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REPORT

EXPERT GROUP MEETING ON POST FINANCIAL CRISIS AND POTENTIAL EXIT STRATEGIES BEIRUT, 24-25 FEBRUARY 2011

External Peer Review for the Survey of Economic and Social Developments in the ESCWA Region 2009-2010

Summary

The aim of the expert group meeting (EGM) was to review the preliminary work and results pertaining to The Survey of Economic and Social Developments in the ESCWA Region 2009-2010 and to enhance knowledge among policymakers in the region regarding issues that should be tackled in order to design and implement suitable social and macroeconomic exit policies and strategies for a better response to the post global financial crisis period. Upon review of the preliminary work, the EGM facilitated the exchange of views, ideas and experiences in order to give additional input, and experts brainstormed on the theme of the Survey 2010-2011, on Conflict and Spillover Effects, in order to chart the course of the debate relating to its preparation.

Discussions centred on: (a) the recent economic trends and developments in the Economic and Social Commission for Western Asia (ESCWA) region and the global financial crisis; (b) the financial implications of the global financial crisis; and (c) Arab economic integration and macroeconomic exit strategies.

The brainstorming round-table discussions focused on: (a) interactions of economics and politics in the Arab region; (b) the recent upheaval in Egypt; (c) the new role of the State; and (d) a new development agenda and the role of the United Nations.

At the conclusion of the discussions, it was recommended that the forthcoming issue of the Survey adopt an approach that links the economic impact to the social situation and studies the trickle-down effects at the structural, institutional and social policy levels. Various topics were recommended for inclusion, covering inflation, exchange rates, income distortion, tax evasion and regulation, progressive taxation, governance and transparency.

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Introduction

1. The Survey of Economic and Social Developments in the ESCWA region is a mandated publication and has been known as the ESCWA flagship publication since 1974. The Survey addresses major economic and social trends in the ESCWA region, and traces developments at the global level and their regional implications. In addition, the Survey:
 - (a) Provides an ahead of the curve analysis of the main developmental challenges, focusing on the development assets, opportunities and constraints of the region;
 - (b) Provides periodic (annual) country and regional outlooks, presenting analysis and projections of economic development at the country and regional levels;
 - (c) Discusses the socio-economic consequences for the region of various ad hoc issues focusing on the transmission channels of shock and their implications on macrostability, growth and poverty and identifies concrete policy options for consideration by member countries.
2. The present theme of the Survey was inspired by the speed and extent of the global financial crisis that halted the expansion of the world economy. These financial shocks forced policymakers and experts to reconsider their mode of analysis, usually based on the claim that economic development depends primarily on the creation of an enabling environment for the private sector, including free markets, and free flows of trade and finance. Presumably, given these conditions, economies will naturally grow. In this region, the evidence accumulated so far, points to the contrary. In the presence of an underdeveloped institutional framework, regional growth has been pinned almost entirely on oil.
3. Towards the end of 2008 and in 2009, ESCWA member countries experienced resilient economic expansion. However, sentiment and confidence started eroding due to the high variability in crude oil prices and the collapse of regional financial and real estate asset prices. The emerging fragility in the sentiment and confidence of economic actors is an essential source of concern for the economic growth prospects of the region. Moreover, the impact of the global financial crisis on regional social and economic development has to be assessed in the light of a series of reforms and institutional developments. This 2009-2011 Survey highlights the implications of the global financial crisis for ESCWA member countries and proposes potential macroeconomic exit strategies for implementation in the near future.
4. As of today, most ESCWA member countries have utilized both monetary and fiscal measures to deal with the cyclical component of the crisis. Regional monetary authorities intervened to stabilize money and capital markets, actively protected the financial sector by such measures as capital injections and share purchases, and introduced expansionary fiscal stimuli packages, with potential additional fiscal support measures when warranted. However, having dealt with the crisis with both fiscal and monetary macroeconomic policy tools, ESCWA member countries have not yet tackled the structural components of the crisis or identified strategies whereby the ESCWA region could become structurally resilient in the face of any future potential economic or political crisis.
5. While the 2009-2010 Survey tackles the implication of the global financial crisis on the ESCWA region and potential exit strategies, the 2010-2011 Survey will deal with different type of shocks, namely shocks originating from political/social conflict-related issues. Therefore, the main theme of the 2010-2011 Survey of Economic and Social Developments in the ESCWA Region will be Conflicts and Spillover Effects. Although the ESCWA region has emerged from the global financial crisis with minimal damage, so far, in terms of lost output and employment, some ESCWA member countries, namely Egypt, Jordan, Lebanon and Yemen are now facing new challenges/shocks emanating from conflict and social unrest. To this purpose, in addition to the economic implications for fiscal stance/space, debt sustainability and rating, interest and exchange rate policies, economic integration and trade facilitation, foreign direct investment (FDI) and private sector developments, and development strategies in conflict-affected areas; and the social

implications for poverty, unemployment, displaced/refugees, gender and youth of the various conflicts in the ESCWA region, the second day of the EGM will be devoted to four brainstorming sessions on the following topics:

- (a) Quantifying the effect or estimating the opportunity cost of political/military conflicts (the opportunity cost for growth and development);
- (b) Identifying possible conflict-sensitive strategies and how they can be incorporated in development agendas;
- (c) Identifying the relationships between conflict and institutions (governance issues), and between conflict and fiscal spending (its impact on the provision of social services);
- (d) Identifying the new role of the State in the absence of a vibrant private sector (the lack of FDI and domestic resource mobilization due to the high-risk premium associated with conflict and instability that deter private sector development);
- (e) Rethinking the Washington Consensus, which discusses macroeconomic deficits (balance of payment and budget deficits) but does not discuss knowledge, gender, and democracy deficits;
- (f) Identifying social inequality as a source of conflict.

I. RECOMMENDATIONS

A. RECOMMENDATIONS FOR THE CURRENT SURVEY

6. It was agreed to add the following text to the current Survey, to make the connection with the ongoing events in the region which started in January 2011, as follows:

As this Survey was being finalized, the Jasmine Revolution erupted in Tunisia, it was followed by the Lotus Revolution in Egypt and the Cactus Revolution in the Libyan Arab Jamahiriya. These events are unprecedented in their dynamics and the potential change they will bring about to the region. The consequences of this sea-change will become apparent as events unfold. At the same time, it is evidently clear that a new model of economic development in the region is emerging and it is critical that it responds to the aspirations of the people who have led these revolutions. Better economic policies to promote good governance and institutional building are urgently needed to create more and better jobs, and to bring about the necessary change the region has been aspiring to.

B. RECOMMENDATIONS FOR THE FORTHCOMING SURVEY

7. A number of recommendations were made by the experts to ESCWA for the forthcoming Survey, summarized as follows:

- (a) Tackle the following primary topics in the forthcoming Survey: inflation; the exchange rate; income distribution; tax regulation and evasion; progressive taxation; governance and transparency; the type of FDI received by the country as opposed to only the amount; and the impact of FDI on job creation;
- (b) Adopt an approach that connects the economic impact to the social situation and studies the trickle-down effect at the structural, institutional and social policy levels;
- (c) Segregate and analyse social indicators by gender;

(d) Tackle the issue of democracy in Arab countries, explicitly in publications of ESCWA, in general, and the Survey, in specific;

(e) Develop a strategy for regional integration and cooperation, for example in the food sector.

II. DISCUSSION TOPICS

8. Over the course of the two days, experts discussed The Survey of Economic and Social Developments in the ESCWA Region 2009-2010, and the topics of the forthcoming Survey 2010-2011 in a brainstorming session dedicated to current priority issues in the Arab region.

A. THE SURVEY OF ECONOMIC AND SOCIAL DEVELOPMENTS IN THE ESCWA REGION 2009-2010

9. The first presentation by EDGD was entitled The Recent Economic Trends and Developments in the ESCWA Region and the Global Financial Crisis. The results of the survey, the latest observed trends in the ESCWA region with respect to economic development and their social implications, were presented. The crisis impacted ESCWA member countries in two different ways; the oil-dependent countries that are not economically diversified fared worse than the more diversified economies. A common weakness witnessed across the ESCWA region was that economic development hadn't translated into social development (health, education and equality). The presentation discussed recent macroeconomic trends (oil prices, oil revenues, export destinations, remittances, current accounts and fiscal balance, capital and FDI inflows, market trends, public debts, monetary and fiscal policies), and provided some projections and expectations in the light of the global financial crisis.

10. Discussion followed the presentation, tackling the following issues:

(a) Regional integration: does it protect or threaten the region when a financial crisis strikes? Some experts believe that it protects the region, while others believe that it puts the region at higher risk;

(b) Exchange rate: should countries adopt a flexible or fixed exchange rate? Experts agreed that it depends on the specificities of each country; for example, a floating exchange rate in a small country like Lebanon would be disastrous;

(c) Type of FDI: experts agreed that FDI is important for both the economic and social well-being of the country as it produces jobs and they suggested that the type of FDI and its impact deserve further analysis;

(d) Fiscal space: some experts thought that ESCWA Governments have overused the available fiscal space to the extent that they are squeezing capital expenditures. Others believed that it is up to the respective Government to decide whether to use fiscal policies or monetary policies to deal with the crisis.

11. The second presentation, entitled The Financial Implications of the Global Financial Crisis, was delivered by EDGD. The presentation described the pre-crisis stance and the effect of the global financial crisis on the banking sector in ESCWA member countries and the financial, monetary and fiscal responses adopted by central banks to confront it. In addition, the banking sector and financial institutions have been affected differently depending on whether they are commercial, Islamic or investments banks. The high level of capitalization in those banks was the primary factor that helped them to withstand the crisis. It is mostly the financial institutions in Gulf Cooperation Council countries that encountered problems following the crisis due to their linkage with the rest of the world.

12. A general discussion then followed the presentation in which the following issues were raised and discussed:

(a) Banks in the ESCWA region are conservative and risk averse and do not invest in financial derivatives. They are consequently well capitalized but a minimum number of loans are granted to finance the private sector, limiting growth and development in a given economy with direct negative consequences on small and medium enterprises (SMEs) which are the backbone of growth and employment generation. Consequently, commercial banks in this region end up investing in Government treasury bills and finance the public sector debt at the expense of the private sector. It is estimated that only 10 per cent of loans in the ESCWA region are granted to SMEs;

(b) Experts suggested that central banks should try to decrease interest rates in the hope of spurring economic growth and explained the existence of high interest rates in the region by the fear of dollarization and the ensuing pressure on exchange rates and foreign reserves;

(c) Banks in this region lack the capacity to assess and manage risk. The absence of data on credit history makes the situation even worse when SMEs request loans. Those loans are often not granted due to information asymmetries;

(d) Experts agreed that the role of commercial banks is to finance the private sector and lubricate the economic cycle by lending money. In order to meet this goal, banks must develop their own risk-assessment tools when granting loans. More reliable data on credit history should be developed in order to back-up bank decisions on loan granting. It was also recommended to use other financial vehicles like capital markets, bond markets, and stock markets.

13. The third presentation, entitled The Arab Economic Integration and Macroeconomic Exit Strategies, was a general overview of Arab economic integration, focusing mainly on trade and financial integration in the ESCWA region. Issues presented were related to regional imports and exports, intraregional and total trade and intraregional investment followed by recommendation for future macroeconomic strategies to be adopted in order to strengthen regional integration.

14. The presentation contained a set of macroeconomic exit strategies for future implementation in ESCWA member countries as follows:

(a) Avoid premature termination of fiscal stimuli for the sake of balanced budgets because it may jeopardize economic recovery and lead to a worsening of human development indicators;

(b) Adopt a development strategy that strengthens the trickle-down effect between growth, employment generation and poverty alleviation;

(c) Focus more on supply side reforms that will help boost employment, the productive capacity of the industrial sector and enhance competitiveness;

(d) Devote efforts to financial sector development; and prioritize economic diversification on the economic agenda of ESCWA policymakers;

(e) Better coordinate macroeconomic and social policies for the purpose of alleviating unemployment and poverty;

(f) Introduce macroeconomic supply-side policies to enhance production capacity and growth, and encourage a greater role of the private sector in growth and development, perhaps a difficult goal to achieve, at least in the short run;

(g) Prioritize financial market integration of the ESCWA region, and promote the bond markets of ESCWA member countries to reduce reliance on international financial flows and contain the exchange rate risk;

- (h) Reach regional trade agreements as a way for middle and low-income ESCWA member countries to increase trade, spur growth, and lower unemployment rates;
- (i) Adopt a common currency to protect ESCWA member countries from future potential balance-of-payment crises;
- (j) Improve the financial and monetary policy coordination of central banks through enhanced regional financial integration and macroeconomic policy coordination;
- (k) Form an integrated ESCWA capital market to lower the interest rates of the region;
- (l) Enhance South-South trade and financial integration as the optimal macroeconomic policy option to avert future financial/economic crises from affecting the ESCWA region.

15. A discussion followed the presentation, tackling the following issues:

(a) Experts discussed the pillars of integration and the readiness of the ESCWA region to achieve this long-term goal. Some of them thought that the prerequisite infrastructure (communication and common currency) needed for integration does not exist. Many questioned the value of integration and whether it would help member countries or would constitute an additional hurdle especially during crises. Those experts viewed the Euro Zone experience as a disheartening model, especially after the economic crisis took its toll and were suggesting that integration is only possible when all countries reach their full development potential;

(b) Other experts explained that manufacturing requires infrastructure to facilitate trade, but infrastructure linking countries of the region is still not well developed. Consequently, the solution might be to make use of what is available, and explore such advantages present, especially in the services sector, as tourism, education and health.

B. BRAINSTORMING ROUND TABLE

16. On the second day of the EGM, a round table was held on the latest issues defining and shaping the Arab region. The round table shed light on possible priority issues to be discussed in the forthcoming issue of the ESCWA flagship publication, *The Survey of Economic and Social Developments in the ESCWA Region, 2010-2011*.

Round table I: Interactions of Economics and Politics in the Arab Region, chaired by Mr. Samir Makdisi

17. Experts discussed the economic and political environments that would lead to development in the Arab world. They agreed that economic and political factors are highly entwined and should be studied in tandem.

18. Experts started with a discussion on democracy, questioned its meaning, debated whether it is democracy that produces development or the other way around, and whether we should wait for democracy to emerge before discussing development. The following ideas were the highlights of the discussion:

- (a) Asian countries achieved development without democracy;
- (b) The ESCWA member countries do not reflect the trend observed in other regions where an increase in GDP per capita is related to an increase in democracy;
- (c) Corruption is not necessarily related to an authoritarian regime; for example, Singapore is authoritarian but corruption-free;

(d) It is believed that a democratic system encourages economic growth better than a non-democratic system;

(e) Countries of the ESCWA region have different histories and experiences with democracy; authoritarian regimes in this region have recently failed and many now hope that a democratic alternative will produce better development results;

(f) Experts agreed that it is not democracy that matters but the perception of democracy, and not the written laws but their enforcement. This problem is encountered in ESCWA member countries where, to suit the elites of the community, laws are neither enforced nor amended;

(g) Democracy requires that institutions provide a safety net;

(h) Educational reform, starting from school levels, is also important to foster and instil democratic and human values in the coming generations.

Round table II: Focusing on Egypt, chaired by Mr. Ibrahim Awad

19. Experts discussed the recent political revolution in Egypt and the predisposition that allowed its success after 30 years of authoritarian rule. Egyptians have tried to rebel against the governing group many times in the past. However this never succeeded, and the regime has kept its grip on Egypt through infiltration by the state police of such communities as universities that might stir a revolution. In addition widespread use of the Internet allowed youth to stay updated on information and in contact with each other, leading to the success of the revolution.

Round table III: The New Role of the State, chaired by Mr. Husam Zomlot

20. Experts explained that a State has both functional and institutional dimensions; what its functions are and what it looks like. Some experts thought that the role of the State is country specific and is determined by ethnic composition and socio-economic factors. Furthermore, different States have different tools and it is important that the State is able to expand and provide employment and security to its citizens at large. Other experts contradicted this view.

Round table IV: A New Development Agenda and the Role of the United Nations, chaired by Mr. Raed Safadi

21. Experts agreed that the role played by the United Nations agencies in the 1980s was different from the current role. For example, while in the past those agencies had more leverage to help in macroeconomic reform, currently this role is taken by the International Monetary Fund. Furthermore, United Nations agencies provided financial aid that was supposed to help in development but instead promoted corruption. Consequently, the role of United Nations agencies is very much intertwined with how functional (transparent or democratic) the State is. This brings us back to the role of the State and the importance of having healthy and functional State institutions.

22. Experts concluded that such United Nations agencies as ESCWA can provide both short-term as well as long-term support. During crises situations, organizations like ESCWA can support countries by helping them manage the crisis, and in the long term, international assistance agencies can help Governments in developing their structural aspects and policies, such as setting a new development agenda to create 5 million jobs in the next 10 years.

III. ORGANIZATION OF WORK

A. VENUE AND DATE

23. The EGM was held at the United Nations House, Beirut, from 24 to 25 February 2011.

B. OPENING

24. The Director of the Economic Development and Globalization Division, gave the opening address and welcomed participants. He outlined the EGM goals, the importance of the Survey as a flagship publication of ESCWA, and the role of the EGM thematic discussions in shaping the main topic of the forthcoming Survey. He reviewed the scheduled agenda with the participants and adopted it.

C. PARTICIPANTS

25. The EGM engaged a group of experts with social and economic expertise on the ESCWA region and other regions.

D. AGENDA

26. The first day, Thursday, 24 February 2011, included the following presentations:

- Opening;
- Session one: Recent Economic Trends in the ESCWA Region and Post Financial Crisis Situation;
- Session two: Financial Implications of the Global Financial Crisis;
- Session three: Arab Economic Integration and Macroeconomic Exit Strategies.

27. The second day, Friday, 25 February 2011, included brainstorming/round-table discussion on:

- Interactions of Economics and Politics in the Arab Region;
- Focusing on Egypt;
- The New Role of the State;
- A New Development Agenda and the Role of the United Nations.

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