Mounting development challenges posed by the world economic crisis: policy options in the Arab region

The global economic crisis comes at a time when countries and citizens in the Arab region have been trying to adjust to wildly fluctuating food and fuel prices. In addition, the region is increasingly affected by climate change, with increasing desertification, rising coastal waters and scarcity of fresh water. The confluence of these crises exposes explosive vulnerabilities across the region, at the centre of which are poverty and unemployment. This calls for intervention from different stakeholders; and responses to the economic crisis should take into account the need to tackle the other crises as well. Arab governments should strengthen co-ordination, enable citizens to participate in setting development priorities, and orient social policies to reduce poverty in a sustainable and equitable way.

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The global economic and financial crisis comes at a time when countries and citizens have been trying to adjust to wildly fluctuating food and fuel prices. Like other parts of the world, the Arab region is experiencing shrinking economic activity, higher rates of poverty and unemployment, growing demands on social services, further economic insecurity and increasing violations of economic and social rights.

Past economic crises have had disproportionate impacts on the poor, and this one will be no different in that regard. This means further stress on communities that have already been suffering due to climate change and fluctuations in food and energy prices. Arab countries are particularly vulnerable to the fallout from the global crisis since recent gains in human development indicators are fragile and not built on long-term Government policies that would help safeguard their sustainability. Moreover, conflict and political instability are widespread and likely to worsen due to the economic downturn.

Key development challenges facing the region

Rising numbers of people living in poverty

The Arab region witnessed a noticeable reduction in poverty levels from the 1980s to the early 1990s. During the mid 1990s, however, the proportion of people living in poverty – at the most basic USD 1 and USD 2 per day benchmarks – rose and essentially remained stagnant into the 21st century, with only a very gradual decline. Since the population of the region has been steadily growing, the total number of people living in extreme poverty has actually increased.

Moreover, if the poverty threshold is raised a little – for example from USD 1 to USD 2 a day or from USD 2 to USD 3 or 4 a day – the numbers rise substantially. Indeed, raising the poverty line from USD 2 a day to USD 3 a day more than doubles the total number of people living in poverty from 45 million to 92 million. In Egypt, over 70% of the population lives on USD 3 a day or less; this proportion rises to over four out of five if the line is raised to USD 4 a day.[2]

Measurements related to higher poverty lines do matter, particularly at a time when families across the region have recently had to absorb much higher costs for basic goods, including both food and fuel, which account for a large proportion of their expenditures. UN sources note that, as a result of the food crisis, around 31 million people in the Arab region are hungry (about 10 % of the total population). This reflects an increase of 6 million hungry people compared to 1992, including record numbers in Sudan and Yemen,[3] precisely during a period in which overall human development indicators showed continuing improvements. Indeed, the food prices crisis has exposed the vulnerabilities in a region that imports more than 50% of food consumed.

Arab governments implemented a variety of measures in response to the food crisis, often including direct provision of basic foods or increasing subsidies for them. These measures – together with controls on exports – have done little to ensure that prices will not rise considerably in the future or that, more fundamentally, supplies of basic foods will be sufficient. Core issues such as increasing food production, supporting small farmers in selling their products and accessing markets, ensuring poor consumers have access to affordable food and addressing the imbalances in the global trade system and agreements on agriculture have not been adequately addressed.

Persistent and rising inequalities

The high degree of inequalities between countries, as well as sustained inequalities within many countries, is another notable feature of the region that has to be taken into consideration. The increase in wealth in recent years has not translated into equity and, as the privileged have not shared, a good part of the region's population is currently living in poverty or in poverty's treshold. Moreover, countries in conflict such as Iraq, Lebanon, the Occupied Palestinian Territories and Sudan have not experienced the consistent growth trends witnessed by many of the other countries in the region.

Chronic unemployment

One of the reasons for the persistent proportion of people living in poverty in the region is chronic unemployment. In fact, even during those years in which economies were growing and individual incomes also seemed to be on the rise, unemployment was high and increasing. Other factors make this one of the major concerns in light of the global crisis, including: (1) the high birth rate and relatively young populations of the region, which means that many new graduates and school leavers enter the labour force with diminishing prospects for work; and (2) the concentration of economic activity in sectors with low job creation capacities, such as real estate and finance.[4]

At a time of falling output across the globe, the gap between available jobs and numbers in the labour force is likely to increase sharply. The return of nationals who had been working abroad as economic migrants will further swell labour markets, with cutbacks in economic activity in the Gulf Cooperation Council (GCC) countries having serious repercussions in poorer countries.[5] It is therefore important that Governments and other institutions on which poor and vulnerable communities rely – such as families over-

1 This article is a shortened version of a policy document developed by the two organizations on the occasion of the UN High Level Conference on the Economic and Financial Crisis and its Impact on Development.

2 Iqbal, F. Sustaining Gains in Poverty Reduction and Human Development in the Middle East and North Africa. Washington, DC: The World Bank. 2006.

3 According to Jacques Diouf, Director General of the UN Food and Agriculture Organization (FAO), speaking at the High Level Conference preparatory private sector and civil society forum, 19 June 2009.

4 International Labour Organization (ILO). *Global Employment Trend Brief*. Geneva: International Labour Office. 2007. The report indicates very high labour force growth in the Arab region, averaging 3.7% annually between 2000 and 2005. In 2005–2007, unemployment exceeded 13%, while youth unemployment rates in the Middle East and North Africa (MENA) were the highest around the globe and estimated by the ILO at 25.7% in 2003 (ranging between 46% in Algeria and 6.3% in the United Arab Emirates). These official aggregate data are likely to both under-estimate the rate of general unemployment and also mask the higher rates in poorer countries such as Egypt, where 20% would mean well over 10 million unemployed citizens looking for work.

5 Khan, A., Abimourched, R. and Ciobanu, R. O. "The Global Economic Crisis and the Impact on Migrant Workers." ILO Global Job Crisis Observatory, 2009. Available from: <www.ilo.org/public/english/support/lib/financialcrisis/featurestories/story11.htm>.

> “We should form an international watchdog coalition to monitor what is going on with the stimulus packages, and be able to have rapid responses if governments do not use this money properly. Rights based approaches to trade and finance must be constructed in order to end the crisis, above all by reconstructing safety nets in the North and South. We don’t want to just “tweak” the economic model in order to fix it, but instead to reconstruct it completely. In order to advocate for this, political moments such as the UN Conference and the World Social Forum must be taken advantage of, in order to bring people and social movements together at this critical time.”
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> Tanya Dawkins *(Global-Local Links Project, Miami)*

seas, aid donors and banks – are able to fill gaps when individual incomes are under such pressure.

Governments’ economic policy tools and sources of revenue

Economies in the Arab region have been growing based on rentier and semi-rentier models. They include oil producing countries, where the bulk of GDP and government revenue comes from exports of oil products, and non-oil producing countries, heavily dependent on different kinds of income, mainly remittances, foreign aid and bilateral and multilateral loans.[6]

Since the mid 1980s, Arab governments have enhanced economic reforms triggered by the decline in income due to fluctuating oil prices and related shrinking remittances. Reform measures have also been externally driven, focusing on programmes prescribed by institutions such as the IMF and the World Bank that focused on pro-cyclical policy recommendations, cutbacks in government spending, privatization, as well as liberalization of trade, interest policy and exchange rates.[7] At the same time, social policies were increasingly marginalized.

In undertaking policy choices and designing measures, governments in non-oil producing countries have increasingly given weight to aid flows, foreign direct investment (FDI), trade liberalization and remittances, while oil producing countries continued to focus on rent from oil exports.[8] However they have seen increasing budget deficits, and current account deficits in 2008 amounted to 1% of GDP in Egypt, 2.7% in Syria, 13.5% in Lebanon, and 18% in Jordan.[9] The IMF reported a 1–2.6% current account deficit for the Maghreb countries in 2008, which is expected to worsen by 2012. With export opportunities shrinking, budget deficits are expected to increase – especially due to decreasing demand in the European market, which absorbed the highest proportion of exports from the Arab region, and limitations on demand by Gulf countries that absorbed exports from other labour-abundant Arab countries. In addition, revenues from taxes are expected to fall as a result of the crisis, with further falls expected in wages, remittances and government transfers. The resulting diminution in public and private resources puts recent development gains at serious risk, leading to a possible rise in the incidence and depth of poverty and unemployment, unless targeted measures and decisive actions are undertaken.

The crisis has exposed the fluctuating nature of aid and remittances as well as the limited returns from trade liberalization. These policy options cannot be considered factors of a stable nature on which long-term sustained growth policy is built. Such policy tools should be considered complementary to a more stable policy that needs to be developed in the region, with significant orientation towards giving primacy to supporting intra-regional production cycles and intra-regional trade as well as domestic consumption and production.

Aid and foreign direct investment (FDI)

For some Arab countries, aid has become a significant proportion of GDP, particularly in countries affected by conflict such as Iraq, Lebanon and the Occupied Palestinian Territories, though amounts fluctuate greatly. The net official development assistance (ODA) given to 22 Arab countries by all donors reached USD 17.1 billion in 2006. This was almost 20% of the total ODA donated by donors to developing countries.[10]

However, this increase has been concentrated in a few countries and tends to reflect the geopolitical and military events in the region and the underlying strategies of the main international actors. Indeed the less developed countries in the region (including Comoros, Djibouti, Mauritania, Somalia and Yemen) received only 25.3% of the ODA received between 2000 and 2006. On the other hand, 46% of the assistance in that period went to Iraq. Overall, Iraq, the Occupied Palestinian Territories and Sudan received 63% of the total assistance.[11] It is evident that there is a clear gap between the orientation of assistance flowing to the region and human development priorities.[12]

With regard to overall FDI, the Arab share during the decade between 1990 and 2000 was only 2.1% (1% between 1990 and 1999). It then increased dramatically from USD 6 billion between 1995 and 1999 to more than USD 24 billion in 2006.[13] Around 34% of countries’ FDI comes from other Arab countries. Between 1996 and 2006, the share of FDI as a percentage of GDP rose from 1% to 1.7% for the whole region (excluding Iraq). In resource-poor and labour-abundant countries, it rose significantly from 2.4% to 8%; in resource-rich, labour-abundant countries it went from 0.2% to 0.9%; and in resource-rich, labour-importing countries it decreased from 0.7% to 0.3%.

These inflows – concentrated in Egypt, Jordan, Lebanon, Morocco and Tunisia, as well as the United Arab Emirates – are being fuelled by the completion of major privatization deals and increased investments in the energy sector. For example, FDI in Egypt increased to USD 6.1 billion in 2006 due to a telecommunications license and privatization in the banking sector. This suggests that FDI flows were not designed according to human development priorities and did not prioritise social added value.

It is reasonable to assume that both ODA and FDI may not be delivered according to previous projections due to the global tightening in budgets. This will mean less investment per person at a time when falling incomes from hydrocarbons and taxes have already resulted in tight budgets. It will also put greater pressure on budgets in poorly resourced and

6 Allisa, S. “The Challenge of Economic Reform in Arab World: Toward More Productive Economies.” Carnegie Endowment for International Peace, May 2007. Available from: <www.carnegieendowment.org/publications/index.cfm?fa=view&id=19147>.

7 Al-Jourchi, S. “Economic and Social Rights: Preliminary Review of International and Regional Initiatives”. Prepared for the Arab NGO Network for Development, 2008.

8 The World Bank has indicated in several of its reports that the GDP growth in resource-poor and labour-abundant Arab countries has been driven by strong flows of tourism revenues, remittances and increasing FDI.

9 Saif, I. and Choucair, F.“Arab Countries Stumble in the Face of Growing Economic Crisis”. Carnegie Endowment for International Peace, May 2009. Available from: <www.carnegieendowment.org/files/economic_crisis_wc_english.pdf>.

10 Mahjoub, A. “Official Development Assistance in Arab Countries.” Prepared for the Arab NGO Network for Development in preparation for the Financing for Development Review Conference (Doha, 2008).

11 Another large recipient of aid in the region is Egypt; between 2000 and 2006 it received 10% of the ODA to Arab countries from the Development Assistance Committee.

12 *Ibid.*

13 This section is based on numbers in World Bank. *Economic Developments and Prospects: Job Creation in an Era of High Growth.* Washington, DC: World Bank, 2007.

labour-abundant countries that currently depend on FDI for more than 8% of their GDP.

Trade

Trade liberalization has been one of the major policy recommendations promoted and adopted within the region as a tool for further growth and attraction of FDI. Arab countries have been very active in expanding and deepening trade agreements among themselves and have significantly opened their economies to trade, investment and capital flows with countries in other regions. Yet, despite the many reforms, total trade in 2005 in Arab countries represented only 4% of world trade. Furthermore, despite massive hydrocarbon exports and trade liberalization, the region accounts for only 5.5% of global exports, of which 90% is oil.[14]

On the regional front, despite the launch of the Pan-Arab Free Trade Area (PAFTA) in 1997 and the removal of tariffs for the movement of goods between 19 out of 22 Arab countries so far, intra-Arab trade today ranges between 10% and 13% of their overall trade volumes. This is a slight increase from the 9% achieved in 1997. The lack of agreement regarding rules of origin for products that are important from an intra-regional trade perspective is one of the major obstacles PAFTA currently faces.

As regional and bilateral trade agreements proliferate,[15] trade policy tariffs have been significantly reduced in almost all the region's countries, with most non-tariff barriers eliminated or significantly reduced. Overall, the region ranks second among developing regions on tariff reforms carried out since 2000, trailing behind only Europe and Central Asia.

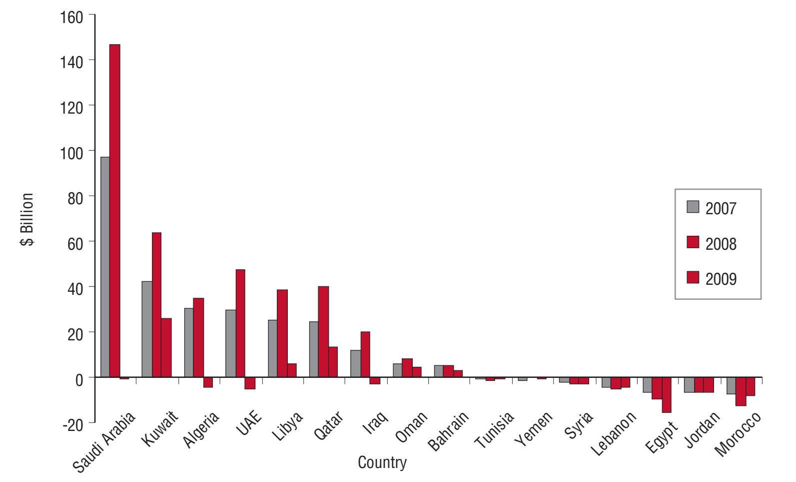
All Arab countries – both oil-exporting and not – will see a shock to trade accounts as a result of the crisis. While the former have been hit by oil price fluctuations and the fall in demand, the latter will see their exports to Europe and countries of the Gulf decreasing due to shrinking demand, and all of them will be forced to limit imports. Together with the higher relative costs of most needed imports such as foodstuffs, the impact on the region's trade balance will be dramatic.

Remittances

At more than USD 30 billion, remittances constitute a greater inflow than aid to the Arab region, having a huge impact on families and communities. A substantial proportion of low-income households are dependent on them. Resource-poor and labour-abundant countries – including Djibouti, Egypt, Jordan, Lebanon, Morocco, the Occupied Palestinian Territories and Tunisia – saw remittances increase from USD 8 billion in 1996–99 to USD 13.9 billion in 2006.[16] Similarly in resource-rich, labour-abundant countries such as Algeria and Syria, remittances increased from USD 1 billion to USD 2.5 billion and USD 0.5 to USD 0.9 billion respectively over the same period.[17] In 2007, remittance inflows made up around 9% of GDP in Morocco, 5% in Tunisia and 2.2% in Algeria.[18]

The World Bank predicts that remittances, having risen almost 8% in the previous year, will fall in 2009. The size of the fall is hard to gauge, although the worst-case scenario modelled last year predicts a 5% drop in 2009 compared to 2008 and a further fall for 2010.

CHART 1. Trade balances in Arab Region 2007-09



Source: based on IMF data.

Social policies

The Arab countries suffer a consistent deficiency in terms of social policies. This is in part a reflection of the lack of satisfactory levels of participation in the process of developing policy responses or rescue schemes by different stakeholders, including civil society organizations. In addition, it reflects the limited capacities official institutions have in developing comprehensive economic and social policies. Affordable, quality social services are lacking, as is access to these services, and the scope of social protection measures that are available for various social groups is limited.[19]

Social policy problems in the labour market relate to making available quality social services that are affordable. Another problem is the scope of social protection measures that are available for the different social groups. Comprehensive social policies are necessary to cushion against possible social unrest, especially as governmental responses fall short in curtailing the negative impacts of the crisis. Such policies need to extend beyond the regular social safety nets that existed before the crisis, which were often limited to food subsidies, energy subsidies, cash transfers and support for microfinance schemes. Comprehensive social policies also need to encompass the informal sector, which already employs a large segment of the population in the Arab countries and is expected to expand further in light of the crisis.

A persistent lack of coordination and comprehensive policy-making

The diverse capacities and nature of the Arab countries' economies imply that the responses to the crisis will vary, as well as the timeframes. No cooperation or common responses have been undertaken at the regional level. Overall, there has been no sense of urgency, and a comprehensive vision that pays careful attention to social policies has been lacking.

14 Arab Monetary Fund. *Joint Arab Economic Report 2006*. Available (in Arabic only) from: <www.amf.org.ae>.

15 Currently, six Arab countries are in the accession process to the WTO. While there are obvious advantages to membership in terms of multilateral market access and rules-based protection, terms of accession currently under negotiation undermine development prospects. Most acceding countries are being asked for greater liberalization and implementation commitments than original WTO members had to make.

16 World Bank. *op. cit.*

17 *Ibid.*

18 Saif and Choucair. *op. cit.*

19 Even in a country such as Tunisia, where the social security fund is considered a model one, the Government is facing problems responding to the needs of the newly unemployed as a result of the crisis (Saif and Choucair 2009).

The GCC countries' responses came more quickly and were more extensive. At the sub-regional level, they agreed to coordinate their fiscal, monetary and financial policies and set in place measures to help ease inter-bank lending rates and add new regulations to their stock markets. At the national level, they relaxed monetary policy and led expansionary fiscal policies in a few sectors. In other countries of the region, responses were sluggish; many governments insisted, at the early stages of the crisis, that their countries were isolated from its impacts. As their fiscal policies gave little room for manoeuvre, these countries were cautious about taking any expansionary policy decisions, and their interventions lacked planning and focused on short-term stabilization.

Moving forward: policy considerations to face the crises

It is evident that Arab governments need to prioritize long-term structural changes while addressing short-term needs in light of the crisis. In doing so, they can add value by (1) working together and capitalizing on their regional capacities and cooperation in facing the crisis; (2) providing the poor and vulnerable communities with greater protection of their economic and social rights; and (3) providing spaces for the active participation of different social partners, including civil society and women's groups, in drawing up economic and governance frameworks.

This should be an opportunity for Arab governments to review the assumptions behind policymaking processes related to social and economic reform, including revising relations between economy, finance and production and consumption patterns. This requires giving priority to building sustainable development and prioritizing social equity, decent work, gender equality and environmental sustainability. It includes as well supporting stable long-term growth in the productive sectors and developing comprehensive policies to address poverty eradication. Employment creation should be central to short-term and long-term policies, with an emphasis on decent work opportunities in sustainable productive sectors.

As the economic crisis is intertwined with the food and climate crises, responses must address all of them. In the run-up to the Copenhagen negotiations of December 2009, Arab governments should to take an effective, more proactive role coordinated with other developing countries. New ways of production and consumption, and trading in an environmentally sustainable way, should be at the core of discussions for reforming the development system.

On social policies

Social priorities, including strengthening automatic macroeconomic stabilizers and social insurance systems, should be determined through the participation and representation of multiple stakeholders, including civil society organizations. Social insurance systems should encourage individuals to work or be recognized for their role in households, families and communities. Furthermore, properly targeted social policy packages should be employed to limit the impacts of rising unemployment and the related incidence and depth of poverty in many communities.

On trade

There is need for assessment and, where necessary, revision of the outcomes from the liberalization undertaken as part of World Trade Organization (WTO) memberships and regional and bilateral free trade agreements. Trade policies should be undertaken within the context of comprehensive development strategies, built on assessments of their sustainability and human rights impacts. Governments should ensure that any continuation of the WTO Doha round guarantees true special and differential treatment for developing countries, including greater access to markets in developed countries by reducing subsidies.

Furthermore, the Arab governments should consider steps to review trade and investment agreements that limit policy space and may be impeding their ability to effectively respond to the crisis, especially in the area of capital flows and the liberalization of financial services.

Intra-regional trade and economic cooperation in general should be conducted on the basis of special and differential treatment and choice by countries; limitations and barriers to enhancing inter-Arab trade and economic cooperation resulting from the overlapping membership of Arab countries in multiple regional economic blocks should be addressed. This includes urgently needed coordination and harmonization of economic integration policies.

On Aid and FDI

Governments should set in place clear policies that allow for directing aid and FDI to areas and sectors that directly contribute to poverty eradication, increased employment opportunities, gender equality and human development priorities.

Furthermore, regional financial resources need to be mobilized towards sustainable development, particularly access to quality basic economic and social infrastructure. Accordingly, Arab countries should work to augment liquidity through regional channels. Regional cooperation arrangements can be particularly effective because of a greater recognition of cross-border externalities and greater sensitivities to the distinctive conditions in neighbouring countries.

On addressing falling government revenues

Arab governments could increase their stable sources of revenues through enhancing a fair, effective and progressive means of taxation. This needs to be complemented by efficient, effective, transparent and accountable public finance management systems and practices through participatory mechanisms. Tax avoidance should be addressed through supporting greater transparency in tax payments, a country-by-country reporting standard for multinational corporations, and a truly multilateral agreement on the automatic exchange of tax information.

On regional cooperation

As the crisis is global in nature, no single country can face its ramifications alone; hence a more collective effort should be pursued in the region, at both governmental and private levels. Re-thinking regional cooperation as a solution to the crisis can give a powerful impulse to building an alternative development project that is more sustainable and equitable. Such cooperation would enable an enhanced coordination of labour policies, amongst other priorities. Within this context, there is need to establish time-bound implementation mechanisms for decisions undertaken at the Arab Economic, Social and Development Summit.[20]

In light of such orientation, there is a need to revise and reform the mandates and mechanisms of existing regional institutions, including the regional development banks. Such reform should serve towards achieving stronger links between finance and the needs of the real economy.

In conclusion, governments in the Arab region should strengthen their co-ordination, enable citizens to participate in setting development priorities, and orient their social policies to reducing poverty in a sustainable and equitable way. The current convergence of crises presents an opportunity to revise outmoded policies and instigate action that will prevent the current crisis from becoming a human catastrophe in the region.

20 This includes implementation of agreed projects, such as the emergency programme on food security and programmes on common railways, water security, a common electricity project, limiting unemployment, implementing the Millennium Development Goals (MDGs) in the least developed countries in the region, and education and health care.