

# The Dilemmas of Economic Growth in the Middle East

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## Brief Analysis

Leaders of the Middle East, along with leaders around the world, can create a new path toward economic development and prosperity in the Middle East. The alternative would be to descend into regional instability bred by a 3 percent annual Middle East population growth. But leaders need to deflate their expectations for immediate economic prosperity in the Middle East. Peace process discourse has created unrealistic expectations about not only the potential level of prosperity but also the expected immediacy with which it could be achieved. There is no New Middle East, and economic prosperity is a long-term, not a short-term, goal. Nevertheless, people in the Middle East need to (and can) feel some immediate economic dividends of peace. But for that to happen, international leaders need to reevaluate their thinking about economic development in the Middle East.

> To begin, Middle Eastern countries need to recognize the real sources of capital for underwriting their economic growth. The source is private, not public. Countries have been given the impression that an international Marshall-like investment plan will finance economic development in the Middle East, but this is not the case. Only private capital, through direct foreign investment, can provide the financial resources for generating economic growth in the third world today. The role of public capital today is to identify areas where potential for economic development exists and to assist in infrastructure development.

> Private capital will not flow to Middle Eastern countries, though, unless they take the necessary steps to provide incentives for that investment. Ultimately, the general transformation of the Middle East is not an Israeli issue or a Middle Eastern issue, but an Arab issue; that is because Arab countries lag so far behind in the basic requirements for attracting investments. Arab countries will have to undergo significant social and economic reform to privatize their economies and foster competitive environments before private investors will consider them lucrative for investment. Private investment has only one interest the search for profit opportunities and it is fleeting. Therefore, countries must seize the existing opportunity to secure this capital.

> Finally, international leaders need to revise the process by which capital is mobilized and directed to economic development in the Middle East. The current system is confined primarily to high-profile international conferences like the Casablanca and Amman summits, issuing many statements of intent but few real projects. The Middle East needs a more business-like and results-oriented professional leadership to locate possibilities for development and to respond quickly to mobilize the necessary capital and resources specifically, a guidance committee consisting of Middle Eastern, U.S., and European professionals.

> In terms of the peace process, several points can be made:

- Palestinians -- The Palestinian dilemma is a labor problem. Palestinian income comes primarily from Palestinians working in Israel. Every time there is a terrorist attack and Israel closes the border (a policy known to be ineffective for addressing terror, but politically essential to allay the fears of Israeli public opinion), the Palestinian economy suffers. And if the terrorist attacks persist, Israel will probably pursue a policy of separation to the eventual detriment of the Palestinian economy.

- Israel -- Economically, Israel benefited tremendously from the peace process. In the last six years, Israel has experienced an economic boom created mostly by the opening of new markets (a consequence of the peace process) combined with the positive impact of the influx of Russian immigrant labor. Nevertheless, Israel must be careful not to give the impression to its Arab neighbors that it is an economic imperialist. It does not need trade with the Arabs that badly given the relatively small role inter-regional trade will play in Israel's overall trade mix and should not derail the possibility of regional economic development by being too loud and off-putting. Rather, it should move slowly and talk quietly so as to reap economic rewards without creating a hostile environment.
- Water -- The only politically and economically viable solution to the water issue in the long term is desalination of sea water. Through technological progress, desalination can become more affordable for everyone.

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The secret to success in the Middle East is not any different from that in any other region. It boils down to fundamental principles: 1) consume only what you earn, 2) support education as much as possible, and 3) be competitive. Now is the time to make a transformation in regional economics in the Middle East, but in an informed manner:

- The Peace Process -- The expectations for prosperity as a consequence of peace are inflated and must be re-appraised. As well, while peace is a necessary pre-requisite for prosperity, it is not a sufficient condition; attention to internal economic conditions in Middle Eastern countries is also essential.
- > Internal Changes -- Economic changes in the Middle East have to be initiated internally; the international community should not give the impression that development can take place any other way for example, through a Marshall Plan. Arab countries have to make the difficult decisions at home to entice private foreign investment. Private capital seeks four fundamentals: a well-managed economy, a stable economy, an educated work force, and good infrastructure. Therefore, it will only be attracted to those countries that have private, stable, and competitive economies, especially in import and export sectors. (With the development of better infrastructure in Middle Eastern countries, stability from peace will become the major incentive for private capital; consequently, foreign direct investment might be the economic dividend for peace process participation.)
- Backing the Winners -- The Middle East needs winners well-managed, economically sound and successful countries to grow and attract capital. Lebanon (because of its confidence) and Egypt (because of its size) are two possibilities. The international community cannot create such winners, but rather must back those countries which make the necessary internal economic changes themselves.
- Israel -- If Israel has created an impression among other Arab countries that it is seeking to dominate them economically, it needs to defuse that impression. For example, there should be a natural synergy between Israel and the Palestinian community, but this synergy has thus far been thwarted by Palestinian concerns about Israeli intentions. Similarly, employment of Palestinians in Israel benefits both communities a win-win situation but unfortunately, political constraints create roadblocks.

This Special Policy Forum Report was prepared by Greg Saiontz.

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