association agreements with Europe, the returns from such agreements can be multiplied if regional integration arrangements, including AFTA, are in place. It is therefore important to try to complete AFTA before association agreements come into force. Also, it is advisable to move beyond free trade towards levels of integration exemplified in a customs union or a common market. Forms of cooperation and integration that improve the region's productive capacity relative to others should be pursued wherever feasible. Meanwhile, existing regional associations that address economic cooperation need to be revitalized and supported. ICT offers a new and increasingly popular opportunity for increased growth-oriented and knowledge-based economic cooperation. Finally, effective regional and subregional economic agreements can form a basis of more sustainable association agreements with partners outside the region. Progress and options with respect to regional integration are discussed in chapter 8.

### **Growth triangles**

Growth triangles provide a new means for sub-groups of countries within regions to cooperate and integrate. The growth-triangle concept is based on the proposition that the sum of factor endowments among compatible economic partners can be greater than the individual parts. In East Asia,<sup>18</sup> cross-border trade, investment, technology flows and enhanced cooperation in hard and soft infrastructure development fostered the electronics boom that propelled the region to the forefront of the industry and created vigorous industrial and economic linkages among collaborating countries. Growth triangles are built on flexible arrangements whereby the capital, labour and natural resources needed to enter regional and world markets can be shared among collaborating countries, with one contributing financial capital and technical know-how, for example, and another providing natural resources and cheap labour unavailable in the first. By combining the endowments of each country, partnerships

emerge that bring more growth and prosperity to partners as a group than any could have achieved alone.

Beyond comparative advantage, growth triangles can also help to create a competitive edge by focusing partner countries' joint resources, skills and knowledge on creating new products and services demanded by new markets, overcoming possible disadvantages that each may face individually. In addition, growth triangles can serve equity objectives; they can help to close the income and growth gap between economic centres and their peripheries by locating new industries in border regions of neighbouring countries (provided economic complementarities and adequate infrastructure are available). Since Arab countries' endowments vary greatly—e.g., the Gulf countries are richly endowed with capital while others such as Jordan, Lebanon and the Syrian Arab Republic are well endowed with labour—growth triangles could help them to combine their resources creatively to participate more effectively in global markets, making global forces work for, instead of against, their priorities.

### **Eliminating conflicts**

Conflicts are not only human disasters and sources of volatility and political instability; they are also major constraints on high and sustained growth. Civil wars have impeded the growth of the mixed oil economies (Algeria, Iraq) relative to East Asia, and the growth of low-income Arab countries compared to the relatively stable middle-income countries of the region. The many recent regional and international conflicts have exacted significant costs. Resolving these conflicts would obviously require a just and comprehensive resolution of the Arab-Israeli question, which is at the core of the region's political crisis. In addition, resolution of other regional conflicts would require enhancing the Arab League's capacity to promote cooperation and conflict resolution among its Member States as well as between League members and other neighbours and partners. Addressing the damage wrought by civil wars, which remains a serious challenge for many Arab countries, would require a fundamental rethinking

*It is therefore important to try to complete AFTA before association agreements come into force.*

*Conflicts are not only human disasters and sources of volatility and political instability; they are also major constraints on high and sustained growth.*

<sup>18</sup> Examples of thriving growth triangles include the South China triangle comprising Fujina, Guangdong, Hong Kong, and Taiwan Province of China, and the SIJORI triangle made up of Singapore, Malaysia's Johore State and Indonesia's Riau Province.

*Arab women remain marginalized and underutilized in all arenas, notably in terms of their economic, intellectual and leadership potential.*

*Policies should aim to correct the distorted incentive structure that forces Arab children to seek work rather than an education.*

of how to respond to, and reconcile, cultural and religious minorities in the Arab world. Recent evidence on the causes of civil wars suggests that they are essentially a response, usually by a social or cultural minority, to political repression and economic deprivation imposed by a dominant central state (Elbadawi and Sambanis, 2001).

#### **Promoting social cohesion**

The central role of social cohesion in the ability of an economy to sustain growth, especially following external shocks, has been demonstrated in countries round the world, perhaps most evidently (although with exceptions) in East Asia. Social cohesion can be high when a society is relatively homogenous (for example, because of religious and ethnic homogeneity or very low income or wealth inequalities). Social cohesion can also be high in socially diverse societies, provided that there are sufficiently strong institutions for mediating conflicts of interest among social groups. One aspect of social cohesion in Arab countries, the expression of solidarity with the poorest segments of society through social networks and charitable support, has already been noted, but persistent inequality, of income or of capabilities and opportunities, inevitably places strains on social cohesion in the long run.

Enhancing essential social cohesion in the Arab world will depend critically on improving political rights and political, social and economic participation and inclusion, as will be discussed in chapter 7. Moving in this direction will not only pay large positive dividends for societies and economies; it will also help them to be resilient in the face of the consequences of the increased economic shocks associated with globalization (which can be especially devastating for countries with low social cohesion). Moreover, it is reasonable to view civil wars as examples of the breakdown of social cohesion at the national level. Given the horrifying effects of such conflicts, enhancing political rights and inclusion should be a top priority for maintaining national integrity and peace.

#### **Tapping the full potential of all**

As noted earlier, economic growth relies on

human resources and capabilities. To be successful and liveable, societies need to do their best to mobilize these capabilities and seek to ensure their optimal deployment and fulfilment. However, significant gaps remain in the mobilization of human capabilities in Arab countries.

The most obvious of these gaps is that Arab women remain marginalized and underutilized in all arenas, notably in terms of their economic, intellectual and leadership potential. As women number half or more of any population, neglecting their capabilities is akin to crippling half the potential of a nation. This is exacerbated by the fact that even in those cases where some women are part of the economic arena, they suffer from extraordinary opportunity deficits, evident in employment status, wages, gender-based occupational segregation and other barriers. These factors block the full integration of women into the economic and intellectual life of their countries. Policies and regulations that can liberate half of the population of Arab countries will have a positive impact on economic growth and social cohesion.

Prospects for optimizing human capabilities over the medium term are deformed by the persistence of child labour. Child labour is both morally reprehensible and bad economics. This form of exploitation is first and foremost against the Rights of the Child as established by consensus in the international community; it also deprives the child of a skills-enhancing education, thereby automatically mortgaging his or her future potential in the work force. Policies should aim to correct the distorted incentive structure that forces Arab children to seek work rather than an education that benefits them and their societies in the medium term.

### *TOWARDS FULL EMPLOYMENT AND POVERTY REDUCTION*

#### **Conceptual and institutional context**

The previous section has focused on ways to reinvigorate economic growth on the grounds that growth is essential for employment creation and that large-scale generation of productive and gainful job opportunities is both

an essential objective in its own right and—along with other benefits from rapid, sustained and humane economic growth—also essential for poverty reduction, which must be at the heart of any human-development strategy. Hence, employment-creating and poverty-reducing growth must be one of the overarching objectives of human-development policies in Arab countries. In this context, however, it should be noted that past patterns of growth have not simply been erratic and insufficient, as demonstrated in earlier sections of this chapter; there are also indications that economic output is being increasingly unequally distributed in favour of capital, a development that does not augur well for the optimal job creation that is essential for poverty reduction.

Moreover, recalling this Report's broad definitions of both unemployment and poverty—which imply that moving towards truly full employment involves more than simply creating formal-sector jobs and that poverty reduction involves more than attacking income poverty, critical though both these objectives are—restoring GDP growth alone will not be enough. It needs to be accompanied by a range of wider initiatives to ensure employment that fully uses human capabilities and promotes human dignity and to address non-income aspects of poverty such as powerlessness and exclusion.

Moreover, development theory and practical experience now emphasize that these wider considerations are also critical for securing rapid and sustained economic growth. On this basis, there is no conflict between properly specified economic development and human-development policies and goals; rather, they should be seen as mutually reinforcing. Perceptions of conflict between them reflect factors such as analytical confusion of means with ends, the influence of outdated dogma and entrenched interests in some instances and, above all, inadequate understanding of the holistic nature of the development process.

This section therefore complements the preceding section and draws on findings from previous chapters to propose actions that will support moving towards full employment and poverty reduction in the broad sense in which these goals are understood in the human de-

velopment paradigm. However, it is contended here that these and other human-development-oriented initiatives designed to improve the use of human capabilities are also cornerstones of the effort to reverse the recent pattern of inadequate growth in Arab countries, which has been both a cause and a consequence of inadequate human development.

Finally, this section also briefly refers to some of the governance and institutional factors (discussed in more detail in the next chapter) that are needed to liberate human capabilities in order to enhance human well-being broadly defined. The primary responsibility for empowering the poor in less developed countries still lies with the state. More effective and responsive state institutions, based on public-service reform and governance reform, including the creation of representative and accountable local governance, will be essential components of efforts towards poverty eradication. However, just as growth alone cannot bear the whole weight of poverty reduction, the state alone cannot secure sustainable growth, full employment and elimination of the scourge of poverty. Arab countries' success in achieving these goals will be conditional on the evolution of a new social contract in which a synergy is generated between a revitalized and efficient government, a dynamic and socially responsible private sector, and a powerful and truly grass-roots civil society.

#### **A policy package towards full employment**

Arab States working towards full employment and poverty eradication will need to take action in three broad areas and on an integrated basis.

- *Monitoring of employment and poverty.* Any programme is only as good as the information on which it is based. Countries need to put in place an efficient, comprehensive system for monitoring employment and poverty. The system should include regular monitoring of basic parameters together with less frequent in-depth analyses of the characteristics and dynamics of employment and poverty. It should be complemented by bringing together currently dispersed data to provide an enhanced, regularly updated information base on human development, covering the state of human ca-

*Employment-creating and poverty-reducing growth must be one of the overarching objectives of human-development policies in Arab countries.*

*The crux of the process of poor-enabling development is major institutional reform that radically raises the share of the poor in the power structure of society.*

pabilities, their use and their outputs in Arab countries.

- *Effective safety nets.* However determinedly implemented, policies take time to produce desired effects and may not be able to reach all citizens (for example, the elderly or the handicapped). Proactive policy therefore needs to be supported by an effective system of social protection. The social safety nets now in place in Arab countries are lacking in coverage and effectiveness. They need to be upgraded to provide for income transfers, indexed to inflation, that are sufficient to guarantee a minimum decent level of living to all in need; in particular, they should provide for adequate unemployment compensation.

- *Supportive development patterns.* Working towards full employment needs to be anchored in a pro-poor process of development based on labour-intensive growth that offers productive, gainful employment opportunities for all individuals available for work. As part of this process, the poor need to be equipped for employment opportunities through pro-poor human-capital accumulation provided through education, training and health-care systems. They also need to be enabled to help to create such employment opportunities through the creation and management of small and micro-enterprises. This entails ensuring easier access to, and firmer command of, other forms of capital, i.e., physical assets and finance, and because small and micro-enterprises are fragile economic entities, additional supportive services will be needed to guard against failure.

The crux of the process of poor-enabling development is major institutional reform that radically raises the share of the poor in the power structure of society. Institutional reform is the path to maximizing the societal capital of the poor. As such, it is institutional reform rather than economic growth per se that constitutes the heart of poor-enabling development. Without it, growth is likely to be slow. More importantly, growth is doomed, in the context of unregulated markets, to grossly favour the rich and penalize the poor.

Some specific dimensions of a policy package designed to attain full employment and eradicate poverty in Arab countries are out-

lined below.<sup>19</sup> To realize its benefits, this package needs to be implemented as an integrated whole.

### **Building human capabilities**

*Education and training.* A full-employment development policy should include the goal of providing universal, high-quality, development-relevant, basic education and ensuring that no beneficiary is excluded on account of poverty. In some cases, this means going beyond providing free education. For the poorest of the poor, some form of affirmative action in the shape of scholarships that provide for the direct and opportunity costs of education will be necessary. As with basic schooling, children from poor backgrounds should not be excluded from higher levels of education by lack of material means. In addition, redressing the gender gap in education and training must be a core element of the policy agenda.

Meanwhile, the quality of education, including its relevance to context-specific life skills and labour-market requirements, needs to be continuously improved at all levels. This is a demanding, complex societal endeavour that extends, as noted in chapter 4, beyond the confines of the education sector. For example, formal education is not the only vehicle for strengthening human resources for productive employment. Informal channels for effective, market-relevant skill acquisition may be more relevant for the poor, particularly in conditions of widespread joblessness. These sources of training would also be relevant for dropouts from the formal education system or graduates with limited skills.

*Health care.* Poverty should not deprive any individual of basic preventive and curative health care. The provision of health care for girls and women should be a priority. The issues raised in chapter 3 with respect to improving health care should be addressed without delay.

### **Employment and productivity**

In addition to reducing joblessness to a level close to full employment—based on higher investment and labour-intensive growth that uses employment-intensive technology with-

<sup>19</sup> This section closely follows the recommendations contained in the report on Poverty in the Arab Region, Bureau for Arab States, UNDP, 1997.

out sacrificing efficiency—the objective of a strategy should be to enhance the social welfare associated with higher employment by improving productivity so that real wages rise and disparities in the distribution of income and wealth fall. The goal should be to double productivity every few years and ensure adequate satisfaction of the basic needs of the working population. Barriers to the gainful employment of women must be lifted.

As well as raising levels of human-resource development, policies for enhancing productivity call for a favourable societal incentive system with positive rewards for education and high productivity. Moreover, a synergistic approach to technology development should be established by simultaneously raising the productivity of labour-intensive technologies in small and micro-enterprises while also strengthening modern technologies and reinforcing the linkages between the two.

*Support for small enterprises.* Development of informal small enterprises can contribute effectively to the strategic goal of poverty eradication through employment generation. Informal small enterprises are labour-intensive and capital-light, conditions that are perfectly suited to the national economies in which the vast majority of Arabs live. A major national effort needs to be put in place to promote them. The formulation and implementation of public policy should take into consideration the multifaceted nature of informal economic activity as well as current constraints to its development.

Small enterprises are notorious for high failure rates unless the economic and institutional environment in which they are set up is truly hospitable. Support for small enterprises needs to cover the entire spectrum of their needs: the legal and regulatory environment, finance, training, technical and management backstopping, and penetration of domestic and foreign markets. Ensuring easier access to, and firmer command over, physical assets, particularly land and water in rural areas, is also critical. Women, by virtue of their higher unemployment rates and proven ability to manage small enterprises and businesses, are prime candidates for programmes aimed at reinvigorating the small-enterprise sector.

This is not to say, however, that informal

small enterprises can be the salvation of Arab economies. The appropriate approach is what the Chinese call "walking on two legs". No economy has developed without significant growth of enterprises of different sizes and, more importantly, without forging strong links between large and smaller enterprises. With wise policies, the promotion of small enterprises should lead, over time, to higher productivity and a process of growth and graduation into the formal sector.

*Sustainable rural livelihoods.* Unemployment and poverty are increasingly acquiring a rural character in Arab countries. Stimulating rural economies needs to be a central goal of policy. In this context, a key role for governments will be to improve rural infrastructure and farm-to-market linkages (domestic or international) and reform price structures in favour of producers. In addition, irrigation systems need to be rationalized, extension services improved, and off-farm employment opportunities promoted for the land-poor and the landless through industrial decentralization, micro-enterprises and public works. Women are a mainstay of agricultural communities; they should figure prominently in the design and implementation of rural-development policies and programmes.

#### **Institutional reform**

*Labour-market reform.* A full-employment policy needs to include ensuring that labour markets offer job seekers free access to information on employment opportunities and efficient employment exchanges. Labour markets also need to be deregulated gradually in order to increase flexibility within a competitive market framework while maintaining essential worker protections. This should be based on balancing the rights of employers with those of workers. As already noted, social safety nets need to provide for adequate unemployment compensation (which should be inflation-linked), and the prospects of productive employment for the jobless need to be improved, including through retraining if needed.

*Reform of public services.* Certain essential economic functions remain the unique domain of government. Nevertheless, governments in less developed countries are often notoriously inefficient, with implications

*The goal should be to double productivity every few years and ensure adequate satisfaction of the basic needs of the working population.*

*For the poor to be heard and their interests recognized, government needs to be made truly representative and effectively accountable to all the people.*

for overall economic performance and specifically for the well-being of the poor in the critical areas of publicly provided health and education services.

Institutional reform in the health sector needs to focus on ensuring more efficient use of resources so that resources can be freed up to achieve wider social coverage. In addition to optimizing the allocation of health budgets, personnel and facilities, consideration should be given to providing health services through schemes that combine publicly owned clinical services, social and private insurance systems, and patient payments based on income. The financing of such schemes should have a positive bias in favour of the poorest segments of society. They could include targeted subsidies for transparently managed community health-insurance schemes in rural areas.

In the financing, management and oversight of education, institutional reform needs to emphasize increasingly modeling the role of the state not on ownership but on partnership. While publicly provided universal primary schooling remains a state responsibility, the state has no monopoly at other levels of education. All key stakeholders should be represented in the governance of education, particularly at the tertiary level where asymmetrical costs and returns require concerted action and independent quality assurance. The advent of privately funded universities should be welcomed in an environment of resource scarcity, but it will not serve Arab higher education to exchange government failure for market failure. The state must lead in building public-private partnerships in education and training systems that do not discriminate against the poor but instead actively promote their inclusion through scholarship schemes, vocational training grants and on-the-job training.

Public-sector reform, as an essential component of an institutional reform package, has many dimensions. For example, incentives for government workers need to be improved through transparent structures, adequate wages and removal of discrepancies among various sectors of government service. Appropriate arrangements for funding the equipment and operation and maintenance services necessary for efficient functioning

should be put in place. Sound public-administration practices that enhance productivity need to be instituted, including basing recruitment and advancement as well as termination of service on merit.

*Development of civil society.* Civil-society institutions have the potential to contribute significantly to poverty reduction and job creation. However, for this potential to materialize, civil-society institutions need to develop into a broad-based, inclusive, efficient and sustainable grass-roots vehicle for efficient, sustainable collective social action that effectively combats the powerlessness that lies at the heart of poverty. However, empowerment of the poor through inclusion in socially effective civil-society institutions can take place only through the full integration of women.

*Governance reform.* Encouraging the development of a vibrant, effective civil society needs to be part of a wider empowerment effort based on reform of governance, broadly defined. As already noted, the poor not only lack all forms of conventional capital—physical, 101 and human; they also have no voice in the affairs of society. Civil-society institutions alone cannot redress this state of affairs. For the poor to be heard and their interests recognized, government needs to be made truly representative and effectively accountable to all the people. Genuine local government, not simply decentralization, ensures more effective participation of people, especially the poor, in the difficult war on unemployment. Meaningful citizenship and political rights will emerge only once they are fully inclusive of women, in practice and not just in the letter of the law. The next chapter discusses key aspects of governance and governance reform in Arab countries in order to advance freedom—the full exercise of human capabilities—within a socially responsible and responsive institutional, legal and political environment. It thus completes the triad of actionable areas proposed in chapter 1 that has framed the structure of this report—building, using and liberating human capabilities as the basis for a human-development strategy for Arab countries.

### Poverty eradication and development from an Islamic perspective: the case of the Arab world

At the start of the third millennium, the Arab countries find themselves in a state of structural underdevelopment and are suffering, in varying degrees, from poverty and dysfunctional economies.

On both the theoretical and practical levels, facts have clearly proved the inadequacy of the conventional economic approach to the problems of underdevelopment and the incapacity of such an approach to provide them with satisfactory solutions. On the other hand, as an untarnishable source of values, Islam advocates unity, brotherhood, solidarity, justice, peace, tolerance, equilibrium, order and discipline. Moreover, Islam encourages knowledge and all efforts aimed at promoting well-being and social justice. Within Islam, the material and spiritual aspects of life are inseparable. That is how Islam considers justice to be a fundamental principle, which should encompass all aspects of human activity.

Islam favours the global approach to the establishment of a society based on social justice by way of full employment (stressing the struggle against poverty), reduction of disparities through an adequate redistribution of wealth, and prohibiting the concentration of wealth and monopolies as well as illicit activities such as appropriation by extortion and usurpation, fraud, corruption, embezzlement of funds and property, hoarding (*kenz*), waste (*tabthir*), extravagant spending (*israf*), miserliness (*bukhl*) and usury (*riba*).

Thus, the struggle against poverty in the Arab world should be tackled within the framework of global policy. This means that national economies should be organized on the basis of full employment on one hand and organization of the economic integration of the Arab countries on the other.

At the domestic level, desirable and necessary measures for the establishment of a just, united society where solidarity prevails should

be taken in four directions:

1. First of all to find ways and means to eradicate poverty by attacking the very roots of the problems through:

- The struggle against unemployment by means of a dynamic employment policy of social transfers for the benefit of the poor and the needy, particularly those who are physically incapable of working.

- The organization of social solidarity on the basis of an equitable policy of social transfers for the benefit of the poor and the needy, particularly those who are physically incapable of working.

In this context, we should call to mind that Islam makes justice of distribution a priority in an Islamic economy. Measures expressly advocated for such a purpose in the Quran and the Sunnah consist of voluntary contributions and mandatory actions such as the *zakat*.

2. It is imperative to increase development expenditure to benefit the sectors of education, health and scientific and technical research. In fact, giving the human factor its full value is imperative since development implies, first and foremost, the promotion of the human being and his/her active and responsible participation in the process of building a national economy, the fruits of which should benefit society as a whole.

3. Moreover, particular attention should be paid to the productive sectors (sectors that generate wealth, so as to ensure the sustainability of development), such as agriculture, small and medium industries, the construction sector and public works. In order to achieve such an objective, the private sector should be encouraged and public expenditure should be re-examined and rationalized.

Each Arab country is a unique case, but generally speaking, it may be said that military and prestige-related expenditures are very high in the Arab world and can be reduced to the

benefit of productive activities and expenditure for development.

4. Finally, it is a matter of adopting institutional tools as frameworks for the economy, conducive to ensuring both social justice and economic growth in a dynamic perspective.

At the external level, the Arab countries have no choice, if they wish to avoid the deleterious effects of globalization but to establish their own regional economic space in an autonomous and viable manner and to position themselves as credible partners at the international level.

Within this framework, Arab regional integration should not be confined to a pseudo-liberalization of exchange of the common market type. It should be a global and coherent procedure implying in-depth and concerted actions among Arab countries, within a regional framework, in order to adapt the structures of industrial and agricultural production, the structures of the regional market and the regional financial space to the real and potential economic possibilities of the regional space in question. On the basis of a structural approach, the establishment of a regional economic space should be organized around common production, financial and exchange objectives in view of increasing inter-Arab real financial flow. The construction in stages of such an economic space necessitates organizing the coordination of economic policies of member countries and the implementation of a common regional policy of development of human resources to promote active solidarity in the Arab world.

The only way for Arab countries to emerge from poverty and structural underdevelopment is to promote economic efficiency, progress, welfare and social justice within a regional framework and from a perspective of unity.

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