



Arab Development Challenges Background Paper 2011

Introduction: Toward the Arab Renaissance

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As recent events in the Arab region have amply demonstrated, the problems of poverty, unemployment and social and political exclusion cannot be forever ignored without their arising demands for change in the basic arrangements of society. Today, the dramatic revolts in diverse Arab societies have highlighted the failures of the pre-existing development model, as well as the necessity and opportunity for transformation, raising the hope that an Arab awakening can initiate an Arab renaissance. This second Arab Development Challenges Report makes an outstanding contribution in this regard, surveying the challenges presented by the current economic and social situation and proposing approaches to them.

One of the elementary pre-requisites of addressing economic and social problems is recognizing that they exist. Disturbingly, but not surprisingly, there has sometimes been considerable unwillingness to do this. Perhaps worse, government and inter-governmental bodies have been intentionally or inadvertently complicit, neglecting what was in front of them. The crisis of insufficient income growth and, most especially, of insufficient employment growth, in the region, has been acute. The unemployed and under-employed in the region, both educated and not, have become a powder keg and indeed one that has been lit. The legitimate but unmet demands of wide sections of the population, including a very large proportion of youth, have been a prime source of the legitimacy crisis of the Arab state. To their credit, the authors of the first Arab Development Challenges Report had recognized this. In addition to highlighting the problem of inadequate and unremunerative unemployment, the report makes signal contributions to the understanding of such crucial issues as the inadequate provision of social services (including health and education), the intensifying and enormously consequential environmental (especially water) crisis and the under recognized but likely substantial recent increases in relative inequalities. It highlights the causal importance of poor uses of the available resources and, ultimately, of failures of effective and accountable governance.

I would like to comment at length on one somewhat specialized aspect of the innovative methodology and substantive contribution of the second Arab Development Challenges Report, about which I have particular knowledge, before returning to the more general aims and content of the report.

The World Bank's poverty estimates for the region have, over a considerable period, purported to show that its level is low in comparison with other regions

of the world and indeed negligible. This characterization has confounded many, who have pointed to contrary observations and evidence. Although the 'inter-ocular test' of being guided by what one believes one has observed with one's eyes, has its limits as a technique of social science, it is also not entirely *without* merit. In view of the unconvincing nature of existing descriptions, how can one arrive at a credible account of poverty in the region – i.e. of who is poor, how poor they are, where they live and how their numbers have been changing over time – questions of obvious importance in the assessment and design of governmental efforts.

I have argued elsewhere that such a question can be credibly answered, although only through a procedure of carefully developing a poverty identification criterion that is substantive and meaningful and of applying it in a manner that is comparable in a relevant sense across space and time. Such an approach, although feasible, requires planning and resources. Can anything be said about the actual profile of poverty in the meantime? It is in relation to this question that the Arab Development Challenges Report 2012 makes a valuable contribution. That contribution is to introduce and implement a new methodology for international poverty comparisons, which draws pragmatically upon available data and concepts to produce a *more* credible estimate of poverty than presented by the World Bank.

The starting point of the new methodology is the recognition that national poverty lines – those constructed by governments or sometimes by non-governmental actors within countries - contain information. How should we think about the information they contain and how that information may best be used? It is possible that national poverty lines reflect considered judgments, made within countries, as to what level of resources is minimally adequate for a person. However, even if such judgments derive from local evidence and reasoning, they may not be grounded in underlying concerns that are common across countries, let alone in methods of identifying the poor that are uniform. National poverty lines may also reflect political or institutional incentives to exaggerate or to understate either the level of poverty or the recent rate of poverty reduction. For all of these reasons, we may expect national poverty lines (and estimates) either to be higher or lower than under a first best approach for regional poverty assessment (i.e. that which would result from applying the same method of poverty assessment, which can be supported by sound reasoning and judgment, uniformly across countries). Moreover, it is not entirely obvious *a priori* that such deviations from the first best as may arise from

national poverty lines would be less serious than those which would emerge, for other reasons, from adopting the World Bank approach (based on the purported purchasing power 'equivalents' of its money metric poverty line). We shall argue nevertheless that national poverty lines do provide a *better* basis than do the World Bank's estimates for poverty assessments in the Arab region, when they are used as an informational basis for the exercise, as they are in the current Arab Development Challenges Report and not simply deferred to mechanically.

It is useful to review some of the reasons that the Bank's estimates have limited credibility in the Arab region. It has already been noted that its estimates are widely perceived to fail the 'inter-ocular test'. Although some of the stark forms of mass poverty visible in other regions are not evident in the Arab region, there is still considerable evidence of poverty and deprivation in the region. The finding of the Arab Development Challenges Report that there is considerable evidence of non-income deprivations in the region and that income poverty and non-income deprivations are even more weakly associated in the Arab Region than they are elsewhere suggests not only the possibility (long and credibly argued by human development advocates) that it is the use of income as well as the level of income that determines the extent of non-income deprivations, but also that income poverty measures in the region may not adequately capture its true extent.

The Bank claims to have derived its international poverty line from national poverty lines actually in use in developing countries, in an inductive procedure. The national poverty lines it uses for the exercise are drawn from a wide range of countries at varying levels of income, but most are from the lower income group and from sub-Saharan Africa. A very large number of the poverty lines used were in fact produced by the World Bank itself and do not therefore represent independent information. The national poverty lines used are constructed using a variety of inconsistent methods and usually ones more appropriate to low income countries. They are converted to a common unit and compared using purchasing power conversion factors (or PPPs) of questionable relevance, which introduce a great deal of resulting 'noise'. Finally, the international poverty line is chosen from among the assembled national poverty lines by using arbitrary criteria, the arbitrariness of which is underlined by the fact that the criteria have shifted unpredictably over timeⁱ. It may not be entirely surprising, then, that the resulting poverty lines are not merely inappropriate for particular countries but inappropriate for entire regions and in particular for

regions having a preponderance of middle-income countries (such as the Arab region or Eastern Europe and the CIS). One reason is that in such countries, the cost of achieving non-nutritional requirements is an important component of poverty avoidance, which is likely to be very poorly captured by mechanically translating national poverty lines constructed in and for low income countries.

As I have argued in other work, the underlying source of the incoherence and invalidity of the World Bank's approach to poverty assessment is the failure to establish a clear, substantive and meaningful criterion for identifying the poor that could be applied uniformly across countries. Such a criterion is a necessary condition for meaningful characterization and comparisons and it is missing. The World Bank appeals to the 'inductive procedure' described above, through which it claims to derive its international poverty line from national poverty lines, but that procedure leads to conclusions that are meaningless and unreliable, for reasons to which we have already alluded.

What is the method adopted in the Arab Development Challenges Report and why is it reasonable to favour its estimates for the Arab region? The report takes seriously the World Bank's own claim to base its criterion for identifying the poverty line on those actually used within poorer countries. However, it implements this idea in a more credible way. Where the Bank uses poverty lines from countries that may have very different circumstances from those in which poverty is being assessed (e.g. using Sub-Saharan African poverty lines to derive an international poverty line which is then used to interpret the extent of poverty in Arab States), the Arab Development Challenges Report uses Arab countries' poverty lines to arrive at a means of evaluating poverty in those same countries. Moreover, where the Bank uses rather arbitrary (and shifting) criteria to arrive at a common poverty line from the poor countries' poverty lines (many constructed by the Bank itself) that it uses for the exercise, the Arab Development Challenges Report uses a more principled approach. This approach simultaneously improves on the Bank's method and that of using countries' own poverty lines to assess poverty in those countries, which has sometimes been proposed. Whereas the former uses countries' own standards in name only, the latter mechanically defers to those standards, failing to allow for the possibility that they are inflated or deflated beyond their warranted levels due to errors and distortions of various kinds. The Arab Development Challenges Report uses an approach that seeks to avoid both of these particular difficulties.

It determines the statistical average relationship between the income level (or more exactly, the consumption per capita) of countries and their official or semi-official (henceforth 'own') poverty line. It then uses this relationship to arrive at a poverty line that would be predicted for that country on the basis of this average relationship. This predicted poverty line is for certain countries higher than the own poverty line for the same the country that was placed in the pool of data used to generate the predictive relationship and sometimes lower. It is this predicted poverty line that provides the basis for national poverty estimates in the Arab Development Challenges Report. A difference between the predicted poverty line and the own poverty line might arise for a variety of reasons. One reason is that criteria for identifying the poor may vary in their level of 'generosity' across countries, even after 'adjusting' for income. Another reason is that the PPP conversion factors used for different countries may incorporate distortions that generate such deviations. Yet another reason is that the institutions that generate the own poverty line in individual countries may have an incentive to distort the poverty line in one direction or another. As long as these 'errors' are not 'systematic' in the sense that they lead to deviations from the 'appropriate' poverty line that are in the preponderance of cases in one direction, the predicted poverty lines will provide a better guide to the appropriate poverty line to employ for a country than will its own poverty line. Of course, such systematic deviations can arise, for political, cultural, institutional or methodological reasons and this must be a reason for caution in interpreting these estimates. It must also be underlined that the concept of 'error' being employed here involves deviations between the own poverty line and that which is 'warranted' for a country in a normative sense – specifically, that it would emerge from a supportable methodology uniformly employed. It is only if the own poverty lines deviate idiosyncratically rather than systematically from these warranted poverty lines that the predicted poverty lines provide a good guide to them. Nevertheless, the Arab Development Challenges Report approach does a better job of implementing the principle of allowing poverty in countries to be judged according to the standards present in those countries than does the World Bank's approach.

Moreover, it has the additional merit that it does so while understanding these standards as being established by the ensemble of countries taken together and not therefore deferring mechanically to the own poverty lines of individual countries. In this way, it helps to diminish the impact of in-country deviations from a warranted poverty line rather than genuflecting to them. As the report

shows, the choice of this approach leads to marked differences in assessments of the level (higher) and trend (less favourable) of poverty as well as in the understanding of the composition of poverty within the region, as compared to World Bank estimates. Moreover, it leads us to the conclusion that poverty in the Arab region is more important as an absolute and relative contributor to global income poverty than heretofore acknowledged.

Given the perspective on the region that the Report presents, of higher poverty and deprivation, as well as of a different pattern of deprivations, than suggested by measures in widespread use, what are the resulting prescriptions for action? Many more persons in the region than previously thought may be afflicted by poverty traps, which if overcome can enable them to become effective contributors to and beneficiaries of, a national economy. A key conclusion for development strategy is that an approach which aims effectively to meet the basic requirements of such persons can not only contribute to social good but also help to unleash a virtuous circle of economic growth and development.

Expanding our perspective further, what other elements of a strategy of national development is likely to be most effective today in the region? The requirements will vary from country to country according to national circumstances. It is, however, abundantly clear that the resource extraction centred strategy of development has been found wanting as a strategy of inclusive growth and development. A second key conclusion for development strategy is therefore that diversification of national economies must be strongly pursued. However, the relatively small domestic market size of many of the countries in the region creates difficulties in implementing a strategy of import substitution, as do the inadvertent consequences, such as protection generated inefficiencies and 'Dutch disease' effects of resource exports. Further, countries in the region cannot, given their economic and social profile, easily pursue (nor may it be desirable that they pursue) a strategy of export led development centred on low wages. It follows that productivity enhancement is of great importance. In addition to broad-based investment in human capabilities, the development of mechanisms of institutional learning tying firms and public bodies can play a vital role. The ostensibly market oriented policies implemented in recent years in many Arab states, in the presence of deep failures of democracy, have brought about crony capitalism more than they have brought about market disciplines. Nevertheless, the conception that firms, left to themselves and provided the right incentives, can bring about national development, is a faint hope more than it is a

development strategy. As successful development experiences elsewhere illustrate, the creation of structures which enable workers, firms and states to learn from one another and to learn together, pairing freedoms with accountability can help countries quickly to acquire competences and resolve dilemmas. In such a perspective on development, there is no formula other than to learn how to learn. In order to do so, society must be empowered to experiment and to learn from experiments, shaping and being shaped by democracy.

The significance of the democratic turn is evident in one other respect. Most governments in the region fail to achieve their potential to generate adequate resources domestically, especially through taxation. This deficiency handicaps the ability of governments to implement the strategy of broad-based investment in persons and in the productive potential of the society which is needed for sustained inclusive development. The reasons for this failure are not purely economic. They derive from the failure to establish a credible compact between state and society which is widely perceived as legitimate. In these conditions, the predominant aim becomes to give as little as possible and to take as much as possible from the state. A consequent tragedy of the commons leads to a failure to achieve the common good. The economic manifestations are chronic fiscal deficits and the need to rely overly heavily on resource extraction, remittances or foreign assistance (depending on the case) in order to plug the gap. To make use of the unused 'fiscal space' requires that the state acquire a new social and political legitimacy, which can underpin greater taxation and public investment, in the interest of sustained and inclusive development. The opening created by democratization provides, therefore, a new opportunity for economic and social uplift. Far from sound finance and political inclusion being at odds, it is only their reconciliation which can provide a lasting solution to the ills of the fisc. In this respect, as in others, the countries in the region stand on the threshold of a new prospect. That the door to a different future has been opened out by a mass of ordinary people, long excluded and demanding inclusion, makes it all the more possible for those who will it to succeed.

Endnotes

ⁱ Reddy 2009

References

Reddy, S. 2009. “The Emperor’s New Suit: Global Poverty Estimates Revisited”. Working paper of the United Nations Department of Economic and Social Affairs, no. 79.