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DEVELOPMENT PROSPECTS FOR NORTH AFRICA

Ahmed Galal and Khalid Sekkat

This edition of Policy Perspective explains why the North African region has been successful in reducing poverty despite modest economic growth and explores the sustainability of past strategies in achieving this outcome in the future. It argues that low poverty in Algeria, Egypt, Morocco and Tunisia can be traced to a combination of social policies, cultural characteristics and the nature of the political regimes rather than economic growth per se. Furthermore, it claims that this favorable outcome is not likely to be sustainable in the future without higher economic growth, improvements of social policies and more inclusive governance structures.

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The development performance of the North African (NA) region over the past two decades is puzzling. On the one hand, per capita GDP and per capita growth (in PPP terms) during this period were higher than the corresponding averages for Sub-Saharan Africa (SSA), but much lower than the averages for East Asia (EAP) and to a lesser extent lower than Latin America (LAC). On the other hand, the NA region fares much better than the other three regions with respect to the level of poverty. This puzzle has been noted previously by Murshed (2008) and Robinson (2009), and our focus in this short paper is on why and whether this outcome is sustainable in the long run.

We argue that past achievements, especially in terms of low poverty rates despite modest economic growth, are primarily the result of social policies, enhanced and/or motivated by cultural factors and political considerations. In the future, further reductions in poverty are unlikely to occur without higher and more sustainable economic growth and more efficient social policies. For growth to be pro-poor and for social policies to be more equitable, however, a

About the authors



Ahmed Galal is the Managing Director of the Economic Research Forum. He has obtained his Ph.D. in Economics from Boston University. His latest publication is "*The Road Not Traveled. Education Reform in the Middle East and North Africa*" *The World Bank*, 2008.



Khalid Sekkat is the Research Director of the Economic Research Forum. He has obtained his Ph.D. in Economics from University of Brussels. His latest publication is "*Market Dynamics and Productivity in Developing Countries*" *Springer and IDRC*, 2010.

more inclusive governance structure is essential.

Due to data availability, we limit our analysis to Morocco, Algeria, Tunisia and Egypt, leaving out Libya. Further, we do not discuss inequality due to measurement and comparability problems (See Bibi and Nabli, 2010). Finally, we focus on the period 1985 onward, as this period is characterized by the initiation or acceleration of ambitious reform programs to accelerate economic development.

1. Past performance

On average the four countries in our sample grew, in terms of per capita PPP, at 1.41 percent between 1985 and 2005 (calculated from the information provided in Table 1). This rate is higher only than the average for SSA (0.21 percent), and while comparable to the average for LAC (1.06 percent) falls far below the average for EAP (6.95 percent). Yet the average percentage of the poor in the population of the NA region over the period 1985-2005, measured by the ratio of headcount at \$1.25 a day (PPP), was in the neighborhood of 5 percent during this period, compared to 11, 42 and 56 percent in LAC, EAP and SSA, respectively. During the same period, the NA

region was able to reduce poverty from 8.5 percent in 1985 to 2.1 percent in 2005.

These averages conceal notable variations among the four countries, but do not change the overall standing of NA relative to other regions. In terms of population in 2005, Egypt is by far the largest in size (above 70 million) and Tunisia is the smallest (10 million). While the same classification holds in terms of GDP, the pattern is reversed regarding per capita GDP (see Table 1). With respect to poverty, Egypt exhibits the lowest ratio (2.7 percent during the period 1985-2005). Algeria exhibits the highest ratio (6.7 percent), with Morocco and Tunisia falling closer to Algeria than to Egypt.

For the most part, since the mid-eighties, all four countries experienced steady per capita growth rates, although Algeria and Tunisia did better than Egypt and Morocco. However, the growth rates were more volatile in Algeria and Morocco than in Egypt and Tunisia, largely because Algeria is highly dependent on fuel exports (36 percent of GDP and 97 percent of merchandise exports) and Morocco is highly vulnerable to fluctuations in agricultural output due to weather conditions (see Sekkat, 2004). Poverty declined over time in Tunisia, Morocco and Egypt while remaining essentially unchanged in Algeria (although data are old in the latter case).

2. How did the NA region reduce poverty despite unimpressive economic growth?

Given that growth rates in the region have not been as impressive as those in East Asia, what might explain the low levels of poverty? Available evidence suggests that social policies, cultural factors and political considerations lie behind observed low levels of poverty.

Table 1: Growth and poverty in North Africa compared with other developing regions, 1985-2005

Country/Region	GDP per capita, PPP (constant 2000 international \$)				
	1985	1990	1995	2000	2005
Algeria	5983	5430	4920	5327	6283
Egypt	2554	2799	3003	3526	3858
Morocco	2984	3338	3180	3578	4052
Tunisia	4502	4633	5098	6276	7447
<i>North Africa</i>	<i>3541</i>	<i>3634</i>	<i>3625</i>	<i>4137</i>	<i>4685</i>
Latin America & Caribbean		6035	6591	7102	7482
Sub-Saharan Africa		1678	1551	1611	1774
East Asia & Pacific		1857	2854	3747	5384
Average growth of GDP per capita, PPP (constant 2000 international \$)					
	1985-2005	1985-90	1990-95	1995-00	200-05
Algeria	0.24	-1.92	-1.95	1.60	3.36
Egypt	2.08	1.84	1.42	3.26	1.82
Morocco	1.54	2.27	-0.97	2.39	2.52
Tunisia	2.55	0.58	1.93	4.25	3.48
<i>North Africa</i>	<i>1.41</i>	<i>0.52</i>	<i>-0.05</i>	<i>2.68</i>	<i>2.52</i>
Latin America & Caribbean	1.06	-0.06	1.78	1.50	1.05
Sub-Saharan Africa	0.21	-0.28	-1.56	0.76	1.94
East Asia & Pacific	6.95	5.76	8.97	5.59	7.52
Poverty headcount ratio at \$1.25 a day (PPP) (% of population)					
	1985	1990	1995	2000	2005
Algeria		6.61	6.79		
Egypt		4.46	2.46	1.81	1.99
Morocco	8.42	2.45	6.76	6.25	2.50
Tunisia	8.65	5.87	6.48	2.55	
<i>North Africa</i>	<i>8.48</i>	<i>4.62</i>	<i>4.64</i>	<i>3.06</i>	<i>2.14</i>
Latin America & Caribbean	15.25	11.32	10.94	10.89	8.22
Sub-Saharan Africa	55.84	57.58	58.78	58.37	50.91
East Asia & Pacific	65.50	54.72	36.00	35.51	16.78

Source: World Development Indicators (WDI) and <http://iresearch.worldbank.org/PovcalNet/povcalSvy.html>

With respect to **social policies**, a first approximation can be gathered from the share of government expenditure in percentage of GDP. By this measure, the NA region spent 15.6 percent over the period 2000-2005, which is slightly lower than the corresponding average of 16.8 percent for SSA but higher than the averages for EAP (13.8 percent) and LA (14.9). More important perhaps is that NA countries have sustained a variety of pro poor social policies for decades. For example, education has been provided for free despite the shift since the mid-80s from a state-led development strategy to a market and private sector based strategy. In the majority of cases, free access at all levels is guaranteed by virtue of the constitutions. In recent years, private provision of education has been allowed in some countries (e.g. Egypt) but the earlier commitment remained (See World Bank, 2008). Similar policies have been put into effect with respect to health and infrastructure services. And NA countries have had multiple safety net programs, especially for those who cannot earn an income for reasons of age, handicap etc. In some cases, commodity subsidies are used heavily (e.g., in Egypt and Morocco).

Turning to **cultural and religious factors**, a number of studies pointed out that the region is more amenable to sharing of wealth than other regions. For example, Gradstein et al. (2001) suggested that across the diverse cultural/religious types in the world, there is the strongest built-in inequality aversion among Muslim majority countries. The **Islamic** charitable practices of *zakat* and *sada'qa* seem to enhance private social responsibility, and to have a poverty-reducing impact (Sala-i-Martin and Artadi, 2002).¹

On the **political** front, Desai et al. (2007) suggest that observed redistributive policies in the region can be traced to politics. Focusing on non-democratic regimes in general, the authors sought to explain

how such regimes stay in power. Considering that repression — the classic answer — is not the best strategy, they suggest that some redistribution to citizens might be necessary to secure and maintain citizen loyalty. Following this approach, NA regimes would prefer welfare spending to circumvent pressures rather than to liberalize politically. The authors' empirical tests support the validity of this thesis.

3. The prospects of growth and poverty reduction in NA

The preceding section suggests that the NA countries' track record in terms of **poverty reduction owes less to growth per se and more to social policies as well as to culture and political economy considerations**. Looking ahead, it is not apparent that past strategies will work well in the future.

Social policies cannot be sustained without strong economic growth. Sooner or later, countries will be forced to comply with the "law of macroeconomic equilibria" (budget and external balances). Moreover, these policies can be reversed suddenly depending on the whims and wills of the rulers. Remittances, especially those coming from the Arabian Gulf countries, are too volatile to rely on as the main instrument for poverty reduction. The experience of the early 1980s and the Gulf war in 1991 validates this point. While social solidarity (taking the form of *zakat* and *sada'qa*) is likely to remain a feature of the region into the foreseeable future, it is difficult to ascertain how many transfers will take

¹Note that *Zakat* is not insignificant, as it amounts to 2.5% of a person's wealth and assets, owned for a full lunar year, including money, crops, harvests, herds, gold and silver, and merchandise excluding dwelling and items of personal use.

place and whether the allocation of these transfers is optimal nationwide. Finally, with political liberalization the world over, following the collapse of the Soviet Union and the spread of democracy in Latin America and Asia, it is difficult to sustain less than inclusive political systems.

From the above discussion, it follows that more rapid growth is probably the most reliable mechanism to prosperity. For growth to be pro-poor, however, it has to be sufficiently high to permit the continuation of smarter social policies. And none of the above will be possible without three things: (1) further economic reforms, (ii) more efficient social policies, and (iii) more inclusive governance structure.

Growth

Taking The Growth Commission (2008) as a reference point, three, inter-alia, fundamental policy and institutional preconditions seem to make a big difference to factor accumulation (human and physical capital) and to total factor productivity (TFP) growth: Competition (internal and external); Macroeconomic Stability; and Sound Institutional Framework and Good Governance.

Over the past two decades, progress has been made. However, the pro-growth reform agenda remains unfinished (for elaboration, see Easterly, 2002; Makdisi et al, 2006; and Sekkat, 2004 and 2008).

- In terms of **competition**, openness to trade ratio² rose markedly in NA (18 percentage points) between 1985 and 2005. However, the performance of individual countries is uneven, showing improvements in Tunisia³ and Morocco, stagnation in Algeria and deterioration in Egypt. Turning to domestic competition, the Egyptian, Moroccan and Tunisian industries

exhibit, in general, high mark ups and high concentration ratios (Sekkat, 2008). These ratios are higher than those in comparable countries (e.g. Turkey).

- With respect to **macroeconomic stability** and exchange-rate regimes, inflation has been modest in the region and on the decline since 1985. In 2005, maximum inflation was 2.6 percent except in Algeria (5 percent). Regarding exchange rate management, Nourira et al. (2009), focusing on the period 1990-2005, found very high overvaluation of the pound (Egypt) but almost no misalignment of the dirham (Morocco) and the dinar (Tunisia).
- Finally, with respect to **institutions**, the World Bank's indicators of governance do not favor the region. On a scale ranging between -2.5 and +2.5 (higher values signal better governance), the region scores -0.35 on average over the 1994-2005 period compared with -0.12 for LAC, -0.39 for EAP and -0.63 in SSA. Again, there are marked differences among the four countries (from a score of 0.10 in Tunisia to -1.08 in Algeria).

Social Policies

Clearly sustained economic growth will enable NA countries to continue previous social policies by relaxing private and public budget constraints.⁴ However, there may be a need to rethink the kind

² We use the ratio of imports plus exports (excluding oil) divided by GDP.

³ The study covers the period 1980-2003. Due to data availability, Algeria was not covered in this study.

⁴ Note also that some growth-promoting policies might hurt the poor and should, therefore, be accompanied by redistributive policies to avoid their marginalization.

of policies to adopt, placing more emphasis on their outcome and effectiveness. There is ample evidence showing that the outcomes of past policies have been largely inefficient and even inequitable. For example, Galal (2006) shows that social expenditure in Egypt was poorly targeted, inefficient, and involving high transaction costs. El-Arabi (2009) finds that spending on basic education in the region tends to favor the poorest households but spending on universities and vocational training strongly favors the rich. Moreover, the distribution of schooling years was found to be biased against the poor, women, and rural people in Egypt (Datt et al., 1998) and in Morocco (Abdelkhalek, 2005). Regarding food subsidies, targeting errors, leakage and under-coverage seem to be widespread. Cornia and Stewart (1995) find that while in Egypt and Tunisia food subsidies show very low exclusion rates, leakage rates are large. They suggested that leakages could be significantly reduced, while maintaining negligible under-coverage, by concentrating the subsidy on a specific good (i.e. hard wheat). Laraki (1989) examining the welfare impact of various consumption subsidy reforms in Morocco, concluded that the country should move toward the removal of current subsidies and the development of low-priced “inferior” goods. The latter would decrease the cost of subsidies without hurting the poor.

In recognition of the above problems, tighter budget constraints and the drying up of resources, policymakers in the region are increasingly concerned with reforming their social policies. **Reform initiatives are underway in several countries, but the pace of these reforms is slow and the fear of change is proving problematic.** Their success depends not only on the willingness of governments to achieve equitable development but also on their ability to counter the opposition of potentially powerful groups. This, in turn, depends on building up a more inclusive governance structure in these countries.

Governance structure

Olson (2000) argued that there is no way of understanding the extreme poverty of many nations without taking account of the extent to which they are misgoverned. Accordingly, good governance depends on the extent to which the ruling authority is inclusive. Dictatorship is superior to anarchy because the dictator has some encompassing interests in the society he/she rules. Democracy is superior to dictatorship because democratic majorities are more encompassing than the interest of the dictator. And apart from any moral considerations, the above assertion is validated by empirical evidence. For example, Gradstein et al. (2001) suggest that democratization tends to reduce inequality through redistribution when the poor outvote the rich.

The problem in the region is that the governance structure is too exclusive. According to the Freedom House Index, which combines the degrees of “Political Rights” and “Civil Liberties”, the NA Region is classified as partially free with an average score of 5.4 (a country is classified as NOT free if the index is between 5.5 and 7). In fact, only Morocco is considered as partially free while the other three countries are classified as NOT free. Since 1972, the date of the publication of the first index, the score for the region has remained unchanged.

Although still not showing up in international indices, we recognize that **some progress is being made with respect to political openness.** In Egypt and Morocco, multi-party systems have been introduced, independent media is emerging, and Non Governmental Organizations are more active than before etc. However, the peaceful transfer of power remains problematic, full representation is questionable, and term limits are being relaxed to accommodate incumbent leaders. In short, democratization is in the making, but the road ahead may be long.

4. Concluding remarks

In this short paper, we sought to explain why the NA region has been successful in reducing poverty despite modest economic growth and attempted to speculate about whether past strategies are sustainable in the future. We provided some evidence in support of the notion that low poverty in the region can be traced to social policies, cultural characteristics and the nature of the political regimes. Furthermore, we argued that this favorable outcome is not likely to be sustainable in the future without higher economic growth, improvements in social policies and more inclusive governance structures.

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ERF Contact Information

Address: 7 Boulos Hanna St., Dokki, Cairo, Egypt
Telephone: 00 202 333 18 600 - 603 | **Fax:** 00 202 333 18 604
Email: erf@erf.org.eg | **Website:** <http://www.erf.org.eg>



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7 Boulos Hanna St. Cairo, Egypt
P.O.Box: 12311
Tel: (202) 333 18 600 - 603
Fax: (202) 333 18 604
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