Economic Growth in the Muslim World

How Can USAID Help?

ISSUE PAPER NUMBER 3

Bureau for Policy and Program Coordination
June 2004

PN-ACY-101

This Issue Paper is one in a series that USAID produces regularly to explore issues related to the challenges of international development.

This publication is available from USAID's Development Experience Clearinghouse (DEC). To order or download, go to www.dec.org and enter PN-ACY-101 as the document identification number in the search box. The DEC may also be contacted at 8403 Colesville Rd., Suite 210, Silver Spring, MD 20910; fax: 301-588-7787; email docorder@dec.cdie.org.

Technical contribution by Anne Beasley, Academy for Educational Development. Editorial, design, and production assistance was provided by IBI–International Business Initiatives under contract no. HFM-C-00-01-00143-00. For more information, contact IBI's Publications and Graphics Support Project at 703-525-2277 or pgsp@ibi-usa.com.

Cover graphic currency: left row, top to bottom: Indonesia, Afghanistan, United Arab Emirates, Jordan; right row, top to bottom, Lebanon, Pakistan, Iraq, Saudia Arabia.

Economic Growth in the Muslim World

How Can USAID Help?

Peter Timmer
Development Alternatives, Inc.
and
Center for Global Development

Donald McClelland
U.S. Agency for International Development

Bureau for Policy and Program Coordination

June 2004

Contents

Executive Summary 1

Economic Growth in the Muslim World:
How Can USAID Help? 5

- Introduction 5
- Overview of the Islamic World 9
- Muslim and Non-Muslim Countries: Key Comparisons 11
- Islam and Economic Growth 15
- Key Issues Facing Muslim Countries 19

Conclusions and Policy Recommendations 23

Annex 1. Countries in the Muslim World 25

Annex 2. Agrarian Economies and Oil Producers 27

Annex 3. Indonesia and OPEC: Two Case Studies 29

Annex 4. Statistical Characteristics of Muslim Economies 31

Annex 5. The Status of Women in Muslim Countries 37

Bibliography 41

Tables

Table 1. GDP Per Capita Growth Rates in Muslim and Non-Muslim Countries, 1990–2000 12

Table 2. The Status of Women in Muslim Countries 13

Table 3. Female Clients of Microfinance Institutions by Number and Quality of Portfolio 14

Table 4. Structural Characteristics of Islamic Countries, 2000 31

Table 5. Per Capita Income in Muslim Countries 33

Table 6. Population Growth (1990–2000) and Age Structure (2000) in Muslim Countries 34

Table 7. The Status of Women in Muslim Countries 37

Table 8. Female Clients of Microfinance Institution in the Muslim World by Number and Quality of Portfolio 39

Executive Summary

The long-standing debate over the impact of religion on economic growth—particularly the current debate over the impact of Islamic thought on the economic prospects of Muslim countries—parallels similar debates over the impact of Catholicism, Hinduism, and other religions. These debates have not had much impact on development practice, partly because of their inconclusive nature.

The issue addressed in this paper is whether Islam, as the "religion of practice" in a wide range of countries, poses serious problems for economic growth or whether the undeniably poor economic performance of many Muslim countries stems from sources unrelated to Islamic theology and practice. Recognizing the tension between progressive and moderate practitioners of Islam and their fundamentalist challengers—a tension that often spills into the political arena—the paper concludes that most Muslim countries face very difficult governance issues that have impeded rapid economic growth

Why do Muslims tend to be relatively poor? The facts are undisputed: Muslims make up 19 percent of the world's population but earn only 6 percent of its income. The issue is whether there are any causal relationships between religion and economic development. Many scholars suggest that religion is typically not a problem, pointing out that Islamic beliefs and values that appear inimical to growth (e.g., the ban on interest and restrictions on speculation) are routinely circumvented. The corporation is now an acceptable and popular organizational form in most Muslim countries. Insurance contracts are legally enforceable. Banks are integral components in every Muslim country's economy. And contracts involving interest payments are commonplace, although payments are sometimes disguised as commissions or fees.

Others believe there are deeper problems. Characterizing an Islamic economic system—"Islamic economics"—as a middle ground between capitalism and socialism, they cite the Koran's overriding emphasis on the need for social justice; rejection of severe economic disparities; condemnation of economic exploitation, usury, and dishonesty; call on well-to-do individuals to use part of their wealth to help the poor and support various charitable endeavors; and repeated expressions of concern for those least capable of defending themselves against poverty. Despite the Koran's emphases, proponents of Islamic economics argue that it can effectively promote both economic development and social welfare in predominantly Muslim countries.

It seems clear that the economic institutions Islamic law prevented—corporate law, banks, stock markets, modern firms, insurance—are all integral parts of most economies of the Muslim world. As a result, economic policy reforms needed to accelerate economic growth in the Muslim world could be adopted without having to confront Islam as a religion. Although Islam harbors elements inimical to economic productivity and efficiency, these have not formed an absolute barrier to economic growth. In fact, Noland's recent analysis (2003) of India, Malaysia, and Ghana provides empirical evidence that there is no consistent, systematic relationship between economic growth and the share of a country's population practicing Islam. He concludes that the impact of Islam on short-run economic performance is as diverse as Islam itself.

The Islamic world is diverse:

- It consists of 48 countries where at least 50 percent of the population is Muslim. These countries of the Muslim world are concentrated in the Middle East and North Africa, Europe and

Eurasia, South and East Asia, and sub-Saharan Africa. Muslim Arabs constitute about 25 percent of the world's 1.2 billion Muslims.

- It also includes several countries with a significant Muslim minority. India is the most prominent, with over 125 million Muslims (12 percent of the population), but Kazakhstan and Uganda, for instance, have substantial Muslim minorities. Even France: 10 percent of the French population is Muslim.
- Muslim countries are both rich and poor. In 2001, per capita income ranged from a low of $100 in Ethiopia to a high of $18,270 in Kuwait. The World Bank categorizes 22 countries as "low-income," with a per capita income of $745 or less.
- Muslim countries tend to be poorer than non-Muslim countries. In 2000, average per capita income in 70 non-Muslim countries in five geographic regions was $5,987. This was nearly twice as high as the $3,375 in 37 Muslim countries. Of course, these averages mask substantial differences across regions and religious groups.
- Of the Muslim countries reporting data, 21 are agrarian (at least 50 percent of the labor force employed in agriculture); many of these countries are in Africa. There are 22 oil producers, many located in the Middle East and North Africa. The average per capita income of the oil producers ($5,233) is four times higher than that of the agrarian countries ($1,272).
- Gross domestic product (GDP) during the decade 1990–2000 grew more slowly, on average, in Muslim countries (2.02 percent) than in non-Muslim countries (2.22 percent). These averages also mask significant differences among geographic regions, individual countries, and different time periods.
- Muslim countries are generally poorer than non-Muslim countries. Their long-term economic problems point to deep-seated failures to establish the core elements that support modern economic growth. The list of the elements is not long, but it is basic: provision of public goods and social infrastructure, a stable macroeconomic environment, and a business climate conducive to growth. Why do governments fail to provide these essentials of growth? And specifically, why are Muslim countries so much worse at doing so than others?

Several factors may hamper economic growth in the Muslim world. These include a social system that values "unchangeability" and thus has a diminished capacity for adaptation and innovation; an emphasis on communalism rather than individualism; a reduced role for public discourse, inhibiting individuals from questioning; an educational system that may limit curiosity; Islamic economics, which forces economic decisions to pass through an ethical or moral Islamic filter; poor economic policy; a difficult geographic "neighborhood"; women's inferior position in society; and culture.

What Is USAID to Do?

What can be done to improve incomes in Muslim countries and help them move forward? It seems clear that any prescription requires dual reforms—in governance and economics. In the case of economics, over the next 5–10 years several relatively tractable opportunities appear to offer scope for important interventions in partner countries, without challenging Islamic governance or orthodoxy.

- *Economic policies.* Analysis shows that government intervention in the domestic economy, which tends to hamper economic growth, was significantly greater in Muslim countries than in non-Muslim countries. Moreover, international trade was significantly less important in Muslim countries than in non-Muslim countries. Promoting increased economic openness and trade reforms should bring faster growth without challenging Islamic principles. Indeed, the Koran, in support of private property rights and in defense of trade among equal partners, would seem to favor such reforms.
- *Banking system.* In many Muslim countries, the banking system's extraordinary inefficiency inhibits it from allocating national savings to their most productive uses. Savings allocation is

often unproductive and wasteful, in part because an unusually high proportion of total investment occurs in the public sector. Sala-i-Martin and Artadi (2003) conclude that "without proper channeling of savings into productive and efficient investment, economic growth is impossible." Thus, basic financial reforms, especially introducing more competition into the domestic banking system, could have substantial payoff, again without challenging basic Islamic principles.

- *Social safety nets.* Approaches to poverty reduction tend to focus on public sector activities. In Muslim countries, however, there is a widespread network of private charities that are enjoined by the Koran to share wealth among the poor. These private charities may offer additional approaches to poverty reduction by providing important social safety nets for the poor, especially in times of significant economic reform.

- *Women's roles.* The status of women in Muslim countries, as measured by employment, education, health, and political participation varies by region. For example, women's participation in the labor force in Muslim countries in Europe and Eurasia (E&E)[1] and East Asia (EA)[2] is very close to that of EMU[3] countries, used as a proxy for the Western norm (see Table 2). On the other hand, their participation is much lower in the Middle East and North African and South Asia than in EMU countries. The ratio of female to male literacy rates in Muslim countries in E&E (97 percent) and in EA (99 percent) indicates near parity between men and women. However, these rates are lower in Muslim countries in other regions.

  Health in Muslim countries, as measured by life expectancy, is lower in all regions than in EMU countries. However, political participation, as measured by the proportion of female seats in parliament in Muslim countries, is higher than in OECD countries in all regions except for the Middle East and Northern Africa.

  In many countries, broader roles are evolving for women. In Muslim countries worldwide, women constitute 55 percent of total borrowers in microfinance institutions, which compares favorably to the 59 percent found across all countries (see Table 3).

  However, in regions and countries where the status of women is lower (the Middle East and North Africa and South Asia), it is often the result of legalized discrimination, such as laws that prohibit women from participating in public life or competing in the labor market. In those countries, USAID must show cultural sensitivity to Islam when implementing programs to support women.

Donor programs and policies should focus on these areas. Specific areas of intervention will, of course, depend on each country situation: no one blueprint applies to all.

[1] E&E region (see Annex 1 for a listing of countries).

[2] EA region includes the Pacific (see Annex 1 for a listing of countries).

[3] Economic Monetary Unit is defined as EU members excluding the United Kingdom and is used as a proxy for the Western norm.

Economic Growth in the Muslim World: How Can USAID Help?

Introduction

Although much of the recent flurry of research and writing on the economics of religion by mainstream academics has been motivated by concerns about links between Islam and terrorism, there is also a long-standing debate over the impact of religion on economic growth. Starting with Max Weber's attribution of the Industrial Revolution to the Protestant ethic, scholars have seen in religious thought both barriers and inducements to the economic behavior that is necessary to achieve rapidly improving living standards. Usually, the arguments are cast in terms of cultural modes of thinking: rational versus mystical, inquisitive versus received wisdom, and self-expression versus authority.

From this broad historical perspective, the current debate over the impact of Islamic thought on the economic prospects of Muslim countries parallels similar debates over the economic impact of Catholicism, Hinduism, Buddhism, and Confucianism. An excellent review of this debate is provided by Noland (2003). Noland also presents important new econometric evidence on the impact of religion, especially Islam, on economic performance.

The debates over the impact of religion on economic affairs have not had much impact on development practice because of their inconclusive nature, a finding supported by the new research reported by Noland and by Barro and McCleary (2002). Although the recent research tends to focus on relatively short-run effects that show up in modern time series data, there is also a longer run dimension that involves the interaction of economic forces and institutional change. From this longer run perspective, in nearly all cases, the dominant religion of a country has seemed ultimately flexible in the face of prospects for rapid economic growth and the behavior needed to realize those prospects.

Fundamentalist Islamic groups seem to be mounting political challenges to mainstream flexibility in a wide range of Muslim countries. An issue addressed in this paper is whether Islam, as the "religion of practice" in these countries, poses serious problems for economic growth or whether the undeniably poor economic performance of many Muslim countries stems from sources unrelated to Islamic theology and practice. This paper argues that the tension between progressive and moderate practitioners of Islam and their fundamentalist challengers often spills into the political arena. In many countries where this challenge is being mounted, there are few mechanisms for open political expression (perhaps a reason for their poor economic performance), so the political challenge is posed as a religious challenge. And precisely because secular governments try to suppress radical religious challenges, violent means, including terrorism, may be used. The result is serious instability in societies facing these challenges, and instability is a major impediment to good economic performance.

The bottom line is that most Muslim countries face very difficult governance issues that have impeded rapid economic growth. This poor performance is then the cause, rather than the effect, of the resurgence of political Islam (now commonly termed Islamism), but this political challenge undermines economic performance even more because of the uncertainty and instability it creates. The first link in this causal chain, from poorly performing economies to religious challenge, has been tested recently for Indonesia by Chen (2003): Despite the difficulty of finding quantitative measures of religious intensity, Chen shows a statistically and economically powerful relationship between loss of income during the crisis and time spent studying the Koran or willingness to place children in Islamic

schools. The underlying theoretical rationale for such effects is that demonstrated religious intensity is a form of social insurance for families because of the role of mosques and Islamic charities in helping the poor.

The key insight from this general introduction is the two-way interaction between economic performance and political governance, and how the internal dynamics of Islamic thought contribute to that interaction. To illustrate that Islam *per se* is not the basic issue, Noland (2003) cites approvingly from Lal (1998)

> But there are important instances (post-Ataturk Turkey, modern Egypt, and most important, major outposts of Islam in Southeast Asia, Malaysia and Indonesia) that show that it is not Islamic beliefs in themselves that have hindered development but dysfunctional *étatism* and *dirigisme*, which, when reversed in the Muslim parts of Southeast Asia, have delivered Promethean intensive growth (66).

What Key Thinkers Say about Islam and Economics

This perspective on the interaction between economics and governance, especially in Muslim countries, examines why Muslims tend to be relatively poor. The fact itself is not disputed: Muslims make up 19 percent of the world's population but earn only 6 percent of its income. Another issue is whether there are any causal relationships between religion and economic development and, if so, what is the direction of causation? As noted, there is suggestive evidence that the economic fortunes of Muslims have nothing to do with Islam per se. The scholars who make this argument point out that Islamic beliefs and values that may appear inimical to growth (e.g., the ban on interest and restrictions on speculation) have routinely been circumvented. Others believe there are deeper problems.

Kuran (1997b) makes four observations on the nature of Islamic civilization based on his reading of the literature.

- *Unchangeability.* Islam stands for unchangeability, and it defines and promotes a social system lacking capacity for adaptation, according to a frequently expressed view of Western scholars and secularist movements across the Islamic world. This explanation emphasizes that religion (Islam) is an obstacle to free thinking and innovation. The implication is that one must choose either "Mecca or mechanization" because the two are not compatible.
- *Communalism*. Islamic civilization remained largely communalist even as Western Europe turned increasingly individualist, and communalist norms dampened incentives to develop capitalist economic institutions. Western thought espouses a strictly individualist economic morality, which encourages people to pursue their own ends without having to consider their social consequences, but a communalist morality focuses attention on collective needs.
- *Public discourse*. Islamic societies have reduced the role of public discourse, discouraging individuals from questioning. The relative openness of public discourse in the West helped create an engine of growth that the Muslim world failed to develop. New ideas tend to emerge in environments hospitable to free inquiry and experimentation. If it is risky to put forth new ideas, they will not be expressed.
- *Education*. Some argue that Islam helped shape an educational system that limited curiosity and innovation. Traditional education, in turn, played a critical role in conditioning individuals to accept the social status quo. The impetus for changing any part of the educational curriculum came largely from abroad.

Kuran (2003) identifies the absence in Islamic law of the concept of a corporation and two institutional bottlenecks that once seriously hampered economic growth in the Muslim world: the Islamic law of inheritance, which inhibits capital accumulation, and the *waqf* system, which locks vast resources into unproductive organizations designed to deliver social services.

- *Inheritance law*. Under Islamic inheritance law, two-thirds of any estate must be divided among a potentially long list of relatives according to a complex set of rules. This had the effect of limiting the concentration of wealth, made it difficult to keep successful enterprises or other property intact over generations, and created an incentive for keeping partnerships small. The system's net effect was to fragment property, especially financial wealth.
- *Waqf system*. The waqf system helped circumvent inheritance regulations, especially for wealthy individuals. A waqf is established by turning immovable private property into an endowment to support any social service permissible under Islamic law, such as a mosque, school, lighthouse, or orphanage. The person establishing the waqf could appoint himself as its trustee and manger, pay himself a salary, appoint family members to salaried positions, and designate a single child as successor. In return for this enhanced material security, the founder supplied social services, thereby unburdening the state of supplying these services. Although the waqf system partly got around the problem of fragmenting wealth, the waqf was not a corporation. It had no legal status as an organization, and because its functions were fixed in perpetuity, it could not change. For example, if new technologies made it optimal to operate on a large scale, small waqfs could not merge to pool resources. Indeed, the waqf system locked resources into uses that were decided centuries earlier, and many once-beneficial waqfs became dysfunctional.

These institutional obstacles to economic growth were largely overcome through radical reforms initiated in the 19th century. The corporation is now an acceptable and popular organizational form in most Muslim countries. Insurance contracts are legally enforceable. Banks are integral components of every economy. And contracts involving interest payments are commonplace, although the payments are sometimes disguised as commissions or fees.

However, traditional Islamic law's lasting consequences are still manifested by the weaknesses of the private sector and deficiencies of human capital, and were exacerbated by state-centered development programs in many Muslim countries.[4]

Lewis (2002) points out that by all standards that matter in the modern world—economic development and job creation, literacy and education, scientific achievement, political freedom, and respect for human rights—Islamic civilization has fallen behind. However, this was not always the case. Islamic societies in the past were pioneers in science and economic development. In fact, for hundreds of years before 1400, Islamic civilization was among the most advanced in the world.

Seeking to find out what went wrong, Lewis cites two diametrically opposed, yet widely supported, answers. The first attributes the lack of economic progress to the abandonment of Islam. Those who subscribe to this view (manifested by the Iranian revolution and fundamentalist movements and regimes in various Muslim countries) advocate the return to pure Islam as practiced in the past. The second argues that present-day problems are due to the past and thus, remedies cannot be found in a return to the past or in Islamic fundamentalism. Those who subscribe to this latter view advocate secular democracy, as illustrated by the Turkish Republic proclaimed by Ataturk in 1923.

Lewis offers two explanations for "what went wrong."

- First, economic progress, at least in the West, is associated with the separation of church and state and a civil society governed by secular laws.
- Second, *lack* of economic progress in the Muslim world is due in large part to the relegation of women to an inferior position in society,

[4] It is worth noting that the corporation, with the legal rights of a "fictitious," infinitely-lived person to have a major impact on Western economic growth. The modern corporation emerged from church and guild organizations in medieval Europe in the 12th century and started to evolve formal legal status, at least in England, in the late 16th century.

thereby depriving the Islamic world of the talents and energies of half its people.

Lewis suggests that these two factors, secularism and feminism, will play a major role in shaping the Muslim world of the future. He also suggests that lack of freedom—freedom to inquire and speak, freedom from corrupt and pervasive economic mismanagement, freedom of women from male oppression, and freedom from tyranny—underlies many of the troubles of the Muslim world.

Sachs's worldwide examination (2000) of why some countries are rich and some are poor explored the role of economics and politics, geography, and culture. His principal conclusions include the following:

- Economic policy (essentially, whether a country is capitalist or socialist) affects economic growth rates.
- Geography matters. Temperate and snow-zone countries, those with coastlines, and those free of malaria grow more rapidly than other countries.
- Culture, if a determinant of economic growth, is subsidiary to geography and the political and economic dimensions. For example, culture may play a role in explaining the underperformance of Islamic societies in North Africa and the Middle East *and* the strong performance of East Asian countries that have an important overseas Chinese community—but economic policy and geography are paramount.

A country cannot alter its geography, nor can it much change its culture in the short run. A country can, however, modify its economic policy environment and political arena, although these modifications are also conditioned by the "hysteresis" of path dependency and inherited institutions.

Sirageldin (1995) compares "Islamic economics" to capitalism and socialism. Suggesting that market capitalism is an economic system where the values that matter can be measured in terms of money, capitalism seems indifferent to many of the social ills often associated with a free market. Conversely, socialism is an economic system where individual motivation and the drive for personal achievement are highly constrained. Islamic economics attempts to balance individual freedom and motivations and social obligations. It forces economic decisions to pass through an ethical or moral Islamic filter. It "tames" the market mechanism, minimizing its potential negative externalities, such as severe inequalities, degeneration of social values, spread of crime, and human alienation.

Management Systems International (MSI), like Sirageldin, characterizes an Islamic economic system as a middle ground between capitalism and socialism (2002, 20). MSI highlights the Koran's overriding emphasis on the need for social justice; rejection of severe economic disparities; condemnation of economic exploitation, usury, and dishonesty; call on well-to-do individuals to use part of their wealth to help the poor and support various charitable endeavors, and repeated expressions of concern for those least capable of defending themselves against poverty.

The issue, according to Sirageldin, is whether an Islamic society that adheres to Islamic economics can compete favorably with other economic systems in a highly competitive global environment characterized by accelerating technological change while maintaining an Islamic ethical system.

Pfeifer (2001) studied the performance of 15 Egyptian firms, seven Islamic and eight non-Islamic. The factor that most clearly distinguishes the two groups is that the owners/managers of all seven Islamic firms indicated that their firm never borrowed (or lent) at interest. By contrast, all eight non-Islamic firms had outstanding loans at interest.

The study found that the non-Islamic firms had a significantly higher average rate of profit. The Islamic firms paid a significantly higher average wage, suggesting that cultural institutions shape economic behavior even in a market economy. All eight non-Islamic firms employed some women; four of the seven Islamic firms had a policy of not employing women. Of course, the small size of the sample suggests caution in reading much statistical significance into the results.

Proponents of Islamic economics argue that it can effectively promote economic development and social welfare in predominantly Muslim societies. However, Islamic economics prescribes certain rules of behavior for Islamic firms. These rules include precepts, such as hiring "the best and most faithful," paying fair wages enabling workers to support their families, and being responsible for the health and other basic needs of their employees. Thus, lower profit rates in Islamic firms may result from pursuit of the social objectives that Islamic economics exhorts.

What should we conclude? According to Kuran (2003, personal communication), there is good news and bad news. The good news is that the economic institutions Islamic law proscribes—corporate law, banks, stock markets, modern firms, insurance—are all integral parts of most economies of the Muslim world. Therefore, economic policy reforms needed to accelerate economic growth in the Muslim world could be adopted without having to confront Islam as a religion. Although Islam harbors elements inimical to economic productivity and efficiency, these have not formed an absolute barrier to economic growth. The bad news is that even if all the bad policies of government were to disappear today, strong private sectors and civil societies could take decades to develop. In addition, it is still necessary to take on Islamism (and Islamists) who want to set back the clock; for example, Islamists who object to insurance markets and interest-based banking. The fundamentalist challenge must be met if Muslim countries are to sustain economic growth. The issue is how to stimulate the appropriate economic policy reforms within the constraints of each country's Islamic political economy. That task requires a much more nuanced view of the Muslim world.

Overview of the Islamic World

The Muslim world is extensive and diverse, comprising 48 countries where at least 50 percent of the population is Muslim. It extends from West Africa (Morocco and Mauritania) to East Asia (Indonesia). The larger Islamic world includes several countries with a significant Muslim minority. India is the most prominent of these countries with a Muslim minority of over 125 million people (12 percent of the population). Others include Kazakhstan, with almost 8 million Muslims (47 percent of the population), and Uganda, with almost 4 million Muslims (16 percent of the population). In France, nearly 6 million people are Muslim (about 10 percent of the French population).

Key Geographical Distinctions

The 48 Muslim countries (Annex 1) are concentrated in five geographic regions: the Middle East and North Africa (18 countries); Europe and Eurasia (7 countries); South Asia (4 coutries); East Asia and the Pacific (3 countries); and sub-Saharan Africa (16 countries). There are no Muslim countries in North America, South America, or Western Europe. The Arab world consists of the 22 countries that form the Arab League. Arab countries are defined as countries where the population speaks Arabic. Muslim Arabs constitute about 25 percent of the world's 1.2 billion Muslims.

The top five Muslim-country recipients of USAID economic assistance over the five-year period 1997–2001 were Egypt, Jordan, West Bank/Gaza, Indonesia, and Bangladesh. In 2002, Pakistan and Turkey were among the top five recipients; Indonesia and Bangladesh were not, though they were still among the top 10. The top five recipients of USAID assistance per capita in 2002 included Albania, Kyrgyzstan, Egypt, Jordan, and West Bank/Gaza.

Structural Characteristics and Resource Endowments

Of the Muslim countries reporting data (Annex 2), 21 are agrarian (at least 50 percent of the labor force employed in agriculture). Most are in Africa, but some are in South and Southeast Asia (Indonesia, Bangladesh, and Pakistan), Eurasia (Afghanistan and Tajikistan), and the Middle East (Yemen). The average per capita income of these agrarian countries, $1,272, is much lower than that of nonagrarian countries, $5,594. This is not surprising in view of the regularities of the structural transformation (Timmer 2002).

Twenty-two Muslim countries are oil producers, many of them located in the Middle East and North Africa. Any connection between oil riches and Islam must be coincidental, as the religion was well established in these countries before oil became a valuable resource. Any connection between Islam and the poor governance and economic performance that often accompanies oil resources is similarly coincidental because these powerful political economy effects are seen in many oil producers, Muslim and non-Muslim alike.

As expected, the average per capita income of oil producers, $5,233, is higher than that of nonoil producers, $2,108. Indonesia, Nigeria, Sudan, and Yemen are both agrarian and oil producing, and all four are quite poor. Nine countries are neither agrarian nor oil producing. Only Turkey and Malaysia can properly be described as industrial.

Annex 3 summarizes two case studies of agrarian and oil-producing Muslim countries. Indonesia, despite its problems, is a success story that may suggest "what to do" in other Muslim countries whose economies are predominately agricultural. The experience of the Middle Eastern OPEC countries may provide insights on "what not to do." These case studies may be instructive for designing growth strategies for the Caspian republics, which have rich oil and natural gas reserves.

Table 4 (Annex 4) summarizes key structural characteristics of the Muslim economies. The agrarian economies tend to be concentrated in Africa, where agriculture contributes, on average, over 30 percent of gross domestic product (GDP). This includes five countries where agriculture contributes over 40 percent. The services sector's contribution ranges, on average, from 38 percent of GDP in East Asia and the Pacific (with only two reporting countries) to 53 percent in the Middle East and North Africa. The average contribution of industry is weakest (22 percent) in Africa and strongest (49 percent) in East Asia and the Pacific. Of course, these regional averages mask significant country differences.

If the diversity of Muslim countries is taken into account, is there anything left to explain their poverty or poor record of economic growth?

Noland (2003) suggests not. His best econometric model, explaining growth for 78 countries from 1970 to 1990, incorporates the standard growth variables but shows no correlation between economic growth and the share of population practicing Islam.[5] His conclusion is notable and provocative: "Some commentators have claimed that Islam is inimical to growth. In general this is not borne out by the econometric analysis at the cross-country or within-country level" (26).

The Political Economy of Islam

Khan (1999) zeros in on the crux of the issue, asking how would one know what an Islamic economy looks like if there has never been one. He draws a sharp distinction between Islamic *countries* as political entities, of which there are many, several with very deep historical roots, and Islamic *economies*, where historical experience is thin. The examples of the latter usually cited—Afghanistan under the Taliban, Iran under the Revolutionary Council of Ayatollah Khomeini, and Sudan under Hassan al-Turabi—certainly give cause for concern that Islamism can be a vehicle for economic growth and improved standards of living. According to MSI (2002), the reason seems deeply rooted in the nature of Islam:

> First, economics is, at best, of secondary importance to Islamists. It does not feature prominently in their political agenda, or in the books, articles and pamphlets that emanate from Islamist circles. Islamist thinkers, politicians, and activists are clearly far more concerned with matters of morality, ethics, and piety than with economic questions. Some even express contempt for economics. As Ayatollah Khomeini once remarked when pressed to address economic issues, "the revolution is about Islam, not about the price of melons." Islamism is driven first by culture (the search for a "moral order," consistent with God's will for mankind, as revealed in the Koran) and, second, by politics (the quest for controlling the levers of power that will make it possible to establish that moral order). Economic concerns are far less central to Islamist thinking and strate-

[5] Intriguingly, the correlation for "Catholic" and "Protestant" are significantly negative (Noland 2003, table 2).

gizing; they come well after cultural and political objectives (19).

To understand the impact of Islam on economic growth in Muslim countries, it is necessary to understand this challenge from Islamism and the links between economics and politics (economic governance). Although it is probably fair to say that Islam per se is not a significant impediment to improved economic performance in any Muslim country (Annex 1), it can be a contributing factor. According to Jabber (2002), poor economic performance in so many of these countries is one of the three basic causes of widespread alienation of the populations of Muslim countries from their governments.[6] This alienation in turn supports fundamental Islamism, which is the main challenge to political authority in Muslim countries. And Islamism's political challenge—often using violent means—undermines the basic economic environment needed to improve investment returns and to stimulate higher standards of living.

From this perspective, analyses of what went wrong economically in the Muslim world have focused on immediate or proximate causes, rather than deep and fundamental causes. Abed's review (2003) for the IMF of the Middle East and North Africa region, for example, provides an extensive litany of policy failures and poor governance as the reasons for their "unfulfilled promise." Islam is not mentioned even once as a factor associated with these problems. Similarly, a USAID review of lessons learned from USAID and other donor experience in providing economic assistance to selected Islamic countries never mentions Islam as a contributing factor to the success or failure of the ten specific projects reviewed. Moreover, neither the IMF nor the USAID review provides guidance on how to fix poor policies or improve governance, when both may well be held hostage to the political challenge from fundamental Islamists. Specific actions for possible support by USAID are identified at the conclusion of this report.

[6] The others are the absence of meaningful political participation and the impact of the information and communications revolution.

Muslim and Non-Muslim Countries: Key Comparisons

Economic Performance

Muslim countries are both rich and poor (Annex 4, Table 5). In 2001, for the 37 Muslim countries reporting data, per capita income ranged from a low of $100 in Ethiopia to a high of $18,270 in Kuwait. The World Bank categorizes 22 as low-income (per capita income of $745 or less) (World Bank 2003).

Muslim countries tend to be poorer than non-Muslim countries. In 2000, average per capita income in the 70 non-Muslim countries located in the five geographic regions was $5,987, nearly twice as high as the $3,375 in the 37 Muslim countries. Of course, averages mask substantial differences across regions and religious groups: in South Asia, for example, average per capita income in the three Muslim countries was *higher*, $2,563, than in the four non-Muslim countries, $2,153. But in each of the other four geographic regions, average per capita income was higher in the non-Muslim countries (World Bank 2003).

GDP during the decade 1990–2000 grew more slowly, on average, in Muslim countries, 2.02 percent, than in non-Muslim countries, 2.22 percent (Table 1). These averages mask significant differences among geographic regions. In Africa from 1990 to 2000, for example, average annual GDP growth was substantially lower in Muslim countries, 1.88 percent, than in non-Muslim countries, 3.03 percent. But in East Asia and the Pacific, the average growth rate was higher in Muslim countries (5.46 percent) than in non-Muslim countries (3.59 percent).

Regional averages also mask individual country performance. For example, although most Muslim countries in Africa tended to perform poorly on average, some countries, such as Mali, performed well: 3.5 percent GDP growth during 1997–2002.

The time period chosen may further have an important bearing. For example, the six Muslim

countries in Europe and Eurasia reporting data had negative average growth rates during 1990–2000; however, they all had positive average growth rates for the more recent period 1997–2002.

Noland's (2003) analysis of India, Malaysia, and Ghana, for which detailed regional data are available on religious practices, examines economic growth trends and relates them to the prevalence of different religions. In India, the analysis finds no significant relationship between the share of the population practicing Islam at the state level and growth in per capita incomes in the state. In Malaysia, a similar analysis showed a significant, negative correlation between the share of the population practicing Islam and per capita income, but in Ghana the correlation was significant and positive. It seems that the impact of Islam on short-run economic performance is as diverse as Islam itself.

Demographic Considerations

Population growth rates (country-by-country data inTable 6 in Annex 4) show no particular pattern in the Muslim world. For the period 1990–2000, regional average growth rates range from a low of 1.6 percent per year in Europe and Eurasia to a high of 2.8 percent in Asia. Of the 48 Muslim countries, the United Arab Emirates, Jordan, West Bank/Gaza, and Afghanistan had relatively high population growth rates of 4.0 percent per year or more. Kuwait had a negative population growth rate of –0.7 percent.

An analysis of the age structure in Muslim countries (Table 6) reveals that at least 60 percent of the population is of working age (15–64) and presumably able to support the other 40 percent of the population—children and the elderly. By contrast, in the West Bank/Gaza, Chad, Mali, Niger, and Somalia, less than half the population is of working age, and presumably is supporting the more than half that are children or elderly. In short, the dependency ratio is relatively high in these countries.

The status of women is measured by employment, education, health, and political participation. Employment is measured by women's participation in the labor force, education by female literacy rates and female literacy parity indices, health by female life expectancy, and political participation by proportion of female seats in parliament. Perspective is provided by statistics for Europe and by including per capita growth in GDP, 1999–2000. This facilitates a comparison of women's status to economic growth in each Muslim country.

Table 1. GDP Per Capita Growth Rates in Muslim and Non-Muslim Countries, 1990–2000

	Muslim countries		Non-Muslim countries	
	GDP growth (%)	**Countries reporting (Total countries)**	**GDP growth (%)**	**Countries reporting (Total countries)**
Middle East and North Africa	3.78	10 (18)	4.03	1 (1)
Europe and Eurasia	–2.42	6 (7)	–0.95	18 (22)
South Asia	3.36	3 (4)	4.87	4 (4)
East Asia and Pacific	5.46	2 (3)	3.59	16 (28)
Africa	1.88	13 (16)	3.03	28 (32)
Total	**2.02**	**34 (48)**	**2.22**	**67 (87)**

Note: Growth calculated on a purchasing power parity (PPP) basis (unweighted).
Source: World Bank, *World Development Indicators*, 2002.

Women's participation in the formal labor force varies by region, and there is not always consistency between per capita growth and participation. As shown in Table 2, growth rates and participation are close to EMU country participation in both Europe and Eurasia and East Asia. In the Middle East and North Africa, participation and per capita growth are lower. However, in Africa, participation is 39.2 percent, only about 2 percent less than in EMU countries, while the per capita growth rate of 2.1 percent is among the lowest. Accordingly, comparing women's status with growth rates yields inconclusive results.

Female literacy rates are heterogeneous, even when the sample is restricted to Muslim countries. Literacy and economic growth (Table 2) are difficult to compare among regions. Growth rates and literacy are both relatively high in Europe and Eurasia, but statistics for other regions caution against drawing hard conclusions. For example, growth rates in East Asia and South Asia are comparable, but literacy rates are very different (82 percent compared to 29 percent). In the Middle East and North Africa, the literacy rate is 54 percent and growth is low, but the literacy parity index indicates that overall literacy rate for men and women in that region is also low, suggesting that literacy is not solely a gender issue. Additional technical analysis showed a statistically positive relationship between the literacy rate and per capita growth.

Female life expectancy in the Muslim countries is not at the level of the EMU baseline (81 years) in any region, but is closest in Europe and Eurasia (71 years), which also has the highest per capita growth. Differences follow expectations by region: the Middle East and North Africa and East Asia are similar, while Africa is lowest (48 years).

Table 2. The Status of Women in Muslim Countries

	GDP growth per capita, 1999–2000[1] (%)	Females in the labor force[2] (%)	Female literacy rate, all ages[3] (%)	Female literacy parity index,[4] 15–24 years	Female life expectancy from birth (age in years)	Female seats in parliament[5] (%)
Europe EMU/OECD weighted average[6]	3.1	41.3	99.9	1.00	81	7.1
Middle East and North Africa	1.9	27.5	54	.84	69.6	4.5
Europe and Eurasia	5.8	41.1	84	.97	71.8	7.8
South Asia	3.0	36.4	29	.65	61.2	11.5
East Asia and Pacific	3.4	40.6	82	.99	68.7	11.5
Africa	2.1	39.2	42	.84	48	9.7

Notes:

1. Weighted calculation based on the total population.
2. Proportion of women in the total formal labor force in percent.
3. Female literacy rate is the percentage of all women who are literate in each country.
4. Female literacy parity index is the ratio of the female literacy rate to the male literacy rate for the 15–24 age group. (A parity index of less than 1 indicates that the proportion of literate females is less than that of males. For example, if 50 percent of women are literate with a parity ratio of .9, it would indicate that 55 percent of males were literate.)
5. Percentage of seats in the lower house of parliament held by women.
6. Europe is represented as the EMU countries (European Monetary Unit countries, which are the EU members excluding Great Britain), except for seats in parliament which uses the OECD countries as a base.

Sources: World Bank *World Development Indicators,* 2001 and 2002; UNDP *Human Development Report,* 2003; *CIA World Fact Book*, 2002 and 2003.

Table 3. Female Clients of Microfinance Institutions by Number and Quality of Portfolio

	Women borrowers (millions)	Proportion of women to total borrowers[1] (%)	Total portfolio ($ million)	Loan loss rate[2] (%)
Total Muslim world[3]	3.5	55	1,553.2	1.6
Total Muslim and Non-Muslim world[4]	4.8	59	2,635.2	1.5

Notes:
1. Calculated by dividing the total number of women borrowers by total number of borrowers.
2. Calculated by dividing total loan loss by total portfolio in each region.
3. Includes Bank Rakyat in Indonesia and Grameen Bank in Bangladesh.
4. USAID 2002 sample plus Grameen Bank.

Sources: USAID *Microenterprise Results Reporting for 2001* and *2002*; The Mix Market, and Grameen Bank *Annual Report 2002*.

The role of women in politics varies according to country and region. It may be affected by a number of factors, including the level of democracy in the political institutions themselves, social and cultural constraints, education, and legal policies. Women's participation in politics, as measured by the proportion of seats held in the lower house of parliament, is less in the Middle East (4.5 percent) than in EMU countries (7.1 percent), but more in other Muslim regions, such as Eastern Europe where it reaches 22.2 percent. In some countries, a specific number of seats are reserved for women; this may contribute to a higher proportion of women members than would otherwise be the case.

Women's participation in microfinance institutions (MFIs) is an indication of their participation in private sector activities. Their participation as MFI borrowers in Muslim countries is compared to that of women in the non-Muslim world (See Table 3. Country-by-country data are in Annex 5, Table 8). Women constitute more than 50 percent of borrowers in all regions, except in East Asia.[4] In the Muslim world, the proportion of women borrowers is 55 percent, which compares to 59 percent for Muslim and non-Muslim countries. Loan losses for borrowers in Muslim countries are 1.6 percent compared to 1.5 percent for the total Muslim and non-Muslim world. These indicators show that a sizeable number of women borrow money for their small businesses in Muslim countries and that they are good credit risks.

[4] The results are shaped by the statistical influence of Indonesia's Bank Rakyat, in which the proportion of women borrowers is only 16 percent out of a total of over 2.9 million clients. The size of this institution significantly affects the worldwide proportion of female borrowers.

The data show that although women do not generally have economic or political parity with men in most Muslim countries (see Annex 5, Table 7), women in other societies face similar barriers. Legal equality—including voting rights—for women became accepted in Western countries only in the 20th century. Given the difficulty of achieving radical cultural change, even in open societies, one should not be surprised to find slow progress toward gender equality in some Muslim societies. However, significant economic growth seems possible while this process is underway.

Qualifying for the Millennium Challenge Account

One of the most revealing ways to assess the economic competitiveness of developing countries is to see how well they score on the original 16 criteria proposed to rank countries seeking to qualify for funding under the Millennium Challenge Account (MCA). Radelet (2003) ranked all the counties having available data. Using two criteria—IDA eligibility and annual per capita income of $2,975 or less—produces a list of 115 countries, of which 36 are Islamic.

For countries to be eligible for MCA assistance, they must also have a passing score for each of three qualifying areas and must satisfy the

corruption criterion.[5] The three qualifying areas and the 16 specific selection criteria are as follows:

- *Ruling justly*: Civil liberties, political rights, voice and accountability, government effectiveness, rule of law, control of corruption
- *Investing in people*: Primary education as a percent of GDP, primary education completion rate, immunization rate, health spending as percentage of GDP
- *Economic freedom*: Country credit rating, inflation, three-year budget deficit, trade policy, regulatory quality, number of days to start a business

Radelet found that the Muslim countries tended to score badly in all three areas when compared to the average scores for all developing countries. In fact, based on his analysis and the data available, only Senegal and Jordan of the 36 Muslim countries would qualify for MCA funding. Muslim countries did particularly badly on individual criteria for civil liberties and political rights. Radelet's findings support the argument that the basic obstacle to Muslim economic growth stems from governance issues, not economic policies per se—with one exception: in one crucial economic freedom area, trade policy, Muslim countries fare poorly.

Islam and Economic Growth

> *"Little else is requisite to carry a state to the highest degree of opulence from the lowest barbarism than peace, easy taxes, and tolerable administration of justice; all the rest being brought about by the natural course of things."*
>
> —Adam Smith, Lectures on Jurisprudence, 1775

What Accounts for Economic Growth?[6]

Adam Smith was making several points about economic growth when he spoke these prescient words in 1775 (Jones 1981, 235). The unit of observation is the state, which is also the decision-maker in Smith's world because it provides what are now considered key elements of good economic governance—"peace, easy taxes, and the tolerable administration of justice." Democracy is not mentioned in Smith's list. As the political mechanism to ensure good economic governance, democracy comes much later. Smith's final point is among the most controversial: economic growth will be "the natural course of things" because of people acting in their own best interest and the pressures of competition from the "invisible hand." An important question is whether Muslim countries systematically prevent the key elements of good governance from emerging.

The human behavior that led Smith to make these observations seems to be wired very deeply in our brains (Diamond 1997, Jones 1988). From this behavioral (and historical) perspective, development is seen as a long-run sequence of decisions by economic agents, acting in their self-interest, that culminate in rising investment and higher labor productivity. The "miracle" of advanced living standards is the set of institutions that permit, even encourage, these decisions for very long periods of time—a century or longer (Jones 1981). At a growth rate of just two percent per capita per year, a $1,000 income becomes $8,000 in a century and $64,000 after two centuries. That is how the United States and Europe became rich—two major wars and, in Europe, increasingly heavy tax regimes notwithstanding.

The Evolution of Thinking on Economic Growth

Economists have conceptualized the process of economic growth around three basic models: specialization and trade, investment in machines, and increasing returns to knowledge. Although the models overlap to an extent and are potentially complementary, each has been held out at some point in the history of economic thought as the fastest road to riches. The basic principles of Islamic governance affect these three models in fundamentally different ways. In general, Islam accorded at least modest support for the trade

[5] Failure on "control of corruption" automatically disqualifies a country from MCA funding, no matter how well it scores on the other categories.

[6] Major elements of this discussion draw on Timmer's background paper for USAID's *Foreign Assistance in the National Interest* (2002).

model and relatively active discrimination against the knowledge model.

Specialization and trade. Much of classical economics was devoted to understanding the process of economic growth. As noted, Adam Smith was highly optimistic about the prospects for higher living standards, to be achieved primarily by higher labor productivity resulting from specialization. However, specialization could only succeed through trade, with the process limited by the size of the market. By lowering trade barriers—whether artificially imposed by governments or naturally caused by long distances or difficult terrain—larger markets became accessible to manufacturers. Competition—the invisible hand—would force manufacturers to more and more specialized forms of production and thus raise labor productivity and living standards.

To be successful, the trade-intensive strategy of economic growth required many transactions, increasingly at long distance, so the institutions—such as rule of law—defending property rights and lowering transaction costs came to be seen as the foundation of a market economy. That is, economic governance has long been seen as an essential starting point for the economic growth process, not something tacked on in midstream. The Koran strongly defends property rights and the efficacy of (fair) exchange, and Muslim traders historically have been very successful.

Investment in machines. The visible success of the Industrial Revolution in the 19th century, first in Britain and then in France and Germany, changed how economists thought about the growth process. Technological change, created by new scientific enterprise and embodied in machines, came to be seen as the driving force of development (Landes 1969, 1990, 1998). And even if not all countries could invent and produce their own machines, all were free to import them and reproduce the factory system that was making Europe so rich and powerful. A "capital fundamentalism" emerged that stressed the accumulation of savings to invest in machines that embodied the latest technologies, the origins of which were exogenous to the day-to-day activities of factory managers or national economic planners.

The "machine model" was available to countries in a hurry to catch up with their rich neighbors or distant trading partners. Many institutional elements of Adam Smith's "trade model" could be circumvented, or substitutes found, if the investment and production process could rely directly on decisions of national planners rather than the profit motive of private investors. Early German industrialization was a "deliberate act of policy" (Cole and Deane 1965), and by the end of the 19th century, it had changed the balance of both economic and military power in Europe. The pace of Soviet industrialization changed the balance of power again during the middle half of the 20th century. A similar strategy was followed by Turkish *étatisme* before World War II, by "Arab Socialism" in the Middle East from the 1950s onward, and as "Islamic Socialism" by Kaddafi, Zulfikar Ali Bhutto, and others.

The "machine model" worked reasonably well when two conditions held. When relatively little trade was needed to achieve labor specialization as the source of higher productivity, higher productivity could be generated through intensive use of capital goods with production primarily for domestic markets. This stimulated the popularity of import substitution industrialization. The second condition was the ready availability of appropriate technology in the form of capital equipment domestically or from the world market that did not have to be invented or developed locally.

Increasing returns to knowledge. As the pace of scientific innovation accelerated in the advanced countries, productivity growth relied increasingly on direct knowledge rather than on technology embodied in machines, and the machine model stumbled in country after country. In those countries—such as Korea, Taiwan, Israel, and Brazil—with nascent institutions to support low-cost trade and absorption of Western knowledge, not just machines, the transition to export-led growth was feasible if not always smooth. In countries without these institu-

tions, which included nearly all countries in Africa and most in the Muslim world, the failure of economic governance led to rapidly failing economies. After years—even decades—of steady economic growth, they have slipped back into economic decline and rising levels of poverty. Some have slipped even further, into chaos and conflict.

The new economic growth model that explains this performance is based on increasing returns to knowledge. That is, instead of a given labor force receiving diminishing marginal returns as laborers use more and more identical machines, marginal returns to knowledge actually increase with greater use because of spillovers, at no marginal cost, to additional users. There are large economic payoffs from new knowledge, especially in the early years of application when patent rights provide market power, encouraging economic entrepreneurs to take advantage of it by using the fundamental science produced in modern research universities and corporate research centers.

Thus, economic growth, instead of depending on exogenous technical change, is now seen as an endogenous process of response to incentives throughout the entire economic system, not just at the level of company investments or consumer decisionmaking (Easterly 2001). The modern concern with enforcing intellectual property rights, as well as property rights for land, goods, and financial assets, is easy to understand from the perspective of this "knowledge model." A failure to defend intellectual property rights will slow the search for useful new knowledge and, consequently, the rate of economic growth.

The difficulty of relying on endogenous growth in poor countries is that knowledge generation and development of sophisticated human capital depend at least as strongly on the "foundation institutions" that ensure property rights and low transaction costs as the Smithian "specialization and trade" model that gave rise to them. It was the long time needed for each society to evolve its own such institutions and investments that gave rise to the search for substitutes that could speed the economic growth process (Gerschenkron 1962), a search that largely failed in the third world. There is an uneasy sense in the development profession that we are back to square one (Landes 1990, Easterly 2001). As Easterly reminds us, the "quest for growth" in this world of increasing returns to knowledge is elusive.

Although Islam is characterized by immense diversity through space and time and has always had a pragmatic side, some Islamic societies may be slow to respond to new and external knowledge or assimilate new technologies. This may be explained in part, by their strict adherence to theocracy and written scripture as the basis of all knowledge. *The Economist*, quoting the UNDP's *Arab Human Development Report* (2002), writes, "There is little Arab writing, or translation from other languages: in the 1,000 years since the Caliph Mamoun,... the Arabs have translated as many books as Spain translates in a year" (2003, 6).

The Empirical Record of Economic Growth

Given the diversity of experience with economic growth—over time and across countries—diligent researchers can show that most "sensible" variables can influence the growth process under some set of circumstances. For example, capital, labor, education, government investment, low inflation, macroeconomic stability, openness to trade, quality of institutions, and democracy have all been shown to contribute positively to economic growth in some set of countries or time period.

Specialists, with insights based on years of experience combined with hard work, are often able to assemble the necessary datasets to help identify the specific factors contributing to economic growth. For example, unstable prices for commodity exports slow down economic growth (Dawe 1993, 1996; Collier and Denn 2001). A favorable balance between rural and urban education, serving as a proxy for reduced "urban bias," speeds up economic growth (Lipton 1977, 1993; Chai 1995). Trade openness was bad for economic growth in the 1930s and 1940s, of little importance one way or the other in the 1950s and 1960s, but highly significant in the 1970s and 1980s (Vamvakidis 1997).

One factor crucial to sustained growth emerges from both the long-run historical record of individual countries and the shorter post-World War II cross-section record of developing countries. Rapid factor accumulation, driven by high domestic savings rates or foreign capital inflows, can lift a poor country onto the first rung of the development process. But eventually, improvements in total factor productivity, or the efficiency with which all inputs are used, including capital, must become the main source of higher incomes. This realization was the real driving force behind the development of the "knowledge model" (Romer 1986, 1990; Prescott 1998).

The difficulties in making the transition from the "machine model" to the "knowledge model" in a trade-driven global economy are clearly seen in the growth record of the 1990s. According to the World Bank's *World Development Report, 2003,* more than a third (44) of the 127 developing or transition economies had lower per capita incomes in 2001 than in 1990, and none of these countries was directly affected by the Asian financial crisis that started in 1997. The decade saw some of the fastest growth on record in global output and in volumes of international trade, so the external environment was favorable to growth. Although trade protectionism on the part of the United States, Europe, and Japan was no doubt one source of poor performance, the principal sources must be sought within the countries themselves.

None of the 44 poor performers are in Asia. Of the 44, one-third (16, 5 Muslim) were part of the former Soviet Union, testifying to the difficulty of transitioning to a market economy in the absence of market institutions. Sub-Saharan Africa accounts for another 17 countries (6 Muslim), testifying to the continuing, widespread difficulty in arresting the economic erosion that has persisted continent-wide for decades. The Muslim countries of sub-Saharan Africa seem to be slipping even faster than the rest of the continent. And despite reasonable economic performance for the region as a whole, 5 countries in Latin America and the Caribbean suffered decade-long declines. Of the 44 countries, 18 are classified as Muslim, a proportion about in line with the number of Muslim countries in the total.

Long-term economic problems point to deep-seated failures to establish the core elements that support modern economic growth. The list of these core elements is not long, but the elements are basic: provision of public goods and social infrastructure, a stable macroeconomic environment, and a business climate conducive to growth. Why do governments fail to provide these essentials for growth? Indeed, why do some governments actively seek to undermine them? And, specifically, why are Muslim countries so much worse at providing these basic elements than others?

Modern political economy—a new academic discipline—has evolved to help answer these questions, including in the context of Islamic societies. Rational choice models of political actors explain why state agents collect private goods from public resources, but they are less successful in explaining how to correct the vicious circle of corruption within the dynamics of a society's own political system (Srinivasan 1985, Alesina and Rodrik 1994, L. Diamond 2002). Even democratic systems with regular elections have not been immune from these dynamics, so it is not possible to recommend with confidence any single approach as a short-run remedy.

Currently, there is an especially intense debate over whether external pressure on Muslim countries to democratize by forming political parties and holding free elections offers an effective way forward. In the very short run, fundamental Islamist parties might well win office and displace the secular and corrupt incumbent. But, as already noted, the economic policies likely to be put forward by such parties are, at best, not well thought out. At worst, the fear is that Islamist parties would abolish democracy after attaining office—the common refrain expressing this fear is "one man, one vote, one time" (MSI 2002, *The Economist* 2003).

Key Issues Facing Muslim Countries

The Muslim share of global population is 19 percent; its share of global income is 6 percent. As noted, most countries where Muslims live in substantial numbers are generally poorer than non-Muslim countries. In fact, quantitative analysis provides some evidence that there is a statistically significant, negative relationship between per capita income and Islam (the share of Muslims within the total population of 132 countries) (Kuran 1997b, 43). Of course, factors other than Islam affect income, and analyzing these often eliminates the significance of Islam in the correlations. Other factors include membership in OPEC, which is associated with significantly higher income due to oil revenues, and being located in sub-Saharan Africa, the world's poorest region, which is associated with significantly lower income. In the short run, what can be done to improve incomes in Muslim countries, as opposed to African countries or non-oil exporters, for example?

The analysis so far has examined the general factors associated with economic growth, whether in Muslim or non-Muslim countries. Within this general context, four key factors seem to be most important in understanding how to help the economies of Muslim countries move forward

- the banking system and quality of investment
- trade policy and economic openness
- human capital and the role and status of women
- poverty reduction and the Millennium Development Goals (including the distinction between public and private responsibilities for providing social safety nets and the role of poverty in causing political conflict)

In all four areas progress can be made without confronting religion in a direct way. In each area, "best practices" in more successful Muslim countries can serve as a guide for reforms in relatively backward Muslim countries. In the face of rising expectations from their populations and the challenge from political Islam, a number of Muslim countries may be prepared to start serious and systematic reforms in these areas, thus making them attractive partners for USAID assistance.

The Banking System and Quality of Investment

Sala-i-Martin and Artadi (2003) focus their analysis of economic growth in the Arab world on the quantity and quality of investment. Documenting the relatively poor economic performance, they note that lack of investment cannot be the reason because investment rates in the Arab world are not low. What is low, however, is the rate of investment by the private sector: an unusually high proportion of total investment in Arab countries occurs in the public sector. As Sala-i-Martin and Artadi point out, public investment is likely to be a drag on economic growth because government revenues must be raised to pay for it, and this has a distorting effect on economic decisionmaking in the rest of the economy; and because much—but not all—public investment is unproductive and wasteful, especially in countries with autocratic regimes and little input from the population.

The tiny share of savings mobilization and financial intermediation that takes place in public capital markets, such as stock exchanges, is partly a cause, and partly an effect, of this phenomenon. "Capital markets are either underdeveloped or nonexistent. Most have low levels of trading and very few listed companies" (Sala-i-Martin and Artadi 2003, 28). As a consequence, the formal banking system totally dominates the financial sector in Arab countries, but according to Sala-i-Martin and Artadi,

> lending remains predominantly short-term and trade-related; very little lending is directed at long-term productive investments…. Governments have protected the banks from competition by restricting entry at the local and international levels, and this has made them inefficient (28).
>
> In sum, although the banking system is the most important part of the financial sector, its

> extraordinary inefficiency does not lead it to allocate national savings to their most productive uses. *Without proper channeling of savings into productive and efficient investment, economic growth is impossible* [emphasis added]. Thus, continuing reform of the banking sector is a necessary process for the Arab world. These reforms must include the: (a) further elimination of abusive and inefficient regulation; (b) opening of financial markets to domestic and foreign entrants in order to promote competition, financial innovation, and modernization; (c) strengthening (public or private) supervision to achieve sound corporate governance and accountability; (d) privatization of the remaining state banks, ensuring that the right incentives for sound commercial policies are in place (i.e., shifting commercial operations away from housing finance at subsidized interest rates to productive long-term investment); and (e) incorporation of the new technologies that are already changing the nature of the financial sector worldwide (28–29).

None of these recommendations speaks to whether Islam as the prevailing religion is in any way associated with the poor policies or an impediment to reform. Certainly the injunction against "unproductive" forms of income, such as interest on loans, could stifle the development of a modern financial sector with its futures markets, hedging instruments, and esoteric risk management strategies. But the basic reforms, especially those introducing more competition into the domestic banking system, would seem to have substantial payoff without challenging basic Islamic principles.

Trade Policy and Economic Openness

Based on the Index of Economic Freedom (Heritage Foundation 2003), government intervention—one measure of economic openness—was significantly greater (in a statistical sense) in Muslim countries than in non-Muslim countries. This same conclusion is also seen in the rankings for the Millennium Challenge Account, where—measured on a scale of 1 to 5 where 1 is most conducive to economic freedom—non-Muslim countries scored 2.65 and Muslim countries scored 3.04.

International trade, also a measure of economic openness, was significantly less in Muslim countries than in non-Muslim countries in 2002. International trade, measured as the sum of exports and imports as a percent of GDP, was 82 percent of GDP in Muslim countries and 97 percent in non-Muslim countries. This difference was statistically significant.

There is no Islamic injunction against trade. Indeed, the Koran, which supports private property rights and defends trade among equal partners, would seem to favor trade as a mechanism for achieving economic growth and higher incomes. The relatively closed nature of Islamic economies, then, is not based on religious principles but reflects the nature of the governments in these countries. Again, trade reforms and increased economic openness should bring substantial rewards in faster growth without challenging Islamic principles.

Human Capital and the Role and Status of Women

In 2000 the status of women, as measured by literacy rates, participation in the labor force, and female seats in parliament varied by region. The ratio of female to male literacy rates, as measured by the literacy gender parity index, was lower in Muslim countries in the regions of Africa (0.84), the Middle East and Northern Africa (0.84), and South Asia (0.65) than in non-Muslim countries (0.92). Nevertheless, in Europe and Eurasia (0.97) and East Asia (0.99), these ratios were higher than in non-Muslim countries.

Women's participation in the labor force in the Middle East and North Africa was 27.5 percent, the lowest in any region, but reached about 41 percent in Muslim countries in the regions of Europe and Eurasia and in East Asia, almost on a par with EMU countries, where it was 41.3 percent (see Table 2).

Women's participation in parliament in Muslim countries, as measured by the proportion of female

seats, was also lowest, 4.1 percent, in the Middle East and North Africa. However, in all other regions it was above the 7.1 percent found in EMU/OECD countries.

The findings for some regions, especially the Middle East and Northern Africa, are consistent with those in *The Arab Human Development Report* (UNDP 2002), which identifies women's empowerment as one of the three "deficits" in the Arab world.[7] The women's empowerment deficit is typically the result of legalized discrimination, such as laws that prohibit women from participating in public life, attaining education, or competing in the labor market.

Changing the status of women in some Muslim societies involves changing internal values. Inglehart and Norris (2003), in particular, cautions USAID about an open strategy to improve women's status in countries where fundamental Islam is already putting pressure on existing governments. However, the United States has a deep concern for basic human rights and gender equality in education, work force participation, and political life. Inglehart and Norris suggest that if there is a conflict between Western and fundamentalist Islamic values and approaches to development, it is here. They report that the cultural divide between Islam and the West is greatest on matters of gender equality, divorce, abortion, and homosexuality, but both societies value democratic ideals equally highly. Perhaps more importantly, young adults seem to share the same restrictive values as their parents.

The short-run impact on economic growth of holding these restrictive values is unclear. Yet Japan became a highly successful and wealthy economy while vastly underutilizing its women in roles outside the household economy, including agriculture. Only now, after a decade of stagnation, falling population, and the "graying" of agriculture, is Japanese society reexamining its attitudes toward women. Although some significant short-run gains in economic performance and human welfare may be possible for a society that does not fully integrate women into its economy, the long-run consequences are likely to be severe.

Poverty Reduction and the Millennium Development Goals

The international donor community has committed itself to achieving an ambitious set of development goals by 2015. The income and human poverty aspects of these goals will be addressed primarily through Poverty Reduction Strategy Papers (PRSPs) to be developed jointly by individual countries and donors, usually under the leadership of the World Bank. All national leaders agreed to this effort at the Millennium Conference at the United Nations in 2000, and their support offers an important vehicle to discuss the economic, political, and social reforms needed to improve the welfare of their citizens.

Dialogue between donors and governments about approaches to poverty reduction naturally tend to focus on activities in the public sector. However, in Muslim countries there is a widespread network of private charities enjoined by the Koran to share wealth among the poor. This network offers an additional avenue in the PRSP process. Nearly all PRSPs make some attempt to engage civil society in the discussions, and nongovernmental organizations (NGOs) often play a very active role. Little is known about the role of Islamic charities in this process, however, and further research is needed to determine whether these charities could play a vital role in poverty reduction in Muslim countries. The evidence Chen (2003) presents from Indonesia on the links between economic distress and resort to more fundamental Islamic values suggests it would be a promising line of research.

[7] The others are the freedom deficit and the knowledge deficit.

Conclusions and Policy Recommendations

Several factors may hamper economic growth in the Islamic world. These include a social system that values "unchangeability" and thus has a diminished capacity for adaptation and innovation; an emphasis on communalism rather than individualism; a reduced role for public discourse that inhibits individuals from questioning; an educational system that may limit curiosity; "Islamic economics," which forces economic decisions to pass through an ethical or moral Islamic filter; poor economic policy; a difficult geographic "neighborhood"; women's inferior position in society; and culture.

Many of these factors no doubt play a role in explaining why Muslim countries tend to be poorer than non-Muslim countries. None alone seems to provide an adequate explanation for Muslim countries' relative retardation, because there are likely to be powerful interactions among these factors. But changing them all in any society is impossible in the short run—and will likely be highly specific to history and events even in the long run.

What is USAID to Do?

It seems clear that any prescription requires dual reforms—in both governance and economics. In the case of economics, over the next 5–10 years several relatively tractable opportunities appear to offer scope for important interventions in partner countries, without challenging Islamic governance or orthodoxy.

- *Economic policies*. Sound economic policy in general and promoting increased economic openness and trade reform should provide the right incentives for increased investment and a level playing field for increased trade, bringing faster growth without challenging Islamic principles. Specific donor interventions might include support for trade capacity building, flexible exchange rates, and trade deregulation and liberalization.
- *Banking systems.* A strong banking and financial system and sound monetary policy are needed to improve the efficiency of private investment allocations. Thus, basic financial reforms, especially introducing more competition into the domestic banking system, could have substantial payoff, again without challenging basic Islamic principles. Specific interventions might include support for transparent corporate governance and more competition.
- *Social safety nets*. Islamic charities can provide an important social safety net for the poor, especially in times of significant economic reform.
- *Women's roles.* Participation of women in the labor force and in the political process is increasing in some regions of the Muslim world. In Muslim countries worldwide, women constitute 55 percent of total borrowers in microfinance institutions (comparing favorably to 59 percent in all countries). This shows that women could be a more significant force in their economies. Recognizing that there must be sensitivity to national cultural morés, USAID should be prepared to strengthen social and economic integration of women into Muslim societies. Such integration can only prove to be a positive influence on economic growth.

Donor programs and policies designed to accelerate the rate of economic growth in Muslim countries should focus on these areas—the economic policy environment, the banking system, the design and implementation of social safety nets for the poor, especially through private charitable Islamic organizations, and women. Specific areas of intervention will, of course, depend on each country situation—no single blueprint applies to all.

Annex 1. Countries in the Muslim World[1]

Middle East and North Africa (18)

Algeria[2]
Bahrain[2]
Egypt[2]
Iran
Iraq[2]
Jordan[2]
Kuwait[2]
Lebanon[2]
Libya[2]
Morocco[2]
Oman[2]
Qatar[2]
Saudi Arabia[2]
Syria[2]
Tunisia[2]
United Arab Emirates[2]
West Bank/Gaza[2]
Yemen[2]

Europe and Eurasia (7)

Albania
Azerbaijan
Kyrgyzstan
Tajikistan
Turkey
Turkmenistan
Uzbekistan

South Asia (4)

Afghanistan
Bangladesh
Maldives
Pakistan

East Asia and the Pacific (3)

Brunei
Indonesia
Malaysia

Africa (16)

Burkina Faso
Comoros[2]
Chad
Djibouti[2]
Eritrea
Ethiopia
Gambia
Guinea
Mali
Mauritania[2]
Niger
Nigeria
Senegal
Sierra Leone
Somalia[2]
Sudan[2]

[1] Muslim countries are those where at least 50 percent of the population is Muslim.
[2] Member of the Arab League (22)

Source: UNDP, *The Arab Human Development Report,* 2002.

Annex 2. Agrarian Economies and Oil Producers

Agrarian Economies (21)

Ethiopia
Burkina Faso
Niger
Guinea
Mali
Chad
Tajikistan
The Gambia
Eritrea
Comoros
Senegal
Somalia
Afghanistan
Nigeria[1,2]
Sudan[2]
Sierra Leone
Bangladesh
Yemen[2]
Indonesia[1,2]
Mauritania
Pakistan

Oil Producers (22)

Albania
Algeria[1]
Azerbaijan
Bahrain
Brunei
Egypt
Iran[1]
Iraq[1]
Kuwait[1]
Libya[1]
Malaysia
Oman
Qatar[1]
Nigeria[1,2]
Sudan[2]
Saudi Arabia[1]
Syria
Yemen[2]
Indonesia[1,2]
Tunisia
Turkmenistan
United Arab Emirates[1]

Neither (9)

Turkey
Uzbekistan
Kyrgyzstan
Maldives
West Bank/Gaza
Lebanon
Jordan
Morocco
Djibouti

1. Member of OPEC (10)
2. Both agrarian and oil producing

Note: Agrarian economies are Muslim countries where at least 50 percent of employment is in the agriculture sector; oil producers are Muslim countries that are members of OPEC and/or Muslim countries categorized in the *CIA Factbook* as exporters of crude oil or oil and petroleum products.

Source: CIA Factbook, 2002.

Annex 3. Indonesia and OPEC: Two Case Studies

This annex summarizes two case studies. The first draws lessons from the Indonesian experience and may suggest "what to do" in other countries whose economies are predominantly agricultural. The second sets out lessons from the Middle Eastern OPEC (Organization of Petroleum Exporting Countries) member countries whose experience may provide insights on "what not to do" in designing growth strategies for the Caspian republics.

Agrarian Economies: Lessons from Indonesia

Indonesia had one of the best-performing economies in the developing world for over 30 years (until the 1997 Asian financial crisis). Economic growth averaged 7 percent per year between 1966 and 1994, 4.3 percent per capita per year. The proportion of Indonesians living in poverty fell from 60 percent in 1965 to 14 percent in the early 1990s. The country shifted from being the world's largest rice importer to being rice self-sufficient in 1984.

When the U.S.-trained team took over management of the economy in 1965, the economy was in chaos, inflation was 650 percent annually, food shortages were rampant, and the country was effectively bankrupt. The Suharto team instituted a long-run strategy for the country's development. Economic policy embraced three elements: a balanced budget, rural investment, and free convertibility of the currency.

Local currency generated from the sale of U.S. food aid commodities provided critical additional spending for development purposes. Much of the money was invested in activities with a high payoff (Green Revolution technology, irrigation facilities, and rural roads) that led to increased rice yields. The food-for-work program also supported labor-intensive rural infrastructure development in the late 1960s and early 1970s. When oil revenues began pouring in during the mid-1970s, the food-for-work program was transformed into the "Inpres" program, a government-supported cash-for-work program. This major effort has been credited with creating rural prosperity by generating income and improving infrastructure.

The benefits of economic growth have been widely shared in Indonesia, and the Suharto government's growth strategy was central to this achievement. Its highest priorities were increasing food production, maintaining stable rice prices (at a level higher than world prices), and investing in rural infrastructure. Initially, the beneficiaries were poor smallholders, largely rice producers; over time, the majority of low-income people benefited.

The emphasis on agriculture and rural investment was an important element in the country's outstanding economic performance. It led to fast growth in rural incomes, greater equality in income distribution, and political stability (which depends on an adequate rice supply).

Lessons from OPEC

According to Amuzegar (1998), OPEC's miscalculations and economic mismanagement caused rising budgetary shortfalls, runaway inflation, mounting external debts, delays and cost overruns in poorly designed projects, and an enormous waste of resources. Yet that experience is valuable because it provides insights of what *not* to do in the four Caspian republics of Azerbaijan, Kazakhstan, Turkmenistan, and Uzbekistan. In a word, they should not mimic the experience of the OPEC countries in the 1970s, because that experience only took them from riches to rags.

Almost all OPEC members have experienced rapidly rising populations together with relatively modest GDP growth rates, resulting in a slow increase or actual decline in per capita income. Real per capita income fell in the 1990s in Iraq, Kuwait, and Venezuela to levels not seen since the 1960s. Libya and Saudi Arabia also had their highest real per capita incomes in the 1960s. Algeria, Gabon, Iran, Nigeria, and the United Arab Emirates had their highest income levels in the 1970s and Ecuador had its in the 1980s. Indonesia is the only OPEC member whose real per capita income peaked in the 1990s.

According to the World Bank, unemployment rates in the Middle East and North Africa (except for some Persian Gulf countries) were the highest in the world during the early 1990s. Moreover, year after year the entire OPEC membership incurred budget deficits, which were caused by rising social welfare expenditures, bloated bureaucracies, limited tax bases, project cost overruns, and large military outlays. Countries with trade restrictions and multiple exchange rates experienced high domestic inflation. Inflation was held in check only in the small Persian Gulf monarchies that maintained relatively stable currencies and pursued liberal trade policies.

While all OPEC countries did poorly, some did more poorly than others. Those that did better had low population growth, high rates of investment in both human and physical capital, low government consumption (including military expenditures), minimal wage-price distortions, large domestic markets, and efficient, clean government. Those that did worse had excessive state intervention in the economy, poorly chosen development strategies, unsustainable services and subsidies, political volatility, and excessive tolerance of rentseeking activities, corruption, and waste.

The lessons are clear. To avoid repeating OPEC's mistakes, the Caspian states should develop market mechanisms. Key measures would likely include a liberal trade and exchange rate system, privatization, and deregulation of prices, wages, and interest rates—all of which will help reduce state dominance over the economy.

Annex 4. Statistical Characteristics of Muslim Economies

The tables in this annex provide statistical data describing the structural characteristics of Muslim countries, per capita income, and population growth.

Table 4. Structural Characteristics of Muslim Countries, 2000
(value added as a percent of GDP)

	Agriculture	Industry	Services
Middle East and North Africa			
Algeria	8.8	59.7	31.5
Bahrain			
Egypt	16.7	33.1	50.2
Iran	17.7	33.3	49.0
Iraq			
Jordan	2.2	24.8	73.0
Kuwait			
Lebanon	11.9	22.0	66.1
Libya			
Morocco	13.5	32.2	54.3
Oman			
Qatar			
Saudi Arabia			
Syria	22.8	28.7	48.5
Tunisia	12.3	28.8	58.9
United Arab Emirates			
West Bank/Gaza	7.8	26.6	65.6
Yemen	14.6	48.0	37.4
Unweighted Average	*12.8*	*33.7*	*53.4*
Europe and Eurasia			
Albania	50.7	22.7	26.5
Azerbaijan	17.0	45.3	37.7
Kyrgyzstan	36.8	29.2	34.0
Tajikistan	29.5	29.7	40.8
Turkey	15.4	25.3	59.3
Turkmenistan	28.1		
Uzbekistan	34.4	23.1	42.5
Unweighted Average	*30.6*	*29.2*	*40.1*
South Asia			
Afghanistan			
Bangladesh	24.6	24.4	51.0
Maldives			
Pakistan	26.7	23.1	50.2
Unweighted Average	*25.6*	*23.8*	*50.6*

(continued)

Table 4. Structural Characteristics of Muslim Countries, 2000 (continued)

(value added as a percent of GDP)

	Agriculture	Industry	Services
Asia and the Pacific			
Brunei			
Indonesia	17.0	47.1	35.9
Malaysia	8.7	51.2	40.1
Unweighted Average	*12.8*	*49.2*	*38.0*
Africa			
Burkina Faso	39.7	19.1	41.2
Comoros	40.9	11.9	47.2
Chad	39.2	13.8	47.0
Djibouti	3.7	14.2	82.1
Eritrea	15.2	22.9	61.9
Ethiopia	52.3	11.1	36.6
Gambia	33.2	12.3	54.5
Guinea	23.6	36.5	39.9
Mali	41.2	21.3	37.5
Mauritania	21.3	29.1	49.6
Niger	37.8	17.8	44.4
Nigeria	29.5	46.0	24.5
Senegal	18.1	26.9	55.0
Sierra Leone	47.3	33.6	19.0
Somalia			
Sudan	41.1	18.5	40.4
Unweighted Average	*32.3*	*22.3*	*45.4*

Source: World Bank, *World Development Indicators,* 2002.

Table 5. Per Capita Income in Muslim Countries
(in U.S. dollars)

Country	Per capita income	Country	Per capita income
High income (2)		**Low income (22)**	
Kuwait	18,270	Indonesia	690
Bahrain	11,130	Azerbaijan	650
Upper middle income (3)		Uzbekistan	550
Saudi Arabia	8,460	Senegal	490
Lebanon	4,010	Yemen	450
Malaysia	3,330	Pakistan	420
Lower middle income (13)		Guinea	410
Turkey	2,530	Comoros	380
Tunisia	2,070	Bangladesh	360
Maldives	2,000	Mauritania	360
Jordan	1,750	Sudan	340
Iran	1,680	The Gambia	320
Algeria	1,650	Nigeria	290
Egypt	1,530	Kyrgyzstan	280
West Bank/Gaza	1,350	Mali	230
Albania	1,340	Burkina Faso	220
Morocco	1,190	Chad	200
Syria	1,040	Tajikistan	180
Turkmenistan	950	Niger	180
Djibouti	890	Eritrea	160
		Sierra Leone	140
		Ethiopia	100

Note: The eight Muslim countries not reporting (including those whose population is less than 1 million) are Iraq, Libya, Oman, Qatar, United Arab Emirates, Afghanistan, Brunei, and Somalia.

Source: World Bank, *World Development Indicators,* 2003.

Table 6. Population Growth (1990–2000) and Age Structure (2000) in Muslim Countries

	Population growth rate, 1990–2000 (%)	Population 0–14 (% of total)	Population 15–64 (% of total)	Population over 65 (% of total)
Middle East and North Africa				
Algeria	2.0	36.1	60.0	3.9
Bahrain	3.2	29.3	71.3	2.5
Egypt	2.0	35.4	60.5	4.1
Iran	1.6	33.8	61.5	4.7
Iraq	2.5	41.6	55.5	2.9
Jordan	4.3	38.6	58.4	3.0
Kuwait	–0.7	33.1	64.7	2.2
Lebanon	1.7	32.1	62.0	5.9
Libya	2.0	33.9	62.7	3.4
Morocco	1.8	34.7	61.2	4.1
Oman	3.9	44.2	53.4	2.4
Qatar	1.9	26.5	71.5	2.2
Saudi Arabia	2.7	40.9	56.2	2.9
Syria	2.9	40.8	56.1	3.1
Tunisia	1.6	29.7	64.4	5.9
United Arab Emirates	4.6	26.8	70.7	2.5
West Bank/Gaza	4.1	47.3	49.3	3.4
Yemen	3.9	46.7	50.4	2.9
Europe and Eurasia				
Albania	0.4	29.3	64.0	6.7
Azerbaijan	1.2	29.2	63.8	7.0
Kyrgyzstan	1.1	34.3	59.8	5.9
Tajikistan	1.5	39.7	55.9	4.4
Turkey	1.5	28.5	65.8	5.7
Turkmenistan	3.5	37.6	58.1	4.3
Uzbekistan	1.9	37.6	58.0	4.4
South Asia				
Afghanistan	4.1	43.5	53.7	2.8
Bangladesh	1.8	37.8	59.0	3.2
Maldives	2.6	42.0	54.0	4.0
Pakistan	2.5	41.7	55.0	3.3
East Asia and Pacific				
Brunei	2.7	32.5	65.1	2.4
Indonesia	1.7	30.6	64.9	4.5
Malaysia	2.5	34.0	61.9	4.1

(continued)

(continued)

Table 6. Population Growth (1990–2000) and Age Structure (2000) in Muslim Countries

	Population growth rate, 1990–2000 (%)	Population 0–14 (% of total)	Population 15–64 (% of total)	Population over 65 (% of total)
Africa				
Burkina Faso	2.4	47.3	50.1	2.6
Comoros	2.6	43.9	53.6	2.5
Chad	2.9	50.4	46.5	3.1
Djibouti	3.0	43.4	53.6	3.0
Eritrea	2.7	45.4	52.0	2.6
Ethiopia	2.3	46.2	51.0	2.8
The Gambia	3.4	40.2	56.6	3.2
Guinea	2.5	44.7	52.7	2.6
Mali	2.5	47.1	49.7	3.1
Mauritania	2.9	44.1	52.7	3.2
Niger	3.4	49.0	48.6	2.4
Nigeria	2.8	44.0	53.4	2.5
Senegal	2.6	44.9	52.5	2.6
Sierra Leone	2.3	45.0	52.4	2.6
Somalia	2.0	47.9	49.7	2.4
Sudan	2.2	40.1	56.4	3.4

Source: World Bank, *World Development Indicators,* 2002.

Annex 5. The Status of Women in Muslim Countries

Table 7. The Status of Women in Muslim Countries

	GDP growth per capita, 1999–2000[1] (%)	Females in the labor force[2] (%)	Female literacy rate, all ages[3] (%)	Female literacy parity index,[4] 15–24 years	Female life expectancy from birth (age in years)	Female seats in parliament[5] (%)
Europe EMU/OECD weighted average[6]	3.1	41.3	99.9	1.00	81	7.1
Middle East and North Africa						
Algeria	–0.08	27.6	57	.903	76	6.0
Bahrain		20.8				6.0
Egypt	3.1	30.4	44	.829	69	2.4
Iran	3.9	27.1	69	.953	70	4.1
Iraq		19.7	46	.496	62	
Jordan	0.8	24.6	84	1.002	73	3.3
Kuwait	–1.4	31.3	80	1.018	79	0.0
Lebanon	–1.3	29.6	80	.959	72	2.3
Libya		23.1	68	.937	73	
Morocco	–0.8	34.7	36	.779	69	6.1
Oman		17.1	62	.972	75	
Qatar		15.0				
Saudi Arabia	1.8	16.1	67	.956	74	
Syria	0	27.0	60	.834	72	10.4
Tunisia	3.5	31.7	61	.920	74	11.5
United Arab Emirates		14.8	79	1.079	77	0.0
West Bank/Gaza	2.9				74	
Yemen	1.1	28.1	25	.580	57	0.7
Weighted Average	*1.9*	*27.6*	*54*	*.839*	*69.6*	*4.5*
Europe and Eurasia						
Albania	6.9	41.3	77	.975	76	5.7
Azerbaijan	10.2	44.6			75	10.5
Kyrgyzstan	3.9	47.3			72	6.7
Tajikistan	8.1	44.9	99	1.000	72	12.4
Turkey	5.6	37.6	77	.954	72	4.4
Turkmenistan	15.3	45.9			70	26.0
Uzbekistan	2.5	46.9	99	.999	70	7.2
Weighted Average	*5.8*	*41.1*	*84*	*.969*	*71.8*	*7.8*

(continued)

Table 7. The Status of Women in Muslim Countries (continued)						
	GDP growth per capita, 1999–2000[1] (%)	Females in the labor force[2] (%)	Female literacy rate, all ages[3] (%)	Female literacy parity index,[4] 15–24 years	Female life expectancy from birth (age in years)	Female seats in parliament[5] (%)
South Asia						
Afghanistan		35.5			43	
Bangladesh	4.1	42.4	30	.706	62	2.0
Maldives		43.4	69			6.0
Pakistan	1.9	28.6	28	.600	64	20.6
Weighted Average	*3.0*	*36.4*	*29*	*.652*	*61.2*	*11.5*
East Asia and the Pacific						
Brunei		35.6				
Indonesia	3.1	40.8	82	.989	68	8.0
Malaysia	5.7	37.9	83	1.002	75	14.5
Weighted Average	*3.4*	*40.6*	*82*	*.99*	*68.7*	*11.5*
Africa						
Burkina Faso	–0.04	46.5	14	.524	45	11.7
Comoros		42.3				
Chad	–2.1	44.7	34	.830	50	5.8
Djibouti			55		47	10.8
Eritrea	7.8	47.4	45	.761	53	22.0
Ethiopia	3.0	40.9	31	.809	43	7.8
The Gambia	2.3	45.1	29	.764	55	13.2
Guinea	–0.3	47.2			47	19.3
Mali	2.1	46.2	34	.540	44	10.2
Mauritania	1.7	43.6	30	.720	53	3.0
Niger	–3.2	44.3	8	.436	48	1.2
Nigeria	1.3	36.5	56	.947	48	3.3
Senegal	2.9	42.6	28	.715	54	19.2
Sierra Leone	4.9	36.8			41	14.5
Somalia		43.4			50	
Sudan	6.4	29.5	46	.874	58	9.7
Weighted Average	*2.1*	*39.2*	*42*	*.837*	*48*	*9.7*

Notes:
1. Calculation based on the total population.
2. Proportion of women in the total formal labor force in percent.
3. Female literacy rate is the percentage of all women who are literate in each country.
4. Female literacy parity index is the ratio of the female literacy rate to the male literacy rate for the 15–24 age group. (A parity index of less than 1 indicates that the proportion of literate females is less than that of males. For example, if 50 percent of women are literate with a parity ratio of .9, it would indicate that 55 percent of males were literate.)
5. Percentage of seats in the lower house of parliament held by women.
6. Europe is represented as the EMU countries (European Monetary Unit countries, which are the EU members excluding Great Britain), except for seats in parliament which uses the OECD countries as a base.

Sources: World Bank *World Development Indicators,* 2001 and 2002; UNDP *Human Development Report,* 2003; *CIA World Fact Book, 2002* and *2003.*

Table 8. Female Clients of Microfinance Institution in the Muslim World by Number and Quality of Portfolio

	Women borrowers (millions)	Proportion of women to total borrowers[1] (%)	Total portfolio ($ million)	Loan loss rate[2] (%)
Middle East and North Africa				
Egypt	70,283	50	42.9	.14
Jordan	10,637	81	11.6	.51
Lebanon	3,927	35	7.4	1.95
Morocco	48,868	60	15.4	.06
West Bank/Gaza	3,306	65	.5	3.37
Regional Total	*130,362*	*55*	*82.5*	*.54*
Europe and Eurasia				
Albania	1,235	20	13	7.3
Azerbaijan	4215	43	2.3	3.85
Kyrgyzstan	21,780	89	4.5	.80
Tajikistan	5,326	82	1.2	1.36
Uzbekistan	228	72	.02	0
Regional Total	*32,784*	*69*	*21.1*	*5.17*
South Asia				
Bangladesh	2,585,472	95	32.1	2.03
Pakistan	3,764	99	14.9	1.67
Regional Total	*2,589,236*	*95*	*47*	*1.91*
East Asia and the Pacific				
Indonesia	477,388	16	1,347	1.55
Regional Total	*477,388*	*16*	*1,347.2*	*1.55*
Africa				
Eritrea	125	90	.01	0
Ethiopia	9,257	50	1.6	9.2
Guinea	9,497	70	1.5	4.3
Mali	133,616	65	13.8	4.92
Nigeria	29,911	97	1.8	2.71
Senegal	40,347	75	16.6	2.44
Regional Total	*222,753*	*69*	*35.3*	*3.8*
Total Muslim World (3)	**3,452,523**	**55**	**1,553.2**	**1.61**
Total Muslim and Non-Muslim World (4)	**4,790,754**	**59**	**2,635.2**	**1.48**

Notes:
1. Calculated by dividing the total number of women borrowers by total number borrowers.
2. Calculated by dividing total loan loss by total portfolio in each region.
3. Includes Bank Rakyat in Indonesia and Grameen Bank in Bangladesh.
4. USAID 2002 sample plus Grameen Bank.

Sources: USAID *Microenterprise Results Reporting for 2001* and *2002*; The Mix Market, and Grameen Bank *Annual Report 2002*.

Bibliography

Abed, George T. 2003. “Unfulfilled Promise: Why the Middle East and North Africa Region has Lagged in Growth and Globalization.” *Finance and Development* (40) 1. <http://www.imf.org/external/pubs/ft/fandd/2003/03 /abed.htm>

Alesina, Alberto, and Dani Rodrik. 1994. “Distributive Politics and Economic Growth.” *The Quarterly Journal of Economics* 109 (2): 465–90.

Amuzegar, Jahangir. 1998. “OPEC as Omen.” *Foreign Affairs* 77 (6): 95.

Barro, Robert, and Rachel McCleary. 2002. “Religion and Political Economy in an International Panel.” NBER Working Paper 8931. Cambridge, Mass.: National Bureau of Economic Research.

Benoliel, Sharon. 2003. *Strengthening Education in the Muslim World: Summary of the Desk Study.* Issue Paper No. 2. Washington, D.C.: USAID. PN-ACT-009. <http://www.dec.org/pdf_docs/PNACT009.pdf>

Berman, Paul. “The Philosopher of Islamic Terror.” *New York Times Magazine*. March 23, 2003, sec. 6:24. <http:// members.cox.net/slsturgi3/PhilosopherOfIslamicTerror.htm>

Central Intelligence Agency. 2002. *The World Factbook, 2002.* <http://www.cia.gov/cia/publications/factbook/>

Chai, C.P. 1995. “Rural Human Capital and Economic Growth in Developing Countries.” Senior honors thesis, Department of Economics. Cambridge, Mass.: Harvard University.

Chen, Daniel L. 2004. “Economic Distress and Religious Intensity: Evidence from Islamic Resurgence During the Indonesian Financial Crisis.” Cambridge, Mass.: Massachusetts Institute of Technology. <http://econwww.mit.edu/graduate/candidates /download_res.php?id=85>

Cole, W.A., and Phyllis Deane. 1965. “The Growth of National Incomes.” *The Cambridge Economic History of Europe, Vol. 6: The Industrial Revolution and After (Part I).* Edited by H. J. Habakkuk and M. Postan. Cambridge: Cambridge University Press.

Collier, Paul, and Jan Dehn. 2001. “Aid, Shocks and Growth.” Policy Research Working Paper No. 2688. Washington, D.C.: The World Bank. <http://www-wds.worldbank.org/servlet/WDSContentServer/WDSP/IB/2001/11/06/000094946_01102304052049/Rendered/PDF /multi0page.pdf>

David, Peter. 2003. “In the Name of God: A Survey of Islam and the West.” *The Economist*. September 13.

Dawe, David. 1993. “The Effects of Export Instability on Investment: The Information Content of Prices and Growth.” Ph.D. dissertation, Department of Economics. Cambridge, Mass.: Harvard University.

Dawe, David. 1996. “A New Look at the Effects of Export Instability on Investment and Growth.” *World Development* 24 (12): 1905–14.

Diamond, Jared. 1997. *Guns, Germs and Steel: A Short History of Everybody for the Last 13,000 Years.* London: Vintage.

Diamond, Larry. 2002. “Democracy and Governance.” Draft background paper for *Foreign Aid in the National Interest: Promoting Freedom, Security, and Opportunity* (The “Natsios Report,” PD-ABW-900). Washington, D.C.: USAID.

Easterly, William. 2001. *The Elusive Quest for Economic Growth.* Cambridge: MIT Press.

Films for the Humanities and Sciences. 1999. “Money: Man-Made or a Divine Gift from Allah?” *Islam Rising.* VHS. Lawrenceville, N.J.: Cambridge Educational.

Gerschenkron, Alexander. 1962. *Economic Backwardness in Historical Perspective.* Cambridge: Harvard University Press.

Heritage Foundation. 2003. *2003 Index of Economic Freedom.* Edited by Gerald P. O’Driscoll Jr., Edwin J. Feulner, and Mary Anastasia O’Grady. Washington, D.C.: The Heritage Foundation.

Inglehart, Ronald, and Pippa Norris. 2003. “The True Clash of Civilizations.” *Foreign Policy* (March–April): 67–74.

Jabber, Paul. 2002. "Political and Economic Reform in the Muslim World." New York: Globicom Inc. <http://128.8.56.16/docs/docs/ppc_ideas/revolutionizing_aid/political_economic_reform_muslim_world.pdf>

Jones, E.L. 1981. *The European Miracle: Environments, Economics and Geopolitics in the History of Europe and Asia.* Cambridge: Cambridge University Press.

Jones, E.L. 1988. *Growth Recurring: Economic Change in World History.* Oxford: Clarendon Press.

Khan, M.A. Muqtedar. 1999. "The Islamic Dimensions of the East Asian Economic Miracle." *The American Journal of Islamic Social Sciences* 16 (4).

Kuran, Timur. 1997a. "The Genesis of Islamic Economics: A Chapter in the Politics of Muslim Identity." *Social Research* 64 (2): 301–39. <http://www.mtholyoke.edu/acad/intrel/kuran.htm>

Kuran, Timur. 1997b. "Islam and Underdevelopment: An Old Puzzle Revisited." *Journal of Institutional and Theoretical Economics* 153 (1): 41–71.

Kuran, Timur. 2003. "Why the Middle East Is Economically Underdeveloped: Historical Mechanisms of Institutional Stagnation." Forum Series on the Role of Institutions in Promoting Economic Growth. Washington, D.C.: USAID. <http://www.mercatus.org/pdf/materials/347.pdf>

Lal, Deepak. 1998. *Unintended Consequences: The Impact of Factor Endowments, Culture, and Politics on Long-Run Economic Performance.* Cambridge: MIT Press.

Landes, David. 1969. *The Unbound Prometheus: Technological Change and Industrial Development in Western Europe from 1750 to the Present.* Cambridge: Cambridge University Press.

Landes, David. 1990. "Why Are We So Rich and They So Poor?" *American Economic Review* 80 (2): 1–13.

Landes, David. 1998. *The Wealth and Poverty of Nations: Why Some Are So Rich and Some So Poor.* New York: W.W. Norton.

Lewis, Bernard. 2002. "What Went Wrong?" *The Atlantic Monthly* 289 (1): 43–45. <http://www.theatlantic.com/issues/2002/01/lewis.htm>

Lipton, Michael. 1977. *Why Poor People Stay Poor: Urban Bias in World Development.* Cambridge: Harvard University Press.

Lipton, Michael. 1993. "Urban Bias: Of Consequences, Classes and Causality." *Beyond Urban Bias.* Edited by Ashutosh Varshney. London: Frank Cass.

Management Systems International (MSI). 2002. "Exploring the Thinking of Islamists: Islamist Views toward Government, the Economy, and Pluralism." Background paper. Washington, D.C.: USAID. PN-ACW-875. <http://www.dec.org/pdf_docs/PNACW875.pdf>

McClelland, Donald G., et al. 1997. *Food Aid in Indonesia*. CDIE Impact Evaluation No. 4. Washington, D.C.: USAID. PN-ABY-236. <http://www.dec.org/pdf_docs/PNABY236.pdf>

Noland, Marcus. 2003. "Religion, Culture, and Economic Performance." Working Paper No. 03-8. Washington, D.C.: Institute for International Economics. <http://www.iie.com/publications/wp/2003/03-8.pdf>

Pfeifer, Karen. 2001. "Islamic Business and Business as Usual: A Study of Firms in Egypt." *In Development in Practice* 11 (1): 20–33.

Prescott, E. D. 1998. "Needed: A Theory of Total Factor Productivity." *International Economics Review* 39 (3): 525–51.

Radelet, Steven. 2003. *Challenging Foreign Aid: A Policymaker's Guide to the Millennium Challenge Account.* Washington, D.C.: Center for Global Development.

Romer, Paul M. 1986. "Increasing Returns and Long-Run Growth." *Journal of Political Economy* 94 (5): 1002–37.

Romer, Paul M. 1990. "Endogenous Technological Change." *Journal of Political Economy.* 98 (5): S71–S102.

Sachs, Jeffrey. 2000. "Notes on a New Sociology of Economic Development." *Culture Matters: How Values Shape Human Progress.* Edited by Lawrence E. Harrison and Samuel P. Huntington. New York: HarperCollins.

Sachs, Jeffrey. 2001. "Islam's Geopolitics as a Morality Tale." *Financial Times.* October 29.

Sala-i-Martin, Xavier, and Elsa V. Artadi. 2003. "Economic Growth and Investment in the Arab World." *Arab World Competitiveness Report 2002–2003.* Edited by Klaus Schwab and Peter Cornelius. Geneva: World Economic Forum.

Sirageldin, Ismail. 1995. "Islam, Society and Economic Policy." ERF (Economic Research Forum) Working Paper No. 199529. Cairo: Economic Research Forum for the Arab Countries, Iran and Turkey.

Srinivasan, T.N. 1985. "Neoclassical Political Economy, the State, and Economic Development." *Asian Development Review* 3 (2): 38–58.

Telhami, Shibley. 2002. *The Stakes: America and the Middle East.* Boulder, Colo.: Westview.

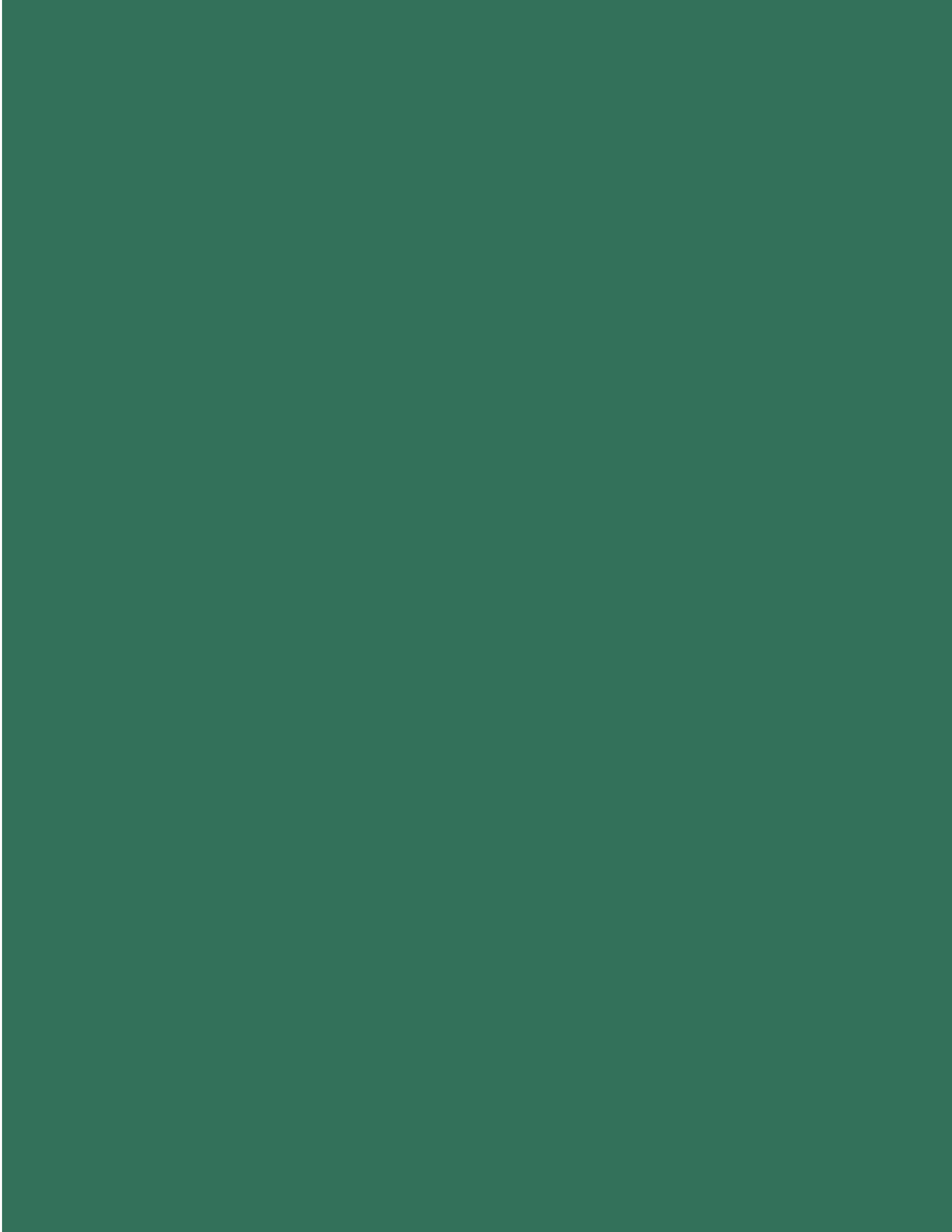
Timmer, C. Peter. 2002. "Agriculture and Economic Development." *The Handbook of Agricultural Economics,* Vol. 2A. Edited by Bruce L. Gardner and Gordon C. Rausser. Amsterdam: North-Holland.

UNDP. *The Arab Human Development Report.* 2002. New York: UNDP.

USAID. 2002. *Foreign Assistance in the National Interest: Promoting Freedom, Security, and Opportunity.* (The "Natsios Report"). Washington, D.C.: USAID. PD-ABW-900. <http://www.usaid.gov/fani/Full_Report—Foreign_Aid_in_the_National_Interest.pdf>

Vamvakidis, Athanasios. 1997. "GATT Was Right: Historical Evidence on the Growth-Openness Connection and Discriminatory Versus Nondiscriminatory Liberalization." Ph.D. dissertation. Cambridge: Harvard University.

World Bank. 2002 and 2003. *World Development Report.* Oxford and New York: Oxford University Press.



For more information, contact
U.S. Agency for International Development
Washington, D.C. 20523-4810
Telephone: 202-712-4810
Internet: www.usaid.gov

PN-ACY-101

ERRATA

1. Footnote 4 on page 7 should read as follows:

It is worth noting in this context that the corporation, with the legal rights of a "fictitious," infinitely-lived person able to function in perpetuity as a financial intermediary, took a long time to have a major impact on Western economic growth. The modern corporation emerged from church and guild organizations in medieval Europe in the 12th century and started to evolve formal legal status, at least in England, in the late 16th century.

2. Table 8 on page 39 should read as follows:

Table 8. Female Clients of Microfinance Institution in the Muslim World by Number and Quality of Portfolio

	Women borrowers	Proportion women to total borrowers[1] (%)	Total portfolio ($ million)	Loan loss rate[2] (%)
Middle East and North Africa				
Egypt	65,624	50	42.9	.14
Jordan	10,637	81	11.6	.51
Lebanon	3,927	35	7.4	1.95
Morocco	46,868	60	15.4	.06
West Bank/Gaza	3,306	65	.5	3.37
Regional Total	*130,362*	*55*	*82.5*	*.54*
Europe and Eurasia				
Albania	1,235	20	13	7.3
Azerbaijan	4215	43	2.3	3.85
Kyrgyzstan	21,780	89	4.5	.80
Tajikistan	5,326	82	1.2	1.36
Uzbekistan	228	72	.02	0
Regional Total	*32,784*	*69*	*21.1*	*5.17*
South Asia				
Bangladesh	2,585,472	95	32.1	2.03
Pakistan	3,764	99	14.9	1.67
Regional Total	*2,589,236*	*95*	*47*	*1.91*
East Asia and the Pacific				
Indonesia	477,388	16	1,347	1.55
Regional Total	*477,388*	*16*	*1,347.2*	*1.55*
Africa				
Eritrea	125	90	.01	0
Ethiopia	9,257	50	1.6	9.2
Guinea	9,497	70	1.5	4.3
Mali	133,616	65	13.8	4.92
Nigeria	29,911	97	1.8	2.71
Senegal	40,347	75	16.6	2.44
Regional Total	*222,753*	*69*	*35.3*	*3.8*
Total Muslim World (3)	**3,452,523**	**55**	**1,553.2**	**1.61**
Total Muslim and Non-Muslim World (4)	**4,790,754**	**59**	**2,635.2**	**1.48**

Notes:
1. Calculated by dividing the total number of women borrowers by total number borrowers.
2. Calculated by dividing total loan loss by total portfolio in each region.
3. Includes Bank Rakyat in Indonesia and Grameen Bank in Bangladesh.
4. USAID 2002 sample plus Grameen Bank.