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ECONOMIC AND SOCIAL COMMISSION FOR WESTERN ASIA

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SURVEY OF ECONOMIC AND SOCIAL DEVELOPMENTS IN THE ESCWA REGION 2005-2006

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UNITED NATIONS
New York, 2006

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Preface

This year's *Survey of Economic and Social Developments in the ESCWA Region* outlines a set of economic policy principles aimed at contributing to the design of development strategies in the region that are employment-intensive, pro-poor and based on human rights.

These policy proposals emanate from three assumptions, namely: (a) the elimination of poverty must be the main priority of member countries of the Economic and Social Commission for Western Asia (ESCWA), given that poverty represents the most important challenge in the region and, moreover, that its elimination is mandated by the Universal Declaration of Human Rights (UDHR), the Declaration on the Right to Development (UNDRD) and the Millennium Development Goals (MDGs); (b) conventional economic parameters, including, among others, rapid and sustained growth, balance of payments equilibrium, inflation control and industrial development must not be regarded as end goals; rather as instruments for the elimination of mass poverty and the achievement of secure, sustainable, equitable and empowering human development in the ESCWA region; and (c) macroeconomic policy instruments can contribute significantly to the elimination of mass poverty.

From this pro-poor viewpoint, conventional economic strategies have been largely unsuccessful. The stabilization and structural adjustment policies implemented in many poor countries in the ESCWA region during the past 25 years have failed to trigger rapid economic growth and the sustained reduction of poverty. These policies are not self-correcting and, perversely, their perceived failure often leads to an intensification of ongoing programmes under even closer supervision by international agencies.

There is both the scope and the urgent need for a shift in economic policy strategies in order to achieve desirable human development goals in the ESCWA region. In this effort, employment creation is the critical link between economic growth and welfare improvement, and it offers an essential platform for the achievement of pro-poor outcomes. The policy principles outlined in this Survey are sufficiently flexible to contribute, with suitable adaptations, to the achievement of these desirable outcomes in most countries in the ESCWA region, including oil-rich, diversified and very poor economies. This can be done through a combination of rapid, sustainable and employment-intensive growth, and by distributing income and assets.

The focus and objectives of this year's Survey are clearly unconventional. In recent decades, macroeconomic policy has become increasingly concerned with ensuring macroeconomic stability, while growth and poverty reduction have been perceived as derived goals. This approach is rejected here. It is postulated, instead, that poverty-reduction objectives need to form the basis of national economic policymaking, and that these objectives must play a central role in the selection of the development strategy of the ESCWA region. In policy terms, this approach to development draws upon the rapidly expanding pro-poor economic policy tradition and, more broadly, on the right-to-development approach.

These literatures, their linkages and their policy implications for the ESCWA region are explained and discussed in detail in the chapters that follow. At a more specific level, the Survey examines the interaction between employment, poverty and economic policy, especially fiscal, financial, monetary and exchange rate policies. These topics are themselves quite broad. Selectivity will be essential in order to identify practical policy options for specific countries or groups of countries within the ESCWA region, and the institutional means to generate more employment-intensive growth in these countries, thereby satisfying MDGs and other human development goals as rapidly as possible.

These goals are both worthwhile and urgent. Given the extremely high rates of unemployment prevailing in the ESCWA region and the patterns of inequality that have been entrenched over long periods in most countries, it has been estimated that the region needs to create 35 million decent jobs during the next decade in order to meet its right-to-development targets. This target is complicated by the coexistence of complex patterns of high unemployment with labour export between countries in the ESCWA region, and between these countries and other regions of the world. It could be argued that several countries in the

region are in an unemployment trap, which is perpetuated by an undesirable and ultimately risk-enhancing policy compact. Current policies tend to do little to address these urgent problems, are incompatible with MDGs and militate against international human rights covenants.

Achieving the ambitious objectives outlined above will require much higher, labour-absorbing growth rates than those experienced in the recent past. However, even this will not be sufficient. There is a vital need for a structural shift in the economic strategy of most ESCWA member countries, which will involve a more enabling policy environment, as well as the qualitative transformation of the social and political conditions underpinning the process of growth. It will be necessary, in particular, to transform the regional security environment, enhance the efficiency of investment, and increase substantially regional cooperation with a view to securing rapid and employment-intensive economic growth, and to achieving human development outcomes. These policy adjustments are urgent. Securing the achievement of the region's human development commitments and upholding the human rights covenants to which countries in the area have signed require significant economic policy adjustments and, at a deeper level, the commitment and determination of national Governments and the existing supranational institutions.

This strategic policy shift will require political resolve as well as domestic and external support. However, these stringent requirements can be satisfied through a combination of domestic political mobilization around clearly defined and achievable targets, and careful use of the region's unrivalled strategic value. While this is a complex exercise, Governments in the region cannot afford to be lax. It is imperative to address the problems of unemployment and growth in the ESCWA region precisely because this part of the world is critically important for global economic and political stability. In addition to this, member countries must address seriously their international commitments to the elimination of poverty and gross forms of inequality. The choice of economic policy at the national level must be guided by these commitments and by the imperative to raise social welfare levels as rapidly as possible.

Mainstream one-size-fits-all policies have systematically failed to contribute to the achievement of these goals and have, consequently, worsened the problems of poverty, deprivation and unemployment in the ESCWA region. These policies need to be discarded, and pro-poor and rights-based policies must be deployed instead. By the same token, security imperatives or historical links with larger countries or economic areas must not be allowed to influence unduly policy choices. Indeed, excessive concern with short-term geopolitical allegiances can impair the capacity of ESCWA member countries to address their pressing domestic economic problems. This will inevitably increase insecurity in the region and reduce the policy space available for the implementation of pro-poor economic policy priorities.

There are four types of countries in the ESCWA region, with significantly different economic features. These are as follows: the core oil producers in the Gulf Cooperation Council (GCC), namely, Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates, whose economies are dominated by oil and whose objective function includes the maximization of long-term oil prices in the international market; the more diversified economies (MDEs) of Egypt, Jordan, Lebanon and the Syrian Arab Republic, where oil production plays a less significant role and diversification is both more easily achievable and economically necessary; the very poor economy of Yemen, with specific problems and limitations; and the devastated economies of Iraq and Palestine. For reasons of space, this Survey groups these economies into two sets, namely, the countries of the GCC and the MDEs, the latter of which includes both the diversified and poor economies.

This year's theme spans eight chapters, namely: (a) recent economic trends and developments in the ESCWA region; (b) rights-based and pro-poor economic policies; (c) the broad principles of rights-based economic strategies for the ESCWA region; (d) reviews of specific policy issues in the ESCWA region, including poverty and distribution; employment generation; savings and investment; and fiscal, monetary, anti-inflation, balance of payments and exchange rate policies; (e) income inequality and poverty reduction; (f) the role of public policies in the ESCWA region; (g) social aspects of the right to development; and (h) conclusions.

The Survey concludes that the post-independence institutional structure reconditioned by wars or the prospects of war attenuates the progress towards the right to development in the ESCWA region. In this region, the right to development is synonymous with the right to security, which can only arise as a result of international collaboration and which, in the wake of the invasion of Iraq, is of immense importance to global stability.

Finally, this Survey was completed before the conflict in Lebanon of July-August 2006. Consequently, some of the economic indicators set forth in this year's publication, particularly with regard to Lebanon, will need to be revised in a subsequent issue. Within the context of conflict-stricken countries and territories, annex II provides some background on the wars that have plagued the ESCWA region, and presents some empirical models on the impact of war from supply- and demand-led growth sides.

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ABBREVIATIONS AND EXPLANATORY NOTES

b/d	barrel per day
CIS	Commonwealth of Independent States
ENDP	Emirates Nationals Development Programme
EU	European Union
EU-15	the original 15 member countries of the European Union
FDI	foreign direct investment
FTA	free trade agreement
GCC	Gulf Cooperation Council
GDP	gross domestic product
HDI	Human Development Index
IFI	International Financial Institution
ILO	International Labour Organization
IMF	International Monetary Fund
IPO	initial public offering
ITCC	independent technology creating capacity
ITLC	independent technology learning capacity
LDC	least developed country
m/b/d	million barrels per day
MDE	more diversified economy
MDG	Millennium Development Goal
NGO	non-governmental organization
OECD	Organisation for Economic Co-operation and Development
OPEC	Organization of Petroleum Exporting Countries
PPP	Purchasing power parity
QIZ	qualified industrial zone
R and D	research and development
SAP	structural adjustment programme
SOE	State-owned enterprise
UDHR	Universal Declaration of Human Rights
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UNDRD	United Nations Declaration on Right to Development
WTI	West Texas Intermediate
WTO	World Trade Organization

References to dollars ($) are to United States dollars, unless otherwise stated.

I. RECENT ECONOMIC TRENDS AND DEVELOPMENTS IN THE ESCWA REGION

A. THE GLOBAL CONTEXT

1. *World economic developments in 2005*

The world economy continued to expand in 2005, albeit at a decelerated rate of growth. The United States remained the core of world economic growth, and Japan kept pace on its economic recovery. The European economies showed robustness and stayed at a low albeit consistent economic growth path. In developing countries, China and India experienced another year of rapid economic growth. The presence of both these countries in the world economy became more visible in terms of setting the demand factors for the global flows of goods, services and capital. From the beginning of the current upward cycles of economic expansion, greater acceleration in growth rates was seen in developing countries. This balanced nature of the economic upturn continued in 2005. However, this trend has not resulted in a significant reduction in unemployment rates in most regions so far. Furthermore, there was no observable reverse in the trend of widening global wage inequality.[1] Despite the efforts of policymakers in accommodating the current world economic situation to promote further economic growth and development, the structural pattern of present world economic expansion has not been pro-poor yet from the standpoint of the Millennium Development Goals (MDGs).

The developed economies marked a growth of 2.4 per cent in 2005 (see table 1), which represents a decline from the 3.2 per cent in the previous year. In the United States of America, sustained and strong domestic demand, both in consumption and investment, spurred growth to 3.3 per cent in 2005. The fiscal policy setting in 2004 amplified the expansion in domestic demand in 2005. This resulted in expanding the current account deficit and the level of Government deficits. While the Government sector caused the investment-savings gap in the economy since 2002, the investment-savings gap in the private sector was expanding rapidly towards the end of 2005. The investment-savings gap in the private sector was $8.3 billion in 2003, and it stood at $351.8 billion in 2005. By taking into account monetary policy tightening through the series of hikes of the Federal Fund rates throughout 2005, while maintaining a neutral fiscal position, the expansion of domestic demand was well sustained by the inflows of capital from overseas. The resulting global imbalance in investment and savings became a major concern to the world economy. Despite this risk factor, the momentum of domestic demand expansion is unlikely to see a sudden halt in the near future. The United States is expected to grow at 3.1 per cent in 2006.

TABLE 1. MAJOR ECONOMIC INDICATORS, 2003-2006

	2003	2004	2005	2006[a/]
Real GDP growth rates (*annual percentage change*)				
ESCWA region	5.2	6.8	6.4	5.4
World	2.6	4.0	3.2	3.3
Developed economies	1.9	3.2	2.4	2.5
United States	2.7	4.2	3.3	3.1
EU-15	1.1	2.3	1.4	2.0
Japan	1.4	2.7	2.1	1.9
Economies in transition	7.1	7.7	6.0	5.9
Developing countries	4.9	6.6	5.7	5.6
Africa	4.4	5.1	5.1	5.5
East and South Asia	6.6	7.4	6.6	6.5
Western Asia[b/]	5.0	6.8	5.8	5.1
Latin America and the Caribbean	1.8	5.6	4.1	3.9

[1] International Labour Organization (ILO), *Global Employment Trends: Brief January 2006* (ILO, January 2006).

TABLE 1 (*continued*)

	2003	2004	2005	2006[a/]
Inflation (*annual percentage change in consumer prices*)				
ESCWA region	2.9	4.6	3.9	3.8
Developed economies	1.7	1.8	2.2	2.0
United States	2.3	2.7	3.4	2.6
EU-15	2.1	2.1	2.1	2.3
Japan	(0.3)	(0.6)	(0.2)	0.1
Economies in transition	12.1	10.3	10.8	9.7
Developing countries	6.4	5.2	5.2	4.9
Africa	3.3	7.0	4.4	4.0
East and Southeast Asia	2.8	3.8	4.3	4.1
Western Asia[b/]	8.9	3.6	4.0	4.1
Latin America and the Caribbean	10.5	6.5	6.3	5.3
Unemployment rates (*percentage*)				
Developed economies				
United States	6.0	5.5	5.1	4.8
EU-15	8.0	8.0	8.1	8.0
Japan	5.3	4.7	4.5	4.5
Economies in transition	8.4	9.5	9.7	..
East Asia	3.3	3.7	3.8	..
South-East Asia	6.5	6.2	6.1	..
South Asia	4.8	4.7	4.7	..
Latin America and the Caribbean	9.3	7.4	7.7	..
Middle East and North Africa	11.7	13.1	13.2	..
Sub-Saharan Africa	10.0	9.9	9.7	..
Short-term interest rates (*LIBOR on 3-month deposits*)				
United States dollar	1.216	1.618	3.556	..
Euro	2.332	2.106	2.184	..
Japanese yen	0.057	0.051	0.057	..
Exchange rates (*nominal exchange rates yearly average*)				
Euro ($ per national currency unit)	1.131	1.243	1.246	..
Japanese yen (national currency units per $)	115.9	108.2	110.2	..
World trade volumes (*annual percentage change*)				
Exports	6.4	11.0	7.1	7.2
Imports	6.1	10.7	7.7	8.3

Sources: Compiled by ESCWA, based on the following: Department of Economic and Social Affairs (DESA), "World Economic Situation and Prospects 2006", which is available at: www.un.org/esa/policy/wess/wesp.html; International Labour Organization (ILO), *Global Employment Trends: Brief, January 2006* (ILO, January 2006); and the International Financial Statistics of the International Monetary Fund (IMF).

Notes: Parentheses ( ) indicate negative numbers.
Two dots (..) indicate that data are not available or are not separately reported.

a/ The figures in this column are forecasts.

b/ This regional classification of Western Asia includes the neighbouring countries of the ESCWA region, namely, Israel and Turkey, and excludes Egypt.

The recovery of the EU-15 countries (the original 15 member countries of the European Union) continued in 2005 at a modest pace of 1.4 per cent. In a general trend, the depreciation of the euro against the United States dollar since March 2005 helped the expansion of exports, and moderate recovery in domestic demand also sustained those economies. However, in two major economies in the EU-15, namely, France and Germany, employment conditions were not improved. Despite its sluggish economic recovery, inflationary pressures were constantly built up. The European Central Bank continued to be in a difficult position as it strove to control inflation while minimizing further negative impacts to the economies of the euro-zone. Reflecting a rapid recovery in exports and weak albeit consistent recovery in domestic demand, the EU-15 countries are expected to grow at 2.0 per cent in 2006.

The economy of Japan proved resilient towards the end of 2005. The private domestic investment and consumption were supporting consistent recovery of the economy from the present cyclical bottom of early 2002. In terms of the consumer price index, the economy has been emerging from deflation. The general price level turned into a positive area in 2006. Consequently, the Bank of Japan is expected to shift its monetary policy from one that is currently significantly relaxed. Moreover, on the fiscal side, the Government of Japan is expected to tighten its fiscal stance given the need to increase tax revenues aimed at reducing a high level of public debt. However, those policy changes are not expected to be extreme, and the Japanese economy is expected to grow by 1.9 per cent in 2006.

The rising commodity prices continued to buoy the rapid economic expansion of the economies in transition, including those in Eastern Europe and in the Commonwealth of Independent States (CIS). That region is estimated to have grown at 6.0 per cent in 2005, with economies that were already showing signs of overheating owing to the highest inflation rate compared to other regions. However, strong inflows of foreign capital continued into investment projects in that region, thereby diversifying its direct investment portfolio in energy, manufacturing and infrastructure. The present trend is expected to continue into 2006, and the region is projected to grow at 5.9 per cent.

On average, the economies of developing countries expanded faster than the developed economies in the current cycle. The trend held out in Africa where economies grew at 5.1 per cent in 2005, even in sub-Saharan Africa, excluding Nigeria and South Africa that attained 5.3 per cent growth in gross domestic product (GDP). Favourable external factors, including the abundant liquidity and higher commodity prices, supported expansion. Increased export earnings and a less restrictive foreign exchange ceiling allowed domestic demand to rise, which can be partly attributed to a greater number of African countries that have developed into energy exporters. However, the difference in economic growth between energy-exporting countries and those countries that suffer from political and security conflicts in Africa has further increased. Despite the divergence in the rate of expansion, the region is expected to grow at 5.5 per cent on average in 2006.

The rapid economic growth of East and South Asia continued in 2005. The economies of that region grew on average at 6.6 per cent. The strong growth in domestic demand in both China and India was remarkable, particularly considering the size of those two countries. Moreover, both countries stepped up the resilience of their economies by taking pivotal positions in the global economy as the destination of foreign direct investment (FDI) and outsourced services, and the focus of global manufacturing activities. The higher oil prices affected the economies in this region, and several oil-importing countries had to reduce fuel subsidies in 2005. Despite the increasing inflationary pressure, the prices were still at manageable levels in 2005 in most countries of this region. East and South Asia are projected to grow at 6.5 per cent, thereby keeping the current momentum. However, the challenge remains for most countries in terms of dealing with high oil prices, the potential risk of bird flu outbreaks, and widening inequality between the urban and rural sectors of their domestic economies.

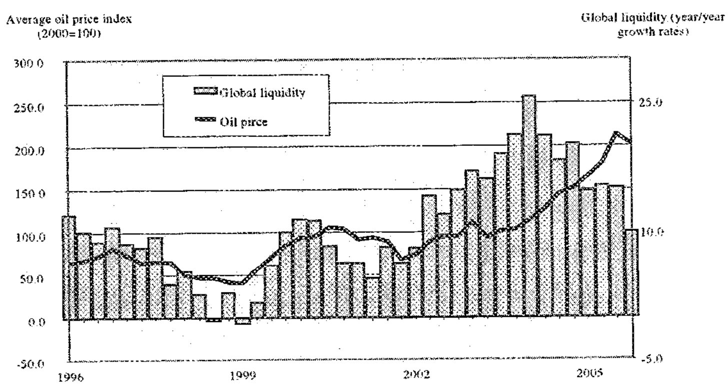
Recovery of the economies of Latin America and the Caribbean continued in 2005, with a growth rate of 4.1 per cent. Higher commodity prices, particularly prices of oil and agricultural goods, buoyed commodity-exporters in the region. However, the manufacturing sector of the region, particularly in Brazil and Mexico, faced intensifying international competition. The improved macroeconomic balance helped the economies of Latin America and the Caribbean to reduce external debt levels and foster an expectation of further stability in their macroeconomic performances. This region is expected to grow at 3.9 per cent in 2006.

2. *Implications for the ESCWA region*

The external economic environment remained favourable for member countries of the Economic and Social Commission for Western Asia (ESCWA) in 2005. This accounted partly for the positive economic expansion of the ESCWA region, which registered the highest rate in the world in 2005 at 6.4 per cent.

One factor underlying and affecting current world economic expansion is the rise of commodity and energy prices, including oil and oil-related products, and the high level of liquidity growth worldwide. Figure I shows the recent movement in the averaged crude oil price and the growth in global liquidity in terms of the total of the United States monetary base and foreign exchange reserves held by central banks around the world.[2] While the level of global liquidity growth has declined from its peak in early 2004, it remained high at the end of 2005. The average crude oil price has been on an increasing trend since early 2002.

Figure I. Global liquidity and oil prices, 1996-2005



Sources: Compiled by ESCWA, based on data from the International Financial Statistics of the International Monetary Fund (IMF), and from the United States Federal Reserve Board.

The effect of higher oil prices is direct to the oil-exporting countries in the ESCWA region, namely, the countries of the GCC subregion, Egypt, Iraq, the Syrian Arab Republic and Yemen. Given that crude oil production continued to stay at a near-maximum level in 2005, these oil-exporting countries experienced substantially increased oil revenues. Previous reform efforts in both the domestic economy and institutions, particularly financial markets, resulted in a leveraged effect by increasing initially domestic wealth in the form of financial and real estate assets. On the other hand, the abundance of global liquidity allows a country to finance its external deficits with relative ease. It is favourable for the countries that consolidate public finance, promote the private sector and pursue active development policy, as more external resources, in monetary terms, are made available to them.

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[2] The averaged crude oil price measures the average of brands of crude oil. For more details, see the International Financial Statistics of the International Monetary Fund (IMF).

Additionally, it provides breathing space for countries that suffer from non-economic factors which impact economic conditions. The abundance of global liquidity in 2005 sustained the economic performance of the ESCWA region, particularly those classed as more diversified economies (MDEs). The combination of both factors, the higher oil prices and the high level of global liquidity, was enough to fend off some negative factors to the region's economy. The adversary effect of higher oil prices for oil-importing countries was moderated as the increasing value import of crude oil and oil-related products did not cause a serious deterioration in the balance of payments. Deficits could be financed by inflows of capital and through transfers of incomes, generated by higher oil revenues and easily accessed as a result of the high level of global liquidity.

This favourable external economic environment is already in the process of change. As indicated in figure I, growth rates of global liquidity are decelerating. Major central banks in the developed economies, particularly the United States Federal Reserve Board, the European Central Bank and the Bank of Japan, are tightening their monetary stances. The response of the private financial sector to a monetary policy change takes time in the globalized and liberalized financial sector. However, the gradual increase in long-term interest rates in those major developed countries and the decrease in the growth rate of global liquidity indicate the end of the current worldwide ease in the monetary regime. The effect of this has already been seen in the periphery of developed economies, including Iceland and New Zealand, whereby those countries had to devalue their currencies in early 2006. Meanwhile, stock markets in the ESCWA region are experiencing downward adjustments.

Moreover, historically, there is a correlation between the level of growth in global liquidity and oil prices. Growth rates of global liquidity peaked in early 2004, and the oil prices trend is expected to follow suit. Considering the current tight demand and supply condition in crude oil markets and scarce production capacity in oil refineries, a sudden drop in crude oil prices is unlikely. However, the speculative congruent of crude oil markets, particularly of oil futures products, is diminishing in 2006 as a result of the slowdown in growth of global liquidity.

The year 2006 represents the transition period in the change in external economic environment for ESCWA member countries. As the world economy is expected to continue its present growth momentum in 2006 at 3.3 per cent, the overall economy of the ESCWA region is expected to follow this trend where growth is projected at 5.4 per cent. However, more uncertainties are expected to be in the region's asset markets as the level of global liquidity growth decreases further. A sudden change of business and consumer confidence is now probable as they have been actively participating in the region's assets markets, and given that the performance of those markets was highly volatile in early 2006.

Inflationary pressures are expected to remain as the level of commodity prices stays at a higher range and the momentum for gradual price rises gains ground. This inflationary trend could equally affect business and consumer confidence. In facing the change in the external economic environment and the uncertainty stemming from it, the challenge for policymakers in the ESCWA region is to lead economies into a soft-landing whereby sudden deterioration in domestic demand creation is averted through the appropriate mix of fiscal and monetary policies.

B. OIL SECTOR DEVELOPMENT

1. *World demand and supply*

Having recognized the continuing expansion of the world economy and accompanying demand for crude oil, the expectation for the growth in the demand for crude oil was firm at the beginning of 2005. According to estimates by the Organization of Petroleum Exporting Countries (OPEC), world oil demand for 2005 grew by 1.2 per cent to average 83.07 million barrels per day (m/b/d). In 2004, the yearly growth in

demand stood at 3.7 per cent. While the level stayed high, the deceleration in demand growth took place towards the end of 2005.[3]

Box 1. Oil specialization and oil prices

There are two types of countries in the ESCWA region whose characteristics rest in their specialization in the extraction of oil. A measure of this is given by:

$$\frac{\text{Fuel exports}}{\text{Total exports}}$$

These two types are as follows:

(a) Highly specialized in oil production, which comprises countries whose fuel exports amount to more than 60 per cent of total exports, namely, Bahrain, Kuwait, Saudi Arabia, Oman, the Syrian Arab Republic and the United Arabs Emirates;

(b) More diversified economies, which includes some countries that have no oil resources such as Jordan and Lebanon, or that have a more diversified economy such as Egypt. Their share of fuel exports to total exports is in the range 0-50 per cent. With regard to Egypt, the oil specialization of that country was striking in the 1970s during the first oil shock, but was subsequently reduced constantly.

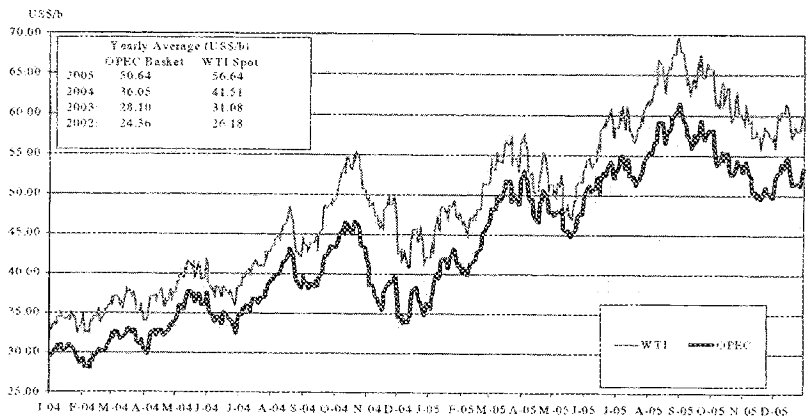
During the period 1975-2000, all the countries experienced, more or less, important reductions in their share of oil exports in the 1980s, with the exception of Kuwait for which the drop was short-lived (see graphs below). Oman's share of fuel export in total export fell consistently, but without shocks. The United Arab Emirates was seemingly the most affected, as far as the data can be trusted. Egypt and the Syrian Arab Republic incurred a collapse in the share of their fuel exports in total exports over the second part of the 1980s, whereas the decrease was more gradual for Bahrain and Saudi Arabia. During the 1990s, the ESCWA region can be decomposed into three groups, namely: (a) countries that increased their specialization in oil production, including the Syrian Arab Republic and the United Arab Emirates; (b) countries whose shares of fuel exports remained more or less constant to the exception of external shocks, including Kuwait and Saudi Arabia; and (c) countries that diversified their exports as oil decreased regularly in proportion to total exports, including Egypt and Oman.

Source: ESCWA.

Oil prices continued their upward trend throughout 2005. Concerns over supply disruptions owing to political conditions in the Middle East and Nigeria, and the devastating hurricanes in North America influenced the price hikes in oil markets. However, the essential underlying market environment was the tight supply-demand situation which has continued. Speculative forces were active in the oil future markets as the high level of global liquidity pushed the general price level of financial assets higher. Consequently, the market was sensitive to any news that could affect either supply or demand of crude oil and oil-related products. The oil price movements in 2005 became more volatile (see figure II). In 2005, the yearly average of West Texas Intermediate (WTI) spot price was $56.64 per barrel (/b), and that of OPEC Reference Basket was $50.64/b. OPEC introduced a new basket in the calculation of its reference price on 16 June 2005, which aimed at reflecting the crude oil brands of OPEC member countries more precisely. It is estimated that the new price is approximately $1 to $2 lower than the old basket price.

[3] Organization of Petroleum Exporting Countries (OPEC), *Monthly Oil Market Report* (February 2006).

Figure II. Crude oil prices, 2004-2005
(*United States dollars per barrel*)



Source: Compiled by ESCWA, based on data by the Energy Information Administration (EIA).

In determining production levels, oil-exporting countries, particularly those of OPEC, responded to rising crude oil prices. OPEC increased the production quota in March and July 2005. Moreover, in September, the Organization decided effectively to suspend the quota system for the last quarter of 2005 thereby making the spare capacity of member countries, at some 2 m/b/d, available to the market. OPEC repeatedly announced that it recognized the importance of maintaining oil market stability.

On the other hand, as demand growth decelerated, some OPEC member countries started considering a reduction in the production quota towards the end of 2005. No consensus was established for a new price band system, or for the appropriate price level for the oil-exporting countries. Given that the spare supply capacity of crude oil of non-OPEC countries is currently limited, a consensus by OPEC on the appropriate price level will be crucial for the prospect of oil markets. According to OPEC, the world total supply was estimated at 84.3 m/b/d in 2005, which represents an increase of 1.5 per cent from the 83.0 m/b/d of 2004.[4]

The structural supply constraint in midstream and downstream stages of oil supplies was not improved in 2005. Despite the fluctuations in crude oil prices, the price rise in oil products was consistent and less elastic. This situation will further stabilize the demand for oil products and, consequently, for crude oil in 2006. Equally, market speculation will probably soften as the growth in global liquidity decelerates. Nevertheless, the level of demand will stay at a historical high level and the supply constraint will remain. Therefore, this Survey forecasts the average crude oil price, in terms of OPEC Reference Basket price, in the range of $52/b to $57/b.

2. *Crude oil production in the ESCWA region*

The surge in oil production in the ESCWA region continued in 2005, increasing by 2.3 per cent from its level in 2004 by generating 19.5 m/b/d (see table 2). The lack of sufficient spare capacities has led to tight oil production in most countries of the region.

[4] Ibid.

TABLE 2. OIL PRODUCTION IN THE ESCWA REGION, 2001-2006
(Thousands of barrels per day)

Country/region	2001	2002	2003	2004	2005	2006 Quota-based[a/]	2006[b/]	2004-2005	
								Percentage	
Bahrain[c/]	190	190	200	200	200	200	200	0	0.0
Kuwait	1 947	1 885	2 172	2 344	2 505	2 247	2 751	161	6.9
Oman	960	900	820	790	770	750	750	(20)	-2.5
Qatar	633	648	748	777	795	726	873	18	2.3
Saudi Arabia[d/]	7 889	7 535	8 709	8 982	9 404	9 099	10 324	422	4.7
United Arab Emirates	2 115	1 988	2 243	2 360	2 445	2 444	2 686	85	3.6
GCC countries	13 734	13 146	14 892	15 453	16 119	15 466	17 584	666	4.3
Egypt	760	750	750	710	700	680	680	(10)	(1.4)
Iraq[e/]	2 594	2 000	1 321	2 015	1 831		2 289	(184)	(9.1)
Syrian Arab Republic	540	550	530	500	480	440	440	(20)	(4.0)
Yemen	470	460	440	420	400	400	400	(20)	(4.8)
MDEs	4 364	3 760	3 041	3 645	3 411	1 520	3 809	(234)	(6.4)
ESCWA region	18 098	16 906	17 933	19 098	19 530	16 986	21 393	432	2.3

Sources: Compiled by ESCWA, based on the OPEC quota as of July 2005; and on OPEC, *Monthly Oil Market Report* (February 2006), table 32.

Notes: Parentheses ( ) indicate negative numbers.

a/ Excluding Iraq which is exempted from the OPEC quota.

b/ For Kuwait, Qatar, Saudi Arabia and the United Arab Emirates, the increase in production in 2006 is based on the increase in production quota in July 2005 as compared to July 2004.

c/ This includes Bahrain's share of the Abu Saafa oilfield. The loss of an additional 50,000 b/d by Saudi Arabia from that oilfield is not recorded here.

d/ This includes a 50 per cent share of the Neutral Zone.

e/ The figure for 2006 is an official estimate, which is based on the assumption that Iraq will boost crude oil production by approximately a quarter to reach pre-war levels.

With the exception of Iraq, the OPEC member States in the ESCWA region produced 5.7 per cent more than their average crude oil production in 2004.[5] On the other hand, non-OPEC countries in the ESCWA region continued to witness a decrease in oil production in 2005, which declined by 2.9 per cent from 2004. Compared to other oil-producing economies in the ESCWA region, Kuwait witnessed the highest percentage increase in oil production in 2005, estimated at 6.9 per cent. Its actual output stood at 2.5 m/b/d, in excess of its authorized quota level of 2.2 m/b/d (effective July 2005).

Moreover, Saudi Arabia, which accounted for some 31.5 per cent of total OPEC production in 2005, boosted average daily production by 4.7 per cent from the level in 2004, and generated 9.4 m/b/d. Owing to its large spare production capacity, Saudi Arabia is the key to maintaining a balance between the overall

[5] The OPEC member countries in the ESCWA region comprise Kuwait, Iraq, Qatar, Saudi Arabia and the United Arab Emirates; and the non-OPEC oil-producers of the region include Egypt, Oman, the Syrian Arab Republic and Yemen.

demand and supply in the energy market. The increase in production in both Saudi Arabia and Kuwait was able to compensate for the lost production from Venezuela, Iraq and Nigeria. On the other hand, Iraq's production is estimated to have dropped by 9.1 per cent in 2005 owing to supply disruptions subsequent to the insurgency attacks and sabotage of the oil infrastructure. Qatar, which has adopted innovation and technology in the hydrocarbon sector, stands as the largest natural gas producer among the GCC economies. It is increasing natural gas liquids and exports of condensates. Moreover, Bahrain lost the additional 50,000 b/d that it used to receive from the Abu-Saafa oilfields, which it shares with Saudi Arabia. It is worth noting that replacing natural gas liquids and exports of condensates that are not subject to OPEC quotas are becoming the region's main options for revenue diversification.

At the very least, the region is expected to maintain its overall oil production in order to meet the high global oil demand in 2006. World demand growth is forecast to continue, albeit at a decelerated pace, while the supply capacity of oil exporters in the ESCWA region will remain crucial for the stability of oil markets.

3. *Oil revenue and its impact in ESCWA region*

In 2005, higher oil prices and growing production led to a substantial increase in oil revenues in the ESCWA region. Gross oil export revenue in the region was estimated at $307 billion in 2005, which is an increase of 40.4 per cent on 2004 (see table 3). Among the GCC countries, Kuwait achieved the highest increase in oil export revenue in 2005, at 53.4 per cent, followed by Saudi Arabia, at 40.3 per cent. For 2006, two projected scenarios have been conducted that rely on the assumptions of realizing, respectively, high and low prices of oil. With a price scenario of $52/b, oil revenues are projected to accumulate to $368.6 billion, while under a more optimistic scenario of $57/b, they will reach $404.2 billion. Decelerating oil export growth rates will temper the current boom.

This increased oil revenue has resulted in a significant fiscal surplus in GCC countries. However, it is significant in the present cycle that the impact of oil market development is leveraged through the boom in the asset markets, particularly of stock and property, in the region. Traditionally, the benefits of oil revenue increases were distributed by the Government in terms of increasing Government expenditures, including benefits to the employees in the public sector, and further holding of foreign assets. The large public sector and underdeveloped private sector had precluded a leveraged impact on the domestic economy of GCC countries in the past. While this mode of distribution is still functioning in GCC countries, a different mode of distribution, through the private sector, is at work and is becoming more active.

TABLE 3. GROSS OIL EXPORT REVENUES IN THE ESCWA REGION, 2002-2006
(Billions of United States dollars)

Country/region	2002	2003	2004	2005	2006 Low[a/]	2006 High[b/]	2004-2005	Percentage
Bahrain[c/]	3.96	4.68	5.55	6.97	7.23	7.93	1.42	25.52
Kuwait	14.06	18.63	25.86	39.67	47.54	52.12	13.82	53.43
Oman	7.52	7.91	9.23	11.01	12.11	13.50	1.78	19.28
Qatar[d/]	5.63	6.72	8.53	9.13	9.49	10.40	0.60	6.99
Saudi Arabia[e/]	63.62	82.02	110.42	154.87	193.74	212.37	44.46	40.26
United Arab Emirates	16.68	22.11	29.62	41.50	51.48	56.42	11.88	40.11
GCC countries	111.46	142.07	189.20	263.15	321.59	352.74	73.95	39.08
Egypt[f/]	3.16	3.91	5.30	7.05	7.21	7.91	1.75	33.08

TABLE 3 (*continued*)

Country/region	2002	2003	2004	2005	2006 Low[a/]	2006 High[b/]	2004-2005 Percentage	
Iraq	9.19	8.35	17.33	28.50	30.50	33.40	11.17	64.46
Syrian Arab Republic	4.56	4.11	3.25	3.15	3.05	3.30	(0.10)	(3.08)
Yemen	3.15	3.46	3.89	5.50	6.21	6.80	1.61	41.28
MDEs	20.06	19.83	29.77	44.20	46.97	51.41	14.43	48.47
ESCWA region	131.52	161.90	218.97	307.35	368.56	404.15	88.38	40.36

Sources: Compiled by ESCWA.

Notes: Parentheses ( ) indicate negative numbers.

a/ These projections assume a low realization of OPEC price per barrel at $52.

b/ These projections assume a high realization of OPEC price per barrel at $57.

c/ This includes Bahrain's share of the Abu Saafa oilfield.

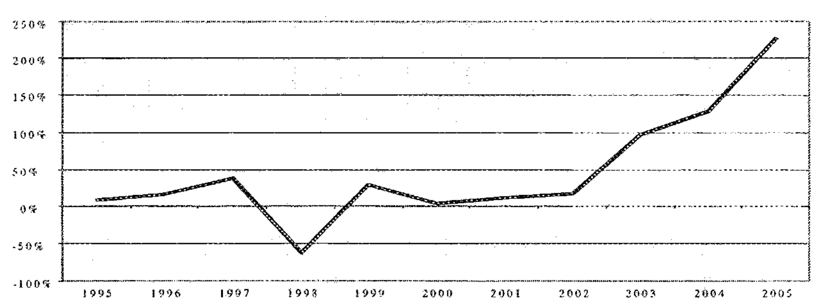
d/ Qatar has been experiencing substantial increases in non-crude oil exports, namely, liquefied natural gas, which are not accounted for here.

e/ This includes a 50 per cent share of the Neutral Zone.

f/ This includes exports of natural gas.

Figure III shows the ratio of annual change in stock market capitalization to gross oil export revenue of GCC countries total. Until 2003, the ratios were significantly low. Specifically, the annual increase in stock market capitalization was on average less than 50 per cent of annual gross oil export revenues. This means that, traditionally, the oil export revenue contributed only partially to domestic asset formation through domestic stock markets. Since 2003, the annual increase in stock market capitalization surpassed annual gross oil export revenue, and reached 220 per cent in 2005. The speed of domestic wealth creation was faster than oil revenues during that period. The leveraged effect of the present oil boom was then at work. However, as results of the first quarter of 2006 clearly indicate, this has since collapsed with the crash of financial markets.

Figure III. The ratio of annual change in stock market capitalization to gross oil export revenue, GCC total, 1995-2005
(*Percentage*)



Source: Calculated by ESCWA, based on various national and international data.

Several factors can explain the current situation. The first factor is economic reform and liberalization policies in the countries of the GCC. Economic diversification efforts resulted in a larger private sector that was less directly dependent on the oil sector, particularly the financial and services sector that witnessed major developments recently. The second factor is the institutional development that governs investment and financial markets. As a result, more family firms in GCC countries went public and sought initial public offerings (IPOs). More domestic assets are open to the participants in domestic economic activities in the region. Equally, innovations in financial markets have prompted more people to participate in stock markets.

Another factor is the favourable external economic environment, particularly globally abundant liquidity. The expansion of market capitalization in the ESCWA region was significantly rapid, compared to other markets in the world until the crash of the first quarter of 2006. The stock markets in the GCC countries were not affected by international investors given that most investments were made by nationals. However, the shift by regional investors in the past few years from foreign investment into domestic ones can also explain the boom in 2005.

The boom spilled over to MDEs, which benefit from relevant GCC trade or business, or from nationals working in the Gulf subregion. Construction projects, based on investments of firms in GCC countries, increased in the MDEs, particularly Jordan and Lebanon. The surge in stock market capitalization was seen in the respective markets of Egypt, Jordan and Lebanon. However, rising oil prices and accompanying hikes of fuel products negatively affected the particularly poor segment of society. Households in the poor segment of society face difficulty in benefiting from the asset price hikes. Rather, they suffer mostly from the hikes in fuel products and residential rents. Moreover, improvements in employment condition have not been apparent in MDEs.

C. OUTPUT AND DEMAND

The recent global oil boom and high level of liquidity growth have underpinned strong growth in the ESCWA region. The emerging capital markets, stock markets in particular, created a leverage that linked external environments into domestic demands. Positive sentiments of expectation dominated stocks and real estate markets during 2005. However, the economy as a whole is increasingly vulnerable to developments in the stock and property markets that show several signs of overheating. Moreover, the regional growth performance exhibits a divergence that is mainly due to security and political concerns.

With the exception of Iraq and Palestine, GDP in constant prices grew by 6.3 per cent in the ESCWA region, inching down from 6.4 per cent in 2004. The ESCWA region experienced another year on the present upward cycle in GDP growth (see table 4). The fact that the short-term economic cycle fluctuations of the region remain closely tied to developments in the oil market makes prediction quite precarious. Official GDP estimates of recent years in some ESCWA member countries were revised upwards, which suggests that the magnitude of the current oil boom has possibly been underestimated.

However, as a trend, the economic expansion for the whole region is forecast to taper off beginning 2006, where overall GDP growth rate attainable for all countries, with the exception of Iraq and Palestine, is predicted to reach 5.4 per cent. Such a deceleration is impacted by the crash in the region's main financial markets as of the first quarter of 2006.

Overall, real GDP rates in the countries of the GCC have hovered at approximated 7 per cent over the past two years, leading to a stable growth in per capita GDP rate (see tables 4 and 5). The realization of the wealth effect was evident in this subregion with a sustained business and consumer confidence. The demand-led economic expansion has benefited the non-oil private sectors, mainly banking services, trade, construction and real estate. While the private sector became increasingly sensitive to stock and property market development at this stage, the lagged effect of public expenditures will sustain domestic demand in 2006. In most GCC countries, large public investment projects are planned, budgeted or partly being

implemented. The growth rate of this subregion is forecast at 5.8 per cent in 2006, despite the booming oil prices and revenues. The recent financial markets crash in the GCC will have its decelerating impact on the drive to invest in the private sector.

TABLE 4. REAL GDP GROWTH RATES 2002-2006
(Annual percentage change)

Country/region	Real GDP growth 2002	2003	2004	2005[a/]	2006[b/]
Bahrain	5.2	7.2	5.4	6.2	6.3
Kuwait	(2.0)	12.7	16.3	6.5	4.1
Oman	2.6	2.0	5.6	4.2	5.5
Qatar	7.3	5.9	8.7	7.6	8
Saudi Arabia	0.1	7.7	5.2	6.8	6
United Arab Emirates	3.0	12.2	7.5	8.0	6
GCC countries	1.1	8.7	7.2	6.9	5.8
Egypt	3.1	4.2	4.9	5.5	4.6
Jordan	5.7	4.1	7.7	7.3	5.6
Lebanon	(1.3)	3.0	5.0	0.0	3
Syrian Arab Republic	5.9	1.1	2.0	4	3
Yemen	3.5	3.8	3.9	4.6	4.2
MDEs	3.2	3.6	4.6	4.8	4.3
ESCWA region[c/]	1.8	7.1	6.4	6.3	5.4
Iraq[d/]	(6.9)	(33.1)	23.0	10.0	7
Palestine	(3.6)	(0.1)	2	4.9	(0.8)
Total ESCWA region	1.3	5.2	6.8	6.4	5.4

Source: Compiled by ESCWA, based on computations of growth rates from real GDP figures at constant 2000 prices, which have been taken from national sources and official figures as provided for by answers to questionnaires from ESCWA member countries.

Notes: Parentheses ( ) indicate negative numbers.

a/ ESCWA estimates as of February 2006.

b/ ESCWA projections as of February 2006.

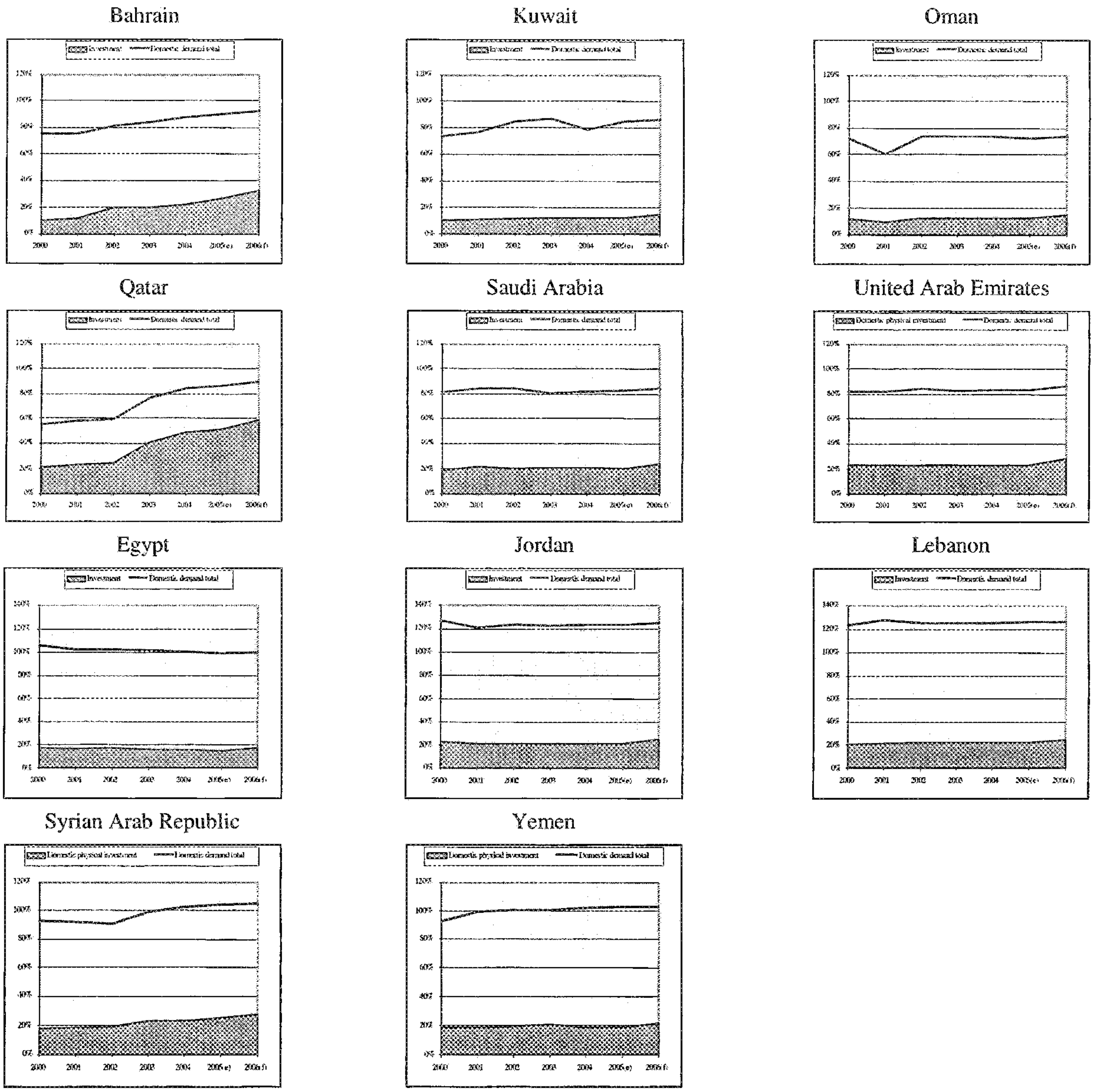
c/ Excluding Palestine and Iraq.

d/ The rates for Iraq are based on official sources, with the exception of 2005 and 2006, which are ESCWA estimates and projections.

Bahrain and Qatar registered a strong investment-led growth in 2005, at 6.2 and 7.6 per cent, respectively. The trend is expected to continue in 2006. Bahrain and Qatar are forecast to grow at 6.3 and 8.0 per cent, respectively. In Saudi Arabia and the United Arab Emirates, the depth of diversification and the size of domestic economy with a steadily growing non-oil sector exhibited a balanced growth in both consumption and domestic investment. Moreover, active fiscal stances in both countries levelled up the domestic demand base. Saudi Arabia grew at 6.8 per cent in 2005 and is forecast to expand to 6 per cent in 2006. The United Arab Emirates registered 8.0 per cent growth in 2005, and is expected to grow at 6 per cent in 2006. Oman's real GDP growth tapered off to 4.2 per cent in 2005 as a slowdown of domestic demand was observed. However, an increasing implementation of energy-related investment projects is expected to accelerate the economy in 2006, resulting in a growth of 5.5 per cent. In Kuwait, the economy is expected to land a stable growth path after two years of extraordinary expansion. Its GDP growth registered 6.5 per cent in 2005, and is expected to grow at 4.1 per cent in 2006.

The GCC countries experienced an increasing trend of physical capital formation (see figure IV). While the rate of domestic physical investment to GDP varies among countries, the trend can be interpreted as an effort by GCC countries aimed at economic diversification. This trend, in turn, will create a more solid domestic demand base, which enhances the resilience of domestic economy upon external shocks. The transformation is ongoing in Bahrain and Qatar, where rapid physical capital formation levelled up the ratio of domestic demand to GDP. However, the ratio of total domestic demand is still significantly lower than GDP in GCC countries. This shows that the fundamental characteristic of GCC countries, namely, their oil-dependency, has not changed.

Figure IV. Ratio of total domestic demand and physical investment to GDP in real terms



Source: Calculated by ESCWA, based on *National Account Studies in the ESCWA region*, Bulletin No. 25 (E/ESCWA/SCU/2005/6).

In 2005, MDEs were largely able to maintain their gradual acceleration in their economic expansion. While some positive developments in the manufacturing sector were seen in Egypt and Jordan, growth of MDEs in the current positive cycle has continuously been led by private consumption. Favourable external conditions, a high level of global liquidity, rapid growth in such trade in services as tourism, and a stable inflow of workers' remittances from abroad loosened the foreign exchange constraints of MDEs, which allowed demand expansion to take place at a rapid pace. Moreover, this positive external economic condition kept Lebanon from experiencing a large decline in its economy with the deteriorating security situation after February 2005. The real GDP growth rate in MDEs, estimated at 4.8 per cent, was the highest rate attained since 2000 (see table 4).

The total domestic demand of MDEs was typically more than GDP (see figure IV), thereby signifying that the contribution to GDP from external demand was negative as the countries imported more than they exported. The level of total domestic demand is high in Jordan and Lebanon, typically more than 120 per cent. In Egypt, the Syrian Arab Republic and Yemen, this level is approximately 100 per cent. While the investment rate is stable, it is still not sufficient to buoy those economies that have such critical structural problems as unemployment and poverty.

The economies of MDEs are still fragile given that the upward cycle is led by private consumption. The variance in GDP growth is dependent on how the consumption can be externally financed. As the growth in regional financial flows can subside, the growth in MDEs is expected to be modest in 2006. In Egypt, the expanding merchandise, energy and services (particularly proceeds from the Suez Canal) support domestic demand. Real GDP growth of Egypt was 5.5 per cent in 2005, and is expected to be 4.6 per cent in 2006. The Jordanian economy was increasingly dependent on external capital inflows for its rapid growth in 2005, estimated at 7.3 per cent, and is expected to slow down after two years of high growth to 5.6 per cent in 2006. The high oil revenue benefited Yemen, which registered a growth of 4.6 per cent in 2005. This growth momentum is expected to continue in 2006, with a growth rate of 4.2 per cent.

Political risks remain, particularly in Lebanon and the Syrian Arab Republic. These could temper business and consumer confidence, thereby affecting investment and further physical capital formation. Owing to the political turmoil in the wake of the assassination of former Prime Minister Rafiq Hariri in February 2005, the Lebanese economy is estimated to have experienced zero growth. While the Syrian Arab Republic registered a growth of 4.0 per cent in 2005, its growth is estimated to be lower than its potential considering the favourable external economic environment that benefited other countries in the region. Lebanon is forecast to grow at 3.0 per cent in 2006, and the same rate of growth is also expected for the Syrian Arab Republic. Overall and with the exception of Iraq and Palestine, MDEs are expected to grow at 4.3 per cent in 2006.

Security tensions persist in the conflict-affected economies of the ESCWA region. War and poor management of oil fields, have led to a decrease in the national oil production during 2005. Consequently, Iraq failed to sustain the recovered economic growth witnessed in the previous year, and its real GDP growth rate declined to an estimated 10 per cent, down from 23 per cent in 2004. The war has diverted the funds needed to finance planned infrastructure projects to security spending, which raises doubts on the sustainability of Iraqi reconstruction given the adverse security situation.[6] Real GDP is estimated to grow at 7.0 per cent in 2006 under stable security situation scenarios, oil sector development and the disbursement of funds to the development of the non-oil sector. However, it is difficult to provide forecasts under these alarming humanitarian conditions.

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[6] A total of $5.6 billion out of $18.4 billion in United States aid was spent on security and public safety sectors, thereby slashing funds allocated to developing the water and electricity infrastructures. According to other estimates, security costs have reached 26 per cent of the $29 billion appropriated by the United States for use in Iraq.

The Palestinian economy witnessed a recovery in 2005. Real GDP growth in Palestine, estimated at 4.9 per cent in 2005, increased by 2.0 per cent from 2004. While the severe constraint on domestic economic infrastructure, including the closures imposed by the separation wall, remained in force, the improvement of external economic conditions resulted in an increased inflow of public and private transfers to the occupied territories. This moved the economy forward in the fragile political and security environment. This fragility was revealed when Israel suspended transfers of customs payments, and donors voiced reluctance to provide economic aid after the establishment of a new Government in the territories in January 2006. The economic outlook for 2006 is highly dependent on the political situation.

In the ESCWA region and with the exception of the conflict-stricken area of Iraq and Palestine, GDP per capita increased by an estimated 3.8 per cent in 2005, which represents a stable development from the growth rate of 3.9 per cent in 2004 (see table 5). Despite the high level of GDP growth, population pressure remained. Iraq's per capita GDP slowed down significantly to 7.1 per cent, from 19.6 per cent in 2004. In Palestine, GDP per capita showed a slight improvement in 2005 after having recorded negative values since 2000. Living standards are expected to remain devastated unless the political situation stabilizes in the short run and the economy improves.

TABLE 5. PER CAPITA REAL GDP GROWTH RATES IN THE ESCWA REGION, 2002-2006
(Annual percentage change)

Country/region	2002	2003	2004	2005[a/]	2006[b/]
Bahrain	3.6	5.6	3.9	4.6	4.7
Kuwait	(5.9)	8.8	12.7	3.3	1.2
Oman	1.7	1.3	4.7	2.9	3.7
Qatar	0.5	(0.9)	2.5	2.8	4.6
Saudi Arabia	(2.6)	4.8	2.5	4.1	3.3
United Arab Emirates	(4.4)	4.6	1.1	2.9	2.3
GCC countries	(2.1)	5.3	4.0	3.9	3.1
Egypt	1.1	2.2	2.9	3.5	2.7
Jordan	2.7	1.2	4.8	4.7	3.2
Lebanon	(2.3)	2.0	3.9	(1.0)	1.9
Syrian Arab Republic	3.3	(1.4)	(0.4)	1.5	0.5
Yemen	0.3	0.6	0.7	1.4	1.0
MDEs	0.9	1.3	2.4	2.5	2.0
ESCWA region[c/]	(0.7)	4.5	3.9	3.8	3.0
Iraq	(9.5)	(34.9)	19.6	7.1	4.3
Palestine	(6.7)	(3.2)	(1.2)	1.6	(3.9)
Total ESCWA region	(1.2)	2.6	4.2	3.9	3.0

Source: Compiled by ESCWA, based on constant GDP 2000 prices and total population estimates from Department of Economic and Social Affairs (DESA), *World Population Prospects: The 2004 Revision* (United Nations, 2005).

Notes: Parentheses ( ) indicate negative numbers.

a/ ESCWA estimates as of February 2006.
b/ ESCWA projections as of February 2006.
c/ Excluding Palestine and Iraq.

D. COST AND PRICES

Both external and internal factors were in place for rising prices in the ESCWA region. Increasing import prices in petroleum products and other commodities were in place, while, internally, the rising rents

stemmed from the hike in asset prices which affected the general level of prices, particularly in GCC countries. Moreover, domestic market structures of the region allowed some business entities to seek price hikes with an unnecessarily wider margin for profit-making. Wages of public sector workers in oil-exporting countries were increasing, thereby reflecting the strong fiscal position of those Governments. Saudi Arabia decided to raise public sector salaries by 15 per cent in August 2005, which affected the wage structure in the private sector upwards.

The average official inflation rate for the ESCWA region was 3.9 per cent in 2005 (see table 6). Within ESCWA member countries, the official inflation rate ranged from a low of 0.7 per cent in Saudi Arabia to a high of 8.8 per cent in Qatar, with the exception of Iraq where the rate was estimated at 37 per cent.[7] In Egypt, the average inflation rate declined from double digits in 2004 to 3.1 per cent in 2005. This is mainly due to the real appreciation of the domestic currency against the United States dollar. With regard to Iraq, serious shortages in petroleum products and electricity supplies have escalated average price levels by creating bottlenecks and stimulating black markets.

TABLE 6. RATE OF INFLATION, 2002-2006
(Annual percentage change)

Country/region[a]	2002	2003	2004	2005	2006
Bahrain	(0.5)	1.6	2.4	3.3	1.6
Kuwait	0.9	1.0	1.3	4.2	1.8
Oman	(0.7)	(0.3)	0.4	1.9	1.1
Qatar	0.2	2.3	6.8	8.8	2.7
Saudi Arabia	0.2	0.6	0.3	0.7	1.0
United Arab Emirates	2.9	3.1	4.7	5.4	4.5
GCC countries	0.8	1.3	1.8	2.7	2.0
Egypt	2.7	4.2	10.8	3.1	8.0
Jordan	1.8	1.6	3.3	3.5	8.4
Lebanon	4.3	3.0	2.4	1.9	2.0
Syrian Arab Republic	1.0	4.8	4.6	4.0	5.0
Yemen	12.2	10.8	12.5	5.6	11.4
MDEs	3.2	4.4	8.8	3.3	7.3
ESCWA region[b]	1.5	2.2	3.9	2.9	3.5
Iraq	19.3	33.6	27.0	37.0	12.0
Palestine	5.7	4.4	3.1	3.5	3.1
Total ESCWA region	2.2	2.9	4.6	3.9	3.8

Source: Compiled by ESCWA, based on International Monetary Fund (IMF), "World economic outlook database" (IMF, September 2005).

Notes: Parentheses ( ) indicate negative numbers.

a/ Subregional average inflation rates are weighted averages whereby weights are based on GDP in constant 2000 prices.
b/ Excluding Palestine and Iraq.

Actual inflation in the region is felt more than the figures indicate. The rapid rise in property rents was observed in the GCC countries, particularly in Qatar and the United Arab Emirates. Moreover, the rise in prices of crude oil and fuel products affect the poorer segments in oil-importing countries, particularly

[7] For an overview of the estimated inflationary gap in the ESCWA region, refer to Department of Economic and Social Affairs (DESA), "World Economic Situation and Prospects 2006", which is available at: www.un.org/esa/policy/wess/wesp.html

Jordan. While the Governments in the ESCWA region are careful to alleviate the effect of general price rises by subsidizing food and other essential items, the present pattern of inflation widened inequality in standards of living within countries as well as within the region. In particular, asset price increases and rent have increased inequality.

In 2006, the moderate economic slowdown and direct policy interventions through subsidies in GCC countries could level off the official rate of inflation to an average of 2.0 per cent. On the other hand, inflation is on an increasing trend in the MDEs given that fiscal intervention to control consumer price levels is not expected in those countries. On average, the rate of inflation in MDEs is expected to be 7.3 per cent in 2006. Continuous supply bottlenecks owing to the unstable security situations is expected to yield inflation rates for Iraq and Palestine in 2006, at 12 per cent and 3.1 per cent, respectively.

E. Labour markets

While the current region-wide economic expansion is high in real GDP growth, it has been less effective in changing the picture of the most significant structural problem, namely, high unemployment. The labour market in the ESCWA region is witnessing a glut on the supply side, owing mainly to labour unfriendly economic growth, import of labour services from abroad and creating high-paying jobs in the public sector and allowing the private sector to import lower-wage labour from abroad. Moreover, the glut can be attributed to the high rates of new entrants into the market, resulting from the demographic increase, the entry of women or even from the significant supplies of expatriates into the GCC countries. Moreover, considerable mismatches exist between the supply and demand sides of the labour markets both in GCC countries and MDEs.

Policymakers in the region are well aware of the problem, and employment is a priority in most ESCWA member countries. Oil revenues continue to dichotomize the market. However, the fact that job creation remains slow in the region makes overall demand in the labour market fairly deficient in meeting excess supply. High unemployment rates remain a serious concern and hover at double-digit levels in most ESCWA member countries.

In 2005, unemployment rates were estimated at 14.8 per cent in Jordan, and 26.5 per cent in Palestine. Lebanon registered an estimated unemployment rate of 8.2 per cent in 2004, compared to 11.5 per cent in 2001 and 8.5 per cent in 1997; and the current unemployment figure in the Syrian Arab Republic is estimated to be greater than the official rate of 12.6 per cent in 2004, owing to the large number of workers who returned from Lebanon. Unemployment rates in both Iraq and Palestine remain inordinately high as a result of the political instability and conflict that hamper investment and employment (see table 7).

The countries of the GCC revitalized their strategies for employment creation for nationals. The effect of the workforce "nationalization" strategies of those countries remains mixed and has so far failed to reach the stated goals.[8] Some GCC countries have moved towards comprehensive reform in their labour markets. Specifically, the Economic Development Board in Bahrain held a national dialogue on education and training reforms to form strategies for human resources development. In Qatar, the Planning Council launched the Manpower Planning Project, though it stated that unemployment was not serious in that country. Saudi Arabia promulgated a new labour law that promotes the participation of women in the labour market and sets a new target for "Saudization". The United Arab Emirates launched the Emirates Nationals Development Programme (ENDP) aimed at matching the skills of potential national employees and demanded skills, with the cooperation of the private sector. As a trend, the human resources development side of the workforce "nationalization" strategies was increasingly stressed in the GCC countries.

[8] These workforce "nationalization" strategies in countries of the GCC are aimed at increasing the ratio of nationals among the employed in the private sector.

TABLE 7. OFFICIAL ADULT UNEMPLOYMENT RATES IN THE ESCWA REGION
(*Percentage*)

Country/region	2001	2002	2003	2004	2005
GCC countries					
Bahrain	5.5	..	..	..	..
Kuwait	..	1.1	..	..	..
Oman	..	..	..	..	..
Qatar	3.9	..	..	1.4	..
Saudi Arabia	..	5.2	..	..	..
United Arab Emirates	2.3[a/]	..	..	..	..
MDEs					
Egypt	..	10.3	11	10.3	..
Jordan	..	15.3	14.5	12.5	14.8
Lebanon	11.5	..	..	8.2	..
Syrian Arab Republic	..	11.7	10.8	12.6	..
Yemen	..	..	11.0	10.6	..
Palestine	..	..	25.6	26.8	26.5
Iraq	..	..	28.1	26.8	..

Source: Compiled by ESCWA, based on official national censuses, except for Lebanon and Yemen which are estimated rates.

Notes: Two dots (..) indicate that data are not available or are not separately reported.

a/ The given rate for the United Arab Emirates is for 2000.

F. EXTERNAL SECTOR

The total gross value of merchandize exports, including re-exports, of ESCWA member countries in 2005 was estimated at $462 billion, while the total gross value of merchandize imports was estimated at $273 billion. The Gulf subregion accounted for some 87 per cent of total exports and 71 per cent of total imports (see tables 8 and 9). Crude oil and oil-related products were continuously the major export product group of the ESCWA region. Despite the current hike of oil prices, the share of oil exports in total exports barely changed in 2005, at 65 per cent. Moreover, non-oil exports grew at the same rate with oil exports. Among others, the apparels sector in Jordan and the steel sector of Egypt have been established as matured export revenue earners for the respective countries.

The large percentage growth in the value of exports can be largely attributed to the higher oil prices and the increased oil production (see table 8). However, re-exports, particularly from Dubai in the United Arab Emirates, is one other main contributor to the total value of exports. In the case of Egypt, the export of natural gas contributed to levelling up the value of exports.

On the other hand, the rapid export expansion of Jordan and Lebanon lost momentum. The apparel goods from the qualifying industrial zones (QIZs) of Jordan faced fierce competition worldwide, subsequent to the expiration of the World Trade Organization Agreement on Textiles and Clothing. Moreover, Egypt established its QIZs for export-oriented textile sector development. While the effect of those events has not been as negative as previously projected, it halted the rapid expansion of the apparel sector in Jordan. Equally, Lebanon's exports suffered from increased competition in the region. Since 2003, Lebanon has expanded its manufacturing exports to other ESCWA member countries. However, Lebanon's exports to Iraq were decreased in 2005 after a rapid expansion that lasted two years. Furthermore, the political

instability and occasional difficulties for transport over the border-crossing points contributed to the performance of Lebanese exports.[9]

TABLE 8. TOTAL EXPORT FLOWS OF ESCWA MEMBER COUNTRIES, 2002-2005
(Millions of United States dollars)

Country/region	2002	2001-2002 percentage change	2003	2002-2003 percentage change	2004	2003-2004 percentage change	2005	2004-2005 percentage change
GCC countries								
Bahrain	5 794	3.9	6 632	14.4	7 519	13.4	9 866[a/]	31.2
Kuwait	14 184	(6.9)	18 366	29.5	24 951	35.9	37 100	48.7
Oman	11 172	0.9	11 669	4.4	13 381	14.7	18 200[a/]	36.0
Qatar	10 978	1.0	13 382	21.9	18 685	39.6	25 100	34.3
Saudi Arabia	72 464	6.6	93 244	28.7	125 728	34.8	182 000[a/]	44.8
United Arab Emirates	52 613	7.7	67 137	28.7	90 639	35.0	132 000[a/]	46.7
Subtotal	166 756	4.8	210 429	26.2	280 901	33.5	405 266	44.3
MDEs								
Egypt	4 688	14.0	6 189	32.0	7 701	24.4	9 500[a/]	23.4
Iraq	12 219	(5.1)	9 711	(20.5)	17 810	83.4	29 000[a/]	62.8
Jordan	2 770	20.7	3 056	10.3	3 911	28.0	4 284	9.5
Lebanon	1 108	24.6	1 629	47.0	1 954	20.0	2 020	3.4
Palestine	241	(17.0)	280	16.1	360[a/]	28.7	385[a/]	6.9
Syrian Arab Republic	6 756	24.8	5 816	(13.9)	5 655	(2.8)	6 550[a/]	15.8
Yemen	3 336	(14.9)	3 734	11.9	4 078	9.2	5 650[a/]	38.5
Subtotal	31 118	4.4	30 414	(2.3)	41 470	36.4	57 389	38.4
Total ESCWA region	197 874	4.7	240 843	21.7	322 371	33.9	462 655	43.5

Source: Compiled by ESCWA, based on official sources.

Notes: In terms of methodology, foreign trade statistics from national statistical sources were processed whereby the original figures in national currency units are converted into United States dollars with the exchange rate stated in the official sources.

Parentheses ( ) indicate negative numbers.

a/ Figures are estimations based on data from trading partners and other relevant information.

TABLE 9. TOTAL IMPORT FLOWS OF ESCWA MEMBER COUNTRIES, 2002-2005
(Millions of United States dollars)

Country/region	2002	2001-2002 percentage change	2003	2002-2003 percentage change	2004	2003-2004 percentage change	2005	2004-2005 percentage change
GCC countries								
Bahrain	5 013	16.4	5 657	12.9	6 485	14.6	7 740[a/]	19.4
Kuwait	8 316	12.4	9 758	17.3	10 426	6.8	14 800	48.7
Oman	6 296	6.1	6 801	8.0	8 866	30.4	8 990[a/]	1.4
Qatar	4 052	7.8	4 897	20.9	6 004	22.6	7 450	24.1
Saudi Arabia	32 290	3.6	36 916	14.3	44 517	20.6	56 100[a/]	26.0
United Arab Emirates	42 652	14.4	52 074	22.1	72 082	38.4	98 900[a/]	37.2
Subtotal	98 619	9.7	116 103	17.7	148 380	27.8	193 980	30.7

9 A poor performance of these exports is expected in the aftermath of the conflict in Lebanon of July-August 2006.

TABLE 9 (*continued*)

Country/region	2002	2001-2002 percentage change	2003	2002-2003 percentage change	2004	2003-2004 percentage change	2005	2004-2005 percentage change
MDEs								
Egypt	12 524	(0.9)	10 939	(12.7)	12 865	17.6	19 500[a/]	51.6
Iraq	9 817	(12.0)	9 934	1.2	21 302	114.4	24 300[a/]	14.1
Jordan	5 076	4.2	5 743	13.1	8 179	42.4	10 454	27.8
Lebanon	6 445	(11.6)	7 168	11.2	9 397	31.1	9 340	(0.6)
Palestine	1 516	(25.5)	1 800	18.8	2 350[a/]	30.5	2 630[a/]	11.9
Syrian Arab Republic	5 070	6.8	5 092	0.4	7 033[a/]	38.1	8 310[a/]	18.2
Yemen	2 921	18.5	3 675	25.8	3 986	8.5	4 450[a/]	11.6
Subtotal	43 369	(4.0)	44 350	2.3	65 112	46.8	78 984	21.3
Total ESCWA region	141 988	5.1	160 454	13.0	213 492	33.1	272 964	27.9

Source: Compiled by ESCWA, based on official sources.

Notes: In terms of methodology, foreign trade statistics from national statistical sources were processed whereby the original figures in national currency units are converted into United States dollars with the exchange rate stated in the official sources.

Parentheses ( ) indicate negative numbers.

a/ Figures are estimations based on data from trading partners and other relevant information.

With the exception of Oman, imports into GCC countries grew at a rapid pace in value (see table 9). The increased imports of both consumption and capital goods were observed to respond to the rapid expansion of domestic demand. The increase in value of imports to MDEs reflected the growing demand for imported goods, as well as the hike in the price of fuel products and other commodities. This is particularly the case in Egypt and Jordan. Lebanon is the only country that registered a decrease in the value of imports in 2005, which, given the rise in oil prices, reveals a significantly weak domestic demand.

In the development of trade policy, the largest economy in the ESCWA region, namely, Saudi Arabia, joined WTO in November 2005. The success of that country in the negotiation process is encouraging for other countries hoping to pursue respective economic reforms. Further economic liberalization is expected in Saudi Arabia following the significant progress of the past few years. Moreover, Saudi Arabia is now eligible to start bilateral negotiations with the United States for a free trade agreement (FTA) through a series of steps for establishing bilateral trade and investment treaties. The experience of the FTA between Bahrain and the United States, which is expected to come into effect in 2006, shows that the process takes time after ratification by both countries.

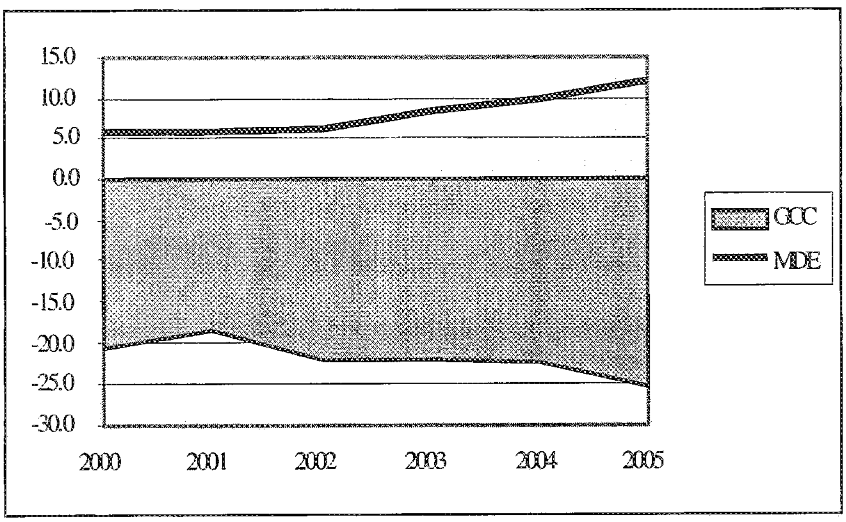
Additionally, while Egypt, Oman and the United Arab Emirates are at the negotiation stage with the United States, it is observed that the process is likely to be delayed for the finalization of each FTA. Meanwhile, in East Asia, China, Japan and Singapore have become candidates for FTAs. Moreover, the GCC has started negotiations with the EU for a region-to-region FTA. While WTO Doha Round negotiations were protracted and the prospects of multilateral trade agreements are still uncertain, Governments, including those in the ESCWA region, have become keen to take advantage of such bilateral trade frameworks as FTAs.

The development of the tourism sector in the region continued to contribute to the expansion of trade in services. Bahrain, Egypt, Jordan, Lebanon and the United Arab Emirates benefited from the increase in proceeds from the tourism sector. However, the rise in transportation costs affected the region by reducing services trade surpluses, particularly in MDEs, with the exception of Egypt where the proceeds from the

Suez Canal kept its services trade account at a significant surplus. The importance of tourism is increasingly acknowledged by GCC countries, including Saudi Arabia where visa clearances for tourists are still strict.

In 2005, the total outflows of workers' remittances from GCC countries were estimated at $25 billion (see figure V). The level of outflows has continued to grow since 2001 to the home countries of expatriate workers in South and Southeast Asia and the ESCWA region. The total inflows of workers' remittances into MDEs, estimated at $14 billion in 2005, originated mainly from North America, Europe and the ESCWA region. The reliance on the inflows of workers' remittances was particularly high in Jordan, Lebanon and Palestine. ESCWA estimates the relative size of inflow of workers' remittances at 15 per cent of GDP in Jordan, 25 per cent in Lebanon and 43 per cent in Palestine in 2005.

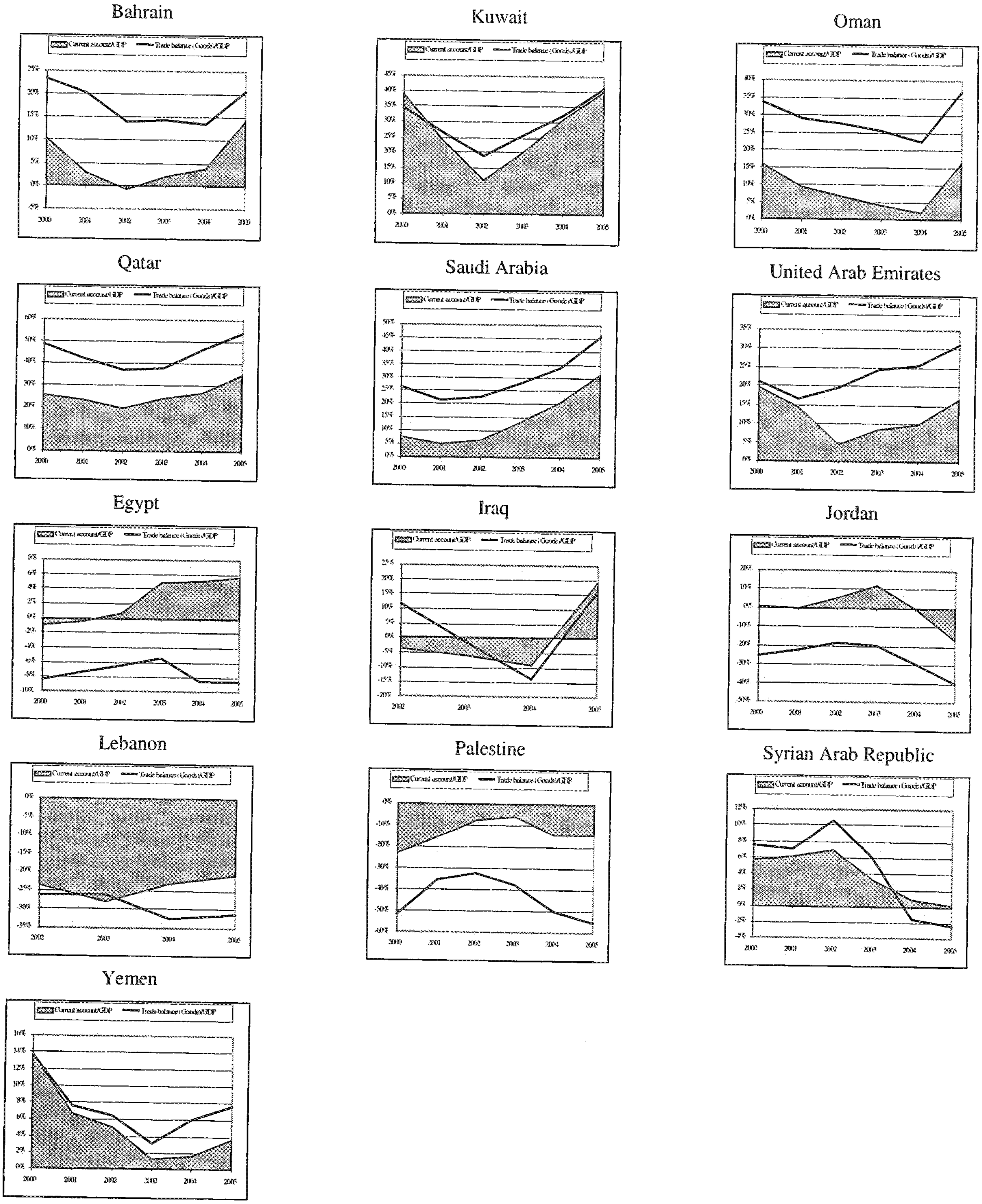
Figure V. Gross inflows of workers' remittances in the ESCWA region, 2000-2005
(Billions of United States dollars)



Source: ESCWA estimation, based on various national and international data.
Note: Negative inflows signify outflows.

In the area of external balance, three ESCWA members, namely, Jordan, Lebanon and Palestine, experienced current account deficits in 2005 (see figure VI). These remain vulnerable to any deterioration of external conditions. Jordan experienced a significant increase in the magnitude of the current account deficit. Jordan's current account had been in surplus until 2004 after which it went into a deep deficit, estimated at 17.1 per cent of GDP in 2005, owing to the increasing value of imports, especially oil. The Central Bank of Jordan held net foreign reserves of $4.7 billion at the end of 2005. This level is virtually the same as that at the end of 2004, which means the current account deficit was well financed by inflows of foreign capital. Lebanon's current account deficit was estimated to be 20.9 per cent of GDP in 2005. The slowdown of the domestic economy and decreased imports contributed to contain the current account deficit at this level. Palestine's current account deficit was estimated at 14.2 per cent of GDP. Meanwhile, the level of trade deficit has consistently grown since 2002. This shows that the economy of Palestine depends more on income transfers and workers' remittances from abroad. In 2006, inflow constraints imposed by some donor countries following the election of a new Government are expected to deepen Palestine's economic malaise.

Figure VI. Trade balance and current account
(Percentage of GDP)



Source: ESCWA, based on various national and international sources.
Note: Figures for 2005 are estimates.

All GCC countries experienced a large increase in the current account surpluses. The current account surpluses of GCC countries stood at 27.6 per cent of GDP on average during 2005, which is an increase from the 18.2 per cent of the previous year.

According to latest figures by the United Nations Conference on Trade and Development (UNCTAD), FDI inflows to the ESCWA region increased considerably in 2004 to $7.9 billion, which represents a rise of 75.6 per cent from $4.5 billion in 2003.[10] Consequently, the FDI accumulated stock in the region stood at $81.8 billion in 2004, compared to $74 billion in 2003. Nevertheless, the regional share of global FDI remains at a modest 1.0 per cent. Foreign inflows to Western Asia are far from surpassing such developing regions as Latin America and the Caribbean and Africa, which recorded 10.4 and 2.8 per cent of global FDI flows in 2004, respectively. Data are not available for 2005. However, early indications show another significant increase of FDI in the region.

G. ECONOMIC POLICY DEVELOPMENTS

Increasingly, Governments in the ESCWA region are facing policy dilemmas. The long-term development priorities require active fiscal expansion. However, considering the rapid rise in domestic asset prices and inflationary pressures from external factors, some Governments must consider soft landings of domestic demand levels. The Governments of GCC countries moved their fiscal stances to the more active mode, albeit still within the trait of prudential fiscal management. In their budgets, more priorities were put on long-term development through increases in social spending and infrastructure investments. The Governments in MDEs were constantly at their fiscal ceiling, and fiscal stances in this cluster are tight. Their prioritization within the fiscal constraint became more difficult, particularly in the light of the rise in energy prices in countries importing oil within this cluster.

Moreover, the issue of subsidies to oil products were on public debate in Iraq, Jordan and Lebanon. If international oil prices remain at the current level, the fiscal constraint on Jordan and Lebanon could worsen. Moreover, the hike in the price of oil products will have considerable repercussions domestically. The Government of Jordan cut the fuel subsidy twice in 2005, in July and September. The decision was taken to contain the budget deficit in the target range of 5.2 per cent of GDP at the end of 2005. The fuel subsidy will be cut in April 2006, September 2006 and March 2007, and a complete liberalization of fuel prices will follow after the total abolition of the fuel subsidy. In parallel to the subsidy cuts, Jordan increased income support to the poor segment of the society through the National Aid Fund. However, it remains debatable whether transfers to the poor will be commensurate with the cost of lifting the subsidies.

It was on the monetary side where the role of demand management was shouldered in the ESCWA region. Central banks of GCC countries warned of possible asset bubbles in the region. In addition to stages of interest rate hikes in parallel with the United States Federal Reserve, other monetary measures, including restriction on speculative lending and open market operations, have been taken to contain excess liquidity in some GCC countries but not in others. The difficulties lay in the nature of selective demand management in the booming period, and their effect was limited.

While the inflexibility in the policy field, which stems from pegging national currencies to the dollar, was examined, Governments in the GCC do not intend to change their foreign exchange rate policies. Central banks in MDEs successfully managed their foreign exchange position without constricting domestic demand. Egypt experienced an appreciation of its national currency against the dollar, while Lebanon defended its currency against concerns over the prospects of the national economy under increasing political

[10] United Nations Conference on Trade and Development (UNCTAD), "World Investment Report 2005", which is available at: www.iked.org/pdf/WIR05overview%20full.pdf.

and security instability in the country. The national currencies of the Syrian Arab Republic and Yemen were under pressure against the dollar, but they were still manageable.

The general trend of reform measures pertaining to institutional development continued in the ESCWA region. Those institutional reforms aim to render economies more open and liberalized, thereby accelerating economic development and diversification by attracting more foreign capital and technology through further inflows of FDI. However, FDI remains of the resource seeking based type and very small causing little if not negative spillovers.

In early 2005, Bahrain passed a law allowing future power generation projects to be undertaken by the private sector. Within that context, an industrial park is currently being established, located within the Bahrain International Investment Park, which offers companies numerous investment incentives, including 10-year tax exemptions. In January 2006, Bahrain introduced new regulations governing business start-ups, thereby facilitating the task and decreasing the costs of setting up businesses in that country. The rules removed many of the pre-approvals that were previously required, and introduced a flat fee for most business registrations. A sounder approach would adopt figure standards of labour hereby giving regional labour a priority of employment.

During 2005, the parliamentary financial committee in Kuwait finalized a proposal to reduce tax on profits earned by foreign companies, from 55 to 15 per cent. Moreover, a greater number of foreign banks, including, for example, the National Bank of Abu Dhabi and HSBC Banks Middle East Limited, were given licences to operate in Kuwait. Additionally, the Central Bank announced the registration of a branch of BNP Paribas Bank, and gave its initial approval to the licensing of Citibank. Equally, Kuwait announced that customs duties on goods imported from 16 Arab countries would no longer be imposed, following the implementation in 2005 of the Greater Arab Free Trade Area (GAFTA).

In June 2005, the telecom sector in Oman was further liberalized with the IPO of the State-owned Oman Telecommunications Company (Omantel) on the Muscat Securities Market. In November 2004, a royal decree was issued aimed at allowing foreign freehold ownership of land in designated areas and tourist zones in the country. Work is ongoing on new laws in the areas of regulation and privatization of key infrastructure sectors, namely, electricity and water.

In March 2005, Qatar enacted a new legislation to establish the Qatar Financial Centre (QFC), wherein international and multinational financial institutions are provided with three-year tax exemptions, full repatriation of profits and 100 per cent foreign ownership. Moreover, the Government decided to open partially the Doha Securities Market (DSM) to regional and international investors. Foreign investors are allowed to own up to 25 per cent of companies listed on the stock market. In May 2005, Qatar launched a telecommunications regulatory body as a move to liberalize the sector. Specifically, the Supreme Council for Information and Communication Technology will be responsible for setting guidelines to allow foreign telecom companies to operate within the country.

Saudi Arabia issued an executive bylaw to the new income tax law, which came into effect on 30 July 2004, whereby the rate of taxation on foreign investors was cut from 45 to 20 per cent. Privatization was vigorously pursued during 2005, mainly in such key sectors as electricity and telecommunications. Private and foreign sector participation was particularly encouraged in the utilities sector, petrochemicals, natural gas and real estate. New laws regulating the real estate market were issued, thereby allowing foreign investors to own and rent real estate property across the Kingdom with the exception of the two holy cities of Mecca and Medina.

Additionally, the Saudi Arabian General Investment Authority (SAGIA) launched the King Abdullah Economic City in December 2005, which is expected to act as a financial hub and a centre for such key

sectors as petrochemicals and pharmaceuticals. In the same month, Saudi Arabia announced plans to liberalize 31 investment areas, including education, financial services, tourism, healthcare and transportation. Subsequently, in March 2006, Saudi Arabia announced that a tax credit formula was under study aimed at attracting FDI to the less developed regions of the Kingdom, with a number of incentives, including, among others, dollar-to-dollar tax reductions for investors, setting up a re-export zone to encourage entrepreneurs, and exempting raw material used in manufacturing from customs duties.

In September 2005, the Dubai International Financial Exchange (DIFX) was launched, which trades in dollars, and dispenses with limits on foreign ownership and minimum listing requirements. In February 2006, the Jebel Ali Free Zone (JAFZA) announced the establishment of the Dubai Auto Zone as the future main marketplace for the automobile industry in the region. Moreover, the Dubai Textile City (DTC), comprising a free zone with a tax-free status, is set to open for business in 2006. In late 2005, the Emirate of Abu Dhabi ratified a law that allows 100 per cent foreign ownership in the Industrial City of Abu Dhabi (ICAD) and in various sector-specific industrial clusters. The law allows foreigners to own property in certain areas, albeit not land, under a 99-year lease. The Dubai property law, which was enacted in March 2006, also gives expatriates the right to purchase 99-year lease properties in specific areas, with the additional right to acquire freehold ownership of land.

Egypt has also moved forward with its privatization programme, with no limitations on company ownership or acquisition of assets offered for sale. Major transactions include the sale of the Government's shares in Alexandria Mineral Oils Company, Telecom Egypt and Bank of Alexandria. Additionally, the Government is working on privatizing and restructuring the insurance sector. During 2005, a presidential decree was issued that established the General Authority for Industrial Development (GAID) aimed at facilitating the provision of land for industrial use to foreign investors. Concurrently, customs duties were lowered and customs procedures were simplified. Tax reform was also implemented whereby personal and corporate taxes were cut by 50 per cent. Key reforms in the financial sector include consolidating and allowing more foreign investment in the banking sector and attracting new foreign investments to establish new mortgage finance companies, the first of which is set to be created during 2006.

Similarly, Jordan has moved forward with its privatization programme by finalizing such major transactions as the sale of the Government's stake in Jordan Telecommunication Company (JTC) and Jordanian Phosphate Mines Company (JPMC) in March 2006. Major deals in the electricity generation sector and the privatization of the Jordan Post Company are expected in 2006. In September 2005, the Government announced a reduction in the time required to license investment projects, down to three days by mid 2006.

In 2005, the Syrian Arab Republic introduced several monetary and banking reforms, including as follows: (a) licensed banks were authorized to sell foreign currencies to Syrian citizens and the private sector; (b) restrictions on transferring profits out of the country were removed, and stamp duties and transactions fees were reduced to facilitate and cut down the cost of the lending process; (c) banks were allowed, for the first time, to borrow from each other at an inter-bank rate not exceeding 4.5 per cent; (d) local banks were allowed to issue letters of credit for the import and export of some 950 items; (e) ceilings on the purchases of foreign exchanges by private individuals were raised; and (f) certificates of deposit were issued for the first time, and the issuing T-bills is currently being considered. Moreover, the Syrian Arab Republic is in the process of launching several substantial projects with Arab and foreign investors, mainly in industry and tourism. These include a $32.7-million petrochemical plant, with Saudi investors; a $200-million project to expand the national cement production, with Chinese investors; a $500-million construction project, with investors from the United Arab Emirates; a $2-billion development and industrial city, with Kuwaiti investors; and a number of projects to be carried out jointly with Arab and foreign investors aimed at developing national oil fields and refineries.

Since the late 1980s, many economies of the ESCWA region have undertaken liberal reform measures as a policy priority, including costly financial incentives, in order to attract FDI. The question arises as to whether FDI has been beneficial for economic growth and development in the sense that it has been associated with positive externalities to these host economies. The answer depends on the type of FDI and on the ability of the host country to absorb and, therefore, to benefit from such investments. A cursory investigation on the direction of foreign investments in some ESCWA member countries shows that these have been directed mainly towards energy sectors, given that the region does not provide a large and open common market to promote market-seeking types of FDI. Consequently, this has prejudiced economic and social development in directions away from balanced development.

Unless investments are directed into market-seeking types, namely, the manufacturing sector, the effect of FDI on employment creation and spill-over effect through linkages to the domestic economy will remain limited. More tellingly, ESCWA economies are characterized by a lack of productive capacity and need to increase considerably both public and private investments in order to accelerate the expansion of productive capacity. Investment in this sense is likely to be more autonomous than induced because a balanced supply boost with employment creation is counteracted by a major demand component.

H. PROSPECTS

The currently favourable external conditions to the economies of ESCWA region are gradually phasing out in 2006. The level of global liquidity is expected to come down further. However, inflationary pressures will remain as the price of commodities, including oil and oil-related products, is estimated to stay in higher territory in 2006. It is challenging for the policymakers in the region to choose carefully their respective scenarios for soft landing. For the countries of the GCC, a gradual series of adjustments of asset prices is needed to maintain sustainable growth of domestic demand, though the crash of financial markets in the first quarter of 2006 will make this more difficult.

Guiding expectation among participants of national economies to the right direction will be a crucial role of the Government by providing the best mix of fiscal and monetary policies. The foreign exchange constraints of MDEs are likely to resurface again in late 2006, though its effect will still be modest in the light of the current level of foreign reserves in the countries of that cluster. In 2006, Governments in MDEs need to commit themselves more actively to their development strategies, and to make regional and international arrangements for supporting such strategies. For Iraq and Palestine, while regional and international support continues to be vital for reconstruction as well as for regional development, political and security considerations are clearly hampering reconstruction.

II. RIGHTS-BASED AND PRO-POOR ECONOMIC POLICIES

The human right to development was recognized by the Declaration on the Right to Development (UNDRD) in 1986, drawing upon the Universal Declaration of Human Rights (UDHR).[11] The connection between these two declarations is more than merely superficial, and it could be argued that the UNDRD elaborates the implications of the UDHR for economic and social development. The UDHR sets out not only general principles concerning civil and political rights, it also describes social and economic rights, including, among others, the rights to social security, work, rest and leisure, education, and participation in the cultural life of the nation.[12]

These social and economic human rights (for equality and demanding State action) are not merely secondary or derived from so-called "first generation rights" (for liberty and against State oppression). Rather they are intrinsic in the UDHR conception of human rights. The artificial dichotomy between primary and secondary-generation rights was created by an orthodox interpretation of the UDHR, which has always regarded the extension of human rights into the economic and social sphere as being deeply problematic. In addition to the right to development, such an extension includes the right to peace, the environment, ownership of the common heritage of humankind and communication. Initially left in the background, the economic and social rights re-entered the human rights discourse through the notion of "right to development".

This right expresses the aspiration to bring about the socio-economic conditions allowing human rights to be realized in full. Not surprisingly, the right to development was advocated primarily by developing countries. It was backed during the Fourth Summit of the Non-Aligned Movement of Countries (Algiers, 5-9 September 1973), before being recognized by the Office of the United Nations High Commissioner for Human Rights in 1977 and being finally adopted by the General Assembly in December 1986. The UNDRD represents the attempt to extend the scope of human rights to include the real (material) conditions limiting the realization of the potential of the majority of humanity. At another level, the right to development provides the legitimacy for much of the institutional activity of the United Nations, as well as validating more broadly the need for international solidarity.

This chapter reviews the principles of development based on human rights and draws their implications for economic policymaking. Two issues are apparent. First, the principles of the UNDRD can be made operational at the level of policy and, reciprocally, consistent economic policies can be designed in order to achieve the UNDRD in poor countries. This chapter brings out these connections drawing upon the pro-poor economic policies currently being developed by United Nations Development Programme (UNDP) and academics working in several countries.

Secondly, the explicit connection between the pro-poor policy literature and the principles of the UNDRD can help to distinguish the ex post impact and, therefore, the ex ante desirability, of different types of policy claiming to support the poor. This is important, given that pro-poor rhetoric is rapidly becoming fashionable and appears frequently even in documents by the International Monetary Fund (IMF). There is a significant risk that this concept could be diluted beyond recognition even if, in many cases, it is being used simply as a fig-leaf for the same mainstream growth strategies that have failed to deliver in most countries. The policy principles outlined below can be used to gauge the actual pro-poor content of macroeconomic policy, as well as to direct the selection of economic policy priorities at the level of Government.

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[11] "Human rights are normally claimed for both their substantive and instrumental value. They are desirable in themselves and they are desirable as they help realize other desirable objectives (e.g. the right to education, the right to health or the right to free speech); but they qualify as human rights not just because they are intrinsically or instrumentally desirable but because they are recognized through an appropriate norm-creating process and the claims for them satisfy the tests of legitimacy and coherence". A. Sengupta, "The human right to development", *Oxford Development Studies*, vol. 32, No. 2 (Carfax Publishing, June2004), p. 184.

[12] See A. Higginbottom, "Human rights, globalization and dependency" (unpublished manuscript, 2005).

A. THE HUMAN RIGHT TO DEVELOPMENT

The UNDRD and the subsequent reports by an independent expert on the right to development to the United Nations Human Rights Commission define development as a "comprehensive economic, social, cultural and political process which aims at the constant improvement of the well-being of the entire population and of all individuals on the basis of their actions, free and meaningful participation in development and in the fair distribution of benefits resulting there from".[13]

This broad-ranging definition transcends conventional or reductionist notions of development as rising per capita GDP, or even as the satisfaction of narrowly defined basic needs measured, for example, through the Human Development Index (HDI). Specifically, the "notion of well-being extends in a rights framework the usual notion of availability of goods and services to a rights-based access of all individuals to at least some of the goods and services related to enjoying fundamental freedoms claimed as human rights and a rights-based process of generating income. The level of well-being can then be described as the level of realization of the fundamental rights and of the rights based per capita real income or the standard of living. Development then would mean improvement in that well-being".[14]

Consonant with this definition of development, Article 1 of the UNDRD states that the right to development, which is "an inalienable human right, is the right to a particular process of development in which all human rights and fundamental freedoms can be fully and progressively realized".[15]

The UNDRD implies that equality of opportunity for development is as much a prerogative of nations as of individuals within nations. In other words, the right to development is as much a collective as an individual right, and it is closely connected with the right of nations to self-determination.[16] This view of development as a process based on human rights suggests that access to economic goods needs to follow five basic principles, namely: equity, non-discrimination, participation, accountability and transparency.[17] A development process that satisfies these principles, secures constant improvements in well-being and realizes all human rights and fundamental freedoms qualifies as rights-based development.[18]

This definition of development accommodates the three basic characteristics of human rights, namely: inviolability, interdependence and indivisibility. These features of human rights imply that the right to development is a composite right, which cannot be realized if any individual right (including civil, political, economic, social and cultural rights) is violated or even curtailed temporarily. In this sense, the right to development can reconcile the "earlier conflict between the countries which championed only the civil and political rights, and the countries which emphasized the fulfilment of economic, social and cultural rights, even at the expense of civil and political rights".[19]

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[13] A. Sengupta, op. cit., p. 198. See also reports from the independent expert, which are available at: www.unhchr.ch.

[14] A. Sengupta, op. cit., p. 182.

[15] Ibid., p. 180. See also Economic and Social Council, "Review of progress and obstacles in the promotion, implementation, operationalization, and enjoyment of the right to development" (United Nations, 17 February 2004); and reports from the independent expert, which are available at: www.unhchr.ch.

[16] A. Higginbottom, op. cit.

[17] A. Sengupta, op. cit., pp. 181 and 193.

[18] Ibid., p.181.

[19] Ibid., p. 183. See also Economic and Social Council, "Review of progress and obstacles in the promotion, implementation, operationalization, and enjoyment of the right to development" (E/CN.4/2004/WG.18/2) (United Nations, 17 February 2004).

Realization of these interdependent rights depends upon access to the goods and services required to fulfil each right, including not only economic, social and cultural rights, but also civil and political rights. In this sense, political freedom is an essential aspect of rights-based development. The increased availability of each right, without prejudice to other rights, requires the relaxation of the resource constraint through economic growth, given that resource reallocation will not suffice in the long-run. Without economic growth, the composite right to development will eventually be violated because resource shifts will, at some point, limit the scope to realize some of these rights. In other words, securing the right to development necessarily requires economic growth.[20]

The recognition that economic growth plays an essential role in the delivery of rights-based development allows a more complex understanding of rights-based development. At this more complex level, rights-based development is a specific strategy for economic growth, which includes the expansion of output and employment accompanied by technological progress and institutional transformations, aimed primarily at improving the well-being of all people, and at contributing to the fulfillment of their human rights and fundamental freedoms. In this manner, the development process can facilitate the realization of the full potential of each individual.

At an even more specific level, the rights, freedoms and capabilities which need to be satisfied by a process of rights-based development are specified by the Universal Declaration of Human Rights (UDHR); the International Covenant on Economic, Social and Cultural Rights; the International Covenant on Civil and Political Rights; the International Convention on the Elimination of All Forms of Racial Discrimination; the Convention on the Elimination of All Forms of Discrimination against Women; the Convention on the Rights of the Child; and the Convention against Torture and Other Cruel, Inhuman or Degrading Treatment or Punishment.

The achievement of these internationally mandated outcomes can be claimed as a right by people, principally against their own State, but also against the international community. By the same token, it is the duty of individual States and the international community to implement policies that contribute to the achievement of rights-based development, and ensure that the ends of the development process are treated as a human right.[21]

While economic growth facilitates the realization of the right to development, growth has not always been conducive to the enjoyment of this right either across or within countries, or across regions and population segments.[22] In order to secure the implementation of rights-based development, it is necessary not only to achieve economic growth but equally to regulate and guide the market in order to ensure that the outcomes of growth correspond to the requirements of the right to development.

The translation of existing potentialities into actual capabilities belongs to the realm of economic policy, and it depends heavily upon the State. In order to support the realization of the human rights and fundamental freedoms explained above, and deliver their international covenants, States must adopt economic policies that are conducive to economic growth, macroeconomic stability, and with pro-poor and rights-based outcomes.

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[20] A. Sengupta, op. cit., pp. 184-185.

[21] Economic and Social Council, op. cit.

[22] See, for example, B. Milanovic, "True world income distribution, 1988 and 1993: First calculation based on household surveys alone", *The Economic Journal*, vol. 112 (Royal Economic Society, 2002), pp. 51-92; and B. Milanovic, "The two faces of globalization: Against globalization as we know it", *World Development*, vol. 31, No. 4 (Elsevier Science Ltd., 2003), pp. 667-683.

A defining aspect of right to development concerns the implementation of policies to eradicate poverty and protect vulnerable groups from the dislocating impacts of development. Poverty is clearly multidimensional, extending beyond income-poverty to include nutrition, health, education, social security and other human rights. In many ways, poverty is "the worst form of deprivation of human rights".[23] Poverty eradication policies are, therefore, essential to secure the right to development. There is a close relationship between economic growth, poverty and economic policy at two levels.

First, the decline in poverty has been most significant where economic growth has been fastest over long periods of time. For example, the decline in poverty has been comparatively faster in Southeast Asia, China and India than in parts of Africa, Latin America and the ESCWA region where growth has been slower and more erratic. In this sense, pro-poor economic policies are essential for the realization of the right to development. Secondly, income transfers, the provision of social services and the promotion of equality within and between countries can also give an important contribution to the reduction of poverty.[24]

Analysis of economic policy through the lens of human rights offers important elements for the evaluation of structural adjustment programmes (SAPs). A vast literature has shown that SAPs systematically lead to higher poverty and unemployment, lower wages and more precarious social service provision, and increased labour repression in the countries where they are implemented. These outcomes are unacceptable from the point of view of rights-based development, given that they compromise, among others, the right to shelter and health, and the right to food and education.[25] Moreover, as the effects of SAPs begin to bite, civil and democratic rights also tend to be eroded, which is also unacceptable from the point of view of the UDHR.[26]

In order to secure the achievement of rights-based development, and support the selection of economic policies conducive to these internationally-mandated goals, an independent expert on the right to development has proposed a model of development compacts aimed at securing international cooperation to implement the right to development in different countries, and at monitoring the achievement of this right. These development compacts are a mechanism for ensuring the recognition among all stakeholders of the mutual obligations to enforce the right to development so that, for example, the implementation of rights-based development programmes in developing countries is supported both politically and financially by wealthier countries.

The institution of a development compact includes the following five main aspects:[27] (a) designing national development programmes that target the realization of selected human rights and norms (which must not violate any other rights), for example through poverty reduction; (b) adopting legislation that incorporates human rights in domestic law and establishing national human rights commissions; (c) specifying the obligations of the national authorities and the international community; (d) organizing support groups for each country that comprise relevant stakeholders, scrutinizing their development programmes, examining the ensuing obligations and drawing recommendations on burden-sharing among the international community, for example through debt relief, investment and the regulation of trade; and (e) determining the residual financing requirements of the development compact, after taking into

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[23] Economic and Social Council, op. cit.

[24] For a detailed analysis, see H. Dagdeviren, R. van der Hoeven and J. Weeks, "Poverty reduction with growth and redistribution", *Development and Change*, vol. 33, No. 3 (Institute of Social Studies, 2002), pp. 383-413.

[25] These rights are provided for under Articles 25 and 26 of the Universal Declaration of Human Rights (UDHR), which is available at: www.un.org/Overview/rights.html.

[26] See A. Higginbottom, op. cit.

[27] A. Sengupta, op. cit., pp. 196-197.

account the contribution of multilateral and bilateral donors, and setting up a financial facility with callable commitments from the donors. The implementation of development compacts along these lines could contribute significantly to the achievement of rights-based development in the ESCWA region and elsewhere.

B. RIGHTS-BASED ECONOMIC POLICIES

This section outlines the principles of rights-based and pro-poor development strategies, and their implications for policy formulation and implementation. A rights-based economic strategy seeking to implement the objectives outlined in the following chapter has three distinguishing features, namely:

(a) It prioritizes rapid growth, structural transformation and distribution, subject to the preservation of macroeconomic stability.[28] These objectives are very different from those of mainstream policies that seek primarily to roll back the State and achieve price stability and static market-based allocative efficiency, with economic growth and poverty reduction set merely as derived goals;

(b) Rights-based growth promotes equity,[29] and it is predicated upon the redistribution of income and assets. Rights-based growth not only needs to be faster, it must also benefit the poor more than the rich in order to reduce absolute as well as relative poverty as rapidly as possible, particularly in the light of achieving MDGs by 2015;[30]

(c) Improvements in distribution and social welfare need to be pursued directly. These improvements must not be merely marginal or conditional upon trickle-down effects. Rather they need to be targeted directly, and the outcomes must be unambiguous across a broad spectrum of measures of welfare and distribution.

Changes in the distribution of income and wealth promote several pro-poor objectives, including, for example, through land reform, universal basic education and vocational training, and the introduction of pensions and other entitlements. Experience shows that those countries that have achieved the most significant successes in poverty reduction have combined economic growth with structural economic transformations and greater equity both before and through the process of growth.[31] This is not necessarily because equality is beneficial for growth.[32] The relationship between these variables, if any, plays no role in the choice of rights-based rather than mainstream growth strategies. In rights-based strategies, equality is not an instrument to achieve growth maximization, and the success of this strategy must not be judged primarily by the achievement of high GDP growth rates. Quite the contrary, in rights-based strategies, economic growth serves equality, and it is conditioned by and conditional upon the reduction of absolute and relative poverty and the improvement of the living standards of the majority of the population.

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[28] See H.A. Pasha, "Pro-poor policies", which was presented at the Fourth Global Forum on Citizens, Businesses and Governments: Dialogue and Partnerships for the Promotion of Democracy and Development (Marrakech, Morocco, 12-13 December 2002).

[29] See T. McKinley, "The macroeconomics of poverty reduction: initial findings of the UNDP Asia-Pacific Regional Programme" (UNDP, August 2003).

[30] Ibid. See also J. Weeks and R. Roy, "Thematic summary report: The macroeconomics of poverty reduction - fiscal policy" (UNDP, 2003), p. 3.

[31] See H.A. Pasha, op. cit.

[32] This relationship has been heavily disputed. For a survey of ideas, see C. Cramer, "Inequality, development and economic correctness" (School of Oriental and African Studies Cramer, C, 2000).

Distribution plays an important role in rights-based and pro-poor economic strategies at two levels. First, pro-poor goals can be achieved more easily if the distribution of assets is modified by public policy, for example, through land reform,[33] universal basic education, skills and training programmes, the introduction of pensions and other welfare entitlements.[34] Empirical evidence indicates that when there are no radical changes in institutions and political power, size distributions of income remain moderately stable.[35] On the other hand, the dynamic processes of income generation and distribution also need to be transformed in order to benefit the poor disproportionately. This includes, among others, support for the development of strategic economic activities, directed credit lines, employment generation programmes, the creation of labour scarcities and incentives for wage increases for low-skilled workers (see chapter IV).

In order to achieve these objectives, rights-based macroeconomic policies need to be consistent, democratic and coordinated. Macroeconomic policy consistency includes both its sustainability and efficiency. This implies, on the one hand, that these policies must not create severe macroeconomic turbulence or generate major welfare traps and disincentives. Given that unsustainable policies cannot be maintained in the long-run, they should normally be avoided even over short periods of time.

Moreover, rights-based policies need to be efficient, or to achieve their stated objectives at the lowest possible cost, including the costs of implementation and monitoring. Policy efficiency is not given ex ante or in the abstract, it varies with the country and its circumstances, and it needs to be assessed continually. For example, the neo-liberal policies sponsored by the International Financial Institutions (IFIs) can be costly. In some countries of the ESCWA region, these policies tended to be excessively contractionary by inducing unemployment and deindustrialization. Indeed, under conditions of instability, they have promoted foreign currency waste through capital flight and luxury imports.

Equally, excessively loose monetary policies can be costly, given that they can trigger consumption bubbles, poor investment choices, inflation, capital flight and balance of payments crises. The potential costs of misguided macroeconomic policies and their distributive implications also need to be considered in order to calibrate the use of different instruments and facilitate the achievement of MDGs and other pro-poor goals.

There can be no guarantee that rights-based macroeconomic policies will be less costly than the alternatives. In order to minimize their cost and check their internal consistency, it is important to foster an environment in which the objectives of public policy are constantly scrutinized, the efficiency of the chosen instruments is assessed continually, and the policy outcomes are regularly checked against their stated goals. In other words, rights-based policy implementation must be democratically accountable.

While policy accountability can help to ensure the consistency and efficiency of macroeconomic policy, its importance is not primarily instrumental. Macroeconomic policy plays a key role in the determination of the levels of welfare, the work patterns and the material prospects of the majority of the population. The only legitimate way to select the targets for Government action and the appropriate policy tools is by involving civil society in the choice, implementation and assessment of macroeconomic policy.

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[33] In most countries, redistributing land to the poor raises labour incomes by raising both land yield and the demand for labour, which in turn produces efficiency gains and immediate benefits for the poor. J.M. Rao, "The possibility of pro-poor development: Distribution, growth and policy interactions" (February 2002), which is available at: www.asiapropoor.net/resources/reports/Reports/Background%20Concept%20Paper%20Rao.doc.

[34] McKinley argued that while macroeconomic policies can influence whether growth is pro-poor, such policies cannot be a substitute for an equitable distribution of productive assets. T. McKinley (ed.), "Introduction" in *Macroeconomic Policy, Growth and Poverty Reduction* (Palgrave Macmillan, 2001).

[35] J.M. Rao, op. cit.

This is especially important given that the desired rights-based and pro-poor outcomes are both complex and diverse.

Moreover, multiple restrictions affect macroeconomic policy. The policy tools are potentially diverse, and there is a non-linear relationship between economic circumstances, policies and outcomes. Democratic participation and accountability enhance the legitimacy of the Government's policy objectives, buttress the regulatory framework required by the chosen policies, and help to assess the implications of deviations from the selected targets. In addition to this, mass participation in policy debates affords people the chance to influence the design of policies that can redistribute income and opportunities.[36]

These debates regarding macroeconomic policy need to be welcomed, given that they can help to break the monopoly of the moneyed interests, professional politicians, paid advisors, lobbyists and established academics in the selection, implementation and evaluation of economic policy.

Finally, rights-based policies need to be coordinated at two levels. First, pro-poor objectives are complex, and they can be achieved only through the use of a large number of policy instruments. These instruments do not operate in isolation from one another. Coordination is necessary given that "all policy tools interact with each other, and what occurs when a Government uses any given tool depends on the state of the other tools and on conditions prevailing at the time. So coordination of several policy tools is vital. The more coordination there is among monetary tools, and between them and other policy tools, the more workable monetary policy is expected to be".[37]

Secondly, rights-based policies require coordination between private and public sector activities and the regulation of inter-sectoral and inter-temporal resource allocation, including international capital flows, by the State through activist and growth-promoting industrial and financial policies. This is not because the State is either necessarily efficient or inherently good. Policy activism and State-led coordination of economic activity are necessary given that the State is a fundamental tool for collective action. The State is the only social institution that is at least potentially democratically accountable and that can influence the pattern of employment, the production and distribution of goods and services and the distribution of income and assets at the level of society as a whole. Only the State can limit the power of unaccountable private interests, raise sufficient funds for democratic economic reforms and ensure that economic activity is guided by the demands of the majority.[38]

The expansion of economic and political democracy will require the extension of the political sphere and the reconstruction of State policymaking and managerial capacity in many member countries of ESCWA. This will require, among others, dismantling at least partially the domestic and foreign-led administrative and policy structures that currently rival the governmental institutions in those countries; and reducing the interference of non-governmental organizations (NGOs) and international financial organizations on the selection, management and appraisal of investment programmes, even when they are aid-funded.[39]

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[36] See C.E. Weller and A. Hersh, "The long and short of it: global liberalization and the incomes of the poor", *Journal of Post Keynesian Economics*, vol. 26, No. 3 (M.E. Sharpe Inc., 2004), p. 482.

[37] J. Sics "Credible monetary policy: a Post Keynesian approach", *Journal of Post Keynesian Economics*, vol. 23, No. 4 (M.E. Sharpe Inc., 2001), p. 674.

[38] MacEwan argued that, within broad limits, the State could construct or shape markets usefully in ways that direct the private sector towards social ends. A. MacEwan, "Debt and democracy: How can heavily indebted countries pursue democratic economic programs?", which was presented at the Symposium on Common Defense Against Neoliberalizm (Istanbul, 6-7 December 2003).

[39] See United Nations Conference on Trade and Development (UNCTAD), *The Least Developed Countries: 2000 Report* (UNCTAD, 2000).

This does not at all imply that the State needs to take over the economy. Pro-poor economic strategies are distinctive not because the State manages individual firms or enjoys significant property rights, rather as a result of the way in which the State coordinates economic activity in pursuit of rights-based and distributive ends. In this context, State ownership of specific assets is a secondary issue. The principal issues are the objectives of Government policy, and the interactions of State institutions with one another and with private concerns.

Possible arguments against rights-based economic strategies can be divided into three groups. First, at a static level, it could be claimed that some countries are too poor to redistribute. Specifically, the per capita income of such countries is so low that redistribution would have little impact on the level of poverty. In the ESCWA region, this could apply particularly to Yemen. However, this argument has limited validity, given that redistribution can help both statically and over time. For example, redistribution increases effective demand and, therefore, indirect investment through an increase in mass consumption. However, it could equally engender a balance of payments crisis by increasing demand for imported goods.

Secondly, at a dynamic level, it could be claimed that there is a trade-off between growth and distribution. While distribution can reduce poverty to some extent, economic growth does so in a more sustainable manner. This could be the case of all MDEs in the ESCWA region. This argument is misleading given that economic growth always redistributes income and wealth. Since redistribution is inherent in the growth of a market economy, it must necessarily be subjected to policy influence through a democratically chosen development strategy.[40]

Finally, it could be argued that rights-based strategies are difficult to implement, and that several Governments have failed significantly in their attempts to follow similar strategies in the past. This is a serious argument, and similar failures could occur in the future. However, rights-based development is inherently worthwhile, and it can be steered in the desired direction through democratic political channels. This is more than can be claimed for the mainstream economic development strategy sponsored by IFIs and by economic policies influenced by those development strategies.

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[40] See H. Dagdeviren, R. van der Hoeven and J. Weeks, op. cit.

III. RIGHTS-BASED ECONOMIC STRATEGIES FOR THE ESCWA REGION

This chapter examines the most common types of development strategy in the ESCWA region through a long-run perspective, and outlines the basic principles of rights-based and pro-poor strategies for countries in this region. The starting point of the analysis can be summarized as follows:

(a) There are two fundamentally different types of economies in the ESCWA region, namely, the oil economies of the GCC and the MDEs. Rights-based policy alternatives for the countries in these clusters will, correspondingly, be different;

(b) Despite these fundamental differences between the two clusters, there are significant commonalities between all the countries in the ESCWA region. For example, there is a gross underutilization of resources in all ESCWA member countries, unemployment and underemployment are significant problems across the region, and pockets of poverty exist even in the most prosperous areas;

(c) There is ample scope for collaboration between Governments and the private sector in all the countries of the region in order to mobilize these underutilized resources and achieve rights-based and pro-poor goals;

(d) Collaboration is not only feasible; it is imperative. Untrammelled private sector activity in the ESCWA region, especially after the recent neo-liberal reforms, has often not been conducive to or even fully compatible with rights-based and pro-poor outcomes. On the other hand, rights-based and pro-poor development strategies cannot be implemented by ESCWA member countries in isolation from the private sector. Strategic partnerships between State institutions and private enterprise play a key role in local development compacts, and they are essential for effective resource mobilization and the achievement of rights-based development.

A. ESCWA DEVELOPMENT MODELS

The mainstream literature on the economic problems of the ESCWA region is entirely predictable. These studies normally include two parts. The first deplores the populist and heavy-handed economic intervention of the Governments in the region; and blames such intervention for the severe problems of unemployment, low productivity, resource misallocation, institutional weakness, debt build-up and economic stagnation in the area.[41]

The second part claims that market-led policies are essential to stimulate the ESCWA economies, and celebrates the policy changes taking place since the late 1980s. These reforms include economic stabilization and, subsequent to that, core structural reforms, especially economic opening;[42] labour market liberalization; the shift from Government-led to private sector-led investment, even where such shifts remain comparatively modest; and the transition from an inward-looking to an outward-looking development strategy.

It is claimed that these reforms are essential to attract investment, create jobs, sustain growth and, in the long run, raise living standards in the ESCWA region.[43] Failure to achieve these desirable outcomes is

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[41] See, for example, G.T. Abed, "Unfulfilled promise: Why the Middle East and North Africa region has lagged in growth and globalization", *Finance and Development*, vol. 40, No. 1 (IMF, March 2003), pp. 10-14; S. Eken, D.A Robalino and G. Schieber, "Living better: Improving human development indicators in MENA will require different approaches to health, education, and social protection', *Finance and Development*, vol. 40, No. 1 (March 2003), pp. 15-17; and the World Bank, *Reducing Vulnerability and Increasing Opportunity: Social Protection in the Middle East and North Africa* (the World Bank, 2002).

[42] This economic opening is referred to as *infitah* in Arabic.

[43] See D. Dasgupta, J. Keller and T.G. Srinivasan, "Reform and elusive growth in the Middle East: What has happened in the 1990s?", *Middle East and North Africa Working Paper Series No. 25* (the World Bank, 2002); H. Hakimian, "From MENA to East Asia and back: Lessons of globalization, crisis and economic reform", in *The State and Global Change: The Political Economy of Transition in the Middle East and North Africa*, eds. Hakimian, H. and Moshaver, Z. (Curzon Press, 2001), p. 90; and K. Pfeiffer, "Does structural adjustment spell relief from unemployment? A comparison of four IMF 'success stories' in the Middle East and North Africa", in *Earnings Inequality, Unemployment, and Poverty in the Middle East and North Africa*, eds. Shahin, W. and Dibeh, G. (Greenwood Press, 2000), pp. 113-114.

attributed primarily to elements of the region's ruling elites, which tend to use the State as a source of patronage and social control at the expense of economic rationality, and the rigidities of regional institutions, especially the labour market.[44]

However, the neo-liberal reforms are flawed on several grounds. Ostensibly, they aim to build a State that, in the economic sphere, provides a level playing field and sound fundamentals. This is unfeasibly vague and, therefore, endlessly open to interpretation and, moreover, insufficient to support sustained and rights-based growth.

Moreover, the mainstream agenda carries the largely implicit corollary that ESCWA member countries must shift their social base towards a narrower coalition, in which the emerging class of entrepreneurs figures prominently.[45] This is a tall order, and it is based on an interpretation of the political economy of the ESCWA region that is neither internally consistent nor, ultimately, conducive to socially desirable outcomes. These prescriptions are also outside the scope of the mandate of IFIs for which "the cause of poverty reduction is best served by more rapid adjustment to fiscal imbalances, rapid adjustment to lower inflation and external deficits and the use of higher interest rates to achieve these ends, internal and external financial sector liberalization, deregulation of capital controls, deep and rapid privatization of State-owned enterprises and, perhaps the strongest unifying factor, rapid and major opening up of an economy to trade and foreign direct investment".[46]

The mainstream approach is also analytically inconsistent given that it focuses inordinately on short-term stabilization, while, at the same time, undercutting the basis for long-term growth.[47] The inability of the IFI-sponsored liberalization programmes to bring about economic stability and rapid growth has become increasingly evident during the past 25 years, both in the ESCWA region and elsewhere. Given the resources that are currently available in the regional economy and those that could be generated through faster growth, the slow improvement in the welfare of the poor is a severe indictment of mainstream economics and of the international community.

Finally, the mainstream agenda is insufficient, because the mere repetition of tired slogans is incapable of responding to the key problems of development, including, for example, creating sustainable competitive advantages; supporting business growth in strategically important areas; assisting employment creation and productivity growth; and monitoring resource use in order to achieve rights-based development objectives while, at the same time, securing environmental sustainability.[48]

Generally, IFIs posit the dichotomous relationship between States and markets as an analytical principle. Such a conjecture implies that the most profound problems of economic development can be

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[44] See R. Hinnebusch, "The politics of economic liberalization: Comparing Egypt and Syria", in *The State and Global Change: The Political Economy of Transition in the Middle East and North Africa*, eds. Hakimian, H. and Moshaver, Z. (Curzon Press, 2001), pp. 111 and 119.

[45] Ibid., p. 116.

[46] R. Kanbur, cited in J.M. Rao, "The possibility of pro-poor development: Distribution, growth and policy interactions" (February 2002), which is available at: www.asiapropoor.net/resources/reports/Reports/Background%20Concept%20Paper%20Rao.doc.

[47] See B. Fine and C. Stoneman, "Introduction: State and development", *Journal of Southern African Studies*, vol. 22, No. 1 (Taylor and Francis Ltd., March 1996), pp. 5-26; and T. McKinley (ed.), "Introduction" in *Macroeconomic Policy, Growth and Poverty Reduction* (Palgrave Macmillan, 2001).

[48] See, for example, H. Hakimian, "From MENA to East Asia and back: Lessons of globalization, crisis and economic reform", in *The State and Global Change: The Political Economy of Transition in the Middle East and North Africa*, eds. Hakimian, H. and Moshaver, Z. (Curzon Press, 2001), pp. 100-101.

resolved simply through the withdrawal of the State, and the subordination of the economy to so-called "global" forces. It ignores the fact that private sector decisions can be costly and destabilizing, and that quality public sector intervention is essential to stabilize the economy and steer it in a socially desirable direction.

Moreover, it vastly overestimates the capacity of ESCWA member countries to respond constructively and at short notice to adverse shocks. International experience shows that the automatic transition to neo-liberal models of development is often a recipe for economic and social disaster, because the market does not generate spontaneously the institutions required for rapid, stable, employment-intensive and pro-poor growth. In their absence, economies are likely to stagnate over long periods, with severe economic implications and enormous social costs.

Unsurprisingly, the outcome of the neo-liberal reforms in the ESCWA region has been uneven. While institutional development and macroeconomic stabilization have strengthened important areas of these economies, as indicated above, other aspects of the reforms could have reached their limits both in terms of their capacity to deliver the stated goals of the reform process and of their contribution to the achievement of pro-poor objectives. These strategic limitations could help to explain the disappointing growth rates of the ESCWA economies during the past 15 years, and the concentration of income and wealth that has accompanied the reforms in some countries. Additionally, they have contributed to the growing dollarisation of ESCWA economies and the financial fragility of the public sector in most countries.

A more fruitful analysis of the current economic problems of the ESCWA region needs to depart from the significant differences between the countries in this region, including their economic and social structures, income levels, growth rates and resource endowments. Despite these important differences, the ESCWA member countries have several features in common. At the level of deep structures, they have been shaped historically by a complex synthesis between their traditional social structures; endogenous technological and economic developments; and concurrent pressures from exogenous economic, social and political forces.

Those traditional social structures remain influential. They are not simply anachronistic residues, and there can be no presumption that they will inevitably be eroded by the relentless advance of marketization inspired by IFIs and by formal political democratization. This prospect is deeply flawed. There is no reason to expect that Western-style modernization must eventually obliterate all the competing influences, and simply replicate in the ESCWA region the developed market societies that are idealized by these commentators.

Colonization and its aftermath, and the specific modality of integration of ESCWA member countries into the global economy, particularly through the export of primary products, capital and workers, have influenced heavily the developmental path of these countries. Specifically, oil economies are connected to international capital circuits through their strategic importance, the oil rents which they capture, and the ensuing liquidity flows towards developed countries. By contrast, MDEs are linked to the core economies through their primary commodity and low value-added exports, labour remittances and geopolitical value.

Additionally, these groups of economies are integrated to one another in richly dynamic patterns that are based primarily on the circulation of large numbers of low-paid workers within the region; the purchase by oil economies of agricultural and manufactured goods that are produced regionally; and their investments in and provision of aid to MDEs. These modes of integration generate a specific type of transformative dynamic.

At the same time, the capture of rents, owing partly to the export of strategic commodities or the sale of geopolitical services, tends to have a socially conservative impact. Rents can perpetuate or even enhance

inequality and exclusion both within and between countries. Moreover, they can help local elites to influence internal and external support. Several ESCWA member countries were able to build comprehensive social protection programmes with these rent flows, and they have achieved relatively good health and nutrition standards rapidly (see table 10).[49]

Despite its strengths, this arrangement is fragile in important respects, including as follows: (a) any reduction in the inflows of rent can have destabilizing political repercussions both in the resource-rich countries and in the economies that depend upon their prosperity, for example, through workers' remittances; (b) neither the rich oil countries with small populations nor the poorer and relatively more populated non-oil countries in the ESCWA region have been able to internalize the complex interlinkages in economic activities that could have permitted their sustained and autonomous economic development; and (c) rent-financed prosperity is generally not conducive to institutional development.

In fact, until the late 1980s most ESCWA member countries intervened extensively in the economy in order to shore up their growth strategies. However, extensive regulation and State intervention were not supported by a solid taxation system, the institutional strengthening of the State or the diversification of the economic base of these countries. During this period, ESCWA member countries were generally interventionist, albeit not strongly so. They were institutionally weak in the planning of socio-economic development, and were largely unable to mainstream a consistent set of economic and social priorities upon conflicting socio-economic interests.

These are not the only sources of structural fragility in the ESCWA region. Tensions between the transformative demands of economic development and the impact of the traditional social structures have also triggered political turbulence. In the oil economies, rents have transformed both the built environment and the institutions delivering social welfare services. The rapid prosperity of these economies in the 1970s and 1980s, and their increasing reliance on oil rents, has created specific tensions within their social structures.

These are largely different from the transformations induced by the endogenous process of capital accumulation fuelled by the rent flows. These tensions include, for example, the rapid release of surplus populations, their rising economic aspirations, and the uneasy coexistence of small native populations with a large imported labour force remaining uncertain about residency rights.

By contrast, economic modernization in MDEs imposes more conventional, albeit not necessarily less strong, tensions and displacements, with the added complication that these economies are heavily conditioned by the fortunes of the neighbouring oil countries. These complex patterns of development suggest that the economies and societies in the ESCWA region, whether they are major oil exporters or not, need never resemble or even converge towards the developed Western model. Even wholesale social and economic transformations need not trigger this convergence. Modernistic models of State-led development during the past half century have not led to the unproblematic modernization of countries in the region that have adopted such models along the supposedly ideal path of the economically advanced Western societies.

The tensions and displacements explained above, and the combination of strategic asset ownership with strategic geographical position explain why the ESCWA region has one of the most serious levels of internal and external conflicts in the world, suffers from significant economic risks, and possesses serious levels of inequality.[50] This combination of factors tends to reproduce itself over time, with some modifications; and it determines to a large extent the regional political economy cycle. This cycle is driven

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[49] See C.M. Henry, and R. Springborg, *Globalization and the Politics of Development in the Middle East* (Cambridge University Press, 2001), pp. 8-11.

[50] This inequality refers to the total resident population of the region.

primarily by fluctuations in oil revenues and workers' remittances, political and military instability, and the response of the local institutions to these exogenous pressures. In this cycle, the connection between economic and political factors is very close.

TABLE 10. WELFARE INDICATORS IN SELECTED ESCWA MEMBER COUNTRIES, 1970-2003

	Under-five mortality (*per 1,000 live births*)					
Country	1970	1980	1990	1995	2000	2003
Bahrain	75	30	19	18	16	15
Egypt	235	173	104	71	49	39
Iraq	127	83	50	122	125	125
Jordan	107	67	40	35	30	28
Kuwait	59	35	16	14	10	9
Lebanon	54	44	37	34	32	31
Oman	200	95	30	18	14	12
Qatar	65	32	25	18	16	15
Saudi Arabia	185	85	44	34	29	26
Syrian Arab Republic	129	73	44	31	22	18
United Arab Emirates	83	27	14	11	9	8
Yemen	303	205	142	126	117	113
	Life expectancy					
	1970	1980	1985	1990	1995	2000
Bahrain	59.9	65.6	68.9	70.4	71.6	73.2
Egypt	54.5	54	56.5	61	63.9	67.6
Iraq	64.1	60.4	62	65	59.5	58.8
Jordan	51.7	61.1	63.7	65.9	68.5	69.7
Kuwait	58.7	69.3	71.3	74.1	75.1	76
Lebanon	53.6	66.6	67	67.9	69.3	70.5
Oman	..	57.4	62.7	67.7	71.2	72.6
Qatar	..	65	67	68.4	69.9	71.6
Saudi Arabia	..	58.7	63	66.3	68.8	70.5
Syrian Arab Republic	..	61.4	64.6	67	69.3	71.6
United Arab Emirates	..	66.2	68.6	71.3	73.7	76.2
Yemen	..	44.2	49.1	52.9	55.7	57.7
	Immunization of one-year old children against measles (*percentage*)					
	1985	1990	1995	2000	2003	
Bahrain	78	87	95	98	100	
Egypt	74	86	89	98	98	
Iraq	70	80	80	90	90	
Jordan	73	87	92	94	96	
Kuwait	91	66	98	99	97	
Lebanon	23	61	85	90	96	
Oman	65	98	98	99	98	
Qatar	62	79	87	91	93	
Saudi Arabia	79	88	94	94	96	
Syrian Arab Republic	27	87	90	96	98	
United Arab Emirates	60	80	90	94	94	
Yemen	13	69	46	71	66	

Source: Compiled by ESCWA, based on United Nations Statistics database (December 2005).
Note: Two dots (..) indicate that data are not available or are not separately reported.

Owing to both economic and political reasons, the outcomes of these cycles and tensions have been strongly adverse in the recent period. Since the mid-1980s and despite the region's natural resource wealth, per capita GDP in the ESCWA region has declined by some 2 per cent per annum, which represents the worst regional performance in the world, while the investment rate fell from 29 per cent of GDP in 1978 to a modest 16 per cent in 2002. The mutually reinforcing decline of output and investment has been arrested only by unexpected increases in oil prices.[51]

The decline and high volatility in oil prices persisted throughout the 1990s. This was the main factor responsible for the economic underperformance of ESCWA member countries. Most countries were forced to adjust to a significant real income decline, mainly through public spending cuts.[52] While the impact of the adverse developments in the oil markets affected the GCC economies very strongly, several MDEs, particularly Egypt and Jordan, managed to diversify further and to reduce their indirect dependence on oil.

The lack of sustained capital accumulation in the region has had negative implications for labour absorption and labour productivity.[53] The ESCWA region has both the highest population growth rate and the highest rate of new entrants into the labour market in the world, thanks to the explosive increase in incomes in the earlier period and the subsequent improvements in health care. Consequently, it is perhaps unsurprising that it suffers from the highest unemployment level across the globe.[54] Approximately 25-30 per cent of the population is unemployed or underemployed in the non-oil ESCWA member countries. Rates are lower in the oil economies, which enjoy the flexibility of being able to expel foreign labour to create employment for nationals.[55]

The potentially devastating poverty implications of this unemployment crisis have been moderated by the traditional social safety nets in the region.[56] Despite these safety nets, outcomes have been hugely disappointing for young people born in the mid-1980s after the end of the oil boom. Unemployment, economic stagnation and the lack of a sufficiently expanding political space to express dissent have fostered the emigration of skilled workers, and have bred resentment among large groups, thereby feeding religious and other forms of extremism.

These forms of dissent have been strengthened by the growing foreign interventions in the region, corruption and the inability of the international community to address constructively the continuing

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[51] See A. Abderrezak "Colonisation's long-lasting influence on economic growth: Evidence from the MENA region", *The Journal of North African Studies*, vol. 9, No. 3 (Taylor and Francis Ltd., 2004), pp. 103-112; D.S. Hakura, "Growth in the Middle East and North Africa", IMF Working Paper WP/04/56 (IMF, 2004), pp. 3-6; and ESCWA, *Survey of Economic and Social Developments in the ESCWA Region 2003-2004* (E/ESCWA/EAD/2004/4).

[52] See D. Dasgupta, J. Keller and T.G. Srinivasan, op. cit., p. 2.

[53] See C.M. Henry, and R. Springborg, op. cit., p. 38.

[54] Between 1980 and 2000, the rate of population growth in the ESCWA region was estimated at 2.9 per cent, which was higher than that in the least developed countries, at 2.8 per cent, and in the whole of Asia, at 1.6 per cent. Moreover, the population in the ESCWA region, which has grown rapidly from 94 million in 1980 to 166 million in 2000, is young with an estimated 19 per cent of the total population of the region aged between 15-24. ESCWA, *Survey of Economic and Social Developments in the ESCWA Region 2001-2002*. See also D. Dasgupta, J. Keller and T.G. Srinivasan, op. cit., p. 1.

[55] "The prolonged contraction of economic activity, combined with chronically high rates of both unemployment and underemployment, has discouraged investment and, consequently, reduced the productivity of labour. Furthermore, it has exacerbated income inequalities and the incidence of poverty, disempowering a sizeable tract of society and helping to create a fertile environment for political unrest. In a region beset by a very regressive income distribution profile, both within and across countries, political unrest should not be treated entirely as an external factor. Rather, political unrest should be seen partly as endogenous to the economic system". ESCWA, *Survey of Economic and Social Developments in the ESCWA Region 2005* (E/ESCWA/EAD/2005/5).

[56] Such safety nets include, for example, the *Takaful* concept, which is grounded in Islamic banking transactions.

occupation of Palestine. Given these strongly adverse developments, the current rise in oil prices needs to last for a considerable length of time in order to provide a lasting solution to the problems of unemployment and social disaffection in the ESCWA region. Furthermore, reform beyond the role of the oil sector in financing development has not been sufficiently effective in diversifying economies and in reforming institutions towards those of developmental States.

Equally, persistent political instability, long-term economic decline and high strategic value are influential at another level. Specifically, these are the main factors responsible for the exceptionally high levels of defense spending in the ESCWA region, and for the long-term leakage of savings from the area.[57]

Finally, the climatic and geological features of the ESCWA region strongly limit the availability of natural water in several countries, and impose high costs on agricultural production, which, in turn, creates pockets of poverty, particularly in rural areas. These difficulties are compounded by the inefficiency of delivery mechanisms and by high levels of water wastage in several countries. By the same token, ESCWA member countries tend to be net food importers, which is one of the key features of their balance of payments constraint.[58]

These factors explain why the human development performance of ESCWA member countries has been less than satisfactory. Moreover, they help to contextualize the rigidity of their economic, social and political structures; the structural insecurity of ESCWA member countries; and the difficulty of reforming their economic policies in order to achieve economic growth, stability and rights-based development. These reforms will remain essential even if the current oil boom proves to be lasting. The current social and economic structures in the region are conducive to capital leakages and destabilizing bubbles in real estate and equity markets, both in the oil economies and in MDEs. In order to achieve sustainable growth and economic diversification, to reduce unemployment and support rising living standards as part of a rights-based development strategy, a significant volume of additional resources needs to be deployed in the region. In addition to this, the countries in the region urgently need to consider their future after the exhaustion of oil and its rents. These issues are discussed in the following sections.

B. INDUSTRIAL POLICY FOR A RIGHTS-BASED DEVELOPMENT STRATEGY

In general, industrial policy includes any State policy or initiative aimed at influencing in a deliberate and systematic way the development of the productive potential of a country. Possible cases for the ESCWA region include relative price shifts and targeted incentives to support the development of priority industries or to create employment through, for example, policies on taxes, trade, exchange rates, finance, interest rates and competition; fiscal stimulus; regulatory support; sector-specific credit lines; the use of State-owned enterprise (SOEs) to supply goods and services that may not be forthcoming from private investors; and aid to research and development or education and training.

When adopted consistently over long periods of time, specific combinations of industrial policies define a development strategy, including, for example, primary export-led growth, import-substituting

[57] "Unlike other developing regions, ESCWA is a high saving region. Between 1971 and 2001, the oil economies alone accrued, in constant prices, about $850 billion in excess saving over investment. Yet, less and less of the saving went into investment. The region as a whole experienced a significant resource and consumption leakage. Apart from the regular symptom of capital flight, only in 2002, $27 billion were remitted by foreign workers out of the oil economies. Resource divestiture, consumption biases, and small markets reduced the saving that could potentially be channelled into regional investment". ESCWA, *Survey of Economic and Social Developments in the ESCWA Region 2004*, Summary (E/ESCWA/EAD/2004/3).

[58] R. Bush, "Poverty and neo-liberal bias in the Middle East and North Africa", *Development and Change*, vol. 35, No. 4 (Institute of Social Studies, 2004), p. 678. See also A. Abderrezak, "Colonisation's long-lasting influence on economic growth: Evidence from the MENA region", *The Journal of North African Studies*, vol. 9, No. 3 (Taylor and Francis Ltd., 2004), p. 107.

industrialization or export-oriented industrialization. This section reviews selected aspects of the industrial policy debate in order to substantiate the rights-based and employment-intensive development strategy outlined hereinafter.

During the past two decades, the debate over the advantages and limitations of industrial policy has been dominated by the mainstream approach. This viewpoint departs from three premises, namely: (a) there is a dichotomy between States and markets;[59] (b) free competition leads to full employment equilibrium in a decentralized and deregulated economy; and (c) markets are efficient, while States are economically inefficient.

At a descriptive level, the mainstream approach leads to the analysis of industrial policy through the interaction between State, society and markets. Crudely, this approach classifies States into, among others, large, small, autonomous, developmental and predatory. Moreover, it has been used to support claims that States can be dominated by sector-specific agendas and, in extremis, to explain the persistence of sub-optimal economic policies by the undue influence upon the State by narrow interest groups or cliques. At a prescriptive or ideal level, the mainstream approach has been used to support the claim that "smaller" States are "better" States.

In this case, the State ideally performs only four basic functions, namely: (a) defense against foreign aggression; (b) provision of legal and economic infrastructure for the markets; (c) mediation between social groups in order to preserve and expand market relations; and (d) harmonization of policies and institutions with the requirements of economic growth. The reduction in the size of the State needs to be achieved primarily through market-friendly policy reforms, which allows market institutions (especially financial markets) to set economic priorities; determine the country's international specialization; and decide the level and composition of output, investment and employment without coordinated decision-making or centralized information provision. These are precisely the approach and the policy prescriptions adopted by mainstream economics and IFIs in the ESCWA region.

The assumptions underpinning the mainstream analysis of industrial policy are inadequate, and the ensuing policy prescriptions are insufficient to guide a rights-based pro-poor development strategy in the ESCWA region for two fundamental reasons. First, the dichotomy between markets and the State is misleading, given that markets and States are inseparable both conceptually and historically, and that they are both heterogeneous and imperfect. Markets and States are social institutions that mediate collective action, and their internal structures and mutual relationship are historically contingent. When they are examined over time and across space, it becomes clear that there are few invariant features distinguishing markets and States from one another unambiguously.[60] Both of them include a wide range of evolving institutions, structured in different ways, and whose borders are conceptually unclear and empirically contingent. Among these, for example, are the revenue service, financial services regulatory agencies, accountancy and consultancy firms, State-owned and private banks, and moneylenders. Markets and States cannot be contrasted as if they were homogeneous and separable for the purpose of assessing the "size" of the State or of discussing economic policies that are ideal in the abstract.

In addition to this, developed markets arise only through State intervention. Indeed, one of the main functions of a national bureaucracy, particularly under free market regimes, is to support the creation of markets and to provide the framework in which they operate. This includes the enforcement of law and

[59] Markets are seen as institutions (laws, conventions, physical and social infrastructure) by which exchange takes place, while the State is a centralized political agency that is ontologically separate from the rest of society, and that is both institutionally and behaviourally distinct from the markets.

[60] See, for example, P. Cammack, "Bringing the State back in?", *British Journal of Political Science*, vol. 19, No. 2 (Cambridge University Press, April 1989), pp. 261-290.

order, property rights, controlling social conflicts, establishing the boundaries between markets, and providing or regulating the private provision of public goods and infrastructure, including health, education, transport, communications, energy, and basic raw materials.

Secondly, markets are not efficient in the abstract, and they cannot provide the parameters to assess economic efficiency under all circumstances. Each market, particularly in the ESCWA region, processes transactions in different ways depending on the product, available technologies, existing regulations, and competitive pressures from other markets and from external producers. Mainstream perceptions of market efficiency and State inefficiency are normally based on invalid comparisons with an idealized version of the financial and currency markets. However, these markets are profoundly different from the markets for oil, computer programs, air travel or health and other public goods, which are supposed to be reorganized along those ideal-topic lines. Efficiency has to be assessed in appropriately specific ways within each market and each policy area. In this case, the argument that efficiency requires the reduction of State intervention in general is invalid.

This critique of industrial policy can support the outline of a pro-poor, rights-based and employment-intensive development strategy for the ESCWA region. This industrial policy strategy is based on four basic assumptions concerning States and markets, namely:

(a) States and markets comprise a large set of heterogeneous institutions that are more or less closely integrated with each other, and that interact continually through their institutional linkages and the potentially conflicting interests that act through and upon them. While these interests do not translate readily into specific policies, the State is not independent from class, group and other interests; and it does not pursue goals separately determined by its personnel;

(b) The State and its economic policies cannot be analysed in the abstract. The legitimacy and potential outcomes of State policy choices depend upon the circumstances of country and time. All that can be said in general is that, in order to maximize their probability of success, development policies need to include a wise choice of long-term priorities, and consistent aims and sufficient instruments; and need to be backed up by broad social consensus and political stability;

(c) Excessively general policy objectives, including, for example, competitiveness, credibility, trade liberalization and inflation control, tend to disguise the content of the specific policies being advocated; and to oversimplify the gains, losses and conflicts associated with these policies;

(d) Economic policies cannot be replicated from one country to another with exactly the same effects. While this does not signify that there are no lessons to be learnt from the experience of others, such an analysis must focus on strategic considerations and on national and historically-specific ways of accomplishing socially desirable objectives, which in the case of the ESCWA region cannot preclude regional integration.

C. PRIMARY EXPORT-LED GROWTH, RENTS AND THE RESOURCE CURSE

The export of primary products has historically been the most important avenue for the integration of ESCWA member countries into the world economy. Primary product exports, namely oil, continue to be critically important for many countries. This mode of international integration was often engineered by forced specialization under colonialism. In other cases, primary export-led growth was the outcome of autonomous decisions to try and capture gains from trade through specialization in areas determined by a country's resource endowments.

The conventional literature tends to treat the potential and the limitations of primary export-led growth superficially. There is generally no consideration of historical circumstances or market structures, and gains from trade seem to follow automatically from specialization. Inability to capture these gains or to use them efficiently to boost economic growth is normally attributed to market imperfections or to political incompetence. One branch of this literature claims that the lack of long-term growth in resource-rich economies and the prevalence of macroeconomic instability, corruption and misuse of resources in these countries are attributed to a "resource curse" or the effects of Dutch Disease, usually in association with the political limitations mentioned above.[61] These limitations have been argued to be especially common in economies that export minerals and fossil fuels.

These approaches are both flawed and misleading for the ESCWA region. Extensive studies have failed to substantiate the arguments that gains from trade are easily available, or that disembodied (non-context-specific) policies are sufficient to secure economic growth, for example, through specialization according to existing comparative advantages.

The experience of most successful countries shows, first, that comparative advantages are built rather than inherited; that social structures and political settlements are critically important for the capture, distribution and productive use of rents and other gains from trade; and that the potential of primary production and exports to support rapid and sustained economic growth depends on socially and historically specific factors, which cannot be summarized adequately by mainstream analysis. It follows that the orthodox economic literature tends to have a misguided perception of the advantages, disadvantages and potential of primary export-led growth and, moreover, to misunderstand the dynamics of this type of production and the scope for long-term success by resource-rich economies.

A systematic analysis of primary export-led growth in the ESCWA region needs to depart from the fact that the potential success of this development strategy depends upon the rate of growth of exports per capita, and the linkages between the export sector and the rest of the economy, including the regional economy. These outcomes are determined by five political economy variables, namely:[62]

(a) The commodity lottery, whereby primary products are significantly different from one another; and the scope for profitable exports is heavily influenced by geography, geology and climate. Some products are extracted from nature largely by labour alone, thereby requiring few inputs and developing few backward or forward linkages. By contrast, other products are more easily conducive to the creation of backward and forward linkages, which stimulate urbanization, industrialization, commerce, public administration, construction, public utilities and other services. Some primary products have high-income elasticity of demand. The oil commodity lottery in the ESCWA region implies that there is only limited scope for choice in primary product specialization; and that policy options and the potential outcomes of primary export-led growth are, in many senses, heavily constrained by factors beyond the control of economic policymaking;

(b) Historically specific market conditions are equally influential. For example, export revenues depend, among others, on the level of protection in developed country markets, the rhythm and direction of technical change, and the availability of substitutes. Moreover, if a large part of a country's export revenues derive from a small set of primary products or from a restricted number of foreign markets, the country becomes especially vulnerable to cycles in those products or markets, which affect import capacity. This is particularly pertinent to the experience of the ESCWA region;

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[61] For a review of the literature, see A. Abderrezak, op. cit.; and M. Perälä, Allyn Young and the early development theory" (Helsinki School of Economics, October 2003).

[62] See V. Bulmer-Thomas, *The economic history of Latin America since independence*, Second edition (Cambridge University Press, 2003), chap. 5.

(c) The type of export sector, whereby primary exports can be destructive if the development of this sector drains resources from the rest of the economy, if it is associated with economic volatility, or if there is a long-term trend for prices to decline. In such cases, narrow specialization in this sector represents a mistake even if this can seem to be advantageous in the short term. Alternatively, export growth can be additive if the export sector is simply added to the existing structure of production by using previously unemployed resources. This type of export-led growth tends to have an enclave structure, with a positive albeit minor impact on the rest of the economy. This is especially common in the case of the oil and mining industries. The demand for mineral and fossil fuel exports tends to be price inelastic, while the quantity demanded is normally heavily influenced by the level of activity in the markets of developed countries. As a result, the prices of these exports, when left uncontrolled, can be relatively volatile. In the case of oil, this volatility has become more pronounced since the mid-1980s after oil was listed in the futures market. This creates uncertainty and instability in the exporting economies, with negative implications for investment in the export sector as well as in complementary sectors. Finally, primary export growth can be transformative if the expansion of the export sector brings significant benefits to the non-export economy. This requires efficient markets, the existence of profit-seeking entrepreneurs or an enterprising peasantry, a mobile wage-working class and an efficient State, not all of which are available at all times in the ESCWA region. Such a convergence when it does occur is more likely in the agricultural export sector, which is often associated with more linkages than the oil and mining industries;

(d) The transfer of productivity gains from the export sector to the rest of the economy, which includes complementary investment in related activities, for example, transport facilities, public utilities, ports, communications, housing and upstream industries. In this case, the expansion of the export sector pulls the non-export economy, thereby raising per capita incomes and living standards across the country. At the same time, the dynamism and diversification of the non-export sector protect the economy from adverse external shocks. By contrast, if the productivity gains are not transferred within the economy, the export rents and gains from trade can be appropriated by a small part of the population and be transferred abroad by foreign companies, luxury or other unproductive imports, or by the foreign investments of the private sector or the State. This drainage of resources is a loss for the economy, and it increases its vulnerability to external shocks. Two critically important aspects of the transfer of productivity gains are the nature and extent of the economic linkages between the export sector and the rest of the economy, which depend on the nature of the commodity exported, its production and market structures, and the fiscal linkages established through Government policy;

(e) Long-term economic success depends, to a large extent, on social structures and policy variables. Lack of social cohesion and the concentration of income and wealth tend to favour predatory accumulation strategies, in which export gains are largely retained by a small section of the population and, subsequently, are transferred abroad either directly or through the State. In this case, overly optimistic expectations of resource revenues can be used to alleviate pent-up social tensions and frustrations, while a large part of the net resource inflows (plus external loans secured on future export income) are wasted on financing socially undesirable policies and projects.[63] These negative outcomes are more likely in unequal and conflictive societies, and in economies exporting oil or mineral products that can have an additive enclave structure, as is often the case in ESCWA member countries. In order to avoid these adverse outcomes, fiscal policy is especially important. By contrast, it is normally easier for relatively equal societies with stable institutional arrangements to manage export revenues productively and spread benefits across the economy.

Moreover, socially unbalanced accumulation strategies can appear through overvalued exchange rate effects or by continuing any unplanned reallocation of resources towards the export sector, rather than away from it. The long-term growth consequences of domestic currency overvaluation can be severe, particularly when the primary export sector is large and has few linkages to the rest of the economy, as in the case of the

[63] See M. Perälä, op. cit.

GCC. By contrast, manufacturing production whether for domestic consumption or for export normally involves a greater division of labour and greater employment. Additionally, it can lead to increasing returns and tends to generate stronger externalities that can more easily support a rights-based and pro-poor development strategy.

Clearly, fiscal policy can play a key role in transferring rents, gains from trade and productivity gains to the non-export economy. This includes the development of linkages between the existing economic sectors, as well as support for the emergence of new economic activities that can help to develop new competitive advantages and offset the trend towards an excessive dependence on the traditional export sector.

D. INDUSTRIAL POLICY FOR ECONOMIC DIVERSIFICATION, GROWTH AND EQUITY

The section above illustrated that primary export-led growth can support socially desirable development strategies in the ESCWA region and elsewhere. However, its long-term success depends partly on Government policy and partly on a range of factors that cannot always be controlled by policy. Depending on the circumstances, this development strategy can lead to economic diversification and the expansion of manufacturing capacity, or to economic concentration, the destruction of diversity and the bankruptcy of the non-export sectors.

Outcomes, which vary from place to place and over time, depend on the structure of the international markets; the size of the domestic market; the type of primary product exported; local social structures and. clearly, Government policies; and a host of social, political and economic factors. Recognition of the potential and limitations of primary export-led growth can help to inform the choice of economic policies that can contribute to the achievement of pro-poor development objectives in the ESCWA region over the long term. The failure to recognize the environment in which economic policy operates in primary export-led economies can sometimes lead to costly failures and even disaster scenarios whereby rents provide largesse for the dominating elites, support corruption and foster unpleasant forms of political radicalism.[64]

As discussed above, primary export-led growth is normally insufficient to support long-term economic development. For example, resource endowments can be depleted, and shifts in tastes and technologies can dislocate the demand for most primary products. For these reasons, primary product exporting countries must be concerned with their long-term economic prospects and their future sources of growth. From the point of view of this Survey, these concerns need to include two analytically distinct issues, namely: the preferred strategy for economic diversification, and its capacity to induce rights-based and pro-poor development outcomes. In turn, these desirable outcomes depend on the following four main factors:

(a) Sustained growth in per capita income can generally be achieved either through the capture of rents from international trade (within the limitations explained above) or through the internalization of vertical chains of economic activities (value chains), including the production, circulation and distribution of increasingly complex goods and services; and the corresponding inter-sectoral linkages, complementarities and synergies, and the development of domestic technological capability;

(b) The extraction of surpluses or rents from primary-production sectors depends on their institutional structure, including, among others, ownership, geography, population density, fertility, geology and commodity lottery; political factors; and the configuration and interaction between different economic sectors. By contrast, the internalization of value chains requires consistent and activist industrial policies, including the coordination of economic activity by the State; the imposition of selectivity and performance

[64] See, for example, R. Bush, "Poverty and neo-liberal bias in the Middle East and North Africa", *Development and Change*, vol. 35, No. 4 (Institute of Social Studies, 2004), p. 678.

standards; the creation of backward linkages; the elimination of bottlenecks; and a concerted effort to address the balance of payments, fiscal and financial constraints, in order to develop untapped potential and create new competitive advantages. These outcomes cannot generally be achieved merely through horizontal industrial policies, including specialization according to comparative advantage. They tend to lead to dynamic resource misallocation, lack of investment coordination and the divergent development of economic sectors, which can create sectoral and macroeconomic imbalances;

(c) By contrast to developed countries, successful late industrialization did not derive from the diffusion of technical change or the spontaneous diversification of the economy. Rather, it owed to the deliberate addition of modern production units to those already in place, either in order to satisfy pent-up existing demand or to produce for export. In either case, large-scale production is required from the start. This requires, among others, long maturity periods, large sunk costs, complex technology and managerial skills, which can be secured only through the intervention of the State or through foreign finance. Whatever the chosen approach to address this financial constraint, it is generally true that later industrialization creates a greater need for a vertical (sector-specific) development policy and a centralized bureaucracy to guide resource allocation;

(d) Long-term economic success also depends on variables that cannot be controlled by short-term policy, including, among others, the size of the domestic market and the labour force, the commodity lottery, terms of trade and balance of payments constraint, the degree of social fragmentation and conflicts, and the country's geographical position. Within that context, East Asia has important advantages vis-à-vis Latin America, for example, and the ESCWA region is singularly privileged in this respect.

Rights-based social and economic development in the ESCWA region depends upon long-term integrated industrial and social policies. These need to support the achievement of economic growth, which can produce additional resources, create employment and reduce economic heterogeneity; and support greater equity, which is essential for social inclusion in a region that exhibits one of the highest rates of regional income and development inequalities.

IV. POLICY ISSUES IN THE ESCWA REGION

Chapter III showed that the combination of growth and equity offers the best opportunity for translating expanded production capabilities into poverty reduction and human development, which is essential for a rights-based and pro-poor economic strategy. This combination is policy-driven.

Experience shows that the impact of growth on poverty and equity can be highly different depending on the economic, social and political features of the society; and on the policies accompanying the process of growth.[65] In other words, it is essential "to forge consistency between the macroeconomic framework and the national poverty reduction strategy. This is usually interpreted as a 'one-way' consistency, in which the anti-poverty strategy has to adjust to a fixed and rigid macroeconomic framework. However, both should be jointly determined to serve the overriding objective of poverty reduction".[66]

In the case of ESCWA member countries, the fiscal, financial, monetary, trade and exchange rate policies required to achieve these desirable outcomes need to be nested in a consistent and enabling pro-poor macroeconomic environment. This environment, framing national strategies on industrial policy, need to focus on the achievement of the following macroeconomic policy objectives: economic diversification through the development of complementary economic sectors;[67] the achievement of balance of payments stability; and the development of non-traditional competitive advantages supporting the reduction of poverty.

These objectives cannot be easily achieved in most ESCWA member countries at the moment, given elevated social demands on the State, a frequently hostile international environment, often insufficient available resources, and an institutional framework that is not always conducive to the achievement of the socially desirable goals outlined above. Moreover, it is unreasonable for the economies in the ESCWA region to aim to compete with South and East Asian countries on the basis of low-wage manufacturing production. This leaves ESCWA member countries with the possibility of internalizing value chains through more skill-intensive manufacturing, or processing bulky minerals where transport costs are high.[68]

The policy suggestions offered in this chapter aim to deliver economic prosperity and higher living standards for the majority of the population, within the specific features and constraints of the ESCWA region. This will involve the consolidation of internal and external balance in these countries, the protection of national economies from adverse external shocks, the transfer of additional policy levers to the domestic authorities, greater intersectoral policy coordination, and stronger linkages between macroeconomic stability and pro-poor goals.

A. POVERTY AND DISTRIBUTION

For the mainstream, poverty is created by social exclusion, and it is defined by the inability to reach arbitrary expenditure lines, for example, $1 or $2 a day. From this point of view, markets are posited as creators of wealth; and market integration is the main force for economic growth in general, and for poverty reduction, more specifically. Reciprocally, the main cause of poverty is presumed to be the absence of markets, or the lack of integration of specific social groups in market activities, for example, through wage work, independent commodity production, services provision or international trade.

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[65] See H.A. Pasha and T. Palanivel, *Pro-poor growth and policies: The Asian experience* (UNDP, 2004), pp. 1-2.

[66] United Nations Development Programme (UNDP), *The role of economic policies in poverty reduction* (UNDP, 2002), p. 2.

[67] Depending on the country, these include heavy and chemical industry, consumer goods manufacturing, tourism and other industries.

[68] See M. Karshenas, "Structural obstacles to economic adjustment in the MENA region: The international trade aspects", in *The State and Global Change: The Political Economy of Transition in the Middle East and North Africa*, eds. Hakimian, H. and Moshaver, Z. (Curzon Press, 2001).

This approach is misguided given that it removes the context of poverty, and obscures both its origins and the mechanisms of its reproduction over time and space. It is equally misleading because, in complex market economies, including all the countries in the ESCWA region, exclusion from local or international markets is normally not the cause, rather it is a consequence of poverty. In these economies, poverty is usually created by the specific form of integration of specific groups into the dominant mode of social and economic reproduction.[69] These forms of integration impose upon the poor exploitative labour regimes in the form of poor wages, precarious commodity production or "self-employment", including, potentially, degrading forms of such work as child labour. In turn, these exploitative labour regimes are associated with low incomes and precarious living standards.

The systemic interpretation of poverty outlined above can offer not only a richer and more comprehensive interpretation of poverty in the ESCWA region, but equally useful policy guidelines for addressing the reproduction of poverty in this part of the world. For example, it implies that poverty cannot be reduced to the inability to reach an arbitrary level of income. Rather, insufficient income is one of the implications of the structural inequalities permeating the economic system.

Additionally, it implies that markets are both producers of wealth and creators of poverty, while being, at all times, vehicles for the exercise of economic and political power. Markets are never neutral, and they always require nurturing, regulation and control by a democratic State. At a further remove, the elimination of poverty requires radical structural reforms in order to remove the inequalities responsible for the reproduction of poverty amid wealth.[70] These include legally condoned inequalities of access to and control over labour, economic resources and political power. In other words, the solution to such deeply ingrained problems of inequality, poverty and distribution is primarily political, rather than economic.

The mere redistribution of existing resources is normally insufficient to secure the elimination of poverty. Economic growth is also essential, given that growth creates new income generating activities, produces labour scarcities that can raise wages, increases the demand for foodstuffs and raw materials produced by the poor, and creates opportunities for the material advancement of large numbers of people. Unfortunately, growth is not a panacea; and growth per se is also insufficient to secure the elimination of poverty. This limitation arises because, while it contributes to poverty alleviation, growth can also create poverty given that it is often associated with the dispossession of large numbers of peasants, rural labourers and urban workers, and their loss of access to productive assets.

Moreover, the structural changes that accompany conventional growth processes can lead to both the underemployment of skilled workers and the elimination of large numbers of jobs. It is not always possible for many workers to find alternative jobs with equivalent pay, or to re-train in order to seek better employment opportunities elsewhere. Similarly, the self-employed can equally face depressed economic prospects given an insufficient access to credit and markets. This approach makes it easier to understand why conventional economic strategies can create poverty as well as reduce it. The impact of growth on poverty is determined by its modality and speed, and by the structural inequalities explained above. In some cases, income and productivity growth can be so rapid that most people benefit despite increasing

[69] R. Bush, op. cit., p. 674.

[70] Ibid., p. 687; and S. Bracking, "Neoclassical and structural analysis of poverty: winning the 'economic kingdom' for the poor in southern Africa", *Third World Quarterly*, vol. 25, No. 5 (Carfax Publishing, 2004), pp. 887-901.

inequality.[71] Alternatively, GDP growth could be insufficient to reduce poverty, thereby leading to the stagnation or even decline of the welfare standards of large numbers of people.[72]

The experience of ESCWA member countries offers an excellent example of these contradictory implications of growth. Between 1960 and 1985, income growth and improvements in distribution in the ESCWA region outperformed all other regions, with the exception of East Asia. Among other social indicators, these gains brought significantly better health standards, lower infant and maternal mortality rates, higher life expectancy, improved nutrition and sanitation, and better education. These positive outcomes have not been completely reversed, despite the region's economic under performance in the recent period.[73]

The ability of the poor to benefit from this period of oil-fuelled prosperity is the main factor responsible for the relatively low poverty levels in the ESCWA region, when compared with other developing areas of the world. The gains from the oil boom were distributed primarily through public sector employment, particularly given that a significant number of surplus workers are employed by the State in most ESCWA member countries; the social security system and the benefits awarded to the poor in the oil-rich countries; and the higher employment levels and labour remittances in MDEs.[74]

Since the mid-1980s, the region has witnessed a significant slowdown in growth and the introduction of structural adjustment programmes and economic reforms in several countries, which have restricted employment, benefits, wages and labour migration throughout the region. The percentage of the population earning less than $2 per person per day increased across the Arab region from 24.8 per cent in 1990, to 29.9 per cent in 1998; while the income of the average Arab citizen fell in real purchasing power parity (PPP) terms from 21.3 per cent to 13.9 per cent of the income of the average counterpart living in a member country of the Organisation for Economic Co-operation and Development (OECD).[75]

According to various household surveys, 16.7 per cent of the population of Egypt lived below the absolute poverty line in 2000, and 11.6 per cent of the population of Jordan were similarly impoverished in 1997. Currently, 17.6 per cent of the population of Yemen lives below the food poverty line, and 41.8 per cent are below the consumption poverty line.[76] In Iraq and Palestine, poverty has increased exponentially owing to the destruction of their respective social and economic infrastructures. In addition to this,

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[71] Within that context, prime examples include Brazil in the period 1950s-1970s, the countries of the GCC in the early 1970s and mid-1980s, and China since the 1980s.

[72] Examples include Russia and several countries of the Community of Independent States (CIS) since the early 1990s; and most countries in ESCWA, North Africa, Latin America and sub-Saharan Africa since the early or mid-1980s.

[73] See R. Bush, op. cit., p. 680; R.H. Adams Jr. and J. Page, "Poverty, inequality and growth in selected Middle East and North Africa countries, 1980-2000", *World Development*, vol. 31, No. 12 (Elsevier Ltd., 2003), pp. 2027-2048; and United Nations Development Programme (UNDP), *The Millennium Development Goals in Arab Countries: Towards 2015 - Achievements and Aspirations* (UNDP, 2003), p. 23. For more information, see the World Bank, *Reducing Vulnerability and Increasing Opportunity: Social Protection in the Middle East and North Africa* (the World Bank, 2002).

[74] For a detailed analysis, see R.H. Adams Jr. and J. Page, "Poverty, inequality and growth in selected Middle East and North Africa countries, 1980-2000", *World Development*, vol. 31, No. 12 (Elsevier Ltd., 2003), pp. 2027-2048.

[75] R. Bush, op. cit., pp. 681-683.

[76] ESCWA, *Survey of Economic and Social Developments in the ESCWA Region 2005* (Summary) (E/ESCWA/EAD/2005/5). See also R.H. Adams Jr. and J. Page, op. cit., pp. 2028 and 2037; and the World Bank, *Reducing Vulnerability and Increasing Opportunity: Social Protection in the Middle East and North Africa* (the World Bank, 2002).

approximately ten million children are still not enrolled in schools; and more than half the women in the Arab region as a whole remain illiterate.[77]

The most important structural factor explaining the reproduction of poverty and vulnerability in the ESCWA region is the mode of integration of the region into the world economy, especially its reliance on rents and such unrequited transfers as oil in the GCC, revenues from the Suez Canal in Egypt, and aid and workers' remittances in most MDEs.[78] At the macroeconomic level, this mode of integration into the world economy generates a significant vulnerability in the oil-rich economies to oil price shifts and Dutch Disease; and to resource drainage through capital flight, the export of savings and high defence expenditures.

By contrast, the vulnerability of MDEs owes primarily to the tightness of their balance of payments constraint because of the volatility of their export prices, the lack of export diversification, the unreliability of labour remittances and the heavy burden of defence spending. The ensuing forms of inequality are justified by powerful cultural and ideological processes. They include inherited values that, while these assign equality to people on the basis of religious faith, do not suggest that their equality should be extended to the economic, social or political domains in this world.[79] In addition to this, the export of large numbers of workers from the largely poorer MDEs to the richer oil economies has contributed to the consolidation of a structural divide in the regional labour markets that has helped to reproduce poverty over time.

Specifically, the wage divide between nationals and non-nationals in the GCC has consolidated structural poverty in these economies and has reduced the scope for economic diversification and the development of the domestic market. On the other hand, the export of workers and the ensuing remittances supplemented by aid, particularly in the case of Egypt, have contributed to the economic, social and political stabilization of inequitable modes of economic governance and wealth-sharing in MDEs.

This combination of forces has created powerful tendencies towards the reproduction of poverty and inequality, especially in terms of institutional processes that intensify social and cultural differences in order to secure the exclusionary appropriation of oil, transport, agricultural and other rents. While in the past this appropriation tended to favour the military and the technocrats, wealthy entrepreneurs have tended to gain most since the economic opening, or *infitah* in Arabic. Institutions and processes that generate such poverty and inequalities include the structure of labour markets, the tax system, the property rights and inheritance laws, the shortcomings of the public health and education systems, and the administrative machinery of the State. The continuing importance of these structural features shows that, despite the lip service paid by many political regimes to the welfare of the poor, most ESCWA economies tend to be structurally biased against this social group. By the same token, there is a strong tendency to avoid the task of transforming the social, economic and political structures that perpetuate inequality.

At the microeconomic level, despite the prevalence of local modes of charity that help to alleviate extreme poverty, the unevenness of the distribution of income and assets, in the context of rent-dependency, contributes to the permanent exclusion of a large part of the population from the core structures of the system of accumulation. They are, in this sense, surplus to requirements, and must either fend for themselves or

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[77] United Nations Development Programme (UNDP), *The Millennium Development Goals in Arab Countries: Towards 2015 - Achievements and Aspirations* (UNDP, 2003), p. 3. See also C.M. Henry, and R. Springborg, op. cit., p. 2; and P. Rivlin, *Economic Policy and Performance in the Arab World* (Lynne Rienner Publishers, 2001), pp. 37-38.

[78] See, for example, W. Shahin and G. Dibeh eds., "Introduction", in *Earnings Inequality, Unemployment, and Poverty in the Middle East and North Africa* (Greenwood Press, 2000), p. 1.

[79] See E.H. Tuma, "Some introductory observations on poverty and earnings inequality in the Arab world", in *Earnings Inequality, Unemployment, and Poverty in the Middle East and North Africa*, eds. Shahin, W. and Dibeh, G. (Greenwood Press, 2000), p. 5.

languish at the margins of society where they are compelled to rely on non rights-based welfare support. They become subjects of charity, rather than citizens.

However, charity, which is an unmediated and decentralized transfer, cannot be as effective for poverty alleviation as coordinated Government policies. There is a significant risk that these modes of structural inequality and social exclusion will continue to feed political extremism, especially through the promotion of attachments to modern forms of religious radicalism. The dissemination of these forms of extremism could be disastrous for human rights in the ESCWA region and elsewhere in the world.

While there have been some significant, albeit uneven, social welfare improvements across the ESCWA region during the past generation, there is still much to be done. Even the modest targets of MDGs may not be achieved in most countries. At a regional level, one-third of the countries are on track for reaching those Goals by the target date of 2015 targets, particularly countries in the GCC; one-third are either stagnating or regressing, and are currently unlikely to meet the MDGs without substantial policy changes; and there are no reliable data for the remaining countries.[80]

Unsurprisingly, there are very different views concerning the most adequate policy changes. IFIs claim that better economic management is the most significant constraint and that "prudent macroeconomic policies, better governance, and more efficient regulatory institutions are necessary elements of an integrated social protection strategy. If these reforms are implemented, then traditional social protection systems could be relieved from some of the current mandates, and scarce resources and reform efforts could be focused on select cost-effective programmes in labour markets, social insurance, and social assistance".[81]

From this point of view, existing social assistance programmes are criticized, including public works programmes, social funds and cash and in-kind transfer programmes. Accordingly, social funds fail largely "to reach the poorest or, often, women. Microcredit granted at low or even negative real interest rates is more of a transfer than a contribution to sustainable development. Public works that pay high wages or have a low labour share in their total costs are unlikely to efficiently meet poverty objectives. Food subsidies can create significant economic distortions and, if universal, are appropriated by the non-poor. In general, targeting mechanisms are weak, leading to leakages toward middle- and high-income groups".[82]

This assessment is unduly pessimistic. Specifically, it fails to acknowledge the important achievements of these social welfare programmes, including social cohesion, the amelioration of income inequality, and the preservation within limits of the welfare gains achieved in the previous period. On the other hand, international experience shows that their rollback through fiscal restraint and means-testing, as is generally advocated by IFIs, is hardly conducive to better outcomes. A different approach to welfare improvement is needed, based on the right to development and pro-poor economic policies made to address development issues across the ESCWA region.

This approach could include "global and regional partnerships based on mutual accountability and responsibility, in which wealthier nations, through funding, debt relief and fair trade agreements, support the efforts of developing countries to adopt relevant development strategies within a supporting global

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[80] For a detailed assessment of the progress made towards the MDGs, see United Nations Development Programme (UNDP), *The Millennium Development Goals in Arab Countries: Towards 2015 - Achievements and Aspirations* (UNDP, 2003); and ESCWA, *The Millennium Development Goals in the Arab Region 2005* (E/ESCWA/SCU/2005/3/Rev.1).

[81] The World Bank, *Reducing Vulnerability and Increasing Opportunity: Social Protection in the Middle East and North Africa* (the World Bank, 2002), p. xii.

[82] Ibid., p.10.

environment. Greater South-South cooperation is also necessary for sharing experience and expertise".[83] Moreover, the integration of Arab markets could "render the region more attractive to world investors, facilitate investment and growth, and generate employment opportunities and income, thereby contributing to the region's poverty alleviation efforts".[84]

In addition to this, significant productivity gains are needed on the basis of improvements to infrastructure, education and training and production technologies. These policy measures are reviewed in more detail in the following sections.

B. EMPLOYMENT GENERATION

The structure of the labour markets in the ESCWA region is a distinguishing feature of this region and remains one of the most important structures of reproduction of inequality in these economies. The oil economies were poor and relatively unpopulated until the middle of the twentieth century. These countries have experienced very high rates of population growth in the wake of their prosperity, especially since the 1960s and, most remarkably, between the mid-1970s and the mid-1980s. Oil rents supported the rapid improvement of the welfare standards in these countries, which, in turn, contributed to the unprecedented increase in their population growth rate.

Moreover, economic prosperity supported the transfer to the GCC countries of a large number of relatively unskilled workers from less wealthy and more populated countries in the ESCWA region and, in specialized segments of the labour market, from Western economies.[85]

While these processes have been pervasive, they are also unstable. Fluctuations in rents immediately affect the capacity of oil economies to accommodate the migrant population, which is largely employed in the oil industry and in other sectors that are heavily dependent on the price of oil. In addition to this, rapid population growth was bound to lead to increased pressure in the labour markets of the GCC. By contrast, emigration in MDEs has functioned as a safety valve until it was limited by the changing fortunes of oil extraction in the GCC, and by the endogenous labour market pressures in these countries. Escape to the north has provided a partial alternative in several countries. However, this route is becoming increasingly difficult to follow. The accession of several countries of Eastern Europe (and, in the future, possibly Turkey) into the EU will limit the opportunities available for low-skilled workers from the ESCWA region in northern markets and, potentially, could aggravate the severe problem of unemployment in MDEs.

The underlying difficulty is that both the oil-rich economies and MDEs have been consistently unable to create enough decent employment for their populations. This limitation has become increasingly apparent as the growth rate of the ESCWA economies has tended to decelerate in the recent period. Economic growth rates of some 2.5 per cent per annum, combined with population growth rates of approximately 2.5 per cent and a significantly high labour force growth rate have raised the ESCWA rate of unemployment to 15 per cent.[86] This unemployment rate is especially high among the group aged 15-24 in MDEs, where it stands at 25-30 per cent.[87] Prolonged economic underperformance, combined with chronically high rates of

[83] ESCWA, *The Millennium Development Goals in the Arab Region 2005* (E/ESCWA/SCU/2005/3/Rev.1), p. 37.

[84] Ibid.

[85] In the countries of the GCC, expatriate workers represent the majority of the total labour force, ranging from some 33 per cent in Bahrain to almost 90 per cent in the United Arab Emirates. ESCWA, *Survey of Economic and Social Developments in the ESCWA Region 2001-2002*.

[86] This regional rate excludes Iraq and Palestine.

[87] ESCWA, *Survey of Economic and Social Developments in the ESCWA Region 2003-2004* (E/ESCWA/EAD/2004/4). See also C.M. Henry, and R. Springborg, op. cit., p. 179.

unemployment and underemployment, has discouraged investment and, consequently, has reduced the productivity of labour in the region. These factors explain the real wage decline in the ESCWA region since the early 1980s.[88]

In addition to these general labour market problems, three other issues are relevant for the assessment of the current rates of unemployment in the ESCWA region, namely:

(a) Without a shift of economic strategy, unemployment rates are likely to continue to rise across the region at least in the short and medium terms, owing to both demographic factors and to the gradual incorporation of women into the labour force, given that their share remains below that of other developing regions;

(b) There is a structural mismatch between labour force qualifications and job market demands. This can be attributed to the relatively low levels of schooling in the region, relative to its income level; to the high wastage from the continuing withdrawal of significant numbers of graduates from the labour force for reasons of marriage or emigration; and to the oversupply of qualifications in areas for which there is little employment demand, including, for example, religious studies. By contrast, there is insufficient supply of skilled personnel in science and technology. While the withdrawal of qualified persons from the labour market can help to alleviate the pressures of unemployment, this minor achievement is highly costly for the economy. Other types of mismatch between labour supply and demand can contribute to the build-up of individual frustration and, ultimately, to social tensions;

(c) The rigidities of the labour markets in the ESCWA region have had a positive and, somewhat paradoxically, stabilizing impact on social welfare. In particular, public sector employment has helped to maintain incomes and employment despite the prolonged economic decline in the region (see chapter III). However, despite these positive outcomes insofar as this has been possible under severely adverse circumstances, there is no doubt that labour could be deployed more productively in outlying regions, for example, in relatively deprived areas or in more promising economic sectors.[89]

The structural features of ESCWA labour markets indicate that rapid labour market liberalization could have severely adverse welfare effects in this region. While the removal of social safety nets could increase the incentives for matching educational qualifications to the demands of the labour market, the removal of State intervention in the regional labour markets is both costly and destabilizing.

Moreover, it is extremely misguided to expect simple liberalization measures to resolve the structural problems of low employment generation, and the mismatch between available qualifications and the labour market demands in the ESCWA region. The market cannot resolve these problems rapidly, cheaply or without social fractures. Only coordinated State intervention and the shift towards a pro-poor and labour-intensive economic development strategy can create socially desirable patterns of employment and help to absorb the current supply of workers in a socially cohesive manner, especially women and the youth.

However, even in the best possible circumstances, the problem of unemployment in the ESCWA region will not be resolved rapidly. It has been estimated that the region needs to create 35 million new jobs during the next decade in order to address the existing shortcomings of the labour market. This requires

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[88] For more details, see the World Bank, *Reducing Vulnerability and Increasing Opportunity: Social Protection in the Middle East and North Africa* (the World Bank, 2002), p. 128 and tables A.2.8 and A.2.14.

[89] See ESCWA, "Analysis of performance and assessment of growth and productivity in the ESCWA region", Second issue (E/ESCWA/EAD/2004/2); and ESCWA, *Survey of Economic and Social Developments in the ESCWA Region 2005* (E/ESCWA/EAD/2005/5).

regional growth rates of some 6-8 per cent per annum.[90] There is simply no realistic prospect that mainstream economic reforms could deliver these growth rates over long periods of time. This has not happened anywhere else, and there is no reason to believe that the performance of mainstream policies in the ESCWA region could yield different results.

Social and economic integration, employment creation and the elimination of poverty requires, in most ESCWA member countries, structural reforms aimed at addressing the existing forms of inequality and at supporting economic diversification, the expansion of domestic markets and employment-intensive growth. The labour market reforms must not focus on liberalization or on rendering economies more flexible. For the reasons explained above, such reforms are inefficient, costly and socially divisive. Rather, reforms must aim to establish the right to work.

This right does not purely imply that the State must alleviate poverty through the creation of low wage and, often, unproductive public sector employment. Instead, it implies the right of the poor to perform work that is socially relevant and that will contribute to the realization of the right to development and the achievement of pro-poor outcomes in the ESCWA region. This requires the implementation of international covenants through pro-poor development compacts, thereby leading to the fulfilment of the right to development in the ESCWA region.

Equally, it requires a coordinated and pro-poor industrial policy strategy that focuses on economic diversification and the internationalization of value chains. This needs to concentrate mainly on basic infrastructure, manufacturing production, processed agricultural output and tourism in order to create a sufficient number of productive jobs. Given this strategic objective, specific demands can be placed on the region's education and employment systems, and on the corresponding social and economic infrastructure, including housing, sanitation, transport and public services.

C. SAVINGS AND INVESTMENT

Compared to most poor regions in the world, ESCWA does not lack savings. In fact, regional savings far outstrip investment, with the difference largely attributed to capital exports by the GCC countries to the markets of developed countries. This is both economically inefficient and socially undesirable. The region needs significantly higher levels of investment in order to raise productivity, eliminate poverty and unemployment, and satisfy the welfare rights of the population. Even the GCC countries need substantial additional investment for economic diversification, employment creation and the promotion of welfare gains and economic and environmental sustainability. Despite these pressing needs, savings continue to escape from the region.

Under these circumstances it is somewhat incongruous to argue that investment in the ESCWA region can increase with further liberalization of the capital account of the balance of payments of the countries in the region, or from the additional liberalization of their financial systems. The opposite is more likely to happen, with liberalization leading to additional capital outflows from the region.

Moreover, there is no conclusive evidence that financial or capital account liberalization supports higher levels of investment; and there is substantial support for the view that liberalization can detract from it.[91] In fact, foreign savings, foreign investment and transfers, including aid, debt forgiveness and workers' remittances, tend to be unreliable and difficult to target. Additionally, they can be contrary to pro-poor outcomes. This is not to deny the importance of aid to very poor countries. Indeed, "foreign aid can play a

[90] See ESCWA, *Survey of Economic and Social Developments in the ESCWA Region 2003-2004* (E/ESCWA/EAD/2004/4).

[91] See H-J. Chang and I. Grabel, *Reclaiming Development: An Alternative Economic Policy Manual* (Zed Books, 2004).

critical role in overcoming obstacles in the transitory phase towards pro-poor policies since the latter are bound to meet stiff resistance from several quarters".[92]

Box 2. Investment

Investment is a key determinant of growth. High-growth countries are countries that have high investment shares. The figure below reproduces the average investment share of GDP over a five-year period by country. After a very high level of investment in the late 1970s, the investment share in GDP has been decreasing over time. In some countries, it dropped from 30 to 20 per cent. In other countries, including Bahrain and Oman, investment plummeted to 15 per cent. This is one of the reasons that can explain the poor growth performances of the past two decades. Meanwhile, it must be underlined that an investment share of GDP of 20 per cent is not negligible. While it is slightly lower than the average rate of investment in the countries of the OECD in the 1990s, at approximately 25 per cent, it is the quality of investment in the ESCWA region that lowers the capital output ratio.

Aid can help these countries given that it alleviates simultaneously the fiscal and the balance of payments constraints, and that it can deliver benefits in kind directly to the poor. Therefore, poor countries in ESCWA and elsewhere need to be entitled to higher levels of unconditional aid from donors. However, it is unwise to depend excessively on aid for the reasons outlined above. Moreover, as countries grow, aid tends to become both less available and less significant as a proportion of the fiscal budget.[93]

Even in the light of these significant risks, IFIs have been strongly advocating further financial and capital account liberalization in order to increase the scope for market mechanisms aimed at determining the allocation of resources and at increasing the scope for the adoption of market-based monetary policy instruments. This will inevitably increase further the problem of dollarisation in the region, even though dollarisation is undesirable given that it compromises the effectiveness of monetary policy.

Despite the reforms, the financial systems in the ESCWA region remain generally small, inefficient, costly, shallow, short-sighted and speculative. Moreover, they are highly concentrated and dominated by foreign banks. The financial institutions tend to offer short-term loans backed up by readily available collateral for trading and working capital, and personal credit for workers in the formal sectors.

While banks also finance the public deficit and participate actively in the foreign exchange market, they do not tend to fund economic diversification or the expansion of priority economic areas. These problems cannot be resolved easily or simply through efficiency gains. A financial system can be highly competitive and, in this narrow sense, efficient and yet, at the same time, dysfunctional if it does not contribute to the national development objectives.

From the perspective of the mainstream, financial sector and capital account liberalization have achieved three important goals in the ESCWA region, namely: (a) they transferred part of the State capacity to coordinate economic activity and allocate resources to the private sector inter-sectorally and inter-temporally (the balance between investment and consumption and the composition of investment); (b) they embedded private sector interests in the policymaking process through the decisive role of commercial banks in the pricing of Government securities, the determination of interest rates and the financing of the public sector expenditures; and (c) they enhanced the role of the private financial institutions

[92] J. Vandemoortele, "Can the MDGs foster a new partnership for pro-poor policies?" (UNDP, 2004), p. 16.

[93] See United Nations Conference on Trade and Development (UNCTAD), *The Least Developed Countries: 2000 Report* (UNCTAD, 2000).

in the foreign exchange market and, therefore, in the relations between the countries in the ESCWA and their counterparts across the world.

Financial system control of the key sources of accumulation has increased this sector's influence over State policies above and beyond its limited resources and the ambiguous outcome of its activities from the point of view of the poor. Despite its disproportionate leverage over economic policies and outcomes, the financial sector in numerous ESCWA member countries remains structurally dependent upon the State.

This can be attributed to the institutional and regulatory framework in which the financial system operates and, moreover, to that fact that the main sources of revenue depend heavily on, among others, the provision of finance for the public sector and remaining SOEs; Government securities trading; personal loans to civil servants; and currency trading backed up by central banks. For example, the financial system of Lebanon is currently draining public funds and social resources, and failing to channel them to priority and welfare-enhancing economic sectors.

These structural and policy shortcomings make it difficult for the Governments in the ESCWA region to implement a rights-based and pro-poor economic development strategy. The cumulative shift to indirect monetary policy instruments is set to increase further the degree of financial system control of social resources. In this sense, the financial systems in the region are only partially fulfilling their essential functions, namely, to make resources available for production, and to fund socially desirable investment projects.

ESCWA member countries need advanced technologies and qualified expatriate workers on a temporary basis and as part of a programme for internalizing specialist skills. However, they do not need portfolio capital inflows or additional avenues for financial speculation. Even FDI is needed only within limits insofar as it internalizes both production and technologies. Domestic production aimed simply at replacing luxury imports is normally insufficient, given that the foreign exchange savings can be subsequently lost through the repatriation of profits and dividends by transnational companies. FDI flows to the ESCWA region have traditionally been modest and heavily concentrated on the oil sector.[94] In the absence of strict technology and skill transfer policies, this form of investment does not tend to have significant and lasting spill-overs.

It is, therefore, necessary to implement FDI policies that target the most vital sectors in ESCWA member countries, rather than those that merely bring the most benefit for foreign capital. This includes infrastructure, environmental management, and the production of durable consumer goods and capital goods demanded by a pro-poor economic development strategy for the region. By contrast, portfolio flows to the ESCWA region, where these exist, have tended to target speculative investment in real estate and specific segments of the capital markets, and to be associated with the takeover of privatized firms. Lebanon is the only significant exception, given that substantial amounts of portfolio investment have been received by this country since the mid-1990s. However, this has been associated with a spiralling domestic public debt.

Implementing the savings and investment policy principles indicated above can help to maximize social welfare in the ESCWA region. This will also require a much greater degree of regional coordination of finance and investment. One of the distinguishing features of the region is the structural inequality between the GCC countries where the resource surpluses are concentrated, and MDEs where the social needs are most pressing. The international environment after the terrorist attacks of 11 September 2001 has

[94] FDI flows into the region stood at $1.6 billion in 2002, or 0.25 per cent of global inflows, which represents a fall of 7.61 per cent from the total of $1.7 billion reached in 2001. See ESCWA, *Survey of Economic and Social Developments in the ESCWA Region 2003-2004* (E/ESCWA/EAD/2004/4).

illustrated the insecurities to which foreign investment by ESCWA member countries can be subjected, and this can offer the catalyst for regional policy changes and incentives to invest in the region.

In that context, preferential treatment for ESCWA capital, including repatriated capital and migrants' remittances, needs to be secured within the region by reforming, among others, the tax, procurement and firm registration procedures, which must be exploited to the maximum extent compatible with WTO regulations. These regulations need to be part of a regional industrial policy package aimed at raising regional investment and trade, internalizing supply chains, and supporting employment generation and productivity growth.

In addition to these policy measures in the ESCWA region, it is equally essential to improve the accountability of public and private investment, particularly given that the resources being deployed are evidently collective, especially in the case of investment drawing on oil or other rents; and that the population has a legitimate democratic claim to influence the allocation of such resources. This applies to investment undertaken by States or SOEs and, moreover, to private capital drawing on privileged access to social property or natural resource rents.

Furthermore, it will be difficult to implement these pro-poor savings and investment policies in the absence of political stability in the region. In addition to promoting regional investment and growth, such stability can release significant amounts of resources that are currently wasted in defence expenditures. Political stability could also help the shift away from rentier activity and towards productive activity, which is essential to support the achievement of pro-poor outcomes in the ESCWA region.

The mainstream theory underpinning the financial sector reforms in the ESCWA region implies that bank lending is a rational decision based on the expert assessment of specific projects and collateral. This is insufficient given that it ignores the environment in which investment takes place. Investment, especially in large or infrastructural projects, can have a significant impact on the composition of growth and the direction of the development process. By the same token, economic growth can support investment projects that may not be viable otherwise. While this does not imply that all projects can be equally profitable, it signifies that investment coordination can improve loan performance and, simultaneously, can contribute to the achievement of socially desirable goals.

Government agencies in the ESCWA region need to select the sectors that could benefit from additional loans. Appropriate incentives can be devised, thereby promoting credit flows to these sectors, including, for example, tax rebates, the reduction of compulsory reserve requirements, adjustments in the calculation of risk-weighted capital in order to favour long-term investment to socially desirable sectors, and loan protection to deflect part of the cost of loan defaults in priority sectors away from the banks. Equally, Governments could fund, through bond sales, specialist agencies that trade priority loan packages in order to help to dilute the credit risks of banks.

In addition to targeting priority areas, incentives must also be available for microcredit, especially in rural areas, given its potential contribution to meeting the basic needs of the poor. In this case, commercial banks could be offered tax and other incentives to make microcredit loans available, or they could be given the alternative of using part of their compulsory reserves in microcredit operations.

One important limitation to the achievement of these socially desirable goals is the concentration and internationalization of the ESCWA banking systems. Large and competitive State-owned banks can help to address these limitations. These banks can introduce competitive pricing practices into the financial market, and limit the bias of transnational banks towards high-value transactions that bring little benefit to the poor.

Additionally, they can satisfy the needs of markets that tend to be ignored by private institutions, including, for example, housing and small-scale agriculture production. State institutions dedicated to these

markets can either be founded or, where these already exist, capitalized through bond sales in domestic or international markets. Additional resources to support the achievement of pro-poor goals could be generated through a modest tax in the range of 0.1-0.5 per cent on all financial transactions, including payments by cheque, transfers of funds and purchases of financial assets. These funds could be dedicated to specific projects, including, for example, the capitalization of microcredit institutions, employment generation programmes, provision of health services and infrastructure.

D. FISCAL POLICY

Chapter III illustrated that rights-based economic strategies require the public sector to induce, regulate and sustain the process of growth; and target resources into priority sectors and into areas that can bring direct benefits to the poor. The public sector can also foster macroeconomic stability, including low inflation and high and stable levels of employment, without which it becomes difficult to secure the desired pro-poor outcomes.

In order to achieve these objectives, Governments need to deploy growth-accommodating (activist) fiscal, monetary and exchange rate policies. These policies are not merely technical tools. Specifically, they can play an important role in eliminating mass poverty and satisfying human needs. On the other hand, these policies help to determine the remit of the State, the structure of employment, the level of economic activity, and the level and direction of economic transfers. With an eye on maximizing human welfare, rather than simply on growth in general, it is important to highlight the distributive implications of fiscal, monetary and exchange rate policy, even if this is not normally done explicitly in mainstream analyses. This section considers the potential role of fiscal policy in pro-poor strategies; while subsequent sections examine the roles of monetary and exchange rate policies.

Fiscal policy refers to the taxation and expenditure policies of the central Government, which are normally implemented by the ministry of finance, either directly or through live ministries or specialized agencies. Mainstream economics argues that the size of the public sector needs to be kept to a minimum given that low taxes, limited regulation and limited public investment create incentives for private sector activity, which is essential because the private sector must lead the process of growth and poverty alleviation.

Moreover, mainstream economics claims that fiscal balance is important in order to avoid inflation and balance of payments disequilibria. In the long run, fiscal balance can also help to limit the size of the public sector and, therefore, to increase choice and economic efficiency. Relatively low taxes, low levels of public spending and limited regulation will presumably create incentives for private sector activity, which can lead the processes of growth and poverty alleviation more efficiently than the public sector.

By the same token, relatively high interest rates raise domestic savings and attract foreign capital, which helps to finance higher levels of investment in the economy. This strategy is limited. It is plagued by theoretical inconsistencies at several levels, and its basic assumptions are at variance with the realities of the ESCWA region. This helps to explain the failure of the structural adjustment programmes aimed at achieving their stated goals of rapid economic growth, poverty reduction and balance of payments sustainability both in the ESCWA region and elsewhere.

By contrast, rights-based development strategies recognize that fiscal policy is potentially powerful, and that it can play a critically important role in achieving pro-poor objectives.[95] According to this economic

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[95] For a reassessment of the importance of fiscal policy, see P. Arestis and M. Sawyer, "Reinventing fiscal policy", *Journal of Post Keynesian Economics*, vol. 26, No. 1 (M.E. Sharpe Inc., 2003), pp. 3-25. Pro-poor fiscal policy is reviewed in detail by N. Kakwani and H. Son, "On pro-poor Government fiscal policies: with application to the Philippines", which was presented at the Asia and Pacific Forum on Poverty: Reforming Policies and Institutions for Poverty Reduction (Manila, 5-9 February 2001); and by J. Weeks and R. Roy, "Thematic summary report: the macroeconomics of poverty reduction - fiscal policy" (UNDP, 2003).

strategy, the public sector needs to induce, regulate and sustain the process of growth; direct significant resources to priority sectors; and preserve macroeconomic stability. This is essential given that poor and middle-income countries are prone to more severe economic crises and with greater frequency than rich economies.[96]

This is especially true in the ESCWA region, owing to its direct and indirect reliance on oil exports, and on oil and other rents. The fiscal policy stance in a rights-based economic strategy is determined primarily by the need to achieve rapid, sustained, broad-based and employment-intensive growth. Growth-accommodating fiscal policies help to stimulate the economy, ensure that growth is led by pro-poor sectors, and secure the achievement of the desired distributive outcomes. Rapid growth plays a more prominent role in rights-based strategies than in mainstream programmes.

However, in order to play these positive roles, rights-based fiscal policies must be bolder and more expansionary than those under an orthodox strategy.[97] Specifically, the central aim of fiscal policy must be "to help achieve the high quality and quantity growth rates that are needed".[98] Additionally, tax and expenditure policies need to be based on "their ability to promote growth, redistribution, poverty reduction and employment creation. The temptation to achieve a balanced budget must be tempered by the immediate and long-term growth and development implications".[99]

While activist and growth-accommodating fiscal policies are essential, they are likely to be insufficient. In order to maximize the distributive and poverty-alleviating impact of growth, fiscal incentives need to be integrated within a broad, rights-based industrial policy strategy, including the targeted expansion of manufacturing industry and agriculture. The Government plays an essential policy role in this strategy by directing, for example, the allocation of resources and by regulating the composition of output and employment while, at the same time, using the available tools to maintain macroeconomic stability.

In order to maximize their impact given the resources available, rights-based policies need to be targeted. Priorities must include, principally, the sectors that benefit the poor directly, especially those sectors that generate income and employment for the poor, and that produce goods and services consumed by the poor with domestic inputs. In most ESCWA member countries, these could include, for example, small-scale agriculture, construction, the informal sector and the production of basic consumer goods. Additionally, pro-poor policies must promote investment and technological upgrading, especially in the manufacturing industry and the non-traditional export sector, given that these can drive long-term growth, particularly in MDEs.

It is known that investment is one of the main drivers of growth. However, growth is also a driver of investment because rapid, broad-based and sustained growth generates the demand that makes individual investment projects viable.[100] Moreover, high investment simplifies the task of reallocating resources

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[96] Weller and Hersh claim that the volatility of growth hurts the poor even more than low growth rates. C.E. Weller and A. Hersh, "The long and short of it: global liberalization and the incomes of the poor", *Journal of Post Keynesian Economics*, vol. 26, No. 3 (M.E. Sharpe Inc., 2004), p. 488.

[97] T. McKinley, "MDG-based PRSPs need more ambitious economic policies" (UNDP, 2004), p. 1.

[98] United Nations Development Programme (UNDP), *South Africa Human Development Report: The Challenge of Sustainable Development in South Africa - Unlocking People's Creativity* (Oxford University Press, 2003), p.196.

[99] Ibid., pp. 196-197.

[100] There is no question that higher rates of capital formation are associated with higher growth rates. See, for example, C.E. Weller and A. Hersh, "The long and short of it: global liberalization and the incomes of the poor", *Journal of Post Keynesian Economics*, vol. 26, No. 3 (M.E. Sharpe Inc., 2004). The reverse line of causation is discussed by T. McKinley (ed.), "Introduction" in *Macroeconomic Policy, Growth and Poverty Reduction* (Palgrave Macmillan, 2001).

towards pro-poor economic sectors. In order to kick-start this favourable cycle of growth and investment, the State needs to identify those sectors that hold the key to rapid, broad-based, employment-intensive and sustained growth; to reducing poverty and inequality; and to alleviating the balance of payments constraint. Their expansion must be supported through targeted industrial, agricultural and trade policies; the investment of public resources; and focused incentives for the expansion of capacity and output.[101]

Targeted public investment in these areas can boost aggregate demand, thereby potentially sparking the recovery of a stagnant economy; loosen the supply constraints on long-term growth; and help to reallocate resources towards poverty reduction objectives, especially in economies operating below potential, as is the case in most ESCWA member countries. While mainstream theory insists that public investment crowds out and is less efficient than private investment, there is no firm evidence supporting this claim.

Conversely, there is a large body of evidence to indicate that public investment generally crowds in private investment in upstream and downstream sectors, including, among others, supplies of inputs and consumables, cleaning, maintenance and security services, trading and finance, and training of labour.[102] Equally, public investment can support private investment and output growth if it expands the physical infrastructure, including roads, ports and airports, water, sewerage and irrigation systems, electricity generating capacity and transmission lines; and boosts labour productivity through, for example, public education and training programmes, public transport or public health provision; or fosters private savings.[103] Public investment can also support quality foreign investment in the country. Within that context, China and Vietnam have enjoyed high rates of growth despite strong public investment programmes. Both countries attracted large inflows of FDI, thereby suggesting that, far from discouraging inflows, major public investments actually facilitated FDI.[104]

There is ample evidence to suggest the following: (a) public investment has played a key role in fostering growth and reducing poverty in several dynamic economies, especially in East Asia;[105] and (b) when public investment falters private sector profitability often declines, thereby reducing the resources available for investment.[106] In this sense, adequate levels of public investment can be essential for sustained pro-poor and rights-based growth, especially in the resource-constrained MDEs.

In order to support economic stabilization and large public investment programmes, Governments in the MDE cluster need to jettison the excessively restrictive fiscal policy stance imposed by mainstream economic strategies, and adopt more proactive policies.[107] This is not necessarily inflationary—in fact, there

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[101] In shaping an alternative economic development strategy, a Government does not simply want more investment; it wants more investment of a certain kind, which translates into focused incentives. See A. MacEwan, "Debt and democracy: How can heavily indebted countries pursue democratic economic programs?", which was presented at the Symposium on Common Defense Against Neoliberalism (Istanbul, 6-7 December 2003).

[102] See, for example, J. Weeks and R. Roy, "Thematic summary report: The macroeconomics of poverty reduction - fiscal policy" (UNDP, 2003).

[103] Persuasive empirical evidence suggests that higher fiscal deficits can actually crowd in private investment by removing physical bottlenecks of infrastructure, thereby raising the factor productivity of private investment. H.A. Pasha, "Pro-poor policies", which was presented at the Fourth Global Forum on Citizens, Businesses and Governments: Dialogue and Partnerships for the Promotion of Democracy and Development (Marrakech, Morocco, 12-13 December 2002).

[104] J. Weeks and R. Roy, op. cit.

[105] See J. Vandemoortele, "Can the MDGs foster a new partnership for pro-poor policies?" (UNDP, 2004).

[106] T. McKinley, "MDG-based PRSPs need more ambitious economic policies" (UNDP, 2004), p. 9. See J.M. Rao, op. cit.

[107] The process of growth has been retarded by an obsession with the elimination of fiscal deficits, particularly where such elimination has been achieved through cutbacks in public expenditure, especially on development and social services. H.A. Pasha, op. cit.

is no evident relationship between fiscal deficits, growth, unemployment and inflation.[108] In other words, public investment programmes can be deficit-financed as long as these deficits are not excessive, the economy is operating below capacity, the balance of payments constraint is not binding, and the deficits can be financed in a sustainable manner.[109]

However, in cases where Governments need to monetize their deficits, care must be taken to limit the ensuing expansion of demand owing to potentially adverse implications for inflation and the balance of payments.[110] Experience indicates that if public deficits are used to finance, in a sustainable manner, investment that expands aggregate supply, then their impact need not be unduly inflationary either in the short or the long term.[111]

Pro-poor public investment must target four priority areas, namely: (a) provision of infrastructure, as discussed above and in chapter III; (b) rural development; (c) technological upgrading; and (d) promoting non-traditional exports.

1. *Rural development*

In several large, non-GCC ESCWA member countries it is especially important to support the development of agriculture and its linkages with other economic sectors given the following three reasons: (a) the economic importance of that sector; (b) the fact that large numbers of poor people live in rural areas; and (c) the potentially severe dislocations to labour and agricultural production arising from trade liberalization.

MDEs in the ESCWA region can draw upon the strategies of China, Indonesia and Vietnam between the 1970s and the 1990s as they attempt to raise agricultural productivity, boost the links with agriculture and other dynamic economic activities, and increase the scope for the production of exportable goods.[112] In order to do this, it could be necessary to transform significantly the land tenure systems in MDEs and invest heavily in better technology and in physical and social infrastructure, including, for example, by using better seeds and fertilisers; and by improving crop selection, irrigation, storage and transportation facilities. This is important given that "strong agricultural growth has been a feature of countries that have successfully reduced poverty at different times" and that the impact on poverty is "likely to be more pronounced the faster the rate of agricultural growth".[113]

Moreover, public investment in rural development, especially in the Mashreq region, can focus on diversifying agriculture into "labour-intensive high-value agricultural commodities such as horticulture and livestock for increased profit incentives and employment opportunities. This may require intervention by the

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[108] See S. Fischer, R. Sahay and C. Végh, "Modern hyper- and high inflations", *Journal of Economic Literature*, vol. 40 (September 2002), pp. 876-877.

[109] For example, if the additional domestic debt of the public sector can be paid off by the tax revenues generated by future growth.

[110] Such cases can arise where financial markets are insufficiently developed, or when debt finance could have adverse distributive implications.

[111] See J.M. Rao, op. cit.

[112] See M. Karshenas, "Structural obstacles to economic adjustment in the MENA region: the international trade aspects", in *The State and Global Change: The Political Economy of Transition in the Middle East and North Africa*, eds. Hakimian, H. and Moshaver, Z. (Curzon Press, 2001).

[113] H.A. Pasha and T. Palanivel, *Pro-poor growth and policies: The Asian experience* (UNDP, 2004), pp. 18-19.

State initially in the process of marketing and in providing minimum support prices to help farmers manage the risks of moving into new economic activities".[114]

The expansion of low-productivity small-scale labour-intensive sectors, including family agriculture, is unlikely to deliver the employment and productivity growth required for the long-term success of a pro-poor development strategy. These sectoral initiatives must be plugged into broader programmes of education, training, technological development and labour transfer to high-productivity sectors in order to deliver higher productivity and better living standards for the poor.[115]

2. *Technological upgrading*

ESCWA member countries need to upgrade their productive capabilities given that productivity gains are the key to sustained growth and rising incomes in the long run.[116] These gains can be achieved in at least two different ways, namely:[117] (a) by developing mass production facilities whereby low-paid unskilled workers engage in repetitive tasks at high speed in traditional plantations or in manufacturing industries that produce clothing, shoes or established electronic products; and (b) by promoting better paid skilled workers to work cooperatively and apply more sophisticated technical skills in the services industry, specialized agricultural production or the manufacture of relatively sophisticated electronic goods, chemicals and machines.

Clearly, most ESCWA member countries cannot move directly into these advanced production processes owing to the lack of adequate technology, infrastructure, skills, managerial capacity and finance. However, this type of development is precisely the kind that rights-based and pro-poor strategies must aim towards, even if these are achievable only in the medium and the long term, and only in certain areas of the economy.

The high road to productivity growth offers several advantages.[118] First, it avoids the trap of trying to compete against much cheaper and often more productive Asian labour. Additionally, it opens valuable export opportunities that can help to relieve the balance of payments constraint in MDEs. Moreover, it requires the development of chains of related activities that, if internalized, can generate employment and growth in other areas of the economy; and demands and supplies a skilled workforce that can be trained by public education programmes and that can transfer their know-how to other areas of the economy.

Consequently, these workers can earn more than the average wage, which in turn helps to raise the expectations of workers employed elsewhere. Finally, these firms can set high standards of safety and security in the workplace that facilitates the regulation and, eventually, the elimination of degrading and unsafe working conditions in other areas of the economy. These outcomes are neither necessary nor automatic. While higher productivity and profitability give firms the scope to improve pay and conditions, the market does not always spontaneously generate exports, internalize value chains, pay salaries

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[114] Ibid., pp. 30-31.

[115] In most cases, this implies moving poor workers out of agriculture and into industry and a more modern service sector. Poverty can then be reduced if industry is able to grow rapidly enough and generate employment. T. McKinley, "The macroeconomics of poverty reduction: initial findings of the UNDP Asia-Pacific Regional Programme" (UNDP, August 2003).

[116] Ibid.

[117] See A. MacEwan, op. cit.

[118] See R.P. Korzeniewicz and W.C. Smith, "Poverty, inequality, and growth in Latin America: Searching for the high road to globalization", *Latin American Research Review*, vol. 35, No. 3 (2000), pp. 7-54; J.A. Ocampo, "Rethinking the development agenda", *Cambridge Journal of Economics*, vol. 26 (2002), pp. 393-407; and J.A. Ocampo, "Beyond the Washington Consensus: An ECLAC perspective", *Cepal Review*, vol. 66 (1998), pp. 7-28.

commensurate with productivity or deliver minimum health standards in the workplace. State regulation and incentives are essential to achieve these outcomes.

Regulation makes it difficult for firms to increase profitability by cutting wages, extending arbitrarily the working day, or bypassing existing health and safety rules. Productivity growth and better working conditions can be supported by legislation aimed at fostering trade union activity and at raising minimum wages; and by the offer of tax and other incentives for investment in priority sectors, the introduction of new technologies and the payment of high wages.

These policies can be partly funded by progressive income taxes and social security contributions. Relatively high wages ensure that the most productive firms reap extraordinary profits, while their less efficient competitors face losses. Export incentives and targeted import protection, to the maximum extent permitted under WTO rules, offer an alternative avenue for profitability and growth. At the same time, workers left unemployed owing to the bankruptcy of inefficient firms or the declining availability of low-paid jobs, especially in MDEs, need to be retrained with public funds in order to find more productive and better-paying employment.[119] These medium-term policies can help to raise economic productivity, increase the flexibility of labour markets and reduce structural unemployment, while creating incentives for exports and for long-term productivity growth in industry, large-scale agriculture and the services sector.

In parallel and at a more immediate level, it is essential to offer incentives for the development of diversified labour-intensive industries that produce non-tradable goods, in the light of their potential for generating employment. These industries, particularly small-scale agriculture, construction, small-scale workshops and some services industries and public works, can support the absorption of the labour force and offer opportunities for on-the-job training for entrants on the formal labour markets.[120]

At the same time, they could help to relieve localized supply constraints in the ESCWA region, for example, through the supply of food, inputs for the manufacturing industry, exportable goods, or the construction of rural roads or irrigation facilities through public works programmes. These incentives and public works programmes can be funded by general taxation and by targeted credit from SOEs and private financial institutions.

3. *Promoting non-traditional exports*

The literature on industrial policy shows that the expansion of exports can contribute significantly to productivity growth given that it exposes producers to the stringent test of foreign market access. Moreover, export growth is essential for the generation of healthy trade surpluses and the accumulation of foreign currency reserves, which supports the stabilization of exchange rates in MDEs.

In the absence of sizeable currency reserves obtained through trade surpluses, MDEs will always be compelled to seek less desirable forms of international finance, especially aid and portfolio capital inflows, or borrow from IFIs with conditions that can limit the ability to pursue rights-based policies. Export growth in the medium and long term requires a competitive and stable real exchange rate, as well as coordinated industrial policy initiatives aimed at developing national competitive advantages in strategically important

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[119] For example, within the framework of a "training-for-jobs" programme, the Government provides training aimed at preparing workers with the specific technical skills needed by a firm. The firm, in return, makes an investment and hires the already-trained workers. Such a programme has a special advantage over other forms of investment incentives, namely, it raises the skill level of workers even in cases where the firm has moved away. A. MacEwan, op. cit.

[120] There is a greater positive impact on poverty reduction when economic growth is concentrated in those sectors that employ most of the poor. H.A. Pasha and T. Palanivel, op. cit., p. 16. See also T. McKinley, "The macroeconomics of poverty reduction: initial findings of the UNDP Asia-Pacific Regional Programme" (UNDP, August 2003).

sectors.[121] The Government will need to become involved in the complex task of picking winners, which has been addressed successfully by several countries in East Asia and elsewhere over long periods of time.[122]

These policy priorities need to be funded primarily by national or regional sources.[123] Raising resources locally to support a rights-based development strategy requires a concerted effort given that, in many ESCWA member countries, the available savings and tax revenues are insufficient to support ambitious pro-poor programmes.[124] Such programmes require support from supplementary public sector spending, in addition to the abovementioned private sources of finance. These additional expenditures need to be financed primarily by taxation, rather than through debt.

In most ESCWA member countries, there is a large untapped potential to raise taxes, given that tax ratios are often below 20 per cent of GDP (see table 11). In most countries, taxation is almost exclusively based on indirect taxes, including taxes on oil, which helps to consolidate the inequalities that currently structure these economies. Some GCC countries levy no income tax at all, and enforcement across the region tends to be so lax that the equalizing impact of taxation is often even more limited than it initially appears to be.[125]

In addition to this, a large part of levied taxes tend to be wasted from the point of view of their pro-poor impact. Countries, including Jordan, Oman, the Syrian Arab Republic, the United Arab Emirates and Yemen, allocate at least a quarter of the central Government budget to defence spending. Egypt and Oman spend only some 15 per cent of the fiscal budget on health and education, while the Syrian Arab Republic spends a paltry 10 per cent.[126] In fact, there tends to be a systematic pattern of substitution between defence and social spending. Indeed, the highest ratio of social to defence spending is found in Tunisia, which enjoys one of the lowest defence expenditures. Owing partly to a conscious decision to devote resources to health and education, the incidence of poverty has decreased rapidly and dramatically in Tunisia.[127]

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[121] See, for example, A.H. Amsden, *The Rise of the 'Rest': Challenges to the West from Late-Industrializing Economies* (Oxford University Press, 2001); A.H. Amsden, "Bringing production back in - Understanding Government's economic role in late industrialization", *World Development*, vol. 25, No. 4 (Elsevier Science Ltd., 1997), pp. 469-480; H.J. Chang, *Globalisation, Economic Development and the Role of the State* (Zed Books, 2003); and H.J. Chang, *The Political Economy of Industrial Policy* (Macmillan Press, 1994).

[122] See M.R. Agosín, and D. Tussie (eds.), *Trade and Growth: New Dilemmas in Trade Policy* (Macmillan Press 1993); H.J. Chang, "The political economy of industrial policy in Korea", *Cambridge Journal of Economics*, vol. 17 (June 1993), pp. 131-157; and G. Gereffi and D.L. Wyman (eds.), *Manufacturing Miracles: Paths of Industrialization in Latin America and East Asia* (Princeton University Press, 1990).

[123] The suggestion that countries need to rely primarily on domestic rather than foreign savings is supported by the pioneering work of M. Feldstein and C. Horioka, "Domestic saving and international capital flows", *The Economic Journal*, vol. 90 (June 1980), pp. 314-329; and by more recent research by G. Calvo, L. Leiderman and C. Reinhart, "Capital inflows and exchange rate appreciation in Latin America: The role of external factors", *IMF Staff Papers*, vol. 40, No. 1 (IMF, 1993), pp. 108-151. For a political economy interpretation of these findings, see G. Palma, "Three and a half cycles of 'mania, panic and [asymmetric] crash': East Asia and Latin America compared", *Cambridge Journal of Economics*, vol. 22, No. 6 (Cambridge Political Economy Society, 1998), pp. 789-808.

[124] ESCWA, *Survey of Economic and Social Developments in the ESCWA Region 2003-2004* (E/ESCWA/EAD/2004/4).

[125] See P. Rivlin, *Economic Policy and Performance in the Arab World* (Lynne Rienner Publishers, 2001), pp. 55-56.

[126] For details, see M.Q. Islam, "Fiscal policy and social welfare in selected MENA countries", in *Earnings Inequality, Unemployment, and Poverty in the Middle East and North Africa*, eds. Shahin, W. and Dibeh, G. (Greenwood Press, 2000).

[127] Ibid.

TABLE 11. TAX REVENUES IN SELECTED ESCWA MEMBER COUNTRIES, 2000-2004
(*Percentage of GDP*)

Country	2000	2001	2002	2003	2004
Bahrain	4.2	4.6	4.5	..	..
Jordan	19.0	19.0	17.9	18.8	20.8
Kuwait	n.a.	n.a.	n.a.	n.a.	n.a.
Lebanon	12.5	11.9	15.1	..	..
Oman	7.2	7.4	..	..	..
Yemen	..	..	..	..	0.6

Sources: Compiled by ESCWA, based on several ESCWA publications and on the World Bank, *World Development Indicators* (the World Bank, December 2005).

Note: Two dots (..) indicate that data are not available or are not separately reported.

Achieving the required levels of sustainable public spending requires significant modernization and expansion of the tax systems in the ESCWA region, and improvements in tax collection and administration in order to raise additional revenue and improve the distributive impact of taxation. Tax revenues play a fundamental role in mobilizing resources for the allocative, distributive, growth and stabilization functions of the State, especially in countries with weak financial systems.[128] Investment in tax collection and administration can bring high returns to the Government, and a pro-poor tax system plays an essential role supporting the improvement of social welfare in the long term.

Despite this, better tax collection and tax administration are insufficient in most countries. In order to fund growth-accommodating and pro-poor fiscal policy, and to distribute income while maintaining macroeconomic stability, most ESCWA member countries will need higher and more progressive tax rates, including a shift away from indirect taxation and towards direct (progressive) taxation.

Additionally, it will be necessary to expand the tax base through the taxation of wealth; large or second properties in rural and urban areas; unearned incomes, especially interest and capital gains; financial transactions; and international capital flows. While economic and managerial obstacles are certainly relevant, especially in economies with weak States and large informal sectors, such obstacles do not constitute the most important constraints to the expansion of the tax base in the ESCWA region. Rather, the constraint is primarily political. However, domestic pressures for economic privileges or threats of capital flight must not prevent the State from mobilizing domestic resources, especially when they are based on rents.

Consequently, while rights-based strategies require activist and growth-accommodating fiscal policies, it is important to avoid excessively expansionary fiscal policies. This is not because expansionary fiscal policies crowd out the private sector. There is no conclusive evidence that this happens in poor countries, nor is such evidence expected in demand-constrained economies as is the case in the ESCWA region. In these countries, private investment is low as a consequence of a poor country, low savings and weak demand; rather than resulting from the State draining away or wasting available savings.

However, pro-poor strategies must normally avoid overly expansionary fiscal, monetary and exchange rate policies for the following three reasons:

[128] Whether higher taxes retard economic growth depends primarily on how the Government spends the money. Specifically, higher taxes can lead to more, not less, economic growth when the public money is spent on creating a more effective infrastructure and a more productive workforce. A. MacEwan, op. cit.

(a) Arguments for such fully expansionary policies generally draw on a narrow reading of the experiences of the United States and large European economies in the mid-twentieth century. These countries could either print the world currency, especially the United Kingdom of Great Britain and Northern Ireland before World War I, and the United States after World War II, or they had much greater access to foreign currency than today's poor countries, whose balance of payments constraint is much tighter;

(b) Expansionary fiscal, monetary and exchange rate policies in poor countries could generate unsustainable booms that could destabilize their economies and political systems. This is especially true for economies that have been starved of investment for long periods, and where high unemployment coexists with low spare capacity in key sectors of the economy. In such cases, a sudden and radical policy reversal can trigger rapidly accelerating inflation and send the national currency spiralling downwards;

(c) The fully expansionary option is not always politically feasible. In particular, if the economic policy change triggers a rapid deterioration of the fiscal balance, the opponents of the strategy will be offered an excuse to attack the pro-poor priorities of the Government. Their hostility could trigger political instability, capital flight, and speculation with foreign currency or treasury bills, thereby accelerating inflation and a balance of payments crisis even before the expansionary and distributive impact of the pro-poor policies can be felt.

In conclusion, pro-poor fiscal policy must be calibrated carefully such that it delivers what monetary and exchange rate policies cannot, namely: targeted investment programmes, incentives for the private sector to support the Government's pro-poor goals, and economic stabilization when this becomes necessary.

E. MONETARY AND ANTI-INFLATION POLICY

In general, monetary policy refers to the regulation by the State of the money supply and the level of interest rates. Monetary policy is normally executed by the central bank, either in its capacity as the regulator of the financial sector, or through its participation in open market operations and Government deficit financing.

Monetary policy can contribute to the success of a rights-based development strategy in four different ways, namely: (a) by supporting the pro-poor fiscal policies outlined above; (b) by helping to minimize investment costs and instability in the domestic financial system, the real exchange rate and the balance of payments; (c) by avoiding excessively low, excessively high or rapidly accelerating inflation; and (d) by supporting the improvement of resource allocation through the provision of targeted credit for priority sectors and the management of the country's capital controls. These claims are discussed and explained below.

The most important monetary policy instrument, especially in MDEs, is the level of interest rates. Rights-based strategies must avoid the mainstream mistake of saddling the interest rates with the potentially conflicting roles of securing the balance between savings and investment, controlling inflation and achieving balance of payments equilibrium.

If interest rates have to fulfil these three roles simultaneously, as tends to be the case in strategies sponsored by IFIs, then they tend to be permanently high given that they cannot fall below the highest of these three levels. If they do, either savings become insufficient to fund the desired investment projects, or else inflation starts to rise or the balance of payments slides into a deficit. All these cases have negative implications for financial stability, investment, employment generation, distribution and growth. For

example, high interest rates over long periods have been associated with regressive distributive shifts, and with financial and balance of payments crises.[129]

The manipulation of interest rates needs to be aimed primarily at securing financial and money market equilibrium, including the balance between savings and investment. Given that interest rates do not distinguish between economic sectors (in principle, everyone pays the same interest rates on loans, regardless of the social importance and the externalities of their investment projects), it is important to supplement the manipulation of interest rates with other instruments, including, for example, targeted credit offering incentives for investment in priority pro-poor sectors.

Inevitably, interest rates play a role in controlling inflation given their influence on the levels of savings and investment and, therefore, on aggregate demand. However, this must not be their main priority. Interest rates need to be used to control demand only exceptionally, in cases where macroeconomic stability is severely impaired. In normal circumstances, fiscal policy must regulate the level and structure of demand. If interest rates are not burdened with this additional task, they can be lower and more growth-accommodating, which in turn supports the expansion of investment and reduces the service burden of the domestic public debt.

Moreover, they allow additional resources to become available for pro-poor objectives.[130] Similarly, interest rates must not play a key role in securing balance of payments equilibrium. A pro-poor development programme needs to include a strategy for the balance of payments, including specific policies for foreign trade, foreign investment and transfers, among them foreign aid. The determinants of these flows are far too subtle to be addressed successfully merely through the manipulation of interest rates.

Mainstream theory claims that inflation control is the most important objective of monetary policy, because low inflation is believed to foster market development, private investment and long-term growth. In other words, there is presumed to be a trade-off between inflation and growth. Additionally, mainstream theory argues that inflation arises primarily from monetary factors, especially the monetization of fiscal deficits; and that low inflation needs to be achieved mainly through fiscal and monetary policy reforms, and by manipulating interest rates. According to the mainstream, these need to be supported by privatizations, trade, financial and capital account liberalization and by other macroeconomic policy reforms aimed at consolidating a specific or conventional development strategy.

There is no question that contractionary fiscal and monetary policy can help to reduce inflation, whatever its causes. However, this strategy is rarely compatible with sustained growth, macroeconomic stability or the achievement of pro-poor outcomes. Specifically, contractionary policies tend to stifle growth, transfer income to the financial sector and the rich, and conflict with the goals of pro-poor fiscal policy, thereby increasing the cost of pro-poor policies and, possibly, even rendering them ineffective.

The orthodox approach is equally inadequate for other reasons. For example, there is no conclusive evidence that a stable trade-off between inflation and growth exists, either in the ESCWA region or elsewhere. If there is a trade-off between inflation and growth then it must be both elusive and unstable, as evidenced by available data, conflicting views in the literature, and by frequently changing estimates of the

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[129] See G. Argitis and C. Pitelis, "Monetary policy and the distribution of income: evidence for the United States and the United Kingdom", *Journal of Post Keynesian Economics*, vol. 23, No. 4 (M.E. Sharpe Inc., 2001), pp. 617-638; and H.J. Chang and I. Grabel, *Reclaiming Development: An Alternative Economic Policy Manual* (Zed Books, 2004).

[130] Argitis and Pitelis have shown that lower interest rates can raise the industrial profit share, reduce production costs and inflation, and improve competitiveness. This less restrictive economic environment promotes investment, productivity and growth. G. Argitis and C. Pitelis, "Monetary policy and the distribution of income: evidence for the United States and the United Kingdom", *Journal of Post Keynesian Economics*, vol. 23, No. 4 (M.E. Sharpe Inc., 2001), p. 633.

equilibrium rate of unemployment in most economies.[131] Orthodox studies often generalize on the basis of a small number of cases of extremely high inflation, none of which are in the ESCWA region, wherein growth was already compromised and where the resumption of growth coincided with the elimination of high inflation.

It is likely that very high inflation hinders macroeconomic performance severely. In these cases, stabilization can be conducive to output and productivity growth. However, high inflation and low growth rates can be symptoms of other economic problems and processes, including, for example, the transition to capitalism in former socialist economies; social conflicts and dysfunctions in the financial sectors in Latin America; supply constraints and civil strife in many high-inflation sub-Saharan African countries; or balance of payments pressures and political instability in several ESCWA member countries. In such cases, inflation stabilization may not be conducive, in and of itself, to the resumption of growth.

More specifically, a general trade-off between inflation and growth is probably non-existent, given that economies are known to grow rapidly over long periods, often decades, with stable or falling unemployment and moderate, non-accelerating inflation. In other words, this trade-off cannot simply be assumed to exist. The relationship between growth and inflation is likely to change depending on the structural and institutional development of the economy, the stage of the economic cycle and the economic policies of the State. Any presumed trade-off has to be shown to exist for each economy, and in each phase of its development. Consequently, it is misguided to design economic policies under the assumption that there is a stable and universally valid trade-off between inflation and growth.

Even if such a trade-off exists, it is likely to be non-linear. While both very low and very high inflation can have adverse consequences for growth, empirical assessments show that moderate inflation has no adverse implications for growth, distribution or the poor; and does not tend to accelerate. Moreover, moderate inflation is not associated with slower growth, lower investment, higher unemployment, less FDI or the deterioration of any other important variables, including the distribution of income.[132] Moderate inflation could even help to sustain economic growth, especially when there is excess capacity and significant unemployment or underemployment.

There is evidence to suggest that moderate inflation is associated with higher incomes for the poorest, and that monetary contraction worsens the relative position of the poor.[133] In fact, several studies claim that excessively low inflation can harm growth, especially if prices and wages are sticky downwards. In addition to this, the optimal rate of inflation tends to change in space and over time, and it can even be positively correlated with the rate of economic growth. Finally, while high inflation can harm the poor, excessively low inflation and conventional stabilization policies can have the same result. There is simply "no strong

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[131] See P. Arestis and M. Sawyer, "Reinventing fiscal policy", *Journal of Post Keynesian Economics*, vol. 26, No. 1 (M.E. Sharpe Inc., 2003), pp. 3-25.

[132] See, for example, M. Bruno, "Does inflation really lower growth?", *Finance and Development*, vol. 32, No. 3 (September 1995), pp. 35-38; M. Bruno and W. Easterly, "Inflation and growth: In search of a stable relationship", *Federal Reserve Bank of St Louis Review* (May-June 1996), pp. 139-146; H.J. Chang and I. Grabel, *Reclaiming Development: An Alternative Economic Policy Manual* (Zed Books, 2004), chap. 11; R. Dornbusch and S. Fischer, "Moderate inflation", NBER Working Paper No. 3896 (National Bureau of Economic Research (NBER), March 1993); G. Epstein and E. Yeldan, "Alternatives to inflation targeting monetary policy for stable and egalitarian growth in developing countries: A multi-country research project" (unpublished manuscript, April 2004); and J.M. Rao, op. cit.

[133] See J. Forder, "Central bank independence: Economic theory, evidence and political legitimacy", *International Papers in Political Economy*, vol. 10, No. 2 (2003), pp. 1-53; J. Vandemoortele, op. cit., p. 13; and J. Weeks et al., "Case study of Viet Nam: Seeking equity within growth", CDPR Discussion Paper No. 2102 (School of Oriental and African Studies, 2002).

evidence in support of the argument that very low inflation is either pro-growth or pro-poor. Actually, too low an inflation rate can be as harmful to the poor as too high a rate of inflation".[134]

Furthermore, mainstream theory claims that inflation is especially costly for the poor, given that their earnings, mainly wages, pensions and benefits, are fixed in nominal terms, and that these tend to be easily eroded by inflation. The poor also hold a larger share of their assets in liquid form when compared to the rich, and these assets are devalued by inflation; and the poor find it difficult to hedge against inflation because they lack access to the financial system.

While these links are probably valid, they do not represent the full picture for the following reasons:[135] (a) many poor people, especially in rural areas, are relatively less exposed to the monetary economy and less dependent on cash earnings than their urban counterparts; (b) the poor are often net debtors, and inflation can reduce their debt burden; (c) those poor who are net food producers can benefit when the relative price of food increases owing to inflation; (d) experiences in Latin America indicate that the middle class can be especially vulnerable to high inflation, because it is highly dependent on monetary exchanges, has little surplus cash to invest and, unlike the rural poor, does not have significant access to home-grown basic goods;[136] and (e) numerous studies show that the poor are heavily and disproportionately penalized by conventional disinflation programmes.[137]

The poor tend to lose in absolute as well as in relative terms under such programmes. In other words, conventional disinflation programmes make the poor poorer and the rich relatively if not absolutely richer. This is because they reduce the real wage and the rate of economic growth, increase unemployment and the cost of debt, and often eliminate labour regulations that helped to protect the living standards of the poor. There is no apparent linear or stable relationship between inflation and the distribution of income, either in the short or long term. This relationship is indirect and highly complex; and simplistic claims that inflation is always worse for the poor tend to draw on a small number of unrepresentative cases. In particular, moderate inflation seems to have no significant impact on poverty and distribution.[138]

More generally, it is misguided to try to address ingrained problems of poverty and inequality in the ESCWA region through anti-inflation policies. Serious attempts to alleviate poverty and improve the distribution of income in this region require specific programmes that involve several levels of Government, rather than resting primarily or exclusively on the monetary authorities.

Rights-based, anti-inflation programmes in the ESCWA region recognize the costs of both inflation for the poor in terms of their income levels and the distribution of income, as well as of mainstream strategies on inflation stabilization. They must also take into account empirical evidence that show that

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[134] J. Vandemoortele, op. cit., p. 13. See also T. McKinley, "The macroeconomics of poverty reduction: initial findings of the UNDP Asia-Pacific Regional Programme" (UNDP, August 2003).

[135] Sahay, Cashin and Mauro claimed that while inflation erodes the wages of the poor, the confiscation of their savings is not a particularly grave issue given that they hold little cash. R. Sahay, P. Cashin and P. Mauro, "Macroeconomic policies and poverty: the state of play and a research agenda" (IMF, 2001).

[136] See H.A. Pasha and T. Palanivel, op. cit., p. 13; and J. Vandemoortele, op. cit., p. 13.

[137] See, for example, G. Garuda, "The distributional effects of IMF Programs: A cross-country analysis", *World Development*, vol. 28, No. 6 (Elsevier Science Ltd., 2000), pp. 1031-1051; M. Pastor, "The Effects of IMF programs in the Third World: Debate and evidence from Latin America", *World Development*, vol. 15, No. 2 (Elsevier Science Ltd., 1987), pp. 249-262; and J.R. Vreeland, "The Effect of IMF Programs on Labor", *World Development*, vol. 30, No. 1 (Elsevier Science Ltd., 2001), pp. 121-139.

[138] See A. Bulíř, "Income inequality: Does inflation matter?", *IMF Staff Papers*, vol. 48, No. 1 (IMF, 2001), pp. 139-159; and H.A. Pasha and T. Palanivel, op. cit., pp. 14-15.

stable moderate inflation does not necessarily have adverse macroeconomic consequences; and that the orthodox obsession with very low inflation can harm the poor given its association with slow growth, high unemployment and high interest rates over long periods. These arguments do not posit that inflation is "good". Rather, they highlight the fact that there are choices with regard to the priority and intensity to be given to inflation control. These are not merely technical issues, and the benefits of very low inflation do not necessarily trump every conceivable alternative every time.

Rights-based, anti-inflation policies in the ESCWA region need to involve a broad range of policies deployed in close coordination, including fiscal, monetary, incomes, price, industrial and exchange rate policies. By contrast, mainstream strategies tend to rely primarily on one or two relatively blunt policies, especially fiscal austerity and interest rate manipulation. This difference arises because rights-based, anti-inflation policies address the causes of structural or long-term inflation which, especially in MDEs, tend to be located on the supply side of the economy.[139] Mainstream anti-inflation strategies concentrate on the monetary symptoms of inflation and its propagation mechanisms, thereby leading to an almost exclusive focus on the demand side of the economy.

However, addressing the causes of inflation normally requires an ample set of economic policy tools, which are backed up by negotiations aimed at coordinating sectoral income demands and at defusing existing distributive conflicts. Rights-based, anti-inflation policies must also seek to promote the long-term growth and equity objectives of the Government, rather than to subordinate all State policies to the goal of inflation stabilization. The combination of a wide variety of policies and the protection of the pro-poor goals of the Government can facilitate the involvement of society in the pursuit of low and stable inflation. This is essential given that, in the absence of a broad-based commitment to macroeconomic stability, the Government is compelled to deploy imperfect instruments with insufficient information and possibly against unwilling social sectors in order to impose its objectives upon society. This increases the cost of inflation control and, in all likelihood, reduces the welfare of the majority.

Output and productivity growth can relieve the infrastructural and supply constraints in ESCWA member countries. In turn, this helps to defuse the distributive conflicts and fosters social cooperation towards continuing growth and further distribution. Centralized bargaining is especially important given that potential sources of inflation and economic instability can be addressed through wage-setting mechanisms and by coordinating conflicting demands on the national income.

At the same time, legal, political and economic incentives need to be used in order to reward compliance and deter non-cooperative behaviour. Equally, other policy instruments can be deployed as part of this long-term strategy of inflation control, including, for example, adjustments in taxation, tariffs and other trade barriers; credit limits; price controls, especially for public utilities; and even, albeit marginally and for limited durations, the manipulation of interest rates and the exchange rate.

While low inflation can be achieved at an acceptable social cost, this requires more than merely controlling public spending, limiting the supply of money or hiking interest rates. Low and stable inflation is the outcome of long-term economic development and a social commitment to price stability, which must be part of a rights-based development compact in the ESCWA region. Social cooperation and policy coordination can foster an environment in which society is committed to low inflation, where economic behaviours are broadly compatible with this objective, and where Government policy contributes directly to this outcome. This can reduce the scope and the need for discretionary action by central banks, especially arbitrary changes in interest rates that can create uncertainty, deter investment, generate unemployment and impose obstacles to the achievement of such pro-poor objectives as MDGs. In a pro-poor policy framework, inflation control is not the province of a single governmental institution, such as the central bank or the

[139] By contrast, inflation in the oil economies tends to be closely correlated with balance of payments.

ministry of finance. Rather, it is incumbent on a strategic national objective that can support the achievement of rights-based development.

F. BALANCE OF PAYMENTS AND EXCHANGE RATE POLICY

The currencies of poor countries are not international means of exchange or reserve value, and they do not serve as units of account for transactions between different countries. These limitations severely restrict the ability of these poor countries to command resources in the world economy. They impose a balance of payments constraint, which represents probably the most important restriction to long-term growth in poor countries, even in the oil economies of the ESCWA region, given that it can trigger currency crises, inflation, unemployment and other destabilising processes.

The balance of payments constraint includes two types of restrictions, namely: on trade (the current account); and on capital flows (the capital and financial account, including debt service, which is a significant problem for several MDEs).[140] Economic strategies inspired by IFIs presume that trade liberalization fosters productivity growth, and that capital account liberalization will help to attract foreign savings to finance any current account deficits. This recipe is not conducive to macroeconomic stability or the welfare of the poor in the ESCWA region; and it needs to be rejected. A different set of arrangements, which are compatible with macroeconomic stability and rights-based outcomes, is outlined below.

The first element is the promotion and diversification of exports. Export growth can contribute significantly to productivity growth, and plays an essential role in generating healthy trade surpluses and in accumulating foreign currency reserves. This protective cushion is needed to allow MDEs to maintain exchange rate stability and expand their policy freedom in order to implement non-mainstream economic strategies.

The second element relates to import policy. Despite arguments by mainstream theory to the contrary, openness and trade integration, either separately or together, do not have a measurable impact on long-run growth.[141] Trade must be liberalized cautiously owing to the differential impact of liberalization on large and strategic economic sectors in MDEs and on the poor. In fact, "open trade is more a result of development rather than a prerequisite for it. As countries grow richer, they gradually take advantage of new opportunities offered by global trade. Trade follows development; it seldom leads development".[142]

Rapid trade liberalization and surging imports, especially if they are based on dumping, must be avoided given their potentially destabilizing effects. In particular, such vital economic sectors in MDEs as agriculture, construction and growth industries must be protected from unbridled liberalization. This is especially important because of the general lack of competitiveness of the manufacturing sector in the ESCWA region.[143] Regulation is important because of the potentially severe social and economic dislocations of import liberalization and, moreover, because historical experience shows that relatively autonomous late development is possible only when domestic industry and agriculture are protected.[144]

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[140] For details, see P. Rivlin, *Economic Policy and Performance in the Arab World* (Lynne Rienner Publishers, 2001), pp. 96-98.

[141] C.E. Weller and A. Hersh, "The long and short of it: global liberalization and the incomes of the poor", *Journal of Post Keynesian Economics*, vol. 26, No. 3 (M.E. Sharpe Inc., 2004), p. 492.

[142] J. Vandemoortele, op. cit., p. 14.

[143] See C.M. Henry, and R. Springborg, op. cit., p. 42.

[144] See H.J. Chang, *Globalisation, Economic Development and the Role of the State* (Zed Books, 2003); and H.J. Chang, (2002).

A rights-based trade policy has to be linked to a broader industrial strategy, including clear avenues for productivity growth and the development of domestic production capabilities in selected areas. Increased trade can foster growth through the transfer of technology and can create opportunities for developing new industries. However, these effects are likely to be limited given that the "positive effects of liberalization disappear over time, which is a pattern consistent with deregulation euphoria in the early years of liberalization, followed by macroeconomic instability and lower growth".[145]

Import liberalization can have a severe impact on the poor for three reasons, namely: (a) the benefits from trade can be concentrated in enclaves, or can increase the returns for skills or assets that are beyond the reach of the poor; (b) liberalization can increase competition from low-wage exporting countries, thereby reducing the scope for economic diversification and growth, and decreasing the wages and employment opportunities of the poor; and (c) heavily subsided exports from rich countries, including grain, sugar, cotton, fruit, meat and dairy products, can undermine the viability of small-scale agriculture and the livelihood of millions of rural poor in the ESCWA region.[146]

Moreover, Weller and Hersh have shown that "the income shares of the poor are lower in countries with deregulated current and capital accounts compared to more regulated ones. This is not because trade is directly harmful for the poor but because of the institutional design under which trade is conducted".[147] Given that liberalization does not have a strong impact on growth rates, the short-term adverse effects of current and capital account deregulation on the income shares of the poor "are not offset by faster income growth in the long-run, which could raise the possibility of faster income growth for the poor".[148] Trade could have a "beneficial effect on the income shares of the poor in the short-run in a regulated environment" and, consequently, countries where trade and capital flows are regulated "do best for the poor".[149]

These conclusions are especially important for countries that are considering the potential advantages of trade integration. Greater economic integration in the ESCWA region represents a policy goal that has been frequently stated. Moreover, within the Arab region as a whole, it has provided a yardstick for evaluating the achievements of Arab nationalism over the past half century. This has been reflected by numerous initiatives at the regional level and by dozens of bilateral trade agreements.

Within that context, among the most ambitious initiatives was the Arab Economic Unity Agreement (1964), which established the Council of Arab Economic Unity (CAEU). This resulted in the Arab Common Market (ACM) that represented a partial free trade area between Egypt, Iraq, Jordan and the Syrian Arab Republic; and subsequently joined by the Libyan Arab Jamahiriya, Mauritania and South Yemen. Egypt's membership of both the CAEU and the ACM was suspended when that country signed the Camp David Accords with Israel in 1979. Borders between other member countries were also closed from time to time owing to political frictions; and the ACM was further weakened by tariff and quota exception lists made available to member countries. Over time, the CAEU and ACM became less relevant; and they were essentially disbanded by the 1990s.[150]

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[145] C.E. Weller and A. Hersh, op. cit., p. 499.

[146] See J. Vandemoortele, op. cit., p. 14.

[147] C.E. Weller and A. Hersh, op. cit., pp. 499-500.

[148] Ibid.

[149] Ibid.

[150] See R. Miniesy, J. Nugent and T. Yousef, "Intra-regional trade integration in the Middle East: Past performance and future potential', in *Trade Policy and Economic Integration in the Middle East and North Africa: Economic Boundaries in Flux*, eds. H. Hakimian and J.B. Nugent (Routledge, 2004), p. 42.

Such difficulties have not been limited to political differences. While local rivalries and regional economic heterogeneity have certainly hampered efforts towards economic integration in the ESCWA region, the most important obstacle to integration has been the mode of articulation between ESCWA member countries and the world economy (see chapter III). This mode of integration does not favour the development of a division of labour that is coherent at a regional level. Quite the contrary, it supports the reproduction of skewed forms of dependence that have, historically, thwarted the development of the countries in the region.

Furthermore, the modest regional trade that currently exists is largely structured among blocs of countries, rather than within the Arab region as a whole. For example, nearly two-thirds of exports to the Arab region by Maghreb countries flow to other Maghreb countries; three-quarters of GCC exports to the region are to other GCC countries; and one-third of the Mashreq's trade with Arab countries is to other Mashreq countries.[151]

While the existing trading patterns can provide a platform for integrating further the economies of the region, this is not a straightforward exercise. ESCWA member countries suffer from chronic unemployment and underemployment, excess capacity, inadequate utilization of resources and widespread economic inefficiencies, which explain the lack of competitiveness of local firms. Under such conditions, the effects of regional integration based mainly on trade liberalization are at best limited and potentially harmful. For example, without adequate compensatory mechanisms, ill-considered attempts at integration could accentuate the economic heterogeneities between ESCWA member countries, thereby leading the stronger members of the group to reap the gains from liberalized trade at the expense of their weaker partners. Concerns with the possibility of polarization have been one of the main factors responsible for stalling attempts at regional integration in Africa and Latin America.

These undesirable outcomes can be avoided if trade liberalization is seen as a means to greater regional integration and if it builds on existing competitive strengths, rather than being an end in itself or a purely destructive strategy aimed at culling uncompetitive firms. If it is part of a regional, rights-based industrial policy, trade liberalization can support efforts to establish a rights-based regional division of labour, including protection of nascent industries, greater integration of production chains, trade coordination and regional financial agreements. This approach to regional trade policy could help to support efforts aimed at increasing the size and coherence of regional markets, which in turn could create incentives for both foreign and local investment in the region.

Subsequently, it could also help to minimize the resources that are currently being channelled to real estate and other speculative uses, especially in the GCC and, more recently, in Jordan and Lebanon; and to reduce the perceived risk associated with investment in the region. Once this new regional division of labour is in operation, it can contribute to the reduction of political tensions and support the reallocation of defence spending towards social spending.

Chapter III illustrated that sustained development, economic diversification and welfare improvements need to be based on the expansion of the manufacturing capacity in the ESCWA region. However, such a successful expansion is unlikely if it is attempted in individual countries or in small blocs of competing countries. In order to maximize the scope for success, regional coordination of manufacturing production is essential.

This requires a supranational organization with the authority to regulate business practices, including, among others, accountancy rules, business registration, tax policies, cross-country claims and labour regulations; to influence the allocation of investment funds; and to determine the production priorities in the

[151] Ibid., p. 47.

region. In order to be successful, this authority must have access to financial resources and needs regulatory powers. In that context, there is an essential need for State investment and directed credit that support the development of the infrastructure and increase regional economic integration.

Moreover, regional coordination of fiscal, tax, monetary and exchange rate policies can provide the essential level playing field for the success of integration efforts. In the absence of policy convergence within a negotiated framework, the gains from integration are limited, and they could even be insignificant.

There is no question that this will be a long and costly process. However, if successful, it could build the conditions for stable and rights-based development in the ESCWA region. Greater integration can help to shield the oil economies from the impact of oil price volatility, support economic diversification and protect the region from potentially adverse developments in the international economy. For MDEs, regional integration offers the prospect of secure access to larger and wealthier markets, improved infrastructure, better conditions for workers employed in other countries, and greater security of access to oil when this becomes necessary.

Additionally, regional integration can improve access to aid and increase security of food and fuel supplies for poor countries. All the economies in the ESCWA region could benefit from stabilization and regional insurance funds for oil and other commodity exports, which could help to secure price and demand stability in the medium term. This proposed strategy for integration can also support the construction of efficient impersonal bureaucracies within each State, which is an essential aspect of democratic governance. This, in itself, is a gain for the region given that it can dilute the power of the elites, and can support the assertion of popular sovereignty and Government accountability to the citizenship.

As was indicated above, rights-based strategies also require the regulation of the capital and financial account of the balance of payments. Capital account liberalization can be highly destabilizing for poor and middle-income countries. Unbridled liberalization fosters the accumulation of excessive foreign debt, especially by the banks, promotes speculative capital inflows that finance consumption more than investment, increases the country's vulnerability to balance of payments crises and facilitates capital flight.[152]

Despite the support for capital account liberalization by mainstream theory, this strategy does not contribute to macroeconomic stability. Moreover, even if it raises the economic growth rate in the short term, this effect tends to disappear in the medium-term. In this context, balance of payments instability is especially damaging for the poor. The link between capital flows and incomes of the poor arises from a "greater probability of financial crises in a liberalized environment. More capital flows, especially short-term portfolio flows, are often associated with a greater chance of financial crises".[153]

Equally, while "high-income earners are more likely to hold financial assets and hence to be hurt by a crisis through declining asset values, low-income earners may be more likely to be affected by declining demand as unemployment rises".[154] At the same time that "economic crises increase the need for well-functioning social safety nets, unfettered capital flows limit Governments' abilities to design policies to help the poor when they need it most—in the middle of a crisis. The poor are the first to lose under such fiscal contractions, and the last to gain when crises subside and fiscal spending expands".[155]

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[152] See G. Palma, "Three and a half cycles of 'mania, panic and [asymmetric] crash': East Asia and Latin America compared", *Cambridge Journal of Economics*, vol. 22, No. 6 (Cambridge Political Economy Society, 1998), pp. 789–808. See ESCWA, *Survey of Economic and Social Developments in the ESCWA Region 2003-2004* (E/ESCWA/EAD/2004/4).

[153] C.E. Weller and A. Hersh, op. cit., pp. 478-479.

[154] Ibid.

[155] Ibid.

Countries that are committed to a rights-based development strategy need to avoid capital account liberalization for the following four reasons: (a) capital controls support macroeconomic stability; (b) pro-poor strategies demand monetary policy autonomy; (c) such strategies require the State to direct investment and other resource flows to growth-promoting and poverty-reducing objectives, which can conflict with the short-term interests of the domestic and international financial sector; and (d) capital controls are necessary to curb tax evasion, given that the tax rates required to fund pro-poor programmes will be higher than abroad. Without capital controls pro-poor macroeconomic strategies are simply impossible.

Several forms of capital control have been used recently by such diverse countries as, among others, Chile, Japan, Malaysia, South Korea and Sweden.[156] In these countries, the use of controls has not resulted in interruptions of economic growth. On the contrary, when controls have been removed, as in Mexico in the early 1990s and in East Asia in the late 1990s, financial crises and severe economic downturns have been the result.

Capital controls are not a fixed set of policies, and there are several different ways in which the flow of funds in and out of a country can be regulated.[157] Controls over the movement of funds across national borders are necessary elements of any general programme of economic change. Without such controls, a Government cedes the regulation of its economy to international market forces, which often means the forces of large internationally operating firms and powerful Governments of other countries.[158]

Forms of capital control can include, for example, restrictions on foreign currency bank accounts and currency transfers, taxes or administrative limits on outflows of direct and portfolio investment, restrictions on foreign payments for technical assistance between connected firms, non-interest bearing quarantines on investment inflows, controls on foreign borrowing and multiple exchange rates determined by the priority of each type of investment. While these controls impose an additional burden on the monetary authorities, experience shows that the task is not beyond the capabilities of the central bank. The most significant obstacle to capital controls is political.

In that light, the choice of a rights-based exchange rate regime is comparatively simple. The choice lies between fixed exchange rate regimes, including currency boards; adjustable pegs; and dirty floating regimes.[159] These alternatives pose difficult problems for ESCWA member countries, given that they tend to incorporate the negative aspects of two extreme types of exchange rate regimes.[160]

Most ESCWA members, with the exception of Egypt, Palestine and Yemen, peg their currencies to the dollar. This has brought inflation down to the levels of industrial countries despite the recent fluctuations of these economies. However, these hard currency pegs render monetary policy ineffective. On the other hand, currency fluctuation increases uncertainty and costs, especially in the context of a historically unstable

[156] See, for example, H.J. Chang, *Globalisation, Economic Development and the Role of the State* (Zed Books, 2003); H.J. Chang and I. Grabel, *Reclaiming Development: An Alternative Economic Policy Manual* (Zed Books, 2004), chap. 9; G. Epstein, I. Grabel and K.S. Jomo "Capital management techniques in developing countries: An assessment of experiences from the 1990s and lessons for the future", which was presented at the Sixteenth Technical Group Meeting of the G-24 (Port of Spain, Trinidad and Tobago, 13-14 February 2003); and A. MacEwan, op. cit.

[157] A. MacEwan, op. cit.

[158] Ibid.

[159] A dirty float is a system of floating exchange rates whereby the Government or the central bank occasionally intervenes to change the direction of the value of the national currency. Free floating regimes are considered too unstable to be considered seriously.

[160] ESCWA, *Survey of Economic and Social Developments in the ESCWA Region 2005* (E/ESCWA/EAD/2005/5).

region. These difficulties tend to be enhanced by the demands of capital account liberalization and intensified international speculation.

In order to preserve macroeconomic stability, poor ESCWA member countries with very concentrated trade patterns, and those where currency substitution is very advanced, could be forced to follow fixed exchange rate systems. This is far from ideal given that it reduces the scope for rights-based, monetary policy initiatives. However, it could be unavoidable in the short term. In this case, the role of pro-poor fiscal policy becomes even more important. Other countries may be able to count on additional degrees of freedom to adopt a dirty floating exchange rate regime or, better still, an adjustable peg that maximizes the scope for monetary policy discretion.

While exchange rate overvaluation can offer immediate benefits to the poor through cheaper imports and lower inflation, this type of exchange rate populism needs to be avoided. It can have destructive implications for the domestic productive base in industry, agriculture and non-traditional exports. Moreover, it can induce consumption and asset bubbles that could be difficult to neutralize. Experience suggests that export growth and the expansion of employment are more easily obtained with selective import protection, export incentives, capital controls and a moderately undervalued exchange rate.[161]

This can be achieved in different ways, including a relatively low currency peg, whenever relevant; expansionary monetary policies; the taxation and regulation of currency trading, especially in futures markets; capital controls; and direct intervention in currency markets. In the medium and long term, however, monetary coordination between ESCWA member countries is essential. This could be extended, in the future, within the framework of a regional system of fixed exchange rates, thereby moving towards a single currency for the area that floats vis-à-vis other major currencies. This could help to stabilize trade and promote investment in the region and, subsequently, to increase the monetary policy space in order to foster a decisive shift towards rights-based economic policies.[162]

In order to facilitate this exchange rate regime shift, it could be helpful to initiate moves towards oil trading in multiple currencies, with a rising percentage of trades in euros, yens and, possibly, even Chinese yuans. This could help to match the region's trade patterns and financial flows. This measure has obvious political implications, and will need to be implemented gradually and with great care and perspicacity.

More pressingly, there is a strong need to address the issue of dollarisation in the region. This can be done through a multipronged strategy, including administrative measures to create disincentives to those banks that hold foreign currency deposits, possibly leading to restrictions in their availability to the public. For example, this could include the imposition of a higher imputed risk to bank deposits denominated in foreign currency, and a higher compulsory deposit ratio on foreign exchange deposits, which could be as high as 100 per cent. These measures can be supplemented by a tax that penalizes citizens who hold assets denominated in foreign currency while, at the same time, offering incentives for the repatriation of assets held abroad.

G. CONCLUDING REMARKS

The implementation of rights-based fiscal, financial, monetary and exchange rate policies in the ESCWA region requires careful policy coordination. It also requires the subordination of these policies to a rights-based development compact and an industrial policy strategy aimed at relieving the supply constraints

[161] See, for example, M.R. Agosín and D. Tussie (eds.), *Trade and Growth: New Dilemmas in Trade Policy* (Macmillan Press 1993); H.J. Chang, *The Political Economy of Industrial Policy* (Macmillan Press, 1994); and G. Gereffi and D.L. Wyman (eds.), *Manufacturing Miracles: Paths of Industrialization in Latin America and East Asia* (Princeton University Press, 1990).

[162] ESCWA, *Survey of Economic and Social Developments in the ESCWA Region 2005* (E/ESCWA/EAD/2005/5).

that currently preclude the welfare improvements expected by the population. The current macroeconomic reform strategy that has been adopted in several countries in the ESCWA region, and inspired by IFIs, focuses on the adjustment of relative prices and the construction of the institutional edifice into which a thriving market economy is expected to grow, thereby filling up the pre-existing spaces.

This strategy is not easily adaptable or replicable, given that it is impossible to wish into existence an institutionally developed economy; and it is undesirable to attempt to impose economic structures from the outside that do not necessarily correspond with the demands, expectations and economic characteristics of the ESCWA region. Economic policies and institutional development must relate to the peculiarities and the state of development of each country while, at the same time, steering the economy towards the fulfilment of socially desirable goals.

The main objectives of the policies outlined in this Survey are as follows:

(a) To increase the degree of coordination across different policy areas in the ESCWA region, including industrial, trade, monetary, financial and exchange rate policy;

(b) To restrict the openness of the capital account of the balance of payments in these countries, thereby expanding the policy space available to the Governments of the region;

(c) To expand the fiscal space available to Governments in order to facilitate the mobilization of the existing rent flows and maximize future growth, thereby pursuing socially desirable goals;

(d) To raise the productivity of resources in the ESCWA region and limit the ability of financial systems driven by elites that control domestic credit, the financing of the State and the balance of payments.

These policies can contribute towards the achievement of rights-based development objectives and, as such, they can claim the attention of the authorities in the ESCWA region. Moreover, these policies are needed urgently, given that failure to shift economic strategies at this relatively favourable moment, with the currently high oil prices, could lead to further capital flight and macroeconomic instability. Even more importantly, it could squander a rare opportunity to achieve important objectives at a relatively low cost.

The choice between orthodox and rights-based fiscal and monetary policies involves both the internal consistencies in each country and their political constraints that influence the selection of economic policy. More specifically, the most important constraint to the introduction of pro-poor strategies in many ESCWA member countries is not resource scarcity or the lack of Government capacity. Rather, it is the lack of political will to confront the internationally dominant or mainstream policy consensus, and to build alternatives based on the collaborative efforts of national Governments, private capital and civil society.

V. INCOME INEQUALITY AND POVERTY REDUCTION

This chapter aims to analyse income inequality and poverty reduction, with the purpose of informing ESCWA member countries on alternative policies to achieve equitable development, for which the MDGs provide internationally agreed measures of success. In that light, the chapter provides a guide for the design of employment-intensive, pro-poor growth policies. Drawing on the experience of countries in other regions, this chapter offers suggestions for Governments that are considering shifts in policy towards pro-poor macro frameworks.

In the context of the current policy discussion, a key issue for the ESCWA region is the creation of a policy framework aimed at achieving the right to development and the MDGs. The region has the resources and current level of development needed to achieve the first Goal if growth over the next ten years is pro-poor. Achieving a more pro-poor pattern of growth requires the following:

(a) A clear definition of pro-poor growth for the ESCWA region that goes beyond a merely technical specification, and relating this definition analytically to the growth process;

(b) Specifying the potential for redistributing the growth increment over time that arises from the level of initial inequality and the structure of production and employment;

(c) Identifying the appropriate macro framework consistent with these policies and programmes, including facilitating aggregate pro-poor growth and diversifying production for employment generation;

(d) Applying the analysis of distribution and growth to policies that are appropriate for poverty reduction in the ESCWA region.

As indicated above, the appropriate macro framework for poverty reduction needs to be part of a development framework, rather than driven by the narrow goal of stabilization. Public investment, both for its employment effect and its potential to crowd in private investment, is central to this macro framework and to the programmes aimed at pro-poor growth.

A. GROWTH AND DISTRIBUTION

Empirical evidence shows that, in many cases, economic growth raises the incomes of those households at the bottom of the distribution. In that sense and contingent on the distribution mechanism, growth can be good for the poor. However, the term pro-poor growth is more specific, and it seeks to differentiate between periods of growth, which are sometimes called "growth episodes", whereby growth is more or less advantageous to those below the poverty line. There is some disagreement and confusion over the use of the term pro-poor growth. The International Poverty Centre of UNDP uses the following definition: "growth is pro-poor when the incomes of the poor rise proportionately more than the incomes of the non-poor".[163]

While this definition is technically sound and has the benefit of clarity, it also has an ethical basis that needs to be made explicit. Explicit in the Millennium Declaration is the principle that people should enjoy "freedom from want", which implies the right to live in peace and prosper.[164] In other words, people have a

[163] This contrasts with a broader definition by Ravallion, who defined pro-poor growth as any increase in GDP that reduces poverty. M. Ravallion, "Defining pro-poor growth: A reply to Kakwani", *International Poverty Centre*, No. 4 (2004). However, Zepeda offered a more appropriate definition whereby growth is deemed pro-poor if, in addition to reducing poverty, it also decreased inequality. E. Zepeda, "Pro-poor growth: what is it?", *International Poverty Centre*, No. 1 (2004).

[164] This phrase was famously coined by Franklin Roosevelt, the thirty-second President of the United States.

right to development.[165] This right requires a pattern of growth that is equitable and that fulfils the aspirations of the non-rich as well as the rich.

Furthermore, it implies that the reduction of poor as defined by some arbitrary income line is not sufficient, given that inequality itself serves as a barrier to the aspirations of people. This is particularly relevant to the oil-rich States of the ESCWA region. Consequently, pro-poor growth as defined above must not merely reduce poverty; it must equally reduce inequality. An acceptable degree of equality could be debated and established in every society. Until such a degree is reached, society could commit itself to pro-poor growth, even if poverty was calculated and deemed to be low according to some national or international standard.

Moreover, given the natural resource wealth of some ESCWA member countries, the head count poverty rate for both $1 and $2 per day is low compared to all developing countries in other regions. However, such comparisons are rendered academic in the broader pursuit of the right to be free from want and to live in an equitable society. Consequently, the broader term "pro-equity growth" will be used in the discussions below to replace the more common "pro-poor growth".

B. A PRO-EQUITY MACRO FRAMEWORK

1. *Fiscal policy*

A pro-equity macro framework for the ESCWA region must have three goals, namely: (a) to keep the growth rate well above the rate of population increase; (b) to reduce substantially the variability of growth; and (c) to foster a more equitable growth path. Within that context, specifying how to raise growth rate represents the least problematic of these elements. Aside from such exogenous factors as political tensions, the major limitations to faster growth are a restrictive fiscal policy, a contractionary monetary policy and, in some countries, a constraint in the balance of payments.

Converting a restrictive fiscal policy to an expansionary one can be achieved through an employment-intensive public investment programme, which is financed by borrowing or, preferably, by increasing development assistance and debt relief. A monetary policy aimed at accommodating growth requires the use of interest rates as a long-term investment instrument, rather than for short-term stabilization. For non-oil exporters, the balance of payments constraint could be relieved by interventions in order to establish a stable and moderately undervalued real exchange rate. Moreover, development assistance for these countries could provide support during the transition towards a stronger export performance.

Out of the three goals stated above, reducing growth instability represents perhaps the most challenging issue given the structural characteristics of ESCWA member countries, particularly in the light of the reliance of most of these countries on the volatile price of petroleum exports (see table 12). There is some strong evidence of growth instability, particularly in countries of North and West Asia where a reversal has occurred in almost 20 per cent of all years.[166] Moreover, two-thirds of these years were consecutive, which indicates that instability has come in clusters of years.

The fiscal and monetary policies in almost all stabilization and structural adjustment programmes have been pro-cyclical, thereby exacerbating the world market factors that destabilize ESCWA member countries. Reversing this strategy is not a simple matter of increasing expenditure. A pro-equity fiscal policy that fosters growth requires more public expenditure of a particular type, namely, that which can achieve the three necessary elements of demand expansion, supply enhancement and redistribution.

[165] E. Zepeda, "Pro-poor growth: what is it?", *International Poverty Centre*, No. 1 (2004).

[166] This measure uses year-on-year growth reversals of ten percentage points as an indicator of instability.

TABLE 12. SUMMARY OF INSTABILITY MEASURES BY REGION, 1961-2002

Region	Number of countries	Growth rate	Growth countries (with 0 or 1)	Reversals (percentage of all years)	Consecutive reversals (percentage)	GDP growth (standard deviation)
Sub-Saharan Africa	42	3.5	21.4	15.3	68.0	7.2
Latin America and the Caribbean	28	3.8	39.3	7.7	66.3	6.3
Asia	20	5.7	40.0	6.3	22.2	4.8
North and West Asia	16	3.6	31.3	19.6	68.2	5.5
Total	106	-	31.1	12.2	60.1	6.2

Source: Compiled by ESCWA, based on the World Bank, *World Development Indicators* (World Bank, December 2005).

Note: A hyphen (-) indicates that the item is not applicable.

In the absence of a robust public investment programme, the pro-equity element in fiscal policy consists of social expenditure, counter-cyclical measures and progressive taxation. While each of these is important, the capacity to intervene counter-cyclically is limited in many developing countries; and progressive taxation is not necessarily feasible for institutional reasons.

More importantly, to base redistribution on current budgets does not constitute a growth strategy. If sustained, it can create a new, more equal distribution. However, with the exception of a possible one-off impetus resulting from the positive incentives to the poor of the redistribution, it has little impact on sustainable growth rate. For this reason, public investment is the sine qua non of a pro-equity growth strategy and, moreover, the reduction of public investment undermines that strategy.

The emphasis placed on public investment requires consideration of one of the major arguments against it, namely, the crowding-out phenomenon.[167] The argument that public investment in developing countries could crowd out private investment is surprising. Typically, those who make this argument also urge Governments to undertake major policy changes aimed at encouraging FDI, usually without expressing strong concern that such foreign investment could crowd out private domestic investment. In general, crowding out occurs when an economy is near full employment. When there are unused resources, there is economic space for an increase in all types of expenditure, both public and private. Even in cases where crowding out occurs under full employment, it is unlikely to be comprehensive (see box 3).[168]

Finally, a substantial part of private sector investment in the ESCWA region does not borrow for investment or does not do so in those financial markets that could be affected by Government borrowing. Investment by small producers is often self-financed or financed through indigenous sources with little connection to the formal banking system. Foreign investment, wherever it contributes to an economy in a member country, is not typically financed from domestic financial markets.

[167] While the crowding-out phenomenon applies to all expenditure, only the case of investment is considered here.

[168] In economic terms, the elasticity of private investment with respect to Government expenditure of any type will be less than minus one.

Box 3. The Harrod-Domar Model

Public investment induces growth, both in its demand and capacity effects, unless the return on the marginal private component is sufficiently higher than on the public component such that the growth impact remains negative. This can be shown formally using the simple Harrod-Domar Model, where y is the rate of growth, v is the incremental capital-output ratio, and i is the share of investment in output. Let the subscripts pr and pu be private and public investment, respectively, and 0 and 1 be two time periods. Without public investment, the warranted (potential) rate of the growth is:

$$y_o = [v_{pr}][i_{pr0}]$$

Let the 'crowding out' ratio be α (the fraction by which public investment reduces private investment), and the private output-capital ratio be the same in both time periods. Then, the new growth rate with public investment is:

$$y_1 = [v_{pr}][\, i_{pr0} - \alpha i_{pu1}] + [v_{pu}][i_{pu1}]$$

The two scenarios can be compared by subtracting y_0 from y_1:

$$y_1 - y_0 = i_{pu1}[v_{pu} \; \alpha v_{pr}]$$

Crowding owing to the introduction of public investment will reduce the rate of growth if and only if, $v_{pu} > \alpha v_{pr}$; in other words, only if public investment is more capital-using than private investment by the ratio of crowding out. If the capital-output ratio for public investment is smaller than for private investment, public investment never reduces the growth rate, no matter what the value of α, assuming its upper limit to be unity (total crowding out). If crowding out is total, the growth rate falls only if public investments are more capital-using than private ones. Consequently, public investment has a negative impact on the capacity-creating source of growth only under the very restrictive conditions in which crowding out is total and private investment uses less capital per unit of output. The former is unlikely and the latter can be avoided by public choice of investment projects. The considerable work that has been undertaken on employment intensive public works can provide practical guidelines to ensure that public investments are not excessively capital-using. Theory and practice suggest that crowding out is unlikely to have a negative impact on growth.

2. *Monetary policy*

Perhaps the most concrete application of the framework determined by price, as opposed to that determined by demand, manifests itself in the policy of targeting inflation. Within that framework, every economy is presumed to be in or moving towards general equilibrium, and inflation is the result of expectations and random shocks. In other words, inflation has no structural cause; it follows from people's anticipation, and these anticipations are primarily the result of Government behaviour. In its most inflexible form, inflation targeting involves assigning to the central bank the mandate to use its policy instruments to realize an inflation rate below a specific rate. The instrument to hit the target is almost always the nominal interest rate. In practice, attempting to fulfil such a mandate overrides all other policy objectives, including, for example, those aimed at achieving a competitive exchange rate, stimulating investment and managing the budgetary cost of national debt.

The major argument in favour of inflation targeting is that a low inflation rate with a small variation fosters growth by providing a stable macroeconomic environment for private investment. Within that context, there are two issues, namely, the effect and wisdom of targeting inflation, and the inflation rate that needs to be targeted.[169] The presumption that inflation targeting can yield positive benefits requires a prior

[169] These issues are addressed in a training module for the United Nations Development Programme (UNDP).

acceptance that such a policy is feasible. In other words, most central banks in developing countries must be convinced that, by using the monetary instruments available to them, they can realize a predetermined rate of inflation and maintain it with small variability. This proposition is not credible given the large and unavoidably stochastic element of the policy outcomes in the ESCWA region.

Despite the recessionary consequence of choosing a numerically low target and attempting to achieve it in the context of severe random shocks, many external agencies vigorously defend the policy aimed at reducing inflation. According to those proponents, the so-called "bottom line" is that inflation is substantially negative for the poor and, conversely, that inflation targeting is significantly positive for the poor. While such reasoning appears repeatedly in documents emanating from the International Monetary Fund (IMF) and the World Bank, there is little evidence to support it. In one of the few empirical studies of the distributional impact of inflation, Galli and van der Hoeven found that while restrictive monetary policy is often beneficial for inequality in countries with high inflation, "reducing inflation in economies with initially low inflation might increase inequality".[170]

Given the inference that inflation targeting is anti-poor, there is a need to find other variables that, if targeted, contribute to a pro-equity growth path. It is important in this context to distinguish between a commitment to an outcome, and assigning it as a mandate to a governmental agency. In the latter case, if the target is binding in the sense of requiring specific policy action, the possibility arises that attempting to achieve it could be inconsistent with other policy outcomes.

While in principle real targeting has its attractions for a pro-equity macro framework, it suffers from two major problems, namely: (a) the relationship of the target to policy instruments; and (b) the feasibility of such targeting by ESCWA member countries.

The fundamental goal of a pro-equity macro strategy is poverty reduction. However, this cannot be targeted in an operational manner. It is futile to have annual poverty targets given that the incidence of poverty fluctuates in response to many short-term changes over which the Government has limited or no influence. It is generally recognized that poverty reduction is a long-term process. If poverty targets are set for a longer period, the issue of short-term policy priorities remains, and poverty targeting becomes indistinguishable from a commitment towards achieving MDGs.

On a purely technical level, poverty targeting, as opposed to monitoring growth for its poverty impact, is not possible as a macro policy mandate. Governments have no macro instrument that acts directly on poverty. A similar argument exists for inflation, given the impact of interest rates on the cost of borrowing, rather than on inflation itself. However, the links between macro instruments and poverty are diverse and inherently contingent.

The suggestion that real output could be the mandated target is superficially appealing. While some macro instruments have a direct impact on real output, the stochastic component of aggregate output in ESCWA member countries is so significant that setting this target is non-operational. Additionally, targeting real output suffers from problems of conflict among policy objectives. Specifically, Governments must inevitably face circumstances in which it is necessary to constrain real output to prevent an even larger decline, particularly in cases of unsustainable trade deficits or excessive inflation. In such circumstances, macro policy requires a flexible mandate.[171]

[170] R. Galli and R. van der Hoeven, "Is inflation bad for income inequality: The importance of the initial rate of inflation", *ILO Employment Paper 2001/29* (ILO, 2001).

[171] This flexibility is sometimes known as "constructive ambiguity". Ibid.

The structural characteristics of ESCWA member countries render mandated targeting either unfeasible, undesirable or both. A political commitment to poverty reduction is feasible and desirable when each aspect of macro policy is assessed ex ante and ex post for its poverty impact; and when such assessments are subject to public scrutiny. One manifestation of this commitment could be a poverty assessment of the annual budget.

Once liberated from the constraint of inflation targeting, monetary policy can contribute to pro-equity growth. However, monetary policy can do little to promote pro-poor growth when it is used as the major instrument for macro management. By contrast, when acting in support of an expansionary fiscal policy, monetary policy can indirectly foster growth that is pro-poor. Generally, if inflationary pressures are weak, this support could take the form of positive, albeit low, real interest rates and an expanding monetary supply.

While these can appear simple guidelines, their application in ESCWA member countries is not straightforward. Specifically, the financial markets in all countries of the region are underdeveloped, which hinders the ability of the State to sell Government bonds to private agents. For this reason, legislation across the region requires commercial banks to hold a portion of their reserves in Government bonds. In practice, this requirement has tended to have an anti-poor bias, given that it redistributes general revenue to the wealthy as interest payments. The narrow bond market implies that deficit spending, if financed domestically, tends to be covered by monetization.

Moreover, narrow financial markets imply that the effectiveness of monetary policy to stimulate private investment is low. However, the limited ability of the central bank to stimulate investment does not imply there is no pro-equity role for the central bank rate. Lower central bank rates could have two pro-equity effects, namely: (a) lower rates can have a positive impact on income distribution given that Government bonds are largely held by the wealthy or by the institutions of the wealthy; and (b) lower rates imply a smaller domestic debt service in the public budget, thereby producing fiscal space for pro-equity Government expenditure.

Allowing the money supply to expand faster than real output can also have a pro-equity impact by increasing access to credit in informal financial markets. Equally, it encourages financial deepening, which is the ratio of the money supply to aggregate output and which is typically low in the ESCWA region. Money supply management raises the question of the most adequate instruments needed to counter inflationary pressures, where these became a serious policy concern.

Within that context, the key policy issue is the definition of what constitutes a serious concern. Cross-country regressions suggest that inflation is uncorrelated with growth for the rates that characterize ESCWA member countries.[172] Consequently, with growth and poverty reduction set as goals, a tolerance for moderate inflation is required. This is especially the case owing to the weakness of financial markets and given that the only effective instrument for reducing inflation in most countries is fiscal contraction.

Finally, a pro-equity monetary policy requires low real interest rates, a tolerance for moderate inflation rates, and an expansion of the money supply that accommodates growth and financial deepening. In order to achieve these outcomes, it is perhaps more pro-equity to finance prudent fiscal deficits through monetization, rather than through bond sales that redistribute income to the wealthy.

C. PRO-EQUITY POLICIES FOR THE ESCWA REGION

Identifying appropriate and effective policies aimed at achieving pro-poor growth in the ESCWA region is limited owing to the lack of data on income and wealth distribution. A survey of data sources

[172] M. Bruno and W. Easterly, "Inflation and growth: In search of a stable relationship", *Federal Reserve Bank of St Louis Review* (May-June 1996).

reveals that only three countries of the region have the most basic distribution data after 1990, namely, Egypt, Jordan and Yemen. While some of the other countries have statistics from earlier decades, the changes have been so fundamental that these statistics cannot be taken as indicative of current circumstances. Consequently, there is an urgent need for all the countries in the region to collect data on poverty and wealth distribution on a regular and consistent basis.

The three countries with statistics on wealth distribution cannot be taken as typical of the region. Egypt has a population almost three times that of the next most populous country in ESCWA, namely, Iraq; and two out of the three countries are heavily dependent on petroleum exports, as are more than half the countries in the region. The Gini coefficients of income distribution for the three countries with data suggest a relatively low degree of inequality by international comparisons (see table 13).[173]

TABLE 13. LIVING STANDARDS AND PUBLIC EXPENDITURE INDICATORS IN THE ESCWA REGION, EARLY 2000s

Country/ territory	Per capita GDP annual growth rate, 1990-2003	HDI	HDI rank a/	Per capita GDP purchasing power parity, 2003	HDI-GDP rank b/	Population living below		Public expenditure (percentage of GDP)		Gini Coefficient
						$1	$2	Health	Education	
Bahrain	1.5	.846	43	17 479	-7	..	..	3.2	4.1	..
Egypt	2.5	.659	119	3 950	-10	3	44	1.8	3.9	34.4
Jordan	.9	.753	90	4 320	14	2	7	4.3	8.1	36.4
Kuwait	-2.3	.844	44	11 080	-11	..	..	2.9	4.8	..
Lebanon	2.9	.759	81	5 074	14	..	..	3.5	..	..
Oman	.9	.781	71	13 584	-30	..	..	2.8	3.1	..
Palestine	-6.0	.729	102	2 302	26	..	..	..	..	..
Qatar	..	.849	40	19 844	-13	..	..	2.4	3.5	..
Saudi Arabia	-.6	.772	77	13 224	-33	..	..	3.3	5.8	..
Syrian Arab Republic	1.4	.721	106	3 576	8	..	..	2.3	4.0	..
United Arab Emirates	-2.1	.849	41	22 420	-18	..	..	2.3	1.8	..
Yemen	2.4	.489	151	889	15	16	45	1.0	..	33.4
Average	.1			9 812				2.7	4.3	

Source: Compiled by ESCWA, based on United Nations Development Programme (UNDP), *Human Development Report 2005*, which is available at: http://hdr.undp.org/reports/global/2005/.

Notes: Two dots (..) indicate that data are not available or are not separately reported.

Iraq was excluded owing to the lack of available data.

a/ The HDI rank assesses the ranking according to the Human Development Index (HDI), with 1 representing the highest position.

b/ The HDI-GDP rank assesses the HDI rank minus the rank order of per capita GDP.

[173] The Gini coefficient is a measure for income inequality.

Data on social indicators suggest that there is considerable economic and social inequality in the region. Table 13 illustrates the rank order of countries according to the Human Development Index (HDI) by UNDP, and as per capita GDP. While these two ranks are generally expected to correlate to some extent, some significant differences can be observed, namely, Palestine, which has a ranking of HDI that is 26 places above its per capita income rank; and Oman and Saudi Arabia, whose HDI ranking are, respectively, 30 and 33 places below their income ranks.[174]

While seeking to avoid generalizations, it is tempting to postulate that the low HDI ranks for Oman and Saudi Arabia result from economic and social inequalities, especially gender discrimination. The validity of the inequality hypothesis is suggested by an inspection of public expenditure on health and education as a share of GDP. Relatively high social expenditures and a low HDI provide prima facie evidence for a pattern of expenditure that is inequitable. Out of 12 ESCWA members, more than half have a negative difference between the HDI and per capita income, including all the countries that rely heavily on oil exports.

This negative relationship can be viewed as an opportunity, given that the countries with the lowest HDIs compared to their per capita incomes have the oil resources needed to raise dramatically those indicators over a relatively short time period. In practice, achieving this does not represent a fiscal constraint. International experience provides many examples of how both current and capital expenditure could be used to reduce inequalities and poverty. It is those countries without substantial oil revenues that face the much more serious problem of generating the domestic resources in order to fund effective redistribution and poverty reduction.

Specific to the issue of redistribution, perhaps the most important determinant of the effectiveness of the various measures of each redistribution strategy is the structure of an economy. This structure depends on the level of development that largely conditions, among others, the national production mix, the endowments of socio-economic groups, direct and indirect taxes on income and assets, prices paid for goods and services, and transfer payments. These elements of the distribution system are initial conditions that delineate the scope for redistributive policies. In this analytical context, the implementation requirements of redistributive policies can be summarized by the following algebraic framework:

$Y =$	$(V - T)$	$+\ wk$	$=$	pq	$+\ S$
Y denotes the income of a household	V are transfer payments, including unemployment benefits, pensions, child benefits and aid to the disabled; and T are progressive taxes on income and wealth	w is a vector of rates of return, including minimum wages, low-wage subsidies, other labour market regulations and public employment schemes; and k is a vector of assets, including human capital, land reform and education		p is the price vector of goods and services; and q is the quantity vector of those goods and services	S is household saving

The tax and expenditure policies, which are represented by V and T in the equation above, can generate secondary and tertiary distributions more equitably than the primary distribution if there is a strong formal sector.[175] This is clearly the case given that Governments can apply progressive income taxes most effectively to wage employees and corporations. All empirical evidence shows that the formal sector wage

[174] In the case of Palestine, the significant difference in the two ranks can be largely attributed to the sharp economic decline arising from the conflict and geographic fragmentation.

[175] The secondary distribution is household income after taxes; and the tertiary distribution is household income after taxes and all transfer payments, including, for example, pensions, allowances and housing subsidies. For a review of fiscal policies for redistribution, see K. Chu, H. Davoodi and S. Gupta, "Income distribution and tax and Government spending policies in developing countries", IMF Working Paper 00/62 (IMF, 2000).

bill and profit shares increase with the level of development. Equally, the urbanized population and working-poor urban households are more easily targeted than either the rural poor or the urban households in the informal sector. The experience of a number of middle-income countries has demonstrated the effectiveness of basic income payments for poverty reduction.

To a certain extent, specific economic structures allow for effective use of taxation for redistribution in a few low-income countries that are typically relevant only for middle-income countries. If the economy of a low-income country is dominated by oil, then modern sector corporations can generate a large portion of national income. This allows for effective taxation despite a limited administrative capacity of the public sector. The tax revenue can be redistributed through poverty-reduction programmes, albeit not through transfer payments, if the labour force is predominantly rural.

Interventions to change the distribution of earned income, which is represented by wk in the equation above, alter market outcomes and tend to be more effective in middle-income countries.[176] While the most common intervention is the minimum wage vector, there are many other policies to improve earnings from work. Further mechanisms include public employment schemes and tax subsidies to enterprises aimed at promoting low-wage labour. It is unlikely that any of these schemes could be effective in low-income countries, given the enforcement problems with regard to minimum wage, targeting difficulties for employment schemes, and restricted impact in terms of wage subsidies.

Interventions that affect directly the prices and access to goods and services, which is represented by pq in the equation above, could potentially be quite powerful instruments for poverty reduction. Subsidies to selected commodities do not require targeting. Rather, they require identification of those items that carry a large weight in the expenditure of the poor, which constitutes an administrative advantage. While multilateral adjustment programmes typically require an end to such subsidies on grounds of allocative efficiency or excessive budgetary cost, there are no such restrictions according to WTO rules as long as subsidies do not discriminate between domestic production and imports.

Whether subsidies can generate excessive fiscal strain depends on the products covered and on financing. Again, the level of development of a country is of central importance for the effectiveness of subsidies. In low-income countries with the majority of the poor in rural locations, consumer subsidies are unlikely to have a significant impact on the poor residing outside urban areas. The provision of basic goods, including, for example, delivering milk to schoolchildren, can be an effective instrument for poverty reduction even in very low-income countries.[177]

Globally, the poor suffer from inadequate health and education programmes compared to their less poor counterparts. Expenditures on education and health have the practical advantage that programmes aimed at helping the poor are easily identified, despite varying needs and specificities at national and regional levels. However, providing such services to the poor in some ESCWA member countries can be as politically charged as other more obviously controversial measures, including asset redistribution. This is equally the case of infrastructure programmes aimed at poverty reduction. To the extent that these programmes reduce public investment in projects favoured by the non-poor, especially the wealthy, they are not easier to implement than measures that appear superficially to be more radical.

Table 14 provides a summary of the discussion, with poverty-reducing measures listed by rows, and the categories of countries across columns. The table indicates that for those middle-income countries that

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[176] F. Paukert, *Incomes policies in the wider context: Wage, price and fiscal initiatives in developing countries*, ed. D. Robinson (International Labour Organization (ILO), 1992).

[177] For a discussion of redistribution policies for the rural poor, see Y. Tamura, "Redistribution policies for the rural poor in developing countries: Towards more equitable development" (University of Malaysia Press, 2003).

are "redistribution" countries, a redistribution of current income and assets is the most effective means of poverty reduction, and the methods to achieve this are feasible. For other middle-income and most low-income countries that are categorized as "redistribution with growth", the measures for redistribution of current income and assets are less feasible. However, the instruments to achieve the more modest goal of redistributing the growth increment could be feasible.

TABLE 14. FEASIBILITY OF REDISTRIBUTION INSTRUMENTS BY CATEGORY OF COUNTRY

Redistributive instrument	Redistribution of current income and assets (middle-income countries)	Growth with redistribution policies (middle-income and most low-income countries)
Progressive taxation	Yes	Yes for some countries
Transfer payments	Yes	Yes for some countries
Consumer subsidies	Yes	Yes
Public investment	Yes	Yes
Education and health	Yes	Yes
Infrastructure and public works	Yes	Yes

Source: Compiled by ESCWA.

While implementing an agenda of redistribution is challenging, the problems must not be exaggerated. In many countries, these challenges could prove no more intractable than the problems associated with implementing other economic policies. As noted above, orthodox monetary policy is difficult to implement if a country is too small or underdeveloped to have a bond market. Similarly, replacing tariffs by a value-added tax is a daunting task in a country where commerce is undertaken primarily through small traders.

Moreover, the lack of public sector capacity can limit the ability to execute a range of so-called supply side policies, namely: privatization, transparency mechanisms, and decentralizing the service delivery of the central Government.[178] Recognizing these constraints to adjustment programmes, multilateral agencies have largely decided that constrained implementation is ultimately better than non-implementation. The same argument can be made for a redistributive growth strategy in the ESCWA region. Specifically, in order to achieve poverty reduction, it could be preferable to implement redistributive growth imperfectly than to implement the status quo imperfectly.

D. CONCLUDING REMARKS

Poverty reduction has become a priority of development policy, albeit sometimes only at the rhetorical level. Growth alone is a relatively blunt instrument for achieving poverty reduction, given the consensus of empirical work suggesting that it is typically neutral of distribution. The poverty reduction agenda in some ESCWA member countries requires fostering policies of redistribution if it is to be successful; and a growth policy that incorporates equity as a starting point, rather than as an afterthought, by shifting the policy debate such that the costs and limits of growth are viewed as critically as the costs and limits of redistribution.

The design of country-specific policies for redistribution requires information that is largely unavailable in the ESCWA region. With the possible exception of Yemen, the absence of such information is not the result of a lack of financial or human resources for designing and implementing surveys, or for analysing the results. Moreover, the surveys that are required are standard. Specifically, these constitute

[178] R. van der Hoeven and W. van der Geest, "Africa's adjusted labour markets: Can institutions perform?", in *Adjustment, Employment and Missing Institutions in Africa* (James Currey, 1999).

labour force surveys to identify sources of income and working conditions, and household surveys to identify consumption patterns.

Inequality has several dimensions that are important for the design of policy, which adequate labour force and household surveys could reveal. These are as follows:

(a) The distribution of income by households provides the necessary information to analyse tax incidence and make the tax structure more progressive;

(b) The surveys must be broad enough to be representative of the regions within a country. This information is essential in order to design and locate public investment projects aimed at reducing poverty;

(c) Surveys need to be explicitly designed in order to identify mechanisms that currently discriminate against women in both the public and the private spheres. This is particularly relevant in the ESCWA region and could be best achieved through a separate investigation that is distinct from labour force and household surveys. Specifically, such an investigation needs to include the legal and customary mechanisms that restrict girls and women in terms of accessing education, health and the labour force. Within that context, it is important to stress that attaining MDGs and moving towards a just and equitable society involves achieving Goal 3, namely, promoting gender equality and empowering women.

VI. THE ROLE OF PUBLIC POLICIES IN THE ESCWA REGION

A. The State in the ESCWA region and the triple squeeze of unemployment, democratization and globalization

At present, most of the economies in the ESCWA region are growing after two decades of stagnation. However, this growth is dependent on one unsustainable trend, namely, a substantial surge in the price of oil. Sooner or later, this trend will end, possibly abruptly.

Consequently, the relative abundance of capital currently offers the Governments of the region an opportune juncture to implement some structural changes that are urgently needed to set the region on the path of sustainable growth, free from fluctuating oil prices. Failure to do so will consign this present opportunity to a time-bound gain similar to those experienced during the great oil booms of the 1970s.

However, at the beginning of the twenty-first century, the luxury of avoiding reform is not a viable option for any Government in the region. The State institutions in every country in the region are under pressure from three different directions, namely:

(a) Unemployment, which has become a permanent feature in the region, marginalizes tens of millions of people, who in turn are pressuring the State to change its policy direction so as to include them in the economic life of the region;

(b) Authoritative features of public institutions are perceived by the majority of people in the region as responsible for waste, stagnation and unsound social and economic policies;

(c) The old relationship between the State and the local economy is challenged by the ongoing process of globalization. Fiscal and monetary policies in the monetarist tradition appear to lose their efficacy as external pressures for homogenization of trade regimes increase, and as cross-border flows of capital between the ESCWA region and the rest of the world pose continuous threat to the exchange rate policy of each country.

Under the pressure of this triple squeeze, the effectiveness of the State is deteriorating. The State has to embark on a reform programme aimed at restoring its efficacy and enabling it to cope with the difficult social and economic problems.

The purpose of this Chapter is twofold, namely: (a) to examine the present conditions of public institutions and policies in the region, thereby identifying the key elements of the structural reform needed; and (b) to spell out elements of a strategy for action to be implemented by the Governments of the region individually and collectively.

B. Theoretical perspective: the role of the State in creating social infrastructure

Out of all the areas of economics, the economics of growth has received the most interest over the past two decades. Theoretical and empirical studies have demonstrated that differences in output per worker can be attributed to differences in physical and human capital per worker and to differences in productivity. There is therefore a clear need to understand why capital and productivity differ so much across countries.

Researchers interested in this field have observed that the same development programme undertaken by different States has resulted in staggeringly different outcomes; shining success contrasts with utter failure. Students of the subject maintain that the differential effectiveness of States as agents of the developmental process can in fact be connected to differences in their internal structure and their external ties.

Effective States, dubbed developmental States, have a well-trained bureaucracy that is selected according to a screening procedure that emphasizes competence and corporate identity. While its internal coherence does not preclude strong ties with the business community, it provides it with an autonomy and capacity to formalize its own programme and carry it through. Given these attributes, effective bureaucracy has been called embedded autonomy.[179]

At the other end of the spectrum is the predatory State, whose bureaucracy is chosen according to a patronage system that emphasizes cliques or political loyalties. The bureaucracy of such a State has little internal organization; and its members operate by no uniform set of rules and with the purpose of exploiting individual and group opportunities. Consequently, as an organization, it has no autonomy and is captured by special interests.

Moreover, developmental States extract relatively few resources from the economy and, in turn, provide much in the way of public goods that constitute an able environment, thereby reducing risks, encouraging investment and fostering development. By contrast, predatory States provide few public goods in return for extracting large quantity of resources, and distort and impede development.

The challenge facing all ESCWA member countries is how to augment and solidify the developmental features of their States while, at the same time, purging them of their predatory features. Generally, this cannot be accomplished without major institutional changes related to the separation of power, endowing the judiciary with autonomy and power, reallocating resources in favour of education and health services, and allowing an atmosphere of free exchange of ideas and free inquiry.

Reformed along these lines, the public sector can be capable of performing its developmental role in terms of creating social infrastructure. Social infrastructure refers to public institutions and policies that encourage investment over consumption and production over diversion.[180] The former requires a complete change in the investment climate of the region in order to accomplish the double tasks of encouraging Arab investors, thereby repatriating their financial resources; and of stimulating foreign investors to increase their activities in the region. The latter requires a drastic institutional change that empowers the majority of citizens to enable them to participate in productive economic activities and to fight rent-seeking activities.

In other words, the former concerns enabling firms, and the second relates to enabling individuals, thereby increasing the scope for action of both. Consequently, the two are intertwined and are the two sides of the same dynamic process. This becomes a process that is driven by a rights-based and pro-poor strategy of growth, and that fosters an investment climate conducive to increased productivity and employment opportunities for the vast majority of citizens.

1. *Investment climate*

A change in the role of the State is required in order to reduce the perceived risk and increase the perceived return associated with investment. This change involves four factors, namely:

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[179] Autonomy implies that the bureaucracy can design long-term economic policies without the interference from private investors. It can exercise a large measure of control over the behaviour of domestic and foreign capital. Moreover, embedded autonomy implies that the bureaucracy needs to be immersed in a dense network of ties that bind them to poor classes that can become allies in the pursuit of societal goals. See P. Evans, *Embedded Autonomy: States and Industrial Transformation* (Princeton University Press, 1995).

[180] See R. Hall and C. Jones, "Why do some countries produce so much more output per worker than others?", *The Quarterly Journal of Economics* (February 1999).

(a) To ensure stable macroeconomic conditions as outlined in chapter V. Sound monetary and exchange rate policies that result in low unemployment rates reduce uncertainty and risk, and create a hospitable environment for investment. On the other hand, the regulated openness to trade, especially regional trade, attracts market- or efficiency-seeking FDI, which in turn promotes competition and innovation. Various empirical studies have demonstrated a strong relationship between investment, openness to trade and FDI, even one foreign flows do not lead economic performance and the recipient country having adequate absorptive and learning capacities;[181]

(b) To improve the quantity and quality of physical and financial infrastructure. Improving the investment climate depends, in a fundamental manner, on improvements in the quantity as well as the quality of physical infrastructure, especially those related to transportation, electricity, water and telecommunication. Various studies have shown that expanding the availability of such infrastructure significantly reduces costs of production. Other studies have also demonstrated that the impact of investment in infrastructure on economic growth represents a rate of return that can be as high as 60 per cent. Clearly, improving financial services is equally essential in terms of promoting the investment climate, given that it allows for the optimal allocation of resources among competing investment projects and reduces the risk associated with all investment endeavours;

(c) To foster the state of technology and the capacity for undertaking research and development (R and D) activities, which in turn raises the following two issues: (i) technological progress is the major source for improving investment efficiency and economic growth in the long term; and (ii) technological progress is advanced by R and D activities, which has the characteristic of public good. These two factors necessitate a leading role by the State in terms of promoting R and D activities, including, among others, financing universities to conduct scientific research, and subsidizing the private sector to carry out R and D activities;

(d) To improve the quality of public institutions, particularly given that State institutions that have a tainted bureaucracy impose barriers to entry and high operating costs, and increase risk and uncertainty for firms. On the other hand, a well-trained national bureaucracy, which is characterized by embedded autonomy, is effective in terms of facilitating entry, lowering transaction costs and reducing uncertainty for firms, especially medium and small-sized firms.

2. *Empowerment and inclusion*

While improving the investment climate spurs growth, growth patterns vary. Specifically, some growth episodes that occur with large inequality and that exclude many people cannot be sustained. Moreover, concentrating the fruits of growth in the hands of an elite can create adverse incentives and discourage investment in physical capital, human capital and technology, thereby leading to future stagnation.

Sustained growth therefore requires the effective participation of the majority of the citizens by the dynamic process known as empowerment. This is aimed at enabling the majority of people to participate effectively in society and the economy; and, more specifically, at improving their health and education, thereby enabling them to acquire assets, information and the legal standing needed to achieve two tasks, namely: (a) to become part of the socio-political structure of the country; and (b) to acquire the power with which to challenge corrupt officials and bureaucratic hurdles.

Various empirical studies have demonstrated that excluding sizable portions of the population, which results in poor distribution of income, has negative repercussions on economic growth. The findings of these

[181] See D. Romer, *Advanced Macroeconomics* (McGraw-Hill, 2001).

studies have demonstrated that there are several channels through which income inequality is bad for growth. Countries with comparatively higher income inequality tend to have lower accumulation of human capital through education and higher total fertility.[182] Other studies have demonstrated that there is a significant tendency for countries with less equal income distribution to have a higher degree of political instability.[183]

C. THE PRESENT CONDITIONS OF THE SOCIAL INFRASTRUCTURE IN THE ESCWA REGION

The State in the ESCWA region is strong, powerful and all embracing. However, it is not performing fully the functions of the developmental State. Its power tends to constrain economic activities rather than expand it, given that such power is concentrated mainly in areas of security and control. The State in the ESCWA region exhibits little capacity in terms of producing the public goods needed for investment and growth.

Moreover, its strength is currently severely challenged and weakness exacerbated by three powerful trends, namely:

(a) The sense of frustration felt by under-represented, more educated women and by the unemployed in general. It is equally related to the disappointment experienced by those living in volatile conditions who have difficulties sustaining income. There is significant pressure for a policy change in the light of the chronic unemployment across the region;

(b) The recognition that the region is lagging behind other regions in Asia, Africa and Latin America in the areas of accountability and the rule of law;[184]

(c) The pressure of globalization given that many of its macroeconomic tools appear to lose their efficacy; that external pressures of harmonization of trade regimes increase; and that cross-border flows of capital threaten the domestic base according to the whims of international speculators.

For those reasons, the State in every ESCWA member country is under the triple squeeze of unemployment, democratization and globalization. Owing to the dislocations caused by globalization, Governments have difficulty in providing more economic opportunities and in creating employment with a new set of policy responses. In short, reforms aimed at transforming the role of the State to that of developmental State are now on the agenda.

The role of the developmental State, outlined above, concerns fundamentally the creation of social infrastructure. This requires establishing institutions and designing policies aimed at empowering firms by improving the investment climate; and at empowering individuals by expanding the opportunities of the poor. The prevailing conditions of the social infrastructure in the ESCWA region are analysed below.

1. *The investment climate in the ESCWA region*

Tables 15 and 16 compare the investment rates in, respectively, MDEs and the countries of the GCC between the years 1990 and 2003. The first shows a major decrease in those rates in MDEs and, moreover,

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[182] See D. Weil, *Economic Growth* (Pearson, 2005).

[183] Economists have constructed an index of socio-political instability. The index combines data on the number of politically motivated assassinations, deaths owing to mass domestic violence, coups, and whether a given country is democratic. A smaller value of this index represents a lesser the degree of instability.

[184] To read more about the state of inclusiveness and accountability see the World Bank, "Better governance for development in the Middle East and North Africa: Enhancing inclusiveness and accountability" (World Bank publications, 2003), p. 16.

an investment that falls short of savings, which indicates a resource gap. The gap is filled mainly by external borrowing or by income generated from exporting labour, including to the GCC. The second table shows a drop in investment rates for some of the countries of the GCC and an increase for others. However, the level of investment is modest for all the countries of that cluster. Moreover, all those countries have substantial excess capacity of savings to investment rates, thereby indicating a process of monetization of wealth assets. Strikingly, both clusters have their ratios of investment to GDP considerably below the relevant country groups.

TABLE 15. INVESTMENT AND RESOURCE GAPS IN MDES, 1990 AND 2003
(*Percentage of GDP*)

Country/territory	Investment		Resource gap	
	1990	2003	1990	2003
Egypt	29	17	(31)	(26)
Iraq				
Jordan	32	23	(31)	(26)
Lebanon	18	17	(82)	(26)
Palestine				
Syrian Arab Republic	17	24	0	7
Yemen	15	17	(6)	(5)
Middle-income group	26	27	1	3
World	22	27	0	0

Source: Compiled by ESCWA, based on the World Bank, *World Development Indicators* (World Bank, December 2005).

Note: Parentheses ( ) indicate negative numbers.

TABLE 16. INVESTMENT AND RESOURCE GAPS IN THE COUNTRIES OF THE GCC, 1990 AND 2003
(*Percentage of GDP*)

Country	Investment		Resource gap	
	1990	2003	1990	2003
Bahrain				
Kuwait	18	9	(14)	9
Oman	13	13	22	21
Qatar				
Saudi Arabia	15	19	9	21
United Arab Emirates	20		25	
High-income group	23	20		
World	22	21	0	0

Source: Compiled by ESCWA, based on the World Bank, *World Development Indicators* (World Bank, December 2005).

Note: Parentheses ( ) indicate negative numbers.

The investment climate across the entire ESCWA region is clearly in urgent need of improvement. Specifically, the current climate does little to encourage small and large firms and farms to invest, innovate, create jobs and improve productivity. The deficiency in the investment climate is illustrated by considering the following four factors: (a) macroeconomic environment; (b) physical and financial infrastructure; (c) R and D activities; and (d) quality of institutions.

(a) *Macroeconomic environment*

With regard to the first factor, most Governments of the region have in fact set their macroeconomic policies with the objective of achieving a single target, namely, a low inflation rate; and they have largely succeeded in that mission (see table 17). However, the price for achieving such comparatively low inflation rates has been costly in terms of widespread unemployment, with a regional average that is currently estimated at 15 per cent and that represents the highest rate in the world. Most ESCWA member countries have abandoned the use of monetary policy to stimulate the economy and reduce unemployment by adopting the policy of fixed exchange rate and the gradual removal of restrictions on capital mobility.

TABLE 17. INFLATION RATES IN SOME ESCWA MEMBER COUNTRIES, 1980-2003

Country	1980-1990	1990-2003
Egypt	17.4	7.0
Jordan	5.7	3.0
Kuwait	2.9	1.9
Oman	..	0.2
Saudi Arabia	(0.8)	0.5
Syrian Arab Republic	23.2	4.9
Yemen	..	20.5

Source: Compiled by ESCWA, based on the World Bank, *World Development Indicators* (World Bank, December 2005).

Notes: Parentheses ( ) indicate negative numbers.

Two dots (..) indicate that data are not available or are not separately reported.

(b) *Physical and financial infrastructure*

In the area of physical infrastructure, there is a large difference between MDEs and the countries in the GCC. Table 18 shows that per capita consumption of electricity and energy in the GCC countries exceeds by far the global average, while the consumption in MDEs is substantially less. Similar discrepancies exist regarding the availability of paved roads. However, there is a common challenge in terms of the availability of water resources. While access to improved water sources for most countries in the region is comparable to the world average, alarmingly, that access has been declining since 1990 for some countries.

TABLE 18. SOME INFRASTRUCTURE INDICATORS IN THE ESCWA REGION

Country	Kilometres of paved roads 1997-2002	Kilometres of paved roads (per million of people) 2002	Electricity consumption (per capita in kWh) 2003	Transmission and distribution losses (percentage of output) 2002
Egypt	49 984	739.4	1 127	13
Iraq	38 399	1 554.6	977	6
Jordan	7 301	1 377.5	1 453	12
Kuwait	3 587	1 494.4	14 808	5
Lebanon	6 198	1 377.3	2 558	16
Oman	9 840	3 784.6	3 505	17
Saudi Arabia	46 406	2 020.5	6 259	8
Syrian Arab Republic	9 187	527.9	1 243	32

TABLE 18 (*continued*)

Country	Kilometres of paved roads 1997-2002	Kilometres of paved roads (per million of people) 2002	Electricity consumption (per capita in kWh) 2003	Transmission and distribution losses (percentage of output) 2002
United Arab Emirates	1 088	272	10 992	9
Yemen	7 705	401.3	152	15
World			2 456	9
Middle-income group			1 720	12
High-income group			9 503	6

Source: Compiled by ESCWA, based on the World Bank, *World Development Indicators* (World Bank, December 2005).

In the area of financial infrastructure, most countries in the ESCWA region have implemented a reform programme aimed at financial liberalization and including deregulation, removing ceilings on interest rates, the gradual opening of the financial sector to foreign participation and the privatization of banks (see tables 19 and 20). While negative interest rates were common in most MDEs before these reforms, positive rates are currently maintained in each country. Similarly, the ratio of currency to deposits has declined only modestly in most countries, thereby indicating a marginal improvement in financial deepening that has little impact on economic growth.

TABLE 19. MONETARY INDICATORS IN SOME MDES, 1992 AND 2000

Country	Real rate of interest		Ratio of currency to deposits	
	1992	2000	1992	2000
Egypt	(3.6)	7.4	10.8	17.2
Jordan	(0.7)	6.2	31.5	22.9
Lebanon	(46.8)	5.5	7.2	3.0
Syrian Arab Republic	(2.7)	7.1	60.0	73.3
Yemen	(25.6)	2.6	97.7	80.4

Source: Compiled by ESCWA, based on International Monetary Fund (IMF), *International Financial Statistics Yearbook 2004* (IMF, 22 September 2004).

Note: Parentheses ( ) indicate negative numbers.

TABLE 20. MONETARY INDICATORS FOR COUNTRIES OF THE GCC, 1995 AND 2000

Country	Real interest rate		Ratio of currency to deposits	
	1995	2000	1995	2000
Bahrain	3.8	6.9	7.8	6.0
Kuwait	3.1	3.9	4.4	5.4
Oman	6.2	8.7	18.5	19.2
Qatar	1.0	7.2	8.2	6.2
Saudi Arabia	3.9	7.5	29.0	23.8
United Arab Emirates	..	..	8.5	8.6

Source: Compiled by ESCWA, based on International Monetary Fund (IMF), *International Financial Statistics Yearbook 2004* (IMF, 22 September 2004).

Note: Two dots (..) indicate that data are not available or are not separately reported.

(c) *R and D activities*

R and D activities are crucial for the productivity of investment. Technological progress in a society means acquiring the capacity to apply scientific knowledge to organization, production and marketing within the political and economical context of society. It is a specific knowledge, rather than general knowledge, which can be applied everywhere in the same way. It cannot be acquired merely by borrowing it from others or by transferring it through FDI.

Building the capacity for technological improvement requires a substantial investment in resources in order to acquire, in the first instance, the capacity to use technology and, subsequently, the capacity to apply the technology. The first stage requires society to make considerable investment in terms of creating scientific communities that are capable of understanding exogenous technological knowledge and of adapting such knowledge to local needs and conditions. It involves building the knowledge and skills that are required for selecting, maintaining, improving and optimizing the use of new technologies.

This entails the establishment of an independent technology learning capacity (ITLC), which, through the added value of R and D, ensures that the cost of technology to society is minimized and that its benefits are maximized. The accumulated capacity that comes with the further maturation and deepening of the ITLC process enables society to create technology and adds to the world pool of knowledge. This more established stage is referred to as independent technology creating capacity (ITCC).

Crucially, the process of assimilating existing knowledge in the ITLC stage is not unlike that of creating entirely new technology. In each case, success requires allocating resources and an investment that responds to market incentives. It is not possible to embark on the ITCC phase without first creating an indigenous community that is genuinely capable of understanding foreign technology and of adapting it innovatively to local conditions. A considerable investment is required to enable the creation of an ITLC in which domestic scientists, engineers and skilled workers become the carriers and agents of technological progress.

While the ESCWA region invested very heavily in the introduction of new technologies during the latter half of the twentieth century, this was largely characterized by a reliance on turnkey and off-the-shelf projects that maximized costs, minimized returns and made little contribution to the creation of local ITLC.

(d) *Quality of institutions*

The quality of public institutions helps firms to expand the scope of their activities and facilitates the entry of new firms into the market, thereby fostering competition. Table 21 presents some indicators related to the impact of public institutions on the business environment in seven ESCWA member countries; and highlights that the number of procedures required to start a business in six of these countries is more than the world average.

2. *"Kicking away the ladder" in the ESCWA region*

Despite significant differences in the standards of living between MDEs and the countries of the GCC, both clusters have followed the same pattern of social development in the last quarter of the past century. Alarmingly, income inequality has been increasing in almost every country in the region, and is currently at its highest level of inequality.

TABLE 21. BUSINESS ENVIRONMENT INDICATORS, 2004

Country	Starting a business		Registering property	
	Number of procedures required	Number of days required	Numbers of procedures required	Number of days required
Egypt	13	43	7	193
Jordan	11	36	8	22
Oman	9	34	4	16
Saudi Arabia	12	64	4	4
Syrian Arab Republic	12	47	4	23
United Arab Emirates[a/]	12	54	3	9
Yemen	12	63	6	21
Low-income group	11	63	7	100
Middle-income group	10	51	7	80
High-income group	7	27	5	50
World	10	50	6	80
East Asia	8	59	5	9

Source: Compiled by ESCWA, based on the World Bank, *Doing business in 2005: Removing obstacles to growth* (the World Bank, International Finance Corporation and Oxford University Press, 2005).

a/ The number of days required to start a business is considerably shorter in the Jebel Ali Free Zone in Dubai.

According to the University of Texas Inequality Project (UTIP), every ESCWA member country, with the exception of Yemen, ranks above the fiftieth percentile in the inequality scale among 140 countries. Some in the GCC, namely, Kuwait, Oman and Qatar, rank above the ninetieth percentile.[185]

The increasing inequality of income among the people of the region, coupled with the widespread poverty in MDEs is a testament that the mass of people have not benefited from the vast oil wealth generated in the region in the past four decades.[186] Rather, a process of marginalization has been taking place in most countries of the region whereby the initial successful winners of growth managed to earn influence with the Government and used such influence to prevent other elements of society from emulating them. This process has been dubbed "kicking away the ladder".[187] It has left millions of people in the ESCWA region lacking access to basic health facilities, education, housing and secure employment.

In its 2002 issue, the *Human Development Report* found that illiteracy rates in the Middle East were much higher than in other poorer countries around the world and that this trend was increasing; and underscored that ten million children aged 6-15 were out of school, which was set to increase by 40 per cent by 2015 with current trends.[188] Additionally, the Report noted that spending on health in the majority of Arab States was in the range of 3-4.5 per cent of GDP, which is lower than the average of 5.7 per cent for middle-income countries, as classified by the United Nations.

[185] See University of Texas Inequality Project, which is available at: http://utp.gov.utexas.edu.

[186] According to recent estimates by the World Bank, one out of every five people in the Middle East and North Africa live on less than $2 per day.

[187] This is an old expression that was first used by F. List in 1830 to refer to the interaction between industrialized England and rural Germany. The term was revived in 2002 by H.J. Chang to describe the impact of the policies known collectively as "Washington consensus" on developing countries. Recently, the term has been applied to describe the interaction between successful elites and those who seek to emulate them in a given country. See N. Stern, J. Dethier and F. Rogers F, *Growth and empowerment: Making development happen* (MIT Press, 2005).

[188] See the United Nations Development Programme (UNDP), *Human Development Report 2005*, which is available at: http://hdr.undp.org/reports/global/2005/.

This low level of public spending on education and health is a clear indication of defective social policies, and is evidenced by many cross-country statistical studies of the quality of public institutions. Table 22 shows that most ESCWA member countries rank very poorly in measures relating to Government effectiveness, regulatory quality, rule of law and control of corruption. Moreover, when compared to countries that have similar income per capita, the ESCWA region ranks at the bottom on the indices of public accountability and the quality of public administration.

TABLE 22. GOVERNANCE INDICATORS IN THE ESCWA REGION, 1996-2004
(*Percentile ranks*)[a/]

Country	Government effectiveness	Regulatory quality	Rule of law	Control of corruption
Bahrain	75.5	72.2	69.1	76.8
Egypt	49.0	27.1	54.1	51.2
Iraq	3.4	4.9	0.5	2.5
Jordan	62.5	56.2	60.4	68.5
Kuwait	69.2	55.2	67.6	76.4
Lebanon	42.3	31.0	43.5	39.9
Oman	79.5	64.0	83.1	77.3
Qatar	78.4	45.8	78.8	72.4
Saudi Arabia	53.3	38.9	57.0	61.1
Syrian Arab Republic	86.1	79.3	78.7	86.7
United Arab Emirates	86.1	79.3	78.7	86.7
Yemen	3.4	4.9	19.3	34.5

Source: Compiled by ESCWA, based on D. Kaufmann, A. Kraay and P. Zoido-Lobatón, "Governance matters: From measurement to action", *Finance and Development*, vol. 37, No. 2 (June 2000).

a/ A percentile rank indicates the percentage of countries worldwide that rank below the selected country. For example, in the governance effectiveness of Bahrain, 75.5 per cent of countries around the world rank worse and 24.5 per cent rank better than Bahrain.

TABLE 23. EMPOWERMENT INDICATORS

Country/group	Index of public accountability[a/]	Index of the quality of administration[b/]	Index of governance quality[c/]
Low-income group	38	30	28
Yemen	19	33.5	22.5
Lower middle-income group	54	41	41.3
Egypt	30	38	30
Jordan	45.	50.7	44
Syrian Arab Republic	18	28	18.6
Upper middle-income group	65	56	56
Bahrain	31.5	66	50
Lebanon	42	35	32
Oman	26.6	53	39
Saudi Arabia	17	48	32
High-income group	74	65	68.5
Kuwait	44	56.6	48.5
Qatar	23	42	30
United Arab Emirates	34	73.6	56.4

Source: Compiled by ESCWA, based on the World Bank, "Better governance for development in the Middle East and North Africa: Enhancing inclusiveness and accountability" (the World Bank publications, 2003).

a/ The index of public accountability is an aggregate index of 12 subjective/perception measures, including, among others, political rights, civil liberties, freedom of press and polity score.

b/ The index of the quality of administration is an aggregate index of 10 subjective/perception measures, including, among others, corruption, bureaucratic quality and property rights.

c/ The index of governance quality is an aggregate index of the 22 subjective/perception measures of the previous two indices.

TABLE 24. GROWTH RATES OF HUMAN CAPITAL IN SOME ESCWA MEMBER COUNTRIES[a/]
(Percentages)

Period	Human capital[b/]	Literacy rate 15 years and over	Literacy rate 15-24 years
1975-1980	7.1	2.5	2.2
1980-1985	5.7	2.6	2.0
1985-1990	3.5	1.9	1.8
1990-1995	2.6	1.8	1.1
1995-2000	1.6	1.3	1.3

Source: Compiled by ESCWA, based on United Nations Development Programme (UNDP), *Human Development Report 2005*, which is available at: http://hdr.undp.org/reports/global/2005/ UNESCO Institute for Statistics, "Education statistics" (2005); and the World Bank, *World Development Report 2005: A Better Investment Climate For Everyone* (World Bank, 2005).

a/ The countries are as follows: Bahrain, Egypt, Iraq, Kuwait and the Syrian Arab Republic.

b/ Human capital is taken to be the average years of schooling for the ages 15-64.

All these factors are responsible for preventing the region from moving on the path of sustainable growth. They are impeding the process of accumulation of both physical and human capital as well as arresting the growth in productivity. The latter predicament is manifested by the inadequate State subsidy to R and D activities (see table 25), and by a poor institutional structure that encourages rent-seeking activities and reduces efficiency.[189]

TABLE 25. EXPENDITURES ON RESEARCH AND DEVELOPMENT ACTIVITIES, 1996-2002
(Percentages of GDP)

Country/group	Expenditure on R and D activities
Egypt	0.19
Kuwait	0.20
Syrian Arab Republic	0.18
East Asia and Pacific	1.11
Middle-income group	0.75
High-income group	2.54
World	2.36

Source: Compiled by ESCWA, based on the World Bank, *World Development Indicators* (World Bank, December 2005).

D. ELEMENTS OF STRATEGY IN THE ESCWA REGION

As underscored above, the current investment climate across the ESCWA region is not conducive for the creation of a vibrant and innovative private sector. This uncongenial environment can only be changed effectively with a strategy that embodies a vision of development and aimed at two strands, namely: (a) creating an investment climate that is conducive to entrepreneurship and growth; and (b) empowering and investing in poor people, thereby encouraging their participation in the growth process.

However, the region must also have the foresight to recognize that building such an environment cannot be achieved entirely in each country. The new environment requires certain structural changes that no country in the region is capable of undertaking on its own. Chiefly, certain changes require the combined

[189] Sustainable growth is maintained by increasing the factors of production and/or by increasing productivity. The latter is effected by technical progress and efficiency, which requires discouraging unproductive activities (rent-seeking activities).

efforts of all the countries in the region within the framework of a new and serious effort of regional coordination.

In that light, the proposed strategy needs to embody a view of development as one of structural changes aimed at empowering the firms, the people and the region. In other words, this strategy can be expressed simply in terms of the following three dynamic processes: (a) improving the investment climate; (b) empowering the poor; and (c) integrating the economic activities at the region level. The salient features of each of these processes are reviewed below.

1. *Improving the investment climate*

The factors that shape the investment climate include macroeconomic environment, physical and financial infrastructure, R and D activities, and quality of institutions. An outline of the changes needed in each element is set forth below.

(a) *Macroeconomic environment*

Central banks in most countries of the region adopt a tight monetary policy in order to keep a low rate of inflation. Indeed, some countries have gone a long way in terms of adopting a disinflation programme. As a consequence of this policy, the real rate of interest in most ESCWA member countries is relatively high, which is not conducive to investment activities. Strikingly, tight monetary policy is used in a region that suffers from a very high rate of unemployment.

The only justification for such a policy is that the central banks in the region are working with the following two assumptions: (a) that the inflationary pressure is significantly high despite the high rate of unemployment, and that relaxing the tight monetary policy could result in a situation of stagflation (high rates of both inflation and unemployment); and (b) that inflation in the region is caused by inflationary expectations.[190]

Past experience of inflation in the ESCWA region and in other developing countries has cast considerable doubt on the validity of the second assumption. The cause of inflation in the ESCWA region is more likely to be generated from the supply side rather than the demand. In other words, inflation is most likely the result of structural bottlenecks.

Prominent among those bottlenecks is the inelastic supply of foodstuffs caused by primitive technology in agriculture. Since the early 1970s, policies have been needed to promote expansion in the agriculture sector. The sector has to increase the supply of food in order to counterbalance the increase in demand generated by an increase in both income and population. The former arises from the increase in the price of oil and the latter occurs from the natural growth rate in population, which is among the highest in the world. A failure to implement those policies has led to an inadequate supply of food, which in turn has led to an increase in food prices, thereby causing an increase in the general level of prices.

The second important bottleneck is the Government budget constraint. The above mentioned phenomenon referred to as "kicking away the ladder" has forced many Governments of the region to monetize the budget deficit, which resulted in inflation. This can be attributed to the fact that the phenomenon has two contradictory impacts on the Government budget once growth takes place. First, Government revenue does not increase significantly with growth, given that most of the increase in income is channelled to the rich who, in this region, do not pay their equitable share of taxes. On the other hand, the

[190] Inflation cannot be caused by high aggregate demand given the high unemployment; and, moreover, it cannot be caused by expansion of the money supply given the tight monetary policies of banks.

expenditure side of the budget rises to finance subsidies for the basic foodstuff of the poor, without which social unrest could emerge.

The third bottleneck is related to the foreign exchange. This bottleneck was used to cause inflation in the late 1980s and during the 1990s given that the exchange rate was overvalued in most MDEs. That high value of the exchange rate was not sustainable; and once it crumbled under the pressure of financial speculators, prices of imports tended to rise, thereby pushing the inflation rate up.[191]

Any meaningful analysis of inflation in the ESCWA region cannot be divorced from the more general socio-economic and socio-political contexts. The present attempt by some central banks in the region to obfuscate this link and reduce the complex social and economic phenomenon to a straightforward technical problem of disinflation will result in the temporary reduction in the inflation rate and a long-term increase in the unemployment rate.

The policy of disinflation can be reasonably successful in certain developed countries where inflation is caused largely by a built-in expectation. However, the technique of disinflation addresses the symptom of the problem and not its cause in most ESCWA member countries given that the very process of economic growth, which is caused by an increase of the price of oil, creates an increase in aggregate demand with weakly responsive domestic supply in the short term.

(b) *Physical and financial infrastructure*

The physical infrastructure is analysed below, within the contexts of empowering the people and integrating the economic activities at the region level.

In the area of financial infrastructure, financial reforms in most ESCWA member countries have resulted in only modest improvements in monetary and credit aggregates. Prior to implementing further measures of financial liberalization, banks need to improve their internal credit assessments and their risk appraisal systems. Moreover, central banks need to develop market-based monetary instruments in order to use, rather than direct, administrative restrictions.

2. *Empowering the poor*

The shortfall of fundamental freedoms, which countries of the region suffer from, cannot be overcome without a complete political reform aimed at achieving three goals, namely: (a) the adoption of a bill of rights that guarantees civil liberties to all citizens in their daily lives and in acts of political, social and economic participation; (b) the presence of institutional procedures through which citizens can choose the leaders of their Government and express effective preferences with regard to alternative policies; and (c) the existence of institutions to provide checks and balance, and to constrain the power of the executive branch of the Government.

These principles cannot become a reality in the lives of the citizens of the region by merely amending constitutions or by holding free elections that are monitored by foreign observers. Specifically, democracy requires the effective participation of citizens, which depends on the capabilities of individuals and, most importantly, on their income, education, health and security.

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[191] In 1980-1988, the inflation rate in Jordan averaged at 5 per cent. The financial crisis of 1989 forced the devaluation of the Jordanian Dinar by 45 per cent, thereby increasing the inflation rate dramatically to reach 25.7 and 16.2 per cent in 1989 and 1990, respectively.

(a) *Distributing income fairly*

As was shown above, past episodes of growth in the region were short-lived owing partly to the unequal distribution of the benefits of growth. The majority of people were excluded from participating in the growth process, which created adverse incentives and discouraged investment. Moving towards a strategy of pro-poor growth requires the adaptation of redistributive measures in order to ensure a more equitable distribution of income and to help people to move out of poverty.

Various redistribution mechanisms could be used, including, chiefly, the redistribution of income by reforming the tax system. The reform must aim to increase the reliance on income progressive taxes, restructure property tax, and introduce presumptive taxes. Another mechanism is the redistribution of wealth by securing property rights to the poor and by undertaking effective land reform. In cases of abject property, a simple redistribution of money is needed, preferably by using the mechanism of smart transfer.[192]

(b) *Reallocating public expenditures*

Currently, the allocation of public expenditures in most ESCWA member countries is not conducive to growth or to empowerment. Governments in the region are not spending enough on education, health and R and D activities. Moreover, the quality of public universities has deteriorated in the past 25 years across the region; and these universities do not have the capacity to admit thousands of qualified secondary school graduates every year. In both MDEs and countries of the GCC, private profit-making universities are proliferating in order to satisfy the excess demand for higher education.

Consequently, the system of higher education is moving along a significantly suboptimal structure whereby the private sector is in charge of producing education services for profit. Free education is no longer available for a sizable segment of the poor; and those students who receive a good education are mainly children of the rich who can afford studying in the United States, Europe or in some elite private universities in the ESCWA region.

Education has not been given due concern by most Governments in the region, and that has created an adverse path dependence that is detrimental to growth and that acts to reinforce the process of "kicking away the ladder". Most countries of the region currently allocate some 5-6 per cent of GDP to education at all levels. This ratio is comparable to the average ratio of middle-income countries, at 5.5 per cent, and is approximately half the average ratio of industrialized countries, at 10-12 per cent. There is a compelling reason to change radically the present system and to restore the role of the public sector as the principal provider of high education. Consequently, the share of GDP allocated to education needs to be higher than that of industrialized countries, or more than 10-12 per cent, until a new equilibrium with a high human capital emerges.

However, increasing expenditures on education is not sufficient unless it is accommodated by a comprehensive reform of the education system. This reform needs to emphasize the training of students, thereby enabling them to acquire both the critical thinking and practical skills needed in the market. This substantial quantitative and qualitative expansion poses a challenge, which is beyond the capacity of any country in the region to handle by itself. This is an area where regional coordination can prove to be very efficient.

Similarly, the health system in most countries of the region is suboptimal. The system is polarized between significantly poor public services and very expensive private services. The public sector needs to

[192] A smart transfer is a transfer of money to the poor with built-in conditionality. It is a means-tested transfer conditioned on children under a certain age attending school and visiting a medical doctor a specified number of times a year.

assume its role and expand both the scope and the quality of services to R and D activities, where it is deemed to have the characteristic of regional public good.

Empowerment measures remain largely ineffective if these are not accompanied by increasing public expenditures on pro-poor infrastructures. To a large extent, the poor can be identified as those living in neighbourhoods that have insufficient supplies of clean water, lack sanitary facilities, and have extremely limited transportation and communication services. Infrastructure services aimed at helping the poor allow them to improve their health and education, promote their inclusion in the political structure of the country, and contribute to environmental sustainability.

3. *Integrating the economic activities at the region level*

ESCWA member countries have lagged behind other regions in the world in developing their economies along the new concept of regionalism. A new view of regionalism emerged in the late 1980s as one option available to developing countries intent on integrating their economies at the global level, while still providing them with means for dealing with the adverse effects of globalization.

Regional integration among ESCWA member countries can benefit from an economy of scale, increase in intra-industry trade through further division of labour and product differentiation, and promote the region's bargaining power in its trade relations and its efforts to transfer technology. Lessons learned from past experiments of regional integration by developing countries, especially Arab countries, suggest that an emphasis based solely on trade liberalization through the formation of a free trade area or custom union is not suitable to set the stage for integration. ESCWA member countries suffer from chronic unemployment and underemployment, excess capacity, inadequate utilization of resources and widespread distortions in most markets.

Under such conditions, the effects of regional integration based mainly on trade liberalization are at best limited and at worst harmful. Designing an effective regional scheme calls for a more deliberate approach that emphasizes cooperation and coordination among member countries, with a view to creating an enabling environment better suited to tackling the fundamental economic problems of the region. This undertaking involves changing the regional pattern of production, employment and trade in order to improve the investment climate of the region, and to empower economic agents and young entrepreneurs. This is a major task that demands the coordination of economic policies among member countries, especially in the areas set forth below.

(a) *Regional exchange rate policy*

As explained above, most ESCWA member countries have resorted to stabilization based on exchange rates as a strategy for controlling inflation. They have chosen high unemployment, limited integration in the regional and global markets, and sluggish internal growth. Clearly, the region needs to aim for a lower rate of unemployment, deeper integration with regional and world markets, and sustainable growth. This requires higher private capital flows and more long-term investment in MDEs by investors in the GCC. Creating an environment conducive to this needs more flexibility in the exchange rate regime. Countries in the region are not economically strong enough to overcome the so-called "fear of floating", which results in the de facto use of a managed floating regime system even when a free floating regime has been formally adopted.

Regional monetary coordination becomes the only viable alternative. The ultimate aim of such coordination is the creation of a single currency area.[193] This involves policy harmonization to eliminate gradually capital market fragmentation. A unified and vibrant regional capital market is essential to mobilize national savings and to pool regional savings, thereby allowing optimal allocation among competing investment projects.

[193] See F. Naqib, "Macroeconomic stabilization policies for the high risk economies of the ESCWA region" (2005).

Integrating capital markets, however, is a lengthy process that involves harmonizing tax measures. This could be greatly assisted by modernizing the procedural and logistical dimensions of links among ESCWA member countries; by establishing regional information facilities to assist potential investors and traders; and by modernizing and simplifying border-crossing facilities and procedures, which are currently a formidable impediment to the movement of both people and goods.

(b) *ESCWA fund to finance regional R and D activities*

The product of R and D activities has the characteristics of a public good. In other words, the public cannot be prevented from using and benefiting from it. This implies that leaving its production entirely to the private sector will result in a suboptimal outcome, namely, an underinvestment in R and D activities. Analogously, the outcome of R and D activities becomes a regional good given the shared language and history, and similar cultures, topographies, climates, natural resources and economic problems.

Consequently, R and D investment that deals with a common problem of the region will be suboptimal if it is directed only to one country. Adopting a serious and effective policy to support R and D at the regional level requires creating a suitable environment for building a common ESCWA independent technology learning capacity (ITLC) that provides a new source of effective and much needed support for the process of development in each country.

Moreover, the establishment of a regional fund for R and D could enable pooling of Arab financial resources and allow R and D activities to be launched at a scale that is not possible in or by any single country. Additionally, pooling Arab human resources could help to create the critical mass of scientists needed for addressing major areas of technological development, without the costly and crippling dependence on imported know-how. Such a fund could mobilize the efforts of talented individuals and foster an effective network of institutions from all the countries of the region aimed at adopting technology and addressing needs in any country or group of countries.

(c) *Regional coordination in higher education and health services*

Creating suitable infrastructure for R and D activities, as suggested above, will not be effective if the institutions of higher education in the region remain in their current condition. At present, universities in the region lack the facilities needed to conduct serious research, and the capacity to absorb qualified new graduates from high schools. The region spends billions of dollars annually on a suboptimal system of private universities. Additional billions are spent on students studying for first university degrees in foreign countries.

Moreover, tens of billions of dollars are spent every year on patients who receive medical care in foreign hospitals owing to the fact that medical schools in the region are weak and unable to provide hospitals with qualified doctors. As a striking example, the entire region lacks an academic centre for research dealing with cancer, or heart or liver disease.

As discussed above, the adoption of a pro-poor growth strategy requires reallocating public resources in favour of health and education. While such reallocation could go a long way in terms of empowering the poor, it cannot on its own optimize the health and education systems. Countries acting individually are unable to finance higher education institutions that are equipped with research facilities in all specializations; and to develop their systems of medical learning that can provide local hospitals with the latest techniques of treatment. By using a fraction of the substantial resources that are currently being spent by member countries on education and health outside the region, particularly in Europe and the United States, a regional coordinated effort can be financed aimed at improving gradually the education and health services in the ESCWA region.

(d) *Regional coordination in infrastructure*

The successes of the three-pronged strategy will depend to a great extent on improving regional infrastructures. This is owed to the fact that countries acting individually cannot obtain low-cost structure without participation in regional projects, particularly with regard to water, transportation and, in the case of MDEs, energy. Equally, serious problems of environmental degradation and water safety need regional efforts to achieve adequate solutions. More importantly, the use and management of water resources in the region are not at present optimized, thereby creating both waste and regional tension. Accordingly, a regional water arrangement has to address the three issues of distribution, conservation and expansion.

Similarly, further integration of the unified regional electrical power system could build on the existing link between Jordan, Lebanon and the Syrian Arab Republic and increase effectiveness. A regional scheme could benefit the countries involved by making available a more reliable and cheaper supply of electricity.

Revitalizing trade between ESCWA member countries requires a major project aimed at upgrading overland travel in the region by building modern highways and railways. One such proposal involves the construction, improvement and upgrading of the road along the eastern Mediterranean coast from Turkey to Egypt.

E. CONCLUDING REMARKS

The analysis of the economic conditions in the ESCWA region reveals the following points:

(a) The countries of the region are not performing the functions of the developmental State. Specifically, there is a failure to provide the social infrastructure needed for sustainable growth. To a large extent, public institutions and policies are responsible for the high rate of unemployment, and for the sluggish growth that has arrested development in the region over the past two decades;

(b) The region cannot jump from lower, short-lived paths of growth and development to higher sustainable paths if the Governments of the region continue to follow traditional reforms aimed almost exclusively at improving the business environment. The correct strategy of reform needs to recognize two essential points, namely: (i) sustainable growth cannot be maintained without the effective participation of the majority of people; and reform in public institutions and policies must be carried out with the determined and unfaltering purpose of implementing a pro-poor growth strategy; and (ii) sustainable growth in the region cannot be maintained without the production of some public goods that countries acting individually are unable to produce optimally. These goods have the characteristic of being regional goods; and their optimal production therefore requires regional coordination and cooperation.

In short, countries of the region under the triple squeeze of unemployment, democratization and globalization cannot carry on business as usual. They need to embark on major reforms programmes aimed at implementing significant structural transformation.

In that light, this chapter presented and assessed the three-pronged pro-poor growth strategy, namely: (a) improving the investment climate, which allows the State to play the important role of promoting capital accumulation needed for growth and to combat chronic unemployment; (b) empowering the poor, which is urgently needed to allow the State to pursue true democratic reform as demanded strongly by the people; and (c) integrating the economic activities at the region level, which enhances the viability of options that offer States in the ESCWA region capacities to fulfil an accumulation function within a broader network of socio-economic and political cooperation.

VII. SOCIAL ASPECTS OF THE RIGHT TO DEVELOPMENT

A. THE GLOBAL STAGE AND REGIONAL CONTEXT

In 2005, Governments took stock of the progress made towards internationally agreed goals and standards, particularly the MDGs, and reiterated their commitments to such targets. The stage is currently set for a frank assessment of the pledges made at the Millennium Summit and "to making the right to development a reality for everyone and to freeing the entire human race from want".[194] Globally, while some progress has been achieved, regional, national and intra-national inequalities persist in the distribution of resources and income; and access to basic services and opportunities, markets and information.

In the regional context, while fair to strong progress in achieving the MDGs was recorded in the Gulf and Mashreq subregions, Palestine and Yemen remained off-track. Given the high fertility rates and lower mortality rates, there is an added momentum in the demographic profile of the region. The population in the ESCWA region is set to grow to nearly 215 million by 2020, at the current rate of annual growth of 2.6 per cent and a total fertility rate of 3.9.

Moreover, the region remains predominantly young with 37 per cent of the ESCWA population aged under 15, and 20 per cent of the population aged 15-24 in 2004.[195] In order to ensure a smooth youth-to-adult transition as this population matures into the economically active population (aged 25-64), further efforts are required to promote youth employment and participation. Intraregional and international migration continues to impact the region, against the backdrop of moves by countries of the GCC to nationalize their private labour markets.

In the light of inequalities, marginalization and poverty, effective responses need to be channelled through governance and mechanisms that provide social protection and that promote the human rights of all citizens through strong legislative and institutional frameworks. The adoption of a rights-based approach helps to clarify adequate responses that enable fundamental social rights.

To varying degrees, commitments have been made across the region to human rights by signing, ratifying and acceding to basic human rights instruments (see annex I). Specifically, seven out of the thirteen ESCWA members are signatory to the International Covenant on Economic, Social and Cultural Rights; and the International Covenant on Civil and Political Rights. Additionally, national centres for human rights have been established in several member countries, which suggest an increasing acknowledgement of the rights-based framework in the region.[196] However, further efforts are required to translate these rights into national legislation.

B. SOCIAL ISSUES

1. *Youth*

Regionally, the youth population aged 15-24 has grown from 24 million in 1990 to an estimated 39 million in 2005, at an annual growth rate of 3.1 per cent. There is a male bias in the gender constitution with an average of 95 young women for each 100 young men in 2005. The percentage of youth out of total

[194] United Nations Millennium Declaration of 8 September 2000, para. 11.

[195] ESCWA, *Statistical abstract of the ESCWA region*, Twenty-fourth issue (2005), p. 2.

[196] Within that context, Jordan set up a national centre for human rights mandated with monitoring transgressions of human rights, taking and following up on complaints, and informing citizens of their legal rights; Egypt set up a national council for human rights to monitor and assess the situation of human rights in the country; Bahrain established a centre for human rights in August 2002 to focus on relevant training and studies; and Qatar announced the establishment of a centre for human rights.

population is estimated at 20.4 per cent for the ESCWA region, and is highest in the Syrian Arab Republic, where youth accounts for 22.9 per cent of the total population.[197]

(a) *Youth unemployment*

Given an anticipated 40.8 million new entrants into the labour market in the Arab region by 2010 and currently high youth unemployment rates, youth employment represents a major policy challenge.[198] The youth-to-adult unemployment ratio is more than double in most countries, thereby indicating a high share of first-time jobseekers among the unemployed and that youth are at greater risk of unemployment. Disincentives to enter the labour force add to the decline in youth economic activity rates; and many in this age-bracket opt to stay in the education system or to abstain from entering the labour force owing to limited opportunities for work that fit their aspirations.[199]

In general, the region is experiencing a trend of saturated public sector jobs compounded by pressures for faster employment generation from a growing youth population, an increasing number of whom are highly educated. The characteristics of youth unemployment differ across the region. In the countries of the GCC, this has created a pool of national graduates in a job market vacuum where they are overqualified for lower-paid and lower-skilled private sector jobs, albeit under-qualified for managerial and technical positions. In addition, Governments in the GCC have set in place nationalization strategies aimed at redressing the imbalance of expatriate workers in the private sector, and at promoting the appointment of nationals over non-nationals.

By contrast, while the number of national graduates in Oman is equally significant in the unemployed population, available data indicate that the majority of jobseekers have not attended schooling above secondary level.[200] In Egypt, comparatively more educated graduates are unemployed than their less educated counterparts.[201] In the Syrian Arab Republic, while youth unemployment can be attributed to the population boom and lack of employment in the public sector and State-owned factories, more than half the unemployed youth have primary or no formal education.[202] Tailored policy responses are required to generate employment opportunities in the private sector, and to realign educational and vocational training programmes aimed at increasing incentives to remain in education, and with a view to matching such programmes with the technical and professional needs of the labour market.

Given the challenges of youth unemployment, many initiatives and programmes are being set in place to promote youth employment. However, there is a need for structural changes in policymaking in order to promote the targeting of resources, and to establish linkages between education, vocational training, labour markets and employers. Policies are needed to promote incentives towards employment over receipt of social assistance, in addition to strategies aimed at promoting entrepreneurship through, for example, microfinance.

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[197] ESCWA, *Compendium of social statistics and indicators: A special issue on youth* (2005), pp. 18 and 21.

[198] ESCWA, "Population and development: Demographic profile of the Arab countries", which is available at: http://www.escwa.org.lb/popin/publications/new/DemographicprofileArabCountries.pdf.

[199] ESCWA, *Compendium of social statistics and indicators: A special issue on youth* (2005), p. 29.

[200] United Nations Development Programme (UNDP), Oman: Human Development Report 2003, pp. 135-136.

[201] United Nations Egypt, "UN common country assessment: Embracing the spirit of the Millennium Declaration" (United Nations, 2005), p. 23.

[202] United Nations Country Team in Syria, "Syrian Arab Republic: Common country assessment" (United Nations, 2005), pp. 31-32.

Within that context, Jordan has implemented self-help microfinance programmes and replaced its recurrent cash assistance programme with a welfare-to-work family income supplement that links welfare to training and employment. Similarly, Egypt intends to introduce a law on small and medium-sized enterprises and to design a national strategy for microfinance; and the Syrian Arab Republic launched the Agency for Combating Unemployment, which is funded primarily by the Government, that provides credit for micro enterprises and small- and medium-sized enterprises.[203]

Furthermore, child labour, particularly in agricultural sectors, poses a challenge to policymakers in the region. While the proportion of working children has decreased over the past decades in the region, its prevalence remains a serious contravention of children's rights as guaranteed by the Convention on the Rights of the Child. The low age of criminalization in some countries, and the status of begging and truancy as a punishable offence also raise concern with regard to the safeguarding of children's rights and to alleviating their plight. In addition to derogating their rights, child labour denies children access to further opportunities during their lives.

(b) *Education*

Universal primary education is a direct goal of the MDGs; and all ESCWA members, with the exception of Iraq, Palestine and Yemen, are on track towards achieving this by the target year of 2015. As a vehicle towards the exercise of multiple social rights, including the right to employment and an adequate standard of living, education is a social prerequisite.

Despite significant strides in literacy rates and coverage, the role of education as an enabler of development and social rights continues to be hampered by gender and urban/rural disparities, a mismatch between education and labour market needs, obsolete curricula, poor teaching methods and school dropouts. In general, educational curricula focus on didactic rather than critical analytical skills that are in demand in modern, knowledge-based societies. Moreover, there is a lack of investment to create incentives aimed at pursuing scientific and academic research, and of investment in physical infrastructure and information technology infrastructure.

Given that education and vocational training systems are instrumental in developing human capital for labour markets, there is an urgent need to strengthen this link. However, increasing the number of years spent in education is currently having little impact on income differentiation. Consequently, the incentives to pursue education, particularly higher education, are low. Shortcomings in relevance and quality have influenced the decision by many youth to drop out of education. A focus on the right to education highlights the role of Government in strengthening the education sector, thereby enabling access to quality education and linking it to employment, and fulfilling the aspirations of individuals.

(c) *Youth participation*

There is a prevailing sense of disengagement and lack of involvement of youth as agents of change in the decision-making processes in the region.[204] Policies aimed at addressing multiple areas of youth

[203] United Nations Development Programme (UNDP), "Jordan Human Development Report 2004: Building sustainable livelihoods" (2004), p. 72; United Nations Egypt, "UN common country assessment: Embracing the spirit of the Millennium Declaration" (United Nations, 2005), p. 34; and United Nations Country Team in Syria, "Syrian Arab Republic: Common country assessment" (United Nations, 2005), p. 8.

[204] Reflections made in a regional report on Arab youth indicated that youth did not feel policies directly addressed issues of most concern to them and that they were not sufficiently represented in decision-making processes. Global Youth Action Network, "Arab youth and WPAY, challenges and successes, 1995-2002: A regional overview" (28 April 2005). Moreover, a survey conducted in 2004 by the National Council of Childhood and Motherhood in Egypt on National Youth Aspirations revealed that young people feel excluded from political processes and unable to influence the decision-making process. United Nations Egypt, "UN common country assessment: Embracing the spirit of the Millennium Declaration" (United Nations, 2005), p. 47.

development, including health, reproductive health, education, and community activities, tend to be piecemeal. Despite diverse NGOs operating in the area of youth, their responses fall short of a comprehensive impact to integrate youth fully in the development process. Consequently, there is a need for a systematic mechanism that promotes youth participation.

2. *Migration and poverty alleviation*

A complex pattern of migrant labour is emerging in the region against a backdrop of stagnating economic growth and regional disparities, conflict, increasing youth unemployment and modestly diversified economies overshadowed by oil revenues. Within the context of high national unemployment and segmented labour markets, Governments of the GCC have tried to set in force nationalization programmes in favour of hiring nationals, particularly given that migrant labour accounts for a large share of national markets.

The main channels of migration in the ESCWA region take place through rural-urban migration, migration from other developing countries, intraregional migration, and forced migration arising from conflicts in the region. There are an estimated 14 million international migrants and 6 million refugees in the ESCWA region. Saudi Arabia hosts the largest number of migrants, followed by Egypt, owing to a significant influx of migrants from Sudan since the 1970s. Moreover, the majority of migrants from outside the region consist of nationals from India, Pakistan and the Philippines; and intraregional migratory flows reveal that Egyptians and Jordanians tend to move to the GCC, while Iraqis travel to Jordan and the Syrian Arab Republic.[205]

(a) *Migration as a response to inequalities of opportunity*

Migration reflects the choice of many to invest their skills for higher reward or potentially better opportunities abroad in the face of limited or poor income-generating opportunities at home. National economic development is instrumental in order to reduce incentives towards outer migration and to provide individuals the choice of remaining in their home countries.

The current trend of Governments in developed countries is to implement selective immigration policies that favour skilled labour. This is set to impact patterns of migration. The reduction of remittance emigration opportunities for unskilled migrants could result in increasing pressure on labour markets and social systems in countries of origin. In tandem, it could increase incentives and opportunities for skilled individuals to migrate and invest their skills outside the region, thereby further depleting the talent pool of these countries. Consequently, active policies are needed aimed at diversifying the economy and at providing employment prospects that match the aspirations of skilled labour with adequate wages.

(b) *Migration aimed at alleviating poverty*

As a single contributor to GDP, remittances represent a sizeable source of revenue for countries of origin, which feed back into local economies. Specifically, six countries of the GCC generate the largest source of remittances in the Arab region, which accounts for 6 per cent of the GDP of countries of origin.[206]

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[205] International Organization for Migration (IOM), *World Migration 2005: Costs and Benefits of International Migration*, vol. 3 (IOM, 2005), p. 25.

[206] In 2002, remittances accounted for \$2.3 billion in Lebanon; \$2.9 billion in Egypt or 3 per cent of GDP; \$2 billion in Jordan or 22.8 per cent of GDP; and \$1.4 billion in Yemen or 15.7 per cent of GDP. With regard to contributing countries, the United Arab Emirates paid out \$4.5 billion; followed by Kuwait at \$2.3 billion; Oman at \$1.5 billion; Qatar at \$1.4 billion; and Bahrain at \$1.3 billion. International Monetary Fund (IMF), *Balance of Payments Statistics Yearbook 2002* (IMF, 14 November 2002).

While these remittances can serve to alleviate poor living standards in migrant households, they often fall short of changing patterns of poverty and creating sustainable poverty alleviation.

When assessing the impact of migration on livelihoods, the correlation between migration, inequality and poverty alleviation merits further examination. While migration has been shown to have a poverty-alleviating effect for migrants, there is also evidence to suggest that the largest determining effect of current poverty status is previous poverty status. This highlights the resounding effect of the poverty trap among poor populations.[207]

Additionally, it is necessary to identify whether and how remittances, which can account for a sizeable proportion of total household income, are channelled and injected back into local communities and economies. Fieldwork studies from Egypt suggest that only a modest proportion of remittances from rural-to-urban migrants sent back are used on investments, with productive gains and a multiplier effect on income and employment generation.[208]

As regional and international destinations for labour migration tighten the inflow of migration into their countries, the impact will be felt by migrant households that have hitherto adopted migration as a poverty alleviation strategy. There is therefore a vital need for strategies aimed at a sustainable alleviation of poverty, particularly where there is a concentration of households that receive migrant remittances, in order to offset shocks and promote the development of more long-term solutions in generating livelihoods.

(c) *Forced migration and internally displaced populations*

In addition to transitory labour migration, the region is host to forced migration and its accompanying settlement patterns. Governments are faced with the need to address the complex social issues confronted by and through these refugee populations and internally displaced populations. Conflict and political strife continue to plague the region that plays host to asylum seekers and migrants.

Moreover, the conflicts in Iraq and Palestine continue to affect surrounding host countries. Despite this presence of forced migration in the region, only two ESCWA member countries are signatory to the Convention relating to the Status of Refugees of 1951.[209] Lebanon and Jordan are not signatories to the Convention, despite significant Palestinian refugee populations in both these countries. This Palestinian diaspora is therefore compelled to live in a national and political vacuum; and refugees are denied basic rights to an identity, employment, education and other basic social services, thereby resulting in a spiral of deprivation and social tension.

Equally, internally displaced populations within countries of conflict pose challenges to social development. In post-war Lebanon, that group suffered from reportedly high levels of unemployment, poverty and a lack of social integration as a direct consequence of the civil war.

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[207] R. Sabates-Wheeler, R. Sabates and A. Castaldo, "Tackling poverty-migration linkages: evidence from Egypt and Ghana" (Development Research Centre on Migration, Globalisation and Poverty, October 2005), pp. 40-43.

[208] A. Zohry, "Interrelationships between internal and international migration in Egypt: a pilot study" (Development Research Centre on Migration, Globalisation and Poverty, July 2005), p. 86; and the World Bank, *Reducing Vulnerability and Increasing Opportunity: Social Protection in the Middle East and North Africa* (World Bank, 2002), p. 11.

[209] Yemen acceded to the Convention relating to the Status of Refugees on 18 January 1980; and Egypt acceded on 22 May 1981.

(d) *International migrants*

The ESCWA region is a large destination for international migrant labour, particularly female migrants from Asia. Despite the significant presence of international migration in the region, few countries are signatory to international conventions that regulate the rights of migrant workers, namely: the International Convention on the Protection of the Rights of all Migrant Workers and Members of their Families; the United Nations Protocol against the Smuggling of Migrants by Land, Sea, and Air; and the Protocol to Prevent, Suppress and Punish Trafficking in Persons, especially Women and Children.

These Conventions and their implementing frameworks provide legislative and institutional templates to safeguard the intrinsic rights of migrant workers and serve to pave the way towards securing their basic rights.

3. *Urban governance*

Urban agglomerations are swelling in the ESCWA region, which challenge Governments and municipalities in terms of fulfilling the right to housing and securing tenure for many of its inhabitants. More than half of the total population in the ESCWA region is currently urbanized, which is set to increase to 60.9 per cent by 2020. The urbanization rate is 90 per cent or more in Bahrain, Kuwait and Qatar; and even countries with lower urbanization rates are experiencing sharp increases in this rate.

For example, the urban population in Yemen, which is currently the smallest in the region, is set to increase at 5.41 per cent annually between 2000 and 2010.[210] Rapid urban growth results in corresponding pressures on countries in order to respond to demands for urban employment, education, housing, water supply, sanitation and basic social services.

Moreover, pockets of poverty have appeared in these urban agglomerates, with a steady rise in densely populated and informal settlements. The urban population in such informal settlements is estimated at 40.7 million across the region, which represents 35.3 per cent of the total urban population.[211] Squatter settlements sprawl capitals and major cities of Arab countries, where residents suffer from high insecurity, fear of eviction and further deterioration of living standards. Irregular and poor housing represent more than one-third of the newly-established housing units in most Arab cities. The overpopulated and under-serviced conditions in these settlements are owed largely to unaffordable housing and to inadequate urban governance.[212]

By empowering local municipalities and citizens to take charge of their environment, urban governance is instrumental in achieving the right to housing and secure tenure. Urban governance is largely a result of decentralization policies and the involvement of partners in the private and civil sectors. However, a review of cross-country experiences in the Arab region reveals that decentralization has been mostly restricted to the administrative aspects of policymaking, rather than political or financial aspects. Instead of embodying a real devolution of power, the ESCWA region portrays a mixed diluted/delegation process whereby decision-making remains essentially top-down.

Decentralization has sometimes entailed a transfer of responsibilities without a corresponding transfer of power to local levels. In addition, local authorities have tended towards such specific projects as housing

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[210] R. Warah, "The challenge of slums: Global report on human settlements 2003 (Global Policy Forum, 2003).

[211] United Nations Statistics database, "Indicator 32", which is available at: http://unstats.un.org/unsd/mi/mi_worldregn.asp.

[212] ESCWA, "Regional Campaign on Secure Housing, Land Tenure and Good Urban Governance, 2003-2006" (2005), pp. 1-2.

and poverty alleviation that transpose rather than address true social problems. The weak capacity of local authorities is also highlighted in terms of their know-how, equipment and resources. Consequently, the capacity of municipalities and local authorities to play a strong role in the provision of adequate and affordable housing remains limited. Those municipalities that have been able to play a decisive role have tended to be important municipalities either in key cities or with influential mayors.

Urban governance practices need to be put in place that establish a link between urban management and the provision of adequate housing, secure tenure and improving the urban setting. Priority must be given to expanding access to such basic services as drinking water, a cleaner environment, and safe and secure housing, particularly in lower-income areas and informal settlements in the region. This in turn can promote the right to housing and land tenure, enhance citizenship, empower local governance, and combat urban poverty.[213]

Conflict in the region has severely undermined the right to housing in affected areas. In Iraq, the conflict has caused a shortage of housing and loss of facilities that have displaced thousands of families and delayed the return of refugees. The ongoing conflict in Palestine has intruded on the rights of civilians to housing and adequate living through an aggressive policy of dispossession, military action against civilian homes and habitats, and land confiscation.[214] The United Nations Special Rapporteur on adequate housing in Palestine concluded that the occupation has had a devastating impact on the housing and living conditions of Palestinians.[215] A swift and democratic resolution of those conflicts, which respects economic, social and cultural rights, will be instrumental in accelerating the rights to development of both Iraqis and Palestinians.

C. RIGHT TO DEVELOPMENT

The right-to-development approach harnesses the development agenda and obligations of the State to fulfil fundamental rights and entitlements as stipulated by the international human rights system. It weaves the intrinsic importance of human rights into the national agenda, thereby becoming the new currency of development and setting new values and incentives for economic development and security. While the human development paradigm advocated national agendas to address the needs of people, the human rights approach goes one step further in setting development as an obligation of the State to the individual holder of rights.

1. *The State as principle enabler of the right to development*

The right-to-development framework stipulates that the primary responsibility to enable rights set down by the international human rights system lies with national Governments. Commitments made to international human rights agreements need to be complemented with national measures aimed at creating a legislative and institutional environment that is conducive to the attainment of human rights, and at implementing development in a participatory, integrated and comprehensive manner.

While there has been some progress in this area, challenges remain in terms of ensuring equal opportunity for all segments of society and of creating an environment wherein all individuals can enjoy

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[213] Ibid., p. 2.

[214] Economic and Social Council, "Report of the Special Rapporteur on adequate housing as a component of the right to an adequate standard of living: Visit to the occupied Palestinian territories (5-10 January 2002)" (12 June 2002), p. 9.

[215] Ibid., p. 70. Moreover, the Special Rapporteur noted that congruent rights on adequate housing in Palestine were being undermined, including the right to life; the right to an adequate standard of living; the right to freedom of movement and residence; the right to popular participation; the right not to be subjected to arbitrary interference with one's privacy; and the right not to be subjected to cruel, inhuman and degrading treatment or punishment.

their social rights. The prevalence of kinship and tribal networks in securing access to goods and opportunities is an obstacle to a rights-based environment. Rather than operating on the principle of access based on equal moral claim to a good or service, such practices distort the relationship between duty-holder and rights-bearer.

The perception of these practices by poorer populations can discourage them from pursuing their right to public goods and services. For example, Egypt has developed a new social contract and is working towards implementing an environment that is conducive to integrated human rights. In May 2005, that country joined the UNDP project on Strengthening the Rule of Law in the Arab States: Modernization of Prosecutors' Offices; and aims to establish a justice academy under the Ministry of Justice to train judges, prosecutors, paralegal officers, experts and secretaries.[216]

However, a strong legislative and judicial environment is not sufficient. There is an equally strong need to make vulnerable and poor populations aware of their entitlements to public goods and services in order to enable them to claim such rights. Consequently, Governments have the duty to raise awareness of human rights in society, which is currently significantly low among these populations, and to enable secure access to mechanisms through which individuals can make claim to their rights.

2. *The right to the provision of goods and services*

In general, the right to social security is guaranteed in national legislation. The main forms of social assistance comprise subsidies, social insurance, social funds, micro finance, and non-formal mechanisms.[217] The right-to-development framework implies an obligation by the Government that public services enable individuals to exercise their rights. This therefore entails issues of access, quality and coverage. Moreover, integrated solutions are required given that rights are indivisible and interlinked, with an impact on one right having a knock-on effect on another.

The strategy of providing subsidies on basic utilities, food and public services as a prime form of welfare often fails to target the poor and fulfil their right to social assistance. Moreover, in the light of growing fuel prices, the impact and necessity of subsidies as a social strategy is coming under increasing scrutiny. Social policies require more holistic planning, targeted access and coverage in order to enable the social rights of those in true need of social assistance.[218]

With regard to the right to social security, a significant number of people are not captured by the formal security nets, particularly those in the informal, self-employed and agricultural sectors. In addition, given that beneficiaries have to apply for assistance themselves, the lack of awareness, illiteracy and fear of being registered alienates them from the assistance to which they are entitled.

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[216] United Nations Egypt, "UN common country assessment: Embracing the spirit of the Millennium Declaration" (United Nations, 2005), p. 60.

[217] These non-formal mechanisms include family networks and religious charitable contributions.

[218] There are trends towards such an approach to social policies. For example, a poverty alleviation programme was initiated in Jordan in 2001 to reform the provision of welfare and strengthen Government capacity in order to increase access to the right to social security and assistance. A wide-range of activities have been implemented under that programme, including, among others, poverty mapping, governance and coordination, micro-finance, public-private partnerships, health and education strategies, public awareness activities, and budget reforms aimed at unifying line ministries under one system. Similarly, Bahrain aims to reorient its programmes from a charity-oriented approach towards developmental policies. Within that context, a welfare fund is to be launched through the 25-Year National Action Plan to pool resources and unify aid aimed at providing assistance to vulnerable populations. In addition, Bahrain has expressed interest in implementing the integrated social policies framework promoted by ESCWA.

In principle, access to such public services as health and education is universal in all countries. While primary education is compulsory and free for all children in ESCWA member countries, there are differences in terms of quality, access and starting ages between public and private education institutions. For example, in Lebanon, the disparity of access, quality and starting age for education in public and private provision of education has widened inequalities in education.

In addition to requiring Governments to provide free education, the right to education entails quality in enabling rights through a participatory process. For example, in order to combat urban-rural disparities in Egypt, the Ministry of Education issued the National Plan for Education for All that aims to include all Egyptians in the education system and improve the quality of education. Initiatives are being undertaken to decentralize the education system in order to increase local ownership among parents, teachers and students.

In the area of health, while all the countries of the GCC provide high quality and Government-funded health services, the financial viability of these services has come under strain, with trends towards increasing private healthcare services in the sector. In other countries, social insurance coverage is an important factor in accessing healthcare services, particularly where Government expenditure accounts for a lower amount of total expenditure on health. Moreover, with the coverage of social insurance often limited to formal sector workers, those outside these formal social safety nets must bear the individual financial burdens of healthcare costs.[219]

3. *The rights-based process and civil society organizations*

The right-to-development approach holds Governments accountable to services and outcomes and, moreover, to processes of development that are in accordance with human rights. This entails the right of individuals to participate in transparent and inclusive processes of governance. The presence of civil society varies within the region. In general, while some civil society organizations and charities have been active in providing social assistance to vulnerable groups, there is no tradition in advocacy and little participation as an active voice in the public sphere.

4. *Equal value of individuals in policies*

The right to development stipulates that all individuals hold rights that have universal intrinsic value. It is the duty of the Government to uphold these rights and enable individuals to exercise their rights. As all individuals are equal holders of rights, the Government must address them with equal concern throughout its programmes and allocation of resources.

Moreover, individuals are entitled to high-quality services and the Government has an obligation to ensure that these are provided, particularly to those in need of such services. In addition to legislating for these rights, Governments therefore have the duty to implement policies and programmes aimed at providing for the rights of vulnerable groups, including the disabled. This implies the provision of treatment and rehabilitation, and policies to promote their inclusion and equal access. Legislation to safeguard and promote the rights of disabled persons has been enacted in several member countries. However, this needs to be followed up with policies aimed at raising awareness of these rights among the disabled population and society at large, and at promoting the inclusion of disabled persons in society in order to enable them to exercise their rights.

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[219] In Yemen, the coverage of primary healthcare services is not comprehensive, particularly in rural areas, thereby resulting in comparatively high out-of-pocket expenditures. In the Syrian Arab Republic, despite improvements in healthcare services and public health expenditure, there remains a strong need for improvements in the management of the health sector, equal distribution of resources according to geographic area, and the drafting of a national system of health insurance. In Lebanon, the health sector was largely privatized during the civil war and has resulted in healthcare delivery that is unaffordable for large sections of the population. By contrast, households in Jordan living under the national poverty line are entitled to free treatment in the public sector, and the majority of the population that is not covered by health insurance largely comprises unemployed 20-34 year-olds from middle-income households.

D. Policy implications

The right to development entails devising a rights-based strategy of development and creating a transparent, accountable, legal and institutional infrastructure in which to promote the rights of individuals. Moreover, by focusing on processes of development, it ensures that policies target vulnerable populations towards equal opportunities, and that policies and programmes are accessible to all groups and individuals in society.

Rather than providing piecemeal cash assistance as survival mechanisms, social policies become enablers of social rights that address marginalization and deprivation. The provision of social security must be widened to ensure universal coverage and inclusion of vulnerable populations. Specifically, quality education and access to healthcare and social insurance must be made accessible to all populations and are instrumental to future employment. Basic human rights standards and frameworks are contained within human rights instruments and plans of actions.

Consequently, the ratification of human rights conventions and translation of their provisions into the national legislative and institutional environment are an instrumental first step towards the fulfilment of the right to development. Furthermore, such strategies and plans need to be elaborated within the confines of their fiscal constraints and implications.

1. *Priority on youth employment*

The sheer demographic force of youth calls for an urgent response to their needs and rights to income-generating activities that match their education, aspirations and demand for adequate wages. While employment opportunities will ultimately depend on economic policies to generate jobs, policies need to be put in place to facilitate the transition of youth to the labour market. Current fragmented and dislocated education and vocational training policies need to be channelled through a comprehensive strategy that links curricula and skills to labour market needs.

The right to development entails the right of youth to decent employment and to participate in their development as agents of change. The current despondency of youth and their sense of disengagement with the decision-making process serve to further hinder their development. Policies that promote youth employment must therefore ensure the participation and empowerment of youth.

Within that context, the Youth Employment Network assists countries to develop national plans of action on youth employment aimed at providing a holistic framework with which to tackle the burdens of youth unemployment. The focus is both on the creation of employment and on decent employment that guarantees basic employment rights. In the case of Egypt, the Network has assisted in drafting a national action plan on youth employment in cooperation with various ministries and worker, employer and youth representatives. There is a need to promote more capacity-building towards this framework in order to enhance youth employment at the national and regional levels.

Despite discussions by the United Nations Programme on Youth on establishing a youth development index, there are currently no youth-specific indicators to measure the dynamics of poverty, globalization and development on youth. However, there is a strong need to collect, monitor and develop statistical data regarding the situation of youth, thereby capturing their experiences and the multiple issues that they confront. In that respect, a youth development index needs to include indicators that reflect and measure regional specificities in the process of youth-to-adult transition.

Box 4. Right to development

The right to development represents a convergence of thinking along the development trajectory. It merges the human development and human rights approaches to development, defined as follows:

(a) *Human development*: The human development paradigm promotes the expansion of the capabilities and freedoms of individuals by addressing institutional barriers, environmental arrangements and resource constraints. It is essentially a goal-oriented approach that is primarily concerned with the social arrangements needed in place to realize individual needs:

(b) *Human rights*: The human rights approach focuses on the entitlements of individuals to secure their capabilities and freedoms. Moreover, it emphasizes the duties of the State and other agents of development to provide, facilitate and promote these rights. It is concerned with how the goals of development are being realized and whether the process is in accordance with human rights standards.

The right to development paradigm integrates the human development and human rights approaches into a holistic framework without prejudicing one against the other. It goes beyond the focus on outcomes of freedoms and capabilities to a focus on the social, political and cultural process in realizing rights and freedoms. The goals of human development are converted into human rights claims whereby each social, economic, civil and political right is vital "not just in their instrumental roles but also in their substantive constitutive role".[a/] Each right must be implemented in a rights-based manner through a process that respects international human rights standards agreed upon in international treaties and declarations, as well as the human rights principles of transparency, accountability, equality, participation, non-discrimination, universality and indivisibility. National development programmes must be implemented in accordance with the right-to-development approach that sets out the following:

(a) The State has primary responsibility for implementing the right to development and, to this end, for coordinating with all levels of Government and public institutions as well as other relevant stakeholders, civil society organizations, national, regional and international agents;

(b) In providing goods and services, both the availability of and access to resources are equally important. Consequently, macroeconomic stability and the efficient allocation of resources are twinned with the distribution of resources through institutions and social arrangements targeted to expand individual capabilities and freedoms;

(c) A progressive, step-by-step realization of rights as the complex interdependent nature of rights renders it difficult to fulfil and implement all rights concurrently;

(d) Human rights principles of accountability, transparency, equality, non-discrimination, universality and indivisibility must be adhered to throughout the process of development;

(e) The potential of civil society organizations in terms of implementing and monitoring principles of accountability, transparency and participation must be emphasized;

(f) All individuals hold rights that have universal intrinsic value. It is the duty of the State to uphold these rights and to enable individuals to exercise their rights.

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a/ Economic and Social Council, "Fourth report of the independent expert on the right to development, Mr. Arjun Sengupta, submitted in accordance with Commission resolution 2001/9" (20 December 2001), para. 8.

Economic employment generation and poverty alleviation in deprived communities can decrease incentives for workers in search of alternative sources of income, thereby fulfilling the right to "making the option of staying in one's country a viable option for all".[220]

By focusing on the rights of migrants, migration policies must address the welfare and poverty alleviation strategy of migrant workers. In order to offset the vulnerability of intraregional migrants, there is a need for an interregional transfer of social security benefits through, for example, a regional labour mobility framework aimed at managing the transfer of labour, benefits and social security and, therefore, at guaranteeing the rights of migrants to income security and well-being.

3. *Integrated social policies*

The State needs to adopt an integrated approach to social policies if it is to fulfil its duties in terms of providing basic services, social security and social insurance. There are some trends in the region towards an integrated social policy approach aimed at addressing multiple processes of poverty entrapment. In so doing, a focus on the fulfillment of social rights, needs and entitlements can ensure that this agenda responds to needs and provides people with the tools to lift themselves out of poverty, rather than focusing on mere survival mechanisms.

Recognizing that coherent and harmonized social policies are the pillars of unity, equality and social justice in every State, ESCWA has been promoting the integrated social policies framework since 2001 to highlight the vital link between social policies and economic stability, and to focus on the need to place policies centered on individuals within the same strategic framework in all Arab countries.

The practice of social policy in the countries of the region has often been uncoordinated, outdated or lacking in relevance in terms of national specificities. This weakness at the national level has been further aggravated by political, social and economic instability, thereby resulting in a waste of financial and natural resources. Most critically, the shortcomings in social policy practice have had a detrimental impact on the population, who represent the most valuable national resources.

In order to remedy this situation, Governments and related stakeholders must have the necessary status, resources and information for taking ownership of and giving high priority to the design, implementation, institutionalization and monitoring of flexible and well-informed policies.

Within the current phase of the integrated social policies framework, national conferences on promoting social policies are set to be held in ESCWA member countries aimed at enhancing the well-being of Arab citizens through national ownership of informed, integrated social policies that operate within a purposeful framework of policy action. These national conferences will dissect existing social policy frameworks in each country, and use success stories in policy practice to determine country-specific characteristics of mechanisms required for the effective design, implementation, coordination and evaluation of home-grown social policies.

4. *Urban governance*

The realization of housing rights, secure tenure and urban governance represent key social rights and, moreover, are crucial in terms of reducing poverty and achieving the MDGs. These rights encompass the legal security of tenure; availability of services, materials, facilities and infrastructure; affordability;

[220] B. Shakoori, "Demographic transition and its implications on employment and international migration" (ESCWA, 2006), p. 16.

4. *Urban governance*

The realization of housing rights, secure tenure and urban governance represent key social rights and, moreover, are crucial in terms of reducing poverty and achieving the MDGs. These rights encompass the legal security of tenure; availability of services, materials, facilities and infrastructure; affordability; habitability; accessibility; location accessible to basic social facilities; and cultural adequacy.[221] Policies must aim to provide adequate and affordable housing, and to improve the quality and safety of urban environments through a sound framework of urban governance. Stronger linkages need to be established between the provision of housing and improving the urban setting and urban management.

Additionally, priority must be given to expanding access to such basic services as drinking water, a cleaner environment, and safe and secure housing, particularly in lower-income areas and informal settlements in the region. Within that context, ESCWA continues to promote the Regional Campaign on Secure Housing and Land Tenure and Good Urban Governance to assist member countries in terms of strengthening urban governance.

5. *Rights-based approach to vulnerable groups: disabled persons*

International standards and rules of procedure on disability, including the Standard Rules on the Equalization of Opportunities for Persons with Disabilities, emphasize the importance of guaranteeing the rights of disabled persons through national legislative and institutional frameworks.[222]

Currently, the Declaration on the Rights of the Disabled Persons of 9 December 1975 stipulates the rights of disabled persons to include the following: (a) the inherent right to respect for their inherent human dignity and to enjoy a decent life as normal as possible; (b) the same civil and political rights as other human beings; (c) entitlements in order to allow disabled persons to become as self-reliant as possible; (d) right to medical, psychological and functional treatment; medical and social rehabilitation; education, vocational training and rehabilitation; aid, counselling, placement services; and other services that enable them to develop their capabilities and skills in order to facilitate their social integration/reintegration; (e) right to economic and social security and a decent level of living; (f) right to secure and retain employment, according to their capabilities, or to engage in useful, productive and remunerative occupations and join trade unions; (g) entitlement to the special needs of disabled persons to be taken into consideration at all stages of economic and social planning; (h) right to live with their families or with foster parents, and to participate in all social, creative and recreational activities; and (i) right to protection against all exploitation.

In addition to access to quality medical treatment and rehabilitation, the rights of disabled persons include such services and opportunities as education and employment that are afforded to other members of society. In order that these rights be fully realized, it is necessary to raise awareness and address social, physical and attitudinal barriers to the full integration of disabled persons in society. This requires the injection of resources and a priority accorded to disabled persons equal to all other able-bodied members of society.

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[221] The right to housing entails the right to live in security, peace and dignity. Office of the High Commissioner for Human Rights, "The right to adequate housing (Art. 11 (1)): 13/12/91. CESCR General comment 4" (1991).

[222] The current draft on a convention on disability can provide a sound framework with which to translate the rights of disabled persons into national legislation.

VIII. CONCLUSIONS

Development concerns the unleashing of human potential and broadening the choices of people. It is a fair and balanced outcome that combines the right to food with the right to vote. Moreover, development is freedom from hunger, oppression and from all that stands in the way of people shaping their own future.[223]

Choosing the appropriate development strategy is a function of the overall vision for the future of the economy and society, and of the context defining the parameters within which such a strategy will be articulated. It is crucial to start with a correct appreciation of the forces that shape the present, and the full legacy of the past without losing sight of the long-term objectives of development. This prospective and thorough assessment of the undercurrents of this particular historical process form the connecting grounds that allow the pursuit of development objectives.

More decisively, it reorients policy in a way that cushions the costs of short-term economic experiments with liberalization, fosters an agenda that cuts across the divide of economic efficiency and social values, and promotes the idea of development as a human right.

The intrinsic value of the right to development, with the Millennium Declaration at its pinnacle, has been widely recognized. In essence, the right to development is an "inalienable human right by virtue of which every human person and all peoples are entitled to participate in, contribute to, and enjoy economic, social, cultural and political development, in which all human rights and fundamental freedoms can be fully realized".[224]

This right includes the following: (a) full sovereignty over natural resources, including self-determination and popular participation in development; (b) the right to work and equality of opportunity; (c) the creation of favourable conditions for the enjoyment of other civil, political, economic, social and cultural rights; and (d) peace and security, which are essential elements for the realization of the right to development.

The individual is identified as the beneficiary of the right to development, as of all human rights. The right to development can be invoked both by individuals and by peoples. It imposes obligations on individual States to ensure equal and adequate access to essential resources, and on the international community to promote fair development policies and effective international cooperation.[225] Recognizing the right to development and the international covenant on economic, social and cultural rights, the State must bridge the wealth divide through public or private economic policies, thereby promoting the right to decent work and the right to comprehensive development.

This Survey reaffirms that, across the ESCWA region, much of the economic policies are concentrated in the competence of the State. It is therefore the efficiency and practicality of public policies that need to be accountable and come under independent public scrutiny. The role of economic policy and, more specifically, of fiscal policy is to find the appropriate regime that mediates disparate developments and puts interest back in the national and regional economies.

Moreover, the ESCWA region is interconnected with the global economy to the extent that it is unfeasible to lock in resources for development without international cooperation. Specifically, the international community has the "responsibility to create a global environment conducive for development. Indeed, by virtue of their acceptance and commitment to the legal instruments, the members of the

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[223] Sen, A.K. *Development as Freedom*, (1999) Oxford University Press.

[224] General Assembly resolution 41/128 of 4 December 1986 on the Declaration on the Right to Development, Article 1.1, which is available at: http://www.unhchr.ch/html/menu3/b/74.htm.

[225] Ibid.

international community have the obligation to support effectively the efforts of those States that set for themselves the goal of realizing human rights, including the right to development, through trade, investment, financial assistance and technology transfer".[226]

Without this rudimentary cornerstone of an economic strategy designed to reduce poverty and unemployment, it is unlikely that any economic programme of action can meet the basics of human rights and to secure the right to development. Consequently, this year's Survey analysed and examined the progress made by ESCWA member countries with regard to the right to development; and sought to shed some light on the social and economic relationships that tie down the fulfillment of development as a right, with emphasis on MDGs and the 2005 World Summit Outcome.

A. THE REGION IN PERSPECTIVE

The Survey identified unemployment as the most pressing policy imperative; and each chapter focused directly or indirectly on this issue. The failure to meet the target of poverty alleviation under the right to development points to shortcomings in the way various national institutions relate to each other and to the outside world.

It is at this fundamental level that disparities in development were explored and the causal mechanisms were laid bare in this Survey, particularly in terms of making social policy central to economic policy, expanding public investment, strengthening regional cooperation, and relinquishing moderately inflation targeting. When development is enshrined as a right, it becomes the responsibility of all participants. Furthermore, in a globalizing world, the accountability cuts across national boundaries. Development as a right must therefore be a combined regional and international effort.

Oil rents continue to polarize the regional economy. A highly capitalized oil sector created few jobs relative to the capital invested in it and, as an adjunct, the expansion of decent employment occurred through patronage in the public sector. However, that expansion was insufficient to absorb the high rate of new entrants into the labour force. In the presence of weak financial intermediation between money assets that accrue from oil wealth and physical capital and a healthy rise in income associated with rising productivity, the rest of the regional economy leaned progressively more towards the service and informal sectors.

These sectors already hire more than ten million extra-regional workers and pay out poverty wages far below the reservation income of nationals. If, instead, these ten million jobs had been diverted to workers from the region under the guise of an effective framework of regional economic cooperation, then the domestic demand component could have positively tilted the development course of the region.

Rather than replacing migrant labour with domestic or regional labour, the point being made here concerns regularizing existing foreign labour in decent jobs and hiring preferentially surplus domestic and regional labour in newly available jobs. The relationship of extra-regional labour with the domestic economies needs to be determined on the basis of the relatively lower consumption and savings ratios and the minor contribution they make to income relative to domestic or regional labour.

A virtuous circle cannot arise in the ESCWA region merely by tapping profits from short-term financial and commercial activity in oil rents. If and when the very volatile oil price tumbles, it will put in check a whole mode of development that is predominantly based on oil revenues. It is not difficult to foresee that the oil rush is not sustainable. Oil prices began to fall in 1984 and lacklustre prices lasted well into 2002, which impacted GDP growth, Government expenditure and total employment.

[226] Economic and Social Council, "Review of progress and obstacles in the promotion, implementation, operationalization, and enjoyment of the right to development" (E/CN.4/2004/WG.18/2) (United Nations, 17 February 2004).

Furthermore, while deepening labour force differentiation enhances short-term rents in all the economic sectors, it is important to recall the overarching condition of geopolitical risk and its impact on inter-temporal preferences, institutional stringency and an already uneven developmental State that is inherent in all the member countries.

From the standpoint of the ESCWA region, the appropriate development strategy has to be addressed within the context of risky small markets with low absorptive capacities. At one end of the spectrum, Yemen as a least developed country (LDC) had a real per capita average income of $530 in 2004 (2000 base year), while, at the other end, the real per capita income of Qatar was estimated at $36,161, which represents some sixty eight times that of Yemen.[227]

Within the existing institutional context, presumptive redistribution that reduces concentrations of private wealth and increases interest in regional development is highly unlikely either within or across member countries. The interregional/intraregional wealth and income divides between lowest and highest quintiles/deciles in this region is highest globally. Specifically, some two trillion dollars in excess savings have been divested outside the region over the past three decades.

Moreover, the inherited forms of social bonding along confessional, ethnic and tribal lines were reinforced by the constraints imposed on the post-independent States. This means that there is a high degree of dislocation between social and economic conditions; and that progress in fostering a common denominator across national or neighbouring social groups will remain slow without a greater degree of decision-making drawn from an acknowledgment of the rights of all citizens.

Mounting political instability, compounded by stresses owing to institutional development, has further discouraged individuals from participating in the development process and has caused persistent leakages. Despite excess savings, the ESCWA region is off track in terms of meeting many of the MDGs. Conflicts, particularly in Iraq and Palestine, obstruct substantially investments in infrastructure, plant and equipment and create social schisms that set back social development for a very long time.

Moreover, political instability shifts the accent in development to stabilization efforts and limits the public input in the decision-making process. It draws resources away from social and economic capital into the process of reinforcing political capital. Consequently, institutions tend to be remoulded with an eye on security concerns, which perpetuates sluggish and highly erratic economic growth.

This reinforcement of political capital further distorts income distribution and wealth in favour of political strongholds, which adds weight to the euphemism of "privately-owned public sector". The weak post-independence starting point and successive conflicts have weakened the accountability of institutions, and have sapped resources to the point where development has fallen short of fulfilling the desired end as a human right.

B. General policy emphasis

This Survey has underscored the need for a radical shift in development policy in the ESCWA region in order to keep pace with the demands of development as a right and to achieve the MDG of halving poverty by 2015. Rather than launching from an academic diagnostic of the economic mechanism that lies behind the shortfall, this Survey sought to expose the ways in which different social groups and regional and extra-regional institutions are related to each other, and are situated with regard to the allocation of national or regional resources.

[227] These are ESCWA estimates.

In a context of continuing dependency, deepening national and social rifts hollow out the role of the State as the enabler of a common will, and accentuate the negative impact of the international division of labour. When governance that is accountable to the public weakens, sovereignty over national resources also tends to weaken. In other words, the national ownership of domestic resources must mean unequivocally that nationals own their resources and that the institutional context facilitates that ownership.

The latter operational requirement implies that the issue of governance incorporates national and international dimensions simultaneously. This is particularly the case given that the international liberalization of resources, including free capital movement, implies anti-development flows. Locking in resources for the purpose of development in an otherwise capital-rich developing region requires close links between the social and political orders.

Given that this realignment of social and political interests has not occurred, there is a need to understand why globalization undermines development in some countries in the ESCWA region and not in others, and why the issue of good governance is a matter that applies exclusively to small developing States. A point of departure for policies advocating rights-based development is to explore how to connect regional and national forces in a joint programme of action for development.

If the ESCWA region is to achieve the right to development over the next decade, it will require decent employment-generating economic growth. However, this entails more than simple changes in the growth optimization strategies of member countries, or minor adjustments to fiscal and monetary policies. Specifically, it involves a shift in the institutional parameters that contribute to heightened regional insecurity, block greater efficiency in investment and inhibit closer regional coordination.

In that light, the State or the institution responsible for development could find it difficult to reinvent itself as a mediator of various national and social interests, to guarantee further welfare that enhances capital accumulation, and to implement comprehensively policies or clauses that contain conflicts of interest. Harbouring a long-term view of development implies that the neighbourhood effect must figure prominently in the analysis, and that the issue of regionalism becomes a corollary to the issue of development as a human right.

The fundamental premise of the right to development is that freedom represents, essentially, a logical predicate of development. Social achievements accomplished by participatory democracy are safeguarded and hard to reverse. While development can proceed under conditions of partial or selective democracy, this remains susceptible to dissolution given that its achievement also represents a partial or selective realization of the public will and aspiration. Partial and selective democracies exclude significant sections of the population from representation, even if they appear otherwise through prevailing voting systems.

Within that context, the essence of the democratic process is undermined by several factors, including the absence of an unbiased flow of information; lack of provision of basic needs, thereby rendering social groups vulnerable to manipulation en masse; poor institution of legal rights; and the perceived precariousness of the State as a viable institution. The regional social structure is organized in such a way that there is little room for input into the developmental decision-making process. However, there is a temporary trade-off between participatory democracy and development under the duress of external threat conditions. In such a case, the developmental process must not come at the expense of individual human rights.

Meeting the concerns of development as a human right requires a process of capital accumulation that guarantees the right to work. In the light of the rental mode of accumulation that fails to generate employment and of the eroding effects of liberalized adjustment on welfare in the 1990s, absolute poverty levels have risen in some areas, partly as a result of a skew in income distribution against the poor. This

Survey has listed many tools aimed at stabilizing or enhancing income distribution measures needed for the ESCWA region.

When savings outstrip investment by a ratio of nearly two to one, there is a tendency to maintain that the rich save while the poor do not and that, consequently, income inequality is good for development in the early stages. However, current account surpluses in the countries of the GCC are largely related to capital exports from the region. That so little has been done to redress national and regional income distribution could be attributed to the structure of institutions that intensifies social and cultural differences, while maintaining the current mode of acquisition of rents.

Despite the ability to afford the luxury of equity and various forms of social security valves and mechanisms, member countries cannot enjoy the long-term stability needed to maintain sustainable social programmes as long as oil rents remain volatile and as there is a bias for commercial, as opposed to national, industrial capital.

The right to development must therefore be realized through a programme of coordinated regional action. Under the right-to-development approach, development plans are implemented through a regional development compact, and with an emphasis on regional and international cooperation. Under the regional development compact, ESCWA member countries could undertake to fulfil their national human rights obligations under the right to development, while the international community could provide the necessary safeguards to assist an agenda of industrial development and regional cooperation.

To that end, the immediate points to consider are as follows: (a) joint regional investment facilitated by intraregional trade and access to markets; (b) intraregional transfer of resources and technology; (c) protection and guarantees for regional labour and capital, including, for example, preferential legislation that facilitates the flows of regional labour and capital; and (d) restructuring the regional financial system in order to provide a greater share of power and decision-making to those member countries endowed with less capital, and to increase the flow of private capital to their economies.

Development under occupation or conflict, particularly in Palestine and Iraq, is potentially reversible and highly tenuous, which contravenes the International Bill of Human Rights. While in such cases national security and personal safety are clearly policy imperatives, the long-term strategy for development and control over national resources must remain under the jurisdiction of the national populations.

This meagre development across the region can be attributed to a historical process that has shaped institutions under strong external influence, and continuing political tensions and risks. This has resulted in a highly inequitable and fragmented market that is incapable of retaining resources. In short, the post-independence institutional structure, which has been reconditioned by wars or by the prospects of war, attenuates the progress towards the right to development. In the ESCWA region, the right to development is synonymous with the right to security, and this can only come as a result of international collaboration.

International relations and economic imbalances, particularly the dollar as an overstretched global currency, have become more dependent on the prolongation and/or outcome of the conflict in Iraq. The peoples of the Middle East are duly entitled to peace and security. Moreover, they are ready for the speedy implementation of international resolutions relating specifically to the rights of people to development, peace, justice and self determination.

Annex I

STATES SIGNATORY TO INTERNATIONAL CONVENTIONS IN THE ESCWA REGION

Legislation related to human rights	Bahrain	Egypt	Iraq	Jordan	Kuwait	Lebanon	Oman	Qatar	Saudi Arabia	Syrian Arab Republic	United Arab Emirates	Yemen
International Conventions												
International Covenant on Economic, Social and Cultural Rights (ICESCR) of 16 December 1966	✗	✓	✓	✓	✓	✓	✗	✗	✗	✓	✗	✓
		14 Jan 1982	25 Jan 1971	28 May 1975	21 May 1996 acceded	3 Nov 1972 acceded				21 Apr 1969 acceded		9 Feb 1987 acceded
International Covenant on Civil and Political Rights (ICCPR) of 16 December 1966	✗	✓	✓	✓	✓	✓	✗	✗	✗	✓	✗	✓
		14 Jan 1982	25 Jan 1971	28 May 1975	21 May 1996 acceded	3 Nov 1972 acceded				21 Apr 1969 acceded		9 Feb 1987 acceded
Optional Protocol to ICCPR of 23 March 1976	✗	✗	✗	✗	✗	✗	✗	✗	✗	✗	✗	✗
Second Optional Protocol to ICCPR, adopted and proclaimed on 15 December 1989	✗	✗	✗	✗	✗	✗	✗	✗	✗	✗	✗	✗
International Convention on the Elimination of all forms of Racial Discrimination (ICERD) of 21 December 1965	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
	27 Mar 1990 acceded	1 May 1967	14 Jan 1970	15 Dec 1995 acceded	15 Oct 1968 acceded	12 Nov 1971 acceded	2 Jan 2003 acceded	22 Jul 1976 acceded	23 Sep 1997 acceded	21 Apr 1969 acceded	20 Jun 1974 acceded	14 Oct 1972 acceded
Convention on the Elimination of all Forms of Discrimination Against Women (CEDAW) of 18 December 1979	✓	✓	✓	✓	✓	✓	✓	✗	✓	✓	✓	✓
	18 Jun 2002 acceded	18 Sep 1981	13 Aug 1986 acceded	1 Jul 1992	2 Sep 1994 acceded	16 Apr 1997 acceded	7 Feb 2006 acceded		7 Sep 2000	28 Mar 2003 acceded	6 Oct 2004 acceded	30 May 1984 acceded

Legislation related to human rights	Bahrain	Egypt	Iraq	Jordan	Kuwait	Lebanon	Oman	Qatar	Saudi Arabia	Syrian Arab Republic	United Arab Emirates	Yemen
Optional Protocol to CEDAW of 10 December 1999	✗	✗	✗	✗	✗	✗	✗	✗	✗	✗	✗	✗
Convention against Torture and Other Cruel, Inhuman or Degrading Treatment or Punishment (CAT) of 10 December 1984	✓	✓	✗	✓	✓	✓	✗	✓	✓	✓	✗	✓
	6 Mar 1998 acceded	25 Jun 1986 acceded		13 Nov 1991	8 Mar 1996 acceded	5 Oct 2000 acceded		11 Jan 2000 acceded	23 Sep 1997 acceded	19 Aug 2004 acceded		5 Nov 1991 acceded
Optional Protocol to CAT of 18 December 2002	✗	✗	✗	✗	✗	✗	✗	✗	✗	✗	✗	✗
Convention on the Rights of the Child (CRC) of 20 November 1989	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
	13 Feb 1992 acceded	6 Jul 1990	15 Jun 1994 acceded	24 May 1991	21 Oct 1991	14 May 1991	9 Dec 1996 acceded	3 Apr 1995	26 Jan 1996 acceded	15 Jul 1993	3 Jan 1997	31 Apr 1991
Optional Protocol to CRC on the involvement of children in armed conflict of 25 May 2000	✓	✗	✗	✓	✓	✓	✓	✓	✗	✓	✗	✗
	21 Sep 2004 acceded			6 Sep 2000 signatory	26 Aug 2004 acceded	11 Feb 2002 signatory	17 Sep 2004 acceded	25 Jul 2002 acceded		17 Oct 2003 acceded		
Optional Protocol to CRC on the sale of children, child prostitution and child pornography of of 25 May 2000	✓	✓	✗	✓	✓	✓	✓	✓	✗	✓	✗	✓
	21 Sep 2004 acceded	12 Jul 2002 acceded		6 Sep 2000 signatory	26 Aug 2004 acceded	8 Nov 2004	17 Sep 2004 acceded	14 Dec 2001 acceded		15 May 2003 acceded		15 Dec 2004 acceded
International Convention on the Protection of the Rights of All Migrant Workers and Members of their Families (ICMWR) of 18 December 1990	✗	✓	✗	✗	✗	✗	✗	✗	✗	✓	✗	✗
		19 Feb 1993 acceded								2 Jun 2005 acceded		

Legislation related to human rights	Bahrain	Egypt	Iraq	Jordan	Kuwait	Lebanon	Oman	Qatar	Saudi Arabia	Syrian Arab Republic	United Arab Emirates	Yemen
United Nations Convention against Corruption (CAC) of 9 December 2003	✓	✓	✗	✓	✓	✗	✗	✓	✓	✓	✓	✓
	9 Feb 2005 signatory	25 Feb 2005		24 Feb 2005	9 Dec 2003 signatory			1 Dec 2005 signatory	9 Jan 2004 signatory	9 Dec 2003 signatory	22 Feb 2006	7 Nov 2005
Convention relating to the status of refugees of 28 July 1951	✗	✓	✗	✗	✗	✗	✗	✗	✗	✗	✗	✓
		22 May 1981 acceded										18 Jan 1980 acceded
Protocol relating to the status of refugees of 4 October 1967	✗	✓	✗	✗	✗	✗	✗	✗	✗	✗	✗	✓
		22 May 1981 acceded										18 Jan 1980 acceded
Fundamental conventions of the International Labour Organization (ILO)												
Freedom of Association and Protection of the Right to Organize Convention of 1948	✗	✓	✗	✗	✓	✗	✗	✗	✗	✓	✗	✓
		6 Nov 1957			21 Sep 1961					26 Jul 1960		29 Jul 1976
Right to Organize and Collective Bargaining Convention of 1949	✗	✓	✓	✓	✗	✓	✗	✗	✗	✓	✗	✓
		3 Jul 1954	27 Nov 1962	12 Dec 1968		1 Jun 1977				7 Jun 1957		14 Apr 1969
Forced Labour Convention of 1930	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
	11 Jun 1981	29 Nov 1955	27 Nov 1962	6 Jun 1966	23 Nov 1968	1 Jun 1977	30 Oct 1998	12 Mar 1998	15 Jun 1978	26 Jul 1960	27 May 1982	14 Apr 1969
Abolition of Forced Labour Convention of 1957	✓	✓	✓	✓	✓	✓	✓	✗	✓	✓	✓	✓
	14 Jul 1998	23 Oct 1958	15 June 1959	31 Mar 1958	21 Sep 1961	1 Jun 1977	21 Jul 2005		15 Jun 1978	23 Oct 1958	24 Feb 1997	14 Apr 1969
Discrimination (Employment and Occupation) Convention of 1958	✓	✓	✓	✓	✓	✓	✗	✓	✓	✓	✓	✓
	26 Sep 2000	10 May 1960	15 Jun 1959	4 Jul 1963	1 Dec 1966	1 Jun 1977		18 Aug 1976	15 Jun 1978	10 May 1960	28 Jun 2001	22 Aug 1969
Equal Remuneration Convention of 1951	✗	✓	✓	✓	✗	✓	✗	✗	✓	✓	✓	✓
		26 Jul 1960	28 Aug 1963	22 Sep 1966		1 Jun 1977			15 Jun 1978	7 Jun 1957	24 Feb 1997	29 Jul 1976

Legislation related to human rights	Bahrain	Egypt	Iraq	Jordan	Kuwait	Lebanon	Oman	Qatar	Saudi Arabia	Syrian Arab Republic	United Arab Emirates	Yemen
Minimum Age Convention of 1973	✗	✓	✓	✓	✓	✓	✓	✗	✗	✓	✓	✓
		9 Jun 1999	13 Feb 1985	23 Mar 1998	15 Nov 1999	10 Jun 2003	21 Jul 2005	3 Jan 2006		18 Sep 2001	2 Oct 1998	15 Jun 2000
Worst Forms of Child Labour Convention of 1999	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
	23 Mar 2001	6 May 2002	9 Jul 2001	20 Apr 2000	15 Aug 2000	11 Sep 2001	11 Jun 2001	30 May 2000	8 Oct 2001	22 May 2003	28 Jun 2001	15 Jun 2000
Latest periodic reports submitted to committee bodies on international conventions												
ICESCR	Not party	3rd report	3rd report	2nd report	1st report	1st report	Not party	Not party	Not party	3rd report	Not party	1st report
ICCPR	Not party	3rd report	4th report	3rd report	1st report	2nd report	Not party	Not party	Not party	3rd report	Not party	4th report
CRC	1st report	2nd report	1st report	3rd report	1st report	3rd report	2nd report	1st report	2nd report	2nd report	1st report	3rd report[a/]
CRC-OPSC	Not submitted	Not submitted	Not party	Signatory only	Not submitted	Not submitted	Not submitted	1st report	Not party	1st report	Not party	Not submitted
CEDAW	Not submitted	4th-5th report	2nd– 3rd reports	2nd report	1st-2nd reports	2nd report	Not submitted	Not party	Not submitted	1st report	Not submitted	5th report
ICMWR	Not party	Not submitted	Not party	Not party	Not party	Not party	Not party	Not party	Not party	Not submitted	Not party	Not party
CAT	1st report	4th report	Not party	1st report	1st report	Not submitted	Not party	1st report	1st report	Recently acceded	Not party	1st report
ICERD	6-7th report	13-16th report	14th report	9-12th report	13-14th report	14-17th reprt	1st report	9-12th report	3rd report	12-15th report	7-11th report	11-14th report

Source: Compiled by ESCWA.

a/ Available at: http://www.unhchr.ch/tbs/doc.nsf/(Symbol)/CRC.C.129.Add.2.En?OpenDocument.

Annex II

IMPACT OF WARS ON DEVELOPMENT

A. CHRONOLOGY OF WARS IN THE MIDDLE EAST

In the past 50 years, the Middle East has suffered from more wars than any other region in the world. Governments in this region continue to build military capacity, which are being facilitated by oil rents. Despite the significantly negative impact of wars on human development, there are surprisingly few studies that try to assess the effects of militarized conflicts on growth. Generally, mainstream literature on that subject is limited to the link between militarized conflicts and trade, and assesses the direction of the causality between trade and war.

However, a broader perspective needs to underscore the negative effects of wars on growth, particularly in the light of increasing public debts and tax burdens; and of the distortions of industrial production through the disproportionate expansion of militarized manufacture.

Moreover, at a societal level, political conflicts often generate tensions between different groups of the population within a country or region, which can further exacerbate prevailing social, ethnic or religious divides. This disrupts social cohesion and represents a significant barrier to economic prosperity.

Some analysts have argued that more democratic societies have better growth performances given that they promote negotiation rather than conflicts. Moreover, while conflicts have a negative impact on growth, this can be mitigated through efficient institutions. This lends considerable support to the need to change priorities and allocate higher proportions of resources to economic and social development; and to subject all parties to the conflicts of the region to the same international rules.

ANNEX II TABLE 1. CHRONOLOGY OF SOME MILITARIZED CONFLICTS IN THE MIDDLE EAST

Name/type of conflict	Dates
Arab-Israeli	1948
Suez War	1956
Civil war in Yemen	1960s
Six-Day War	1966
Yom Kippur War	1973
Civil war in Lebanon	1975-1990
Invasion of Lebanon by Israel	1982-1985
Iran-Iraq	1980-1988
First Gulf War	1990-1991
Civil war in Yemen	1990s
Second Gulf War	2003-to date

Source: Compiled by ESCWA.

B. EMPIRICAL MODEL ON THE IMPACT OF WAR ON SUPPLY-LED GROWTH

Starting from a basic supply-led growth model, this model progressively includes the variables that theory considers as important determinants of growth performance in conflict-stricken countries. Within that framework, the two main steps are as follows: (a) the introduction of a dummy variable for war and of control variables to reflect the impact of war on economic growth; and (b) proxies for the specialization into fuel extraction in order to test for the natural resource curse hypothesis.

Our starting point is the supply growth model (see MS1 in annex II table 2). The dependent variable is an approximated measure of the growth rate of GDP per capita and is the logarithm of the PPP-adjusted GDP per capita at time *t* (noted y_t) over the PPP-adjusted GDP per capita at time *t-1* as it is equivalent to the growth rate of the PPP-adjusted GDP.

$$\hat{y}_t = \log\left(\frac{y_t}{y_{t-1}}\right)$$

Three explanatory variables are taken into account to test the Solow growth model. The first one reflects the so-called converging effect. It is the lagged PPP-adjusted GDP per capita y_{t-1}. Two other variables are taken into account, namely, the log of population aged 15-64, and the log of the investment share of GDP. In the supply growth model, the population has a negative effect on the growth rate of the PPP-adjusted GDP per capita as it reduces the production per head. The negative sign is therefore in line with theory. In the neoclassical growth model, investment is the variable that positively influences the rate of growth. It is related to the idea that the amount of savings determines investment and production.

In the model MS2, two dummy variables are introduced to take into account the effect of war on growth. The first dummy variable intends to capture the effect of the two major regional conflicts of the 1980s, namely, the Iran-Iraq war from 1980 to 1988, and the height of the war in Lebanon from 1982 to 1985. In this case, the dummy variable is equal to 1 between 1980 and 1988, and zero otherwise. The second dummy variable takes into account the First Gulf War from 1990 to 1991. The dummy for war in the 1980s is negative and significant. Its sign is robust to various controls (models MS3, MS4, MS5, and MS6), thereby confirming that the conflicts of the 1980 were damaging in terms of economic prosperity.

ANNEX II TABLE 2. TESTING THE EFFECT OF WAR ON GROWTH RATE THROUGH SUPPLY-LED GROWTH

	Dependent variable (y_t/y_{t-1})											
	MS1		MS2		MS3		MS4		MS5		MS6	
GDP per capita *t-1*	-0.00	***	-0.00	***	-0.00	***	-0.00	***	-0.00	***	-0.00	***
Log (population 15-64)	-4.78	**	-6.30	***	-5.97	***	-7.12	***	-6.94	***	-3.64	
Log (investment/GDP)	-9.08	***	-8.13	***	-7.27	**	-7.63	**	-9.25	***	-6.18	
First Gulf War			0.87		-2.54		-1.66		-2.00		-2.39	
Wars in Lebanon and Iran-Iraq			-3.53	**	-3.76	**	-5.19	***	-5.64	***	-6.69	*
Democracy index					0.01		0.14		0.03		0.37	
Lagged fuel exports/exports							0.02		0.04		0.01	
Govt. expenditure/GDP									0.32	*	0.50	*
Oil price shock											5.59	*
Bahrain	-17.63	***	-19.47	***	-17.62	***	-26.16	***	-30.01	***	-23.03	
Egypt	-6.03		-1.73		-0.13		-8.77		-10.73		-19.68	
Jordan	-17.98	**	-18.17	**	-15.90	**	-25.75	***	-30.00	***	-33.04	***
Kuwait	-18.01	***	-17.56	***	-16.14	***	-23.06	***	-27.39	***	-25.77	**
Lebanon	-12.72	*	-13.33	*	0.00		0.00		0.00		0.00	
Oman	-19.96	***	-21.39	***	-19.08	***	-23.85	**	-30.08	***	-25.63	*
Saudi Arabia	-5.20		-2.49		-1.61		-5.83		-12.45		-16.35	
Syrian Arab Republic	-14.82		-12.98		-10.93		-21.73		-24.43	*	-28.37	*
Yemen	-18.74	*	-17.51	*	-15.15		-25.50	*	-29.08	**	-30.93	*
United Arab Emirates	Benchmark country											
Observations	213		213		199		162		162		140	
R-squared	0.22		0.25		0.22		0.31		0.33		0.26	

Source: Compiled by ESCWA.

Notes: * significant at 10 per cent; ** significant at 5 per cent; *** significant at 1 per cent.

Model MS3 tries to take into account one of the effects highlighted by the empirical works on social conflicts and growth. The index of democracy rates a country level of democracy from 0 to 10, with respect to general openness of political institutions, with 10 corresponding to a high level of democracy. The index of autocracy reflects the general closeness of political institutions. It is rated from 0 to 10, with 10 corresponding to a high degree of autocracy.

These two indexes are based on such variables as the regulation, competitiveness and openness of executive recruitment that reflect, respectively, the institutionalized procedures regarding the transfer of executive power, the extent to which executives are chosen through competitive elections and the opportunity for non-elites to attain executive office. There are additional criteria, including, among others, the degree of independence of the chief executive, the development of institutional structure for political expression, or the extent to which non elites are able to access institutional structures for political expression. The variable polity 2 is simply obtained by taking the difference between the index of democracy and the index of autocracy. The higher the variable, the greater is the degree of democracy. The sign of this variable is positive as expected, meanwhile its sign is non significant. Moreover, this is a very approximate proxy given that it does not take into account the existence of international institutions to solve conflicts between countries.

The next control variable (model MS4) intends to take into account the so-called natural resource curse hypothesis. The usual proxy is the share of oil production in GDP. According to the theory, a negative sign means that the greater the specialization in the production of fuel, the more adverse the effect on economic growth. The sign is positive, which signifies that contrary to received theory oil rent could represent an opportunity for the ESCWA region. The difference with existing studies can be attributed to the quality of the proxy or to the time length chosen. Previous studies start well before the end of the 1970s to avoid the background noise from the two oil shocks and the counter oil shock of the 1980s.

In the model MS5, the effect of Government expenditure is controversial in economic theory. According to neoclassical authors, higher Government spending has a negative impact as it generates many perverse effects. For example, it is sometimes argued that public spending distorts competition and that public entities are less efficient in the production of goods. However, the argument that is most often put forward is related to the crowding effect. Higher public spending will deter private investment as the correspondingly higher public debt necessary to finance investment raises the demand of financing. The resulting higher interest raises the cost of private investment and reduces its level.

Authors who adopt a more Keynesian approach consider that public spending can be beneficial to growth as production is mainly determined by aggregate demand that is a positive function of public expenditure. In addition, they consider that money is endogenous, which rules out the question of crowding effect. The co-efficiency is positive and significant that goes in the sense of the aggregate demand theory. In addition, the estimation presented here is robust as other coefficients remain relatively unchanged when this variable is introduced.

Finally, in the model MS6, the variable is constructed according to the following equation:

$$\text{oil shock}_t = \log(\text{oil price index}_t - \text{oil price index}_{t-1}) * (\text{exports}_t + \text{imports}_t)/\text{GDP}_t$$

This variable takes into account the high volatility of oil prices over the past 30 years, and the effect it could have on growth. Once this variable is introduced in the model, most of the explanatory variables become non significant even if their signs remain unchanged. This signifies that oil price volatility is a major determinant of growth for oil extracting countries.

Dummies for militarized conflicts are negative and significant, which confirms the hypothesis that peace is beneficial to growth. On the other hand, the supply side growth model does not perform in line with mainstream assumptions, given that investment has a negative impact on growth and that public expenditures have a positive impact on growth. In the Solow growth model, investment is the major determinant of growth and must be positive. In addition, public expenditure is considered as generating more perverse effects than positive effects. It must also be underlined that the coefficient of the proxy for primary product extraction is positive when theory and previous empirical works find it negative.

C. EMPIRICAL MODEL ON THE IMPACT OF WAR ON DEMAND-LED GROWTH

An alternative to supply growth models is the demand-led growth models. In a more Keynesian line, these models state that production and growth adjust to demand. In this case, explanatory variables include the different components of demand, namely: consumption C, investment I, public expenditure G, and external trade which equals exports X minus imports M.

The dependent variable is similar to that in supply-led regression, namely:

$$\hat{y}_t = \log\left(\frac{y_t}{y_{t-1}}\right)$$

Starting from a restricted version of demand-led growth, extended by the inclusion of the conflicts variable and the degree of oil specialization, the different elements of aggregate demand are progressively integrated, namely, trade balance, government spending and consumption.

The first model, MS1, has investment share of GDP as an explanatory variable. The dummy for the wars in Lebanon and Iran-Iraq and the First Gulf war are added along with the proxy for the specialization in fuel extraction. Investment has a positive and significant sign that signifies an improvement with respect to the supply model growth regressions. In addition, the proxy for primary product becomes negative in line with the natural resource curse hypothesis.

In the second model, MS2, trade balance is added to take into account oil exports. The trade balance is composed by exports minus imports of fuel, foods, goods and services. The resulting trade balance is divided by the GDP. It has a positive sign, albeit insignificant value. Moreover, the signs of variables used in the supply-led model are left unchanged. The only noticeable changes are that all the coefficients are shifted upwards, and that the dummy variable for the wars in Lebanon and Iran-Iraq becomes significant at 10 per cent.

ANNEX II TABLE 3. TESTING THE EFFECT OF WAR ON GROWTH RATE THROUGH DEMAND-LED GROWTH

	Dependent variable (y_t/y_{t-1})									
	MS1		MS2		MS3		MS4		MS5	
Investment over GDP	0.21	**	0.34	***	0.38	***	0.43	**	0.44	**
First Gulf War	0.69		1.27		0.64		0.51		0.33	
Wars in Lebanon and Iran-Iraq	-2.46		-3.34	*	-3.94	**	-3.76	*	-3.67	*
Lagged share of fuel exports	-0.02		-0.07		-0.12		-0.13		-0.13	*
Trade balance over GDP			1.75		14.68	***	18.24	*	19.76	*
Share of Govt. expenditure in GDP					0.70	***	0.68	***	0.69	***
Consumption over GDP							7.63		10.76	
Democracy index									-0.17	
Bahrain	2.71		8.24		8.19		8.11		7.10	
Egypt	5.57		10.26	**	19.26	***	18.67	***	18.09	***
Jordan	2.82		5.85		8.80		7.53		6.11	
Kuwait	1.02		6.98		3.87		3.19		2.03	
Lebanon	1.05		4.22		14.03	***	12.53	*	0.00	
Oman	13.02	*	20.71	***	15.45	**	15.33	*	13.74	*
Saudi Arabia	2.63		9.57		4.51		4.09		2.39	
Syrian Arab Republic	4.51		9.66	*	16.00	***	15.35	**	15.12	**
Yemen	3.94		9.37		17.15	**	16.32	*	14.85	*
United Arab Emirates	Benchmark country									
Observations	168		149		149		149		143	
R-squared	0.13		0.17		0.23		0.23		0.24	

Source: Compiled by ESCWA.

Notes: * significant at 10 per cent; ** significant at 5 per cent; *** significant at 1 per cent.

In the third model, MS3, Government expenditures are added to the set of explanatory variables. It has a positive and significant coefficient. It must be noted that the dummy for the conflicts in the 1980s becomes significant at 5 per cent, rather than at 10 per cent; and that the variable for trade balance that was insignificant becomes significant at 1 per cent. Overall, it can be said that this variable improves the quality of the regression.

In the fourth model, MS4, the last component of the aggregate demand, namely, consumption is added in the regression. It is positive, insignificant and has a mixed effect on the other variables. In the last model, MS5, a control variable for the degree of democracy is used in line with the literature on conflict and growth. While its sign is insignificant, it has the advantage of making the proxy for oil specialization significant at 10 per cent.

There is evidence that conflict has a negative impact on war and that, furthermore, promoting peace is a major factor of economic development. This result is independent of the framework used and of the controlled variables.

Annex III

GRAPHICAL DESCRIPTION OF PRO-POOR GROWTH

The International Poverty Centre of UNDP uses the following definition of pro-poor growth: "growth is pro-poor when the incomes of the poor rise proportionately more than the incomes of the non-poor". This definition is demonstrated graphically in annex III figure I, where the vertical axis is household incomes in ascending order of size, and the horizontal axis is the growth rate of those incomes. If all incomes grow at the same rate, growth is distribution neutral and all households enjoy equal proportional increases.

The positively sloped line shows the case in which the rate of growth increases with ascending distribution, which is consistent with poverty reduction. By contrast, a flatter slope can be designated as "anti-poor" growth, which, strictly speaking, is restricted to cases in which the growth rate is negative for households below the poverty line and is, consequently, a measure of unequal distribution growth. Moreover, the negatively sloped line unambiguously represents pro-poor growth, since the increase in the income of those below the poverty line is proportionately greater than for those above it.

It should be noted that the degree to which growth is pro-poor by this definition can be measured in a variety of ways. At any point in time, the growth rate of household incomes is the weighted average of the rate for the poor and the non-poor. In this annex, the following formula is used:

$g = Hg_p + (1 - H)g_{np}$ where H is head count poverty ratio;* and g_p and g_{np} are the growth rates for the poor and non-poor, respectively.

The extent to which growth is pro-poor over any time period can be measured by the following ratio:

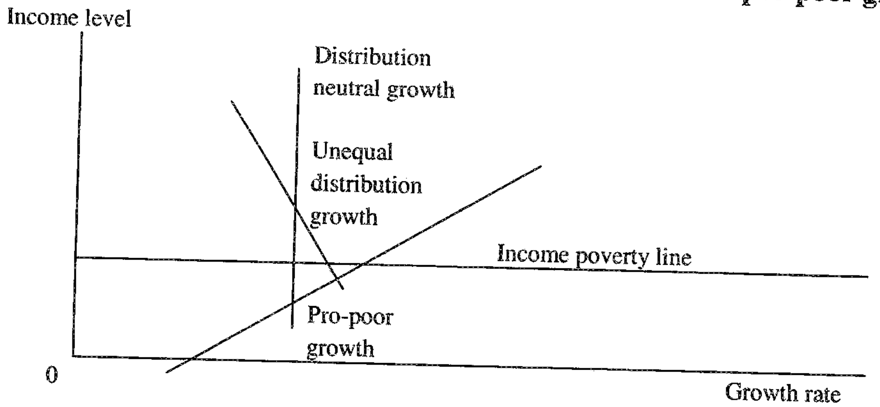
Index of pro-poor growth = IPPG = g_p/g_{np}

For any rate of growth of aggregate household income, this index is a function of the head count poverty ratio. If the aggregate rate is g*, then:

$g_p = (g - [1 - H]\, g_{np})/H$

Annex III figure II shows the index of pro-poor growth for a 5 per cent overall rate of growth and head count ratios of 30 and 50 per cent. Below an index of unity (neutral distribution growth between the poor and non-poor), a higher head count ratio results in a lower measure of pro-poor growth. This measure of pro-poor growth has the advantage of being easily measured from household surveys, assuming they are consistent in design, thereby allowing a cardinal measure of the degree to which growth is pro-poor. Its disadvantage is that the index is only defined for positive growth rates.

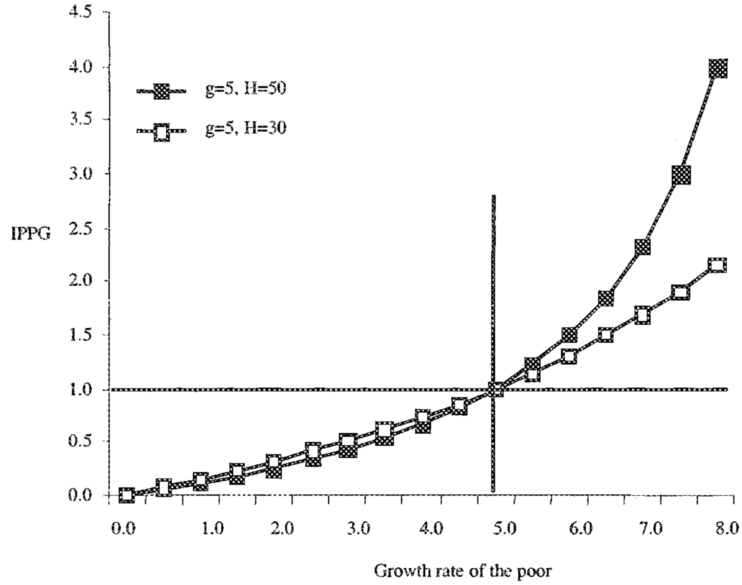
Annex III figure I. Graphical demonstration of a strict definition of pro-poor growth



Source: Calculated by ESCWA.

* The head count ratio is defined as the proportion of the population below a given poverty line.

Annex III figure II. Indices of pro-poor growth for 5 per cent growth and head count ratios of 30 and 50 per cent



Source: Calculated by ESCWA.

Annex IV

COMBINING GROWTH AND REDISTRIBUTION

For most countries, the income distribution statistics are not detailed enough to estimate accurately the change in poverty when income or distribution changes. However, many countries have summary measures of inequality, including, for example, the Gini coefficient, based on income distribution by quintiles or deciles of the population. A standard approach is to take one of these summary measures and use a distribution function that generates it, with a simple formula to assign incomes to households from the poorest to the richest.

Such a formula is assigned various parameters (or fixed numbers) until it generates the summary measure of inequality. The simplest distribution function is the Pareto, which has two parameters, namely, per capita income and an exponential inequality coefficient (which is represented below by the Greek letter α). The latter parameter determines the increase in income between any two households, for example, from the poorest to the next poorest. If the coefficient is two, the second poorest household has an income that is double that of the poorest. For an equal distribution of income, the coefficient is zero.[1]

A family of curves can subsequently be generated to show a constant degree of poverty of decreasing level as they shift to the right (see annex IV figure I). Inequality is constant for each curve; and poverty varies as a result of changes in per capita income. Given the assumption of a poverty line of $1 per day, all the curves begin on the horizontal axis at $365.

The figure clarifies the following policy alternatives: (a) redistribution of current income (RCY) involves a vertical (downwards) movement; (b) distribution neutral growth (DNG) involves a horizontal (rightwards) shift; and (c) redistribution with growth (RWG) is represented by a vector lying between the two.

Additionally, the figure below shows the case of increasing inequality growth (IIG), in which the growth of per capita income worsens the distribution of income to the extent that it leaves poverty unchanged (movement along the constant poverty level curve for P = 20 per cent).

The figure yields the following generalizations:

(a) Given that the schedules converge to the left, the impact of redistribution on poverty declines as per capita income declines. At low incomes, both redistribution and redistribution with growth are less effective relatively to distribution neutral growth;

(b) For a given per capita income, the lower the level of inequality, the greater the impact of redistribution on poverty reduction. In other words, when the poor are clustered close to the poverty line, the income transfer necessary to raise them out of poverty is less than if the same number of households were more unequally distributed.

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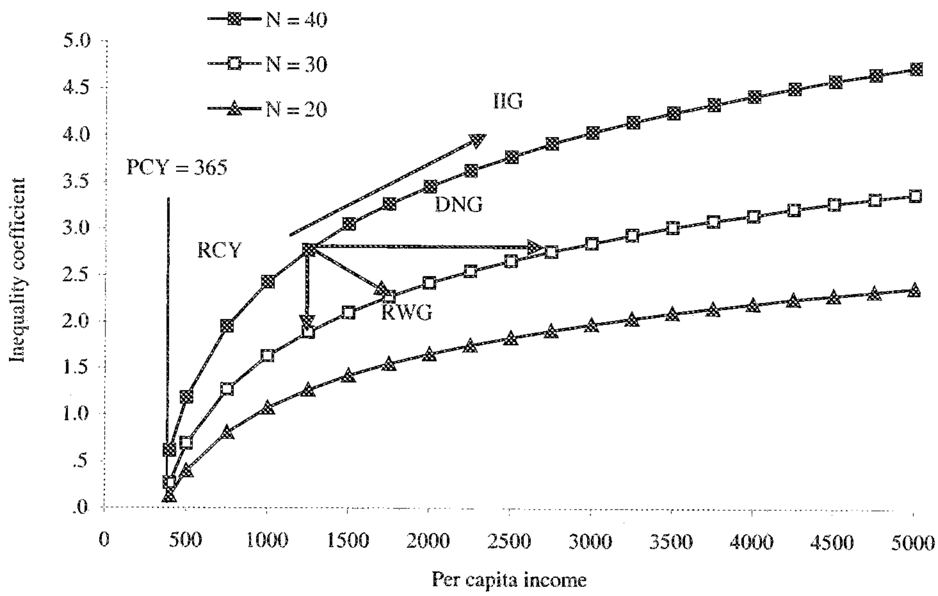
[1] The general form of the function is $Y_h = Ah^a$, where Y is the income household number h, so that h is the ordinal rank of all households from 1 to n. The letter A is a scalar to ensure that $S(?Y_1,\ Y_2 \ldots Y_n)$ = total household income. The inequality coefficient is a, which has a lower limit of zero (any number raised to a power of zero is one, so that all households have the same income) and no upper limit.

Annex IV figure I. Relationship between inequality and per capita income for constant levels of head count poverty



Source: Calculated by ESCWA.

The growth-distribution interaction on poverty reduction can also be shown for growth rates. In annex IV figure II, the percentage reduction in poverty is on the vertical axis and growth rates on the horizontal. Three lines are shown for increasing degrees of inequality as they rotate clockwise (increasing values of α holding initial per capita income constant). The figure shows that for any initial per capita income, the more growth reduces poverty, the less the inequality of the initial income distribution.

From the initial position at point a, distribution neutral growth increases the rate of poverty reduction along the schedule $\alpha = 1.3$ to point b (an increase in the growth rate with distribution unchanged); redistribution of current income involves a vertical movement to point c; and a shift from a to d is a case of redistribution with growth.

Note that using a head count measure of absolute poverty has an inherent bias towards the effectiveness of growth alone. Assuming all income distributions to be relatively continuous,[2] any distribution neutral growth in per capita income, no matter how low, will reduce poverty. However, by defining poverty to be below a certain income level, redistribution reduces poverty only to the extent that it moves a person above that level, in this case above a per capita income of $365. In other words, redistributions that reduce the degree of income poverty for those below the absolute poverty standard do not qualify as poverty reducing.[3]

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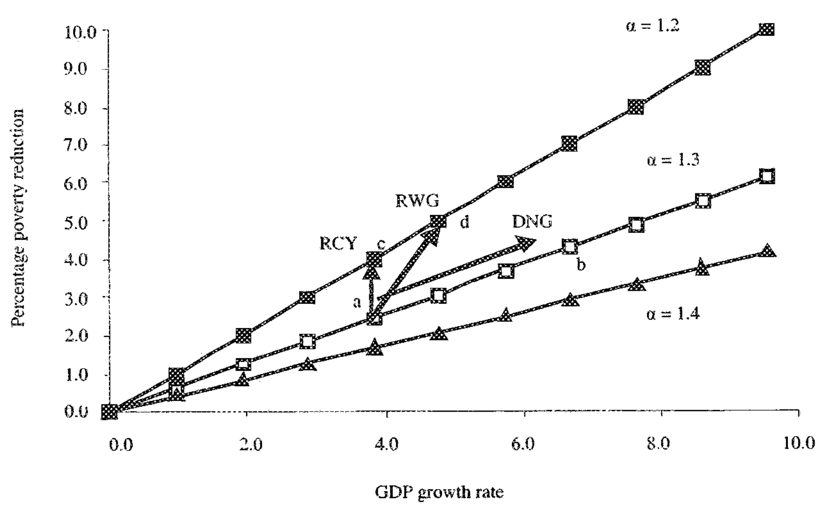
[2] That is, we assume there are no 'gaps' in the distribution below and near the poverty line.

[3] A redistribution of one percentage point of GDP from the richest ten per cent of the population to the poorest ten per cent, equally distributed among the latter, raises the incomes of all those in the lowest decile but might shift none of them above the poverty line.

Assuming that the absence of a distribution policy implies distribution neutral growth, the proposed equal distribution growth implies income transfers, or an implicit tax. Moreover, assuming that per capita income lies above the poverty line (all ESCWA member countries are above the $365-level), the redistribution tax would be negative up to the point of mean income (positive income transfer), then positive above (negative income transfer). If income were normally distributed, the tax would be negative through the fiftieth percentile. For petroleum exporting countries, the redistribution need not involve a household income tax, since it could be realized through a progressive distribution of oil revenues.

Annex IV figure II. Poverty reduction and GDP growth for degrees of inequality



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