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LAISSEZ-FAIRE ECONOMICS IN THE ARAB WORLD

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Neoliberalism, which adopts laissez-faire economics as its frame of reference, is based on the claim that economic development depends on the creation of an enabling environment for the private sector, including free markets and free flows of trade and finance. Promoting fiscal stability at the expense of public investment in social and physical infrastructures and relying heavily on indirect taxation in contrast to progressive and capital gains tax is perceived to contribute to development mainly through the transfer of resources from governments to the private sector. Given these conditions, it is assumed that economies will naturally grow.

The laissez-faire policies pursued over the past three decades in the Arab world have in fact proved incongruous with the demands of the regional economy. Instead of cushioning the decline in oil prices and the rising costs of political tensions, they became pro-cyclical, accentuating their impact. Indirect taxation aimed at the working population, shrinking public investment, a pegged exchange rate policy with de facto open capital accounts, and liberalization of trade represent a few of the policies that created the social disaster that culminated in the "Arab Spring." The flows of geopolitical rents and remittances into newly industrializing states such as Egypt and Syria deindustrialized these economies and held back capital accumulation. In the latter years of the neoliberal transformation, the Arab region exhibited the world's highest rates of unemployment and income inequality and its lowest rate of global investment.[1] The economic history of the region came to mimic that of the western world: a pre-1980s state interventionist golden age and a post-1980s monetarist leaden age.[2]

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[1] United Nations Economic and Social Council, "Summary of the Survey of Economic and Social Developments in the Economic and Social Commission for Western Asia Region," 2007-2008. Available at: http://www.un.org/Docs/journal/asp/ws.asp?m=E/2008/20.

[2] Dean Baker, Gerald Epstein, and Robert Pollin (eds.), *Globalization and Progressive Economic Policy* (Cambridge: Cambridge University Press, 1998), 19.

Since the start of piecemeal neoliberalism in the early 1980s, Arab economies have experienced torpid growth. The real GDP per capita for the Mashriq sub-region, for instance, was growing annually at a respectable average rate of around five percent during the 1970s. After the laissez-faire age began, real GDP growth declined at an annual rate of around negative three percent between 1980 and 1990, and it grew at the low average rate of 0.5 percent during the 1990s. Since the second oil boom in 2002, the real GDP per capita growth rate of the region has been about three percent; concomitantly, the investment rate has been as low as 17-18 percent (down from a high of around 30 percent in 1980), implying that oil rent represents the principal driver behind this more recent growth phenomenon. Calculated over 30 years, the real GDP per capita growth average in the Arab Mashriq is as low as one percent.[3] Declining investment, especially in industry, plants, and equipment, can account for the greater part of this poor economic performance. What are the reasons behind this prolonged contraction in capital accumulation rates?

At its genesis, private investment growth hinges on prospective returns and degree of risk. For Kalecki, the investment-growth nexus, defined as the inducement to invest, is determined by the gap between the prospective rate of profit and the rate of interest. Later theoretical advances are permutations of this core idea of demand-led investment.[4] The rate of capital accumulation depends on profitability, which, in a circular manner, depends on economic growth. If interest rates were to suddenly fall, it follows that the risks would be lower, the capital output ratio would be higher, and the growth rate would rise.[5] Although analytically sound, this argument is not fully compatible with the specificities of the Arab world.

Assuming that returns can be redressed through bolstering balanced growth (meaning proportional growth in all sectors), it is the component of risk that is definitively challenging in the Arab case. In view of various internal and external security concerns, many Arab states carry within them the potential for failure. The risks to investment in the Arab world are serious because the stability elements allowing for the calculation of risk are not present over the long term. Keynes, having lived through two world wars, differentiated between unquantifiable uncertainty and quantifiable risks. He noted:

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[3] Records based on World Development Indicators, World Bank, various years.

[4] M. Kalecki, "A Macrodynamic Theory of Business Cycles," *Econometrica*, Vol. 3, No. 3 (July 1935).

[5] This is Kaldor's interpretation of Kalecki. See F. Targetti and A.P. Thirwall, *The Essential Kaldor* (London: Gerald Duckworth & Co. Ltd, 1989).

> *By "uncertain" knowledge…I do not mean merely to distinguish what is known for certain from what is only probable...The sense in which I am using the term is that in which the prospect of a European war is uncertain...About these matters there is no scientific basis on which to form any calculable probability whatever. We simply do not know.*[6]

The prospect of war, omnipresent in the Arab world, alters the background for investment decision-making, miring it in uncertainty. The risk function in the Arab world is thus only partly associated with typical market and price volatilities. Rather, it is one in which the bulk of capital assets could wither instantaneously as the state—being the institution of all institutions—fractures. The investment function in the Arab world is therefore subject to time incoherence and structural shifts. This is a case of *historical uncertainty as distinct from actuarial risk*. Although the ordinary types of market risks will always be present to some degree, the potential for collapse is portentous. The uncertainty shifts the ground beneath intertemporal preferences and brings the horizon of the future closer to the present, eliminating a future for which to plan. As such, investors will be primarily concerned with how returns must redress initial capital costs within a short gestation period. Subsequently, money capital takes the form of unrequited transfers, turns into capital flight, and/or gets lodged into speculative and ephemeral endeavors.

Uncertainties that could unfold into complete collapse reduce private capital's drive to invest over the long term. When public investment into the social and physical infrastructure became restrained by laissez-faire policies, private investment moved into areas of finance, insurance, and real estate (the typical FIRE economies). As a result, the capital output ratio became lower and the growth rate began to exhibit high volatility. More importantly, the retreat of public investment was not offset by private investment. The overall investment rate fell consistently over the neoliberal age. Raising investment under these tenuous conditions must be preceded by ensuring stability over the long run through enhanced democratic, communal, and national security. Only these changes can underwrite a nexus of investment and growth.

It should also be recalled that underdevelopment is a productive capacity matter. Development is about the redeployment of real resources and not

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[6] John Maynard Keyes, "The General Theory of Employment," *The Quarterly Journal of Economics* (February 1937). Available at: http://membres.multimania.fr/yannickperez/site/Keynes%201937.PDF.

about the amount of cash held. A financially endowed state may import factories wholesale with staff and machines; however, without the necessary linkages to the national production base, the supply-chain network will not be enhanced. Moreover, underdevelopment cannot be tackled by supply or demand side policies tailored for advanced economies. It is both a supply and demand side issue at once. Taken together the Arab economies are small, composing around two to three percent of world income. Paradoxically, "small markets would induce small investment and the reciprocal condition also holds." Nurkse resolved this enigma by suggesting a state-funded "big push" approach that would boost demand and supply simultaneously.[7] The subsequent crowding in of private investment would raise incomes and break the vicious circle of underdevelopment. The one-sided supply and open-market policies of the neoliberal age, however, did the exact opposite. They deconstructed capacity, cheapened it at prices set by the global market, and sent the wealth abroad in money form.

Laissez-faire literally means to let do or do as you like. In the absence of an equal playing field, laissez-faire policies gave local and global elites *carte blanche* to do as they like. Development policy became primarily a matter of redressing public account shortfalls with much spending centered on building political allegiances and regime stability. These policies, implemented under western-backed authoritarian rule, were adopted at a time of demographic transition, and the developmental failure was, in a very Malthusian sense, inversely blamed on population growth. Yet it is the neoliberal policies themselves, rather than high birth rates, that disengaged real resources to the detriment of the real economy. The shrinking of the productive base meant that exclusion, which is inherent to capitalism, became a more pronounced systemic mark of the new economy. Hence, for every person finding a job in the 1980s, there were two new entrants into the labor market reaching working age. By the late 1990s, there were nearly four new entrants to every person finding a job.[8] The rate of job creation fell much faster than the rate of growth in the labor force. While the majority of the labor force was becoming effectively unemployed, the chimerical policy advice of the World Bank and the International Labor Organization (ILO) remained set on private sector-led development and supply-side aspects of the labor market. When incomes were steadily falling and led by public sector compression and poverty rates

[7] R. Nurkse, "Growth in Underdeveloped Countries: Some International Aspects of the Problem of Economic Development" *American Economic Review*, Vol. 42, No. 2, 571-583 (1952).

[8] United Nations Economic and Social Commission for Western Asia, *Analysis of Performances and Assessment of Growth and Productivity in the ESCWA Region, Second Issue* (United Nations, 2004).

were rising, oddly, the mainstream policy advice was that the problem was the rigidity of the labor market.[9] With declining productivity, rising inequality and abjection, and an absence of autonomous civil society institutions, wealth in the Arab world was generated principally by resource and rent grab.

Neoliberalism was introduced on premises that were incompatible with the inherent conditions of the Arab world. The very "market" that neoliberalism aimed to free did not exist in the Arab world to begin with. For example, the labor market is theoretically a place where productive labor services are exchanged for money value. In the Arab world, the labor share forms 20 to 25 per cent of total income (KILM), whereas this figure stands at around 70 per cent in advanced economies. Average productivity is dismal by standard ILO estimation, and, if unemployment is measured by imputing a minimum historically determined level of subsistence into it, more than half of the labor force could be classed as unemployed. This method of calculating unemployment presumes that for a person to be considered employed, the income earned from employment has to fund necessary living conditions. Since more than half of the population in the Arab world survives on less than two dollars a day, by implication more than half would be unemployed. Equally important, most of those remaining employed are clients of the rentier state, not workers who exchange labor services for money wages. Not only is the labor market different than the "ideal" of the market, but every other market in the Arab world is qualitatively different on account of the social agency steering the market.

The theoretically concocted market and its supposed efficiency criterion cannot guide the allocation of resources and a real economic process; the result has been the transformation from an even-distribution public sector-led economy with a paternalistic welfare state to a highly uneven private sector and privately owned public sector-led economy. Under rentier class rule, laissez-faire has produced more of a trickle-up than a trickle-down effect.

Development depends on the nature of the agent of development and orientation toward capacity building. Various developmental challenges—the contradiction between a restrictive monetary policy and a vigorous fiscal stimulus plan, the disjunction between regional savings and regional investments, the absence of automatic stabilizers, and the rentier character of

[9] Please see: http://www.ilo.org/public/english/region/arpro/beirut/downloads/events/qatar/skills.pdf.

most Arab states—are issues with which the Arab world is faced at present. However, it is the retention of resources and their redeployment in the national economies through various selective price and protective measures that represent the principal problematic. The rentier characteristic of the class in charge of development limits the capacity of states to intervene in a productive, efficient manner and to respond to the needs of the working segment of the population. Focusing on the institutional level of responses to the challenge of development is a way to reintroduce historical, social, and political elements in the analysis and to qualify overgeneralizations that might be counterproductive.

A broader understanding of the social structure and the institutional framework allowing for autonomy of policy is thus a good starting point for assessing policy options. For macro policies to work jointly and interdependently and become developmental tools, the principal structural element underlying the policy framework, which is the linkage of development to security and sovereignty, has to be tackled. Capital accumulation and long term investment depend on a rearticulation of the security arrangement in a way that guarantees the security of the working population and popular sovereignty.

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