

Islam, Globalization, and Economic Performance in the Middle East

Marcus Noland and Howard Pack

The Middle East is a demographic time bomb: the economy must grow 5–6 percent annually for the next two decades to absorb new entrants to the labor force. The only plausible way for this to occur is through a successful process of cross-border economic integration. Islam itself is not an impediment, but public opinion harbors reservations about globalization. This can create a vicious circle in which insecurity in both its economic and cultural dimensions precludes those measures necessary to accelerate growth.

The Middle East is sitting on a demographic time bomb. According to the United Nations Development Program's (UNDP) *Arab Human Development Report 2002*, the population of the Arab region is expected to increase by about 25 percent between 2000 and 2010 and 50 to 60 percent by 2020. The latter figure represents an increase of as many as 150 million people, or more than two additional Egypts. Even under the UNDP's more conservative scenario, in 2020, Bahrain, Kuwait, Qatar, and the United Arab Emirates will be the only Arab countries with median ages above 30.

These figures suggest that the region as a whole will experience labor force growth greater than 3 percent for roughly the next 15 years. On current trends,

according to an Arab League report, unemployment in the region could rise from 15 million to 50 million over this period. Under plausible assumptions about the rate of productivity growth and required investment levels, the economies of the region will have to maintain investment rates on the order of 30 percent of gross domestic product and income growth of 5

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to 6 percent each year to absorb all this labor. It is a very tall order, and recent history is not reassuring.

Fragmentary data from the 1950s and more comprehensive data from the 1960s indicate that, measured either in terms of per capita income growth or what economists call “total factor productivity growth”—how much economic bang one gets for the buck—the performance of countries in the Middle East was markedly different from other developing countries. The region was superior to sub-Saharan Africa (the other region most profoundly marked by weak states and arbitrary boundaries), worse than East Asia, and comparable to Latin America and South Asia.

This pattern had changed by the 1980s, following a decade that witnessed an acceleration of inflation globally, the collapse of the Bretton Woods system of fixed exchange rates, two oil shocks, and a deceleration of income and productivity growth rates worldwide. The experience in the Middle East differed considerably among the region’s countries, with those states relying on oil production rather than a more diversified economy suffering the worst. During the 1980s, the region as a whole actually experienced negative growth in per capita income, although Egypt, Morocco, and Tunisia were notable exceptions. And while per capita incomes once again began to rise in the 1990s, it was at rates markedly slower than those experienced by Latin America and South Asia, not to mention East Asia.

Still, the failure to achieve rapid growth in order to absorb the rising number of labor force entrants could have dire implications. In a Zogby poll of Arab attitudes, Saudi males stand out as uniquely dissatisfied and pessimistic about their children’s future.¹ Presumably these feelings are rooted in the reality of dwindling employment prospects, the 40-percent decline in per capita income from its peak in 1982, and the lack of political voice. Dissatisfaction and pessimism about the future are mildly correlated with age, education level, and access to the Internet, with the youngest and least advantaged sections of society having the bleakest appraisal of the future. And, of course, fifteen of the nineteen September 11 hijackers were Saudi males.

Islam Is Not The Issue

Recent years have seen a revival of the neo-Weberian correlation between economic prosperity and religious observance. In this new rendition, instead of Calvinism acting as an agent of economic advancement, Islam is cast as an inhibitor. For example, in one of the world’s most widely circulated series of economic working papers, three professors at prominent U.S. and European institutions characterize Islam as being negatively associated “with attitudes that are conducive to growth,” and on the basis of their analysis of World Values Survey data, they assert that among adherents to the world’s major religions, Muslims are the most “anti-market.”² Popular commentaries are less nuanced.

There is, of course, some surface plausibility to this notion: Muslims around the world are often resident in poor countries such as Bangladesh

and Pakistan, though it is also the case that many live in Indonesia and Malaysia, largely Muslim nations which have relatively high income levels and growth rates. Islam is associated with distinct practices such as the prohibition on *riba*, the charging of interest, or the injunction to observe *zakat*, the paying of alms, which could serve as causal links between theological belief and economic performance. Yet attempts to rigorously assess the impact of these unique practices suggest that they have little, if any, impact on the accumulation and allocation of capital.³

Likewise, research has generally failed to uncover links between Islam and economic performance in the context of conventional growth models that emphasize such factors as macroeconomic stability and educational attainment. When one introduces into these standard growth models explanatory variables such as the Muslim population share, the statistical results are not robust.⁴ If anything, Islam appears to promote growth. This result is obtained whether the examination is of large cross-sections of countries over decades, smaller groups of countries for most of the 20th century, or sub-national jurisdictions within multi-ethnic, multi-religious states with substantial Muslim populations.

These results hold even if one allows the size of the Muslim population to indirectly impact economic performance, for example, by affecting educational attainment or the degree of political stability. Muslim countries do not appear to systematically deviate from the norm in any observable way. Statistically speaking, the economic performance of Muslim countries equates with what economic fundamentals would suggest.

Popular Attitudes And Successful Globalization

If not Islam, then what explains the relative underperformance of the Middle East in recent decades? A litany of indicators documents the weakness of the region's linkages to the world economy: import tariffs average over 20 percent, most of the larger countries in the region are not members of the World Trade Organization (WTO), the region's share of world exports has fallen steadily, and as a whole it attracts roughly as much foreign direct investment as Sweden.

It is almost impossible to imagine the Middle East generating the rapid employment growth necessary to absorb new entrants to the labor force without a big expansion of international trade. Countries such as South Korea or Taiwan, which achieved sustained periods of economic growth at rates sufficient to cope with an increasing population, did so in the context of an outward-oriented development strategy. In the early 1960s, the level of per capita income in Egypt, South Korea, and Taiwan was virtually identical, but the latter two quickly pulled ahead, leaving Egypt a generation behind. Twenty-five years ago, each of these

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Asian countries already achieved exports of manufactures *ten times what Egypt has today*. And although Egypt has a population more than South Korea's and Taiwan's combined, the Asian countries export more manufactures in two days than Egypt does in an entire year.

Although it is theoretically possible that the authorities could manage domestic aggregate demand in such a way to generate balanced growth of this magnitude for a decade or more, it is highly unlikely that it is possible in practice. The domestic economy will almost invariably develop bottlenecks if the authorities try to push it down a balanced growth path with such rapidity for such a sustained a period of time. The problem is particularly acute if the small size of the domestic market hampers firms. It is difficult to imagine a large economy like Egypt successfully pulling this off; it is virtually impossible to conceive of smaller economies like Syria or Tunisia doing so.

In one sense, the comparison with South Korea and Taiwan may be unfair—it is possible to argue that the contemporaneous levels of income in the 1950s or 1960s in these countries reflected wartime disruption of the late 1940s and early 1950s and that underlying social capacity was actually quite high. Unlike Egypt, the Asian countries, in a sense, were in the process of returning to their long-run development trajectory rather than blazing new trails.⁵

Yet similar, though less dramatic, comparisons could be drawn with other countries. Today, taking the level of physical capital, human capital, arable land, and labor into account, the most relevant comparators to Egypt and Jordan may be the Philippines, Costa Rica, and Bangladesh. Even tiny Costa Rica, with a population roughly 5 percent of Egypt, exports more than twice as many manufactures as Egypt or Jordan. And Egypt and the other countries of the region will not be able to pick and choose their competitors. Whatever the lessons of history, they will have to compete against large, formidable rivals such as China and India in world markets.

Yet it is unlikely that the Middle East will even be able to compete successfully with China or India on the basis of low wages, as they are already multiples of those found in the Asian giants, let alone other countries in the region. The possible competitive advantage of the Middle East instead lies in its proximity to Europe and its ability to service the European market in a more timely fashion than competitors in Asia, Latin America, or sub-Saharan Africa. This means integration into cross-border supply chains in which there is a premium on reliability, flexibility, and fast delivery. But as noted in a recent World Bank publication, the nations of the region are conspicuously absent from international production networks.⁶

This close integration with producers beyond the region requires cross-border investment and frequent physical contact, which immediately raises issues relating to political risk, broadly defined to include not only expropriation but also the physical security of both facilities and personnel. In the extractive sector, the location of production is determined largely by geology—if the marginal cost of extraction is sufficiently low relative to

the world price, someone will run the risk of producing from that location (though the case of Sudan should stand as a warning that the simple existence of mineral deposits is not a sufficient condition for this to hold).

The same does not hold for manufacturing or back-office type service-sector activities that are not location-specific. In this regard, the Middle East must compete with alternative locations in Asia, Africa, and Latin America, and the security risk could potentially prove to be a serious constraint. While the attacks against “off-shoring” of American white-collar jobs have mounted, the targets of concern have been countries such as India, China, the Philippines, and Mexico—not Syria or Egypt. (In this regard prospects might be better for the former French colonies of the Maghreb once the process of outsourcing white-collar tasks begins in earnest in Francophone Europe.) Another great fear in America today—terrorism—also plays a role, and although there have been occasional threats against foreign businesses and attacks on foreign tourists, most notably at Luxor in 1997, to date this does not appear to be a major problem.

Less dramatic than terrorist attacks, though perhaps more important for economic development, are public attitudes toward foreigners and globalization. The 2003 Pew Global Attitudes survey revealed a significant level of discomfort with globalization in the Middle East.⁷ As indicated in Figure 1, the percentage responding positively to globalization varies across the Middle East, with the populations of Jordan and Egypt considerably less accepting of globalization than either other Arab countries or other regions of the world surveyed. Three of the many questions posed in the Pew poll have particularly high correlations with measures of risk in economic exchange, especially foreign direct investment that involves a local physical presence. The regional pattern of responses to these three issues—the necessity of closing large, inefficient factories; the need to protect their way of life against foreign influence; and desirability of societal acceptance of homosexuality—are displayed in Figures 2–4.⁸ Relative to most respondents in the rest of the world, Arabs were less willing to close inefficient factories, more committed to protecting the local way of life, and less tolerant of homosexuality. The picture that emerges from the pattern of responses to the full set of Pew survey questions is of local populations that are relatively averse to change, instead favoring the maintenance of existing economic and social arrangements, especially if the forces of change are regarded as emanating from foreign or non-traditional sources.

Controlling for economic fundamentals, such as the level of per capita income, macroeconomic stability, and corporate taxes, across a broad sample of countries these responses have some explanatory power with respect to measures of interest such as levels of inward foreign direct investment. Although the precise channels of causality are ill-defined, it is plausible that the attitudes manifested in the survey responses are underpinning behaviors and practices that may impede successful globalization. The question about closing of factories could be interpreted as a straightforward question about the priority placed on efficiency. The questions about protecting against foreign influence and accepting homosexuality could be interpreted as capturing the extent of entry barriers to human capital from

non-traditional sources.⁹ So, for example, in a statistical sense, if Egyptian attitudes toward foreign influence were at the mean level of the least xenophobic countries of Latin America, Eastern Europe, and Sub-Saharan Africa, and Asia surveyed (Peru, Ukraine, Angola, and China, respectively), one would expect foreign direct investment (FDI) in Egypt to be almost 90 percent higher than it is. Likewise, if attitudes toward homosexuality in Jordan mimicked the most tolerant countries surveyed from Latin America (Argentina), Eastern Europe (the Czech Republic), Sub-Saharan Africa (South Africa), and Asia (the Philippines), FDI would be expected to be more than twice as high as it is today.

From this perspective, the attitudes revealed in the Pew survey are not auspicious. In a narrow sense, they reveal support for the current inward-

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oriented development strategy, which has been a relative failure, but at the same time, they may signal more profound levels of insecurity that could make successful globalization problematic. Given Egypt's labor abundance and proximity to Europe, an obvious potential market niche would be in the production of high-end garments, but fashion designers are known for their flamboyance if nothing else, and wholesale fashion buyers may rank second only to MTV producers

in their capacity to outrage traditional moral authorities. It is not clear that societies grappling with deep issues of self-definition and European fashion houses are necessarily a good fit.

Islam May Be Part Of The Issue

The 2003 Pew survey also examined attitudes toward Islam and political life in a number of predominantly Muslim countries around the world, as well as several with large Muslim minorities, such as Nigeria and Tanzania. The poll revealed ubiquitous feelings of solidarity with co-religionists in the *umma* and widespread support for the notion that Islam was under threat, though the perceived sources of this threat were multiple and predominately reflected local concerns.

In this regard, concerns manifested through Islam may simply be one symptom of more complex social processes. Islam may matter, but not in the simple sense that belief in Allah dooms one to a low personal savings rate or that Islamic banking systems handicap financial efficiency. Instead, the implications of Islamic observance are more subtle. Today there are Muslim communities in the Middle East that are relatively discomfited by aspects of ongoing social change. To the extent that adherence to Islam is a significant component of personal and communal identity, Islamic belief will be one prism through which these developments are evaluated. This pattern of apprehension may be reinforced if Islam itself is regarded as being part of this contested terrain.

Yet the centrality of religious belief in this formative process should not be overstated. As revealed in the Zogby poll, religious orientation is generally only a secondary or tertiary source of personal identity in most Arab countries in the Middle East; rather, Arab ethnicity is the primary identifier. It is almost surely the case that feelings toward foreigners or homosexuals are derived from some admixture of religious teachings and prevailing cultural norms. Religious beliefs are but one input in a complex reaction to globalization.

Conclusion

Broadly speaking, the long-run economic performance of the Middle East appears neutral when viewed in comparison to other developing countries, and the concern expressed in some quarters about the impact of Islam on economic development would appear unwarranted. That said, there is serious cause for concern.

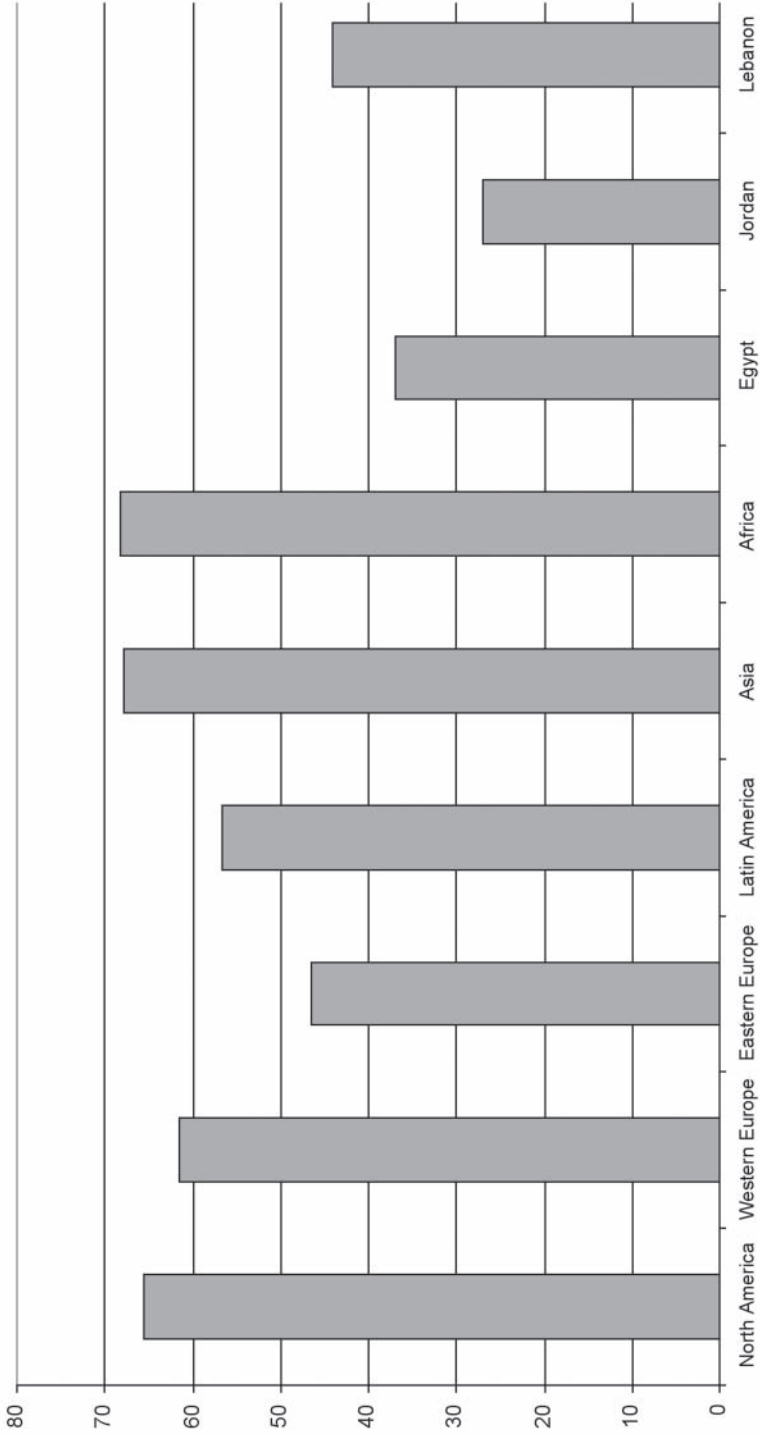
For reasons that are not fully understood, economic performance has slipped over the past quarter century or so relative to a broad set of comparators. This concern is made particularly acute by two ongoing developments, one external and one internal. The external source of worry relates to the successful ongoing globalization of China, India, and smaller rivals, which has created a more competitive global economic environment in which the Middle East must operate. The global marketplace simply embodies increasingly stringent competitive pressures and is less tolerant of substandard policies and practices than existed twenty or even ten years ago.

The internal pressure comes from demographics. The Middle East has entered a period in which its bulge generation is entering the labor force, and the imperative is to create jobs. It is almost impossible to imagine a sustained creation of employment opportunities on the needed scale without a successful process of globalization and cross-border economic integration.

This immediately raises difficult issues of sovereignty and cultural identity, and with them come obvious possibilities for self-reinforcing processes. The degree of insecurity in both economic and cultural dimensions presumably relates to actual economic performance, embodying possibilities of both virtuous and vicious circles. In this regard, the recent experiences of Saudi Arabia could be read as a cautionary tale: weak economic performance leading to pessimism about the future, accompanied by possibly counter-productive policy interventions, culminating in bouts of political extremism. It is not unreasonable to expect the exacerbation of this trend and its expansion into nearby states.

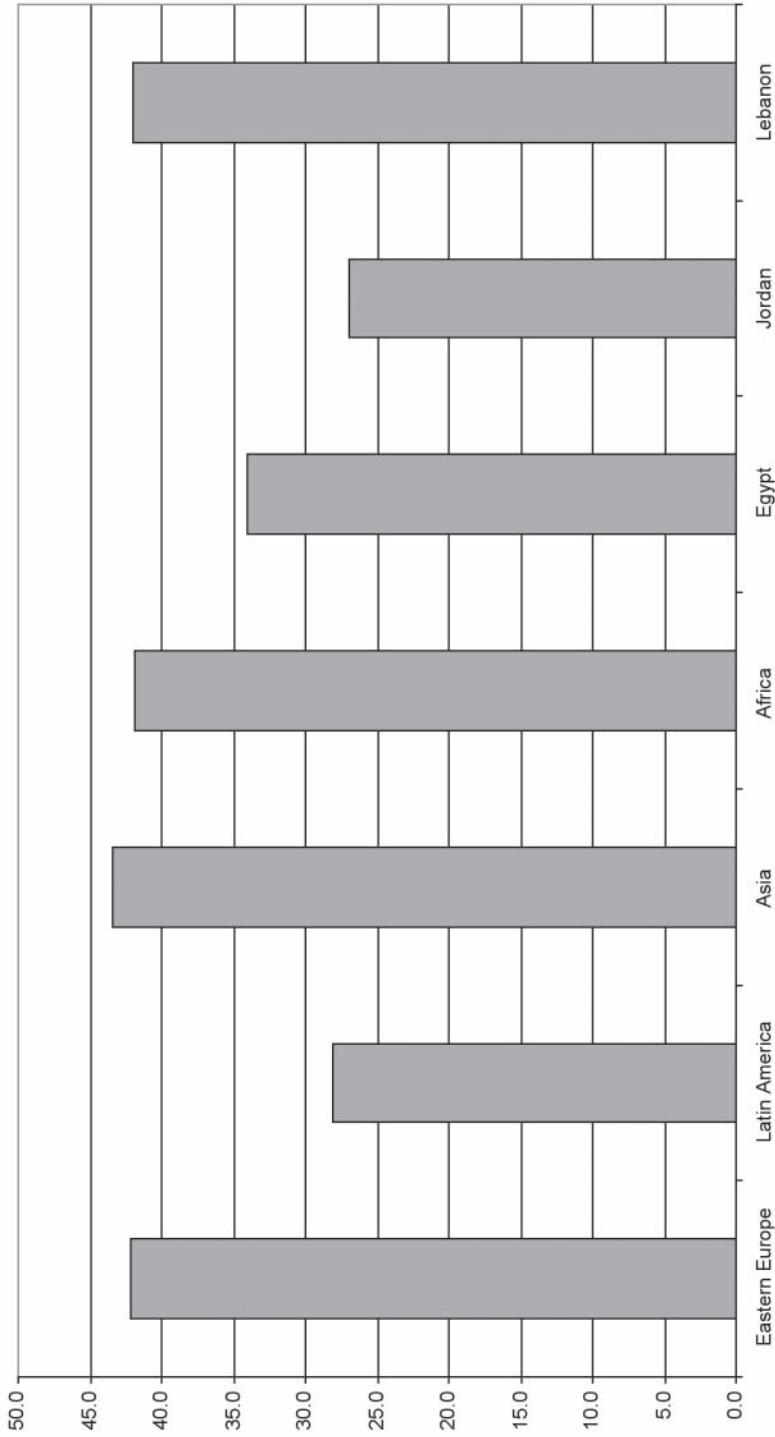
The good news is that to the extent that the Zogby poll accurately gauged regional attitudes, Saudi Arabia is the extreme case. Moreover, with fertility now dropping, the region may be well through the process of demographic transition, and as the size of the cohorts entering adulthood begins to shrink, there will be a concomitant diminution in the problems that all societies face in socializing young adult males. This process of absorbing a rapidly growing labor force, while prolonged, is self-terminating

Figure 1 Opinion of Globalization
(% who responded it is 'good')



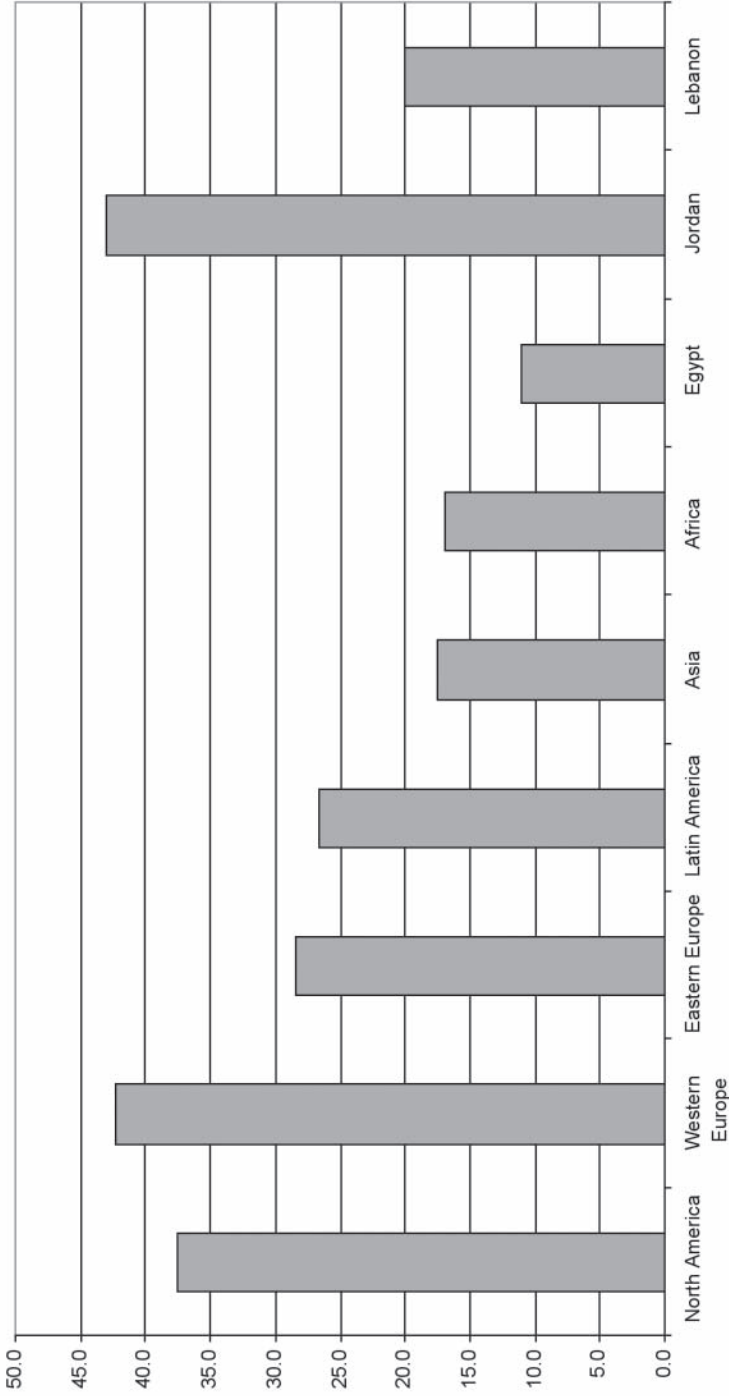
Source: Pew Research Center for the People and the Press, *Pew Global Attitudes Project, 2002 and 2003*.

Figure 2 Opinion on Closing Large Inefficient Factories
(% who responded 'hardship but necessary')



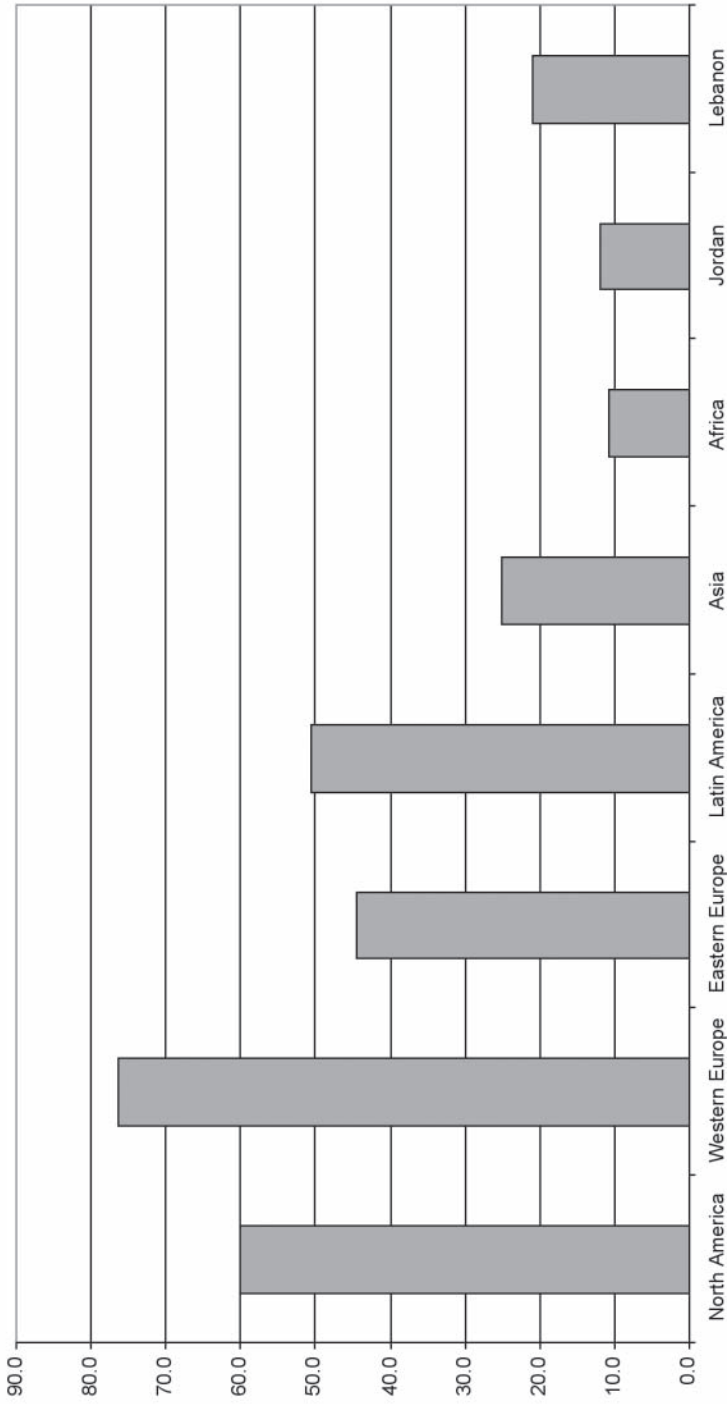
Source: Pew Research Center for the People and the Press, *Pew Global Attitudes Project, 2002 and 2003*.

Figure 3 Way of Life "Needs to be Protected against Foreign Influence"
(% of respondents who disagreed)



Source: Pew Research Center for the People and the Press, *Pew Global Attitudes Project, 2002 and 2003*.

Figure 4 "Homosexuality Should be Accepted by Society"
(% of respondents who agreed)



Source: Pew Research Center for the People and the Press, *Pew Global Attitudes Project, 2002 and 2003*.

and not without end. Indeed, should the region manage to successfully surmount this challenge, it can look forward to a complementary period of “demographic dividend” as this generation enters its most productive working years—a phenomenon that contributed to the outstanding performance of East Asia over the past four decades. If the Middle East is able to cash in on this dividend, future pundits may praise the disciplined “Islamic ethic” as a contributor to development just as they today erroneously condemn it as an obstacle to growth.

Notes

¹ James Zogby, *What Arabs Think: Values, Beliefs, and Concerns*, Zogby International and The Arab Thought Foundation, (2002).

² Luigi Guiso, Paola Sapienza, and Luigi Zingales, “People’s Opium? Religion and Economic Activities,” *NBER Working Paper 9237*, (Cambridge, MA: National Bureau of Economic Research, 2002).

³ Timur Kuran, *Islam and Mammon* (Princeton: Princeton University Press, forthcoming).

⁴ Marcus Noland, “Religion, Culture, and Economic Performance,” *Working Paper Series 03–8* (Washington: Institute for International Economics, 2003).

⁵ Marcus Noland and Howard Pack, *Industrial Policy in an Era of Globalization* (Washington: Institute for International Economics, 2003).

⁶ World Bank, *Trade, Investment, and Development in the Middle East and North Africa*, 2003.

⁷ “Views of a Changing World,” The Pew Research Center For the People and the Press, June 2003.

⁸ The country samples in Figures 1–4 differ slightly from figure to figure. Respondents in North America, Western Europe, and Japan were not asked about closing factories. The pollsters were not permitted to ask the question about homosexuality in Egypt.

⁹ The cross-national correlation of attitudes toward homosexuality and prosperity in particular echoes a similar relationship observed across metropolitan areas in the United States. Richard Florida, *The Rise of the Creative Class* (New York: Basic Books, 2002).