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SUMMARY OF THE SURVEY OF ECONOMIC AND SOCIAL DEVELOPMENTS IN WESTERN ASIA, 2011-2012

Summary

Concerns are growing that the world economy may slip into a recession again, following an initial recovery from the recession of 2009. It is estimated that gross world product increased by only 2.8 per cent in 2011, compared with 4 per cent in 2010. The impact of the global downturn on member countries of the Economic and Social Commission for Western Asia (ESCWA) varies depending on their integration with Europe, the United States and the rest of the world. Oil prices are expected to remain high, but if another global recession was triggered, they could drop below break-even prices.

Social movements spread across the Arab world in 2011 and introduced some uncertainty in the ESCWA region. Due to high oil prices, economic growth in the ESCWA region is estimated at 4.8 per cent in 2011. Growth in the countries of the Gulf Cooperation Council (GCC) is estimated at 5.7 per cent in 2011, up from 4.4 per cent in 2010, while growth in the more diversified economies (MDEs) in the region fell to 2.3 per cent in 2011, from 5.7 per cent in 2010. The outlook for 2012 is uncertain due to the volatile situation in the Syrian Arab Republic and the political transition process in Egypt and Yemen. Growth in the GCC countries is projected 4.6 per cent in 2012. Iraq is expected to achieve a double-digit economic growth rate. Excluding Iraq, only 0.8 per cent growth is expected for MDEs in 2012.

Both GCC countries and MDEs relied on expansionary fiscal policies in 2011, and introduced discretionary social spending to quell political unrest. The policies included increased public sector employment and wages, subsidy hikes and increased social benefits. Large deficits in some countries are creating concerns about debt sustainability and plans of fiscal reform are being discussed.

Unemployment in the region is high and even increasing, especially among youth. Social movements placed job creation at the top of the regional and national development agendas. Previous macroeconomic policies have led to economic exclusion and inequality. Therefore, it is crucial that macroeconomic policies, such as government spending, taxation and exchange rates, be designed in a way conducive to job creation.

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A. GLOBAL CONTEXT

1. Concerns are growing that the world economy may slip into a recession again, following an initial recovery from the recession of 2009. The gross world product is estimated to have increased by only 2.8 per cent in 2011, compared with 4 per cent in 2010. The slowdown was most evident in developed countries, which experienced a 1.3 per cent increase in gross domestic product (GDP) in 2011. Growth in developing countries decelerated by 1.5 per cent, sinking to 6 per cent in 2011.[1] Sovereign debt distress in Europe continues to plague the world economy. After months of political stalemate, the eurozone Governments took bold steps to reach a solution for Greece and European Union leaders also agreed to back a new fiscal compact treaty. Nevertheless, the crisis is still far from being settled and concerns that it could spread to larger economies in the eurozone remain. The public debt of the United States of America was downgraded in August, 2011, which impacted financial markets worldwide and weakened market confidence. In November, the failure to reach an agreement on deficit reduction triggered automatic spending cuts of US$1.2 trillion over a ten-year period starting in 2013.[2] On a positive note, the manufacturing index reached the highest level in seven months in January 2012, suggesting that the United States economy has regained some momentum. Growth in major developing countries including Brazil, India, Russia, South Africa and Turkey is slowing due to the tightening of domestic fiscal policy. Below-consensus growth is expected in China.[3]

2. In 2011, global unemployment rates remained high at around 6 per cent, particularly in countries facing sovereign debt distress.[4] Youth unemployment has soared, especially in developed countries. For example, in Spain, youth unemployment is estimated at 40 per cent. Youth unemployment is detrimental both in economic and social terms. It creates psychological stress for individuals and may factor into social unrest. Youth unemployment is extremely high in North Africa, Western Asia and some European countries. At its meeting in Cannes, France, in November 2011, the Group of 20 recognized the importance of employment generation and adopted the Cannes Action Plan for Growth and Jobs.

3. Food prices remain high despite falling from their peak in the first quarter of 2011. The 2011 annual food price index exceeded the 2010 annual index by 24 per cent.[5] High prices had global implications and contributed to famines in Somalia and other parts of East Africa. The effects of high food prices can be devastating for the poorer segments of society. Countries have responded to the issue of elevated food prices in different ways. Many of them have used domestic subsidies or price controls, which are often fiscally unsustainable, to shield their populations from elevated costs.

4. The global outlook for 2012 is gloomy and characterized by a significant risk of downturn. Slow growth, unresolved debt and deficit challenges in Europe, Japan and the United States have eroded market confidence. Optimistic forecasts indicate a global growth of 2.6 per cent in 2012. However, the European debt crisis and the weakened economy of the United States could create a downward spiral, pushing the world economy into a double-dip recession. Global economic growth could fall to around 0.5 per cent.[6]

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[1] United Nations Department of Economic and Social Affairs (DESA), *World Economic Situation and Prospects 2012,* (New York, DESA, 2012).

[2] DESA, *World Economic Situation and Prospects Monthly Briefing,* 38: (December 2011), p. 4.

[3] World Bank, *Global Economic Prospects 2012*, (Washington D.C., World Bank, 2012).

[4] International Labour Organization (ILO), *Global Employment Trends 2012,* (Geneva, ILO, 2012).

[5] World Bank, *Food Price Watch*, (Washington D.C., World Bank, 2012).

[6] DESA, *World Economic Situation and Prospects 2012*, (New York, DESA, 2012).

5. The impact of these developments on the member countries of the Economic and Social Commission for Western Asia (ESCWA) depends on the degree of integration with Europe, the United States and the rest of the world. Several countries in the region are heavily integrated with Europe, and are impacted by weak demand for exports and reduction in remittances. In addition, most regional stock markets fell following the downgrade of the United States debt in August 2011. Furthermore, if the financial crisis in developed countries was to trigger a global recession, oil prices could drop below the break-even threshold, which would negatively impact oil-exporting countries in the ESCWA region.

B. Oil sector development

6. The oil sector is, and will continue to be, essential for any analysis of the ESCWA region due to the large revenues it generates directly and indirectly. It represents a large share of exports for the majority of ESCWA member countries, including the six Gulf Cooperation Council (GCC) countries, Iraq, the Syrian Arab Republic, Yemen and, to a lesser extent, Egypt. The remaining countries are indirectly impacted by oil sector developments through remittances and tourism and export revenues.

7. According to the Organization of the Petroleum Exporting Countries (OPEC), the total world demand for crude oil in 2011 averaged 87.8 million barrels per day, while the total supply of crude oil averaged 87.6 million barrels per day. Between 2010 and 2011, total world demand for crude oil increased by 0.8 million barrels per day. Demand from countries of the Organisation for Economic Co-operation and Development contracted by almost 1 per cent, while demand from developing countries increased by around 2.4 per cent and demand from China increased by over 5 per cent.[7]

8. The OPEC reference basket price continues to increase and reached a 10-month high in February 2012 at US$117.50 per barrel. The price increase is due to speculative activities in the crude oil futures market and to geopolitical risk premium amid fears of supply disruptions The geopolitical risks include the security situation in Libya, tension between the Sudan and South Sudan and Iranian threats to block exports. Libya almost put a halt to oil production due to the security situation. Production in Libya was almost zero in the third quarter of 2011, but by February 2012, it was back at 1.2 million barrels per day, close to its pre-crisis level of 1.5 million barrels per day. South Sudan has temporarily shut down its export flow due to its disagreement with the Sudan over pipeline tariffs. In addition, following the European Union ban on oil imports, the Islamic Republic of Iran threatened to block all oil exports through the Strait of Hormuz, which increased oil prices temporarily.

9. The total crude oil production of ESCWA member countries in 2011 was estimated at 19.5 million barrels per day, up from 18 million barrels per day in 2009. Production in ESCWA member countries that are OPEC members was estimated at 17.8 million barrels per day, while production in non-OPEC members was around 1.7 million barrels per day. Crude oil production in the Syrian Arab Republic is expected to decline almost by half in 2012, from 0.37 million barrels per day to 0.22 million barrels per day, as operators leave the country due to security concerns. Attacks on oil installations have also been reported. In Yemen, oil production is falling due to strikes and pipeline bombings. OPEC expects production in Yemen to drop from 0.21 million barrels per day in 2011 to 0.19 million barrels per day in 2012.[8]

10. Overall supply and demand for 2011 remained unchanged from 2010 since non-OPEC production and demand saw a similar downward adjustment. The demand for OPEC crude (30 million barrels per day) is expected to be almost unchanged in 2012, as an increase in non-OPEC supply will match the increase in global demand. Prices in 2012 are expected to decline with the economic slowdown in developed countries and below-consensus growth in China. Nonetheless, oil prices will remain resilient. Most projections are for

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[7] Organization of the Petroleum Exporting Countries (OPEC), *Monthly Oil Market Report, March 2012*, (Vienna, OPEC, 2012).

[8] Ibid.

prices to be around US$100 per barrel, provided that there is no dramatic shock to the world economy (see table 1). If market fundamentals weaken sharply, OPEC may agree to production cuts at its June meeting, in order to stabilize prices.

TABLE 1. CRUDE OIL PRICE ESTIMATION AND FORECAST, 2009-2012
(*United States dollars*)

	Minimum	Maximum	Annual average	Forecast annual average for 2012		
				Lower	Median	Higher
2009	38.1	78	61.1			
2010	68.2	90.7	77.5			
2011	100	118.1	107.5			
2012				80	100	120

Source: OPEC data for 2009-2011. ESCWA forecasts for 2012.

C. ECONOMIC TRENDS AND DEVELOPMENTS

11. After the pessimism that prevailed in 2008 and 2009, the economic outlook of the ESCWA region improved in 2010. However, uncertainty returned in 2011 as social movements spread across the Arab world. Political unrest has had direct adverse effects on economic activity in Bahrain, Egypt, the Syrian Arab Republic and Yemen, and negative spillover effects on neighbouring countries, particularly Jordan and Lebanon. Political unrest contributed to higher oil prices which boosted growth rates in oil-exporting countries. Economic development in 2011 was affected by uncertainty in Egypt and Yemen amidst changes in leadership, the escalation of hostilities in the Syrian Arab Republic and tension between the Sudan and South Sudan following secession. Those factors will continue to influence the economic outlook.

12. Growth in the ESCWA region is estimated to have increased from 4.7 per cent in 2010 to 4.8 per cent in 2011. Growth was especially high in several oil-exporting countries, reflecting high oil prices that averaged US$107 per barrel. Political unrest reduced growth rates in the more diversified economies (MDEs), particularly the Syrian Arab Republic and Yemen where growth rates are estimated to have contracted by 2 per cent in 2011.

13. In 2011, GCC countries benefited from high oil prices and grew by an estimated 5.7 per cent, up from 4.4 per cent in 2010. Kuwait, Saudi Arabia and the United Arab Emirates increased oil production to compensate for the disruption of oil production in Libya. The economic performance of those countries was not significantly impacted by social movements because high oil prices enabled them to maintain fiscal expansion and support household income and private consumption. This was not the case in Bahrain, where the social unrest of 2011 tarnished the country's reputation as a stable financial hub and key financial and tourism sectors suffered causing economic growth to drop from 4.5 per cent in 2010 to around 2.5 per cent in 2011. Growth in GCC countries is mainly driven by the oil sector, but the non-oil sector is increasingly contributing to growth. In Saudi Arabia, the non-oil sector is estimated to have grown by 5 per cent in 2011, which is one of the highest growth rates in decades. This growth rate is expected to remain at 5 per cent in 2012 supported by high public spending and investment and increased private consumption.[9] Non-oil exports from Saudi Arabia are mainly destined for East Asia, where growth should remain firm.

14. Social unrest suppressed the economic performance of MDEs and growth fell from 5.7 per cent in 2010 to an estimated 2.3 per cent in 2011. Iraq benefited from high oil prices, growing at a rate of 9.6 per cent in 2011. Excluding Iraq, the average growth rate for the MDEs was only 0.7 per cent. This was driven by the instability in the Syrian Arab Republic and Yemen. Political unrest also affected neighbouring countries, particularly Lebanon where growth decelerated drastically, from 7 per cent in 2010 to an estimated

[9] National Bank of Kuwait, *GCC Economic Outlook*, (Kuwait, National Bank of Kuwait, 2012).

2 per cent in 2011. Egypt faced political uncertainty in 2011 and growth fell to around 1 per cent. Overall in MDEs, the financial environment worsened and capital inflows declined, widening current deficits in Egypt, Jordan, Lebanon and the Syrian Arab Republic. In those four countries, political turmoil has severely impacted the vital tourism industry.

TABLE 2. REAL GDP GROWTH AND CONSUMER PRICE INFLATION, 2009-2012
(*Percentage*)

	Real GDP growth (decrease)				Consumer price inflation (decrease)			
Country/area	2009	2010	2011[a/]	2012[b/]	2009	2010	2011[a/]	2012[b/]
Bahrain	3.1	4.5	2.5	3.5	2.8	2.0	(0.5)	3.0
Kuwait	(4.6)	2.0	5.0	5.5	4.0	4.0	4.7	4.0
Oman	1.1	3.8	4.5	4.0	3.5	3.4	4.2	3.5
Qatar	12	16.6	16.0	7.0	(4.9)	(2.4)	1.9	2.0
Saudi Arabia	0.1	4.1	5.1	4.5	5.1	5.3	5.8	4.0
United Arab Emirates	(1.6)	1.4	3.2	3.5	1.6	0.8	2.0	2.0
Gulf Cooperation Council countries[c/]	**0.3**	**4.4**	**5.7**	**4.6**	**3.0**	**3.0**	**4.1**	**3.2**
Egypt[d/]	4.7	5.1	1.8	1.6	11.8	11.3	11.5	11.0
Iraq	4.2	7.3	9.6	10.5	(2.8)	3.1	6.0	5.0
Jordan	2.1	3.4	3.2	3.2	(0.7)	5.0	4.4	5.5
Lebanon	8.5	7.0	2.0	2.5	1.2	4.0	6.0	6.0
Palestine	7.4	9.3	4.0	5.0	2.8	3.7	2.9	4.0
Sudan	4.5	5.5	(1.0)	0.0	11.3	13.2	18.9	19.3
Syrian Arab Republic	5.9	3.4	(2.0)	(5.5)	2.8	4.4	6.0	10.0
Yemen	4.3	7.8	(2.5)	1.0	5.4	11.1	17	12.0
More diversified economies[c/]	**5.0**	**5.7**	**2.3**	**2.6**	**6.2**	**8.3**	**10.2**	**9.9**
MDEs excluding Iraq[c/]	**5.1**	**5.3**	**0.7**	**0.8**	**8.0**	**9.3**	**11.1**	**11.0**
Total ESCWA region[c/]	**1.6**	**4.7**	**4.8**	**4.0**	**3.9**	**4.6**	**5.8**	**5.0**

Source: National sources and ESCWA forecasts.

Notes: a/ Preliminary data as at March 2012.
b/ Forecasts as at March 2012.
c/ Figures for country groups are weighted averages, based on GDP at 2005 exchange rates.
d/ Figures for Egypt are for the fiscal year from July to June.

15. The 2012 outlook for the ESCWA region is extremely uncertain, as the situation in the Syrian Arab Republic is expected to remain highly volatile and political uncertainty is still characterizing the transitional phase in Egypt and Yemen. The region is vulnerable to a global downturn which could affect oil prices and reduce demand for non-oil exports. Oil-exporting countries will drive growth as oil prices are expected to remain high at around US$100 per barrel. In 2012, the GCC countries are expected to grow by 4.6 per cent, and MDEs, excluding Iraq, are expected to grow by 0.8 per cent, as Iraq is expected to achieve double-digit growth rates. Developments in the political and security situation could have a significant impact on forecasted figures. A severe contraction of 5.5 per cent is expected in the Syrian economy. The tourism sector of Lebanon will continue to be affected by the crisis in the Syrian Arab Republic. However, increasing capital inflows and remittances from GCC countries will allow growth to increase from 2 per cent in 2011 to 2.5 per cent in 2012. In Qatar, the era of double-digit real GDP growth rates is probably over, but it will continue to record the highest growth rate of GCC countries due to liquefied natural gas production and Government expansionary policies. In GCC countries, public wage increases from 2011 are expected to encourage private consumption.

16. The increase in global commodity prices resulted in an increase in consumer price inflation in the ESCWA region from 4.6 per cent in 2010 to 5.8 per cent in 2011. Many countries used subsidies to mitigate the impact of global prices on domestic consumer prices. Nevertheless, inflation is estimated to have increased from 3 per cent in 2010 to 4.1 per cent in 2011 in GCC countries and from 8.3 per cent to 10.2

per cent over the same period in MDEs. The increase is driven by high inflation in Egypt, the Sudan and Yemen. Currency depreciation in Egypt, the Sudan and the Syrian Arab Republic has contributed to the problem. A global recession could lower inflationary pressure, while recent salary increases could create demand-pull inflation, especially in GCC countries. Low interest rates could spur rapid credit growth and generate inflationary pressure. The strength of the United States dollar is deflationary for most countries in the region and the dollar is expected to gain strength as the European economy struggles to contain the sovereign debt crisis. Oil and food prices are expected to remain high, but if they fall in 2012, inflation could fall as well. Therefore, average inflation rates are expected to drop in GCC countries (3.2 per cent) and in MDEs (9.9 per cent) in 2012. However, inflation is expected to remain high in Egypt, the Sudan and Yemen, and reach a double-digit rate in the Syrian Arab Republic.

17. Social unrest will affect capital flows in the region, especially the inflow of foreign direct investments (FDI). Even though it is very difficult to determine the total impact, ESCWA estimates that FDI dropped by around US$10 billion in 2011, to its lowest level in six years.[10] Expectations for 2012 are gloomy given that several countries in the region are still in a transitional state. Uncertainty is a major detriment to investment. Jordan and Lebanon will receive lower FDI given their proximity to the Syrian Arab Republic and vulnerability to the impact of the conflict. Egypt experienced a severe drop in FDI in 2011. In 2010, Egypt received US$6.4 billion in FDI, but in the first three quarters of 2011 it received only US$376 million.[11] In 2010, Saudi Arabia received US$9.9 billion in FDI. According to provisional figures released by the Saudi Arabia Monetary Agency, FDI in the first three quarters of 2011 amounted to US$6.3 billion, and it is likely that the total for 2011 was lower than the total for 2010.[12] The Inter-Arab Investment Guarantee Corporation estimated that FDI in Yemen will decrease by US$200 million. FDI in Lebanon dropped from US$4.5 billion in 2010 to US$3 billion in 2011. ESCWA estimates that the region as a whole experienced a decrease in FDI of at least 16 per cent in 2011. Even though several countries in the region still have attractive investment environments, short-term uncertainty and political instability are expected to cause a decrease of capital inflows. Oil prices are expected to remain high, and GCC countries are likely to maintain their high capital spending, which may offset the declining FDI inflows from outside the region.

18. Egypt is facing dangerously low and dwindling levels of foreign exchange reserves. Large amounts of capital have flowed out of Egypt over the past 12 months, forcing the Central Bank of Egypt to sell foreign exchange reserves in order to prevent a collapse in the Egyptian pound. According to the Central Bank of Egypt, foreign exchange reserves fell by approximately US$2 billion a month, in October, November and December 2011 and in January 2012. In February and March 2012 the drain on Egypt's foreign reserves showed signs of abating, with the reserves falling by US$600 million, resting at US$15.2 billion at the end of March. The reserves cover now just over three months of imports, the lower threshold for foreign reserves. Egypt's foreign exchange reserves being now perilously low, raises concerns that the Egyptian Central Bank will not be able to keep the Egyptian pound stable. Egypt must secure additional foreign funding and is currently negotiating with the International Monetary Fund (IMF), but an agreement is not expected before June 2012. The pressure on the Egyptian pound stems from general economic stress, a decade of high inflation and a fixed exchange rate that has eroded economic competitiveness. Egypt may be facing an orderly devaluation under a credible stabilization programme, or a disorderly devaluation under populist pressure and confusing macroeconomic policy. If not properly managed, a balance-of-payments crisis could be triggered in 2012. If growth returns, Egypt could be able to rebuild its foreign reserves. A devalued currency could be beneficial and could kick-start the growth process. Of course, a weaker currency might also drive inflation and destabilize the political situation which would reduce growth by hampering the recovery of the much-needed tourism sector.

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[10] ESCWA, *Survey of Economic and Social Developments in the ESCWA Region 2010-2011*, (Beirut, ESCWA, 2011), E/ESCWA/EDGD/2011/8.

[11] Central Bank of Egypt, *Monthly Statistical Bulletin*, 179: (February 2012), pp. 93-94.

[12] Saudi Arabian Monetary Agency, *Quarterly Statistical Bulletin*, (4th Quarter, 2011), p. 82.

19. In March 2012, q year after the outbreak of unrest in the Syrian Arab Republic, the economy is distressed and the exchange rate under pressure. Since March 2011, the Syrian pound has gradually depreciated in black market exchanges. Between February and December 2011, the black market rate fell by around 50 per cent, while the official rate of the Syrian pound depreciated by around 20 per cent. This raised fears of inflation. According to the Syrian Central Bureau of Statistics, inflation started to accelerate in December 2011 and increased by 4 per cent from December 2011 to January 2012. In January 2012, the Syrian Central Bank decided to adopt a managed floating exchange rate in order to reduce the discrepancy between official and black market exchange rates. In March 2012, the official exchange rate plunged further and the Syrian Central Bank intervened by selling dollars to stabilize the rate.

20. The secession of South Sudan on 9 July 2011 radically changed the economic profile of the Sudan. The Sudan lost around 75 per cent of its oil reserves to South Sudan. Oil accounted for half of Government revenue and 90 per cent of exports before partition. The loss of oil has resulted in a decline in foreign reserves and a depreciation of the currency. Inflationary pressure has increased, especially for food products. The Sudan agreed to the so-called zero-option, by which it would retain the full debt burden after secession. The Sudan has become one of the most highly indebted least developed countries in the world with a debt level exceeding most commonly used thresholds of debt sustainability. Debt constrains fiscal policy and the ability of the country to pursue a much-needed diversification agenda.

D. ECONOMIC POLICY DEVELOPMENTS

21. Recent developments and trends have created a number of macroeconomic challenges for policymakers in the ESCWA region. Most countries in the region have currencies pegged to the United States dollar or have a managed exchange rate. The effectiveness of monetary policy is limited and tied to the policy of the United States Federal Reserve. Fiscal policy is therefore the main tool to address macroeconomic challenges, but it is constrained in non-oil exporting countries. In response to the global financial crisis in 2008 and 2009, most ESCWA member countries successfully introduced counter-cyclical fiscal policies. The policies strained fiscal resources and if a global recession returns in 2012, the capacity of ESCWA member countries to conduct such strategies will be limited.

22. GCC countries continued fiscal expansion in 2011, introducing discretionary social spending to quell political unrest. Increased public sector employment for youth, hand-outs and increased salaries were implemented. Bahrain, the only GCC country strongly affected by social unrest, introduced a number of social spending measures such as a 1,000 dinar (US$2,600) hand-out per household and a cost–of-living subsidy.[13] Overall in GCC countries, social spending was added to the already expansionary fiscal policy that has supported diverse projects including infrastructure projects and spending on education and health. It is estimated that Government spending in GCC countries increased by 17 per cent in 2011.[14] Nevertheless, GCC countries expect to post healthy surpluses given the high price of crude oil. However, break-even rates are a source of vulnerability if oil prices fall. The break-even threshold is highest in Bahrain at US$112 per barrel, while is around US$80 per barrel for the other GCC countries.[15]

23. In 2012, public spending increase in GCC countries is expected to slow to around 6 per cent, the lowest rate of increase in several years. Fiscal policy will remain expansionary in most countries. In January 2012, Oman announced a budget that confirms this view including Government plans for spending on education, health care and the creation of 36,000 new Government jobs. Bahrain is also expected to continue its loose fiscal policy as it is difficult to roll back the policies introduced in 2011. Government spending in Bahrain may shift, and a larger share may be directed towards infrastructure rather than cash handouts. Since

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[13] National Bank of Kuwait, *GCC Economic Outlook*, (Kuwait, National Bank of Kuwait, 2012).

[14] Ibid.

[15] National Bank of Abu Dhabi, *GCC economic development and outlook 2012*, available at http://www.nbad.com/news/detail.php?ID=3514&phrase_id=14513.

the global financial crisis, the United Arab Emirates has been reappraising large infrastructure projects and reprioritizing activities. In January 2012, Abu Dhabi's executive council approved a development programme including such large scale projects as the Khalifa Port and Industrial Zone, the Abu Dhabi International Airport and housing and health-care projects. Also, in Kuwait and Saudi Arabia, a tense political situation will ensure a loose fiscal policy in 2012.

24. While GCC countries have the fiscal space for continued expansion, MDEs are more constrained. However, MDEs also responded to the political tension stirred up by social movements by increasing spending on subsidies, public sector wages and social benefits. This is problematic as most countries are running out of fiscal resources, and because such measures might have detrimental long-term effects if increased social spending comes at the expense of productive investments. Lower investment could negatively impact the long-term growth trajectory. Most countries have been running large, consecutive fiscal deficits, which have led to increased indebtedness, particularly in Jordan and Lebanon.

25. The fiscal outlook for MDEs will continue to be marked by high social spending. There are now increasing concerns about the sustainability of debt, and fiscal reforms are being discussed in several countries. Jordan revealed a three-year fiscal reform agenda to reduce the deficit to 3.5 per cent of GDP by 2014 by removing tax exemptions, reducing spending and reforming the subsidy system. However, the fear of social unrest forced the Government to temporarily abandon its plans. In Yemen, disruptions in oil production and increased public sector wages widened the fiscal deficit in 2011. Given the need for stability, efforts to rein in public spending will probably be deferred until 2013. In Egypt, the Government has issued conflicting statements about fiscal policy, first saying that the deficit will widen, and then saying it will stick to the budget plan. In Lebanon and the Syrian Arab Republic, deficits are widening. The deficit in the Syrian Arab Republic is expected to increase due to European Union sanctions on oil revenue and the economic standstill. The Sudan is adjusting its fiscal policy through large spending cuts, the bulk of which has been to development spending and federal transfers to states. This may have an adverse impact on poverty reduction and progress towards the Millennium Development Goals. Despite fiscal austerity measures, the deficit as a share of GDP is expected to double in 2012. Iraq is the exception among MDEs as higher oil prices and production increase Government revenue. Iraq's 2012 budget includes a 20 per cent increase in total expenditure.

26. Monetary policy in GCC countries remained relatively unchanged in 2011. The Central Bank of Kuwait kept its official policy rate at 2.5 per cent. However, in 2011, the Central Bank appeared to be less aggressive than in previous years in its demands that banks take additional provisions. The money supply in Kuwait increased throughout 2011, keeping liquidity in the system and putting downward pressure on interest rates. In Oman, the Central Bank has kept the interest rate at 2 per cent since 2009. In the past few years, authorities in Qatar have taken measures to tighten bank supervision and strengthen financial stability. In 2011, the Qatar Central Bank cut the deposit rate from 1.5 per cent to 0.75 per cent to stimulate private sector credit. In Saudi Arabia, monetary conditions have improved since the beginning of 2011 and liquidity, bank lending and deposit growth are all increasing. The gap between the Saudi Arabia Interbank Offered Rate (SAIBOR) and the London Interbank Offered Rate (LIBOR) narrowed in the second half of 2011, reflecting greater liquidity in the Saudi banking system. The United Arab Emirates was regarded as a safe haven during the unrest in the Arab world and consequently experienced a surge in liquidity in the beginning of 2011. The Central Bank of the United Arab Emirates has maintained its main policy lending rate at 1 per cent.[16]

27. Monetary policy in MDEs witnessed small changes in 2011 as most of the countries are tied to the monetary policy of the United States. In Egypt in November 2011, the Central Bank increased interest rates for the first time since 2008. This was intended to support the Egyptian pound and boost local currency deposits. With the downward pressure on the Egyptian pound, it is expected that the Central Bank of Egypt

[16] National Bank of Kuwait, *GCC Economic Outlook*, (Kuwait, National Bank of Kuwait, 2012).

will raise interest rates further in 2012, which might have a detrimental effect on economic growth. The Central Bank of Jordan increased its policy interest rate in May 2011 to manage inflation. Additional increases are not expected in 2012. In the Syrian Arab Republic, the threat of currency devaluation forced the Central Bank to impose restrictions on foreign-currency transactions and abandon the peg to the IMF special drawing rights. Currently the system includes official, private bank and black market rates of exchange. In Iraq, the Central Bank has actively responded to declines in inflation by reducing its policy rate.

28. Financial sectors in the region remain relatively underdeveloped. Loan–to-deposit ratios are below unity in most countries which demonstrates that there is excess liquidity. Financial sectors lack depth and width, which creates challenges for the private sector, especially small and medium-sized enterprises (SMEs). Banks find it more convenient to fund large businesses. Small and medium-sized businesses need inclusive financial infrastructure to access finance.[17] Research shows that SMEs lie at the core of private sector development and are essential for job creation. There is a strong need for better access to finance for SMEs to address the unemployment problem in the region. More vibrant and robust SMEs can drive private sector growth job creation. Countries in the ESCWA region need overarching national strategies for financial inclusion to ensure that SMEs are given access to finance.

E. SOCIAL DYNAMICS

29. High global food prices, economic stagnation, decades of social problems and political exclusion led people to protest. The calls for dignity, freedom and social equity have demonstrated that the policy of economic exclusion is no longer tenable. Although the movements and their underlying causes are complex and the demands of the people differ from country to country, there are similarities. Issues related to unemployment, poverty and inequality have been highlighted in most countries. Social movements in the ESCWA region carried an internal political agenda and argued that the first change should be political to catalyse socio-economic improvements.

30. The social and political engagement of the Arab people over the past year is encouraging. The increased social and political participation of youth in this region inspired youth worldwide as the “Occupy Wall Street” and the “99 per cent” movements in the United States and Europe have shown. The participation of women in social movements was remarkable, particularly in Egypt, Jordan, the Syrian Arab Republic and Yemen. In recognition of the crucial role of women in social movements, the Noble Peace Prize was awarded to the Yemeni activist Tawakkul Karman. The central role of women in the revolutions must be reflected in the aftermath of the revolutions. The region must take this opportunity to integrate women’s perspectives into political positions and concrete actions.

31. High unemployment, particularly among youth, is one of the most critical social development challenges in the ESCWA region. According to the International Labour Organization (ILO),[18] unemployment rates in the Middle East are among the highest in the world, and the average unemployment rate is estimated to have increased from 9.9 per cent in 2010 to 10.2 per cent in 2011,[19] with male unemployment estimated at 8.3 per cent and female unemployment at 18.7 per cent. Table 3 shows the differences in selected ESCWA member countries.

[17] ESCWA, Corporate Financing and Firm Employment: Does Size Matter?, forthcoming.

[18] International Labour Organization (ILO), *Global Employment Trends 2012: Preventing a Deeper Job Crisis*, (Geneva, ILO, 2012). Due to the limited availability and inconsistency of unemployment data, ILO figures are used. Their classification of the Middle East differs slightly from the ESCWA region, including Iran and excluding Egypt and the Sudan.

[19] Preliminary estimates show another slight increase to 10.3 per cent in 2012.

TABLE 3. UNEMPLOYMENT IN SELECTED ESCWA MEMBER COUNTRIES, TOTAL AND BY GENDER
(*Percentage*)

Country/area	Total unemployment	Male	Female
Egypt (2009)	9.4	5.2	22.9
Jordan (2009)	12.9	10.3	24.1
Saudi Arabia (2009)	5.4	3.5	15.9
Syrian Arab Republic (2010)	8.4	5.7	22.5
Yemen (2009)	14.6	-	-

Source: Data adapted from ILO database *Key Indicators of the Labour Market*, available at http://www.ilo.org/empelm/pubs/WCMS_114060/lang--en/index.htm.

32. ILO estimated that youth unemployment increased from 25.4 per cent in 2010 to 26.2 per cent in 2011. Vulnerable employment in the region has declined slightly, falling gradually from 32.4 per cent in 2005 to 29.5 per cent in 2011. More than 40 per cent of women work in vulnerable employment situations, compared to 27 per cent of men. An additional challenge is the large informal sector in the ESCWA region which accounts for around one third of GDP in Egypt, Jordan, Lebanon, the Syrian Arab Republic and Yemen. Workers in the informal sector are excluded from most forms of social protection.

33. Labour markets in GCC countries rely on expatriate labour. Unemployment rates in GCC countries are often not comparable to other countries in the region because the large foreign labour force skews the statistics. Unemployment among nationals is probably much higher than what aggregate statistics show.[20] Job creation for nationals is a key issue to address the rapidly growing youth population in GCC countries. Although Governments have created additional public sector jobs, unemployment rates for youth have been increasing. Moreover, the strategy is not viable in the long term. In addition, GCC countries have adopted so-called “nationalization” policies aiming to replace expatriate labourers with nationals. However, economic diversification must be the core strategy to provide more jobs for national youth.

34. Poverty and inequality are also widespread in the ESCWA region, but are inadequately reflected in most indicators. Poverty in Yemen and the Sudan is around 50 per cent, according to national poverty definitions. In the other MDEs, poverty is also sizeable and varies from 20 to 40 per cent. Poverty has special manifestations in GCC countries and should be addressed.[21] Region-specific indicators of poverty should be developed. Indicators of inequality, such as the Gini coefficient, indicate moderate levels of income inequality in most ESCWA countries. However, the results are controversial and clash with glaring manifestations of rising inequality in many countries in the region.[22] Disparities are manifested in access to public services, electricity and water in rural and urban areas. Such inequalities fuel rural-urban migration and perpetuate the challenge of social dislocation.

35. Unemployment, poverty and inequality are not new problems, but have become more serious due to globalization and ineffective domestic social and economic policies. Social movements and political protests brought these issues to the top of the Governments’ agendas. Several countries responded to the protests by adopting policies to increase unemployment benefits and wages, housing allowances and public sector jobs. However, these measures were not sufficient to tackle the root causes of discontent and there is a need for a comprehensive social policy. At this transformative stage, the focus has been on political reform rather than socio-economic development. The experience of several countries in the region, Egypt in particular, has shown that the strong focus on political reform negatively impacted the overall reform agenda. Without substantive socio-economic dialogue among transitional bodies, the discussions digressed into a traditional election competition and ideological debate. The region needs to discuss a new approach to development

[20] ESCWA, Labour Market Data: Structures and Challenges in the ESCWA Region, forthcoming.

[21] ESCWA, Arab Millennium Development Goals Report 2011: An Inclusive Development Approach in a Time of Transition, forthcoming.

[22] United Nations Development Programme (UNDP), *Arab Development Challenges Report 2011: Towards the Developmental State in the Arab Region*, (Cairo, UNDP, 2012), p. 10.

based on inclusion, equality and participation. By promoting diversification and competitiveness, the region can move away from the jobless growth of the past. Economic and social policymaking can be synchronized with a long-term development vision.

II. MACROECONOMIC CONDITIONS AND THE LABOUR MARKET

36. Social movements placed job creation at the top of regional and national development agendas. Macroeconomic policies led to widespread economic exclusion and inequality. To describe the current labour market and derive macroeconomic policy directions, this chapter will address a set of questions:

(a) How can countries improve the employment intensity of growth?

(b) How do economic structure, de-industrialization, taxation and private and public spending influence the labour market?

(c) How do exchange rate regimes influence growth and employment creation?

37. Development challenges are both quantitative and qualitative. This chapter will discuss the relationship between macroeconomic policies and employment generation, and will concentrate on the demand side of labour markets to investigate the impact of government spending, taxation and exchange rate on job creation. The link between unemployment and GDP growth represents one dimension of the problem. A comparison with other regions will illustrate the extent of the problem. Over the past two decades the average economic growth in Southeast Asia was marginally greater than in the ESCWA region, but the unemployment rate is approximately two-thirds lower. The pattern of growth in Southeast Asia favoured job creation.

38. An assessment of the employment intensity of growth in the ESCWA region over the last decade emphasizes the challenges in the region (table 4). Recent research has shown that the slow pace of job creation relative to economic growth is but one factor contributing to unemployment in the region. On average, each per cent of GDP growth in MDEs yielded employment growth of 0.74 per cent, while each per cent of GDP growth in GCC countries yielded 0.66 per cent employment growth. The region shows a greater tendency to create jobs than other middle-income countries, as measured by the average employment to growth elasticity in the 2000s.[23]

TABLE 4. EMPLOYMENT TO GROWTH ELASTICITY IN SELECTED ESCWA MEMBER COUNTRIES
(*Percentage*)

Country/region	Employment/GDP 2000-2004	Employment/GDP 2004-2008	Employment/GDP 2000-2008
Bahrain	0.44	0.34	0.39
Kuwait	0.41	0.46	0.44
Oman	0.50	0.42	0.46
Qatar	1.26	1.03	1.15
Saudi Arabia	1.00	0.68	0.84
United Arab Emirates	0.88	0.51	0.70
GCC average	0.75	0.57	0.66
Egypt	0.82	0.57	0.70
Jordan	0.69	0.58	0.64
Lebanon	0.52	0.37	0.45
Syrian Arab Republic	0.65	1.03	0.84
Yemen	1.12	1.05	1.09
MDEs average	0.76	0.72	0.74

Source: Adapted from World Bank, *Economic Developments and Prospects, September 2011*, (Washington D.C., World Bank, 2011), p. 56.

[23] Elena Ianchovichina, *Is MENA's Job Problem About Economic Growth or Employment Creation?*, (19 September 2011), available at http://menablog.worldbank.org/mena%E2%80%99s-job-problem-about-economic-growth-or-employment-creation.

39. Access to labour markets in several countries in the region is marked by some form of core-periphery divide (e.g. rural/urban, coastal/inland). Structural issues of the labour market must be taken into account when designing macroeconomic policies. Capital-intensive extractive industries with low job intensity make up a large share of the economies in the region. This has changed somewhat during the last decade, and some labour-intensive sectors (e.g. construction, tourism, trade) are on the rise. These sectors are relatively small, and jobs in non-oil sectors have been filled by foreign workers because the jobs are deemed unattractive by citizens.

40. Public spending in the region is skewed towards short-term discretionary social policies and subsidies, so-called "subsidies for peace". The creation of public sector employment discourages productive capacity and long-term employment opportunities. There is a positive correlation between public spending and unemployment. Countries in the region need to review their tax systems to address issues related to governance and corruption. High taxes will reduce the ability of the private sector to invest and hire more people.

III. CONCLUSION

41. The global economy and the ESCWA region recovered in 2011, but the outlook for 2012 is gloomy and characterized by a significant risk of downturn. The ESCWA region will be impacted through lower demand for exports and reduced remittances. If market fundamentals weaken sharply, oil prices might also drop below break-even thresholds in oil-exporting countries. This could reduce fiscal space in GCC countries and add to the financial strain on MDEs. High unemployment rates have increased the vulnerability of individuals and societies. A global financial downturn would magnify the existing problems in the region, aggravate uncertainty and make political transition more difficult.

42. There is a need for enhanced diversification to foster employment creation. Taxation, public spending and exchange rate policy can contribute to boosting diversification and private sector development. Strong governance mechanisms are needed to develop the private sector so that it can generate employment opportunities. The region needs to establish an institutional environment that is conducive to privatization. The goal is to foster efficient, liberalized financial markets to improve access to finance and reduce State-dependency.