The Arab Economy and the Middle-Income Trap

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GDP Per-Capita in 2015 Prices[1]: USD

Country	2014	2024
Middle Income	4,441	6,173
Arab	6,213	6,282
Morocco	3,052	3.479
KSA	23,405	24,917
Jordan	4,282	4,017
Sudan	1,307	582
UAE	43,023	42,512
Lebanon	7,830	5,834

Source: World Bank

In the economic growth literature, two interesting ideas stand out: nominally speaking, the first captures a standard idea and the second happens when the first idea fails midway. In concreate terms, the first idea is economic catch-up or convergence[2], and it takes place when poorer countries grow faster than richer ones, closing income gaps, and driven by the adoption of existing technologies, higher returns on capital investments, and higher capital labor ratios. The second idea is the middle-income trap, obtained when a country achieves rapid

[1] GDP per capita is expressed in 2015 prices so as to capture real increases in GDP per capita by neutralizing any inflationary effects.

[2] There two types of convergence: sigma and beta convergence. Sigma convergence is the reduction in *dispersion in per-capita income across countries*; and beta convergence is the catch up by low-income countries that would grow faster than high-income ones thus closing the gap. For simplicity, we are not going to distinguish between these two convergences in this note.

growth to reach middle income but then stagnates and can no longer catch up, and as a result fails to transition to a high-income economy[3].

What we like to do in this note is to check whether the Arab economy has fallen into a middle income trap and, if it had, why that is so. It is widely believed that such a fall takes place when economies experience a decline in annual real GDP per capita growth from 4-5% to 2-3% or less. In number terms, we can see from the table above that the average world middle income country experienced an increase in its real GDP per capita from $4,441 to $6,173, growing at an annual rate of 3.9% between 2014 and 2024. So the average world middle income economy is just converging. But that is not the case for the average Arab economy: its real GDP per capita grew from $6,213 to $6,282 at an average annual rate of 0.11% only! Clearly, the average Arab economy is hardly growing, let alone converging, and as such it is stuck in a middle income trap.

Of course, the Arab economy is just an average of diverse income groups comprising 22 countries in total: 7 Mashreq countries (Egypt, Jordan, Lebanon, Palestine, Syria, Yemen, and Iraq); 6 GCC countries (KSA, UAE, Qatar, Oman, Bahrain, and Kuwait); 5 Maghreb countries (Algeria, Morocco, Libya, Tunisia, and Mauritania); and 4 Arab African countries (Sudan, Somalia, Djibouti, and Comoros). To account for this diversity, and to get a clearer idea why Arab middle income was trapped, we present in the table above real GDP per capita for a representative country from each group: Morocco, KSA, Jordan, and Sudan. We can see that only Morocco and KSA witnessed increases in their real per capita GDP between 2014 and 2024: Morocco from $3,052 to $3,479, at an average annual rate of 1.39%; and KSA from $23,405 to $24,917, at an average annual rate of a low 0.65%. And, though these two countries are growing in real per capita terms, they are not converging. But Morocco's performance is still a notable one – though it is unsung -- making it one of the very few Arab

[3] For more on the middle income trap, see: World Bank Report, *Middle Income Trap*, 2024.

countries whose real per capita GDP is markedly improving. In fact, the experience of countries such as Morocco has introduced a new concept to the convergence literature, namely conditional convergence: given that countries are conditioned by different structural characteristics, their income can converge to different steady states, mainly other than that of the US or similar high income countries.

But why does the middle income trap happen and why does the Arab economy find itself stuck in it? It is because, being in the middle, the average Arab economy is unable to compete with low-cost producers (wages too high) and advanced innovators (productivity too low). It struggles to move up the value chain which requires innovation and higher productivity to continue catching up. Mainly, it is the product of 4 shortcomings: 1) policy outdatedness: reliance on policies that emphasize quantitative accumulation (basic capital) rather than qualitative investments (smart technology); 2) institutional weaknesses: lack of Institutions that foster good governance at the political level and creativity and sound business development at the economic level; 3) talent gaps: inefficient use of skilled labor or insufficient talent accumulation to shepherd the transition to higher income; 4) political and security instability: malleability to geopolitical tensions and mindless militarism in addition, of course, to democratic deficits. And unless and until these political and economic drawbacks (made worse by climate change and protectionism) are dealt with, the Arab economy will not resume convergence, perhaps not even conditional convergence, to free itself from the middle income trap.

We would like to end with two cautionary tales, that of the UAE and Lebanon. The UAE is obviously a high income country and doesn't need to converge in the strict economic sense, but its real GDP per capita has nevertheless to grow at the steady state rate of 1-2%. And though the UAE has become a 'model' for successful growth – not just in the Arab world but also the entire world – its real

GDP per capita fell from $43,023 to $42,512 between 2014 and 2024. Two reasons were behind the decline: first, high population pressures that saw total population increase from 8 million to 11 million; second and perhaps more important, growth was still driven by extensive accumulation (e.g. real estate and conventional capital and labor) rather than intensive accumulation (high tech and sophisticated capital and labor). That is not to say that the UAE hasn't achieved tremendous milestones – far from it – but the point is that its income convergence hasn't yet been fully underpinned by the requisite fundamentals.

In the case of Lebanon, the story is by far more tragic. We can see from the table that Lebanon's real per capita GDP fell from $7,830 to $5,834 between 2014 and 2024; and the tragic part is that that should have never happened. In growth episodes, there are a select but few small countries – mainly: Singapore, Hong Kong, South Korea, Taiwan, Israel, Macau, and Aruba – who were able to transition to high income countries at different time periods, from a per capita GDP that was close to that of Lebanon in 2014, by growing at rates of more than 4% annually. When the Lebanese civil war ended in 1990, it was claimed that the new Lebanon could become the 'Singapore of the Middle East', and frankly why not! The country had the good talent, the good resources, and the good geography to join the above select few; however, that unfortunately wasn't to happen, as it was spoiled by the country having a plenty bad politicians, bad militias, and bad neighbors.

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