the (considerable) costs of such an economically inefficient strategy. They will increasingly have to export in order to eat, to reform and revamp their water allocation mechanisms, and to find new, often unpalatable ways of cooperating with their neighbors. Such shifts, in turn, will require a rather dramatic change in the role of the state in the economy. We devote the next three chapters to this central issue.

NOTES

1. Bahrain, Israel, Jordan, Kuwait, Libya, Oman, Qatar, Saudi Arabia, the UAE, and Yemen.
2. Algeria, Egypt, Gaza, Iran, Iraq, Jordan, Lebanon, Morocco, Syria, and Tunisia.
3. According to the World Bank, for LDCs as a whole, the average income elasticity of water demand is approximately 0.30.
4. The formula is $D = n + ye$, where D = the rate of growth of demand, n = population growth, y = the rate of growth of per capita incomes, and e = the income elasticity of demand, or the percentage change in quantity demanded for every 1% change in income.
5. In 1970 a barrel of oil would buy roughly one bushel of wheat; by 1980 the same barrel would purchase six bushels, and even in May 1986 a barrel (of US$14.00) oil would still buy over three bushels.
6. As argued by a Muslim Brotherhood delegate in Jordan's parliament in February 1994.
7. Bimodalism refers to a land-tenure system that combines a small number of owners holding very large estates with a large number of owners holding very small farms.
8. The shah's land reform provoked Ruhollah Khomeini to attack the policies so vociferously that he was forced into exile in Iraq, thus beginning the long saga that culminated in the revolution of 1978–1979.
9. The list of disincentives to Sudanese cotton production in the late 1970s was formidable: an overvalued exchange rate, explicit taxes on cotton, allocating the input costs of *all* crops in the Gezira Scheme to cotton, and long (sometimes up to two-year) delays in payments. Many of these problems were ameliorated in the early 1980s.
10. In the early 1980s price controls applied to cereals, olives, wine grapes, sugar beets, milk, dates, beef, and poultry; prices for pulses, lamb, forage crops, fish, and most vegetables and fruits were uncontrolled (Cleaver 1982, 36).
11. Sectoral policies (e.g., price supports) transferred *into* agriculture a nominal sum equal to 1.3% of GDP, but when the impact of exchange-rate overvaluation is included 3.8% of GDP was transferred *out of* agriculture between 1961 and 1985 (Hansen 1991).
12. This is not true for all users. Urbanites who buy drinking water from water vendors typically pay the full cost of water provision, while farmers who pump groundwater pay both the capital and the operation and maintenance costs of such services. The current situation, in which some users pay the full costs while others pay nearly nothing, is both inefficient and highly inequitable.
13. The cost of desalinating brackish water using reverse osmosis is now about US$0.65 per cubic meter, while that for sea water exceeds US$1.00 per cubic meter (World Bank 1994f).

7

THE EMERGENCE OF THE PUBLIC SECTOR

Our concern in this chapter is to document and analyze the prodigious growth in the economic functions of the Middle Eastern state. Despite more than a decade of economic crisis and adjustment, the relative shares in the economy of the Middle East's public sectors have not diminished. There is little that is unusual about the region in this respect. What is striking, however, is the relative lack of variation in the degree and scope of state intervention across countries that otherwise differ greatly.

Middle Eastern states are big; they employ large numbers of people as civil servants, laborers, and managers—sometimes, as in the case of Egypt, as much as half of the nonagricultural workforce. These states monopolize resources; they control large investment budgets, strategic parts of the banking system, virtually all subsoil minerals, and the nation's basic infrastructure in roads, railroads, power, and ports. Whether size and resources translate into strength is a question to be examined on a case-by-case basis. Certainly the potential for strong states is there, especially when resources are coupled with control over, or control by, the military. There is, unsurprisingly, abundant contrary evidence that size spawns red tape and administrative paralysis, that resources are diverted into corruption and patronage, and that authoritarian leaders cannot push administrative agencies at a speed and in the directions that they would like.

Though attenuated after years of economic stagnation and crisis, the legitimacy of an interventionist state has long been widely accepted in the Middle East. This does not mean that most Middle Easterners accept the legitimacy of the particular state under which they live—that frequently is not the case. Rather, it has been conceded in the abstract that the state and its leaders have a right and an obligation to set a course for society and to use public resources to pursue that course. Two principles flowing out of the Western liberal tradition are given short shrift. One is that state authorities, *to the extent possible, should confine themselves to the maintenance of law and order, regulation (but not too much) of economic life, provision of basic* social-welfare benefits (health and education), and defense of the borders. The Middle Eastern state has taken on functions vastly more complex than these, and its citizenry has endorsed the effort. The other is that the emphasis is on the ends of state intervention, and checks and balances are seen not as preventing abuse of power but as impeding the state's progress toward its goals. Therefore, to some extent, there has been an acceptance of a high concentration of power—economic, administrative, and military. It can be argued that in Muslim society political authority is legitimate only insofar as it promotes the interests of the community of believers, the *umma*. This yields an organic image of society, a living community whose "health" the state must maintain.

Religious and cultural antecedents notwithstanding, it is our conviction that it is more the politics of decolonization and development than history and culture that account for the interventionist, organic state in the Middle East. The caretaker states of the colonial era, concerned with law, order, and taxation, have logically evoked their opposites, states that impinge upon all aspects of their citizens' lives. Moreover, the postcolonial state has seen as its duty the reparation of all the economic damage resulting from colonial policies. It has had to mobilize human and material resources on an unprecedented scale. The goal has been to overcome "backwardness" and build a prosperous, educated citizenry, a diversified economy, and national power. These tasks and goals are culture-blind. Hence we find basic similarities in the goal orientation and interventionism of states in societies as widely varied in cultural origins as Indonesia, India, Burma, Ghana, and Tanzania.

THE STATE AS ARCHITECT OF STRUCTURAL TRANSFORMATION

It is not only outside observers but also the leaders of Middle Eastern states themselves who see their tasks in terms of "engineering," architecture, blueprints, and the like. They are designing new societies, and the state is that collection of agencies that will enable them to build what they have designed. Ideologies vary but not the perceived need for state intervention. And no state in the region has been able to forgo the exercise of elaborating a national plan.

The point of departure for the state is backwardness—a condition, it is alleged, imposed on the region by imperial powers. Its three major components are (1) an economy mired in the production of cheap agricultural commodities requiring an unskilled workforce, (2) the perpetuation of this system of production by denying education and the acquisition of modern skills to all but a privileged few, and (3) the forcible integration of this backward agrarian economy into an international division of labor. To remedy backwardness requires a supreme effort, a kind of military campaign on three fronts. Only the state can coordinate the campaign and mobilize the inherently scarce resources needed to carry it out. So, along with the engineers and architects there are the inevitable Bonapartes, and, as Tunisia's Habib Bourguiba has demonstrated, they need not all wear a marshal's uniform.

The area has an inadequately educated, poor population and an agricultural system characterized by small pockets of high productivity in a landscape of low yields and by the inefficient use of scarce capital. However ironic it may seem in retrospect, the leaders of the state saw the need for intervention in order to avoid wasting scarce resources. The comprehensive and rational planning effort anticipated would require an inventory of available resources, a strategy for their development and utilization over time and in light of the profound structural changes that would take place in the economy and society as the plan unfolded, and the construction of the economic levers needed to implement the plan.

Throughout the region it was assumed that the private sector could not be relied upon to undertake this kind of resource mobilization and planning. The least critical saw the private sector as too weak financially, too close to a commercial and trading rather than an industrial past, and too concerned with short-term profit to be the agent of structural transformation. More severe critics emphasized the greed and exploitativeness of the private sector, its links to interests in the metropole, and its tendency to export capital rather than reinvest profit. Private sectors might be tolerated, but nowhere, save in Lebanon, did they enjoy legitimacy. Reliance on private entrepreneurs and on the law of supply and demand to allocate scarce resources would be wasteful, it was believed, and would not extricate the economy from its trap.

As important as efficiency for the state leaders was equity. Gross inequalities in the distribution of assets in Middle Eastern societies, not to mention absolute poverty for large segments of the population, were associated with the colonial system of exploitation. A more equitable distribution of assets within society became a universal goal throughout the area, again regardless of ideology. Some states pursued redistribution with greater conviction than others, but all espoused it as an ideal. The Great Depression, leading to absolute declines in the standard of living of rural populations, and the privations caused by World War II sensitized Middle Eastern elites to these equity issues. It was again assumed that the private sector could do little to alleviate them, and, if left to its own devices, would probably aggravate them.

The Middle Eastern state took upon itself the challenge of moving the economy onto an industrial footing, shifting population to the urban areas, educating and training its youth wherever they lived, raising agricultural productivity to feed the nonagricultural population, redistributing wealth, building a credible military force, and doing battle with international trade and financial regimes that held it in thrall. These were goals widely held if poorly understood by the citizens at large. There were no impediments, then, to the expansion and affirmation of the interventionist state.

ATATÜRK AND THE TURKISH PARADIGM

The Republic of Turkey has been an example if not a model for many of the other states in the Middle East. Because it achieved real independence in 1923 after successful military action against European forces (Italian, French, and Greek) that were bent on dismembering all that remained of the Ottoman Empire, Turkey showed what could be done to thwart imperialism. It possessed an inspiring leader, Mustapha Kemal Atatürk, "father of the Turks," who built a secular, republican, nationalist system in Anatolia. His sweeping reforms, from the abolition of the caliphate to the introduction of the Latin alphabet, have been too well studied to require treatment here (see, inter alia, Lewis 1961). For our purposes it is important that by the late 1930s Turkey was endowed with a credible military structure, the beginnings of a diversified industrial sector, and a rapidly expanding educational system.

Atatürk's contemporaries, including Reza Khan of Iran, who was to found the Pahlavi dynasty, looked on with varying degrees of admiration.[1] So too did Arab nationalist politicians such as Habib Bourguiba of Tunisia, who would lead their countries to independence. There were also students and young army officers in the turbulent 1930s who learned from the Turkish experience lessons that they would come to apply in the 1940s, 1950s, and 1960s. An Iraqi officer who later participated in the Golden Square conspiracy to oust the British from Iraq attended Atatürk's funeral and wrote (Salah al-Din Sabbagh, quoted in Hemphill 1979, 104): "I saw signs of progress which amazed me . . . a social revolution in education and economics, and in cultural and spiritual affairs. I saw the pride of the Turks in their fatherland, pride in their nationalism, their self-reliance and their independence."

In April 1931 Atatürk issued a manifesto containing six principles that were to be embodied in the 1937 Constitution of the Republic. He declared that the society and the Republican People's party (RPP) that he headed would be republican, nationalist, populist, secular, etatist, and revolutionary. The principles of etatism (a term meaning "statism" taken from the French and retaining a strong Bonapartist flavor), populism, and revolution will be our main concern here. The first provided legitimation for a strongly interventionist state. Populism meant that the masses were the object of political and economic policy and that distributive issues were at the top of the policy agenda. The revolution lay in Turkey's rejection of empire along with the sultanate and caliphate, its militant republicanism, and its confrontation with the imperial powers of Europe. Within a few years of the enunciation of these principles, Turkey embarked upon an economic experiment that was to be emulated in several countries following World War II (Hershlag 1968, 74): "Turkey became first among the backward countries to conduct an experiment in planned development with its first five year plan in 1934." It also built a large public-enterprise sector and pursued a policy of import-substituting industrialization under the auspices of the state.

Turkey's trajectory toward this experiment was erratic, and there is no question that the world depression forced it to revise profoundly the strategy that had prevailed in the 1920s. It is important to review these antecedents. First, Turkey was in a shambles after World War I. The empire itself had been destroyed, and the Arab portions had fallen under French or British control. The basically agricultural economy had been badly damaged, especially in the fighting against the Italians, French, and Greeks. Then, after the signing of the Treaty of Lausanne in 1923 between Turkey and the major war victors, an enormous exchange of population took place. By 1926 perhaps 1.3 million Greeks had left Anatolia, taking with them vital skills in commerce and trades. In their place came 400,000 Turks, mainly peasants from Thrace, whom the rural world could absorb only with difficulty.

Turkey inherited the Ottoman debts, which were finally settled at the end of the decade. It was fortunate that no reparations were imposed upon it as a successor to the empire that had fought on the side of Germany in that war. The fact that Turkey had signed a treaty of friendship with the USSR in 1921 may have militated against vindictive policies on the part of the allies. The Lausanne Treaty did impose restrictions on Turkey's ability to place tariffs on imports from Europe and hence to protect its own nascent industries. Nonetheless, Atatürk was determined from the outset to promote Turkey's industrialization and to liberate its economy from dependence on the West.

In contrast to what was to transpire after 1931, the republic's strategy was to rely on private-sector initiative and to avoid taxing the peasantry in order to finance industrial growth. The Organic Statute of 1924 declared private property and free enterprise to be the basic principles of the state. Its credo, not always honored, was that "the task of the state begins where the activity of private initiative ends." With the founding of the Iş (Business) Bank in 1924 to finance private enterprise, the state showed its willingness to foster the growth of an indigenous capitalist class (F. Ahmad 1981; Boratav 1981).

Again in contrast to what came later, the new republic implemented policies that were relatively favorable to the rural world. In 1924 the *'ushr* tax, or tithe, was abolished. This tax had generated as much as 29% of government revenue. Its abolition was of particular benefit to smallholders and poor peasants. In its place the government introduced a land and unutilized-property tax that fell most heavily on wealthy landlords. Throughout the 1920s agricultural prices were allowed to rise. Although agricultural production was at an abnormally low ebb following the war, it grew by an impressive 58% between 1923 and 1932, while cereals alone increased by 100%. At the same time urban consumers had to pay high prices for commodities controlled by government monopolies: tobacco, salt, sugar, matches, alcohol, gasoline. In many ways this was the inverse of the urban bias that was to develop in the 1930s and 1940s, when factory smokestacks were referred to derisively as "Atatürk's Minarets."

After 1929, with the onset of the world depression, agricultural prices collapsed. No nonagricultural private sector had yet emerged that could pick up the slack in the economy, even supposing that world economic conditions would have allowed such a development. As soon as the tariff restrictions of the Lausanne Treaty had expired in 1929 and before the onset of the depression, Turkey introduced higher tariff barriers to protect local industry. As the world crisis affected the Turkish economy, there was not time enough to see if the private sector would respond to the protective measures.

When, on April 20, 1931, Atatürk launched the etatist experiment, he said (Hershlag 1968, 69), "We desire to have the Government take an active interest, especially in the economic field, and to operate as far as possible in matters that lend themselves to the safeguarding of vital and general interests, or, in short, that the Government ensure the welfare of the nation and the prosperity of the state."

In May 1932 Turkey negotiated a historic interest-free twenty-year loan from the Soviet Union for the equivalent of US$8 million. This may have been the first loan of its kind to a developing country, and no other such loan was made by the USSR for the next twenty-five years. It was to be used to buy Soviet equipment for two sugar refineries and a textile mill at Kayseri. Repayment was to be made in Turkish exports to the USSR. The Soviets set up a special trade agency, Turkstroj, to implement the loan agreement, and in 1935 it negotiated with the Sümer Bank created by Turkey especially to manage the project financing of its First Five-Year Plan. A pattern of economic assistance was thus established that was repeated in Egypt, Algeria, Syria, Iraq, Iran, and Morocco in the 1950s, 1960s, and 1970s.

In the year following the loan Turkey drew up the five-year plan, and its implementation began in 1934. Atatürk, like nearly every head of state we shall consider in these pages, headed a coalition of interests and ideological perspectives within his government and party. Left-of-center figures who had been offstage during the 1920s were given much more prominence during the etatist era. There was much more talk now of the "Kemalist Revolution," and the private-sector strategy of the earlier years was abandoned. Rather than the state's being the handmaiden of a growing private sector, it was now to seize the "commanding heights" of the economy and bend the private sector to its will. In this new atmosphere the state technocracy and party ideologues could denigrate the private sector and talk of the necessity of state intervention. The left-of-center voices found a forum in the journal *Kadro* (cadre, or party organizer). The secretary general of the RPP, Recep Peker, was known to be an advocate of forced-pace change "to tear away from a social structure the backward, the bad, the unjust and harmful, and replace them with the progressive, the good, the just, and the useful elements" (cited in Karpat 1959, 72). Finally, the prime minister, Ismet Inönü, a man who saw etatism primarily in terms of the political and administrative obligations of the state, was to some extent eclipsed by Celal Bayar, who saw the need for much more aggressive economic intervention on the part of the state. Bayar came out of the Iş Bank and became minister of economy in 1932 and then prime minister, replacing Inönü, in 1937.[2]

The five-year plan was a blueprint for ISI, emphasizing local processing of Turkey's primary commodities and minerals. A major part of the program lay in developing the textile industry, utilizing Turkish cotton, and selling to a large domestic market. This kind of thrust is often associated with the so-called easy phase of ISI. Other industries of a similar nature are food processing, sugar refining, and simple assembly. But Turkey went somewhat farther, launching projects in basic chemicals—superphosphates, chlorine, caustic soda—as well as in cement, iron, paper and cellulose, artificial silk, and hemp.

Even prior to the First Five-Year Plan, the Turkish state owned several enterprises; there were processing plants associated with the tobacco monopoly, beet sugar refineries, a shoe factory, wool mills, and a cotton-weaving plant. It had taken over power generation and the railroads from foreign interests. The plan added some twenty new enterprises to the public patrimony. A State Office for Industry was set up in 1932 and by 1936 was empowered to inspect the accounts of private-sector industries and to enforce price and wage controls. The Central Bank had been established in 1930 as the bank of issue. In 1933 the Sümer Bank was created and absorbed the Bank for Industry and Mines. Sümer Bank provided financial management and supervision to state-owned enterprises, planned new projects, and invested in others coming under the plan. By 1939 Sümer Bank's holdings accounted for 100% of production in artificial silk, paper, cardboard, iron, and superphosphates, 90% of shoes, 80% of steel and lubricants, 70% of coke, 62% of leather, 60% of wool, and 55% of cement (Hershlag 1968, 92). The Iş Bank went well beyond private-sector financing to invest in a number of joint ventures. The Eti Bank to finance mineral exploration, extraction, and marketing was set up in 1935. In this way the state in the 1930s had the financial leverage to orient all economic actors in accordance with plan priorities.

Work on drafting the Second Five-Year Plan was started in 1936, and the plan itself was formally adopted by the Grand National Assembly in September 1938, just before Atatürk's death. Over a hundred new enterprises were planned. The first efforts at "industrial deepening" were projected. The Zonguldak-Karabük region was slated to become a heavy-industrial-growth pole, built around coal, steel, and cement and serviced by its own Black Sea port. A major effort was to be made in power generation, basic chemicals, engineering, and marine transport. Part of the plan was to disperse industry in order to benefit backward areas, especially Eastern Anatolia, as well as for strategic reasons.

Some of the seemingly inevitable side effects of this sort of big-push strategy began to make themselves felt during the 1930s. The government ran a growing deficit due in large part to an outsized bureaucracy. The civil service, not including the military or part-time personnel, reached 127,000 in 1938 and 184,000 in 1945 (Karpat 1959, 129). About 35% of the budget went into their salaries. The size of the civil service was due not so much to the overproduction of university graduates that characterized most of the Middle East by the 1960s as to the absorption of the personnel of the Ottoman bureaucracy set up to administer an empire. The deficit of the government stood at TL13.8 million in 1930/31 and TL125 million in 1939/40. Over the same decade Turkey was obliged to borrow abroad, from the Soviet Union, Germany, and the UK. Still, in contrast to other countries in the region in the 1960s and 1970s, Turkey was able to finance most of its investment out of its own resources. The level of investment was modest by postwar standards; the government was investing annually about 5% of national income, with another 5% coming from the private sector.

World War II interrupted the Second Five-Year Plan, and a period of severe privation ensued. Import substitution continued of necessity as Mediterranean shipping was disrupted during the hostilities. A major shift in the political domain after the war, leading to a two-party system and the victory of the Democrat party, which had come to oppose etatism, ushered in a liberal economic phase during the 1950s. Only after a military takeover in 1960 did Turkey return to etatism. By that time it had been joined by another half-dozen states in the region.

REPLICATING THE PARADIGM

It would be an exaggeration to say that other states in the Middle East slavishly imitated the Turkish experience. In fact, state-led ISI spread throughout the developing world in the years after 1945 and, as a strategy, had a logic independent of any single country's efforts. We shall see that among Middle Eastern states, the tremendous growth in publicly owned assets and the development strategies associated with them had varying sources of inspiration, some external and some internal.

We are distinguishing here between public-sector enterprise and other governmental agencies that employ the bulk of the civil servants. Generally, public-sector enterprises have their own statutes, personnel policies, and salary and wage scales. They are companies in the legal sense that make and sell products or deliver services for a fee. They enter the national marketplace directly and usually with great impact.

If we look at the developing world as a whole around 1980, we find impressive statistics on the weight of public sectors in their economies. On average the output of public-sector enterprise, exclusive of financial institutions (banks, social security and pension funds, insurance companies), accounted for 8.6% of GDP; these enterprises on average employed 47% of the manufacturing workforce in the organized sector, utilized 27% of all manufacturing investment, and, on average, ran deficits equivalent to 5.5% of GDP (World Bank estimates). State-owned manufacturing enterprises frequently accounted for 25–50% of value added in manufacturing. Some Middle Eastern states, especially Egypt, Algeria, and Syria, were well above these averages: Egyptian state-owned enterprises accounted for around 60% of value added in manufacturing and Syrian ones for 55%. The output of Algeria's and Egypt's state-owned enterprises reached 13% of GDP, while Syria's was close to 11%. Turkey's state-owned enterprises were, in 1980, producing about 8% of GDP and accounted for 25% of value added in manufacturing.[3]

The question of publicly owned assets is important to this study in two ways. First, the assets are always the instruments of a given state's development strategy. In that sense, they shape production, absorb and allocate scarce resources, and orient patterns of consumption. This may help or hinder the development of private-sector activity. They are always instruments of political preemption and control. Second, when we speak of publicly owned assets we are obviously dealing with a fundamental aspect of property relations and hence of class. What the state owns private individuals or firms do not. In theory, public ownership is ownership by the "people." The state acts as custodian, manager, and fiduciary on behalf of citizen-owners. The latter monitor the state through their representatives in parliament or the party or on the boards of directors of public enterprises. But this is almost everywhere a fiction. The state builds public enterprise to pursue ends that it alone defines.

The last statement, however, begs some crucial questions. The state cannot be taken as a homogeneous bloc. It always contains diverse interests and factions that prevail at different times and in different combinations. Furthermore, crude indicators of ownership and economic weight such as those presented in the preceding paragraph tell us little of intent or direction. The states in the Middle East with the weightiest public sectors are to be found among the frequently conservative oil exporters. Moreover, in Turkey in the 1950s, despite the professed liberalism of the Democrat regime, the public sector actually grew. More important, public enterprises may implicitly or explicitly be put, in part, at the service of the private sector (Turkey in the 1920s) or be designed to marginalize the private sector over time (Egypt after 1961). The weight of the public sector in the two cases may not differ much, but direction and intent are quite different.

The final begged question is whether the managers of public assets, those "atop the commanding heights" or "in control of the major means of production," come to constitute a dominant class that seeks to reproduce itself and to exclude others from the assets it controls. We shall try to advance some tentative answers to all these questions in the remainder of this chapter.

Arab Socialism and State Enterprise

One set of Arab states adopted the Turkish paradigm and went well beyond it. These states' strategies were explicitly socialist and populist, hostile to the indigenous private sector and to foreign capital, and aimed at far-reaching redistribution of wealth within their societies. The strategy has not always been sustained and on occasion has been officially abandoned (e.g., Egypt after 1974, Tunisia after 1969, the Sudan after 1972). The principal experiences we have in mind are those of Egypt (1957 to 1974), Algeria (1962 to 1989), Syria (1963 to the present), Iraq (1963 to the present), Tunisia (1962 to 1969), the Sudan (1969 to 1972), and Libya (1969 to the present). What all these have in common is a blueprint for the radical transformation of their societies and economies. In these states the campaign for growth, equity, and national economic sovereignty was no mere metaphor. Indeed, Habib Bourguiba of Tunisia likened his country's quest for development to a jihad and said that Tunisians should be dispensed of the obligation to fast during the month of Ramadan just as if they were warriors.

A number of basic assumptions underlay these experiments. The first of these was that profit and loss should not be the primary criteria for assessing public-sector performance. Rather, the creation of jobs, the provision of cheap goods of first necessity, the introduction of new economic activity to remote or poor regions, and the achievement of self-sufficiency in goods of a strategic or military nature would be more appropriate tests of success. Second, it was assumed that the operation of supply and demand was inferior to planning and the application of administered prices. In market situations, goods of first necessity (food and clothing) are often the objects of speculation, and because demand for them is relatively inelastic, prices may rise precipitously. The state had to set prices so that such goods were always within reach of the poorer strata. Similarly, the price of inputs and credits supplied to priority industries should not reflect their scarcity value.

The large-scale private sector was seen as untrustworthy. Most of the regimes under consideration nationalized it or sharply curtailed its activities. The private enterprise that remained was subjected to state licensing and price and wage controls and had to compete with the public sector for scarce credit and foreign exchange.

Foreign investment was viewed with suspicion. Entire sectors of the economy, such as basic metals, chemicals, and minerals, were reserved exclusively for public-sector enterprise; neither foreign nor domestic private capital was to be allowed in them. The favored form of collaboration with foreign capital was through turnkey projects and management contracts in which foreign investors acquired no equity in the host country. Socialist Algeria, in the 1970s, was able to do billions of dollars' worth of business with the United States, France, Japan, and other countries through such formulas.

The setting up of closed sectors for public-sector enterprise underscores another assumption: that there is nothing inherently inefficient about monopolies. In many instances state-owned enterprises enjoyed monopolies in entire lines of production or were the sole purchasers (monopsonists) of certain inputs (raw cotton or sugar beets). Egypt, after 1961, took matters further, putting the entire banking, insurance, and foreign-trade sectors under public ownership. The supply of investable funds and the importation of vital production inputs thus became a state monopoly. For all this to work—to promote overall growth, industrialization, and a more equal distribution of income—required that the planners anticipate the interaction of all the economic variables that, today, computer models chew over, that the managers pursue efficiency even while protected by tariffs and monopoly status, and that the civil servants put in an honest day's work. By and large none of those requirements were met.

Egypt. Egypt was the first Middle Eastern country in the postwar era to adopt a strategy of radical transformation. In many ways it was far more integrated into the world economy than Turkey. It had been one of the leading exporters of raw cotton for nearly a century. The British occupation after 1881, the economic dependency on Britain that ensued, and the role of the Suez Canal in world trade made Egypt's a classic colonial economy. As in Turkey, the world depression and World War II set Egypt on the path toward ISI. It was the Egyptian private sector, partly indigenous and partly foreign, that led this effort.

In 1952 the Egyptian monarchy was overthrown by a military coup led by Col. Gamal 'Abd al-Nasser and a group of his colleagues known as the Free Officers. From 1952 to 1956 Egypt promoted public-sector growth but, as did Turkey in the 1920s, did so either to help the private sector or to undertake projects that the private sector could not finance or manage. The old Aswan Dam was electrified to augment Egypt's power supply, and it was decided to promote a new, giant dam at Aswan to increase hydropower generation severalfold and to ensure a predictable

supply of irrigation water to the agricultural sector. Work was begun on an iron-and-steel complex at Helwan and on a large fertilizer plant at Aswan.

It was not until the Suez War of November 1956 that the public sector grew at the expense of the private. Because of the participation of Britain and France, along with Israel, in a direct attack on Egypt, all assets owned by the former two in Egypt were taken over by the Egyptian government. The attack itself had been provoked by Egypt's nationalization in July 1956 of the Suez Canal Company. With the wartime sequestrations of banks, trading companies, insurance companies, utilities, and some manufacturing enterprises, the Egyptian state found itself in possession of a very substantial patrimony. It was only then that the term "socialism" was adumbrated and that left-of-center voices in Nasser's coalition gained greater prominence. In 1957 Egypt contracted its first loan for economic assistance from the Soviet Union, followed in 1958 by a Soviet loan to help build the Aswan Dam. In 1957 Egypt began its first five-year industrial plan, with strong emphasis on state enterprise. By 1960 it considered itself ready for a five-year plan for the entire economy.

After 1956 there was some evidence of private-sector disinvestment and profit-taking and of growing suspicion between the private sector and the regime. The privately held Misr Group and Bank Misr had been essentially taken over by the state by 1960. The new Ministry of Industry was empowered to license and regulate all private industrial activity. The elaboration of the First Five-Year Plan was carried out without consulting the private sector, although the latter was called upon to mobilize about 55% of all investment over the five-year period.

The failure of the private sector to do so allegedly provoked a wave of nationalizations through the Socialist Decrees of July 1961. In one fell swoop, the Egyptian state took over most large-scale industry, all banking, insurance, and foreign trade, all utilities, marine transport, and airlines, and many hotels and department stores. The bulk of agricultural property remained in private hands, but new desert reclamation projects were owned by the state.

The First Five-Year Plan embodied a straightforward ISI strategy, combining aspects of the easy (textiles, sugar, automobile assembly, pharmaceuticals) and hard (heavy engineering, steel, chemicals, and fertilizers) phases. It generated 1 million new jobs and growth rates of 6% per annum. Yet in 1965 it ended in crisis.

The Achilles' heel of ISI, whether under public or private auspices, is the economy's ability to earn foreign exchange. For the major oil exporters that at one time or another pursued an ISI strategy (Iran, Algeria, Iraq) this was not a major problem, but for Turkey, Egypt, and Syria it certainly was. As Turkey learned in the 1930s, ISI often reduces imports of one kind—for example, finished textiles or refined sugar—only to increase imports of another kind—for example, raw materials such coking coal for new steel plants or capital goods such as turbines and power looms. Egypt's new industries were designed to market their products in Egypt. They did not have the economies of scale and basic operating efficiency that would have allowed them to export to other markets. Thus, although they needed imports to function, they could not generate the foreign exchange to pay for them.

To finance its Second Five-Year Plan, Egypt had little choice but to try to borrow more heavily abroad. It was not very successful, and even the Soviet Union was reluctant to extend new lines of credit. At the same time, the state's large outlays on construction and social services drove up domestic demand without commensurate increases in the supply of goods, so that inflation reared its head. Finally, the fact that few state-owned enterprises were profitable and many were being padded with redundant personnel in an effort to create jobs meant that the government had to resort to deficit financing to cover their losses. In short, although rates of growth in production and the delivery of services were quite respectable, the Egyptian state nonetheless faced an external and a domestic fiscal crisis.

The Second Five-Year Plan, which, like Turkey's, would have led to industrial "deepening," had to be abandoned for want of adequate financing. Then came Egypt's disastrous defeat in the June War of 1967 and Israel's occupation of the Sinai Peninsula. Egypt lost its oil fields there, the Suez Canal was closed to traffic, and tourism was badly disrupted. Egypt went into severe recession. Its strategy for radical structural transformation through public-sector enterprise had to be revised.

President Nasser died in September 1970, and his successor, Anwar al Sadat, cautiously pursued a policy of economic liberalization aimed at reforming and streamlining the public sector, stimulating the private sector, attracting foreign investment, and promoting exports. Public-sector enterprise was subjected to sharp criticism for its chronic inefficiency and huge operating deficits. Although Egypt continued to produce five-year plans, they had clearly lost their mystique, and the notion of socialist transformation was downplayed. Egypt's initial blueprint, the crises that developed in its implementation, and the revision of the blueprint constitute a sequence that has been repeated elsewhere in the region.

Even though heavily criticized, Egypt's public sector continued to grow throughout the 1970s. Entering the 1980s it included 391 companies employing about 1.2 million workers. The market value of its assets was about £E38 billion. In 1983/84 its wage bill stood at £E5.7 billion (over 20% of GDP) and over the period 1975 to 1982 had grown at 19% per annum. It accounted for 22% of total value added in the economy. The return on its total investment was only 1.5% per annum. Counting public authorities that ran everything from the Suez Canal to the Aswan High Dam, along with the civil service, the public and governmental sector in the early 1980s, before the structural adjustment effort began, had 3.2 million employees—more than a third of the total workforce and over half of the nonagricultural workforce—and over £E90 billion in assets. Total public expenditures in 1980 represented 60% of GDP, total government revenues 40% of GDP, and the public deficit 20% of GDP. As one observer put it, "There are few, if any, developing countries in the world with such high proportions" (Ahmad 1984, ix).

Algeria. Algeria is one of the few LDCs to rival Egypt in terms of the weight and extent of its public sector. To a greater degree than in Egypt, the overall size of the Algerian public sector was the result of ideology and long-term policy.

Independent Algeria emerged in 1962 out of seven years of revolutionary warfare against the French. Many of the leaders of the National Liberation Front (FLN) were committed socialists and occasionally marxists. The nature and intensity of their struggle made it inevitable that Algeria would confront France and the imperialist world in general. International business interests and the Algerian private sector itself were seen as likely enemies of Algeria's revolution (Leca 1975, 124). At no time did the state see its role as helpmate to the private sector as did Turkey during the 1920s or Egypt up to 1957. The National Charter of 1976 reiterated a position that had been constant since 1962 (Benissad 1982, 29):

> In Algeria, private property cannot be a source of social power. It cannot be the basis for exploitative relations between the owner and the workers. It can only function to the extent that it does not prejudice the interests of the laboring masses, nor constitute a brake or obstacle to the inexorable evolution of our society toward socialism. . . . In the industrial domain, the intervention of the national private sector is restricted to small-scale enterprise involved in the last stage of industrial transformation, downstream of the production or the imports of the public and socialist sectors.

From 1966 to 1989 the commanding heights of the economy were reserved to the state. Collaboration with foreign firms was extensive but was carried out on a contract basis involving turnkey projects, technical assistance, and purchase of technology. Direct investment was carefully avoided. Like all states in the region, Algeria was the exclusive owner of all subsoil minerals. French companies that had developed the country's petroleum and natural gas deposits were nationalized between 1969 and 1971, giving the state exclusive control over their production, refining, and marketing. The hydrocarbon sector, after the surge in world petroleum prices in 1973, came to represent over 30% of GDP.

In many ways Algeria could not have avoided heavy state intervention even if its official ideology had not been socialist. On the eve of independence, nearly all of the French settler community in the country, nearly 1 million strong, packed up and left. This was an exodus even more devastating than that of the Greeks from Turkey in 1922–1923. The French settlers had dominated modern farming, skilled trades, the small industrial sector, and government services. The new state inherited agricultural, industrial, and residential property, and the first two were given over to "worker self-management" units. In the agricultural sector, over 2 million hectares were cultivated by about 130,000 permanent workers on 2,000 farms. The state owned the farms, but, in theory, the workers had full control over their operations. The same formula was applied to industrial units. These consisted of about 400 small-scale enterprises, only 5% of which employed more than 100 persons, with a total workforce of 15,000.

In the early years, when Ahmad Ben Bella was president, the experiment in self-management was seen as putting power in the hands of the working people and constituting a barrier to the emergence of a dominating and domineering bureaucracy and technocracy. The period 1962–1965 was one of near-romantic populism and socialism, but already one could see government agencies arrogating basic decision-making power in all spheres of production. The FLN, which had seen many of its militants absorbed into the civil service, could do little to defend the populist experiment, and the workers themselves soon reverted to apathetic clock punching.

The romantic period came to an end in June 1965 when the minister of defense, Houari Boumedienne, overthrew Ben Bella and ushered in an era of "rational" top-down planned development that, implicitly, saw the masses as a source more of disruption than of revolutionary support. Worker self-management was paid lip service but deprived of any effective autonomy.

Boumedienne met one significant challenge from Ben Bella's old coalition. In December 1967, Tahar Zbiri, the army chief of staff, and Abdelaziz Zerdani, the minister of labor, who was close to the General Confederation of Algerian Workers (UGTA), tried to engineer a coup against Boumedienne. Zerdani saw the Algerian development strategy moving toward authoritarian state capitalism in which the workers would be made to pay a heavy price while their unions would be muzzled. He appealed to his old friend Zbiri, like himself a Berber from the Aurès Mountains and a former guerrilla fighter. The coup attempt failed, the conspirators fled, and Boumedienne, in close concert with his minister of industry, Abdesslam Belaid, pushed Algeria down the very path that Zbiri and Zerdani had tried to bar.

With the First Four-Year Plan, 1969–1973, Algeria launched a program built on heavy industry. Oil and natural gas were to serve two ends: First, they would be the feedstock for a modern petrochemical sector producing fertilizers and plastics; second, the earnings from their export would pay for the importation of plant and capital goods for steel manufacture and vehicle assembly. It was expected that the agricultural sector, especially the self-managed units, would be an expanding market for the new products (fertilizers, irrigation pipes, tractors). The local private sector was regarded as irrelevant to the effort, and foreign firms were seen mainly as providers of technology. The slogan was "Sow oil to reap industry."[4]

By the time Algeria initiated its Second Four-Year Plan, world petroleum prices had quadrupled. In contrast to Egypt, Algeria faced no financing problems in the mid-1970s. In that sense, its experience emphasizes some of the inherent weaknesses of state-led ISI, for by the late 1970s important elements of the strategy had been called into question. Rather than the agricultural sector's generating demand for new industrial products, there was a general decline in agricultural production, especially in the self-managed sector. Algeria became a major importer of food. Insufficient domestic demand coupled with tariff protection and monopoly position meant that public-sector industries operated below capacity and at high cost. They had little hope of exporting except to some of their East European creditors. Finally, some of the imported technologies, for example, in natural gas liquefaction, were so sophisticated that costly units were frequently shut down for technical reasons.

Near the end of his life, President Boumedienne acknowledged the shortcomings of his approach. In his "state of the nation" address of March 1977, he warned (as cited in Nellis 1980, 410): "Management is henceforth a battle to win, just as we

have won that of investment. In truth, the problem of the management of the economy, and more particularly the production and service units will constitute our major concern for the coming years."

Boumedienne died on December 27, 1978. His successor, Chadli Benjadid, a former liberation army commander and a man who had supported Boumedienne in 1965, was elected president in 1979. During his tenure, which ended in 1991, Algeria's public sector was extensively overhauled (see Chapter 9). However, it still dominates the Algerian economy. In the late 1980s there were some fifty public-sector companies and twenty authorities with assets valued at over US$100 billion, employing 80% of the industrial workforce and accounting for 77% of industrial production. Add to this 260,000 civil servants and 140,000 teachers and other employees of the educational system and one has 45% of the nonagricultural workforce on the public payroll. Finally, the Algerian state in the late 1970s was able to invest the equivalent of 25–30% of GDP annually. This could not be achieved, however, without stimulating inflation and increasing the external debt, which stood at US$23.3 billion in 1987 (World Bank data). The collapse of international petroleum prices in 1984/85 forced Algeria to question the very premises of the strategies it had followed since the mid-1960s.

Syria and Iraq. Since 1953 Syria and Iraq have fallen under the domination of the same pan-Arab party, the Ba'ath, or Arab Renaissance party. Since its founding in Syria after World War II, this party has called for Arab unity and socialism and has tried to propagate its message throughout the Arab world. The major obstacle to its spread was perceived by its leaders to be Nasser's Egypt, especially when that country entered its socialist phase after 1961. Many of the policies of state intervention implemented by the Ba'ath in Syria and Iraq sprang in part from its socialist ideology, but just as important were the fears of Ba'athi leaders that Egypt's socialist transformation would dazzle the radical youth of the Arab countries.

Both Syria and Iraq, in contrast to Algeria, had substantial indigenous trading and landowning bourgeoisies and no foreign settler communities (see, inter alia, Batatu 1978 and Khoury 1983b). Prior to the Ba'ath's coming to power, both countries pursued policies whereby the state helped the private sector through the development of infrastructure and banking credit. Neither country had made significant advances in industrial production, although Iraq enjoyed the revenues from a sizable oil sector.

In the 1950s, under the Iraqi monarchy, oil revenues gave the state tremendous leverage in the economy. The public Development Board annually absorbed 70% of those revenues and invested them mainly in infrastructural development. It was this policy that required deferred consumption and contributed to a situation in which elements of the Iraqi armed forces overthrew the monarchy in July 1958.

Almost immediately the new regime, led by 'Abd al-Karim Qassim, disbanded the Development Board and replaced it with a Planning Board and a Ministry of Planning. There was a major shift in investment away from infrastructure and agriculture and into industry. The Ministry of Industry was empowered to promote public-sector projects and to supervise and license private-sector activities (Penrose and Penrose 1978, 253).

The new regime, however, was not Ba'athist. Qassim was merely a nationalist army officer with leftist leanings. He tried, unsuccessfully, to balance Nasserist, communist, and Ba'athist forces within his coalition, contend with Kurdish dissidence, and implement far-reaching agrarian reform. All the contenders battled for the hearts and minds of the officers' corps, and in February 1963 a group of Ba'athi officers overthrew and killed Qassim and set up a government presided over by Colonel 'Abd al-Salam 'Arif. This new regime moved in early 1964 to nationalize all banks, along with thirty-two large industrial and commercial firms. With these moves the state's share in large manufacturing concerns rose to 62% of gross output, 46% of employment, and 55% of wages. Once more the state had captured the commanding heights, and most observers concede that Iraq acted in order to steal Egypt's thunder (Batatu 1978, 1,031; al-Khafaji 1983). It was not, however, until 1972–1975 that full nationalization of the petroleum sector took place.

The nationalization coincided with the first big increase in world petroleum prices. With the oil sector under state ownership, the state's share in GDP rose to 75% in 1978, although if the petroleum sector is excluded the state's share was a more modest 23%. By 1977 there were some 400 public-sector enterprises, employing 80,000 workers. They absorbed over 60% of all industrial and commercial investment (Stork 1982, 36; al-Khafaji 1983, 36). Total government employment in 1977 reached 410,000, or nearly half of Iraq's organized workforce. Adding to this 250,000 members of the armed forces (a figure that rose to over a million in the 1980s), 175,000 in the Ba'ath militias, 260,000 in the police, 120,000 pensioners, and thousands of schoolteachers, we find that by 1980 one in four Iraqis was on the state payroll (Batatu 1978, 123). Saddam Hussein's public sector had a far more sinister aspect. Not only was it heavy with police and intelligence personnel but, it is estimated, it came to employ about a quarter of the workforce as part-time paid informants (al-Khalil 1989, 38).

Between 1958 and 1961, Syria had been a member, along with Egypt and North Yemen, of the United Arab Republic (UAR). In those three years, under Egyptian pressure, land-reform measures were undertaken as well as some steps toward expanding public-sector enterprise. Egypt's Socialist Decrees of July 1961 alarmed the Syrian private sector, which feared they would be applied in Syria. In league with sympathetic army officers, these elements brought off a coup d'état that took Syria out of the UAR and installed a somewhat conservative, pro–private-sector military regime in Damascus.

In March 1963, a month after the Ba'ath had come to power in Iraq, yet another military coup brought the Ba'ath to power in Syria. A year later, in May 1964, the regime took over the country's banks, and in the wake of private-sector protests in Hama seven enterprises of "reactionary capitalists" were nationalized. Then in January 1965 the regime undertook far-reaching nationalizations. Assets worth US$50 million were taken over, and the public-sector share in industrial production rose from 25% to 75%. Again, part of the motive was to demonstrate to organized labor that Syria's socialist experiment was as radical and devoted to workers' welfare as Egypt's (in general, see Hannoyer and Seurat 1979; Chatelus 1982; Longuenesse 1985). In fact, Syria structured its public sector exactly on the Egyptian model, using general organizations to supervise production in specific sectors such as textiles, chemicals, and metals.

A more radical wing of the Ba'ath seized power in 1966, but its militancy was manifested mainly in confronting Israel and sponsoring Palestinian guerrilla attacks. This faction's image was battered in the June War of 1967, and, in 1970, after an internal trial of strength, Hafiz al-Assad, the minister of defense and commander of the air force, took power. The shift to some extent resembled that from Ben Bella to Boumedienne. Assad is an organization man, mistrustful of the masses and of revolutionary adventures. He has relied on the large power structures of the country—the armed forces, the bureaucracy, the Ba'ath party, and the public sector, perhaps in that order—to control, preempt, and police, rather than mobilize.

Between 1970 and 1982 employment in public-sector enterprises rose from 57,000 to 119,000, or half the industrial workforce. In just two years the public-sector wage bill doubled, from 3.5% to 6% of GDP. In 1979 Syria's total workforce was about 2.1 million, of which about a third were engaged in agriculture. Combined public-sector and civil-service employment probably totaled 350,000. There may have been 230,000 Syrians in uniform and, although there is some overlap with the preceding categories, perhaps 200,000 members of the Ba'ath party (Drysdale 1982, 5–7). Some 220,000 workers, in both the public and the private sector, were unionized and under Ba'athi supervision. Again, as we have found in all the preceding experiments, the state not only owned the major means of production but controlled through the payroll, the party, and the armed forces the most strategically situated elements of the workforce.

This dominance in Syria and elsewhere was achieved at the expense of economic efficiency. The strategic sectors became used to their privileges and to low levels of performance. The state hesitated to alienate them by asking more of them or paying them less. This held true especially for the military; in 1981 Syrian defense outlays were 13% of GNP, placing it among ten nations worldwide to spend more than 10% of GNP on defense. Inflation and a growing external debt (according to the World Bank, it increased tenfold between 1970 and 1983 to $2.3 billion) plagued the economy, especially after the Syrian intervention in Lebanon in 1976.

Tunisia. Since its independence in 1956 and up to 1987, when Gen. Zine Ben 'Ali deposed Habib Bourguiba on the grounds that he was medically unfit to govern, Tunisia maintained uninterrupted civilian rule. Nonetheless, during those same years it built an interventionist-state system that resembled those of Egypt, Turkey, and Algeria. Bourguiba founded the Neo-Destour party in the 1930s, rallied the small-scale trading and commercial groups, the professionals and intelligentsia, and the trade unions, and led the coalition to power (Moore 1965).

Although the French settler community in Tunisia was smaller than that of Alge-a, it nonetheless dominated the modern private sector. There was no such mass ex-dus of settlers as had occurred in Algeria, but the fact remained that there was no idigenous industrial bourgeoisie upon which the new state could rely to promote ıe country's structural transformation.

From the outset, then, much as in Turkey in the 1920s, Bourguiba built a power-ıl state apparatus, to some extent gutting the Neo-Destour of its best cadres, subor-inating the trade unions, and using the state to mobilize capital and raw materials) stimulate private activity. In 1962 Tunisia launched its first three-year plan, fol-ıwed by a series of four-year plans. The state's role in resource mobilization was, ntil the 1970s, overwhelming (Table 7.1).

Tunisia in the 1960s was quite literally boxed in between the Arab world's two ıost ostentatious socialist experiments, Algeria's to the west and Egypt's to the east. y 1964 Bourguiba had decided that it was necessary to give a more radical cast to ıe Tunisian strategy. In October 1964 the Neo-Destour party became the Socialist)estour party and called for the "coexistence" of the public, private, and cooperative :ctors. The First Four-Year Plan, 1965–1968, was to embody a socialist transforma-on of the economy: cultivators were to be grouped into agricultural cooperatives, nd state enterprise would spearhead the industrialization drive. A young intellec-ıal, Ahmed Ben Salah, active in the Neo-Destour and the unions prior to indepen-ence, was made secretary of state for planning and national economy and was the riving force behind the experiment.

Both the extent and the pace of state intervention had been dictated by Bour-uiba's failing health. The Combatant Suprème, as he liked to be known, feared that ıe socialist experiment would be jeopardized if he were to die before it had been nplemented. But Bourguiba's health was restored, and Ben Salah, by forcing the

TABLE 7.1 Evolution of Total and Industrial Gross Fixed Capital Formation in Tunisia (%), 1962–1981

'ross Fixed 'apital 'ormation	*Three-Year Plan 1962–1964*	*Four-Year Plan 1965–1968*	*Four-Year Plan 1969–1972*	*Four-Year Plan 1973–1976*	*Four-Year Plan 1977–1981*[a]
'otal					
Public sector	74.7	70.9	59.1	53.2	64.7
Private sector	25.3	29.1	40.9	46.8	35.3
ıdustrial					
Public sector	84.7	86.7	60.5	43.7	63.6
Private sector	15.3	13.3	39.5	56.3	36.4

ᵃverage for first three years of the plan.
ıurce: Signoles and Ben Romdane (1983, table 4, 119).

pace of cooperative formation, alienated much of the regime's petty capitalist and small landowning constituency. In 1969, Bourguiba turned on Ben Salah and put him on trial for treason. The statist experiment was overhauled, and Tunisia adopted a strategy of stimulating its private sector and promoting exports to the EEC. The shift in emphasis is shown clearly in Table 7.1 (see also Chapter 9). Still, the Tunisian state remained, until the late 1980s, a dominant force in the economy and, through its modest oil exports, had substantial revenues at its disposal. Those rents explain the rising share of the state in gross fixed capital formation after a decline in the early 1970s. In 1982 the public-enterprise sector alone employed 180,000 persons, or over 11% of the workforce.

The Sudan. The Sudanese economy is, among the major countries of the region, the most heavily dependent on its agrarian sector. About 70% of the population is rural, and half the workforce is employed in farming, animal husbandry, or fishing. Prior to independence in 1956, Sudanese industry was based on agricultural processing: cotton ginning, seed crushing for edible oil and feed cake, and soap manufacture. After a military coup d'état in 1958, the Sudanese state began an ISI strategy built around public enterprise. Once again the Egyptian example proved contagious, and, as in Algeria, Egypt, Syria, and Iraq, the Soviet Union stepped in with technical assistance, planning advisers, and soft loans. The strategy was maintained during a turbulent return to civilian control between 1964 and 1969 and then was accelerated when Major Ga'afar al-Nimeiri seized power in May 1969. His coalition initially had a strong marxist and communist faction that engineered several nationalizations of foreign banks and indigenous private firms.

In the summer of 1970 Nimeiri purged his government of its communist and marxist members and within a year began to denationalize the assets he had just taken over. In the early 1970s the regime acted to support private-sector growth within the general ISI framework, but state enterprise remained the dominant economic force in the economy. Public companies dominated the sugar, textile, cement, food processing, and canning sectors and had a significant share of leather, edible oils, soap, and detergents. The million-hectare Gezira Scheme was owned by the state; cotton and groundnuts were grown on the scheme by 100,000 tenant farm families. One of the largest state-owned farms in the world, it has for years been the backbone of Sudan's rural economy. The state also owned all mineral deposits, including some oil deposits in the south-center of the country, the Sudanese railroads, and all hydro- and thermal-power systems.

As has been the case for the other countries under consideration, the state in the Sudan was the country's principal employer. With over 400,000 people on the public payroll in 1977, exclusive of the armed forces, the state employed 8% of the entire workforce and 21% of the nonagricultural workforce (Table 7.2).

Libya. The Jamahiria, or "mass state," of Libya represents the unacknowledged combination of romantic revolutionary and Islamic programs with a kind of cynical

TABLE 7.2 Growth in Public Employment in the Sudan, 1955/56–1976/77

	1955/56	*1976/77*
Central government	31,283	119,115
Local government	80,000	157,457
Public corporations	65,125	132,144
Total	176,408	408,716

Source: Sudanow, December 1977, 11.

authoritarianism. As in all the major oil-exporting nations, the state dominates the economy by the simple fact of owning the petroleum and controlling the proceeds of its sale. That was the case under the Idrissid monarchy, and it has been the case since 1969, when the monarchy was overthrown by the then-lieutenant, now colonel, Mu'ammar Qaddhafi. He eventually elaborated a new theory of the state of the masses, the Jamahiria, in which all productive units and all workplaces were to be directly governed by popular congresses. Bureaucratic hierarchies, top-heavy party structures, and elaborate command channels were all depicted as antithetical to true popular democratic control. Libya's experiment, on paper, was one of worker self-management with a vengeance (see Fathaly and Palmer 1980).

Beginning in 1979 Qaddhafi led an assault on private-sector interests unrivaled anywhere in the Middle East. He expropriated all private industry. In 1981 all bank deposits were seized without warning, and a program to abolish retail trade by replacing it with state-owned supermarkets was begun. By this time three-quarters of the workforce was on the public payroll (Anderson 1986). The Libyan state and regime never really relinquished effective control of production and administration to popular committees. The oil and banking sectors were kept under tight state control, as were and are the 60,000–70,000 men and women in the armed forces. Libya had multiyear development plans like other countries we have considered, and the leadership did not allow the "people" to question, much less change, any of the plans' major parameters.

Liberal Monarchies

It may be that socialism entails a significant public sector, but the converse is not true. The monarchies of pre-1979 Iran, Jordan, and Morocco all professed liberal economic credos in which the private sector was to be the leading force. The role of the state was, once again, that of handmaiden to the private sector. Yet if we look at statistical indicators of state activity, we see that these three countries possessed public sectors of a size and weight equal to those of the socialist countries. The experience of these monarchies highlights the general point that one should not confuse state ownership with socialism. Some "radical" regimes have waved the flag of public ownership to demonstrate their socialist bona fides, while "liberal" regimes have passed over in silence the substantial assets they control through state ownership.

Iran. Next door to Turkey in Iran a would-be Atatürk appeared on the scene following World War I. Colonel Reza Khan of the Persian Cossacks had de facto taken over the Iranian state by 1924, and it was his intention to proclaim a republic, have himself made president, and build a state system as Atatürk was doing in Turkey. The Shi'ite clergy of Iran, however, vehemently resisted the plan for a republic and persuaded Reza Khan to proclaim himself shah (emperor) in 1925 and found the Pahlavi "dynasty."

Aside from this nontrivial distinction, Reza Shah set about building a nation in the ethnically and geographically fragmented society he inherited from the Qajars. The state apparatus and the armed forces grew side by side, and, as in Turkey, the depression pushed the Iranian state into ISI. The private sector benefited from credit provided through the state Industrial Bank as well as from high tariff walls against imports. But the state did not wait to see how the private sector would respond to these incentives, and by 1941 there were public enterprises in textiles, sugar, cement, and iron and steel. Through consumption taxes and trade monopolies, the Iranian state, over the period 1926–1940, was able to invest some US$400 million in industry and infrastructure, a very substantial sum for that era. Another US$120 million was invested by the private sector. All this was done with very little foreign borrowing. The modest revenues from the sale of oil in those years were turned over to the military (Issawi 1978). Iran was neither populist nor revolutionary, but it was just as etatist as Turkey.

Reza Shah was sent into exile in 1941 by the Allies, who feared his collaboration with the Axis. His young son, Mohammed Reza Pahlavi, became the new shah. He did not consolidate his grip on power until his showdown in 1953 with the prime minister, Mohammed Mossadegh, a nationalist leader who brought under state ownership the British-controlled Anglo-Iranian Oil Company. After that time, Iran's economic strategy marched on three legs: petroleum exports, continued ISI, and a division of labor between the public and private sectors. State enterprise undertook the deepening process in iron and steel, copper, machine tools, aluminum, and petrochemicals, while a dynamic private sector, sometimes in joint ventures with foreign capital, moved into finished metals and special steels, synthetic fibers, paper, automobile assembly, and sugar. Iran in 1944 established a Plan and Budget Organization and launched its first national plan. In this respect it was well ahead of all countries in the region except Turkey.

This kind of division of labor was what one would have expected—it reconciled the regime's professed economic liberalism with a strong state presence in the economy. But in the 1970s a very significant shift in the division of labor occurred, one that contains lessons about the logic of public enterprise in the Middle East. With the first great surge in petroleum prices in 1973/74, the shah's state had at its disposal a tremendous volume of rents. Neither the shah nor his advisers nor the state technocracy proposed investing these rents in private-sector growth. Rather, the new funds allowed the state to expand and consolidate in an atmosphere in which public authorities either disregarded or were actively hostile to the private sector (Razavi and Vakil 1984, 66; also Katouzian 1981, 237).

The dream of the Great Civilization had established a subjective development goal in the shah's mind. It was then necessary to refine the strategy of development. This was to be a big-push type of industrialization financed by oil revenues. Given that oil reserves were seen to have a twenty-year horizon and that the shah probably knew himself to be fatally ill, the speed with which the big push was to be implemented was to be of paramount importance in the shaping of expenditure patterns.[5]

Those expenditure patterns revealed a dramatic reorientation in the 1970s (Table 7.3). In 1973 the shah prophesied that by 1980 there would be no more than 2 million people, or 300,000 farmers, left in Iran's agricultural sector (Katouzian 1981, 304). In essence, he had resurrected his father's blueprint: a powerful state and a powerful military establishment. By the end of the 1970s, government investment and consumption represented 43% of GNP. Military expenditures, which neared US$10 billion in 1978, were the equivalent of 10% of GNP. One-quarter of the nonagricultural workforce, 1.5 milllion people, were on the public payroll.

A few general propositions can be extracted from this example. First, regardless of the ideology of the regime, one of the major factors making for the expansion of the state's economic role is the *control* it offers the nation's leaders over resources and people. It denies those resources and people to other contenders for power. In this sense it is doubtful that the shah ever wanted a powerful and autonomous private sector to develop in Iran. A prosperous, subordinate, parasitic private sector, yes; a true national bourgeoisie, no. When given his monopoly over Iran's external rents in the 1970s, the shah showed the real content of his liberalism.

Has the Islamic Republic of Iran reversed this pattern since 1979? The question is of more than passing interest, for Iran's Muslim state could be something of a harbinger for the rest of the region. The constitution of the Islamic republic is explicit on the role of the public sector, which is to include "all major industries, foreign trade, major mines, banking, insurance, power, dams, major irrigation systems, air, sea, land and rail road transport." Shortly after Khomeini's return to Iran, a wave of nationalizations took place in June and July 1979 involving 27 banks, insurance companies, and heavy industries, such as the Iran National Auto Works, with 12,000 workers, and the Behshahr Industrial Group, with 13,500. By the end of 1982 the National Industrial Organization controlled about 600 enterprises, with 150,000 employees. In addition, the Foundation for the Disinherited (Bonyad-e Mostaz'afin) was created to take over the assets of the Pahlavi family, the Pahlavi Foundation, and the expropriated property of the shah's entourage, including farms and apartment buildings (Bakhash 1984, 178–184).

TABLE 7.3 Public and Private Shares in Gross Fixed Capital Formation in Iran (billions of rials), 1963–1977

Gross Fixed Capital Formation	*Third Development Plan 1963–1967*	*Fourth Development Plan 1968–1972*	*Fifth Development Plan 1973–1977*
Public	74	146	734
Private	77	141	319

Source: Razavi and Vakil (1984, 76).

There was, then, no rollback of the state under the Islamic republic, yet it is clear that the new regime was deeply divided on the issue of state ownership and intervention in the economy. The Guardianship Council, whose duty it is to monitor the constitutionality of legislation, in 1982 declared unconstitutional land-reform measures passed by the parliament as well as the law giving the state a monopoly in foreign trade. At the same time, an important faction of radicals in the parliament sought to use the state to engineer a far-reaching redistribution of wealth in Iranian society. In early 1988 Khomeini's pronouncements showed that he was leaning in the direction of the more radical, statist elements. Since his death, and despite the emergence of the more pragmatic Hashemi Rafsanjani, the same tension continues unresolved (see Chapter 9).

The Kingdom of Jordan. The Jordanian economy is small and, since the Israeli occupation of the West Bank in 1967, severely truncated. It is dynamic and growing but highly dependent on external assistance. In 1976/77, for example, when GNP stood at US$1.7 billion, external assistance exclusive of military aid stood at US$500 million.

The Jordanian state has controlled the economy in three ways. First, as the direct recipient of the external assistance, it has been able to channel investment in the ways it sees fit. This channeling has taken the form of large-scale joint ventures with state, foreign, and local private capital in fertilizers, cement, petroleum refining, and so forth. State pension and social security funds as well as the Housing Bank and the Industrial Development Bank have been the conduits for substantial public finance. In 1980 the state had a significant equity stake in private firms in mining (42%), manufacturing (23%), tourism (27%), and transport (20%) and owned 90% of the shares of the Jordan Phosphate Mines Company, 100% of the Jordan Automatic Banking Company, and 99% of the Agricultural Products Manufacturing Company (Rivier 1980, 111, 206). The second lever in the hands of the state has been the phosphate sector, the country's single largest export and foreign-exchange earner. The third lever has been the defense budget, which stood at US$246 million in 1978, or 15% of GNP.

The Jordanian private sector, a large proportion of which is of Palestinian origin, has been given the lead in promoting exports of fruits, vegetables, and manufactured goods to Arab and regional markets. If it were not so internally divided between Palestinians and non-Palestinians, Jordan would have been a good candidate for an export-led growth pattern à la Hong Kong or Singapore. Its relatively well-educated and hardworking population and its no-nonsense political leadership might have been sufficient to attract foreign investment and technology. There is no way, however, given its small population and narrow resource base, that Jordan could have pursued an ISI strategy.

The Kingdom of Morocco. Morocco and Iran up to 1979 followed similar development strategies. Morocco, like Iran, had a substantial trading bourgeoisie that was never totally eclipsed by French economic interests during the protectorate, 1912–1956. The country's economic ideology has always been liberal and pro-private-sector. Yet, like the shah, King Hassan II may be reluctant to see a national bourgeoisie with its own resource base gain an undisputed foothold in the economy. Finally, although Morocco is not an oil exporter, it has been the world's leading exporter of phosphates, and through the giant public holding company, the Cherifian Phosphates Office (OCP), it controls the most important sector of the economy.

The state's control of the economy has taken the form of direct ownership of assets (mines, railroads, dams, sugar refineries) and equity positions through public holding companies. The OCP and the Cherifian Foreign Trade Office (OCE) own assets themselves and have a controlling interest in a host of affiliated enterprises. The OCE, for example, between 1965 and 1975 helped launch twenty-five branch operations involved in citrus exports and wound up controlling about US$5 billion in assets. In addition, the state controls a number of special investment agencies such as the Caisse de Dépôt et de Gestion, which handles social security and pension funds, and the National Bank for Economic Development, which has been a favored channel for World Bank credits.

The post-1973 surge in world petroleum prices was followed closely by a large jump in world phosphate prices. The Moroccan state found itself in control of windfall rents and, just as had occurred in Iran, used them not to invest directly in the private sector but to expand the public sector. The 1973–1977 plan was revised in midcourse, with public investment targets rising from 11 billion to 29 billion dirhams (ca. US$6 billion), destined mainly for the steel, sugar, cement, and chemical sectors. The number of public-sector firms increased from 137 in 1970 to 238 in 1976 and state equity in them from 700 million to 2.2 billion dirhams (el-Midaoui 1981, 234–238; el-Malki 1982, 175). The share of the government and the public sector in total gross fixed capital formation reached 19% in 1977 (Table 7.4). The Moroccan state employed well over 400,000 persons in the civil-service and public sector. There were at least another 150,000 in the armed forces and police. At least one-quarter of the nonagricultural workforce was on the public payroll.

Since the big push in public-sector expansion in the mid-1970s, phosphate prices have tumbled, and Morocco's military involvement in the Saharan war cost the country on average US$300 million per year for a decade. The government by 1983

TABLE 7.4 Sources of Gross Fixed Capital Formation in Morocco (millions of current dirhams and % GDP), 1968–1977

Gross Fixed Capital Formation	*1968*	*1970*	*1972*	*1975*	*1977*
In millions of current dirhams					
Government[a]	500	580	710	2,150	4,650
Public enterprises	950	1,050	950	3,400	4,530
Of which: transfers	(390)	(500)	(400)	(1,190)	(1,940)
Other sectors	740	1,360	1,520	3,310	6,170
Of which: housing	(250)	(440)	(580)	(1,130)	(2,180)
Total	2,190	2,990	3,180	8,860	15,350
In percentage of GDP					
Government[a]	3.1	3.0	3.1	5.6	9.6
Public enterprises	5.8	5.4	4.2	8.9	9.4
Of which: budget transfers	(4.2)	(2.6)	(1.7)	(3.1)	(4.0)
Other sectors	4.5	7.0	6.6	8.7	12.8
Of which: housing	(1.5)	(2.3)	(2.5)	(3.0)	(4.5)
Total	13.4	15.4	13.9	23.2	31.8

[a] Includes civilian investments only.
Source: World Bank (1981, 25).

had been driven into large public deficits and a cumulative external debt of around US$10 billion. It was obliged to restrict its current expenditures and investment and to revert to its pre-1974 policy of stimulating the private sector and luring in foreign investment. Although the number of enterprises in which it had a majority stake increased, the share of the state in total equity of these companies declined.

Princes and Kings of Oil

The most conservative regimes in the Middle East, the princedoms of the Gulf and the Kingdom of Saudi Arabia, are also those with the largest state sectors. They are conservative in the sense that they share nonrepublican forms of government, a concern for the protection of Islamic values, a fierce anticommunism, and dominant classes with roots in older maritime and transdesert trading communities.

Their economies have been swamped by oil revenues. They combine small populations (Saudi Arabia is by far the biggest, with about 11 to 12 million inhabitants), little or no agriculture (with the exception of Saudi Arabia; see Chapter 6), no tradition of manufacturing, and a common resource, oil, that has generated tremendous rents. The share of the oil sector in the gross national products of these countries reached the following levels in 1980: Saudi Arabia, 66%; Kuwait, 51%; the UAE, 65%; Oman, 69%

(World Bank data). Kuwait's lower figure merely signals that its rents had diversified and that the country had begun to draw significant revenues from its foreign investments.

With this kind of financial clout at the disposal of the state, it was inevitable that all new investment programs would fall within the state sphere. For most of the princedoms, industrialization will never be a realistic option except in the petrochemical field, where public enterprises have formed joint ventures with foreign multinational corporations (Kubursi 1984). Private-sector activity is booming and occasionally crashing, as in the Kuwaiti stock market (known as Suq al-Manakh) scandal of August 1982 (Beblawi 1984, 232–234). But such activity is confined to trading and speculative investment, while the public sector dominates the productive sectors and, of course, the civil service.

The civil administration has grown prodigiously in all these countries. Kuwait's expanded from 22,000 in 1963 to 146,000, of whom 90,000 were foreigners, in 1980. Saudi Arabia's grew from 37,000 in 1962 to 232,000 in 1981, to which we should add another 81,000 part-time or nonclassified employees (Ayubi 1985; see also Islami and Kavoussi 1984; Chatelus 1982, 23). The entire native Saudi workforce in 1980 totaled 1.5 million, and there were 800,000 foreign workers in the country. Ayubi saw this expansion as a function of increased educational output unaccompanied by significant industrialization. Public employment serves the purpose of political control of the educated. It also serves as window dressing: "a respectable and modern looking tool for distributing part of the oil 'loot' and for 'disbursing' largesse camouflaged in the language of 'meritocracy and national objectives'" (Ayubi 1985).

Saudi Arabia has gone farther and established a giant public-enterprise sector, with over forty corporations in housing, storage, agriculture, and basic industries. In the plan period 1976–1980 alone, Saudi Arabia disbursed US$290 billion, which went into infrastructure, port development, and new industrial cities at Jubail and Yanbu. The 1980–1985 development plan, although less spectacularly funded, was designed to put Saudi Arabia on an industrial footing. The then–oil minister, Ahmad Zaki Yamani, prophesied that Saudi Arabia would soon rank alongside Argentina, Brazil, and South Korea as a semi-industrialized country (*Middle East Journal*, March 1984, 25–27). Whereas the goal may be to shift some of the burden of industrialization onto the private sector, it is likely that even if significant industrialization takes place, it will involve mainly public-sector joint ventures with foreign capital.

Israel and Post-Atatürk Turkey

Israel, for obvious political, social, and religious reasons, is a case apart, but in the structure of its economy, the weight of the state, and some of its ideological predispositions it has shared many features with the socialist states of the Arab world and with Turkey. This sharing is all the more striking in that before there was any Israeli state at all, the Zionist community in Palestine had well-organized party and union structures and cohesive farmer-soldier communities in the kibbutzim. That a powerful and somewhat autonomous state grew out of such a highly structured civil society says much about the logic and attractiveness of the interventionist state.

It was David Ben Gurion, the first Israeli prime minister, who developed the doctrine of etatism (in Hebrew, *mamlachtiut*) and subordinated to the state his own socialist labor party, the MAPAI, and its powerful trade union affiliate, the Histadrut. The Histadrut included in its membership about 70% of Jewish wage earners in Palestine. In addition, the new Israeli state asserted its control over the Zionist defense force, the Haganah, which had fought successfully to achieve and then defend Israeli independence.

What Ben Gurion did in absorbing the labor movement into the state sector, robbing the kibbutzim of their most dynamic leaders, and putting the MAPAI and the Israeli Defense Forces under state control is not unlike the process undertaken by another charismatic civilian, Habib Bourguiba, in Tunisia after 1956. As Ben-Dor pointed out (1983, 109), "there was an overwhelming paradox in a man trying to use his party as a base of power from which to destroy the party-state linkage."

There were, however, a number of factors that made Israel's experiment in state building unique. First, there was the "acquisition" by the state of all the property previously owned by Arab Palestinians who had left their homes during the hostilities of 1948 (cf. Turkey in 1923 and Algeria in 1962). Second, the Jewish immigrant population of Israel doubled between 1948 and 1952, most of the newcomers were "Oriental," and the state had to undertake their economic, cultural, and social integration into what had been a predominantly Ashkenazi society. Third, Israel, like Jordan, has always been dependent on external assistance and financial flows, and it is the state that controls their disbursement. Between 1950 and 1974, for example, such assistance totaled US$19.5 billion. Finally, the state runs Israel's military-industrial complex. Defense outlays were the equivalent of 17% of GNP in 1972 and 30% in 1979, probably the highest proportion in the world at that time (in general, see Rosenfeld and Carmi 1976; Arian 1985; and Kimmerling 1983).

What had emerged in Israel by the late 1960s was a large, paternalistic welfare state with vaguely socialistic objectives and extensive public ownership. In this system, "the citizen would be perceived as an object available for the activities of the state and its bureaucracy, this latter serving as [a] paternalistic body deciding what was good for the citizens and for the collectivity as a whole. By definition, the reasoning of the authorities was better than and took precedence over the individuals and groups" (Kimmerling 1983, 99).

The Israeli variant of statism was given practical effect by state-owned or state-controlled enterprise. Histadrut in the 1970s had 1.5 million members, or 80% of the employed workforce. It in turn had controlling interests in several corporations: Solel Boneh in construction, the Koor holding company, with 250 industrial, financial, and commercial firms under its control (Koor was one of the Fortune 500), Bank Hapoalim, and others. There were 200 corporations in Israel in which the government had at least 50% equity. In addition there were some 450,000 persons on the public payroll, including the professional military, teachers, and municipal employees. Arian

TABLE 7.5 Public and Private Shares in Investment in Turkey (%), by Plan Periods, 1963–1987

Investment	*1963–1967*	*1968–1972*	*1973–1977*	*1979–1983*	*1984–1987*
Public	48.0	44.0	46.4	46.1	56.2
Private	52.0	56.0	53.6	53.9	43.8

Sources: Celasun (1983, p. 103); TÜSIAD (1988, p. 9).

(1985, 36) estimated that in the late 1970s about 52% of the Israeli workforce was employed by the state and Histadrut, with the remaining 48% in the private sector.

The Israeli economy paid a heavy and familiar price for *mamlachtiut.* Huge government deficits resulting from indexing wages to the cost of living, heavy defense expenditures, and various forms of subsidies produced triple-digit inflation in the mid-1980s. Despite flows of concessional aid and grants, Israel's external debt had risen to US$12.5 billion in 1980, or 62% of GNP, the highest ratio in the Middle East. After the Labor Alliance lost power to the Likud in 1976, there were important modifications in the Ben Gurion formula, and some efforts at containing government expenditures and promoting exports through devaluation were undertaken. In 1986 Israel implemented a determined inflation-reduction program, cutting government expenditures, temporarily freezing prices and wages, and increasing tax receipts.

Since Atatürk's death in 1938, Turkish development strategy has oscillated in intent, but the weight of the public sector has remained predominant. In the decade of the 1950s—the first ten years of two-party democracy—the Democrat party, led by Adnan Menderes and Celal Bayar, rejected etatism in favor of a liberal economic policy to benefit commercial farmers and the industrial bourgeoisie. Nonetheless during the 1950s eleven new state-owned enterprises were started, the initial objective of selling off some public enterprises was abandoned, and the share of public in total investment rose from 38% in 1952 to 62% in 1959 (Roos and Roos 1971, 43).

The brief military takeover in 1960 ushered in another period of national planning and state-led ISI. This thrust was modified in the Second Five-Year Plan, 1968–1972, to put a greater burden of investment on private industry. Subsequently, the RPP government under Bülent Ecevit, with the Third Five-Year Plan, 1973–1977, resurrected the statist strategy, giving new authority to the State Planning Organization and stressing intermediate and capital goods industries (Walstedt 1980, 85–87; Hale 1981, 198–200).

At the end of the 1970s, the state sector remained the economy's center of gravity. The public share in total investment had stayed fairly constant for twenty years (Table 7.5), while public investment in the manufacturing sector had risen from 34% in 1965 to 65% in 1980 (World Bank 1982, 218). Employment in state-owned enterprises had grown from 362,000 in 1970 to 646,000 in 1980, or the equivalent of 16% of the nonagricultural workforce. In the manufacturing sector alone, state-owned enterprises accounted for 32% of value added, 36% of employment, and 43% of investment.

STATE CAPITALISM, THE STATE BOURGEOISIE, AND THE PROCESS OF ACCUMULATION

There is remarkable consensus among observers of widely differing political viewpoints that the interventionist state in the Middle East (and elsewhere) gave rise to a state bourgeoisie that controls but does not own the major means of production and to a process of accumulation that is called state capitalism.[6]

As Fitzgerald has pointed out (1977, 70, 87) for Latin America, there are two fundamental types of state intervention and capitalist accumulation. Both aim at structural transformation of the economy. They are not mutually exclusive and, as the Turkish case has shown, may oscillate over time. The first is a process whereby the state helps nurture or strengthen a private sector. It does so, as noted in the preceding pages, in several ways. It provides roads, railroads, ports, and electrical power to stimulate economic activity in general. Through its basic industries and mines it provides raw materials (coal, oil) and semimanufactured goods (iron, aluminum, chemicals, synthetic fibers) that feed directly into private production. It provides cheap credit and protective legislation. It may take over failing private enterprises. In this process of accumulation, the state transfers surpluses on its own operations, profits if any, and external rents to the private sector and tries to absorb all major risks for that sector.

This has been the predominant process of accumulation in the Middle East, although it is important to remember that it is frequently interrupted and that within the state sector itself there are always powerful lobbies that decry the handmaiden role. It is worth repeating that the state, when it gains access to an increased volume of external rents, uses those rents to expand its own activities with little regard to the private sector: thus Iran and Morocco after 1973/74 and Tunisia after 1977, when its own oil revenues shot up. Structural crises may also provoke episodes in which the state sector mobilizes resources by and for itself, as did Egypt and Syria in the 1960s. By and large, however, we see the handmaiden process at work in Turkey since 1950, in Egypt since 1974, in Tunisia since 1969, in Morocco since 1956, in Iran since 1963, and in the Sudan since 1972. Israel also fits somewhat awkwardly into this schema. Leftist critics of the Ba'athi experiments in Syria and Iraq are wont to attribute the same role to state intervention in their economies (e.g., al-Khafaji 1983; Longuenesse 1979), but our view is that in both countries there are dominant coalitions committed to state power and, to some extent, to a socialist vision of society such that the private sector is encouraged only insofar as it remains subordinate to the state, the party, and the plan.

Гhe second process of accumulation is one in which the state undertakes all the re-.rce mobilization and infrastructure development functions mentioned above but ·tures the surplus of its own activities, of a substantial portion of private-sector prof- and of external rents in order to finance its own expansion. Its goal is to dominate aspects of resource allocation and to seize, once and for all, the commanding heights :he economy. When this process is under way, the slogans of "socialist transforma-ı" or the "noncapitalist path" have generally been used to describe it.

Turkey in the 1930s flirted with this strategy. Egypt explicitly adopted it with the :ialist Decrees of 1961 and then gradually dropped it after 1974. Algeria has de-ibed itself in those terms since 1962, although after Boumedienne's death in 1978 regime became more attentive to private-sector interests. Tunisia between 1964 l 1969 adopted and then abandoned the strategy. Whatever the critics may say, ą and Syria have both adhered to it since 1963. Finally, it may be that Libya, since 75, has gone further than any country in the region outside the marxist regime in former PDRY in strangling the private sector.

Гhe term "state *capitalism*" calls attention to a basic dynamic in both processes: te enterprise, whether in the service of the private sector or of itself, may not in-ve any major revision of the relations of workers and managers to the means of ·duction. The simple fact of public ownership does not mean that the profit mo-: disappears or that the workers gain control of the surplus value of their own or. "Exploitation," the counterpart of the drive for financial profit, does not dis-ear. Again, critics on the left are especially inclined to see the state technocracy stituting itself for the private sector without any fundamental change in the rela-ıs of production. It is true that no regime has rejected financial efficiency and the .eration of a surplus as legitimate criteria, among others, for measuring public-tor performance. There may be "exploitation" in the process in the form of sur-s transfers from agricultural populations to the service and industrial sectors. The :, however, that public-sector enterprises generally operate at a loss, reveal low lev-of managerial performance, and carry more workers than they need must give us ıse in labelling them "state capitalism."

We approach the concept of a state bourgeoisie with the same caution. There is a npelling logic to the *assumption* of a dominant state class. After all, much of this pter has inventoried the size and strategic importance of the assets owned by the e. They do constitute the major means of production, except in the agrarian sec-where the state nonetheless has the means to orient production. It stands to rea-that the professional managers of public assets could develop the attributes of a s, standing as they do in a similar position in relation to the means of production sharing a common set of interests and goals, that is, class consciousness. The ex-nce of such a class is all the more plausible in that conventional class actors are ık or in decline. The old landowning classes have been destroyed by land reform, le an industrial bourgeoisie has yet to emerge. The managers of public assets ;ht be expected to fill this class vacuum, but the fact is that there is little evidence t they have ever done so.

This judgment is based upon an observable paradox in the identity of the state bourgeoisie. It cannot really ensure its own incumbency or its reproduction as a state class. A dominant capitalist bourgeoisie will, in the marxist view, perpetuate its control of the means of production and pass that control on to its offspring through the juridical device of private property until the final showdown with the proletariat. But members of the state bourgeoisie have no legal title to their offices; they cannot transfer them, and the higher they are in the state hierarchy the less likely it is that they will hold their own positions for very long. The fate of economic "czars" in the region is illustrative: Aziz Sidqi, the driving force behind Egypt's industrialization in the 1960s, disappeared from the scene in the 1970s; Algeria's minister of industry, Abdesslam Belaid, met the same fate after 1980, although he reappeared briefly after 1991. Toward the end of his regime, the shah of Iran put under house arrest some of his longtime advisers such as Prime Minister Amir Abbas Hoveida. Bourguiba tried his own acolyte, Ahmed Ben Salah, for treason.

The survival of the members of this class is dependent upon three factors: (1) their ability to move from position to position within the state hierarchy, (2) their technical competency, making them marketable in *any* milieu, and (3) their ability to build nest eggs (farms, businesses, investments, foreign bank accounts) outside the state sector. Seen in this light, the state bourgeoisie is a strange class indeed. Property is not the source of its power; it has no juridical claim to the positions that are the source of its power; and it cannot and may not even want to reproduce itself as a state class (Waterbury 1991).

At any point we can see it as a class merely by identifying those who are in formal positions of power and the resources they control. Thus Walstedt saw that in Turkey (1980, 187) "a self-perpetuating power group was born, linking bureaucrats, labor unions, and local politicians, that was far more powerful than any private capitalist power blocks operating in Turkey." Waterbury (1983, 260) saw 200,000–300,000 members of the state bourgeoisie in Egypt. But where are it and its offspring going? Perhaps into a private sector that it has helped to foster? to other sectors within the state? out of the country altogether? Or, finally, perhaps back and forth across a public-private divide that for years has had little operational and, in states such as Kuwait or Saudi Arabia, very little juridical meaning?

When social scientists do not know what is happening, they invoke "transitional phases." We can do no less. Powerful interventionist states with large public sectors and the groups that dominate them grew out of, on the one hand, the need to promote the structural transformation of their "backward" economies and, on the other, a kind of class vacuum in which a temporarily dominant class emerged on the strength of its education and competency rather than its property. The process of state intervention has contributed directly to the demise of some classes (large landowners, traditional trading bourgeoisies, craftspeople) and promoted others (capitalist farmers, bureaucratic middle classes, a small-scale manufacturing bourgeoisie). The process of intervention has also resulted in deep-seated crisis in the state sector itself and in the economy in general, calling into question the feasibility of continued intervention on the same scale as in the past. We are witnessing in several Middle Eastern societies a cautious retreat of the state and hence a gradual weakening of the state bourgeoisie. In some instances this is best seen as an effort to rationalize state intervention and to make it more efficient. Algeria is a case in point. In others, such as Turkey, an assertive private entrepreneurial sector is ready to take over from the state the role of leading the development process. Falling in between are countries like Egypt and Tunisia, where economic liberalization measures have been introduced in the absence of strong, self-assured private sectors (see Chapter 9). In the mid-1990s, after ten to fifteen years of reform and adjustment in several economies, it is still hard to know if we are at the dawning of a new era in which the state will confine itself to regulating market economies or merely in a period of stocktaking and statist regrouping.

Whatever the answer, what has changed—and changed dramatically—over the past thirty years is the confidence that leaders and led once placed in the efficacy of state intervention. That confidence is largely gone, and the positive legitimacy granted state intervention has been replaced by a kind of resignation born of habit and the lack of alternative agents of change.

NOTES

1. It is important to remember that for many Muslims Atatürk is probably the most despised leader of the twentieth century precisely because he abolished the caliphate and tried to subjugate the Islamic establishment in Turkey.
2. Atatürk died in November 1938. Inönü became president, and Bayar resigned as prime minister. The latter returned to prominence after 1950 when Turkey's first open elections brought the Democrat party, of which Bayar was a founder, to power.
3. A number of advanced industrial nations, especially Austria, Italy, France, and the UK, reveal similar proportions.
4. The strategy owed a great deal to the French economist G. Destanne de Bernis (1971).
5. The fear that time was running out, as noted earlier, impelled Bourguiba to delegate broad powers to Ahmed Ben Salah in Tunisia's version of the big push.
6. On the state bourgeoisie, see, for example, Amin (1980, 8), Batatu (1979, 110), DERSA (1981, 263–283), Hannoyer and Seurat (1979, 127–133), Hussein (1971, 137–186), al-Khafaji (1983, 39–44), Longuenesse (1979, 9), el-Malki (1982, 163), Nellis (1980, 417), Raffinot and Jacquemot (1977, 99), Trimberger (1978, 119), Walstedt (1980, 187), Waterbury (1983, 232–262; 1991).

8

CONTRADICTIONS OF STATE-LED GROWTH

It is now widely acknowledged that both state intervention in the economy and the public-enterprise sectors have, by and large, malfunctioned financially and economically. Other than in petroleum and banking, public enterprises have failed to generate profits and constituted a net drain on state resources; to remain afloat they have required subsidized credit and inputs, foreign exchange at preferential rates, and constant flows of working capital and new investment. At the same time, public enterprises have not solved many of the social and economic problems they were designed to address.

In many respects state-led growth achieved a great deal. Both absolute and per capita national output grew at respectable rates in most countries of the region even before the massive infusion of oil rents during the 1970s and early 1980s. Structural transformation, whether measured by the share of industry in output or by employment, also proceeded at rates that were not unfavorable in international comparative perspective (see Chapter 3). This performance was no mean achievement considering the rapidity of population growth, the heavy burden of defense expenditures, the limited natural resource base apart from oil, the initially low levels of literacy, and the perennial political instability of the region.

However, industry was seldom internationally competitive; because of both price and technical inefficiencies, many "infant industries" never grew up. Overvalued exchange rates and domestic-price distortions led to serious misallocations, some of which we have documented earlier for both agriculture and industry. Too often, the wrong price signals led state managers and private economic actors to produce the wrong things with the wrong combination of inputs. Heavy industry grew rapidly, while agriculture and light industry were relatively neglected. International comparative advantage was often ignored. For example, in two of the leading industrial nations, Egypt and Turkey, much investment took place in industries in which profitability was actually negative if international prices were used for the calculation.

Furthermore, the multiple goals of state-owned enterprises (supplying cheap inputs to other industries, providing jobs for the rapidly expanding labor force) often gave the managers of these industries little incentive to minimize costs, even with a given technology. Capacity utilization was often poor (for example, the Algerian steel plant at El Hadjar operated at only 40% of capacity in the early 1980s [Nelson 1985, 208]), leading to higher unit costs, which had to be either subsidized from the state budget or passed on in the form of higher costs to other industries. Usually the former approach was adopted.

Allocative efficiency and "X-efficiency"[1] were not the only problems with the state-led-growth strategy. The stress on heavy industry and import substitution failed to create sufficient jobs for the rapidly expanding workforce, and, as we have seen in Chapter 6, the relative neglect of agriculture until the late 1970s contributed to the widening food gap. Finally, many countries continued to rely on external sources of investment capital and to accumulate large external debts. The goals of both social justice and national economic independence proved elusive.

Many countries of the region tried to invest more resources than were saved domestically. The "resource gap" (gross domestic investment [GDI] minus gross domestic savings [GDS]) was large and in percentage terms considerably larger than that for other LDCs (Table 8.1). There was, and is, great variability in this indicator across countries and over time. Unsurprisingly, during the oil boom the oil-exporting countries typically saved more than they invested. Indeed, this phenomenon led to the creation by the World Bank of a new category of developing country, "capital-surplus oil exporters," composed, prior to the collapse of oil prices in the mid-1980s, of Saudi Arabia, Libya, Kuwait, and the UAE. Other oil exporters, principally Iran, Iraq, and Algeria, had adequate national savings to meet investment.[2] Another group of countries (Sudan, Morocco, Tunisia, Egypt, Syria, Turkey, Israel) had resource gaps in 1985 ranging from 2 to 11% of GDP. Two other countries (the former YAR and Jordan) had massive gaps, 36% and 44% of GDP respectively. Mainly because of heavy debt repayments, domestic savings exceeded domestic investment in all middle-income countries from 1980 to 1985.[3] In comparison with this reference group, MENA countries had very large resource gaps, filled for the most part with continued foreign borrowing and with aid from the United States, the EEC, and the capital-surplus oil exporters of the Gulf.

There were several reasons for this resource gap, but the inefficiencies of the state-owned enterprises certainly made an important contribution. For example, the "budgetary burden," or net deficit, created by these enterprises was 4% of GDP in 1978–1981 in Tunisia and 3.5% in Turkey in 1978–1980 (Floyd 1984). These deficits contributed to high rates of inflation, which, in their turn, led to overvalued real exchange rates and therefore to uncompetitive exports and domestic-price distortions. The failure to develop internationally competitive industrial (and agricultural) exports, combined with rapidly expanding domestic incomes and demand, exacerbated the deficit of the balance of trade. The public sector, originally created in part to generate foreign exchange, too often simply absorbed it.

TABLE 8.1 MENA Resource Gaps, 1965, 1985, 1993

	GDI/GDP			*GDS/GDP*			*Resource Gap*		
	1965	*1985*	*1993*	*1965*	*1985*	*1993*	*1965*	*1985*	*1993*
Algeria	22	36	29	19	38	28	−3	2	−1
Egypt	18	25	17	14	16	6	−4	−9	−11
Iran	17	–	29	24	–	30	7	–	1
Iraq	16	–	–	31	–	–	15	–	–
Israel	29	16	22	15	9	14	−14	−7	−8
Jordan	–	31	30	–	−13	−13	–	−44	−43
Kuwait	16	21	23	60	30	30	44	9	7
Morocco	10	22	23	12	12	17	2	−10	−6
Oman	–	30	17	–	43	27	–	13	10
Saudi Arabia	14	31	24	48	21	27	34	−10	3
Sudan	10	7	–	9	−3	–	−1	−10	–
Syria	10	24	16	10	14	7	–	−10	−9
Tunisia	28	27	29	14	20	20	−14	−7	−9
Turkey	15	20	27	13	16	22	−2	−4	−5
UAE	–	31	25	–	59	33	–	28	8
Yemen	–	21	20	–	−15	3	–	−36	−17
LDC average									
Middle-income	22	21	23	21	23	22	−1	2	−1
Lower-middle income	18	20	23	15	19	22	−3	−1	−1
Upper-middle income	24	22	23	24	26	21	0	4	−2

Source: World Bank (1987; 1995g).

The failure of state-led growth to close the twin gaps between domestic savings and investment and between exports and imports contributed to the accumulation of large foreign debts (Table 8.2). In most cases, there was a marked increase in external indebtedness and a rise of the debt-service ratio (debt repayment as a percentage of export revenue). Although these debts were not nearly so large in absolute terms as those of Latin American debtors like Brazil (about US$125 billion) or Mexico (about US$100 billion), they were large enough to narrow the options for policymakers and to increase the influence of international lending agencies in the policy process.

Finally, just as the goals of efficiency, growth, and national independence were only partially achieved, the ideal of increasing equity also proved elusive. The employment problem clearly was not solved, and the gap between rich and poor often

TABLE 8.2 Total External Debt, 1993

	External Debt (US$ millions)
Algeria	25,757
Egypt	40,626
Iran	20,550
Iraq	86,000
Israel	25,770
Jordan	6,972
Morocco	21,430
Oman	2,661
Sudan	16,561
Syria	19,975
Tunisia	8,701
Turkey	67,862
Yemen	5,923

Source: World Bank (1995d; 1995e).

either widened or remained roughly constant. It appeared to many observers that those equity gains that were achieved had a high efficiency cost, as in expensive consumer-subsidy programs or in the swelling ranks of redundant public-sector employees. And, as we have seen, the education and health systems seldom promoted a real equalization of human capital in the region.

Despite high levels of redundant labor in state-owned enterprises, disguised and open unemployment remains a serious problem in most Middle Eastern societies. Some redistribution of wealth has taken place through public-sector-employment drives and the location of state-owned enterprises in backward areas, but the distribution of income in most Middle Eastern countries remains highly skewed (Chapter 10). The state-owned enterprises have not—again, except for the petroleum sector—contributed to exports, while their import needs and hence claims on foreign exchange have remained high. Finally, although the prominence of agriculture in economic activity has diminished, it has been the service sector more than industry that has picked up the slack. It is not at all clear that centralized planning and state enterprise have accelerated the process of structural transformation.

Despite this generally acknowledged situation and the need for reform, little has been done in the past fifteen years. There have been efforts to stimulate the private sector, and there has been talk of "privatization," that is, selling equity in state-owned enterprises to private investors. By and large, however, the economic weight of public enterprise in the Middle East has been little diminished.

THE CONTINUED DOMINANCE OF PUBLIC-SECTOR ENTERPRISE

State enterprise has arisen within two broad developmental frameworks. The first is an explicitly socialist and redistributive one in which equity issues take precedence over profit-and-loss criteria in assessing state activities. When reform is first called for in such systems, it is in terms of making the public sector more efficient, reducing the deficits of specific enterprises, increasing monetary incentives for workers, allowing price increases, linking budgetary support and banking credit to performance, and perhaps even reducing the personnel list. The shift here is toward state capitalism. That shift began in Egypt in 1965, when Nasser first denounced the inefficient performance of the public sector, and in Algeria sometime between 1967 and 1969. Discipline, productivity, and profitability become the watchwords of the new era, but frequently they remain slogans more than effective guides to improved performance.

The second framework is represented by the state-capitalist experiments, in which socialism is never at issue and profitability, at least in theory, always takes precedence over redistribution. Even by these criteria, however, the performance of state-owned enterprises in nonsocialist countries such as Turkey, Iran, Morocco, and Saudi Arabia has been lackluster. When the issue of reform is raised in these countries, the main elements of the proposal are to use more public resources to stimulate private-sector activity directly and to privatize public-sector assets.

In neither framework have many steps been taken toward reform and privatization. After thirty or more years of strong state intervention in the economy, powerful bureaucratic, managerial, and political interests stand in the way of any diminution of state economic activities.

It is not always possible to discern which groups, organizations, or class interests carry the most weight in promoting or defending the state's role in the economy. Organized labor is generally a staunch supporter because of relatively high wage levels and benefit packages and, above all, because of job stability and relatively light workloads. In many ways unions in the public sector constitute a labor aristocracy (for example, the unemployed in many Middle Eastern countries outnumber those in the public-sector labor force by two to one [see Chapter 5]) and defend their privileges in the name of socialism and the toiling masses. When regimes begin to promote state capitalism, the unions find themselves in a difficult position. They sense that the public sector is under fire and seek to defend it against its critics. Yet they do not want to pay the price of greater efficiency, which entails higher productivity: more output per hour of work for the same pay. They may resist the introduction of incentive systems that reward individual or group performance and insist that pay and promotion be based on nondiscriminatory and "nonexploitative" seniority systems. In other words, they may try to sap the very logic of the state-capitalist thrust. Union leaders generally know that this is a dangerous game; if public-sector performance does not improve, its critics will inevitably call for disinvestment and privatization, an even worse outcome for the unions than state capitalism.

The managers of public assets are likely to resist efforts at reform. Frequently they have formed alliances of convenience with labor that have led to low productivity and high enterprise deficits. Managers may well prefer periodic bailouts from the state to the harder option of exacting higher levels of performance from the workers and from themselves. They have generally been drawn to the public sector by its salaries and "perks," which are better than those found in the civil service and even in parts of the private sector. Although in the 1970s, when rates of inflation were high throughout the area, these salary advantages eroded, it is still the case that the work is less demanding and jobs and promotion are more secure than in the private sector. Individual managers may have good prospects for shifts into the private sector, but most public-sector managers will prefer the quasi-sinecures they have. The opportunities for side payments and moonlighting compensate for deteriorating salary levels.

Some segments of the civil service will also have a strong interest in the perpetuation of large public sectors. Whereas the autonomy of individual enterprises varies from country to country, in all instances government ministries directly oversee their activities. They draw up and supervise sectoral and enterprise budgets, review contracts, help design projects, and control personnel procedures. Thus, in the Ministries of Industry, Agriculture, and Defense, where the bulk of state enterprise is concentrated, extensive bureaucracies have developed to monitor them. The Ministry of Planning may plan public-sector activity, while the Ministry of Finance controls enterprise budgets, credit flows, and rates of corporate taxation (see, inter alia, Roos and Roos 1971, 64). Auditing agencies check the books of hundreds of public-sector firms. Any reduction in the size of the public sector could lead to a reduction in the ranks of supervisory personnel. Civil servants may therefore resist recommendations for greater operational autonomy of state enterprises in the context of state capitalism and recommendations to sell off parts of the public sector.

For some twenty years up to the early 1980s, the external donor community showed some predilection for public enterprise and direct state intervention in the economy. The degree of that predilection was not at all uniform. For example, the U.S. Agency for International Development (USAID) has never been a strong supporter of public enterprise, although there was a time when the U.S. government saw the Tennessee Valley Authority as a model for regional uplift that could be exported to the developing world. The attractiveness of public-sector enterprise to other donors lay in the possibility, so it seemed, of bypassing cumbersome entrenched bureaucratic agencies in order to promote specific projects (e.g., fertilizer industries) or programs (e.g., diffusion of new varieties of wheat). For bilateral donors there was also the attraction that large public-sector enterprises could become important purchasers of equipment and technology from the donor's home economy. The point is that although the donors, since the advent of Margaret Thatcher in the UK and Ronald Reagan in the United States, have become

major proponents of public-sector reform and privatization, not so long ago they supported public-sector expansion.

Parts of the private sector frequently find it in their interest to have a large public sector alongside them. Large public enterprises in basic metals, plastics and petrochemicals, and other semimanufactures such as cotton yarn may support private-sector manufacturers with a regular and cheap supply of inputs—Turkey, Algeria, and Iraq are all notable in this respect. Likewise, the public sector may prove a reliable and not very cost-conscious purchaser of private-sector goods, from automobile components to army uniforms. Several observers have concluded that the stirrings and growth of the private sector in several Middle Eastern countries, notably Turkey and Egypt, are an assertion of class interests and that they are the principal force behind the gradual abandonment of state regulation of the economy. Private interests, sustained over decades by state contracts and protection, are alleged to be sufficiently powerful to force the state into retreat or at least to put it more directly at the service of the private sector. Doubtless, some private interests will benefit from the process of liberalization that we summarize under the rubric "economic reform." We do not believe, however, that private class interests *caused* such policies. Moreover, it is not clear that most private interests would have a stake in the reform of the public sector. They can have the best of both worlds through an inefficient public sector that continues to feed business to the private sector and by comparison makes private enterprise performance look good (see Chapter 9).

The public sector and the civil service together have been an important source of state revenues and savings that will not easily be abandoned or allowed to run down. State employees represent a captive source of income tax and social security payments. Taxes and payments are simply deducted from salary and wage payments; evasion is virtually impossible. Income tax and even social security payments outside the public sector are very difficult to collect and generally represent a tiny proportion of total government revenues. For example, in 1980, 60% of Egypt's total wage bill was paid out to civil servants and public-sector employees. Social security payments represented 10% of all government revenues, income tax on salaries of government personnel another 5%, and profits tax on public-sector enterprise, returns on public assets, and public sector self-financing another 40%. Indirect taxes (sales tax, stamp duties) and tariffs and customs, a substantial proportion of them levied on goods produced in or imported by the public sector and the government, accounted for another quarter of total revenues. External assistance represented 13% of total revenues. The remaining 7% came from corporate and income tax revenues from the nongovernmental sector and the proceeds on bond sales (Waterbury 1983, 202). *The state sector in Egypt, taken in its broadest sense, was the source of most state revenues and by the mid-1990s the locus of a captive workforce of over 4 million.*

It may well be that public sectors and big government tend to conserve their predominance in Middle Eastern economies, seemingly regardless of the ideologies of individual regimes, because of the extraordinary power they offer political leadership to preempt resources from actors outside the state system, to finance state activities, and to control strategic sectors of the workforce. It does not surprise us to see leaders of self-proclaimed socialist regimes defending their public sectors, but at first blush it seems surprising to see large public sectors in nominally liberal or liberalizing economic systems such as those of Egypt, Jordan, or Tunisia. The economic risks of inefficient public enterprise may not outweigh the political risks of giving up the leverage over resources and people that public enterprise provides.

It is the political calculus of these two kinds of costs that determines the manner in which political elites respond to the poor performance and fiscal burdens characteristic of public-sector enterprise. To some extent equity (in the form of redundant labor, relatively high remuneration, and low productivity) and inefficiency have been combined and paid for through deficit financing and borrowing abroad. When foreign creditors refuse to advance new lines of credit until the fiscal mess is cleared up, a painful day of reckoning can no longer be postponed.

The timing, pace, and content of reform efforts in the MENA region have varied widely across countries (see Chapter 9). Common elements with major political consequences are the efforts to restrain public expenditures, to hold in check if not reduce the size of the public-enterprise sector, to stimulate private enterprise and investment, and to remove subsidies on consumer goods, agricultural and industrial inputs, and credit. In addition, there have been efforts to liberalize foreign trade, to reduce the tariff protection of domestic producers, and to stimulate the export sectors of the economy. Each of these moves produces winners and losers. Combining them in the reform effort will send shock waves through well-established coalitions of economic interests and beneficiaries of the status quo.

THE POLITICAL ECONOMY OF STRUCTURAL ADJUSTMENT

The failures arising from mismanaged ISI and public enterprise have been general across all the countries in the region. They were doubtless exacerbated in countries with no or very limited petroleum reserves by the increase in world petroleum prices in the 1970s. Growing import bills coupled with stagnant exports led to burgeoning trade deficits that had to be financed by foreign borrowing, both commercial and multilateral. The reaction of most Middle Eastern countries to inflation in their import bill for petroleum and nonpetroleum products was to promote the expansion of their economies, perhaps with the long-range hope that such expansion would lead to increased exports.

Turkey, for example, found itself in one of the region's gravest economic crises in the late 1970s. It was governed at the time by fragile and changing political coalitions, dominated by the Republican People's party (led by Bülent Ecevit) and the Justice party (led by Süleyman Demirel). Neither of these protagonists could afford to promote economic austerity for fear of alienating a significant part of the electorate. The result, in the words of Celasun (1983, 11), was that

> despite the oil crisis and related external shocks, Turkey attempted to preserve its growth momentum under the Third Plan (1973–1977) through rapid reserve decumulation and massive external borrowing. Instead of relying upon internal adjustment to promote balance of payments improvement, the various coalition governments pursued expansionary policies, while allowing a decline in marginal savings ratios, and negative import substitution in the energy and manufacturing sectors.

Other countries replicated this scenario to some extent, although Turkey was unique in the nature of its party-competitive political system. What we see, then, is some degree of imported inflation, combined with high domestic-investment levels. The latter, unaccompanied by significant increases in domestic production, led to high domestic inflation. Governments responded to the inflation by resorting to ill-considered deficit financing in order to maintain salary levels and to cover the operating losses of public-sector enterprises. Foreign resources were used to pay for current consumption rather than to increase production. Eventually, as foreign debt snowballed, current borrowing was used to some extent to cover payments on past debt.

Without some fundamental restructuring of the basic parameters of the economy, the vicious circle described above would lead to debt default and economic collapse. It was to address the issues of restructuring the economy that the World Bank, in cooperation with the IMF and other multilateral lenders, developed strategies and multiyear loan programs for structural adjustment. These were no longer conjunctural, designed to deal with a particular balance-of-payments crisis or short-term disturbance in economic performance, but rather aimed at the basic assumptions of development strategy. Ideally, structural adjustment could and should take place without sacrificing growth, but even then, the process necessarily entrains deflation and austerity for important segments of the population. Whether structural adjustment programs are leveraged by the World Bank and other donors or begun spontaneously out of domestic considerations (India has been notable in this latter respect), they go to the very heart of structural transformation: the balance between agricultural and nonagricultural sectors and the adjustment of policy and investment in favor of the former; the balance among public, private, and foreign enterprise; the amount of resources devoted to the public sector writ large; and the balance between the ISI sector and sectors capable of promoting exports.

The first steps toward austerity and restructuring were frequently taken in the wake of balance-of-payments crises. Typically, the affected country turned to the IMF in order to borrow in excess of its quota in the Fund. The IMF in turn disbursed these funds in "slices" (tranches) as the country took a sequence of steps to prevent a recurrence of the balance-of-payments shortfall. These first measures became part of a short-term stabilization program or standby agreement. Often the reform measures included reductions in government spending and increases in interest rates to dampen the rate of inflation and stimulate savings. Between 1956 and 1984 Egypt, Iran, Israel, Morocco, Syria, Tunisia, and Turkey entered into a total of fourteen such agreements.

Short-term remedies often proved inadequate to address structural problems, and issues of structural adjustment to be carried out over several years became part of the agenda. In the early and mid-1980s, Turkey, Egypt, the Sudan, Tunisia, and Morocco were all wrestling with structural adjustment programs. Even countries that had experienced no severe balance-of-payments problems, such as Algeria and Iraq, had, because of problems of food security, unemployment, and poorly integrated domestic markets, spontaneously moved in the direction of structural adjustment. Although countries that undertake structural adjustment programs at the behest of their major creditors frequently complain that economic reform is being rammed down their throats heedless of potential political upheaval, the converse may also be true. The oil boom of the 1970s allowed the shah of Iran to finance large capital-intensive projects in the public sector, continue to neglect agriculture, and generate high rates of inflation in an overheated economy. His failure to use Iran's petroleum rents for structural adjustment set the economic stage for his own downfall. As Bienen and Gersovitz (1985) have argued, stabilization and structural adjustment programs are at least as likely to contribute to political stability as to undermine it.

The simple fact is that the imbalances caused by years of unsuccessful state-led ISI exact a high political price one way or another unless the country is able to borrow abroad indefinitely the resources that it cannot generate at home. Otherwise some sort of "biting the bullet" is unavoidable. Let us briefly review some of the typical measures that will have to be undertaken.

Generally, government deficits will have to be reduced to some target level—say, 4% of GDP. To do this governments may have to implement salary and hiring freezes and slash investment budgets. Such measures go to the heart of the state's role as employer of last resort and may deny public-sector enterprise the flows of investment to which it has become accustomed. 2 Second, devaluation of the national currency may be called for. The object here is to promote exports, and it may be the agricultural sector that can most quickly meet the foreign demand induced by the new exchange rate. However, all imports will become more expensive. Industries reliant on imported raw materials and capital equipment will see their operating costs soar; urban consumers used to cheap food imports will likewise be hit; the military will find that its penchant for fancy imported armaments is costing much more. The short-term effects of devaluation can be devastating before its long-term benefits begin to be felt.

3 Structural adjustment programs will generally seek to stimulate national savings by raising interest rates. This in turn will tend to dampen consumption and inflation while making borrowing more expensive. The end of cheap or subsidized credit in the long run will encourage more careful project selection and a more efficient utilization of capital, but the short-term effect may be to put many firms out of business and many people out of work.

4 There will be measures to reduce administrative interference in pricing mechanisms and to allow supply and demand to determine price levels. Subsidies of consumer prices and inputs in the manufacturing sector may be reduced or phased out, increasing the cost of inputs and the final price of manufactured goods. Subsidies on fuel, fertilizers, and agricultural-credit rates may be ended, raising the costs of agricultural production. Thus, despite a range of anti-inflation measures (reduced government spending and credit squeezes), the cost of living, especially for urban populations, may rise dramatically.

5 Structural adjustment generally entails a revision in the terms of trade prevailing between the agricultural and nonagricultural sectors. Policies that have held down the producer prices of agricultural commodities that feed into local industries (sugarcane, cotton, sugar beets) or of basic food crops (wheat, rice, oil seeds) may be raised to stimulate production. Presumably if production does increase, the prices of such commodities will eventually fall, but the near-term effect may also be to raise the cost of living for urban populations and the cost of production for the manufacturing sector.

6 Finally, there will be an effort to streamline the public sector and to stimulate the private. Public-sector enterprises will be called upon to increase productivity, reduce costs and idle capacity, generate a financial return on their investments, and, ideally, meet their investment needs out of their own earnings rather than relying on government financing of their deficits. The effort to make the public sector more efficient will mean that redundant labor will gradually be let go, no new hiring will take place, and management will be called upon to concern itself with issues of inventory controls, waste reduction, market research, and quality control. At the same time, new sources of commercial credit to the private sector may be opened, and the public sector may find itself competing with local private or even foreign joint-venture enterprise in areas where it had previously enjoyed a monopoly position. It will be the private rather than the public sector that is targeted to lead an export drive to reduce the country's balance-of-payments problems.

To summarize: Successful structural adjustment will require at a minimum reduced government spending; a shift of investment resources from the urban to the rural sector and from the public to the private sector; a move away from a planned economy to one in which the market plays a major role in allocating resources; and, in the most general sense, a move to an economy in which equity concerns may be "temporarily" sacrificed to those of efficiency. The process is inevitably painful. Standards of living for people on fixed incomes and/or low- and middle-income urbanites may decline; privileged labor unions may find their wages and benefits eroding; educated and skilled youth may face an economy generating very little employment. Short-term economic contraction, it may be argued, is the price that must be paid to assure future sustained growth, but getting from the short to the longer term often proves politically perilous, if not fatal.

Two kinds of pitfalls must be avoided. The structural adjustment "medicine" must not be so powerful as to lock the economy into a downward spiral of contraction, business liquidation, unemployment, and slack demand. Judicious resort to government pump priming and foreign borrowing to keep the economy expanding will be called for. But the second pitfall is related directly to seeking that delicate balance between austerity and growth. The application of stabilization and structural adjustment programs may be so diluted that they achieve the worst of both worlds—a deterioration in standards of living for important segments of the population without the structural reforms that would set the stage for further growth.

There are basically three kinds of response to such pressures that national leaders may adopt. The first is outright rejection of structural reform, generally citing the deleterious consequences for equity and the likelihood of economic stagnation. In Turkey's turbulent party-competitive system in the 1970s, none of the major political leaders could afford to advocate belt tightening. A second gambit is to adopt a posture of rejection of some or all of the recommended reforms but quietly to pursue their implementation. Both Sadat and Mubarak of Egypt from 1976 on followed that tactic to some extent. The risk, of course, is charges of hypocrisy and subterfuge when and if the game is revealed (Bienen and Gersovitz 1985, 749; J. Nelson 1984, 986–991). Finally, leaders may accept the reforms but claim that they are being implemented purely out of domestic concerns and because they make sense. One might view the reforms introduced in Turkey after the military takeover in September 1980 in this light.

The major risk, however, at least as it is perceived by political leadership, is that austerity will provoke violence, especially among urban populations. Cost-of-living rioting in Middle Eastern cities has severely tested the regimes of Morocco in 1965, 1982, and 1984, Tunisia in 1978 and 1984, Egypt in 1977, Algeria in 1988, Jordan in 1989, and the Sudan, where it may have been the catalyst to the overthrow of Nimeiri in March 1985. We have already noted the crisis into which Turkey's expansionary policies had driven the economy in the 1970s. Even before the military seized power in the midst of escalating civil violence, the civilian government, in January 1980, introduced sweeping policy changes that included sharp increases in the prices of public-sector goods, elimination of a wide range of price controls, a major currency devaluation, export incentives, favorable legislation for foreign investors, and curbs on government spending. It is moot whether this program could have been implemented with the same force had the military not intervened to put an end to civil violence as well as to open democratic life. The trade unions and universities were muzzled, and the return to civilian government in November 1983 was under the strictures imposed by Turkey's senior officers. The figures in Table 8.3 give some indication of the impact of the austerity measures.

In Egypt, the challenge of structural adjustment was first posed unequivocally in 1976. The country had fallen in arrears on payments on its commercial debt; the government deficit and domestic inflation were growing in lockstep, the public sector was riddled with idle capacity and large aggregate losses, and price disincentives prevented agriculture from taking up the slack. Egypt entered into a standby agreement with the IMF in the spring of 1976. Part of the reform package was to reduce the level of subsidies of several consumer goods in order to lower the deficit. In November 1976 President Sadat faced Egypt's first openly contested parliamentary elections since 1952. He put off action on subsidy reductions until January 1977. When

TABLE 8.3 Unemployment and Wages in Turkey, 1979–1983

		Wages (TL/day)	
Year	*Unemployed*	*Gross*	*Net*[a]
1979	189,467	75	41
1980	263,354	56	29
1981	341,336	52	33
1982	468,654	50	31
1983	549,081	51	32

[a]Net of insurance payments, income tax, stamp tax, and "financial balance tax."
Source: Central Bank, Republic of Turkey (1984, 110).

the price increases were announced, three days of severe rioting ensued in Alexandria, Cairo, and several other Egyptian cities. Sadat immediately revoked the price increases, and the stabilization program was shelved.

That Egypt's economy did not then founder was the result of great luck and some skillful political maneuvering. In the fall of 1977 Sadat made his historic trip to Jerusalem in search of a peace that might, among other things, enhance Egypt's image as a home for foreign investment and lighten the burden of military expenditures on the economy. In fact, the Camp David Accords of March 1979, which established formal peace between Egypt and Israel, led to Egypt's ostracism from the Arab world and a drying up of Arab aid and private investment in the Egyptian economy.

In the late 1970s, however, other processes, unplanned and unanticipated, were in train. The booming oil economies of the region needed manpower at all skill levels to implement their gargantuan development plans. By 1980 hundreds of thousands of Egyptian migrant workers were remitting to the home economy upwards of US$3 billion per year. The recovery of oil fields in the Sinai Peninsula after years of Israeli occupation coincided with a second surge in international petroleum prices. By 1980 Egyptian oil exports were earning the country US$4.5 billion per annum. The surge in oil prices also was reflected in increased transit fees in the Suez Canal. According to the IMF, these fees earned the economy nearly US$1 billion in 1981/82. Finally, the peace between Israel and Egypt did stimulate tourism, which in 1980 generated US$700 million in revenues.

Egypt was awash in unanticipated foreign exchange, and it became increasingly dependent on foreign rents (Figure 8.1). These external resources could have been used to cushion the impact of the structural adjustment process initiated in 1976 and aborted in 1977. Instead they were used to pay for increased consumption, mainly in the form of imports and increased consumer subsidies. They allowed

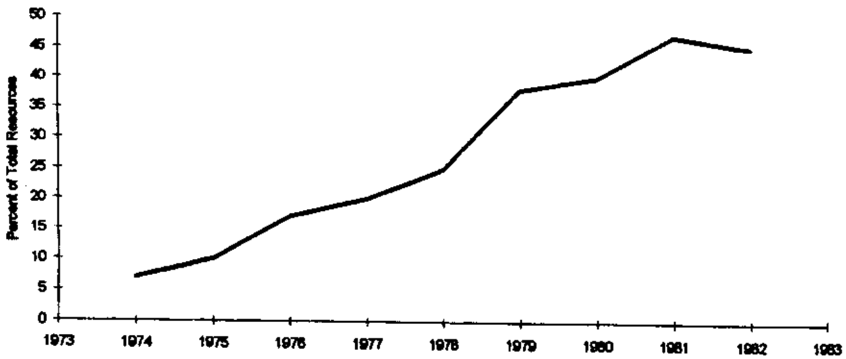

FIGURE 8.1 Share of exogenous resources in total resources in Egypt, 1974–1982.
Source: IBRD (1983, 5).

Egypt to avoid structural adjustment rather than to make the process less painful. By the middle 1980s, a global oil glut was manifest, and the bottom dropped out of international oil prices. Egypt's oil earnings plummeted, the demand for Egyptian labor in Arab oil-exporting economies slackened and the flow of remittances began to diminish, tanker traffic through the Suez Canal tapered off, and numerous terrorist incidents in 1985 and 1986 scared away tourists. Ten years after first nibbling at the bullet, Egypt was once again faced with the entire structural adjustment package. In the early 1980s, the World Bank and other donors became increasingly alarmed at Egypt's economic prospects in light of softening petroleum prices and the lack of domestic economic reform. A 1983 World Bank report put the matter succinctly and starkly:

> Egypt's public finances are extraordinary in several respects compared to those of other countries at similar income levels. The public sector's dominance in its economy requires the mobilization and expenditure of a vast amount of resources. Total public expenditures are 60% of GDP, total revenues are 40% of GDP and the public-sector deficit is 20% of GDP. There are very few, if any, developing countries in the world with such high proportions. These heighten the normal fiscal issues of the efficiency, equity and development impact of public-sector economic operations.

The reforms envisaged by the bank and others involved the following:

- Reduction of consumer subsidies, which were running at about £E4 billion per annum in the early 1980s or circa 7% of GDP.
- Energy pricing and conservation: Petroleum products in Egypt were priced at about 16% of the world prices prevailing in the early 1980s; this indirect subsidy to the rest of the Egyptian economy was worth US$2.5 billion per annum.

- Exchange-rate management and trade policy (i.e., devaluation and export promotion).
- Tax reform to introduce a unified, global income tax-rate structure.
- Agricultural production policies to improve the terms of trade between the agricultural and nonagricultural sectors and to promote agricultural exports.
- Public-sector reform, giving state-owned enterprises greater financial and managerial autonomy and requiring them to sell their products/services at their real market value and to pay market wages to attract skilled labor but also to shed redundant unskilled labor. (The bank did not at this time recommend privatization or divestiture.)

These reforms were advocated at a time when bank forecasters sketched out oil-price scenarios that they thought were fairly pessimistic. They saw a decline in world prices to about US$25 per barrel but thought that price would hold, at least in nominal terms, throughout the 1980s. In fact, by 1986 the price had dropped to around US$15 per barrel. Egypt's day of reckoning seemingly could no longer be postponed.

In the mid-1980s Egypt had become one of the world's major debtor nations, with over US$38 billion in foreign obligations (not including Soviet military debt) and annual debt service charges in excess of US$4 billion (i.e., as much as or more than earnings from the export of oil). Since the late 1970s, Egypt's military debt to the United States had grown to US$4.5 billion, and interest on that debt ran at 13% per annum. "Peace," as anyone would have predicted, did nothing to lessen the economic burden of Egypt's military preparedness. In 1986 Egypt had fallen US$1 billion in arrears in some of its foreign payments.

The Egyptian government's internal debt in the middle 1980s had reached nearly £E30 billion or about US$20 billion at the market exchange rate prevailing at that time. The budgetary deficit of the government, already at 16% of GDP in 1981/82, increased to over 20% in the mid-1980s. An acceptable level from the point of view of the World Bank and the IMF is around 4%. The annual financing requirements of state-owned enterprises alone at that time were well in excess of £E1 billion and were met largely by overdrafts on public-sector banks and the printing of money.

President Hosni Mubarak came to power in 1981 after the assassination of President Sadat by Muslim extremists. The new president was only too aware of the depth of alienation of large segments of Egypt's youth, faced with a soaring cost of living and a shrinking domestic job market. To take on structural adjustment reforms at the very moment that external markets for Egyptian labor were beginning to contract must have seemed as politically suicidal as it was economically inevitable.

Several other Middle Eastern states have to varying degrees shared in Egypt's distress. The *Economist* (July 20, 1985) surveyed one of these states and noted the following symptoms: an inflation rate of 180–200% per annum, the highest per capita foreign debt in the world (US$6,200 per person), unemployment running at 10% of the workforce, an absolute decline in the standard of living, and an annual growth rate of GNP of about 1%. The causes of the disease were seen as lying in a defense establishment that annually absorbed 20% of GNP, a massive welfare state, subsidies of basic consumer goods, the indexing of wage increases to the cost of living, a "huge socialist bureaucracy—encompassing not only trade unions but also banking, transport, farming, insurance, education," the dampening of private initiative through public quasi-monopolies, and "irresponsibly disbursed American aid." Public-sector expenditures were at a level equivalent to 30% of GNP and the deficit in 1984 at about 16% of GNP. The trade deficit had reached US$2.5 billion. The country surveyed by the *Economist* was Israel.

Prime Minister Shimon Peres promoted austerity measures that went much farther than any attempted in Egypt. He slashed the government budget from US$12 to US$10 billion, including outlays for housing, education, welfare, and civil service salaries. Some US$800 million in subsidy reductions were being planned. Simultaneously, the government set its sights on promoting high-tech exports as well as military hardware, the latter of which earned the country over US$1 billion in 1984.

We are at the end of a major developmental phase in Middle Eastern societies and in LDCs as a whole. State-led growth has brought about a certain amount of structural transformation, but rapid population growth has overwhelmed the income-raising effects that such transformation was presumed to yield. The state has overextended its capacities to manage and guide increasingly diversified economies. It was able to give a big push to industrialization but unable to deal with the complexities of industrial deepening, the efficient use of labor and capital, and the need to export in highly competitive world markets. Part of the complexity and diversity that state intervention brought about lay in the creation of new social actors and interests that benefited from state policies (land-reform beneficiaries or the recipients of subsidized credit) or from state business (the whole range of subcontracting). Over time, these groups became entrenched in their economic niches, absorbing resources and saving and investing in such a manner that they developed some economic autonomy and the means to lobby effectively vis-à-vis the state. Indeed, many state functionaries joined their ranks.

These beneficiaries of the decades of ISI have not yet lost all their leverage in the political system, but their claims to public resources and favorable public policies are under challenge. The international donor community and international capital markets have exerted pressure for change that is difficult to resist. The discrediting of centrally planned economies in Eastern Europe and the former Soviet Union has deprived the upholders of the status quo of a viable economic model. Structural transformation under conditions of austerity will be far more difficult politically than it was when large public outlays and ISI went hand in hand.

NOTES

1. "X-efficiency" arises when an enterprise's total costs are not minimized because the actual output from given inputs is less than the maximum technologically possible level.

2. Iran and Iraq joined their poorer brethren in facing a resource gap once they embarked on their mutual slaughter, but there are no international data on this issue for these two countries after 1980. Unofficial estimates placed Iraq's debt at as much as US$90 billion, while Iran had entirely depleted its accumulated reserves at the end of the war (*Middle East*, July 1988).

3. The difference between domestic savings and domestic investment was +2% for all middle-income countries, −1% for lower-middle-income countries, and +4% for upper-middle-income countries.