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ECONOMIC POLICY IN THE ESCWA REGION AND ITS IMPACT ON EMPLOYMENT

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Acknowledgements

The present report analyses the macroeconomic environment and economic policy framework of ESCWA member countries with the aim to point to some key constraints under which labour-market policy operates. The research was conducted as part of the ongoing efforts of the Social Policy Section of the Social Development Division of the Economic and Social Commission for Western Asia (ESCWA) to build a knowledge base and enhance expertise on labour policies in the region.

The report was written by Steffen Hertog and Nathan Hodson, under the guidance of Gisela Nauk (Chief of the Social Policy Section) and Frederico Neto (Director of the Social Development Division). It builds on extensive research conducted by the two authors, with the support of Christine Rouhana (Research Assistant). The report argues that insufficient job creation in the region is associated with distortionary State spending, high levels of public employment and weak institutional environments. It proposes that Governments promote private employment and private sector activities.

An earlier version of the present report was discussed at the Expert Group Meeting and Workshop on Labour Markets in the ESCWA Region, held in October 2011 at the United Nations House in Beirut. Government officials and labour specialists participated in the meeting, and their comments and inputs greatly enriched the present report.

ACRONYMS

ESCWA	Economic and Social Commission for Western Asia
FDI	Foreign direct investment
GCC	Gulf Cooperation Council
GDP	Gross domestic product
ILO	International Labour Organization
IMF	International Monetary Fund
OECD	Organisation for Economic Co-operation and Development
MENA	Middle East and North Africa
SME	Small and medium enterprise
TFP	Total factor productivity
VAT	Value added tax
WTO	World Trade Organization

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Executive summary

The objective of the present report is to review the impact of macroeconomic developments and economic policies on labour-market developments in the region of the Economic and Social Commission for Western Asia (ESCWA). Core findings of the report include:

- The State continues to play a pivotal role in economies of ESCWA member countries, generating both demand and public employment, which in turn has a strong indirect effect on prices and on private labour markets. Similarly, rents continue to play a crucial role in member country economies, and as a result, rent-seeking often displaces productive economic activities;

- Labour productivity growth across the region has been modest to negative, job generation has lagged far behind the needs of increasingly educated populations and the quality of salaries and work conditions has been mediocre. The informal sector remains large in some member countries. No country in the region has experienced simultaneous, significant increases in employment and productivity;

- Low productivity growth and insufficient job creation result from distortionary State spending and subsidy policies, high levels of public employment, and weak institutional and regulatory environments. There is a fundamental difference between distributional spending (which the United Nations system generally supports) and distortionary spending associated with "excessive" public employment demand. Many member countries are dominated by distortionary State spending that displaces development spending, private employment and private sector activities. It distorts prices and labour-market incentives, resulting in a mismatch of supply and demand. Weak fiscal systems exacerbate these problems and reduce the fiscal policy space.

Before the 2011 political upheaval, progress had been made on fiscal rationalization in some member countries. Yet in response to recent events, fiscal policies in all of the 14 countries surveyed focused on the short term and became distribution-oriented.

Although private investments have increased relative to public sector capital formation, significant shares of private investments go into activities that add limited value, such as real estate. In some cases, labour-intensive sectors like agriculture also suffer from extremely low productivity.

Compared with other ESCWA member countries, Gulf Cooperation Council (GCC) countries generally enjoy a comfortable fiscal cushion that allows them to pursue development and distributional expenditure at the same time. They face a severe long-term challenge of national job creation, as Gulf labour markets are deeply segmented and the majority of nationals are excluded from private employment. In general, GCC countries have developed and benefit from high-quality institutions and infrastructure, economic openness, private sector capacity and factor endowment, although open migration policies that have been in place since the 1960s have led to factor (namely labour) intensive growth. Growth in GCC countries reflects imported labour rather than technological innovations. In the absence of technological innovations, labour productivity has remained weak and GCC countries have struggled to create jobs that are attractive to their citizens.

All ESCWA member countries have implemented economic policy reforms during the past two decades. These efforts included the following:

- Privatization: opening up specific sectors for private investment;
- Temporary macrostabilization, which is threatened by the region's political crisis;
- Reduced price distortions and increased openness to international trade and investment.

Deeper reforms to improve the business and regulatory environment, rationalize fiscal policy, create a modern social protection floor and substitute social protection for State employment have not been fully implemented. As a result of these distortions, the growth pattern has created few high-quality jobs and inequality has increased.

On the basis of the above analysis of partial and distorted reforms, the present report provides a number of generic policy recommendations:

- Rationalize fiscal policy, to reduce distortionary State spending and surplus employment, and provide universal access to subsistence social security, income support and essential social services.

- Build modern fiscal systems to smooth and broaden the public income stream, generate funds for development expenditure and reduce the rent dependence and rent orientation of public funds.

- Streamline bureaucracies and rules to create a more predictable, transparent and smooth investment environment. This can go together with a general shift away from surplus employment to merit-based civil service.

- Execute targeted migration management in GCC countries to incentivize the import of higher-skilled expatriate labour.

These measures can directly or indirectly provide incentives for the creation and uptake of private sector jobs in new and existing sectors that add more value and require higher skills.

Introduction

The fourth issue of the Integrated Social Policy series addresses the topic of labour markets and labour-market policies in the ESCWA region. Labour-market dynamics and policy constraints can only be understood on the basis of a general analysis of the macroeconomic environment and policy framework. The present report provides this background, with a particular focus on factors that determine labour productivity and could facilitate broad-based economic growth conducive to job creation.

The present report comprises two main sections. The first analyses the economic structures and diversification track record of ESCWA member countries. It is subdivided into chapters for Gulf Cooperation Council (GCC) and non-GCC countries, and each explores economic structures, macroeconomic dynamics and labour-market segmentation. Common topics in both chapters include the following:

- Economic growth trends and drivers;
- Productivity trends;
- Private sector development;
- Employment trends and the quality of job generation;
- Fiscal strategies and the resulting investment policies.

The chapter on GCC countries also includes a general analysis of the impact of open migration regimes on labour-market structures, productivity and investment choices. The discussion is broken down by sectors where possible.

The second section addresses economic and investment policies pursued by Governments of ESCWA member countries. It is also divided into GCC and non-GCC chapters, and deals with the following topics:

- Foreign direct investment (FDI) policy;
- Small and medium enterprise (SME) promotion policies;
- Competition policy, tariffs and trade;
- Industrial policy.

The conclusion provides a number of general policy recommendations that build on the results of this analysis.

The report draws on academic sources and reports from international organizations and a wide selection of primary data, some of which has been collected in the field in ESCWA member countries. Qualitative elements of the present report reflect the field experience and expertise of the authors.

I. ECONOMIC STRUCTURE, DIVERSIFICATION AND MACROECONOMIC POSITION OF NON-GCC ESCWA MEMBER COUNTRIES

Countries in the region have weathered the global economic crisis with varying degrees of success. Those that were less open to international markets were able to recover more quickly than those with a great deal of exposure. Nonetheless, growth rates remained fairly high until the latest challenge, which has been coping with massive political change and instability in Egypt, the Syrian Arab Republic and Yemen. The economies of those countries were severely impacted, and instability threatens the region. Tourism and investment have been affected, particularly in Egypt, Jordan and Lebanon.[1] Meanwhile, Iraq and the Sudan face widespread internal security challenges to economic growth, which is needed to create jobs. Palestine is hampered by unique obstacles, shaped by the conflict with Israel. Despite their differences, countries in the ESCWA region face a common challenge: to create private sector employment that does not place heavy financial burdens on the Government.

A. ECONOMIC GROWTH AND THE SIZE AND SHAPE OF THE ECONOMY

In the region, high economic growth rates in the 1960s and 1970s were followed by poor growth throughout much of the 1980s and 1990s. In the 1990s, economic growth barely matched the very high labour-force growth in many ESCWA member countries. Output per labourer grew in Egypt, Lebanon and the Syrian Arab Republic at average annual rates of 1.5, 4.0 and 1.0 per cent. It actually declined in Jordan and Yemen, with growth of -0.6 and -1.1 per cent.[2] High labour-force growth in the ESCWA region had the potential to yield significant gross domestic product (GDP) growth, as it did in East Asia when that region experienced a demographic window of opportunity. Instead, the vast increase in the labour force in the ESCWA region was accompanied by marginal real growth rates. Strong growth creates space to reduce unemployment and increase wages, but when output per labourer is low, job creation often comes at the expense of wage increases.[3]

By the 1990s, most countries in the region had embarked on extensive programmes of macroeconomic stabilization and policy reform, but these did not necessarily translate into strong growth. Poor performance can be attributed to weak capital accumulation. Egypt, Jordan and the Syrian Arab Republic were among the countries that saw high total factor productivity (TFP) growth from the 1980s to the 1990s. However, this was accompanied by declines in physical capital accumulation per labourer, which prevented TFP growth from translating into significant GDP growth.[4]

The situation improved in the 2000s, particularly in the second half of the decade, when the region experienced several years of strong economic growth and job creation. Growth rates in non-GCC ESCWA member countries were very high from 2006 to 2010, ranging from 4.0 per cent in Yemen to 7.3 per cent in the Sudan (see figure 1 and annex I). Real growth exceeded 5 per cent in Egypt, Iraq, Jordan and Lebanon during this period. The Palestinian economy is bifurcated, and Gaza's real GDP has declined since 2005 while the West Bank's economy has expanded considerably.

From 2006 to 2010, gross fixed capital formation grew at an average annual rate that exceeded GDP growth in Egypt, Jordan, Lebanon and Yemen. It grew more than 9 per cent annually in Egypt and 16.6 per cent annually in Lebanon. In the Sudan, the annual capital investment rate was high at 7.2 per cent, which kept pace with GDP growth. Only the Syrian Arab Republic experienced negative fixed capital investment growth. In the Sudan, export growth was quite high, and in the Syrian Arab Republic, increased Government

[1] Richard Nield, 2011, pp. 34-35; and Triska Hamid, 2011.

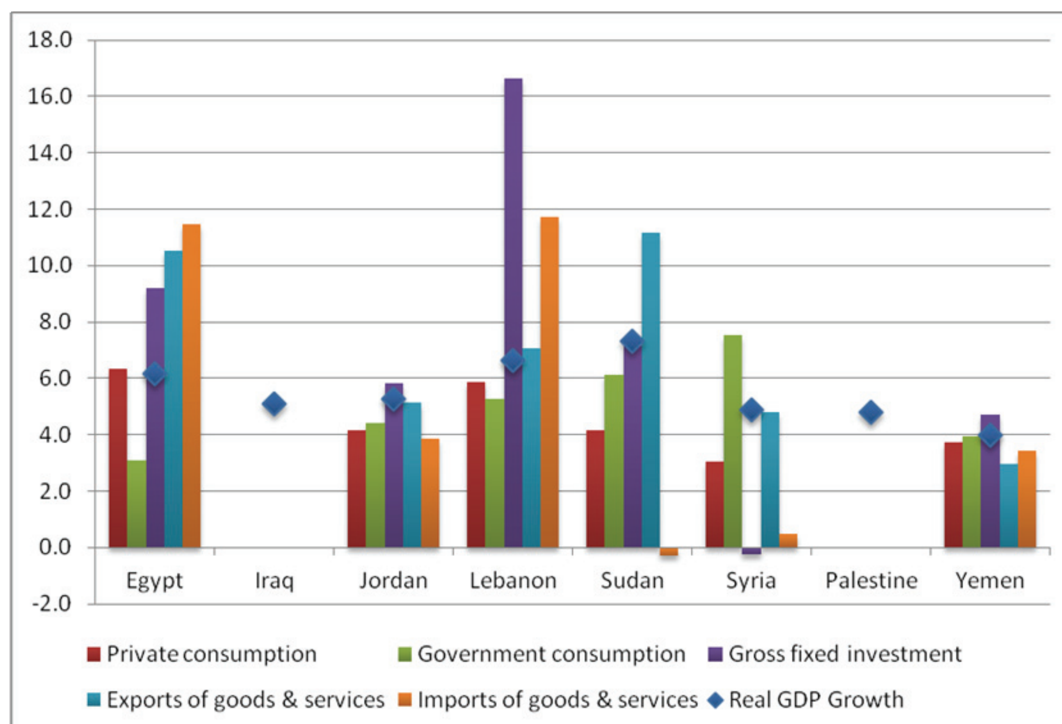
[2] Jennifer Keller and Mustapha Nabli, 2002, p. 6.

[3] Ibid., p. 7.

[4] Ibid., p. 14.

consumption helped drive GDP. In Egypt and the Syrian Arab Republic, the service sector witnessed the strongest growth, whereas industry grew fastest in Iraq, Jordan, the Sudan and Yemen.

Figure 1. Average annual economic growth rates by sector in selected countries, 2006-2010
(*Percentage*)



Source: Economist Intelligence Unit (EIU).

Estimates of the impact of GDP growth on employment vary widely, but seem to be clustered in three groups. The International Labour Organization (ILO) estimated that, from 2004 to 2008, employment elasticity to growth[5] was 0.34 in the Sudan, 0.37 in Lebanon, 0.57 in Egypt, 0.58 in Jordan, 1.03 in the Syrian Arab Republic and 1.05 in Yemen.[6] According to these figures, job creation in the Syrian Arab Republic and Yemen responded most to GDP growth, while job creation in the Sudan and Lebanon responded far less. According to a World Bank development report on the Middle East and North Africa (MENA) region, "trends in the growth of output per labourer are fairly consistent with trends in productivity growth and reductions in unemployment in MENA countries. Countries that experienced faster growth in output per labourer in the 1990s witnessed an increase in worker productivity, a decline in unemployment, or both."[7]

Sectoral composition and trends

In terms of sectoral structures, non-GCC ESCWA member countries vary widely (see figure 2 and annex II). In 2009, mining and utilities accounted for 55.3 per cent of GDP in Iraq, 26.0 per cent of GDP in the Syrian Arab Republic and 30.1 per cent of GDP in Yemen. Hydrocarbons also contributed to the Egyptian and Sudanese economies. Agriculture in the Sudan and the Syrian Arab Republic represents 28.8

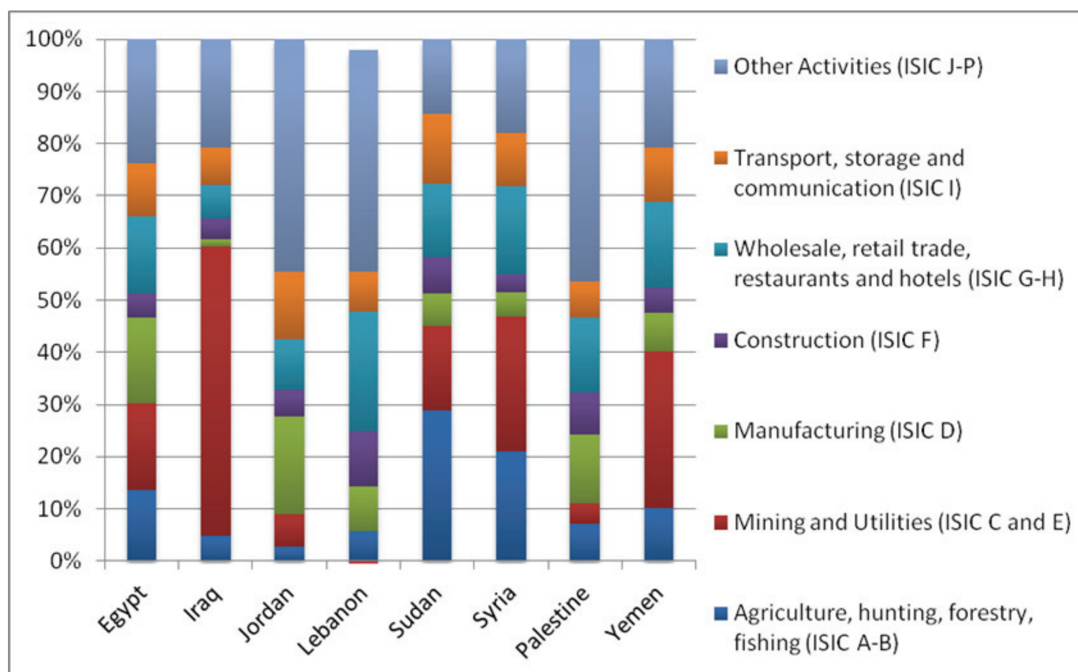
[5] "Employment elasticity to growth" refers to the percentage change in employment for every percentage of GDP growth.

[6] International Labour Organization (ILO), Key Indicators of the Labour Market, 6th edition, table 19, available from http://kilm.ilo.org/KILMnetBeta/.

[7] World Bank, 2004, p. 77.

and 21.0 per cent of GDP. Manufacturing makes up to 18.7 per cent of GDP in Jordan, and contributes significantly to GDP in Egypt and Palestine. Service and government sectors dominate the economies of Egypt, Jordan, Lebanon and Palestine.

Figure 2. Sectoral composition of GDP in selected countries, 2009



Source: United Nations, National Accounts Statistics: Main Aggregates database.

Note: ISIC is the International Standard Industrial Classification of All Economic Activities.

In the Syrian Arab Republic in 2010, increased oil production boosted the economy, as did growth in exports to Iraq and an expanding tourism sector. Growth was limited, however, by the weakened agricultural sector and increased need to import food.[8] Currently, political instability deters investment in several countries, and services are declining in line with a major decrease in tourism. In Lebanon, large capital inflows helped boost activity in construction, tourism, commerce, and financial services.[9] Growth is concentrated in retail trade, construction and tourism and in and around Beirut.[10] In Jordan, increased bank lending, real estate activity, exports and foreign direct investment (FDI) from GCC countries have boosted the economy.[11] In Iraq, rising oil production is expected to drive growth in the near term. With improved security, wholesale and retail trade and private investment are expected to recover.[12] In the Sudan, oil production was the main driver of growth, but it lost 75 per cent of its oil fields with the secession of South Sudan. The country is trying to diversify its economy, and it is expected that the trade of agricultural and manufactured products will create economic growth.[13] In 2010, the economies of non-GCC ESCWA member countries experienced strong service sector growth, but growth in fixed capital formation was lower than it had been in previous years.

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[8] Economist Intelligence Unit (EIU), 2011a, p. 7.

[9] International Monetary Fund (IMF), 2010a, p. 5.

[10] IMF, *Lebanon's Challenge: Reforming When Times Are Improving*, 8 October 2010, available from http://www.imf.org/external/pubs/ft/survey/so/2010/CAR100810A.htm.

[11] EIU, 2011b, p. 7.

[12] EIU, 2011c, p. 7.

[13] EIU, 2011d, p. 6.

TABLE 1. COMPOUND ANNUAL GROWTH RATES OF ECONOMIC SECTORS IN SELECTED COUNTRIES
(*Percentage*)

	Egypt	Iraq	Jordan	Lebanon	Palestine	Sudan	Syria	Yemen
Agriculture, hunting, forestry, fishing	3.6	2.0	3.2	2.0	3.2	3.8	4.6	5.2
Mining, manufacturing, utilities	6.3	1.5	6.4	1.3	4.8	7.0	5.2	7.1
Manufacturing	6.2	1.9	6.4	1.2	4.3	5.2	2.9	9.7
Construction	6.7	10.5	4.5	2.4	5.0	3.5	5.2	5.6
Wholesale and retail trade, restaurants and hotels	5.6	7.2	3.4	1.4	4.3	3.7	5.4	10.0
Transport, storage and communication	8.2	4.1	6.2	-1.6	7.4	5.1	6.3	6.0
Other activities	6.2	6.5	4.3	1.3	6.0	5.8	6.4	6.5
Total value added	5.6	2.5	4.7	1.1	5.2	4.8	5.4	6.9

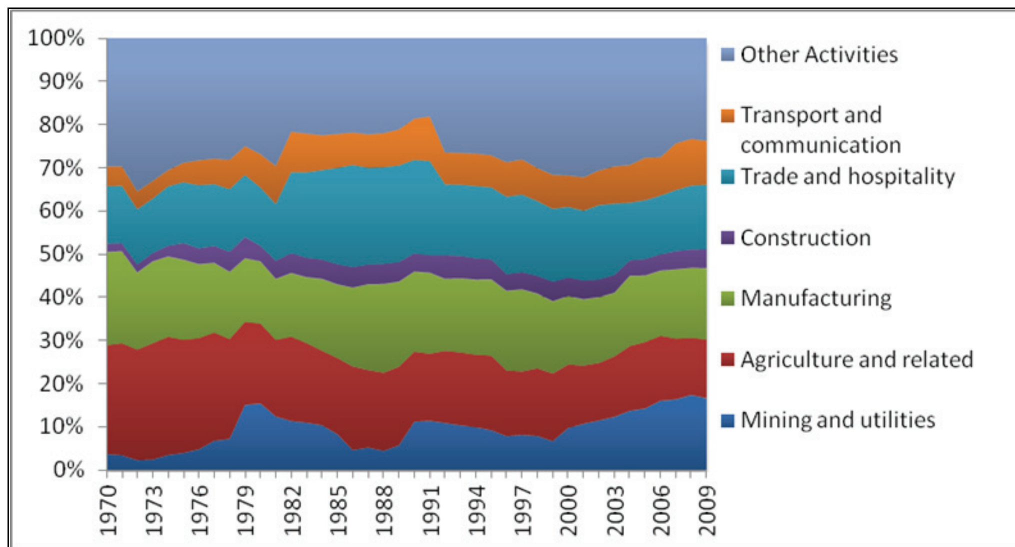
Source: United Nations, National Accounts Statistics: Main Aggregates database.

Note: Data for Yemen: 1989-2009, data for all other countries: 1970-2009.

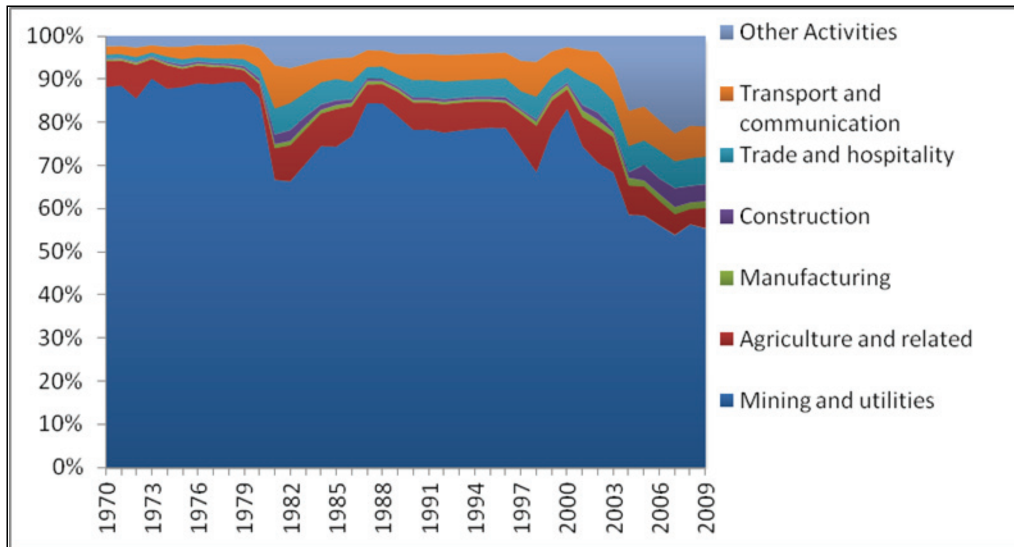
Table 1 shows annual growth rates for a variety of economic sectors, drawing upon data from 1970 to 2009. Manufacturing has shown the strongest growth in Egypt, Jordan, the Sudan and Yemen. Egypt and Iraq have both experienced significant growth in construction. Iraq and Lebanon witnessed the weakest overall growth, reflecting prolonged armed conflicts during this period. An examination of current prices and growth patterns in time series format provides a more nuanced understanding of the economy of each country.

Figure 3. Sectoral composition of GDP of non-GCC ESCWA member countries

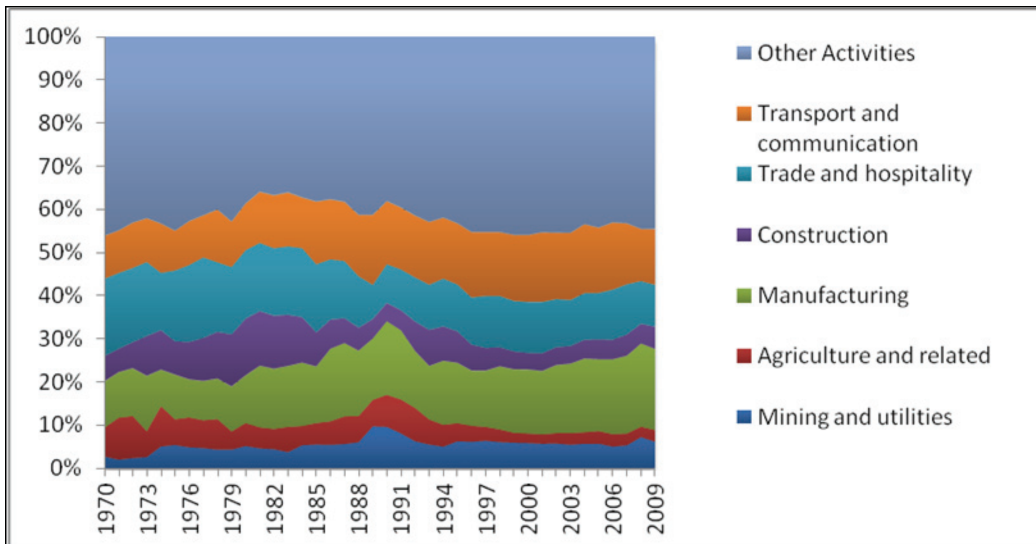
3a. Egypt, 1970-2009



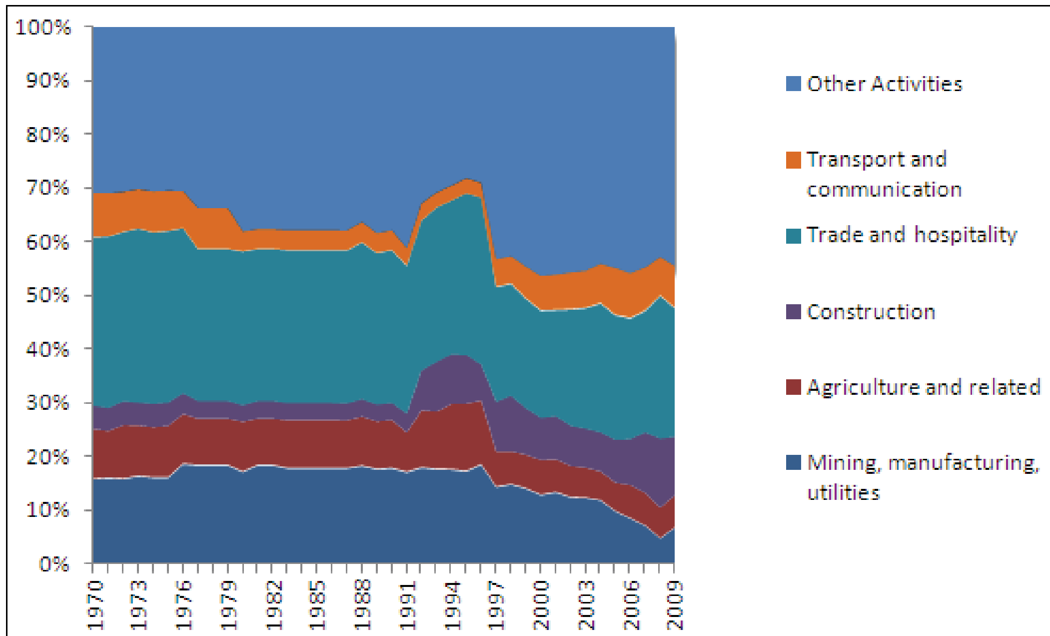
3b. Iraq, 1970-2009



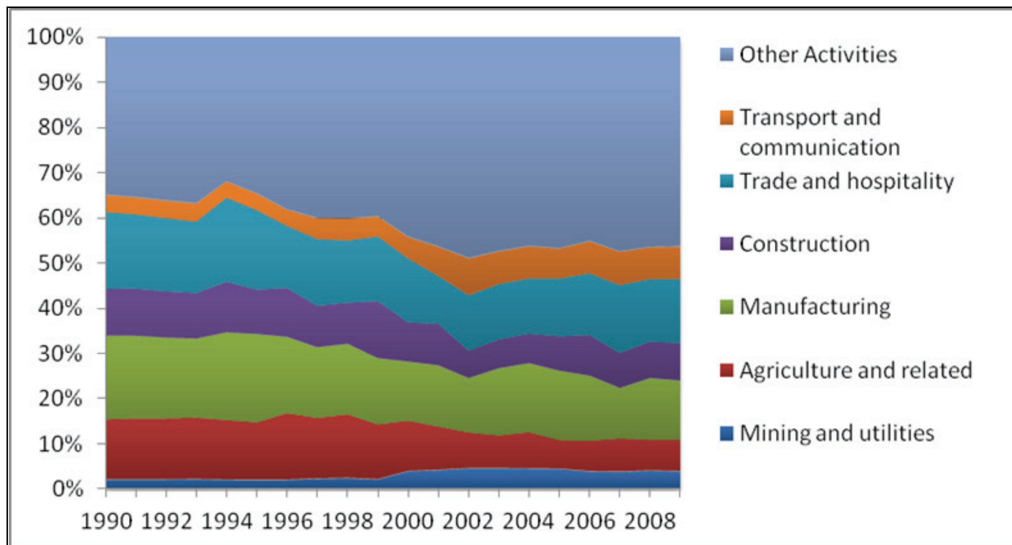
3c. Jordan, 1970-2009



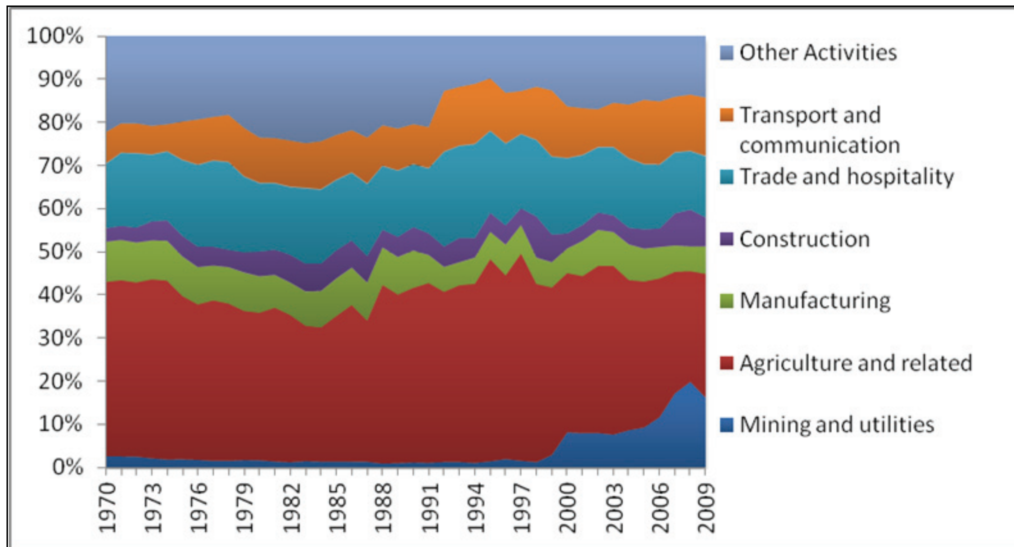
3d. Lebanon, 1970-2009



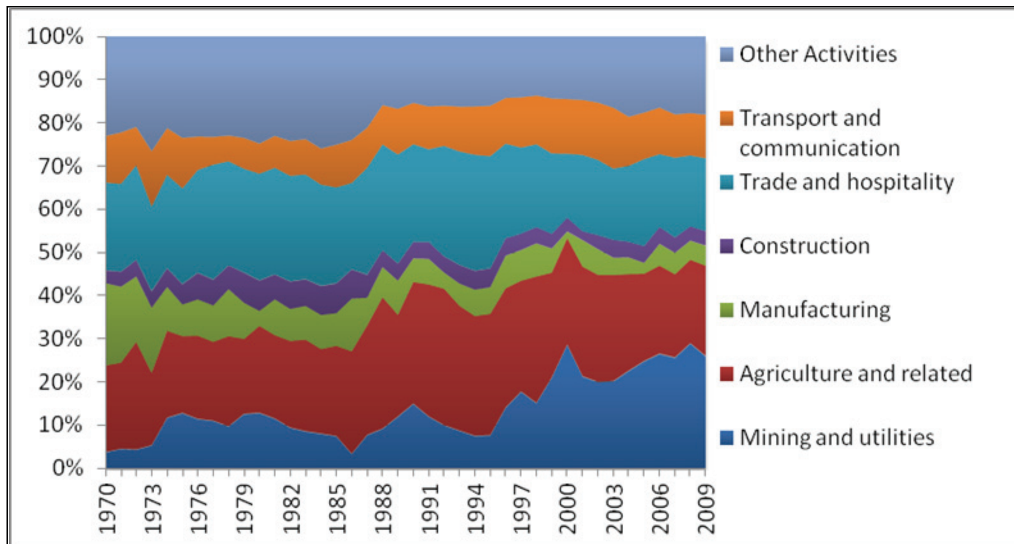
3e. Palestine, 1990-2008



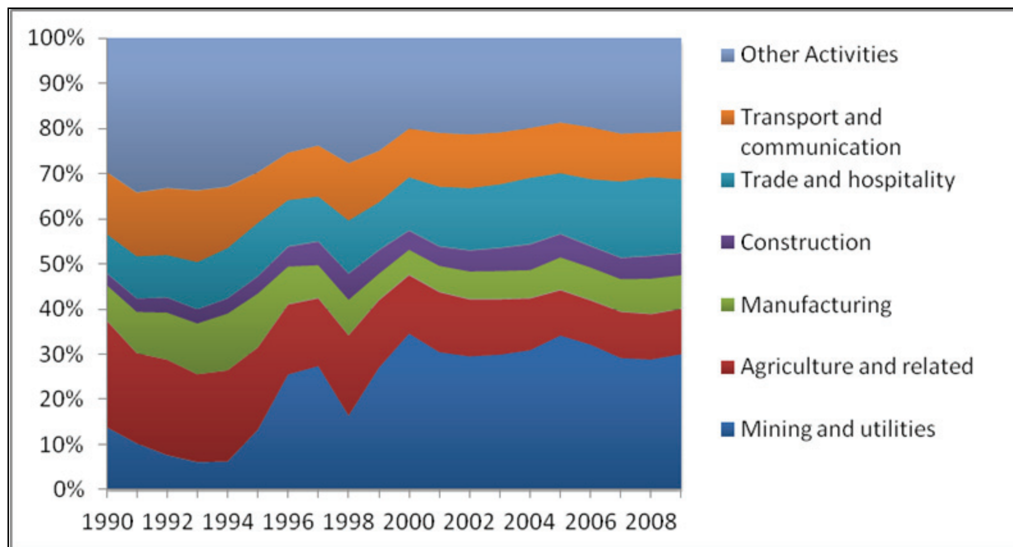
3f. Sudan, 1970-2009



3g. Syrian Arab Republic, 1970-2009



3h. Yemen, 1990-2008



Source: United Nations, National Accounts Statistics: Main Aggregates database.

One consistent trait of non-GCC ESCWA member countries has been a reduction in the contribution of agriculture to GDP (see figure 3). In the four major oil-producing countries (Iraq, the Sudan, the Syrian Arab Republic and Yemen), agriculture was once a more significant part of the economy, but it now accounts for a smaller share of the economy. Expanding oil production has reduced the share of other sectors as well. In the Syrian Arab Republic, for example, the growth of the oil sector has out-paced manufacturing and construction. In the Sudan, the oil sector has grown while the agriculture sector has contracted. The service sector has increased its share over time in Lebanon and Palestine, whereas the agricultural sector has declined. The manufacturing sector in Jordan has steadily expanded over the past two decades.

B. PUBLIC FINANCE: SOURCES OF REVENUE, FISCAL POSITION AND POLICY SPACE

Despite structural reforms during the 1990s, the role of Government in the economies of non-GCC ESCWA member countries is still far too large. Strategic service sectors, including banking, telecommunications and transportation, are publicly owned in many countries in the region. Moreover, government spending as a per cent of GDP ranges from 17.5 per cent in the Sudan to 43.6 per cent in Palestine and amounts to over 30 per cent in most non-GCC ESCWA member countries (see figure 4 and annex III). This rate is near the average for countries of the Organisation for Economic Co-operation and Development (OECD), but it is higher than the rate in other regions. For example, in 2010, government expenditures were 18.8 per cent of GDP in East Asia and the Pacific.[14]

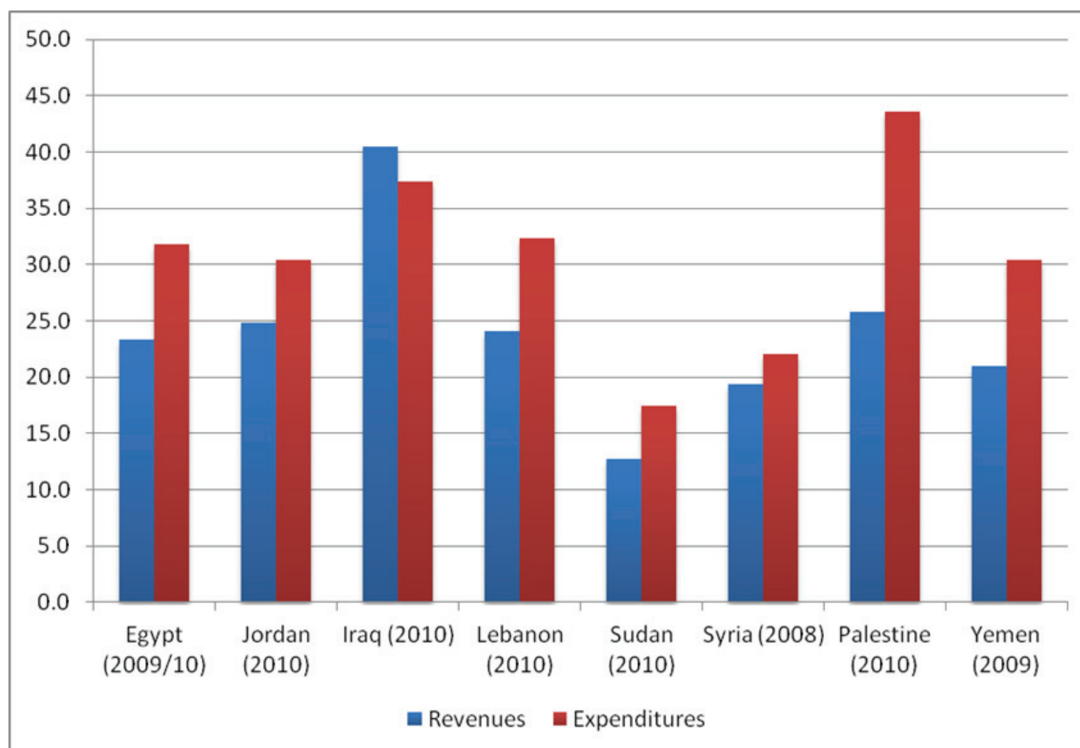
Government spending on wages is high, overwhelmingly so in several countries (see figure 5). Wages and salaries represented 23.3 per cent of total government spending in Egypt, 26.5 per cent in the Sudan and 29.7 per cent in Lebanon. In Iraq and Palestine, government spending on wages amounted to a considerable 41.5 per cent and 48.0 per cent of total spending. Among ESCWA member countries, average public spending on wages is higher than in other regions, including Latin America (26.8 per cent) and East Asia (27.7 per cent), and it is much higher than the OECD average (13.3 per cent).[15] Along with subsidies and transfers, wages dominate government spending in most countries in the region. In Yemen, more than

[14] World Development Indicators, available from http://data.worldbank.org/indicator/GC.XPN.TOTL.GD.ZS.

[15] Ibid., all figures are from 2009.

75 per cent of current spending goes to wages, subsidies and transfers.[16] In Iraq, the 2006/2007 Household Socio-Economic Survey reported that 30 per cent of total household income came from the public sector employment and 15 per cent came from cash and in-kind transfers.[17] One major implication of such high spending on wages and subsidies is that it leaves less money for development expenditure and investment.

Figure 4. Government revenues and expenditures in selected countries
(*Percentage of GDP*)



Sources: Central Bank of Egypt, 2011; Central Bank of Jordan, 2010; Central Bank of Iraq, 2010; Lebanon, 2010b; Central Bank of Sudan, 2010; IMF, 2010b; Palestine Monetary Authority, 2011b; Central Bank of Yemen, 2009.

Notes: Egypt (budget sector only); Jordan, Syrian Arab Republic and Yemen (preliminary); the Sudan (estimated); Palestine is for the Palestinian National Authority.

"Although the size of the central government in MENA is not much larger than in developing countries . . . it is heavily involved in many private-sector economic activities and plays the role of the employer of first choice and last resort."[18] This has created a number of undesirable effects, discussed below.

With the exception of Iraq, all non-GCC ESCWA member countries have run fiscal deficits in recent years. Countries must be mindful of the gap between revenues and expenditures, as public debt is a significant problem and restrains fiscal flexibility. In 2010, IMF estimated gross government debt was about 55 per cent of GDP in the Sudan and near 75 per cent of GDP in Egypt.[19] Lebanon's public debt amounts to 148.2 per cent of GDP and ranks among the highest in the world. Nearly half of the annual budget is allocated to interest payments, curtailing productive public spending.[20] A quarter of Egypt's revenues go

[16] Central Bank of Yemen, 2010, p. 27.

[17] IMF, 2010c, p. 13.

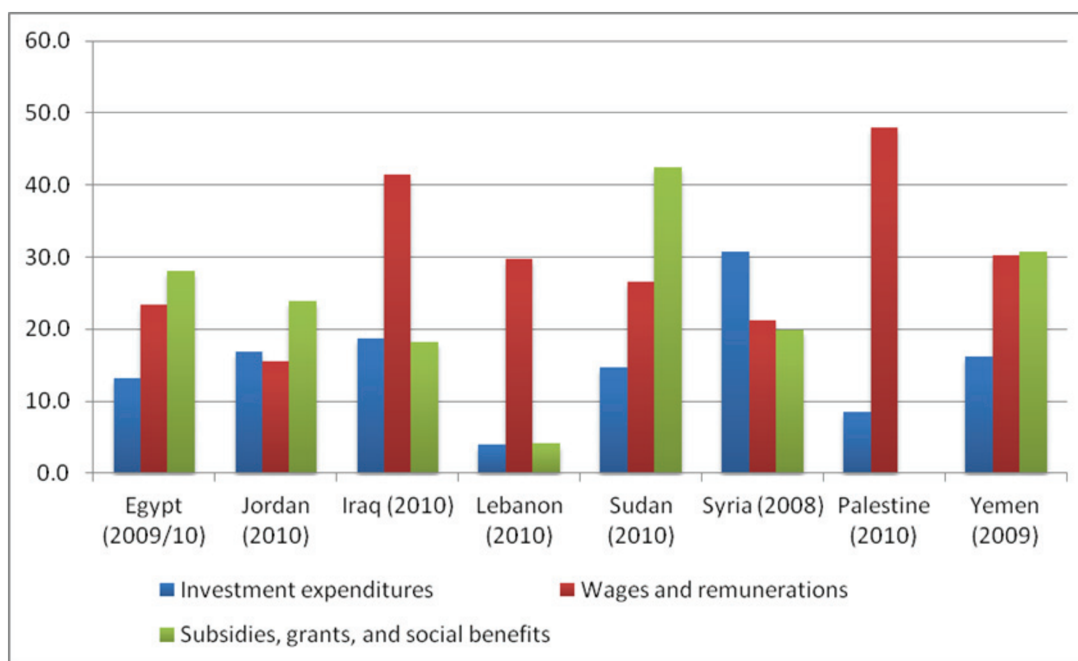
[18] IMF, 2011a, p. 11.

[19] IMF, 2010d, p. 22; and IMF 2010e, p. 20.

[20] Lebanon, 2010b, p. 5.

towards interest payments. Fiscal reform, particularly expanding revenue collection, is vital to reduce the structural deficit and allow government spending to be driven by current and future needs.

Figure 5. Government spending in selected countries
(*Percentage of total expenditure*)



Sources: See figure 4.

Notes: Egypt (budget sector only); Jordan, Syrian Arab Republic and Yemen (preliminary); the Sudan (estimated); Palestine is for the Palestinian National Authority.

Rents, bilateral aid flows and remittances

Since oil exports per capita are much lower in non-GCC countries than in GCC, greater diversification away from hydrocarbons is an important step for labour-abundant, oil-exporting countries. This is particularly the case for the Sudan, the Syrian Arab Republic and Yemen, whose exports include a significant share of hydrocarbons. From 2005 to 2009, natural resource rents hovered between 21 and 33 per cent of GDP for these three countries and made up 88 per cent of GDP in Iraq (see table 2). In all of these countries, such steps as the sterilization of oil revenue should be taken to ensure that resource rents contribute to other productive sectors of the economy.

Additionally, several countries in the region rely on significant external sources of revenue and this has important structural consequences. Two main sources of revenue are foreign aid and worker remittances. Foreign aid has varying significance in the economies of Iraq, Jordan, Palestine and Yemen. Worker remittances make up more than 10 per cent of GDPs of Jordan, Lebanon and Palestine. In Palestine, the combined share of remittances and bilateral aid is 35 per cent of GDP. The significance of foreign aid and remittances means that these countries are vulnerable to developments in GCC countries, where much of the revenue originates. Jordan's economy in particular is dependent on GCC growth, and GCC countries "account for the largest share of Jordanian trade, remittances, grants, FDI and tourism receipts."[21] It is estimated that 600,000 Jordanians work in GCC countries and their remittances reached US$2.7 billion in 2010.[22]

[21] IMF, 2010f, p. 5.

[22] EIU, 2011b, p. 12.

TABLE 2. NATURAL RESOURCE RENTS, BILATERAL AID AND WORKER REMITTANCES IN SELECTED COUNTRIES
(*Percentage of GDP*)

	Natural resource rents		Net bilateral aid		Worker remittances	
	2005-2009 average	2009	2005-2009 average	2009[a/]	2006-2010 average	2010[b/]
Egypt	20.0	10.7	0.7	0.4	4.7	3.5
Iraq	88.0	68.6	24.3	4.1	0.2	0.1
Jordan	2.3	1.7	2.6	2.3	16.4	13.2
Lebanon	-	-	2.0	1.3	21.0	13.1
Sudan	21.7	16.9	4.6	3.9	3.9	3.2
Syria	25.7	14.4	0.2	0.2	2.7	2.8
Palestine	-	-	-	19.4	-	17.6
Yemen	32.9	19.7	0.9	1.0	5.6	4.4

Source: World Development Indicators.

Notes: a/ Figure for Palestine is for 2005.
b/ Figure for Palestine is for 2005; and figure for Yemen is for 2009.

The structural consequences of these rents include external dependence, migration and brain drain, revenue volatility and weak incentives to reform public finance systems. In addition, large remittance inflows can lead to currency appreciation and lower export competitiveness. Of course, remittances have socioeconomic benefits, including poverty reduction and improved standards of living, in addition to potential costs. Remittances are free from political strings and conditions, unlike bilateral aid. Remittances also have a positive impact on domestic demand and foreign exchange earnings.

"Remittances have historically helped finance consumption and small and medium-sized enterprises' investments in labour-exporting countries."[23] In addition to serving as an important source of income, labour mobility also contributes to economic growth and employment creation by improving human capital formation, increasing productive investments, increasing efficiency and facilitating a better match between the skills supply and demand.[24] Furthermore, return migration can lead to increased investments by migrants in their countries of origin.

Fiscal and tax policy

Fiscal policy is closely tied to important labour-market issues. Subsidy regimes can destroy product markets and the employment opportunities they offer. They also distort consumption decisions that indirectly reduce the size of other markets. Along with subsidies, weak taxation means less money for development expenditure on health, education, infrastructure and other vital government programmes. Sales taxes are a viable option to build government capital for development, but it requires good regulation and administrative capacity.

In the Sudan, key structural reforms in the financial sector were completed during the previous decade. Major tax policy and public financial management reforms were implemented. In terms of revenue, IMF noted that, "VAT was introduced, exemptions on income tax were streamlined, excise was imposed on petroleum products, the customs tariff structure was improved, and the granting of new tax exemptions was stopped. Improvements were also made in budget classification, cash management and fiscal reporting."[25] The IMF credited these reforms with boosting real growth, reducing inflation and containing the fiscal deficit.

[23] ESCWA and the League of Arab States 2010, p. 116.

[24] Robert Holzmann, 2010.

[25] IMF, 2010d, p. 17.

"Steady public finance reforms have allowed the Palestinian Authority to tightly control and prioritize expenditures, prepare and execute annual budgets, enhance transparency . . . and prepare annual financial statements for external audit."[26] These improvements boosted investor confidence, which contributed to the economic recovery. In addition, these reforms shifted spending away from wages and subsidies and toward development projects, which improved public spending quality.[27] These reforms drove strong economic performance in the West Bank since 2008.

Despite prior commitments to reduce spending and boost tax revenues, several Governments responded to recent sociopolitical events with tax cuts and increased spending on subsidies and salaries for government employees and new development programmes. Favourable prices have given oil producers greater fiscal space to implement such spending programmes. However, most non-GCC countries cannot afford increased spending measures. Both Yemen and the Syrian Arab Republic face security challenges that may overwhelm government coping mechanism. Non-oil producers in the region may have an even more difficult time meeting spending pledges because the cost of energy has increased.

One result of higher spending on subsidies and wages is that there will be fewer resources for development spending and major infrastructure projects. Some countries have turned to international donors to meet budget shortfalls. Large international agencies have made pledges of support, and GCC countries have also helped resource-poor countries in the region. Saudi Arabia in particular has made pledges of assistance to Jordan and Yemen to help them meet budget shortfalls.

Infrastructure development

To encourage private sector growth and investment, the countries of the region must improve their infrastructure and major utilities sectors. To improve infrastructure in the region, some countries have developed public-private partnerships to reduce the fiscal burdens placed on the State and encourage the involvement of the private sector. For example, Jordan has an ambitious plan for infrastructure development to provide power, water and rail transportation, which will be financed by public-private partnerships.[28]

In Lebanon, the privatization of the State-owned electricity and telecommunications sectors is an essential step if the country is to reduce its massive public debt. According to IMF, Lebanon has the lowest levels of public investment as a percentage of GDP in the MENA region, at an average 2.5 per cent from 2003 to 2008.[29] Low capital spending has created infrastructure shortages, which have resulted in severe bottlenecks. Lebanese authorities plan to develop public-private partnerships, but political uncertainty may hinder those efforts.

C. EMPLOYMENT: THE QUALITY OF JOB CREATION

Labour forces of non-GCC ESCWA member countries share several key characteristics: low labour-force participation, particularly among women; high unemployment overall; and very high unemployment among youth (see table 3). Labour-force participation rates are quite low, ranging from under 40 per cent in Jordan and Palestine to 51.9 per cent in the Sudan. The world average is 61.2 per cent.[30] Despite low participation rates, unemployment rates are high. Officially, unemployment is around 15 per cent in Iraq, Palestine, the Sudan and Yemen, and youth unemployment rates are extremely high.

[26] IMF, 2011b, p. 29.

[27] Ibid., pp. 29-30.

[28] IMF, 2010f, p. 13.

[29] IMF, 2010a, p. 8.

[30] European Commission, 2010a, p. 12.

TABLE 3. LABOUR-FORCE CHARACTERISTICS IN SELECTED COUNTRIES
(*Percentage*)

	Labour-force participation	Female labour participation	Unemployment	Youth unemployment
Egypt (2007)[a/]	50.3	24.4	8.9	24.8
Iraq (2008)[b/]	-	-	15.3	43.5
Jordan (2010)	39.5	14.7	12.5	28.1
Lebanon (2007)	43.4	21.1	9.0	22.1
Sudan (2009)[c/]	52.0		20.0	-
Syria (2010)	43.7	14.0	8.4	18.3
Palestine (2010)[d/]	39.5	14.5	23.7	40.2
Yemen (2009)	42.2	9.9	14.6	-

Source: http://laborsta.ilo.org/; Sudan, 2009, pp. 67-68.

Notes: a/ Unemployment rate is for 2010.
b/ Youth unemployment is for 2006.
c/ Labour-force participation is for 1996.
d/ Youth unemployment is for 2008.

During the past three decades, the public sector of ESCWA member countries has played a major role in absorbing the increasing labour force. Several countries have high levels of public employment (see figure 6). In the Syrian Arab Republic, 28.9 per cent of jobs are with the Government. In Jordan and Iraq, public sector employment constitutes 37.8 and 43.0 per cent of formal employment. Many new entrants to the labour market, particularly women and college graduates, prefer public sector jobs that offer better working conditions and salaries.[31]

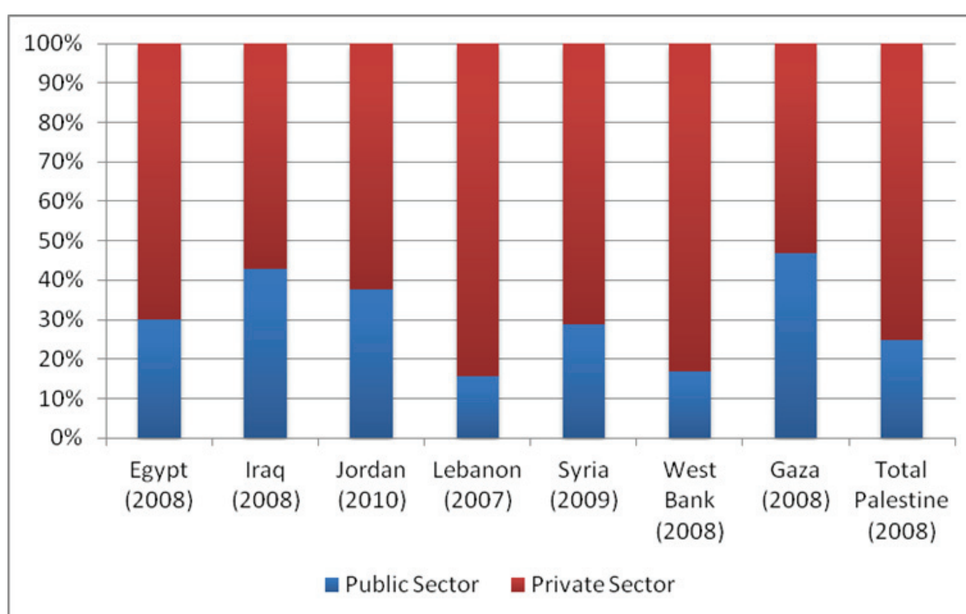
In recent years, the private sector has absorbed more new entrants into the labour force than the public sector. In Egypt, private sector employment as a share of total employment has increased dramatically since the mid 1990s. By 2006, the public sector of Egypt made up approximately, "30 per cent of total employment with 25 per cent in the government sector and 5 per cent in public enterprises as opposed to almost 37 per cent a decade earlier."[32] In Jordan, private sector employment increased steadily from 1995 to 2006, but many jobs in labour-intensive manufacturing and construction projects were created only to be filled primarily by migrants. Such capital-intensive sectors as finance and transport employed a greater share of Jordanians, but they created relatively fewer jobs, and on the whole, migrants filled 62.8 per cent of new jobs created in Jordan between 2001 and 2005.[33]

[31] Ibid., p. 33.

[32] European Commission, 2010b, p. 17.

[33] Ibid., pp. 123-124.

Figure 6. Private and public employment in selected countries



Sources: Egypt: Marga Peeters, 2011, p. 13; Iraq: IAU, 2009, p. 1; Jordan: Department of Statistics, 2010, table 5.9; Lebanon: Central Administration of Statistics, 2007, p. 85; Syrian Arab Republic: Central Bureau of Statistics, 2010, workers distribution by occupations, sector and gender; Palestine: Central Bureau of Statistics, Labour Force Survey 2008, p. 104.

The trend of increasing private sector employment has not reached every country in the region. In Iraq, a labour-force analysis conducted by the Inter-Agency Information and Analysis Unit and the Office for the Coordination of Humanitarian Affairs noted that the number of employees in the Government or in State-owned companies almost doubled from 2005 to 2008, while full-time private employment fell from 25 per cent of total employment in 2003 to 17 per cent in 2008.[34] The analysis found that "opportunities for private sector job creation [were] limited by a dominant public sector, the absence of a conducive regulatory environment, high dependence on oil revenues and security issues."[35] In Palestine, public sector employment grew more than private sector employment from 2000 to 2008 because the Government took steps to absorb many workers who were closed out of the Israeli labour market.[36]

High rates of government employment that outcompetes the private sector in wages and nonwage benefits create a number of undesirable effects on labour markets, including the following: (1) reducing the productivity of the labour market without contributing significantly to growth; (2) creating high wage expectations and hence high reservation wages; (3) rewarding educational credentials that might not have much value in the modern economy; and (4) segmenting the labour-market.[37] Together, these effects hurt the performance of the private sector.

While real wages have increased marginally in some countries, they have stagnated or declined in the Middle East, extending a trend that began in the 1980s.[38] In Egypt, median real wages actually increased

[34] IAU, 2009, p. 3. Available from http://www.iauiraq.org/reports/Iraq_Labour_Force_Analysis.pdf.

[35] Ibid., p. 1.

[36] European Commission, 2010b, p. 87.

[37] World Bank, 2008, pp. 225-228. András Bodor, 2010, noted that in Egypt, the Syrian Arab Republic and Yemen, rates of return for additional education are typically higher in the public sector than in the private sector.

[38] World Bank, 2004, p. 73.

from 1998 to 2006.[39] However, in Egypt, Palestine, Jordan and the Syrian Arab Republic, average public sector wages are greater than average private sector wages (see table 4). In Egypt, although government jobs continue to attract certain groups (including women and vocational school graduates) and pay higher wages than the private sector, the public/private wage gap declined significantly in 2006.[40]

TABLE 4. MINIMUM AND AVERAGE MONTHLY WAGES IN SELECTED COUNTRIES
(*United States dollars*)

	Egypt	Palestine	Jordan	Lebanon	Syria
Public sector (average)	190	433	415	-	186
Private sector (average)	132	391	333	601	178
Minimum wage	126	-	195	318	128

Source: European Commission, 2010a, p. 41.

Note: Data originally provided in Euros. Latest available data according to various national background papers commissioned by the European Commission. For Lebanon private sector, the labour costs (rather than wages) are shown.

High levels of government employment serve important social functions, redistributing wealth and shielding a significant portion of the workforce from economic fluctuations.[41] Those who have access to social insurance programmes receive generous benefits, but many people are not covered by such programmes. Most countries have programmes that provide for old age, disability, survivors and workplace injury, but few provide coverage for health, unemployment, maternity and family allowance. Egypt is the only country that offers unemployment protection, where indemnity is paid for a period from 16 to 28 weeks.[42] This calls for further measures to establish a social protection floor in non-GCC ESCWA member countries to ensure universal access to subsistence social security, income support and essential health services, including assistance to the poor, the unemployed, children and the elderly.[43] The United Nations system strongly supports the social protection floor and its implementation is estimated to cost as little as 1-2 per cent of global GDP,[44] an amount that most ESCWA member countries can afford, provided that there is political will to prioritize this objective.

There are several policy options for containing public spending on wages, reducing public employment and directing new labour-market entrants toward private sector employment. Options include natural attrition and hiring freezes, accelerating attrition through substantial wage adjustments or benefit cuts and encouraging the acquisition of skills better suited to the needs of the private sector. Simulations examining the impact of public sector wage reductions show that while unemployment might increase in the short run, private sector investment and employment is likely to increase in the long run.[45] It is probable that non-GCC ESCWA member countries will continue to provide employment for new job seekers, but it is unlikely that the public sector will remain a leading sector of job creation in the future.

The informal economy

In the private sector labour markets of non-GCC ESCWA member countries, the formal sector does not provide enough jobs and therefore many workers enter the informal sector. Although it is difficult to

[39] European Commission, 2010b, p. 26.

[40] Ibid.

[41] World Bank, 2004, p. 123.

[42] András Bodor, 2010.

[43] ILO, 2009, p. 7.

[44] ILO, 2008, p. 11.

[45] The outcomes of these simulations are reported in Pierre-Richard Agénor et al., 2004.

measure, the informal economy is thought to be quite large among ESCWA member countries. The European Commission estimated that informal work in the Syrian Arab Republic "constitutes 79 per cent of employment outside agriculture, State-owned enterprises and administration."[46] In 2006, an estimated 61 per cent of all employment in Egypt was informal[47] and a combined 64 per cent of formal employment was in the Government and public enterprises.[48] As countries look to the private sector to foster job creation, the potential of the informal economy should not be overlooked.

The informal economy comprises "productive, small-scale activities with the potential for growth and technical upgrading" that rely on labour-intensive technologies and "survival activities that employ people without any particular skill," including, "family enterprises that rely primarily on household labour, self-employed workers with close subcontracting . . . and artisans . . . casual wage workers who work intermittently or seasonally . . . and regular wage workers who work for large firms without employment contracts or social insurance coverage."[49] The informal sector provides opportunities for work and income to many who could not find formal work. However, informal employment can bring about negative economic effects. It "depresses wages, hampers the development of human capital and introduces major distortions into the functioning of the goods and services markets."[50]

A major challenge for Governments of ESCWA member countries is to take advantage of the growing labour force, which is increasingly educated. Governments should develop policies to harness this human capital by creating an environment that fosters private sector development and economic growth.

Structural reforms and their impact

Restrictive labour regulations, including restrictions on hiring and firing are an obstacle to private sector development because they "discourage enterprise restructuring by imposing excessive costs and large administrative burdens."[51] Furthermore, restrictions on hiring and firing have a negative impact on productivity and technology adoption. The European Commission noted that among Arab Mediterranean countries, "labour legislation is extremely rigid on paper . . . but highly flexible in practice due to poor enforcement and the prevalence of informal employment."[52]

Many ESCWA member countries have begun to undertake structural reform programmes, to reduce public spending, boost revenue collection, establish functioning foreign exchange markets and liberalize trade. These measures promote growth and private-sector development, and are expected to improve labour-market outcomes. "Although early . . . structural reforms improved economic outlooks, most countries failed to follow through on reforms . . . the private sector . . . remains stifled by government intervention in the economy and the limited progress in integrating the region into the world economy through trade and investment."[53] Reducing government employment and cutting subsidies have proven more difficult than expected.

[46] European Commission, 2010b, p. 204.

[47] Ragui Assaad, 2007, p. 1.

[48] R. Gatti et al., 2010.

[49] World Bank, 2004, pp.107-108.

[50] European Commission, 2010a, p. 14.

[51] World Bank, 2004, p. 141.

[52] European Commission, 2010a, p. 38.

[53] World Bank, 2004, p. 82.

II. ECONOMIC STRUCTURE, DIVERSIFICATION AND MACROECONOMIC POSITION OF GCC COUNTRIES

The present chapter will provide an analysis of the drivers of growth, economic structures and related labour-market dynamics of GCC countries. These countries are quite different from others in the region and require an analysis of labour-market dynamics specific to high-rent oil exporters with open migration regimes.

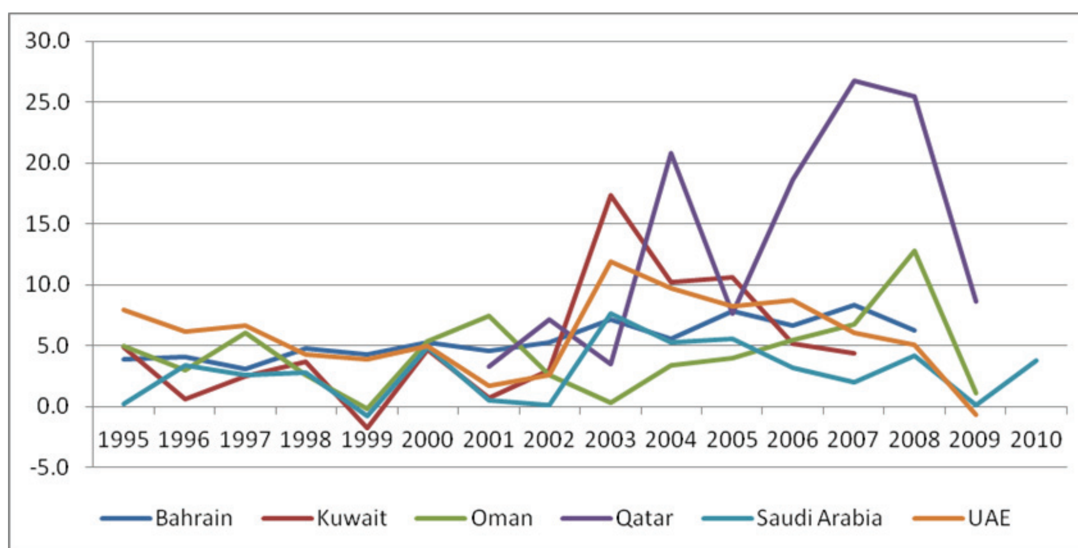
This chapter will review labour-market developments and the composition of GCC economies over time. It will show that although GCC countries have achieved considerable mid-range diversification, it has been driven by State spending. Owing to an open migration regime, growth has been factor-intensive rather than technology intensive, with a small share of well-remunerated "quality jobs" in the economy, labour productivity stagnating at low levels and cheap migrant labour dominating private labour markets. GCC citizens' reservation wages are augmented by generous subsidies that impede the integration of nationals into private labour markets. Nationalization of the labour force will remain difficult unless migration regimes are reformed and the distribution of State resources is disentangled from State employment.

The impact of the economic crisis on GCC countries has been moderate compared with many other emerging markets, and each maintained positive growth rates through 2010 with the exceptions of Kuwait and the United Arab Emirates in 2009. Although private credit creation has been strongly affected by the crisis, stepped-up State spending has guaranteed continued economic expansion, but with the result of a larger government share in the economy, which could make business-driven growth and diversification more difficult in the long run.

A. ECONOMIC GROWTH AND THE SIZE AND SHAPE OF THE ECONOMY

Strong oil prices in the 2000s have driven the growth of GCC economies, and in real terms, oil prices have reached peaks comparable to those of the 1970s/1980s boom period (see figure 7 and annex II). Production levels during both periods are roughly comparable, as are rents to GCC Governments. Growth has slowed, but not stopped as a result of the global financial crisis.

Figure 7. Nominal GDP growth rates of GCC countries, 1995-2010



Source: World Development Indicators.

Much of the recent growth has been driven by oil-financed State spending, which has doubled or even quadrupled during the last decade, reflected in an increase in break-even oil prices.

Sectoral composition and trends

Since the onset of the oil age in the early 1970s, the economies of GCC countries have witnessed above-average real growth in non-mining, non-agriculture sectors, indicating a trend of diversification (see table 5).

TABLE 5. SECTORAL COMPOSITION OF GCC ECONOMIES, COMPOUND ANNUAL GROWTH RATES, 1971-2009
(*Percentage*)

	Bahrain	Kuwait	Oman	Qatar	Saudi Arabia	United Arab Emirates
Agriculture, hunting, forestry, fishing	4.4	6.6	1.4	2.4	7.3	13.8
Mining, manufacturing, utilities	3.2	-0.6	8.9	8.4	4.3	7.0
Manufacturing	9.8	5.4	23.5	9.4	8.6	19.3
Construction	6.1	5.7	7.7	10.8	7.1	10.6
Wholesale and retail trade, restaurants and hotels	6.6	4.6	18.1	10.7	10.7	9.8
Transport, storage and communication	9.7	12.5	22.0	16.4	8.4	12.0
Other activities	9.1	8.1	12.9	10.8	6.5	13.2
Total value added	6.1	1.8	10.0	9.5	5.8	8.8

Source: United Nations, National Accounts Statistics: Main Aggregates database.

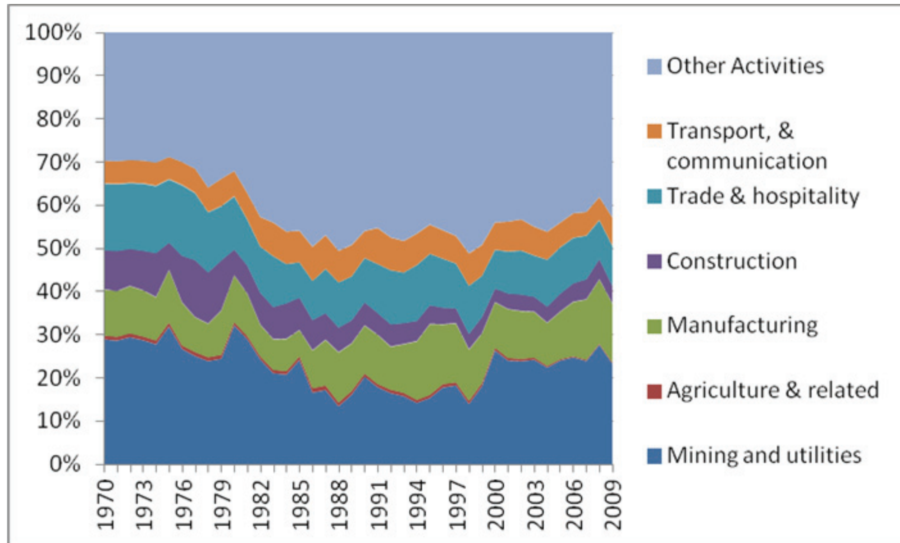
More informative than compound average growth rates are growth patterns in time series format, which show how periods of oil "boom and bust" have shaped the sectoral composition of GCC economies over time. The time series shows that GCC economies achieved greater diversification during the 2000s boom than during the boom in the 1970s.

State spending increased, and mining grew as a share of GDP from 2000 onwards. With the exception of Oman, the share of "mining and utilities" in total GDP has not returned to levels witnessed four decades ago (see figure 8).

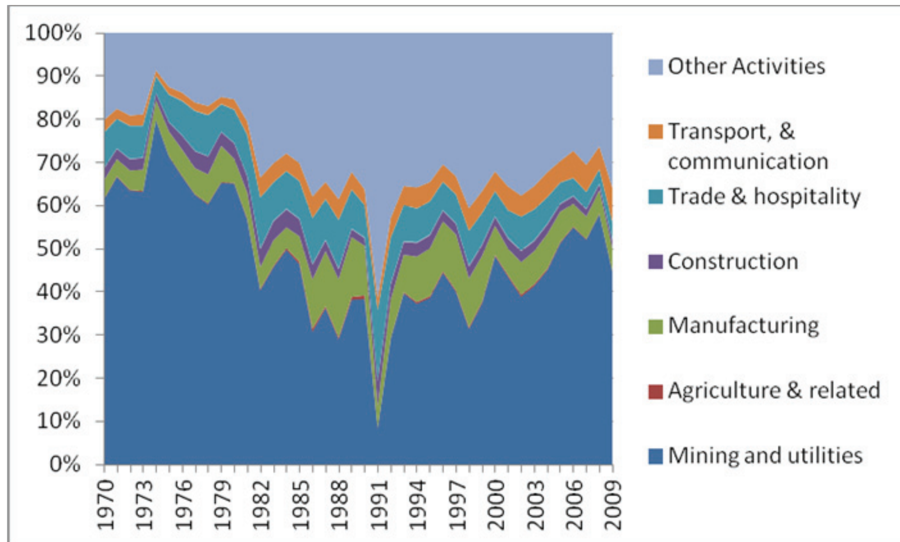
Figure 8 shows growth in the manufacturing sector for all countries (although growth was weak in Bahrain and Kuwait), and expansion in transport and communications, which signifies economic maturation and diversification. While manufacturing still relies on cheap energy input and other locally available feedstock, it is an important step down the value chain and has helped GCC economies develop new markets overseas. The development of transport and communications reflects a maturing local service economy. Oman and the United Arab Emirates have also succeeded in growing their trade and hospitality sectors, signifying another push into a more service-driven economy.

Figure 8. Sectoral composition of GDP of GCC countries

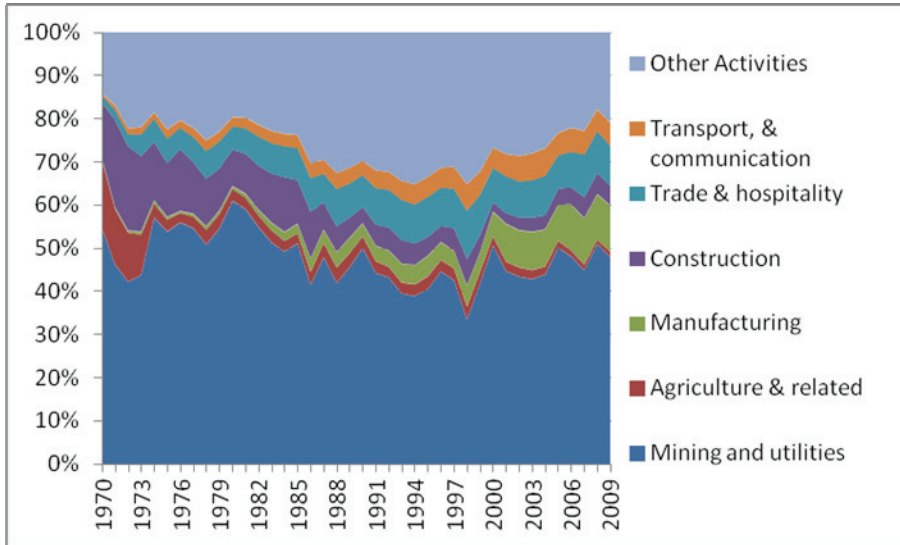
8a. Bahrain, 1970-2009



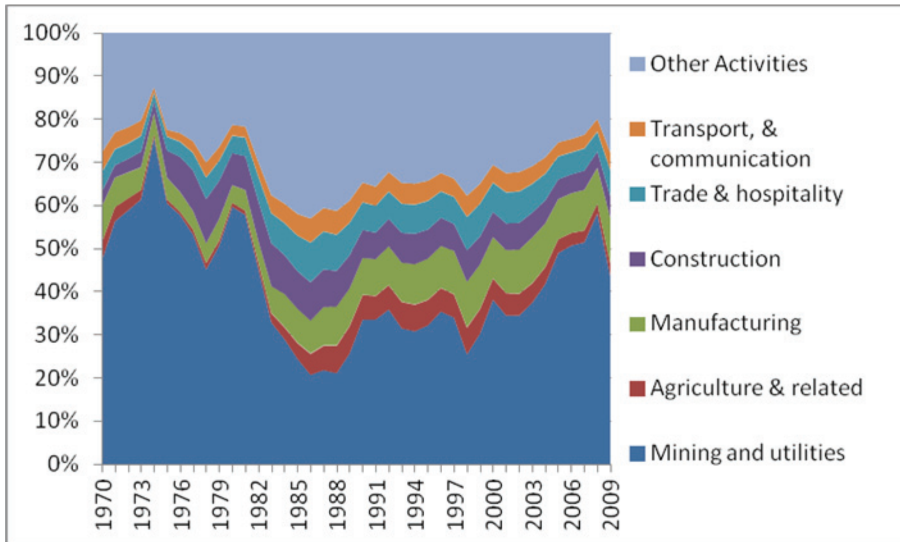
8b. Kuwait, 1970-2009



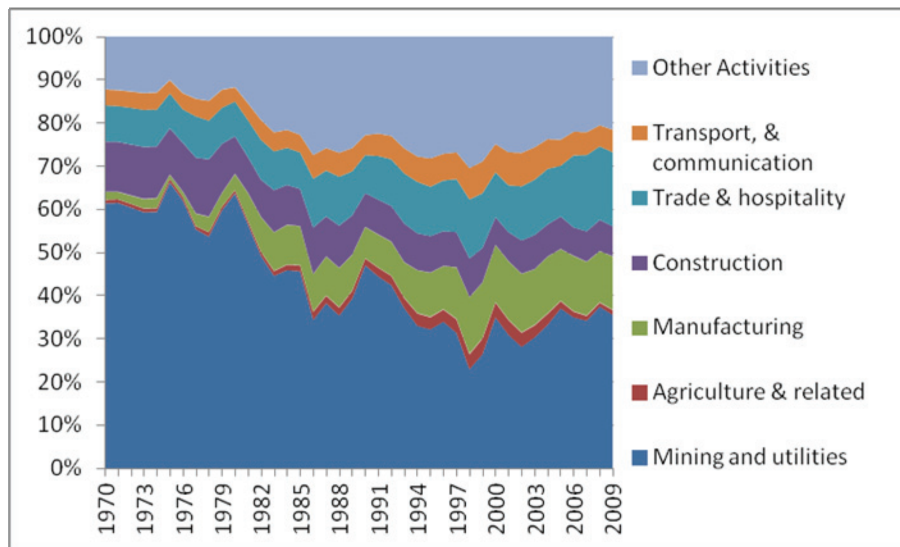
8c. Oman, 1970-2009



8d. Saudi Arabia, 1970-2009



8e. United Arab Emirates, 1970-2009



Source: United Nations, National Accounts Statistics: Main Aggregates database.

Diversification is partially driven by State-owned companies, as is the case for heavy industry all across the region, and transport and hospitality in the United Arab Emirates and Qatar. Available statistics do not allow a breakdown of specific sectors into public and private ownership.

In contrast to the above-mentioned fields, the construction sector represents a diminishing share of GCC economies. This is a positive sign, as construction is often driven by boom-time State expenditure and rapid expansion in the sector has repeatedly proven unsustainable.

The graphs in figure 8 provide the most comparable, detailed longitudinal data on GDP composition in GCC countries. They do not, however, measure the relative growth of subsectors like finance, real estate, public administration, education and health, which are combined in the “other activities” category. In GCC countries, this category is usually the second largest after mining and utilities, and can be taken as a rough proxy for government activities. Of course, considerable shares of finance and real estate are privately held, but the public sector remains the dominant force. Individual national accounts show that the financial and business services sectors of Bahrain, Qatar and the United Arab Emirates have grown.

These sectors remain largely driven by expatriate labour, and are characterized by less advanced technology models. Even banks, which are among the most modern and profitable businesses in GCC countries tend to operate on old technological systems,[54] and there is very little research and development in the region (see chapter IV). More ambitious strategies of technological development and diversification are limited to government-owned companies that can rely on implicit sovereign backing to engage in longer-term research and product development.[55] Examples include the investment of Saudi Basic Industries Corporation into materials research and national human resource development, or the efforts of Abu Dhabi’s Advanced Technology Investment Company in building up a local semiconductor industry through large-scale local recruitment and training efforts.

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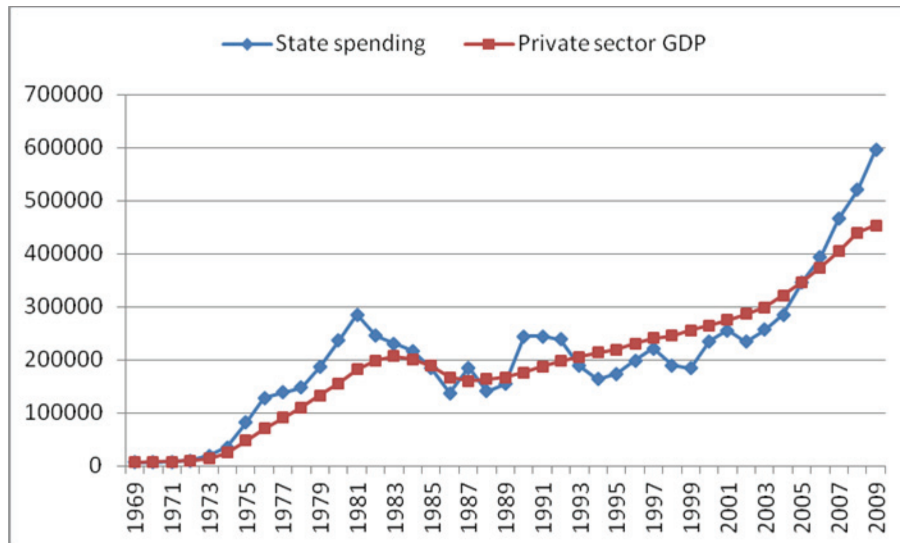
[54] Based on interviews conducted by Steffen Hertog with a human resources consultant working in the banking sector, Dubai, July 2011; a human resources manager at Samba Financial Group, Riyadh, November 2005; and a former human resources manager at a leading Abu Dhabi bank, London, September 2011.

[55] Steffen Hertog, 2010a, pp. 267-268.

Although GCC economies are more diversified, growth patterns in the private sector still broadly follow State spending, as is illustrated by the examples below (see figures 9 and 10).

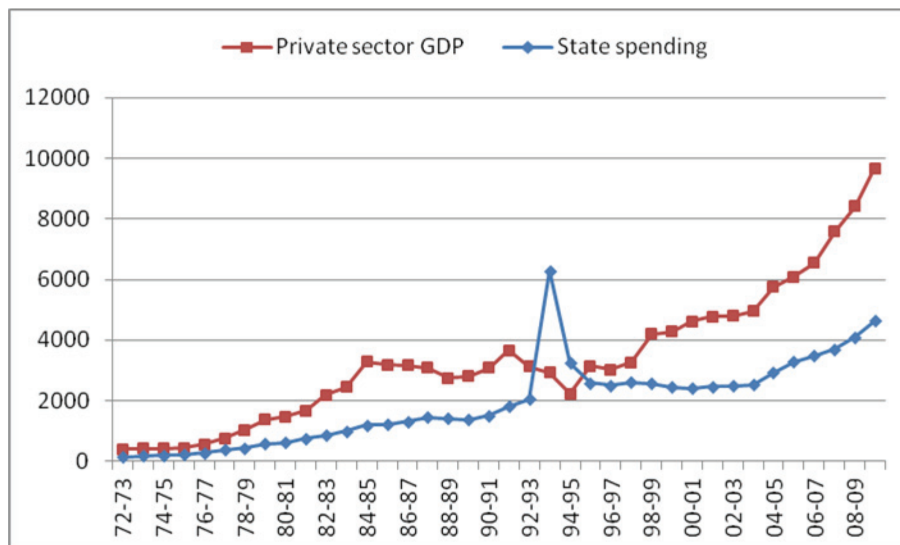
Figure 9. Private sector contribution to GDP of Saudi Arabia vs. total government expenditure



Source: Saudi Arabian Monetary Agency, 2011, section 9, tables 3, 4 and 5.

Note: Amounts are given in millions of Saudi Arabian riyals.

Figure 10. Private sector contribution to GDP of Kuwait vs. total government expenditure



Source: Central Bank of Kuwait, 2012, table 50.

Note: Amounts are given in millions of Kuwaiti dinars.

State spending and the size of the private sector are closely correlated in GCC countries. In regular tax States, public expenditure can drive business expansion which increases government revenue, which in turn allows higher expenditures. By contrast, in GCC countries domestic economic activity creates very little tax income and State revenues are derived from external rents. Revenue can be collected directly through

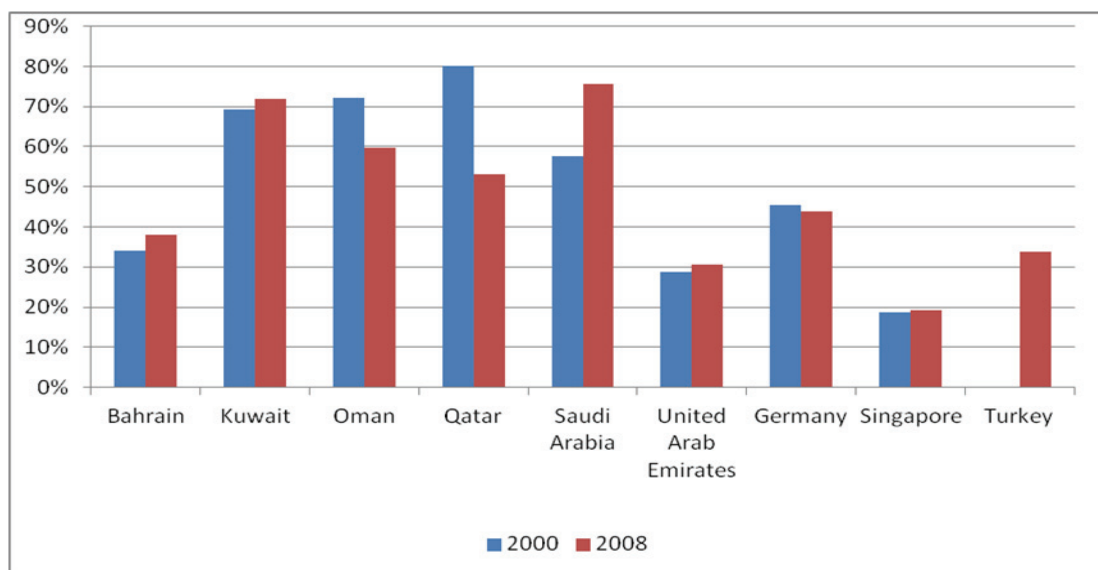
significant spending on State contracts with private businesses and indirectly through spending on public salaries that increase consumption.[56]

Econometric tests show a strong, sustained impact of State spending on the size of business activity. The short-term dependency of business on public expenditure has declined since the mid-1980s, and the annual growth rates of the two are now less closely correlated and short-term spending fluctuations have less impact on the growth path of business. The two variables remain closely associated in the long run, as shown by figures 9 and 10.[57] This means that much of GCC business activity is closely associated with State spending and private sources of demand for services and products are insufficient.

In GCC countries, the share of State spending to generate non-oil GDP, and the share of government consumption tend to be higher than in other countries, including Turkey (figures 11 and 12). Perhaps more importantly, an unusually high share of private household consumption is financed through civil service wages, which dominate the total wage income of GCC nationals. Foreign private-sector workers spend little in the local economy, preferring to remit the dominant share of their income abroad.[58] This diminishes private demand.

Data for Bahrain and the United Arab Emirates appear to show greater diversification of State spending and consumption patterns. In Bahrain, the figures seem to reflect the large private service sector, but data for the United Arab Emirates might understate the Government's role. It is not clear whether United Nations data for government spending and consumption include Emirate-level and public company activities.

Figure 11. Share of State spending to generate non-oil GDP in GCC and selected countries



Source: IMF and United Nations Statistics Division, database.

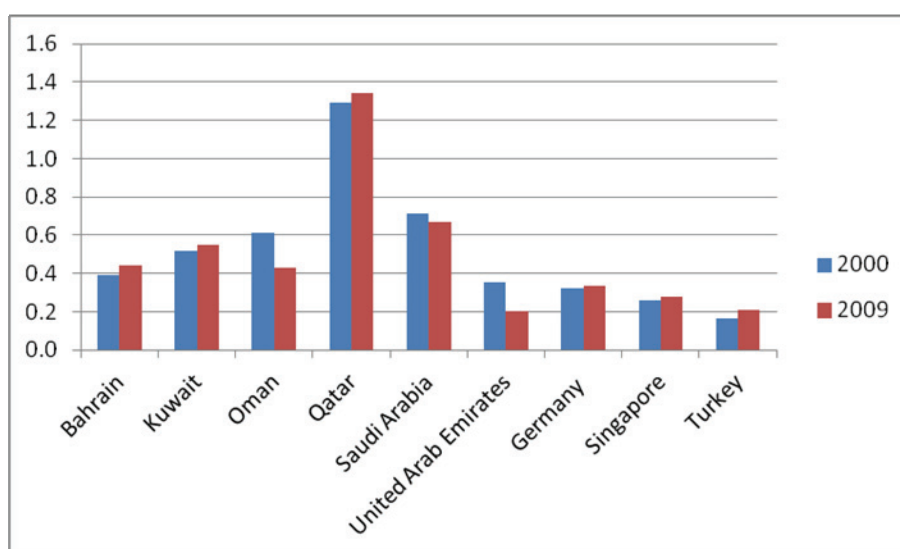
Note: Kuwaiti data are from 2000 and 2007.

[56] In the absence of domestic taxation, it is difficult to imagine how business growth could drive State spending, or to identify a different method to translate business growth into State revenue in the long term.

[57] For econometric evidence from the 1990s see Ahsan Mansur and Volker Treichel, 1999, pp. 26-27. Recent econometric tests conducted by Steffen Hertog using time series regressions and error correction models confirm the findings on data up to 2007. Raphael Espinoza and Abdelhak Senhadji, 2011, provide evidence of strong fiscal multipliers in GCC countries.

[58] Majid Taghavi, 2011, reported that in 2009, an estimated 12 million expatriate workers remitted US$32 billion from GCC countries, or US$2,700 per capita. The average expatriate wage in Saudi Arabia (US$3,200), and the United Arab Emirates (US$4,300) indicates that very little is consumed locally.

Figure 12. Ratio of government to private consumption in GCC and selected countries



Source: United Nations Statistics Division, database.

Business in GCC countries is less dependent on the State than it was during the first oil boom in the 1970s and early 1980s. It now commands a larger share of GDP, and business growth is less closely correlated with State spending than it was up to the mid-1980s.[59]

The subsectoral composition of GDP also seems to be more resilient to short-term fiscal shocks than it used to be. Figure 8 and detailed evidence from Saudi Arabia suggest that this is the case, indicating a smoother short-term growth path for individual business sectors (see annex IV).

Several factors account for the increased short-term autonomy of private business. Perhaps the most important is that demand driven by private consumer spending has grown significantly since the 1970s. Even though much of this demand results from State spending on salaries and benefits, consumption is better at generating competitive markets than direct State support. Figure 13 shows that since the 1980s, GCC Governments have devoted larger shares of their total budgets to non-capital as opposed to capital expenditure. Salaries are a non-capital expense; direct contracts with private companies are a capital expense.

State capital spending has picked up again with the 2000s oil boom, but apart from Oman and Qatar, capital spending relative to total spending is not as high as it was in the 1970s and early 1980s. At the same time, private capital formation has continued to increase, resulting in very high combined levels of capital formation in the late 2000s (see figures 14 and 15).

Thanks to decades of growth and the accumulation of large capital resources, many private businesses in the Gulf have matured in their managerial and technological capacity, are less reliant on State spending and in some cases have become competitive exporters.[60] Private businesses continue to generate few jobs for nationals, however, and their employees tend to be more experienced expatriates who accept lower salaries than nationals. Multinational corporations with a more sophisticated human resources policies often have a better track record in local recruitment in GCC countries (see chapter IV).

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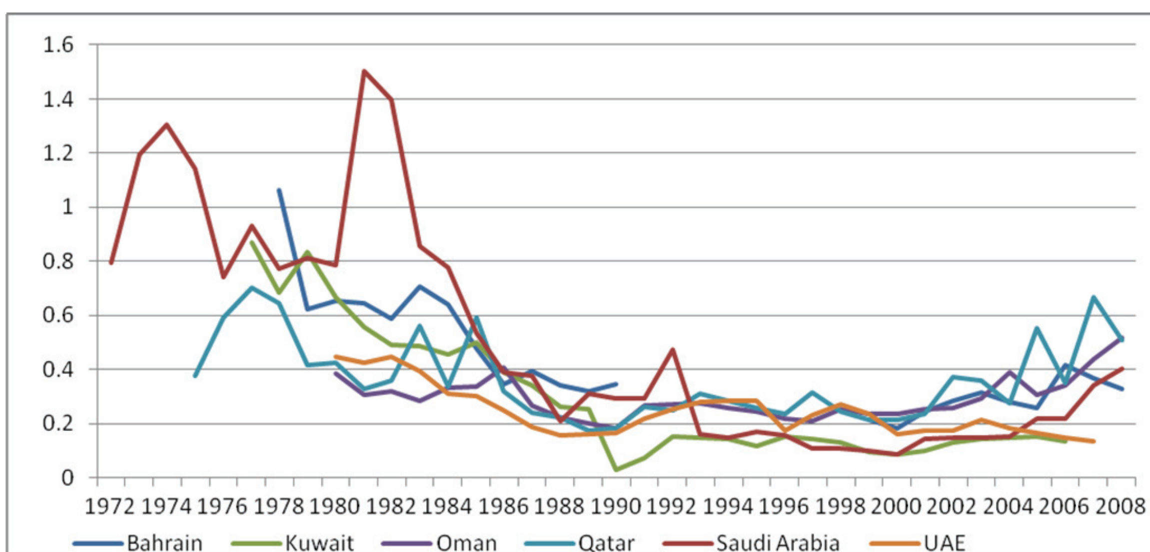
[59] Ahsan Mansur and Volker Treichel, 1999, pp. 26-27; and Ugo Fasamo and Qing Wang, 2001, p. 7.

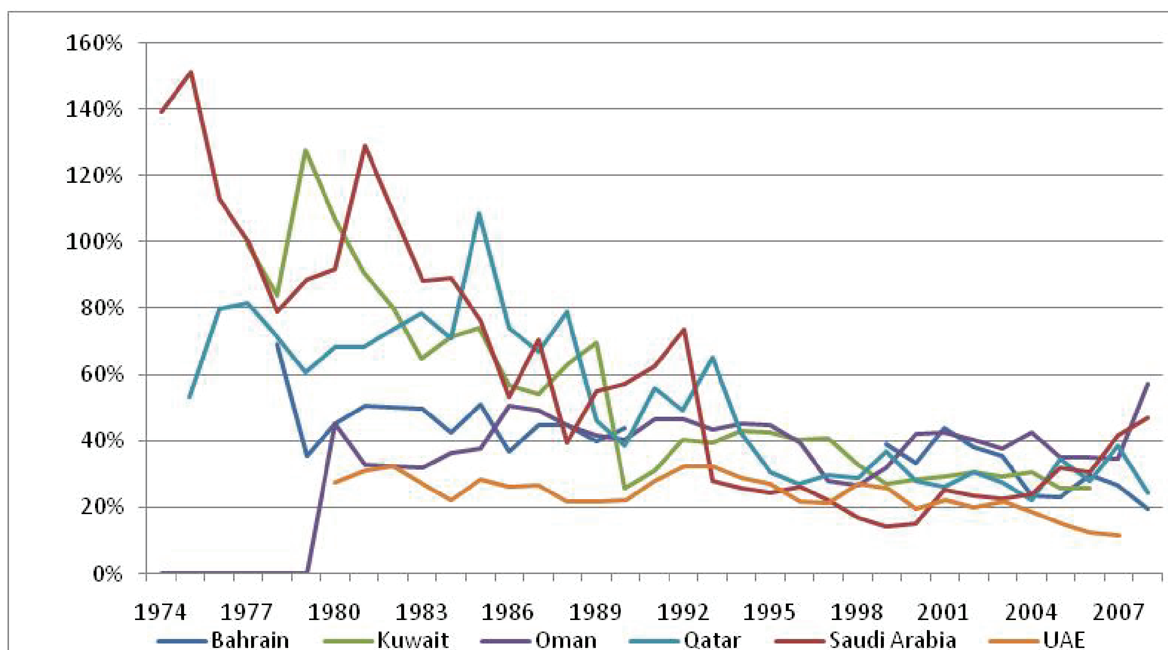
[60] Giacomo Luciani and Steffen Hertog, 2010, pp. 2-3; and Giacomo Luciani, 2005.

Figure 13. GCC: ratio of government capital to current expenditures



Sources: ESCWA, 2009; various national reporting data; and IMF Article IV Staff Reports and Statistical Appendices.

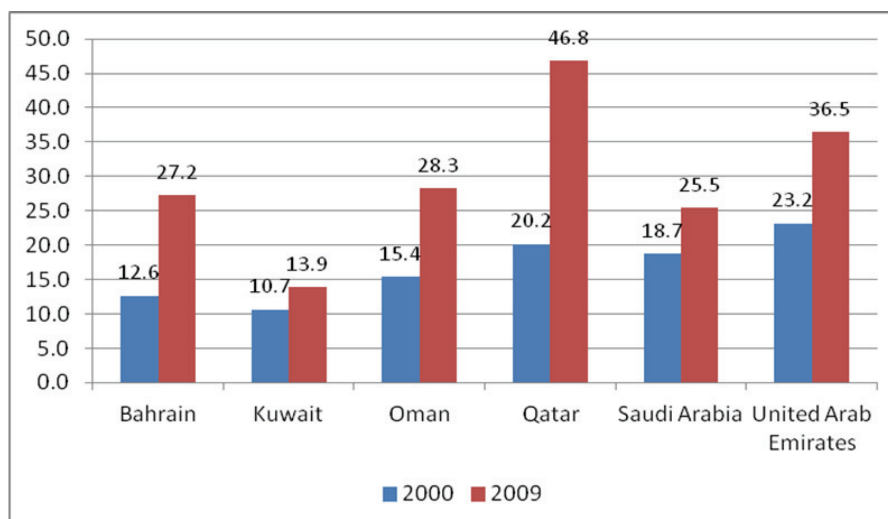
Figure 14. GCC: share of government capital spending in national gross fixed capital formation



Source: Total fixed capital formation based on ESCWA, 2009; sector contributions based on national reporting data and IMF Article IV Staff Reports.

Note: The ratios above 100 per cent for some cases in the 1970s were probably caused by inconsistencies in national accounts and fiscal statistics; this should not affect the general trend.

Figure 15. GCC: capital formation
(*Percentage of GDP*)

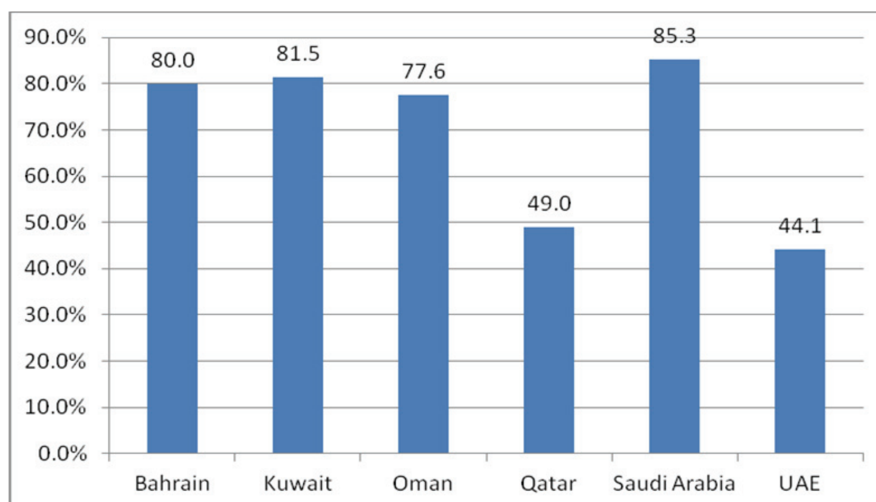


Source: United Nations, National Accounts Statistics: Main Aggregates database.

B. PUBLIC FINANCE: SOURCES OF REVENUE, FISCAL POSITION AND POLICY SPACE

The present report has shown that GCC economies are dependent on long-term State spending which is made possible by external rents. Hydrocarbons constitute between 40 and 85 per cent of State income (see figure 16), with much of the rest accounted for through other forms of rent, for example the returns on international financial investments (see annex V). There has been no attempt to build up a comprehensive tax system in any GCC country, where personal income remains untaxed and businesses are taxed little if at all. Plans for a GCC-wide VAT seem to have been abandoned.

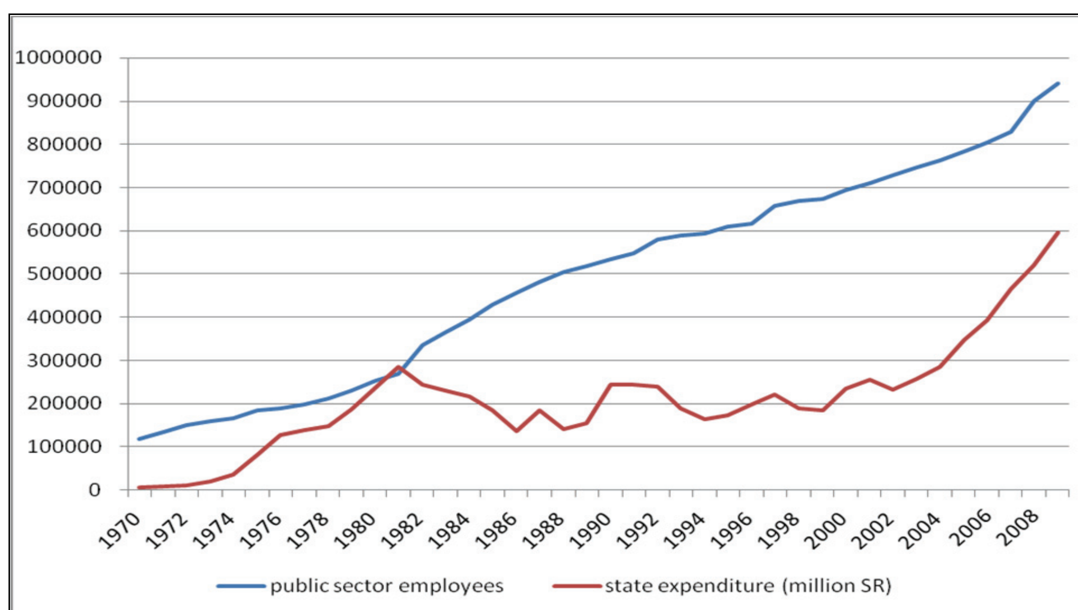
Figure 16. GCC: share of hydrocarbon income in total government revenue, 2009



Source: IMF and various country reports.

Furthermore, an increasing share of State spending has been used for non-capital expenditure, a trend that has only been partially reversed during the recent crisis. Non-capital expenditure is now locked in at very high levels, which is explained in part by a labour force that has been growing even in fiscally lean years (see figure 17), a trend that appears to have accelerated in 2011 in reaction to the Arab Spring.

Figure 17. State employment vs. State expenditure in Saudi Arabia 1970-2009



Sources: Ministry of Civil Service and Saudi Arabian Monetary Agency, 2011, appendix of statistical tables, section 9, table 3 and section 11, table 30.

Distortionary State spending and labour markets

It is estimated that 44 per cent of the budget of Saudi Arabia is allocated to salaries, a high share compared with other countries.[61] While other GCC countries spend less on salaries, the amounts are edging upward, reflecting policies to provide jobs to nationals. Higher costs are a concern, particularly in the lower-rent countries of Bahrain and Oman, in which the break-even price of oil is comparatively high.

Government provision of ever more jobs is a problematic trend, and in the coming years, population increases will exceed the capacity of GCC Governments to supply jobs. Approximately 400,000 Saudis reach working age every year, Bahrain anticipates that more than 100,000 additional jobs for nationals will be required from 2012 to 2022, while Oman requires 50,000 new jobs per year.[62] In the mid-term, it will be fiscally unfeasible to satisfy this level of demand.

The stepped-up provision of public jobs and recent wage increases are likely to drive young GCC nationals out of the private labour market and onto waiting lists for a government position where they can expect a higher salary and superior job security. Less productive public sector jobs elevate wage expectations, price nationals out of the private market and weaken incentives to acquire the education that market economies demand.

Civil service job creation puts pressure on national budgets, but also undermines strategies to increase national participation in private labour markets, which is essential to long-term economic sustainability. Civil service job creation reinforces expectations that may be unsustainable when economic development stalls.

As illustrated above, economic growth in GCC countries remains dependent on increasing public spending: once a higher plateau of spending is reached, there is little autonomous private expansion. Since the 2008 economic crisis, GCC government activity has expanded faster than business activity, indicating a muted impact of stimulatory spending.

[61] Author calculation based on John Safakianakis, 2010.

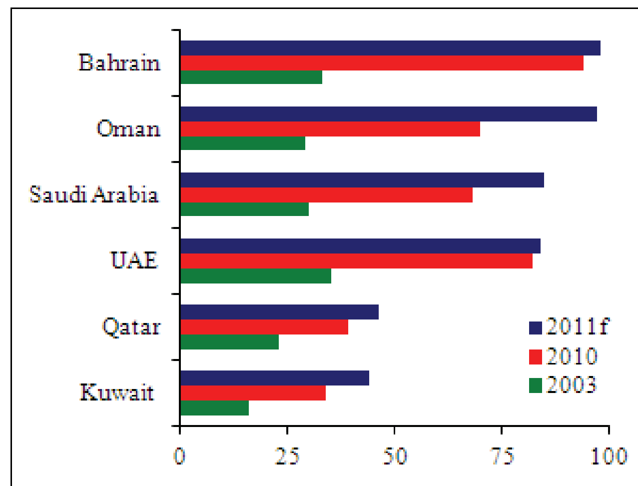
[62] Oxford Analytica, 2011, p. 3.

Fiscal sustainability in GCC countries

Spending has already reached levels that are unsustainable in the long run. Recent budget increases have been far above what was expected before the Arab Spring. In June 2011, Bahrain approved a two-year budget of US$16.44 billion, a 44 per cent increase over the 2009-2010 budget.[63] Kuwait plans to increase spending by 19 per cent over 2011-2012 figures.[64] Saudi Arabia's budget for 2011 was originally planned at 7 per cent above the 2010 budget, but actual spending increased 24 per cent.[65] In Oman, State expenditure for 2011 will be an estimated 17 per cent higher than in 2010.[66]

The break-even oil prices for GCC budgets have increased significantly in the past few years. The oil price at which the Saudi budget breaks even is estimated to exceed 80 dollars per barrel; it was close to 30 dollars just a decade ago. The break-even price for Bahrain is already above 100 dollars per barrel, and the break-even price is nearly as high in Oman (see figure 18).

Figure 18. GCC: break-even oil prices, past and expected
(*United States dollars per barrel*)



Source: Institute of International Finance, available from http://www.iif.com/emr/mena/.

In the short run, this is not a problem, as Saudi Arabia has large overseas reserves and although Bahrain and Oman lack reserves, they are likely to be supported by neighbouring countries before they face a fiscal crisis. The mid-term fiscal maneuverability of GCC regimes, however, could be severely compromised if oil prices drop below 80 dollars per barrel for an extended period.

Even if additional spending commitments are kept to a minimum, expenses will increase with population growth, which is expected to fluctuate between 1 and 2 per cent between 2010 and 2025.[67] Nevertheless, by 2015, the Institute of International Finance has projected that the break-even price for Saudi Arabia will reach US$110.[68]

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[63] Khaleej Times, 2011.

[64] Gulf Base, 2011.

[65] Tamer El-Zayat, 2011, p. 2.

[66] IMF, 2011c.

[67] United Nations, Department of Economic and Social Affairs, 2011, pp. 96-100.

[68] Institute of International Finance, 2011, p. 12.

The anticipated fiscal squeeze will likely impact capital spending, namely infrastructure investments and other public projects. This was the category of spending that suffered first in the lean years after the 1985 oil price crash. Such expenditures are more easily slashed than politically sensitive spending on salaries, social expenditure and subsidies. Most past attempts to reduce entitlements of GCC populations, including public jobs, subsidies and cheap utilities have come to naught or been reversed soon after implementation. Cutting capital spending however could have a negative impact on the long-term competitiveness of GCC economies.

By shifting finite resources toward a large government or public-sector bureaucracy and other forms of State spending today, GCC regimes are compounding their long-term challenges by increasing entitlements and undermining private job creation for nationals.

In the short run, with the exception of Bahrain and Oman, considerable resources remain available for infrastructure expansion and public investment into growth sectors through targeted subsidies or the expansion of strategic public industries. Without fundamental reforms of immigration and labour regulation, there will be increasing numbers of young nationals looking for jobs that the public sector can no longer provide, while private-sector jobs are filled with expatriates.

C. EMPLOYMENT: THE QUALITY OF JOB CREATION

Whatever their long-term sustainability, solid growth and diversification were achieved by GCC economies, especially compared with many other non-Western oil exporters. The impact of diversification on local job provision must be examined. To understand these linkages, a discussion of GCC migration regimes is required. Migration is important not only for the immediate analysis of labour markets; it is the single most important policy area in terms of technology choices, rent-seeking structures and the productivity patterns of GCC economies.

The fundamental difference between GCC labour markets and those in the rest of the world is that they are relatively open to immigrant labour, which dominates private employment in all six countries, and plays an important role in the public sector in several of them. Open migration creates a labour-supply curve that is essentially flat in the long run, and that allows GCC businesses to operate with cheap labour imported from anywhere in the developing world.

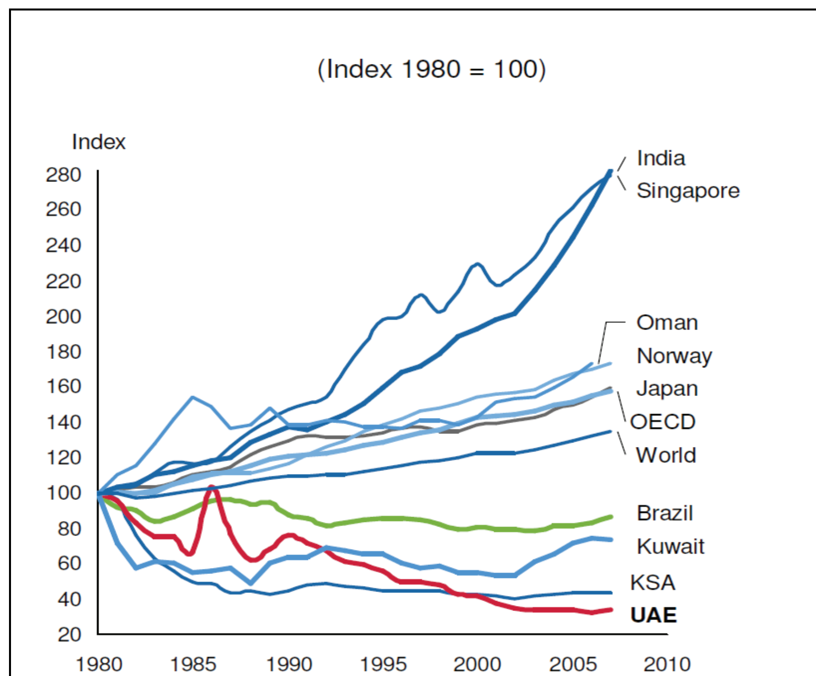
Direct structural implications of this labour/migration regime include the following:

- Most GCC businesses focus on labour-intensive, relatively low-tech production technologies;
- Growth elasticity of the amount of labour in local economies is high;
- Average labour productivity is low and economic growth is driven by increases in factor inputs rather than upgrades in technology or efficiency.

Despite impressive growth, most private sector salaries are low and working conditions are poor. Most private employment is intended for expatriates, and job quality has declined since the 1980s, as low-skill labourers (often from Asia) have replaced mid-skill labourers (often from the Arab region).[69] Since the 1980s, the growth elasticity of employment has been high, meaning that for every percentage point of GDP growth, the labour force has grown by more than 1 per cent. This might have to do with a growing role of very labour-intensive sectors like construction and personal services. Labour productivity has accordingly declined since 1980s for Kuwait, Saudi Arabia and the United Arab Emirates (see figure 19).

[69] Andrzej Kapiszewski, 2006.

Figure 19. Labour productivity growth in the United Arab Emirates in comparison to other countries



Source: United Arab Emirates, Ministry of Labor, based on Booz & Company, 2010.

Researchers have built a macroeconomic model that shows that capital growth in open migration countries similar to GCC countries will be accompanied by growth in foreign labour (through imports), while income per worker remains unchanged.[70] Increases in TFP have only limited impact on income per worker, as greater TFP generates greater labour demand, resulting in a fall in capital per worker as wages remain fixed. Income per worker tends to grow only as foreign reservation wages increase. Yet the reservation wages of foreign workers remain significantly below national reservation wages in GCC countries.

More recently, and after two decades of decline or stagnation, TFP has grown in Bahrain, Kuwait and the United Arab Emirates (see tables 6 and 7). Much of this growth may have been caused by expansion in the oil sector, which is unfortunately not disaggregated in available analyses.[71]

TABLE 6. AVERAGE GROWTH RATES IN GCC AND SELECTED DEVELOPED COUNTRIES, 2000-2007
(*Percentage*)

	GDP	Capital	Labour	Human capital[a/]	TFP
GCC countries					
Bahrain	5.6	2.4	0.9	0.4	1.9
Kuwait	5.8	3	1.8	0.1	0.9
Oman[b/]	4.4	3.3	1.8	0.4	-1.1
Qatar	9.2	7.2	2.8	0.5	-1.3
Saudi Arabia	3.5	2	1.9	0.7	-1
United Arab Emirates	8.8	2.7	3	0.9	2.2

[70] Tarek Coury and Mohamed Lahouel, 2011, p. 3.

[71] GDP is measured in real terms, hence direct effects of the oil sector on GDP are correlated to change (such as production declines and increases in the 1980s and 1990s). The oil sector also has an influence on State spending.

TABLE 6 (*continued*)

	GDP	Capital	Labour	Human capital[a/]	TFP
Developed countries					
Norway	2.6	0.9	0.5	0.7	0.6
Singapore	6	1.1	1.6	0.5	2.8
USA	2.4	1.2	0.7	-0.3	0.7

Source: IMF, 2011d, p. 47.

Notes: Figures are approximate. Figures for United Arab Emirates (and to a lesser extent Saudi Arabia and Kuwait) appear to conflict with figure 19, which is probably the result of different assumptions made on the size and growth of the expatriate labour force.

a/ Human capital is defined in terms of years of schooling of the workforce.
b/ Human capital growth for Oman is imputed from the GCC average.

TABLE 7. AVERAGE GROWTH RATES IN GCC COUNTRIES, 1970-1999
(*Percentage*)

	GDP	Capital	Labour	Human capital[a/]	TFP
1990-1999					
Bahrain	3.4	0.5	1.5	1.0	0.4
Kuwait	-7.8	0.9	-2.2	0.0	-6.5
Oman[b/]	5.6	1.7	2.8	0.5	0.6
Qatar	6.6	2.0	1.5	0.5	2.6
Saudi Arabia	3.2	0.8	2.1	0.6	-0.2
United Arab Emirates	5.9	2.1	3.6	1.2	-1.0
1980-1989					
Bahrain	1.3	1.4	2.7	0.8	-3.6
Kuwait	-0.7	2.4	3.3	0.7	-7.1
Oman[b/]	6.4	4.9	2.6	0.7	-1.7
Qatar	2.6	0.0	4.4	0.4	-2.3
Saudi Arabia	-1.0	1.4	3.9	0.8	-7.1
United Arab Emirates	1.4	3.6	3.3	0.9	-6.4
1970-1979					
Bahrain	6.5	1.8	4.5	1.1	-0.8
Kuwait	1.2	3.1	3.6	0.8	-6.3
Oman[b/]	10.6	4.6	2.5	0.8	2.8
Qatar	6.8	1.1	4	0.5	1.2
Saudi Arabia	13.6	2.8	2.8	0.7	7.3
United Arab Emirates	-	-	-	-	-

Source: IMF, 2011d, pp. 47-48.

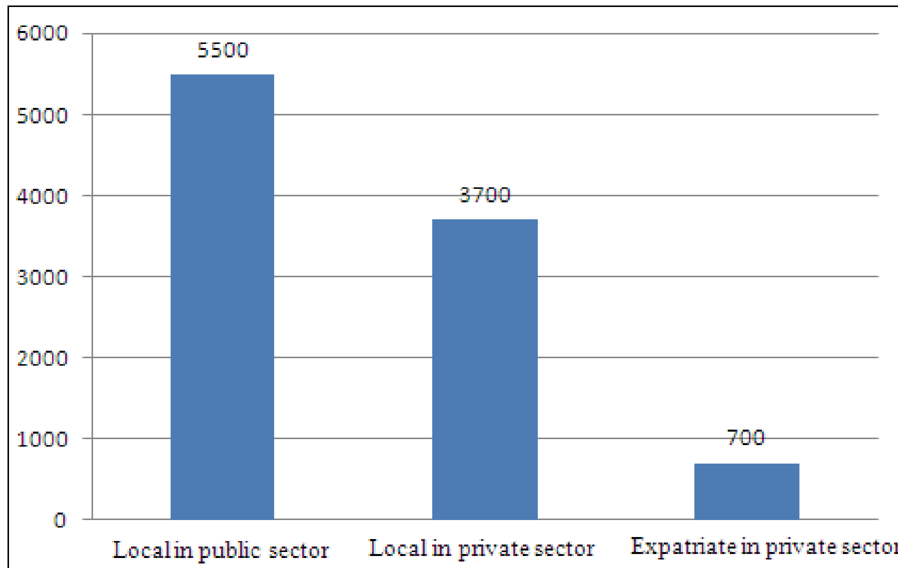
Notes: a/ Human capital is defined in terms of years of schooling of the workforce.
b/ Human capital growth for Oman is imputed from the GCC average.

Labour productivity remains low in the private sector across GCC countries. Despite considerable diversification and some technological upgrading, most private sector jobs in GCC countries continue to pay too little. Good longitudinal data on wages are not available, but cross-sectional surveys have shown that average earnings, even controlling for sector, skill and job type, continue to lie considerably below those available in the public sector.

Even after the boom during the 2000s, average private-sector wages in GCC countries remain uniquely low given the level of development and relative technological sophistication. Public sector wages are significantly higher in all reported cases, resulting in higher reservation wages for nationals in the private

sector. While nationals are generally paid better in the private sector than expatriates, private-sector pay is still lower than public-sector pay. Figure 20 illustrates the double wage gap in the United Arab Emirates.

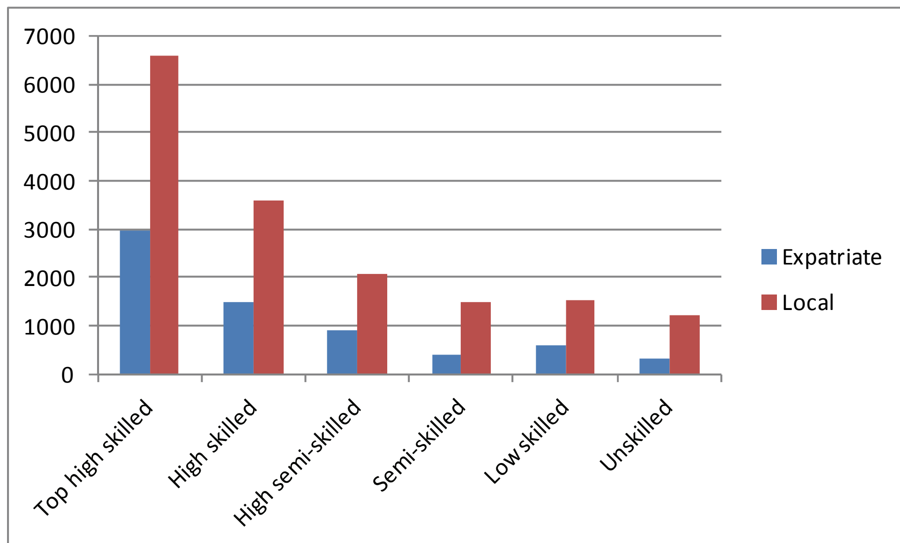
Figure 20. Average monthly wages in the United Arab Emirates, 2008
(*United States dollars*)



Source: United Arab Emirates National Bureau of Statistics, 2008a.

Even when controlling for skill level, the gap between local and expatriate wages in the private sector remains considerable (see figure 21).

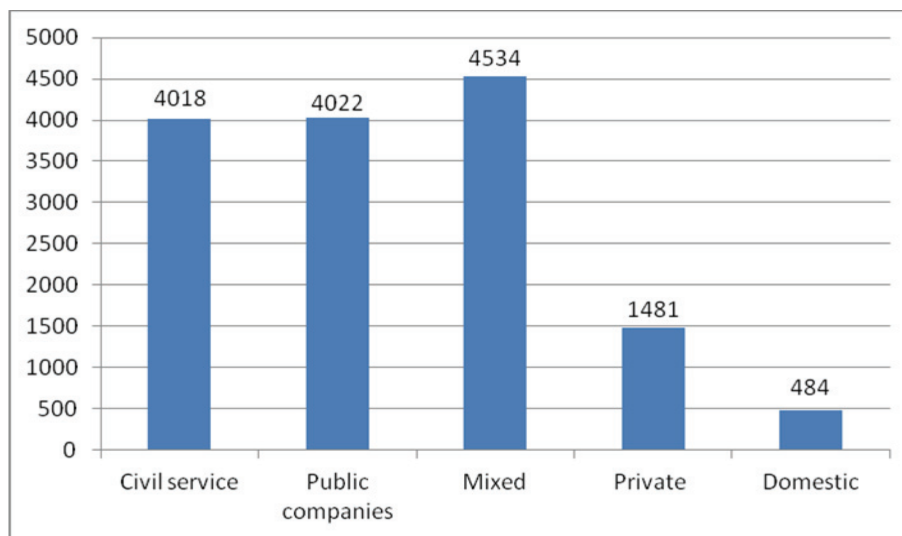
Figure 21. Private sector monthly wages by skill in the United Arab Emirates, 2008
(*United States dollars*)



Source: See figure 20.

The wage gap between public and private sector is considerable in Qatar too (see figure 22).

Figure 22. Average monthly wages in Qatar, 2009
(*United States dollars*)

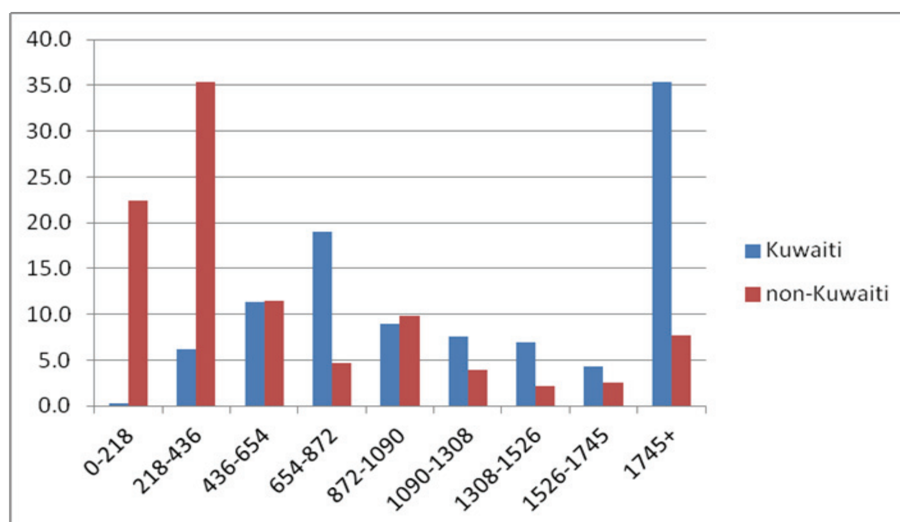


Source: Qatar Statistics Authority, 2009, p. 24.

Note: Data disaggregated by nationality are not available, but most nationals work in the public sector and most foreigners in the private sector (see figure 25).

Data on national vs. expatriate wages in the private sector in Kuwait also confirm a deep segmentation of labour markets by nationality (see figure 23).

Figure 23. Private sector wages in Kuwait, 2008



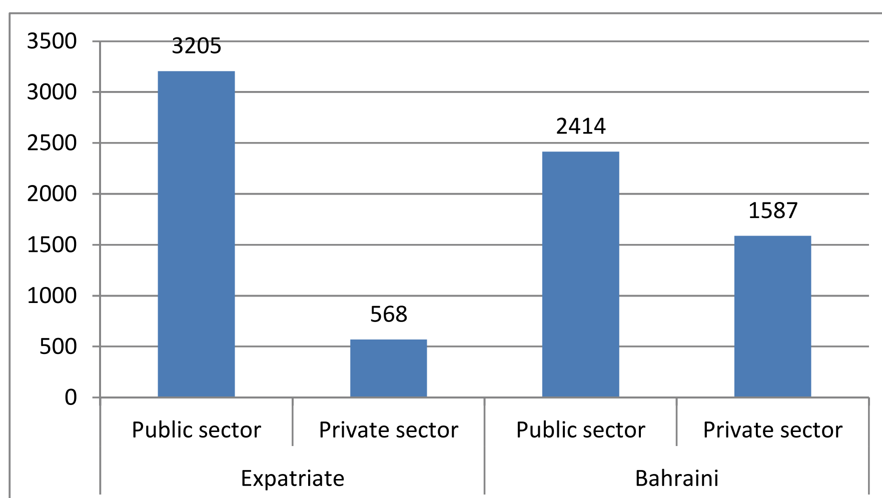
Source: Kuwait Central Statistics Office, 2008, Labor Force Survey, pp. 23-26.

Note: Original data reported in Kuwaiti dinars, converted to United States dollars.

The gaps are significant even in Bahrain and Saudi Arabia which have lower oil rents per capita. The average salary for Saudi nationals in the private sector is about US$800, while expatriates earn an average of US$270. Average wages in the civil service are closer to US$2,100.[72] In Bahrain, private sector earnings for nationals are somewhat better, but still do not reach public sector levels (see figure 24).

[72] Saudi Arabia, Ministry of Labor, 2010, table 54; and Saudi Arabian Monetary Agency, 2011, pp. 204-205.

Figure 24. Monthly wages in Bahrain, 2011
(*United States dollars*)



Source: http://blmi.lmra.bh/2011/12/mi_data.xml.

Note: Figures are for the first quarter, 2011.

Citizens tend to earn more in private jobs than their expatriate counterparts. However, in the public sector the opposite is true. Many employers perceive a gap in productivity between expatriates with extensive training and experience, and locals whose benchmark for effort and work conditions is the local public sector.[73] In the countries where there are more nationals in the private labour market, the work ethic of nationals is seen as an obstacle to doing business. Representatives of local companies were asked to evaluate 15 factors and to select and rank the top five most problematic in their country. The following list of weighted percentages shows the importance of "poor work ethic in the national labour force" in GCC countries. The higher the percentage, the more problematic the respondents believed the work ethic of nationals to be.

TABLE 8. GCC: SIGNIFICANCE OF "POOR WORK ETHIC IN THE NATIONAL LABOUR FORCE"

Country	Ranking
Bahrain	16.7
Kuwait	6.4
Oman	12.9
Qatar	2.1
Saudi Arabia	6.1
United Arab Emirates	7.7

Source: World Economic Forum, 2010, pp. 30-54.

The results show that the work ethic of nationals is a significant concern in Bahrain and Oman.

The focus of private businesses in GCC countries on short-term rent extraction from low-skill, low-cost foreign labour and their unwillingness to invest in long-term productivity upgrades and the skills of local staff have contributed to the exclusion of many GCC nationals from private labour markets (see figure 25). Levels of national labour participation are generally low, and the majority of employed GCC citizens work in the public sector, where prevailing wages are higher and work conditions easier. Major international organizations agree that over-employment in the public sectors is widespread.[74]

[73] Mohammed Al-Waqfi and Ingo Forstenlechner, 2010, pp. 365-367.

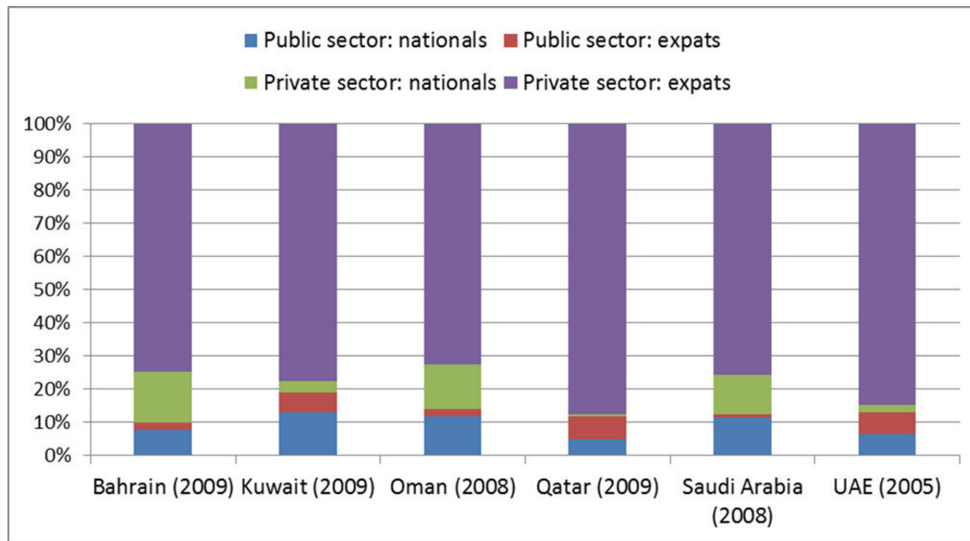
[74] Zafiris Tzannatos et al., 2011, p. 12.

Segmentation of labour markets indicates that the employment of nationals is a result of public sector job creation that reacts to the perceived necessities of wealth distribution and job provision over economic and administrative exigencies. Thus the dominant share of national employment in GCC countries, excluding Oman and Bahrain, is a function of the availability of oil rents (which is largely determined by international market forces) and of the Government's distributional strategies. Employment is minimally influenced by macroeconomic fundamentals, economic policies and investment policies discussed in the present report.

Private sector employment of nationals is vulnerable to macroeconomic forces and economic policy interventions. There is less of a direct transmission of growth to national job creation than in the case of expatriate job creation. Growth elasticity of national employment fluctuates more strongly than foreign employment and is generally lower. GCC countries have seen strong GDP growth but only weak national job creation in the 2000s.

In Saudi Arabia from 2009-2010, the population of nationals grew 2.32 per cent, the population of non-Saudis grew 5.74 per cent and the share of nationals in the private labour force increased 6.34 per cent.[75] In Bahrain the number of nationals in private-sector employment grew from around 61,000 in 2002 to 93,000 in early 2011, while the number of non-Bahrainis in the private sector grew from around 146,000 to 363,000.[76] In Oman, the number of nationals in the private sector more than doubled from roughly 87,000 in 2004 to 178,000 in 2010, while the expatriate population almost doubled from roughly 424,000 to 956,000.[77] The relative success of Omanization has been at the expense of the quality of employment, as in 2009, 74 per cent of jobs held by nationals paid less than about US$520.[78]

Figure 25. Segmentation of GCC labour markets by sector and nationality



Sources: Bahrain, *Labour Market Indicators*, table A; Kuwait Central Statistics Office, 2009; Oman National Center for Statistics and Information; Qatar Statistics Authority, 2009; Saudi Arabian Monetary Agency, 2010, p. 405; Baldwin-Edwards, 2011, tables 4, 6 and 8.

Most jobs that are created during periods of high growth tend to go to foreign workers, and the employment of nationals is often the outcome of administrative interventions. Because multiple factors

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[75] Saudi Arabian Monetary Agency, 2011, table 18.9, and appendix of statistical tables, section 11, table 28.

[76] Available from http://blmi.lmra.bh/2011/12/mi_dashboard.xml. Path: 2011 Q1; Employment; Total employment by citizenship and sector 2002-2011.

[77] Central Bank of Oman, 2009, p. 24 and 2011, p. 24.

[78] Based on Oman, 2010, table 2.5.

influence the outcome, it can be difficult to identify the impact of economic structures and policies on national employment.

One option is to analyse the quality of job creation within segmented labour markets under conditions of open migration. For the most part, private-sector jobs created for GCC nationals during the last decade compare unfavourably with available public sector jobs. The work conditions are less attractive, job security is lower and the pay is considerably below the average wage in GCC countries. In some cases such jobs are taken up by nationals who have failed to obtain public sector employment. Data from the United Arab Emirates suggest that the private sector employs nationals with lower skills, while the public sector attracts workers with higher skills (see table 9). The private-public wage gap for nationals is not unique to the United Arab Emirates, but can be found in all GCC countries.

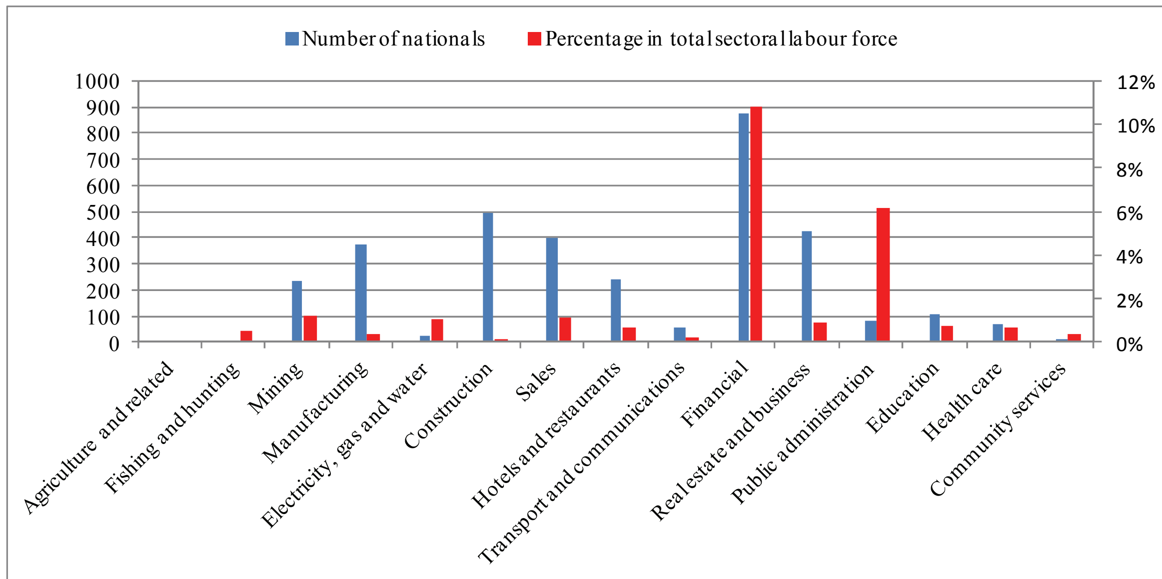
TABLE 9. UNITED ARAB EMIRATES NATIONALS: SKILL LEVEL AND SECTOR OF EMPLOYMENT

Skill category	Public sector (*percentage*)	Private sector (*percentage*)
Top high skilled	38.3	26.0
High skilled	37.3	33.4
High semi-skilled	17.1	30.3
Semi-skilled	3.1	3.9
Low skilled	1.9	4.3
Unskilled	2.2	2.1

Source: Consultant calculations based on raw data from the Government of the United Arab Emirates, 2008.

Nationals engaged in the private sector tend to occupy generic white collar jobs that require neither specialized technical expertise nor manual labour. Higher rates of nationalization are usually limited to service sectors that provide such positions (see figures 26 and 27). The absolute number of jobs in sectors like finance is small relative to the total labour force.

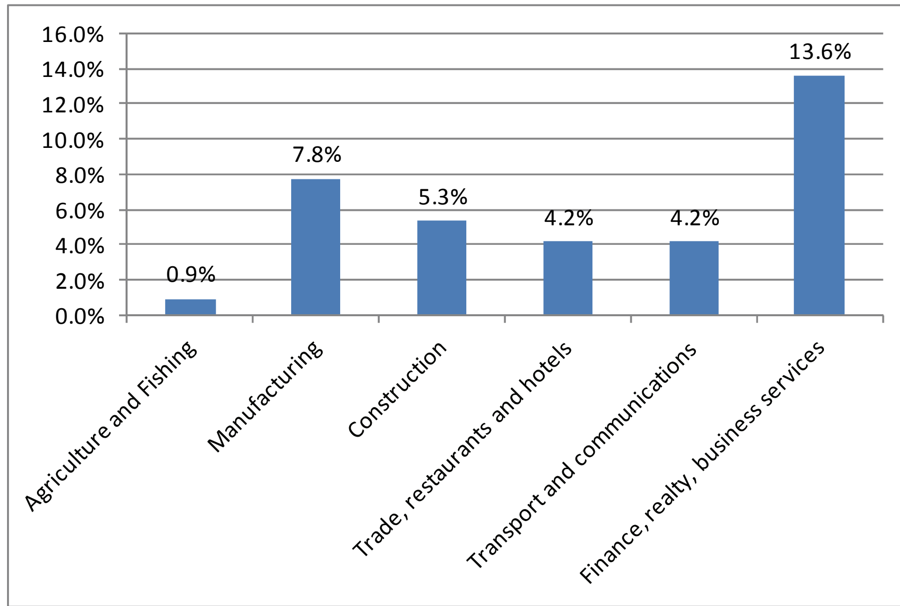
Figure 26. National workers and level of nationalization ratios by sector in the United Arab Emirates



Source: United Arab Emirates, 2008b and 2009.

Note: Absolute number of nationals in blue and the Emiratization ratio in red. Data for 2008, private sector only.

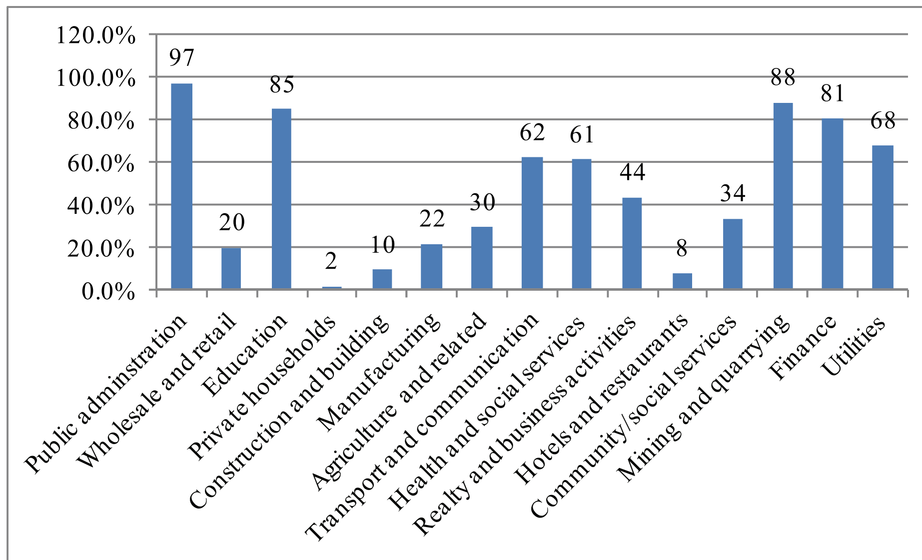
Figure 27. Nationalization ratios by sector in Kuwait



Source: Kuwait, Public Authority for Civil Information, 2011.

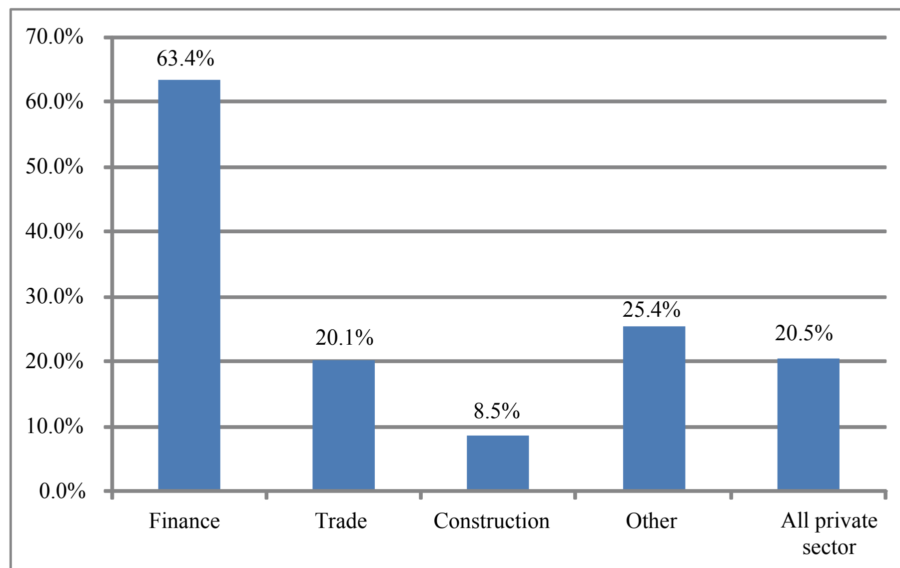
Employment of nationals differs in Saudi Arabia and other lower-rent countries, where more nationals have been pushed into the private labour force. But even in lower-rent countries the only business sectors with relatively higher share of nationals are either publicly owned entities (transport, mining or utilities) or white-collar (finance). There is a similar trend in Bahrain (see figure 28 and 29).

Figure 28. Nationalization ratios by sector in Saudi Arabia, 2007



Sources: Saudi Arabia, 2009, table: Employees by sector and nationality; and Saudi Arabia 2008, table 45.

Figure 29. Nationalization ratios in the private sector in Bahrain, 2011



Source: Bahrain, *Labor Market Indicators*.

The distribution of national labour means that much of the business diversification of the past three decades is dependent on foreign labour, especially in richer countries including Kuwait, Qatar and the United Arab Emirates. In the United Arab Emirates, 95 per cent of "good" private sector jobs paying more than US$2,722 per month were held by foreigners.[79]

Author interviews with human resources managers across GCC countries confirmed that technically demanding jobs in hi-tech sectors usually go to foreigners. While increases in productivity might lead to higher salaries sufficient for nationals, nationals often lack the skills these jobs require.[80] Given that attractive public-sector jobs that do not require specialized qualifications are plentiful, there is little incentive for nationals to acquire such skills.

The public sector remains the most attractive employer and the most effective developer of the national labour force. Outside of finance, well-paid jobs for a significant share of nationals are only provided by technologically advanced, government-owned companies. They include the following: heavy industry giants like Saudi Basic Industries, Aluminium Bahrain and Aluminium Dubai; technology companies like Mubadala and Advanced Technology Investment Company in Abu Dhabi; and service companies like Etisalat and DP World.

While nationalization levels in these entities are generally lower than in the civil service, they are considerably higher than in the private sector. In 2005, the Saudi Basic Industries Corporation reported that more than 75 per cent of its employees were Saudi nationals;[81] nationals represented 40 per cent of employees of the Advanced Technology Investment Company in 2011;[82] and 36 per cent of Etisalat employees are Emiratis.[83] These companies have built an impressive technocratic cadre of nationals, but their

[79] Calculation based on United Arab Emirates 2008a and 2008b.

[80] Maurice Girgis, 2002, pp. 2-3, 24-25; and Booz and Co, 2010, pp. 1 and 6.

[81] Saudi Basic Industries Corporation, 2005, p. 24.

[82] Author interview with Advanced Technology Investment Company executive in Dubai, July 2011.

[83] Etisalat, 2010a.

efforts have not spilled over into the private sector. They are run separately from other businesses and bureaucratic entities, which may explain some of their success.[84] Though the success of these companies is encouraging, their total impact is small. Etisalat employed 3,600 Emiratis in early 2010,[85] the Advanced Technology Investment Company employed 40 Emiratis in 2011.[86] The Saudi Basic Industries Corporation employed some 11,000 nationals in 2006, a relatively small figure compared with total State employment estimated at over 2 million.[87]

Unless the existing immigration regime is changed, shifts in economic fundamentals will not significantly impact national employment. Economic growth will continue to result in low-quality and low-wage job creation, because foreign workers accept lower pay for low-skilled work. Incentives to upgrade productivity and move towards a knowledge economy will continue to be limited, and growth will remain factor-intensive rather than technology-intensive. If specialized skills are needed, foreign workers with those skills will be hired instead of building the skills of nationals at much greater expense.

It is also clear that labour markets remain dependent on State spending and that local demand is directly or indirectly generated through rent recycling, which became much more sophisticated and indirect over the years. When States reduce spending, labour markets are likely to shrink. The private labour market will likely be affected first because Governments have chosen to protect the public labour market in the past, even in times of austerity.

[84] Steffen Hertog, 2010a.

[85] Etisalat, 2010b.

[86] Author interview with Advanced Technology Investment Company executive in Dubai, July 2011.

[87] Available from http://recruitment.sabic.com/programnew.htm.

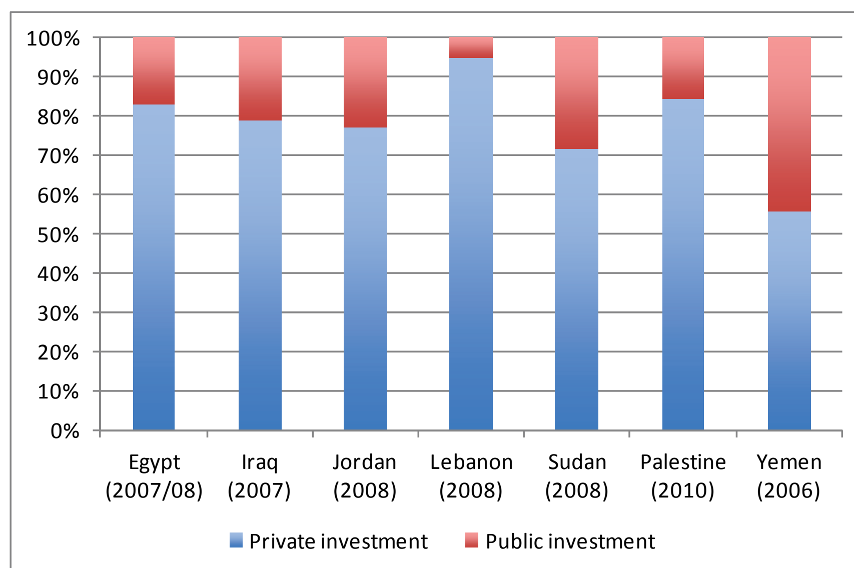
III. ECONOMIC AND INVESTMENT POLICIES OF NON-GCC ESCWA MEMBER COUNTRIES

Direct labour-market reform is an important step towards eliminating rigidities in the market, but comprehensive economic reform is needed to boost long-term economic growth and job creation. Many countries in the region made a clear commitment to reform in the past decade and began taking steps to boost growth and employment. These reforms continued despite the global recession, however, the political turmoil that spread throughout the region during 2011 greatly affected the predictability and potential continuity of various policies and reforms. While some Governments in the region have announced that the general scope and direction of economic policy will not change, others have backtracked from commitments on public spending, employment and subsidies.[88] Therefore, it remains to be seen which economic strategies and policies will be implemented.

FDI results and regulations

Investment has largely been driven by the private sector in non-GCC ESCWA member countries (see figure 30). However, both public and private sector investments have been variously affected by political turmoil. In Lebanon, for example, low public investment is a partial reflection of the country's fractured political environment and inability to build consensus.[89] In other countries, low investment is driven by security concerns. In Yemen, "the construction sector . . . has been badly hit, forcing the laying-off of labourers and reducing employment opportunities for casual workers."[90]

Figure 30. Public and private investment in selected countries



Source: IMF Article IV Consultations.

"Overall, the economies in the region are still biased toward low productivity investments (including in real estate) that have created fewer jobs than are needed to reduce unemployment."[91] The energy and

[88] Steffen Hertog, 2011.

[89] For much of 2011, the Government was unable to collect money that the two State-owned but privately managed mobile phone networks owed to it. Moreover, plans to restructure the heavily subsidized State-owned electricity provider have long been delayed.

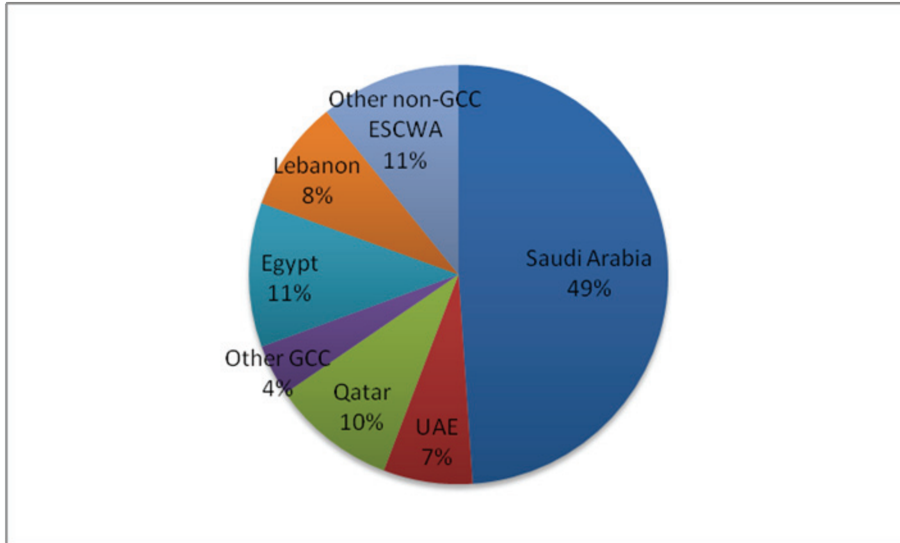
[90] EIU, 2011e, p. 11.

[91] Zafiris Tzannatos, 2008, p. 13.

telecommunications sectors in Iraq have attracted significant foreign investment. In Jordan, investments are concentrated in real estate, tourism projects and financial services.[92]

From 2000 to 2008, FDI into the ESCWA region increased significantly, yet the vast majority of total investments, have gone to GCC countries (see figure 31). In 2010, only 30.2 per cent of FDI into the ESCWA region went to non-GCC countries. The largest recipient was Egypt, with US$6.4 billion (see figure 32). High costs for transport, logistics and communications may discourage investment.[93] Other deterrents include cumbersome bureaucracies and poor business environments, high labour costs relative to much of Asia and weak technology capacity.

Figure 31. Distribution of FDI into ESCWA member countries by country, 2010



Source: United Nations Conference on Trade and Development (UNCTAD), available from http://unctadstat.unctad.org/ReportFolders/reportFolders.aspx.

Among non-GCC ESCWA member countries, Egypt, Lebanon and Jordan have attracted the largest sums of foreign investment. Egypt has aggressively pursued policies to boost FDI inflows and encourage greater private sector investment. "Sustained and wide-ranging reforms since 2004 . . . reduced fiscal, monetary, and external vulnerabilities, and improved the investment climate."[94] Reforms included improving the foreign exchange market, cutting the weighted average import tariff, modernizing tax administration, reducing personal and corporate income tax rates, streamlining business regulations, privatizing a wide range of productive assets and strengthening State banks and banking supervision.[95] Egypt also continued a policy of focusing on public-private partnerships and build-operate-transfer projects.[96] The overall impact of privatization schemes on employment has not yet been fully analysed. "However an earlier study based on 69 firms, which were privatized between 1994 and 1998, found that these privatized firms have experienced significant increases in profitability and operating efficiency, while significant decreases in employment, leverage and risk were found."[97]

[92] ESCWA, 2008, p. 9.

[93] World Bank, 2004, p. 182.

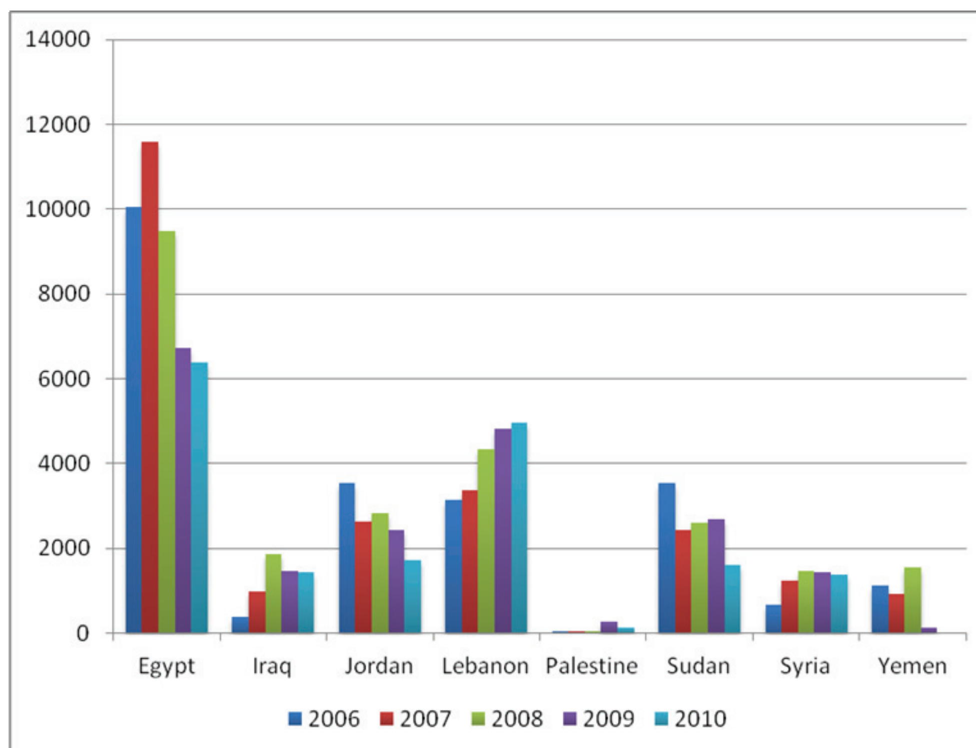
[94] IMF, 2010e , p. 3.

[95] Klaus Enders, 2008.

[96] Karin Maree, 2007.

[97] European Commission, 2010b, pp. 36-37.

Figure 32. FDI into non-GCC ESCWA member countries, 2006-2010
(*Millions of United States dollars*)



Source: UNCTAD, available from http://unctadstat.unctad.org/ReportFolders/reportFolders.aspx.

In July 2007, Egypt declared its adherence to the OECD Declaration on International Investment and Multinational Enterprises, and committed to harmonize the treatment of national and foreign investors and promote responsible international business conduct. Egypt has established a new Ministry of Investment and reorganized the General Authority for Investment and the Egyptian Free Zones. International investors responded quickly to the Government's policy reform efforts, which brought investments to various manufacturing and service industries and allowed further economic diversification away from petroleum.[98]

Some of the non-GCC ESCWA member countries have established an investment promotion authority. The majority of these entities act as one-stop shops. Some deliver only basic information and assistance, while others offer more comprehensive investor services. Various ESCWA member countries provide investment incentives. Jordan, Lebanon, the Syrian Arab Republic and Yemen provide corporate tax holidays for a fixed period of time and low or no customs duties for imported inputs or capital goods.[99] Lebanon has begun to offer easier access to work permits for foreign investors. Moreover, Iraq, Jordan, Lebanon, Palestine and Yemen all "explicitly affirm the principle of national treatment in their primary FDI legislation."[100]

To reap the benefits of trade liberalization, countries must create an enabling environment for foreign and domestic investment. Trade liberalization policies can spur job creation when accompanied by significant FDI inflows, but without FDI, employment growth will be negligible. To attract FDI, deep-seated

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[98] OECD, 2007, p. 9.

[99] MENA-OECD Investment Programme, 2005, pp. 60-63.

[100] Marie-Estelle Rey and Sophie Wernert, 2010, p. 8.

reforms and improvements in the business climate are needed. Several important challenges to greater FDI have been identified by ESCWA: inflation; weak enforcement of legislation; bureaucracy, corruption and red tape; and the dominance of government sectors and slow implementation of privatization programmes.[101] In order to encourage global companies to partner with domestic companies or to create new investments of their own, Governments should take steps towards overcoming these obstacles while developing logistics, transport and information systems.

SME promotion policies

There is strong evidence that SMEs play a large role in several non-GCC ESCWA member countries. According to a presentation by the Jordan Enterprise Development Corporation, the Jordanian economy is highly dependent upon SMEs. In the private sector, 60 per cent of businesses are SMEs, and they provide 37 per cent of total employment in Jordan.[102] In Palestine in 2007, 90.2 per cent of all businesses had fewer than five employees, accounting for up to 95.7 per cent of all wholesale, retail trade and repairs enterprises.[103]

In recent years, SME promotion policies have received some attention, but SMEs remain particularly constrained in the Middle East. The main problems facing SME promoting programmes are sustainability and accessibility. Accessibility is limited by strict banking requirements for the provision of credit to microenterprises.[104] Enterprise-level surveys conducted by the World Bank found that, "only 20 per cent of SMEs in MENA have a loan or a line of credit, a lower share than any other region, and only 10 per cent of their investment expenditures are financed by a bank loan."[105] SME loans as a per cent of total loans are higher in non-GCC countries than in GCC countries and range from 4 and 5 per cent in the Syrian Arab Republic and Egypt to 16 and 20 per cent in Lebanon and Yemen.[106]

There is huge potential for expanding SME finance and support in non-GCC ESCWA member countries, in which large numbers of smaller enterprises are underserved. State banks have an important role to play in SME lending, given that private banks are reluctant to take on risk.[107] Beyond providing direct financing, Governments can help to create the type of environment where private banks can finance SMEs responsibly.

Several non-GCC ESCWA member countries have developed policies to promote SMEs. Egypt's Social Fund for Development provides credit, insurance and incubation support to SMEs. The Small Enterprise Development Organization in Egypt was created to help create jobs for low-income groups in particular. It provided credit and business support services for new and existing small enterprises. According to one estimate, in the 2000s, this programme, "created between 50,000 to 70,000 jobs per year, which corresponds to almost one-quarter of all non-agricultural jobs."[108]

Similar organizations exist elsewhere. In the Syrian Arab Republic, the Government established the Public Commission for Employment and Enterprises Development in 2006 to encourage the growth of SMEs. The Syrian Enterprise and Business Centre also implements an SME support programme, which

[101] ESCWA, 2008, pp. 14-15.

[102] United Nations Development Programme, 2011, p. 15.

[103] Hazem Shunnar, 2008, p. 2.

[104] Maria De Gobbi and Alena Nesporova, 2005, p. 35.

[105] Roberto Rocha et al., 2011, p. 1.

[106] Ibid., 22.

[107] Ibid., 18.

[108] Maria De Gobbi and Alena Nesporova, 2005, p. 43.

includes two business incubators.[109] A number of organizations support SME development in Jordan. In addition to the Jordan Enterprise Development Corporation, which provides industry support, technical assistance, and grants to industry, the National Fund for Enterprise Support was established jointly between Governments of Jordan and Japan to assist in the implementation of development projects.

Regulation of competition, standards and trade

Some analysts have argued that trade openness in the Middle East in the 1980s and 1990s declined as a result of declining foreign exchange earnings and import capacity.[110] This shifted the political calculation of many policymakers as lower imports reduced the political costs of protectionism. As a result, protectionism increased, as evidenced by higher tariff and non-tariff barriers. But as oil prices have rebounded in recent years and as the opportunity to form free-trade agreements has increased, most Arab countries have accelerated their trade liberalization (see annex VI for World Trade Organization (WTO) membership and select free trade agreements).

The scope of trade liberalization in many non-GCC ESCWA member countries has been impressive. "Jordan's trade regime has put through significant reforms during the process of its accession to the WTO [and] currently has bound customs tariffs on all products, except electricity".[111] "In Egypt, import licensing was eliminated in 1993, and the scope of quantitative restrictions progressively reduced."[112] In 2004, Egypt carried out many reforms, which resulted in a reduction of the weighted average tariff.[113] Nonetheless, as the Economist Intelligence Unit reported in 2011, the Egyptian public sector continued to have monopolies or near monopolies in heavy industry, power, transport and insurance.[114]

In recent years in the Syrian Arab Republic, import tariffs have been reduced and the import negative list has been shortened.[115] However, several non-tariff barriers to trade still exist, including "non-automatic licensing, a public monopoly in the trade of certain products, and a negative list which prohibits the import of a number of goods."[116] Like most other countries in the region, the Sudan has also opened considerably to trade since the 1990s. The Government has, "reduced tariffs, abolished most export monopolies, and eliminated exchange rate controls."[117] "Lebanon has undergone major trade liberalization since the beginning of 2000s", and its Tariff Trade Restrictive Index declined significantly.[118]

Despite these reforms, non-oil trade remains relatively low in the region, and non-GCC ESCWA member countries have not fully opened themselves up to trade as a source of employment creation. Mean applied tariff rates can serve as a proxy for trade restrictiveness, which remains high in certain countries (see table 10).

[109] Tatjana Chahoud, 2009, p. 20.

[110] Hadi Esfahani and Lyn Squire, 2007, p. 683.

[111] World Bank, 2010a.

[112] Farrukh Iqbal and Mustapha Nabli, 2004, p. 14.

[113] World Bank, 2010b.

[114] EIU, 2011f, p. 49.

[115] IMF, 2010b, p. 13.

[116] World Bank, 2010c.

[117] World Bank, 2010d.

[118] World Bank, 2010e, the "Tariff Trade Restrictive Index" calculates the equivalent uniform tariff that would keep domestic welfare constant. It is weighted by import shares and import demand elasticity.

TABLE 10. APPLIED TARIFF RATES IN SELECTED COUNTRIES, WEIGHTED MEAN

Country	Rate
Egypt (2009)	8.05
Jordan (2009)	5.18
Lebanon (2007)	4.81
Sudan (2010)	14.75
Syrian Arab Republic (2010)	6.12
Yemen (2009)	4.24

Source: World Development Indicators.

Note: Rates are the average of effectively applied tariff rates (as opposed to bound rates) weighted by the product import shares.

In the long run, several gains in employment-creating capacity result from trade liberalization and outward orientation. First, greater openness encourages new private investment, which directly raises economic growth and creates jobs, particularly in the manufacturing sector. Second, openness fosters competition, encourages technological development, increases the demand for high-skilled labour and forces businesses to reduce inefficiencies. The resulting adaptation generates demand for new skills and trades.[119] Job creation accelerated in Mexico after the implementation of the North American Free Trade Agreement, and manufacturing employment nearly doubled, reaching nearly 16 per cent annually from 1994 to 1999.[120]

In developing countries, removing trade barriers "increases national welfare, improves incentives and increases both the demand and supply of labour, by attracting more people of working age into the labour force," and it promotes manufacturing employment because developing countries have a comparative advantage in labour-intensive industries.[121] In Jordan, from 1995 to 2005, there was, "a positive correlation between increases in export intensity per employee and the average annual rate of employment growth," and a similar correlation was noted between export growth and wage increases.[122]

In the long term, export-led growth brought large employment dividends to a number of countries that integrated into global markets. In the short term in developing countries, openness can hurt protected sectors and dislocate workers in industries that compete with imports. Nevertheless, increased liberalization should result in substantial dividends in job creation and income growth. However, openness in the absence of other enabling factors may diminish job creation. Trade openness has produced fewer manufacturing jobs in the Middle East than in other developing countries, perhaps because "poorly performing labour-market institutions [diminish] the medium-term benefits from increased trade openness while exacerbating the adjustment costs."[123]

Industrial policy and clusters

In order to complement increased trade openness, policies have been developed to encourage and support the expansion of industry. The Industrial Development Strategy of Egypt identified the industrial sector as, "a major growth driver having strong forward and backwards linkages with both the agriculture and services sectors."[124] The plan centres on three main strategies: (1) achieving higher industry growth by

[119] World Bank, 2008, p. 234.

[120] Farrukh Iqbal and Mustapha Nabli, 2004, p. 20.

[121] Dipak Dasgupta et al., 2003, p. 13.

[122] Claudia Nassif and Peter Walkenhorst, 2006, p. 9.

[123] Dipak Dasgupta et al., 2003, p. 15.

[124] Industrial Modernisation Centre, 2006, p. 12.

aggressively developing exports and attracting FDI; (2) leveraging industrial competitiveness to boost productivity; and (3) shifting gradually from low-tech to medium and high-tech industries.[125] The strategy also includes investment promotion, industrial development and SME promotion.

Manufacturing now contributes approximately 20 per cent of the GDP of Jordan, which is the highest among all ESCWA member countries. As outlined in late 2008, the industrial policy of Jordan seeks to increase the competitiveness of industrial products, create an attractive investment environment and focus on export-oriented industries. It aims to accomplish this by providing indirect technical and financial support, promoting investment and encouraging partnerships between the public and private sectors.[126]

In the period 2006-2009, the manufacturing sector made up an average of 4.3 per cent of the GDP of the Syrian Arab Republic, which remains low by regional standards (see annex III). However, while official data show the sector fluctuating a great deal in the early 2000s, real sectoral growth was positive every year from 2005 to 2009. The tenth five-year plan offered a number of benchmarks for the manufacturing industry, among them expanding employment by 10 per cent each year.[127] In addition, new investment and commercial laws were passed, an investment agency was established and industrial cities near Damascus, Aleppo and Homs were created as incubators for new industries.[128] Several ESCWA member countries have established industrial zones and free zones. The advantages are relatively well-known and include economies of scale, better infrastructure, business support and lower costs to businesses. In Yemen, the third five-year plan outlined the establishment of industrial zones to encourage the expansion of SMEs and larger industries. Jordan has made use of Qualified Industrial Zones to greatly expand its industrial capacity and manufacturing exports.

Despite these efforts, average labour productivity, total factor productivity and technical efficiency in MENA countries is low. A study of the relationship between firm-level productivity and investment climate in 23 countries found that poor performance is linked to investment climate deficiencies, including infrastructure, a less experienced and educated labour force, higher costs and low access to financing.[129] To achieve significant gains in manufacturing and industry, MENA countries must first enhance the investment climate.

Agricultural policy

Several countries have taken steps to reinvigorate their agricultural sectors as a driver of growth and employment. In particular, the Sudan and the Syrian Arab Republic have promoted agricultural development and growth. In the Sudan, the agricultural sector employs 44.8 per cent of the labour force and was the main source of foreign exchange earnings (mainly from cotton) prior to the rise of oil.[130] "In 2009, agricultural exports accounted for 90 per cent of all non-oil exports," and the sector has substantial potential for growth because, "only an estimated 15-20 per cent of the Sudan's arable land is under cultivation."[131]

The agriculture sector has grown little in the past decade, and the Government is taking steps to turn this around. Sudanese authorities plan to develop the sector by attracting strategic foreign investors. The Sudan aims to provide better infrastructure, remove structural rigidities and distortions, liberalize investment

[125] Ibid., p. 3.

[126] Jamal Mahasneh, 2008.

[127] Tatjana Chahoud, 2009, p. 12.

[128] Ibid., p. 3. It is likely that ongoing unrest has been an obstacle to these objectives.

[129] Tidiane Kinda et al., 2008, pp. 23-24.

[130] ESCWA, 2011, p. 98.

[131] IMF, 2010d, p. 9.

and the labour market and reform the legal system.[132] Meanwhile, the National Agricultural Revival Program has gained momentum and seeks to implement large irrigation schemes, encourage the development of the agro-industry, and increase spending on irrigation, land preservation, fertilizers and credit services.[133]

The Syrian authorities have taken steps to promote agriculture by providing tax breaks for farmers, rescheduling loans and increasing the procurement prices of key crops. They have also modified the subsidy system to allow for better targeting, improved efficiency and fiscal gains. In 2008, the Agricultural Support Fund was established, "to replace some input subsidies with cash transfers to farmers."[134] By contrast, Iraq has increased subsidies to farmers to sustain the agriculture sector "at the expense of investing in new, potentially far more productive industries."[135] Ultimately, investments in agriculture to promote economic growth and employment must be evaluated in the light of other development opportunities.

[132] Ibid., p. 8.

[133] Ibid., p. 9.

[134] IMF, 2010b, p. 6.

[135] EIU, 2011g, p. 11.

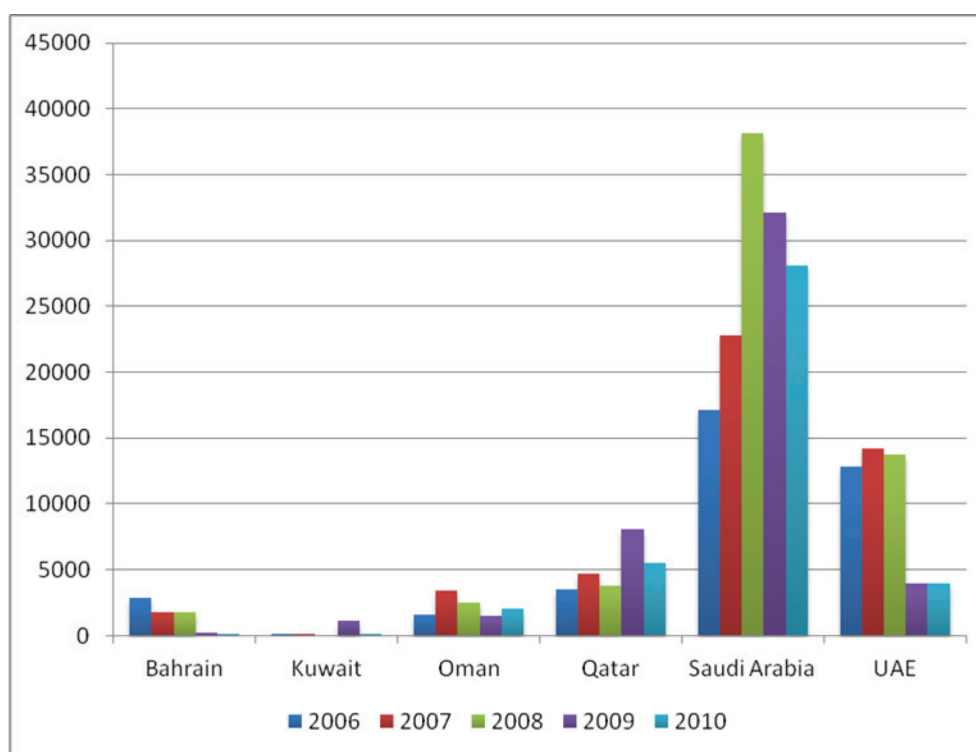
IV. ECONOMIC AND INVESTMENT POLICIES OF GCC COUNTRIES

Each GCC country has pursued strategies of economic diversification, aimed to shift production structures towards a "knowledge economy" and hoped that the private sector would create jobs and provide strategic services. The State has led the development of new strategic sectors like renewable energy, aviation, petrochemicals and plastics and logistics, with the local private sector following behind. After the 2008 economic crisis, business have found it harder to obtain finance and private investment in long-term projects has stalled. While business is likely to return to a more prominent role, it has yet to prove that it can lead the diversification process in a way that creates high-quality jobs for GCC nationals.

FDI results and regulation in GCC countries

In the 2000s, GCC countries attracted a significant level of FDI, with Saudi Arabia attracting the largest share (see figure 33). FDI is spread rather unevenly across GCC economies. Much of it is concentrated in upstream hydrocarbons and heavy industry, and little capital goes into technology or research-intensive industries or service sectors. With the exception of the free zones in the United Arab Emirates, FDI is also concentrated into larger projects, and little foreign investment is made in small and medium companies.

Figure 33. FDI into GCC countries, 2006-2010
(*Millions of United States dollars*)



Source: UNCTAD, available from http://unctadstat.unctad.org/ReportFolders/reportFolders.aspx.

The interest of GCC countries in FDI lies less in the need for capital and more in the region's need for technology, even in sectors that are not research intensive. Unlike many developing countries, the local private sector is well capitalized and needs joint venture partners mostly to provide expertise. Such expertise is often imported rather than built locally.

On paper, GCC economies have always been fairly open to investment. They made significant steps towards opening during the 2000s and for the most part allow 100 per cent foreign ownership in major sectors. In practice, foreigners often prefer local partnerships (which are still formally required in the United Arab Emirates outside of the free zones) to deal with the relatively heavy local bureaucracy and relationship-based business culture.

The administration of FDI by general agreement runs best in Jebel Ali in Dubai and other free zones that enjoy offshore status and are run by separate administrations beyond the control of regular line ministries (for details on FDI policies of GCC countries, see annex VII).

Foreign investment is an important source of local job creation because multinational organizations often have a better national employment record than local companies. Table 11 shows that foreign employers in the United Arab Emirates have an Emiratization ratio about five times higher than local private employers. In addition, international companies tend to have better-developed and longer-term human resource strategies and international training and secondment resources that local companies often lack. Foreign companies tend to be present in capital-intensive industries, however, which have limited job-creation capacity. For example, in the United Arab Emirates foreign investment accounts for only about 12 per cent of the total private sector labour force.

TABLE 11. NATIONALS EMPLOYED IN THE UNITED ARAB EMIRATES

Sector	Percentage
Federal government	52.5
Local government	33.0
Private-public entities	11.1
Private	0.5
Foreign	2.7
Others	31.4

Source: United Arab Emirates, 2008b, table 18.

SME promotion policies

The job creation capacity of SMEs in GCC countries has increased, and increasingly, GCC countries are focusing on SMEs as a strategic policy area. Many issues of SME development are the same anywhere in the world, including difficulty in accessing finance, weak accounting and lack of succession planning. Other issues are specific to the region.

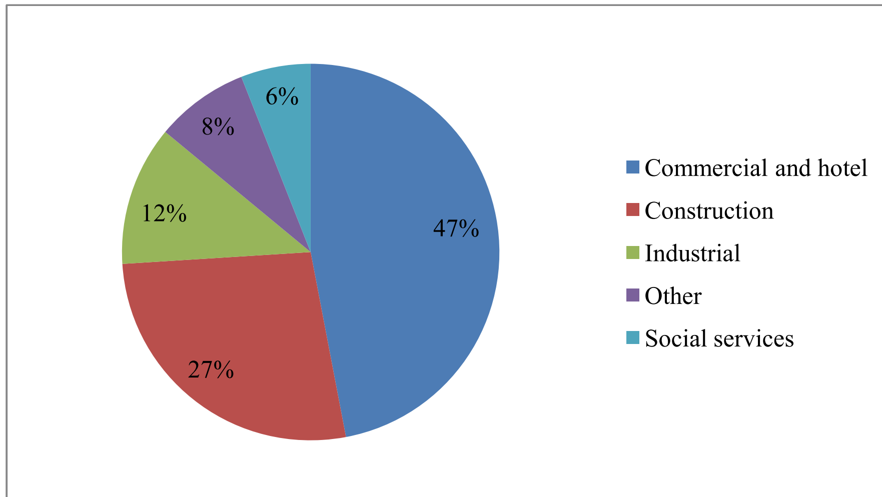
Like in most other world regions, SMEs in GCC countries struggle to obtain finance and often lack the accounting and business planning processes to qualify for services at local banks. State-led provision of SME loans, though well-intentioned, can drive private banks out of the market and create hardships for local companies.

The sectoral structure of Gulf SMEs is skewed towards simple contracting and trading operations, while other sectors tend to be under-represented (see figures 34 to 37).

Because of low wages and constrained career paths, SMEs have created fewer jobs for nationals than large businesses in the private sector. In Saudi Arabia, nationals represent about 10 per cent of the private sector, compared with an estimated 2 per cent of SMEs.[136] Microenterprises in particular offer few employment opportunities to Gulf citizens. The opportunity to act as silent partner or "formal" owner of companies financed and operated by foreigners (a phenomenon known as "tasattur") undermines incentives for nationals to become active entrepreneurs.

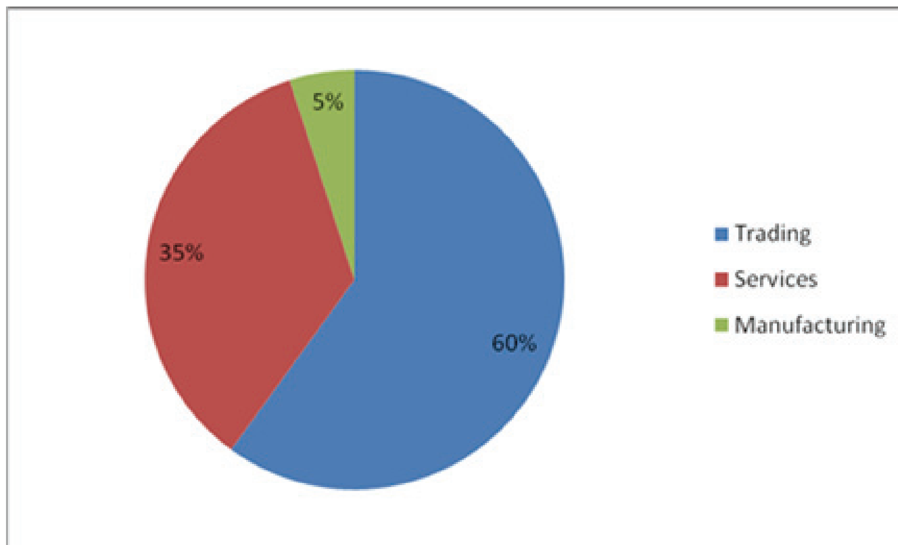
[136] Hertog, S. 2010b, p. 26.

Figure 34. Sectoral distribution of SMEs in Saudi Arabia



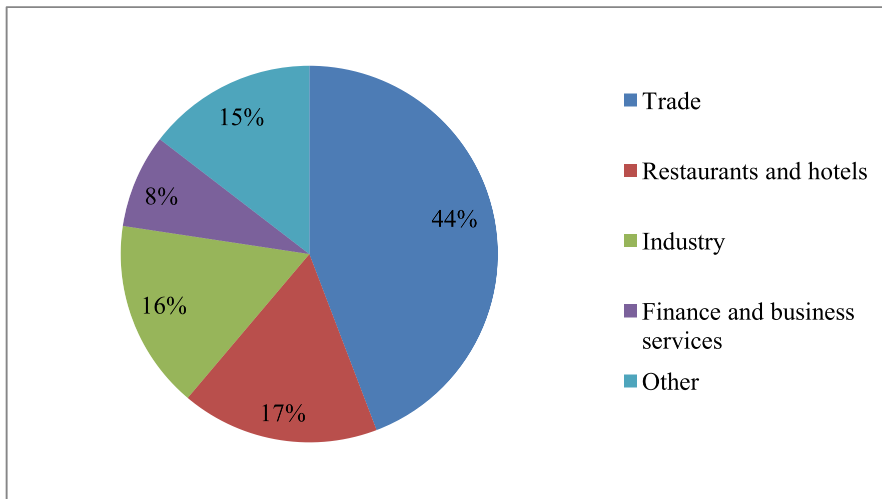
Source: Standard Chartered, 2009, p. 3.

Figure 35. Sectoral distribution of SMEs in the United Arab Emirates



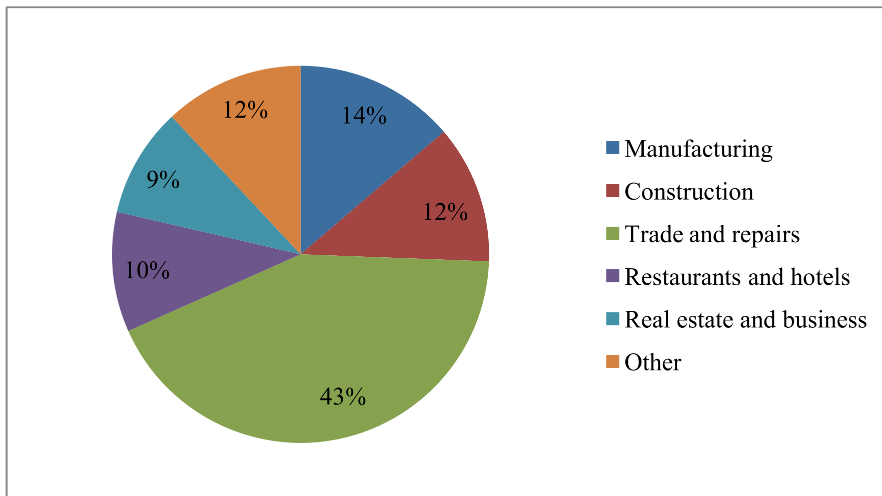
Source: Standard Chartered, 2009, p. 4.

Figure 36. Sectoral distribution of SMEs in Qatar



Source: Qatar Statistics Authority, 2006.

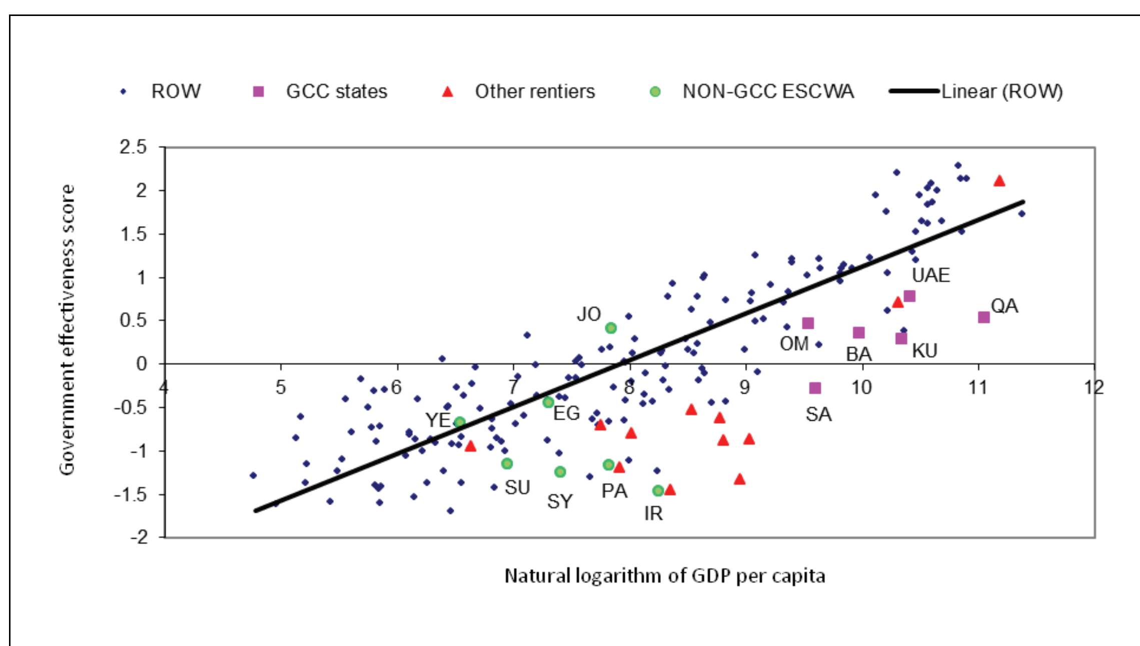
Figure 37. Sectoral distribution of SMEs in Bahrain



Source: Bahrain 2006.

Many SMEs also find the bureaucratic environment in the Gulf difficult and unpredictable, which leads to a focus on short-term, low-tech, low-margin activities and a reluctance to grow and take risks. The bureaucratic environment in most GCC countries has somewhat improved with the introduction of eGovernment and increasing competition for regional investment has led to some regulatory streamlining. Although the quality of bureaucracy in GCC countries is better than in the rest of the Arab world, it remains below OECD levels by most accounts (see figure 38).

Figure 38. GDP per capita vs. government effectiveness



Source: World Bank Governance Indicators and IMF.

Government bureaucracy also ranks high on a list of obstacles that local companies were surveyed about by the World Economic Forum (see table 12). Representatives of local companies were asked to evaluate 15 business factors and to select and rank the top 5 most problematic in their country. The following list of weighted percentages shows how significant inefficient government bureaucracy is for local businesses in GCC countries. The higher the percentage, the more problematic the respondents believed inefficient government bureaucracy to be.

TABLE 12. GCC: SIGNIFICANCE OF INEFFICIENT GOVERNMENT BUREAUCRACY

Country	Ranking
Bahrain	12.3
Kuwait	21.5
Oman	4.5
Qatar	6.2
Saudi Arabia	10.2
United Arab Emirates	11.0

Source: World Economic Forum, 2010, pp. 30-54.

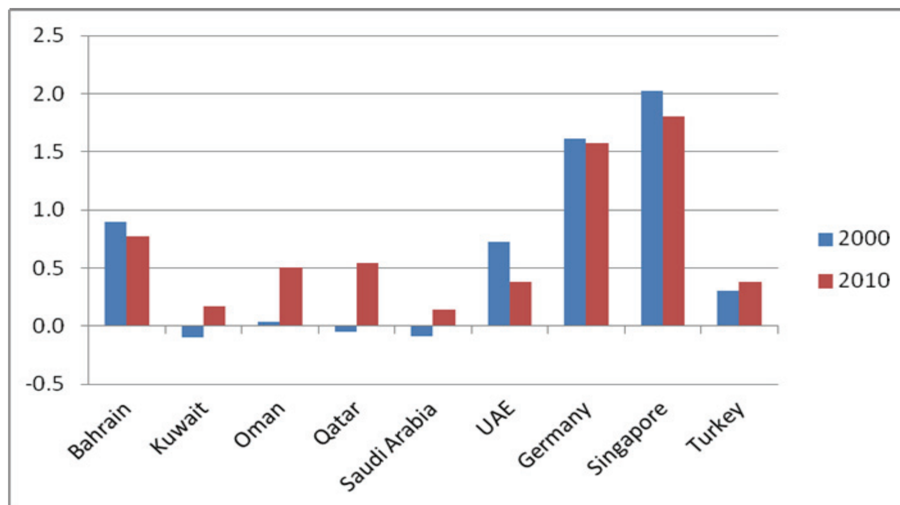
Many SME support programmes focus less on providing the administrative environment and infrastructure to enable SME growth than on providing subsidized credit and free business support services, which are often made available indiscriminately and are sometimes abused. Gulf SMEs continue to operate in a fragmented environment, with sectoral associations or cooperatives weak or non-existent. Existing public SME support programmes are diverse and some are innovative, but they remain fragmented and a systematic evaluation of their results is needed. Lead agencies are needed to coordinate and benchmark SME policies, and publish existing data on SMEs and their markets. The “Dubai SME” organization has developed commonly applied definitions and an Emirate-level SME support policy. Still, there is a need for a strategic vision for SME development that accounts for the specificities of the Gulf business environment, and increases the involvement of GCC citizens in SME development.

Regulation of competition, standards and trade

The regulatory environment in GCC countries has been significantly modernized during the past decade. All countries now have dedicated sectoral regulators in strategic areas like banking, finance and telecommunications which have built considerable administrative capacity and are becoming increasingly independent of the line agencies. In GCC countries, general regulation of consumer standards or competition is less developed. These matters usually remain in the hands of weak ministries or have been delegated to new bodies that have proven incapable of managing such issues. In an administrative environment that is characterized by empire-building and weak horizontal coordination, cross-cutting tasks like the general regulation of competition pose a significant challenge.

The World Bank's governance indicators on the quality of regulation indicates that four of the six GCC countries have improved their regulatory environment during the 2000s (see figure 39), but all remain below OECD levels, though several GCC countries now compare favourably with Turkey.

Figure 39. World Bank ranking of quality of regulation in GCC and selected countries



Source: World Bank Governance Indicators.

All GCC countries are members of the World Trade Organization (WTO), and their compliance with the organization's rules has generally been better than in the rest of the region. Although issues with non-tariff trade barriers remain, GCC countries draw on a tradition of free trade in which obstacles to the cross-border movement of goods were never as pronounced as in the rest of the Arab world and tariffs have historically been modest (see table 13). The further trade liberalization since the 1990s has had only a marginal effect on local labour markets. GCC countries have never engaged in significant import-substituting production on the scale of other Arab countries.

TABLE 13. APPLIED TARIFF RATES, WEIGHTED AVERAGE (2009)
(*Percentage*)

Country	Rate
Bahrain	3.60
Kuwait	4.09
Oman	3.17
Qatar	3.76
Saudi Arabia	3.87
United Arab Emirates	3.73

Source: World Development Indicators.

Note: Rate is weighted by the volume of trade in the specific goods.

Channels and availability of private sector finance

Limits to the availability of private sector finance constitute an important constraint to diversification and job creation. Banks have become even more selective and risk-averse since the 2008 crisis, preferring to loan to government-related entities or central banks. Total loan volumes have stagnated or grown at slow rates, while non-performing loans and write-offs have increased. In 2011, Moody's, a credit rating agency, projected that non-performing loans in the United Arab Emirates would exceeded 10 per cent. Alternative forms of finance, such as corporate bond markets, have shut down almost completely for private companies. Private equity is also constrained and venture capital is restricted to a few State-supported SME investment programmes. There have been very few initial public offerings in GCC stock markets in the last 3 years. In the first half of 2011, the value of initial public offerings in the region fell more than 50 per cent from the previous year.[137]

While improvement is likely in the coming years, many GCC businesses will rely on their own profits to expand their activities. This is particularly the case for SMEs. Local banks remain risk-averse and foreign lenders dominate corporate banking. The lack of finance and aversion to risk constrain growth.

Industrial, research and technology policy

In the past, GCC countries have subsidized industrial infrastructure and inputs, which has led to significant diversification in manufacturing. Industrial cities, the provision of subsidized utility services including cheap gas and water, and concessionary loans have allowed both private and public companies to rapidly expand into areas like petrochemicals, aluminium, construction materials and plastics. As a result, GCC countries have built up an impressive infrastructure, compared with 139 countries (see table 14).

TABLE 14. GCC INFRASTRUCTURE RANKINGS

Country	Ranking
United Arab Emirates	3
Qatar	25
Bahrain	27
Saudi Arabia	28
Oman	33
Kuwait	60

Source: World Economic Forum, 2010, pp. 30-54.

All GCC countries have provided industrial feedstock, electricity and water below international market prices or even below local production costs to boost local manufacturing. The price of gas as a feedstock has been kept particularly low, at less than 20 per cent of what is customary in other markets.

Cheap gas has been used both to produce electricity for energy-intensive manufacturing including aluminium production. Gas has also been used as a bulk feedstock for petrochemicals industries, which has facilitated downstream industries like plastics, in which private investors play a prominent role.

Much of the increase in manufacturing since the 1970s is attributable to such support policies. Industrial cities, with their own separate infrastructure, licensing regimes and utility provision have had the greatest success. While such State support has been useful for kick-starting export-oriented industries, the policy is now facing resource constraints, as gas is becoming scarce and more expensive to develop, and domestic consumption continues to rise (see table 15).

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[137] Available from http://www.pwc.com/m1/en/media-centre/2011/19b-uae-ipo-18082011.jhtml.

TABLE 15. GCC: DOMESTIC NATURAL GAS CONSUMPTION IN THE 2000S

Country	2000 (*billion cubic feet*)	2009 (*billion cubic feet*)	Growth (*percentage*)
Bahrain	303	441	46
Kuwait	339	437	29
Oman	221	520	135
Qatar	532	745	40
Saudi Arabia	1759	2770	57
United Arab Emirates	1110	2069	86
Total	4264	6982	64

Source: United States Energy Information Administration, available from http://www.eia.gov/countries/index.cfm.

GCC countries are attempting to shift from purely feedstock-intensive industries to downstream technology-intensive industries, but the process is slow and is led by State-related entities. For example, the Saudi Basic Industries Corporation acquired GE Plastics and Mubadala pushed into semiconductor manufacturing. It is too early to judge the success of these developments.

Research and development in the region is still underdeveloped and driven by large, State-owned entities. Technology clusters around specific industries have not yet developed, and links between business and local universities are weak. Research and development expenditure is around 2 per cent in OECD countries, but averages around 0.1 per cent in the Arab region.[138]

[138] United Nations Educational, Scientific and Cultural Organization, 2011.

V. CONCLUSION

Although the state of development, economic reforms and labour-market structures differ significantly between GCC and non-GCC ESCWA member countries, the outlines of important policy prescriptions emerging from the above analysis are similar. Several general conclusions stand out.

- State spending must become more incentive-neutral, with less of a distortionary effect on prices, consumption, labour market and education decisions. Current spending needs to be deployed more effectively, most notably through the creation of a modern social protection floor which can substitute for existing distributional structures embedded in subsidy policies and over-employment in the public sector. The current political upheaval in the region has encouraged an increase in social spending, but it is also a chance to negotiate a new bargain between the State and society that is fairer, more inclusive and less wasteful.

- Governments need to retain a long-term focus for strategic development expenditures. The quality of the labour supply is directly impacted by health and education services, which in the past have focused on quantity rather than quality. Labour demand is strongly, though indirectly impacted by the quality of available infrastructure and public services, which are often neglected during a fiscal crisis.

- Modern fiscal systems are needed throughout the ESCWA region to form a solid foundation for rational fiscal policy. Each member country depends in part on rent and/or aid, and a more reliable and broader fiscal basis is needed. Member countries should strengthen tax administration and improve general regulatory capacity to allow targeted interventions to increase productivity.

- All ESCWA member countries must improve the local investment environment to attract private investors to longer-term, higher value-added investments. Reforming practices of local bureaucracies will be difficult, but could go together with a general streamlining of the civil service in the course of fiscal policy reform. Several ESCWA member countries must do more to build and fund independent regulators to guarantee that the playing field in new economic sectors is level and transparent.

- Private businesses, including SMEs, need a smooth administrative environment and reliable infrastructure, which are more important to their success than subsidized credit and free business services.

- There is a need for more jobs, and the quality of jobs also needs to improve. On average, private jobs pay less than civil service jobs across the region, creating undesirable incentives for students and job seekers. Technology upgrades in the private sector are needed to create productive jobs. A safe, transparent and reliable investment environment conducive to long-term investments is needed for technology upgrades. Better infrastructure and human capital are also needed.

- Trade liberalization alone will do little to create jobs in the region and may even destroy jobs in the short run. To create jobs, liberalization must be combined with the reformation of the business environment, targeted expansion of the social protection floor and further practical reforms of FDI regulations.

- Labour unions need to be strengthened to overcome problems and guarantee shared and coordinated investments in training, human resources and technology.

- For job creation to benefit national populations, targeted migration management reforms are needed in GCC countries to incentivize productive employment. This could be done through taxing or otherwise restricting incoming lower-skill foreign labourers, improving the internal mobility, rights and wages of foreign workers and also by subsidizing national labour in strategic sectors while reducing recruitment of the over-staffed civil service. An alternative to wage subsidies for nationals could be a “citizens’ income” provided to all adult GCC citizens except State employees.

Annex I

AVERAGE ANNUAL GROWTH RATES IN NON-GCC ESCWA MEMBER COUNTRIES (2006-2010)

	Egypt	Iraq	Jordan	Lebanon	Sudan	Syria	Palestine	Yemen
Real GDP Growth	6.2	5.1	5.3	6.6	7.3	4.9	4.8	4.0
Expenditure on GDP (*percentage real change*)								
Private consumption	6.3		4.2	5.9	4.1	3.0		3.7
Government consumption	3.1		4.4	5.3	6.1	7.5		4.0
Gross fixed investment	9.2		5.8	16.6	7.2	-0.2		4.7
Exports of goods and services	10.5		5.2	7.1	11.2	4.8		3.0
Imports of goods and services	11.5		3.9	11.7	-0.3	0.5		3.4
Origin of GDP (percentage real change)								
Agriculture	3.4	-0.3	3.3		5.7	-0.8		1.6
Industry	6.2	6.3	5.6		13.0	3.7		4.2
Services	8.7	5.3	5.2		7.8	7.6		4.0

Source: Economist Intelligence Unit (EIU).

Notes: EIU estimates for Jordan, the Sudan and the Syrian Arab Republic 2009, for Jordan, Lebanon, the Sudan and the Syrian Arab Republic 2010, and for Yemen all years; EIU estimates of expenditure growth for Jordan.

Annex II

AVERAGE ANNUAL GROWTH RATES IN GCC COUNTRIES (2006-2010)

	Bahrain	Kuwait	Oman	Qatar	Saudi Arabia	United Arab Emirates
Real GDP Growth	5.8	2.8	6.1	12.9	2.7	3.2
Expenditure on GDP (*percentage real change*)						
Private consumption		5.1	11.1	13.2	7.8	
Government consumption		2.1	4.8	13.8	6.3	
Gross fixed investment		11.5	14.8	10.2	11.7	
Exports of goods and services		-0.3	3.8	17.6	-1.3	
Imports of goods and services		7.2	15.5	16.8	12.4	
Origin of GDP (*percentage real change*)						
Agriculture	6.0	-1.8	2.5	1.2	0.9	-5.3
Industry	3.4	0.5	4.8	16.0	1.1	3.1
Services	7.8	6.3	6.6	11.8	4.4	3.8

Source: Economist Intelligence Unit (EIU).

Notes: EIU Estimates for the United Arab Emirates 2009-2010, Oman 2010, Kuwait 2008-2010, and Qatar 2007-2010; EIU estimates of expenditure growth for Saudi Arabia 2009-2010 and Bahrain 2010.

Annex III

PUBLIC FINANCE STATISTICS IN NON-GCC ESCWA MEMBER COUNTRIES
(*Percentage of GDP*)

	Egypt (2009/10)	Jordan (2010)	Iraq (2010)	Lebanon (2010)	Sudan (2010)	Syria (2008)	Palestine (2010)	Yemen (2009)
Revenues	23.3	24.9	40.4	24.1	12.8	19.4	25.8	21.0
Tax	14.8	15.9	0.9	19.0	6.2	10.2	5.3	6.7
Income and corporate tax	6.7	3.3		3.9	0.7			
Goods and services	5.8	10.6		6.8	3.2			
International trade	1.3	1.5		5.3	1.8			3.2
Other (including property tax)	0.6	0.4		2.9	0.5			
Nontax revenue	8.1	6.7	38.9	3.9	5.9	9.2	3.6	14.0
Hydrocarbons					5.3	5.2		12.3
Grants	0.4	2.1	0.6	1.3	0.7		16.8	0.3
Expenditures	31.8	30.4	37.4	32.4	17.5	22.1	43.6	30.4
Current expenditure	27.6	25.3	30.4	24.6	14.9	15.3	39.9	24.3
Wages and remunerations	7.4	4.7	15.5	9.6	4.6	4.7	20.9	9.2
Purchases of goods and services	2.4	1.6	4.6	0.5	1.5	1.1		3.2
Interest	6.3	2.1	0.5	11.2	1.0	0.6		2.1
Subsidies, grants, and social benefits	8.9	7.3	6.8	1.3	7.4	4.4		9.4
Subsidies	8.1	1.6	1.0		0.1			6.5
Transfers	0.8	5.2	3.0		7.3			2.8
Other current expenditure	2.5	9.6	2.9	1.9	0.3	4.5	15.5	0.5
Military expenditure	2.0	9.1				4.5		
Investment expenditure	4.2	5.1	7.0	1.3	2.6	6.8	3.7	4.9
Other treasury expenditures				6.4				

Sources: Central Bank of Egypt, *Monthly Statistical Bulletin*, August 2011, table 35; Central Bank of Jordan, *Monthly Statistical Bulletin*, public finance tables 25-27; Central Bank of Iraq, 2010, tables 26-28; Lebanon, 2010b, tables 2, 3 and 12; Central Bank of Sudan, 2010, tables 6-2, 6-4 and 6-5; IMF (2010b), tables 1 and 2; Palestine Monetary Authority, 2011a, tables 1 and 26; Central Bank of Yemen, 2009, pp. 11, 26 and 27.

Notes: Egypt (budget sector only); the Sudan (estimated); Palestine (PNA); data for Jordan, the Syrian Arab Republic and Yemen are preliminary.

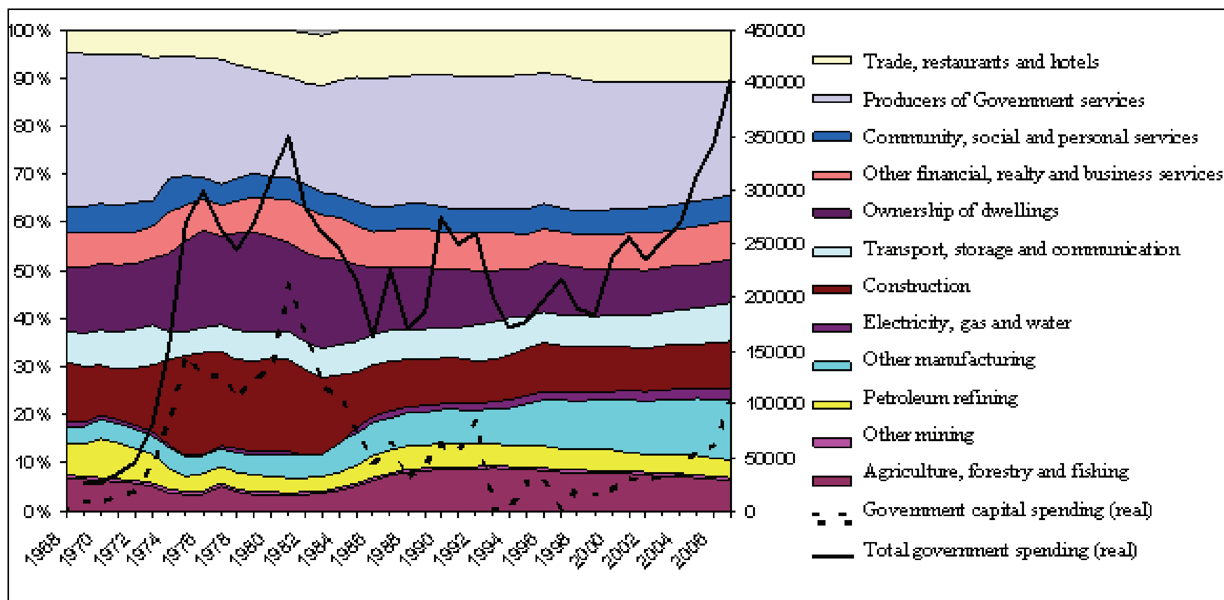
Annex IV

STATE SPENDING AND THE COMPOSITION OF GDP IN SAUDI ARABIA

The private sector of GCC countries relies strongly on rent-driven government spending. The extent to which the composition of GDP reacts to fluctuations in State spending should also be examined. This annex includes a graphical test of this question in Saudi Arabia, where detailed national accounts data are available. In the 1970s and 1980s, higher State spending was correlated with a relative expansion of typical "boom-time" sectors like construction and ownership of dwellings. Current spending provides for salaries, transfers, subsidies, operations and maintenance, while capital spending goes into physical assets such as roads, construction and machinery.

During the second boom period in the 2000s, however, the composition of GDP changed little despite rapid increases in State outlays. The structure of the economy appears more resilient to short-term shocks and on a steadier growth path. Even if the recent boom is followed by a period of reduced spending, it is unlikely to result in the collapse of the real estate sector, as was the case in the second half of the 1980s when spending on government projects rapidly decreased.

Composition of non-oil GDP in Saudi Arabia vs. government spending
(*Millions of Saudi Arabian riyals*)



Source: Saudi Arabian Monetary Agency, 2011.

Though less detailed, figure 8 illustrates GDP composition of GCC countries and supports a similar conclusion. Manufacturing, trade and hospitality, the sectors that are more prominent today, tend to be less reliant on State spending. In the short term, GCC diversification and business activity indicates less sectoral sensitivity to fiscal shocks and less reliance on government intervention. In the long run, however, they remain dependent on State spending.

Annex V

PUBLIC FINANCE STATISTICS IN GCC COUNTRIES
(*Percentage of GDP*)

	Bahrain (2009)	Oman (2009)	Kuwait (2009/10)	Saudi Arabia (2009)	Qatar (2008/09)	United Arab Emirates (2009)
Revenues	23.2	37.5	64.5	36.1	36	25.3
Tax		4.2	0.9		3.7	3.4
Income and corporate tax	2.2	2.1	0.3			0.1
Goods and services	0.6	0.7	0.0			2.5
International trade		0.9	0.6			0.8
Other (including property tax)	0.4	0.6	0.0			
Nontax revenue	19.5	33.2	63.6		32.2	21.9
Hydrocarbons	19.2	29.0	52.7	30.8	20.4	17.5
Grants	0.4					
Expenditures	28.2	41.2	35.3	42.2	25.3	38.4
Current expenditure	22.9	23.4	30.7	29.5	16.8	21.8
Wages and remunerations	11.3	8.4	11.1	14.8	4.8	3.3
Purchases of goods and services	2.8	3.0	6.2	8.3	8.9	6.8
Interest			0.2	1.0	0.5	0.6
Subsidies, grants, and social benefits	7.9	1.0	12.7	1.9	0.3	4.6
Subsidies	1.9		0.0	1.5		
Transfers	6.0		0.0	0.4		
Other current expenditure	0.9		0.5	3.4	2.3	6.5
Military expenditure		9.6	3.9			
Investment expenditure	5.3	14.9	4.6	12.7	8.5	4.5
Other treasury expenditures		2.9				12.1

Sources: IMF Article IV Consultations; Central Bank of Oman, 2010, tables 2.1, 4.2, 4.3 and 4.4; Bahrain, 2010, consolidated table.

Annex VI

SELECTED INTERNATIONAL TRADE AGREEMENTS IN THE ESCWA REGION

	WTO	Bilateral Agreement with US	Bilateral Agreement with EU
Bahrain	Member (1995)	FTA (2006)	
Egypt	Member (1995)	TIFA (1999)	Association Agreement (2004)
Iraq	Observer (2004)	TIFA (2004)	
Jordan	Member (2000)	FTA (2002)	Association Agreement (2002)
Kuwait	Member (1995)	TIFA (2004)	
Lebanon	Observer (1999)	TIFA (2006)	Association Agreement (2003)
Oman	Member (2000)	FTA (2009)	
Palestine			Association Agreement (1997)
Qatar	Member (1996)	TIFA (2004)	
Saudi Arabia	Member (2005)	TIFA (2003)	
Sudan	Observer (1994)		
Syrian Arab Republic	Observer (2010)		Association Agreement (2004)
United Arab Emirates	Member (1996)	TIFA (2004)	
Yemen	Observer (2010)	TIFA (2004)	

Source: OECD, 2010, pp. 5-6.

Note: TIFA -Trade and Investment Framework Agreement.
FTA - Free Trade Agreement.

Annex VII

FDI REFORMS IN GCC COUNTRIES

The increasing mobility of capital has motivated Gulf Governments to provide an environment that attracts and retains investment. This has resulted in significant liberalization of FDI rules, which were already liberal by regional standards. The strategy differs from country to country, and GCC countries have learned from each other. The main sources for this annex are national investment and company laws, supplemented by interviews and press surveys of FDI activity in GCC countries.

Bahrain

Until recently, Bahrain offered one of the smoothest regulatory environments in the Gulf. But it has gradually lost its relative advantage owing to its limited domestic market and Dubai's energetic competition. It has allowed foreign real estate ownership in specific areas since 2003 and permits 100 per cent foreign ownership in a number of sectors. Recently, Bahrain has attempted to reposition itself by promoting new industrial and financial zones.

Kuwait

Kuwait has struggled to attract foreign investors but has nonetheless removed some important legal limitations. A 2001 FDI bill allows for 100 per cent foreign ownership in a number of sectors, and Kuwait has recently issued licenses for foreign banks.[139] Implementation and follow-up of FDI reforms have been deficient, however, which is reflected in very low FDI rates (see figure 26 above). Despite many years of government lobbying, business laws have not been reformed and this also inhibits investment. The parliament is powerful enough to stop any reform initiative emerging from the Government, yet lacks the power to pursue a development programme of its own. Kuwait is perceived as a laggard in the competition for better governance.

Oman

Oman has made reforms on a modest scale. It has lowered taxes and unified them at a level of 12 per cent.[140] Foreign investors are usually restricted to holding a 70 per cent stake in Omani businesses, although, in certain instances, 100 per cent foreign ownership of businesses is permitted.[141] New industrial and real estate zones resemble those of neighbouring countries. It can profit in particular from its geographical location in the lower Gulf.

Qatar

Qatar issued a new investment law in 2000, allowing FDI in all sectors but finance, trade and real estate brokerage. Foreign ownership above 49 per cent is possible, subject to official approval.[142] Financial investment was allowed in 2004 conditional upon the Government's agreement. Foreign ownership of real estate in designated areas has gradually been made possible since 2004. Overall, Qatar's FDI policies have focused on attracting investment in specific zones and projects such as upstream gas and heavy industry in partnership with State enterprises. Qatar has also encouraged financial investment in the Qatar Financial Center, which has separate administrative structures and allows 100 per cent foreign ownership (although its

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[139] Law No. 8/2001, Regulating Direct Foreign Capital Investment in the State of Kuwait, available from http://www.e.gov.kw/sites/kgoenglish/portal/Pages/Visitors/DoingBusinessInKuwait/GoverningBody_OverView.aspx.

[140] Morison Muscat, "Doing Business in Oman," p. 42, available from http://www.morisonmuscat.com/.

[141] For more information see http://www.oman.om.

[142] Law No. 13/2000, Investment Law Regulating the Investment of Foreign Capital in Economic Activities, p. 49, available from www.mbt.gov.qa/English/ForeignInvestor/Documents/rule_13e.pdf.

financial market now is slated to be merged with the existing local market). An enclave strategy may be better adapted to Qatar's small size, limited bureaucratic capacities and large capital resources.

Saudi Arabia

Saudi Arabia has taken a conventional route to FDI reform, tackling national-level regulations. The Foreign Investment Act and Executive Rules, issued in 2000, constituted a significant move away from investment protectionism. It allowed 100 per cent foreign ownership in all sectors apart from those on a negative list that was to be revised regularly, introduced the guaranteed issuing of foreign investment licenses within 30 days and reduced taxes for foreign investors.[143]

The implementation of the law has been slow, with numerous administrative obstacles and unclear rules preventing new foreign ventures from setting up smoothly. It was only through new leadership at the Saudi Arabian General Investment Authority and negotiations over accession to WTO in 2005 that the Saudi Government substantially reduced the negative list and removed administrative barriers that hampered foreign investment. The Saudi investment regime is now very liberal on paper and bureaucratic procedures have somewhat improved in practice. Compared with Dubai's free zone enclaves, however, day-to-day dealings with Saudi Arabian bureaucracy are still more difficult for foreign investors.[144]

Most FDI in Saudi Arabia is tied up in large projects in heavy industry and telecomunications. The attractiveness of Saudi Arabia has as much to do with the 2000s boom and its advantageous natural resources as it does with regulatory reform. It has seen less investment in new services sectors than some of its smaller neighbors.

Many foreign industrial investors partner with large, established State-owned enterprises, which have de facto enclave status and can navigate the bureaucracy when new projects are set up. Moreover, Saudi Arabia has recently created economic cities with separate infrastructure that resemble Dubai's zone-based approach. Currently, however, the economic cities will probably be subject to national-level rules and administration, which somewhat dims their prospect for success.[145]

United Arab Emirates

The United Arab Emirates has focused most strongly on the enclave strategy to attract FDI. Federal-level regulations are being reformed slowly and the basic framework of investment regulations is more restrictive than in neighbouring countries. Individual Emirates, Dubai in particular, are the most advanced in carving out special zones offering high-quality infrastructure, which are administered separately from the rest of the economy under different, often foreign-staffed regulators and with much more liberal rules.

Whereas outside of these zones, foreign ownership is limited to 49 per cent, zones offer 100 per cent foreign ownership in addition to smooth licensing procedures, quick and responsive public services and in some cases, a separate labour administration. This has drawn considerable foreign money to Dubai in particular, a considerable share of which has come from its more sluggish neighbour Saudi Arabia.[146]

Dubai has done more than any other player in the region to spur regulatory and administrative competition between GCC Governments, while its hands-off approach has led to complaints about patchy enforcement of product standards, labour rights and competition rules. Competition for FDI is also unfolding within the United Arab Emirates, and Abu Dhabi has renewed its focus on free zone projects.

[143] For more information, see http://www.saudinf.com/main/c552.htm.

[144] Steffen Hertog, 2010, *Princes, Brokers and Bureaucrats: Oil and the State in Saudi Arabia*. Ithaca: Cornell University Press, chap. 5.

[145] Oxford Analytica, "Saudi Arabia: Economic Cities Require Adjustments," *Daily Brief Service*, 2 March 2007.

[146] Martina Fuchs, 2011, *UPDATE 2-UAE says no plan to raise foreign ownership limit*. Reuters, 20 June.

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