The impact of globalization on economic conditions: an empirical evidence from MENA region

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Abstract

The Middle East and North Africa (MENA) is an economically diverse region that includes countries with a common heritage, at various stages of economic development, and with vastly different endowment of natural resources. Despite undertaking economic reforms in many countries, and having considerable success in avoiding crises and achieving macroeconomic stability, the region's economic performance in the past 30 years has been below its potential. Some countries that pursued reforms, such as Egypt, Jordan, Mauritania, Morocco, and Tunisia, enjoyed the region's most rapid growth rates, but due to the political instability and turbulences they are still lagged behind. The purpose of this study is to empirically investigate the impact of globalization in MENA region on the economic performances to be able to draw a road needed to be travelled towards more open and democratic society, to achieve higher growth rates and a decent life for the millions human beings who live in it. This study uses a panel data covers the period 2001–2014 for Gulf Cooperation Council (GCC) and non- Gulf Cooperation Council (non-GCC) MENA countries and employs Generalized Method of Moments (GMM) approach. Results indicate that Globalization is strongly and negatively affecting economic conditions in non-GCC and it has no effect on non-GCC. The paper is outlined as follows- following the introduction, section two reviews the current economic conditions in MENA countries, section three discusses data and methodology, section four presents results and interpretation of findings, section five provides conclusions and recommendations.

1. Introduction

Globalization is one of the most provocative focuses of the early twenty-first century. Technological advances in communication and transportation, along with free-market ideology, massive increase in trade and cultural exchanges, have increasingly greater influence on worldwide economic, social and cultural processes over national, regional and international arena – Globalization is the process by which the world is becoming increasingly interconnected. Rosenau, says: "Globalization is a label that is presently in vogue to account for peoples, activities, norms, ideas, goods, services, and currencies that are decreasingly confined to a particular geographic space and its local and established practices" (Rosenau, 1997).

Globalization constitutes a merging power capable of bringing together and unifying the different cultural values and world economic systems. Its scope reaches across any known cultural, social, economic, and political boundaries, combining the unique ways of thinking and customs of different ethnicities and world cultures. "It is the interaction of extraordinary technological innovation combined with world-wide reach that gives today's change its particular complexion" (Hutton and Giddens, 2001).

Castells (1996) has argued that in the last twenty years, a new economy emerged around the world. He characterizes it by three essential features: Productivity and competitiveness are a function of knowledge generation and information processing; firms and territories are organized in networks of production, management and distribution; and the core economic activities are global – that is, they have the capacity to work as a unit in real time, on a planetary scale. But sophisticated information systems are essential in such globalization (Castells 2001).

One of the major causalities of the process of globalization has been a fall in the influence of national governments to direct and control their economies. In addition, the internationalization of financial markets, technology and the emergence of institutions such as the World Bank, the International Monetary Fund, the European Union and the European Central Bank, involve new constraints for national government power. Yet while the influence of nation states may have shrunk as part of the process of globalization it has not disappeared. Gee et al (1996) examine the way in which national governments frame their decisions about policy. There is a strong argument that the impact of globalization is most felt through the extent to which politics are now essentially market-driven. Leys (2001) argues, to survive government must gradually manage national politics in a ways to adopt to the pressures of trans-national market forces.

Most technologically advanced economies are truly knowledge-based (World Bank, 1999). The rise of the so-called "knowledge economy" has meant that economists have been challenged to look beyond labor and capital as the central factors of production. Romer has argued that technology has to be considered as a third factor in leading economies (Romer, 1990). However, there are powerful counter-forces and debates against the idea of globalization. Recently, such controversies have overflew journals, these debates raging from whether the term globalization actually presents (Unger, 1997), whether it is further effective compared to former times (Bordo, Eichengreen, and Irwin, 1999), whether it is replacing the country power (Strange, 1996; Wade, 1996), or whether it is more crucial than regionalism (Fishlow and Haggard, 1992; Oman, 1994).

Following Clark (2000), Norris (2000) and Keohane and Nye (2000), globalization defined to be the process of creating networks of connections among actors at multi-continental distances, mediated through a variety of flows including people, information and ideas, capital and goods. Globalization is conceptualized as a process that rusts national boundaries, integrates national economies, cultures, technologies and governance and produces complex relations of mutual interdependence. There are also significant doubts as to whether modern economies are, "knowledge economies". It doesn't follow, for example, that only those nations committed to lifelong learning and to creating a learning society will succeed (Wolf, 2002). The main objective of this study is to analyze the impact of globalization over the past several years, particularly in terms of its impacts on MENA region, to what extent has globalization constrained decision making in MENA countries, and how has it affected the potential for growth, equity and economic conditions.

2. Economic Conditions in MENA Region

MENA, The Middle East and North Africa, has no standardized definition; different organizations define the region as consisting of different territories, the World Bank definition of MENA is used in this study to include the following countries: Algeria, Bahrain, Egypt, the Islamic Republic of Iran, Iraq, Jordan, Kuwait, Lebanon, Libya, Morocco, Oman, Qatar, Saudi Arabia, Syria, Tunisia, the United Arab Emirates, West Bank and Gaza, and the Republic of Yemen. Syria and West Bank and Gaza are not included in any regional trends or forecasts due to lack of data availability (although references to individual indicators may occur where data availability permits. MENA as a collective group, geographic and cultural region is located in Southwestern Asia and North Africa. With a population of 355 million and the vast majority of people living in middle-income countries, the MENA region came into the Arab Spring with

multiple strengths, including a young and educated population, strong resource base, and economic resilience that helped it weather the 2008/9 global financial crisis (World Bank, 2011).
The economies MENA are in need of substantial institutional reform to improve their growth performance so as to create enough jobs for millions of entrants into their respective job markets, and to fight poverty and income inequality. This is necessary not only to reduce the risk of social unrest and domestic/regional conflicts, but also to assure stability of energy supply to the rest of the world and to hamper the violence originating from the region. So, the region's convergence to global standards of governance quality is desirable for increased prosperity and stability both in the region and outside (Sayan, 2009).

According to the World Bank development reports, various years, the following facts are extracted; With respect to the political situation, MENA is in turmoil. Syria, Iraq, Libya and Yemen are in conflict, causing damage to human lives and physical infrastructure. Fifteen million people have left their homes to others countries such as Jordan, Lebanon and Tunisia, giving rise to the biggest refugee crisis since World War II. The current turmoil in Yemen has set that country's development back several years. Violence has made Gaza's unemployment rate the highest in the world and with Gross Domestic Product at only 40% of its potential. Countries undergoing political transitions, such as Egypt, Tunisia, Morocco and Jordan, have to address security concerns over growth-promoting policies. The relatively peaceful oil exporters, such as Algeria, Iran and the Gulf countries, are grappling with low oil prices alongside chronic youth unemployment and undiversified economies. On a positive note, the political consensus around the constitution in Tunisia, and constitutions and legislation in Morocco, Jordan and Egypt that give greater rights to women and protect freedom of expression and information, indicate that citizens are increasingly engaging in policymaking (World Bank, 2014).

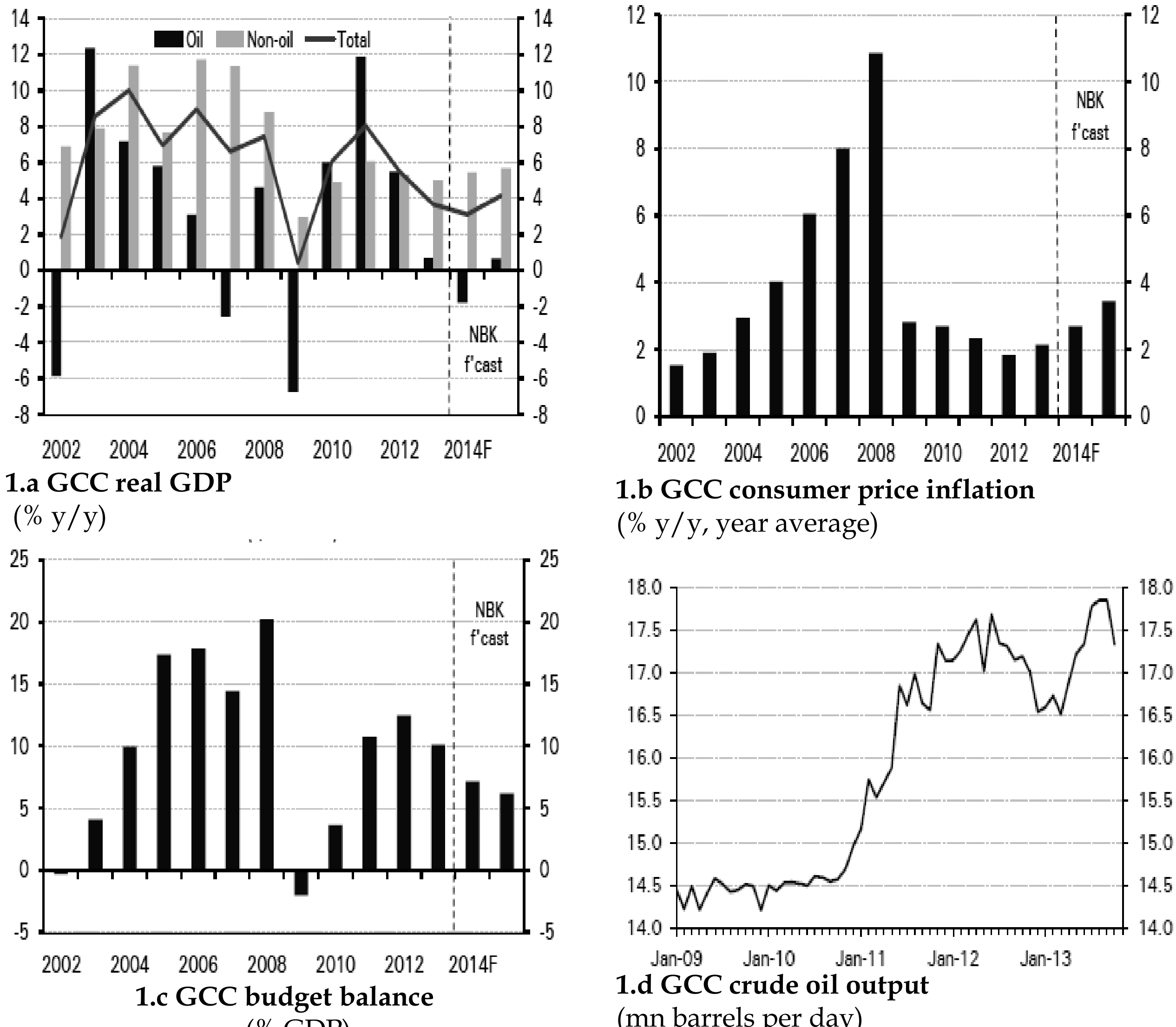
Growth in MENA is about 2.9% in 2015, slightly higher than last year's 2.6%, but considerably below the 4-5% growth the region enjoyed from 2000-2010. The main reasons for the continued, weak growth are: prolonged conflict and political instability in Syria, Iraq, Libya and Yemen; terrorist incidents in places like Tunisia that hurt tourism; low oil prices that are dragging down growth in oil exporters; and the slow pace of reforms that is standing in the way of a resumption of investment. The continuation of weak growth hurt the overall unemployment rate, now standing at 12%, and household earnings in the region. The group of oil exporters grew by around 2.7% in 2015 with growth stagnating in developing oil exporters, at 1.4%. Fiscal deficits continue to mount, leaving the region with a deficit of 8.8% of GDP in 2015, higher than the year before (World Bank, 2015).

The opportunity for political reform in the MENA region is unprecedented. However, structural political change cannot be dissociated from further economic reforms. The interdependent structural challenges faced by many countries—such as high unemployment, low female labor force participation rates, low levels of private sector development, weak public and corporate governance, bloated public sectors, limited competition, and pervasive corruption will need to be addressed (OECD, 2011).

3. Data and methodology

3.1. Data

In order to analyze impact of globalization on the economic conditions, this study splits MENA region into two group of countries GCC and non-GCC MENA as each group has different economic structures, and therefore, different economic performance. GCC MENA member countries of the Cooperation Council of the Arab States of the Gulf formed the early 1980s. GCC countries are Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates. These countries are estimated in a separate group as they have witnessed an unprecedented economic and social accelerating reformation. GCC countries have high contributions to GDP from the oil sector. In past decades, oil proceeds have been used to modernize infrastructure, create job opportunities and improve their economic and social indicators. GCC countries have been able to accumulate official reserves and maintain relatively low external debt. MENA region GCC maintains a unique geopolitical significance throughout history. Situated at the junction point of three continents, the region has been for centuries a thriving center of trade. Some facts about the economic performance of GCC are shown in figure 1 below.



1.a GCC real GDP
(% y/y)

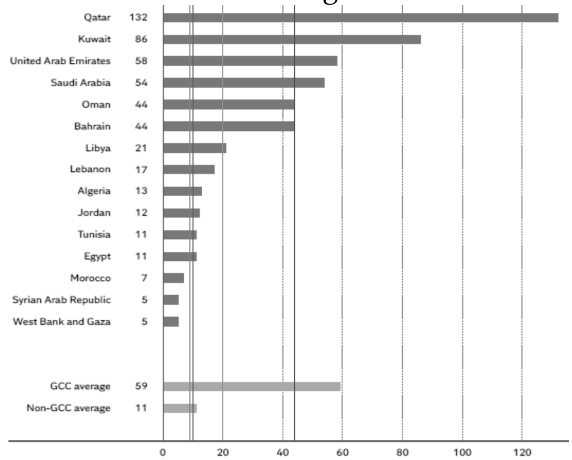
1.b GCC consumer price inflation
(% y/y, year average)

1.c GCC budget balance
(% GDP)

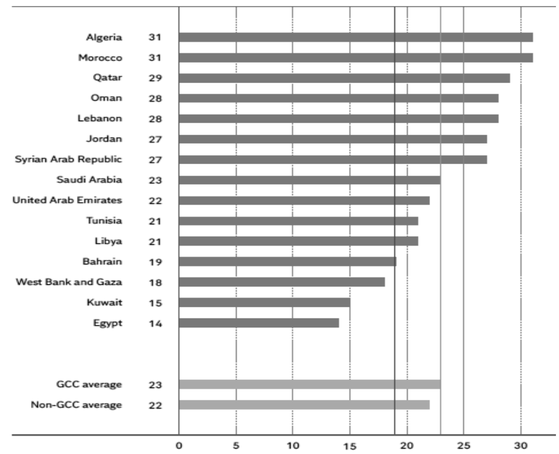
1.d GCC crude oil output
(mn barrels per day)

Figure 1: GCC, Some Economic Facts 2002-2014
Source: NBK Economic Research, MENA Economic Outlook January 2014

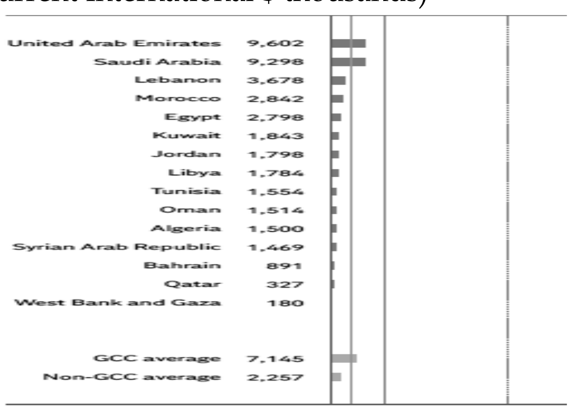
Non-GCC, Non- Gulf Cooperation Council MENA countries, this group of countries is experiencing fast population growth. However, unemployment levels in the region are relatively high, driven mostly by high youth unemployment and low female labor force participation. Non-GCC includes Algeria, Egypt, Iran, Iraq, Jordon, Lebanon, Syria, Yemen, Libya, Tunisia, Morocco and West Bank and Gaza. Because of unavailability of data about Syria and West bank and Gaza, they are excluded from this study. There are large differences existing in the performance of GCC and Non-GCC countries as compared in figures 2 below. MENA countries may have higher GDP growth than High-income countries, but lower GDP per capita levels. On average, governments of MENA countries run lower fiscal deficits and have less debt than High-income countries. Population is expanding fast in the MENA region. Female labor participation is one of the main challenges.



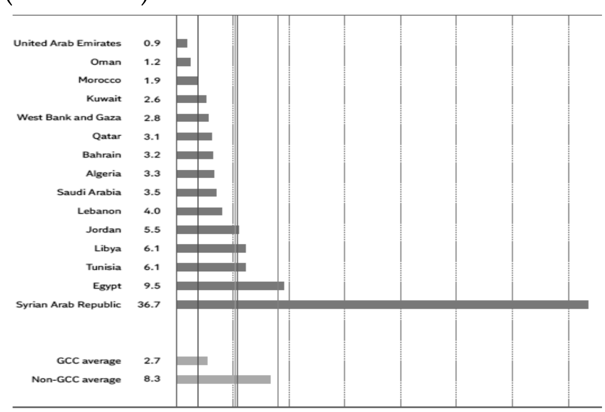
2.a GDP per Capita, PPP
(Current International $ thousands)



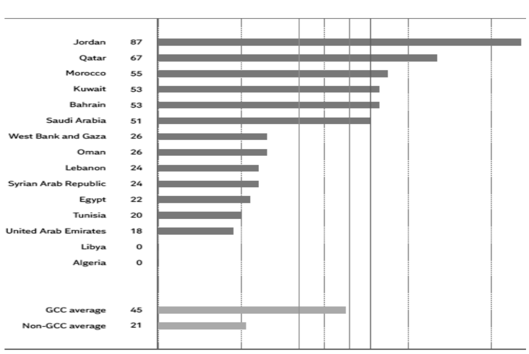
2.b Gross Fixed Capital Formation
(% of GDP)



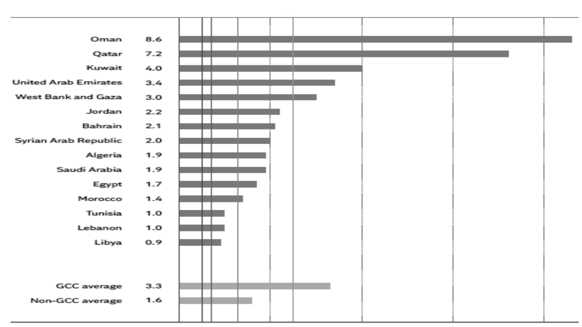
2.c Foreign Direct Investment, Net Inflows (BoP Current US$, millions)



2.d Inflation, Consumer Prices
(Annual %)



2.e Market Capitalization of Listed Companies (% of GDP)



2.f Population growth
(Average Annual % Growth in 2011-2013)

Figure 2: GCC and non-GCC Macroeconomic Indicators 2014
Source: International Monetary Fund's World Economic Outlook 2014
The World Bank's World Development Indicators 2014

3.2. Methodology

This study uses a panel data model to estimate the impact of globalization on economic condition in MENA region. The panel covers the period 2001–2014. Annual data were collected for two groups; GCC and non-GCC MENA region, the model can be illustrated by the following equation:

$$GDP_{it} = \alpha GDP_{it-1} + \beta_1 KOF_{it} + \beta_2 FI_{it} + \beta_3 CVS_{it} + \mu_I + \nu_{it}$$

Symbols	Descriptions	Sources
GDP (Dependent Variable)	GDP per capita, PPP (current international $)	World Bank Database
KOF	Economic Globalization Index	KOF Swiss Economic Institute Database
FI	Overall Freedom Index	Heritage Foundation Database
CVS:	**Vector of Control Variable Set:**	
GCE	General government final consumption expenditure (current US$)	World Bank Database
SSE	Secondary School enrollment education, pupils	United Nations Educational, Scientific, and Cultural Organization (UNESCO)
FDI	Foreign direct investment, net inflows (% of GDP)	International Monetary Fund Database
MC	Market Capitalization of listed domestic companies (current US$)	World Federation of Exchanges database
CPI	Consumer Price Index (Annual %)	World Bank Database
I	Country Index	
T	Time index	
α and β	Parameters to be estimated	
μ_I	Country-specific effect term	
ν_{it}	Error term	

Table 1: Descriptions and Sources of Data

3.2.1 Description of the model

GDP (Gross Domestic Product) per capita, PPP is used as an indicator of the economic conditions of the countries under study. Lagged value of the dependant variable GDP per capita is used as one of the regressors.

The KOF Index of Globalization was introduced in 2002 (Dreher, published in 2006) and is updated and described in detail in Dreher, Gaston and Martens (2008). The overall index covers the economic, social and political dimensions of globalization. Deher examined the impact of globalization on growth in an unbalanced dynamic panel of 123 countries between 1970 and 2000. The overall result showed that globalization promotes economic growth. The economic and social dimensions have positive impact on growth whereas political dimension has no effect on growth.

The current KOF Index of Globalization reflects the economic, social and political dimensions of globalization in 2011 – a year dominated by the Arab Spring. According to the index, globalization has stalled since the outbreak of the financial crisis in 2008. As shown in figure 3, the degree of globalization has then raised slightly afterwards. In all regions, globalization stagnated in 2011 (KOF Swiss Economic Institute, 2014).

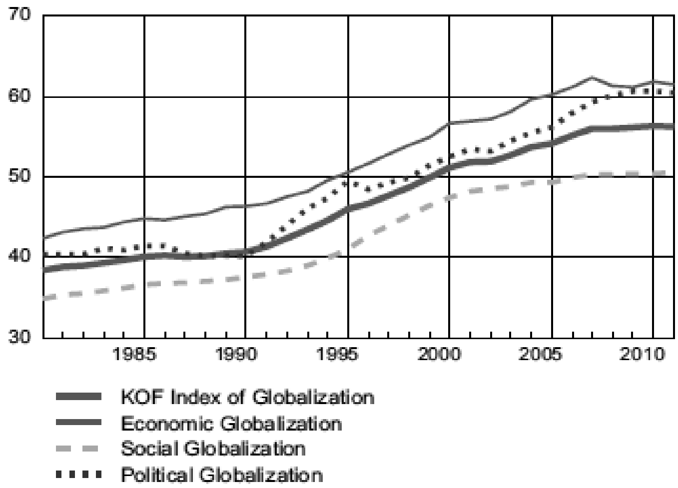


Figure 3: KOF Index of Globalization Worldwide
Source: KOF Swiss Economic Institute, Press Release KOF Index of Globalization April 2014

Dreher results are approved by Rao and Vadlamannati (2011), using KOF and examine its impact on growth rate of 21 African countries during 1970–2005. The positive effect of globalization on economic growth is also confirmed by the extreme bounds analysis. The result indicated that the positive effect of globalization on growth is larger than the effect of investment on growth. The political effect of globalization is analyzed by examining it through perspectives of liberal democracy that is built on ideas of spreading and imposing principles of capitalism and neo-liberalism around developing world (Scholte, 2005).

It is vital to investigate whether the implementation of globalization principles, that include adoption of the liberal democracy by MENA countries, leads to improvement of economic conditions, which is claimed to be the case according Huntington (2009). Democracy Index as well as Freedom Index can be used to find a correlation between degrees of democratic regimes and development by the impact of globalization, because, according to some definitions globalization is identical to democratization process (Scholte, 2005) or often associated with it (Shin, 1994; Diamond, 1992). Since The Economist Intelligence Unit first introduced Democracy Index at 2006 and this study span of time is from 2001 to 2014 so Freedom index is employed.

Pre-2011 MENA region has witnessed its overall score deteriorate, as the political climate gradually regresses. With 15 of the 20 countries in the region categorized as authoritarian, and none rated as a full democracy. Several countries have long had autocratic polities, such as Saudi Arabia and the UAE, and, consequently, their scores have remained largely stable, while the scores and rankings of others, including notably Syria and Libya, have worsened markedly in the wake of chronic instability and rising violence. Libya fell 18 places down the Democracy Index rankings between 2013 and 2014, from 101 to 119, while Syria's already extremely slopped down from 1.86 to 1.4 in 2014, pushing it down to 163rd place out of 167 countries. The most dramatic example of the regression to authoritarianism has been in Egypt, which has fallen to 138th in this year's rankings from 135th in 2013, and 109th in 2012 (The Economist Intelligence Unit, 2014).

Control Variables Set is other variables that affect economic conditions, it consists of;

Government Consumption Expenditure, Secondary School Enrolment as a proxy for human capital, Inflation measured by Consumer Price Index, net inflow of Foreign Direct Investment and Market Capitalization of listed domestic companies as a proxy of financial sector development, details about control variables, how they are measured and sources are explained in table 1 above.

In this model, both GDP_{it} and GDP_{it-1} are functions of μ_I - the unobserved country specific effect-, therefore, GDP_{it-1} is correlated with the error term which violates the assumptions of the classical regression model. This is known as an endogenous variable. Baltaji (1995) stated that in the existence of endogenous and dynamic regressors fixed effect estimators and Generalized Least Square estimators do not result in consistent estimates, and leads to misleading results. Arellano and Bond (1991) suggested a GMM (Generalized Method Moments) estimator as an instrumental variable estimator where the lags of endogenous regressors and the current values of exogenous variables are used as instruments. This process starts with making difference of variables and therefore it is called Difference Generalized Method of Moments (Difference GMM).

3.2.2 Preliminary tests

Two preliminary tests to detect both heteroscedasticity between disturbance term and the autocorrelation have to be conducted.

a. Heteroscedasticity Test:

Firstly, by applying the Likelihood-Ratio (LR) test that was presented at 2003 by Wiggins and Poi for heteroscedasticity detection on both GCC and non-GCC it is found that in GCC countries the degree of freedom is (70) and the p-value is (0.000), while in non-GCC results show that the degree of freedom is (103) and the p-value is (0.000). According to the LR test, the probability in both GCC and non-GCC MENA countries is less than 5%, then the null hypothesis is rejected, indicating that data subject to test is heteroscedastic.

b. Autocorrelation Test

Hence lagged values of GDP are used as one of the regressors in this model so DW (Durbin Watson) statistics to check serial correlation will not be valid. Wooldrige (2002) presented diagnostic test for autocorrelation in panel data in which the disturbance term follows first order autoregressive (AR (1)) process. By applying this model twice on CCG and non-GCC MENA, results show that the null hypothesis of non-existence of first order autocorrelation between the disturbance terms of the regression model is rejected. As the degrees of freedom are (1, 73) and (1, 112) and p-values are (0.000) and (0.000) for GCC and non-GCC countries respectively. So that, data subject to test has the first order autocorrelation.

3.2.3 Estimation of GMM

To in investigate the effect of globalization on economic conditions and performance of the six GCC countries, Difference GMM (AB-1step) is used, employing lagged values of the variables as instrument variables. Results are shown in table 2 below,

Variable	**Coefficient**	**t-Statistic**	**Prob.**
GDP(-1)	1.038986	36.36704	0.0000
KOF	-216.6693	-2.465223	0.0162
FI	393.4151	2.335510	0.0225
GCE	-4.17E-07	-8.426975	0.0000
CPI	-60.09197	-0.423369	0.6734

MC	0.005506	2.114967	0.0380
SSE	0.825821	2.546150	0.0131
FDI	343.5820	1.658874	0.1017
Sargan Test.		0.49	
First order serial correlation (p-value)		0.000	
Second order serial correlation (p-value)		0.135	

Notes: Dependent variable: GDP per capita (ppp)
Source: Author Estimation (statistical work is performed using Eviews 8)
Table 2: GCC Results of the Difference 1-step GMM

While repeating the same test for the ten non-GCC MENA countries, obtained the following results presented in table 3.

Variable	Coefficient	t-Statistic	Prob.
GDP(-1)	0.754309	15.58751	0.0000
KOF	-69.15512	-1.473802	0.1436
FI	-12.59934	-0.482112	0.6308
GCE	-3.46E-05	-0.270341	0.7875
CPI	-59.44081	-2.048649	0.0431
MC	2.91E-09	0.398295	0.6913
SSE	1.04E-07	3.538465	0.0006
FDI	119.8512	1.712646	0.0898
Sargan Test			
First order serial correlation (p-value)		0.52	
Second order serial correlation (p-		0.000	
value)		0.251	

Notes: Dependent variable: GDP per capita (ppp)
Source: Author Estimation (statistical work is performed using Eviews 8)
Table 3: non- GCC Results of the Difference 1-step GMM

4. Results

In both two groups of countries, it is surprisingly to find that the coefficient of KOF measuring the effect of the economic globalization on growth was negative. Statistically significant in GCC and insignificant in non-GCC, indicating that economic globalization affects economic growth and hence the overall economic conditions in an opposite way. In GCC, oil, religion and cultural norms might be singled out as factors against globalization. In non-GCC, globalization doesn't have strong effect on growth. This result could be attributed to the existing wide disparities between the developed and the developing economies such as the majority of MENA countries, makes globalization an instrument by which developed nations guarantee to have an access to world markets and so forth, retarding the growth and development of developing countries.

This result contests with earlier studies, amongst studies by Lee and Vivarelli (2004 and 2006), arguing that the optimistic Heckscher- Ohlin/Stolper-Samuelson predictions do not apply, that is neither employment creation nor the decrease in within-country inequality are automatically assured by globalization leading to more poverty and enlarging income inequality. It is reported that doubts can be raised at both the theoretical and empirical levels regarding the globalization for the developing countries. The theory that predicts growth from greater openness to trade is based on strong simplifying assumptions that ignore the realities of competitive advantage and rapid exposure to market forces in world of falling 'natural protection' (Lall, 2002). Feenstra-Hanson's (1996 and 1997) model points out that what is un skill intensive in a developed country may be skill-intensive in terms of the labor market of the recipient developing countries; accordingly, shifting production from developed towards developing countries (both through FDI and import/export trade relationships) may imply increasing. Also, Stolper-Samuelson (SS) theorem predicts that both trade and FDI should take advantage of the abundance of low-skilled labor in developing countries and so imply an increasing demand for domestic low skilled labor and hence decreasing within-country wage dispersion and income inequality (see Stolper and Samuelson, 1941)

The coefficients of variables tested show diverse results, for GCC MENA, investment in human capital, political stability and financial sector development promote economic conditions while inflation and government consumption do not. FDI is insignificant this might be attributed to the fact that most of the GCC countries depend mainly on oil exports to support development.

For non-GCC coefficient of political stability and democracy measured by freedom index shows a negative sign, this is due to turmoil, revolutions and turbulences in the region, moving its conditions from Arab spring into Arab winter. Increasing education level is positive and significant to economic growth, while inflation is negative and significant, financial market development has insignificant effect, as financial markets in some non-GCC are inactive.

The results of Sargan test accept the null hypothesis hat supports the validity of the instruments used in GMM.

5. Conclusion

This study empirically estimates the impact of globalization on economic conditions in MENA region, using GMM approach for the period 2001-2014. Results indicate that globalization has insignificant negative impact on GDP per capita and economic well being of non-GCC MENA countries while negative and significant in GCC. Evidence obtained in this study shows that political unrest in non-GCC hindered growth levels; education has significant effect while inflation has negative impact on economic conditions. This study recommends that; MENA should encourage investment in human capital, foster financial markets liberalization and openness and give an attention to modify tax regimes to confirm improving foreign direct investment.

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