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SURVEY OF ECONOMIC AND SOCIAL DEVELOPMENTS IN THE ESCWA REGION 2004-2005

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Preface

This year's *Survey* could begin on a very upbeat note. Oil prices rose in 2004, and economic growth in oil-exporting countries and in the Economic and Social Commission for Western Asia (ESCWA) region as a whole is expected to be near to the five per cent mark. Growth during the past two years represents a welcome departure from the poor growth trend established sometime in the mid-1990s. The surging demand for oil from developing countries, particularly China and India, continued, and world demand grew steadily into 2004. Edged on by higher quantities and prices, gross oil export revenues were estimated at $212.6 billion in 2004, a 28.7 per cent increase over 2003. This amount constitutes nearly 40 and 55 per cent of the gross domestic product (GDP) of ESCWA member countries and those of the Gulf Cooperation Council (GCC), respectively. Inflationary pressures were modest throughout, and because of higher than usual fiscal surpluses, public debt levels in the Gulf States were in some instances slightly reduced. However, we cannot be overly enthusiastic about developments in the ESCWA region because, if we were further to examine recent events, there would still be two very important causes for concern.

Firstly, unemployment rates responded poorly to the present round of economic growth and remained dangerously high. Secondly, though more importantly, the situation in the disaster zones in Iraq and the Occupied Palestinian Territory remained catastrophic. With respect to the first issue, unemployment dropped by approximately 1 per cent over a two-year period that witnessed a cumulative growth rate of 11 per cent. In the area that exhibits the highest rate of unemployment globally, this weak response of job creation to growth points to deeper reasons associated with the nature of the accumulation process, which disrupt the interaction between economic prosperity and social development. With regard to the second, weightier, issue, this is another year in which the ESCWA region is beset by conflict, and talk of further "regime change" may still widen the potential for disaster. Speculators have gone so far as to say that the "gates of hell" have been opened. The full repercussions of the war in Iraq and the stalemate in the peace process are yet to be seen. In addition, and as always, continued insecurity in the Near East threatens more than just the region and raises the security premium of the member countries. If and when the very volatile oil price tumbles, a whole mode of development that is based mainly on oil revenues will be held in check. As many in the international arena seek a smooth transition from an international order underpinned principally by a single overstretched currency, many in the region will continue to struggle for the right to development, work and security. Redesigning the international security arrangement by in part the outcome of the conflict in this region means that the peoples of the Near East are in it for the long haul; hence, the theme for this year's *Survey* "Strategies for development out of crisis conditions".

Conflicts preclude the long-term stability needed to redress frail investment in infrastructure, plant and equipment and create social schisms that set back social development for a very long time. Despite surplus savings, the ESCWA region was deemed off course in meeting many of the Millennium Development Goals. The region stands at a fork in the road. It must either reinvest in itself, using private and public assets to promote employment, allowing that process to work against the further deterioration of the security arrangement. Or it could let things go and allow inter-country disparities and regional coordination levels to remain as they are. The choice is clear. There has to be a "New Deal" type of involvement in the economy. In the short term the public sector must allocate resources spatially in a way that redresses inter-country and intraregional disparities. In the long term, the view that a secure and safe long term exists in this region must be created via various insurance schemes and risk sharing measures. Such measures will principally guarantee a reversal of the course of development for the better. Here, it is the long term that is moribund and needs to be revived.

Because the task is daunting, the *Survey* this year falls into three broad analytical categories: economic trends and developments, social conditions and policies, and sustainable development. The objective is to choose a battery of policy measures that aim to cushion the impact of economic and social downturns and to surmount the stress of the prevailing conditions. In the economic sphere, policies are best set in a way that favours institutional change. For instance, the introduction of flat consumption taxes as opposed to progressive taxes may widen tax collection, yet it leaves income distribution and skewed institutions for income taxation weak. In the presence of a debt overhang, the drag of such taxes on output is doubly potent and, should they be too high, they may even reduce the tax base altogether. In the social sphere, the intellectual basis for the argument must be that there is room for redistributive policies in the light of the inequities and, more pertinently, the agency for change has to shift away from a rigid structure and closer to the demands of a politically empowered citizen. Community awareness and other forms of social organization that tap into the individual's creativity and potential have to be considered rather than the simple calculation of human capital.

In a more concrete sense, macroeconomic policy should be centred on regional coordination, investment facilitation and job creation; social policy ought to focus on the citizen's needs and aspirations; and the sustainable development policy framework looks for ways to offset the costs and ameliorate the long-term crisis – including dangers of environmental degradation and natural resource depletion – in a region that has become accustomed to tapping into its natural wealth assets.

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ABBREVIATIONS AND EXPLANATORY NOTES

b	barrel
b/d	barrel per day
b/m^3	billion cubic metres
CIF	cost, insurance, freight
CIP	competitive industrial performance
EU	European Union
FDI	foreign direct investment
FOB	free on board
FTA	free trade agreement
GCC	Gulf Cooperation Council
GDP	gross domestic product
GNP	gross national product
GWh	gigawatt-hour
ha	hectare
HRD	human resource development
ICRG	international country risk guide
ITC	International Trade Centre
ILO	International Labour Organization
IMF	International Monetary Fund
IWRM	integrated water resources management
JPOI	Johannesburg Plan of Implementation
KAR	Kurdish Autonomous Region
kW	kilowatt
LE	Egyptian pound
LL	Lebanese pound
LNG	liquefied natural gas
m^3/c/a	cubic metre per capita per annum
m/b/d	million barrels per day
MENA	Middle East and North Africa
MDEs	more diversified economies
MHT	medium and high tech
MVA	manufacturing value added
MW	megawatt
OAPEC	Organization of Arab Petroleum Exporting Countries
OECD	Organization for Economic Cooperation and Development
OPEC	Organization of Petroleum Exporting Countries
PPP	purchasing power parity
QIZ	qualifying industrial zone
RMB	renminbi
SD	sustainable development
TSP	total suspended particulates
UAE	United Arab Emirates
UNCED	United Nations Conference on Environment and Development
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UNEP	United Nations Environment Programme
UNIDO	United Nations Industrial Development Organization
WFP	World Food Programme
WHO	World Health Organization
WTI	West Texas Intermediate
WTO/ATC	World Trade Organization – Agreement on Textiles and Clothing

ABBREVIATIONS AND EXPLANATORY NOTES *(continued)*

The following symbols have been used in the tables throughout the study:

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

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

Parentheses ( ) indicate a negative figure, except as otherwise stated.

In both text and tables, the following apply:

A slash (/) between years (2004/2005) indicates a crop year, school year or financial year.

A hyphen (-) between years or months (for example, January 2003 - December 2004) indicates the full period involved, including the beginning and end of years or months.

Details and percentages do not necessarily add up to totals, because of rounding.

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

I. RECENT ECONOMIC TRENDS AND DEVELOPMENTS IN THE ESCWA REGION

A. THE GLOBAL CONTEXT

1. *World economic developments in 2004 and their implications for the ESCWA region*

In 2004 the recovery of the world economy gained momentum, and global output growth accelerated to 4 per cent, up from 2.5 per cent in 2003. This expansion of global economic activity has not only been the highest for more than a decade, it has also been extraordinarily broad-based, with all major regions of the world except for the EU-15 zone reporting a growth rate of real gross domestic product (GDP) above 3.5 per cent (see table 1). The balanced nature of the economic upturn is also reflected in the fact that, out of 159 countries covered in the World Economic Situation and Prospects 2005,[1] only 13 experienced a decline in real GDP per capita in 2004.[2] Along with global output growth, international trade expanded significantly that year, driven by strong demand, especially from China and the United States of America. In terms of volume, global trade in merchandise is believed to have increased by slightly more than 10 per cent in 2004, a significant acceleration over the 6.2 per cent growth reported in 2003.

Overall, the developed economies registered real GDP growth of 3.4 per cent in 2004. Within this group the United States was once again the main engine of growth for the global economy. Based on strong consumer spending, high investment levels and rising productivity, real GDP in that country increased by more than 4 per cent in 2004. Despite a reduction in fiscal stimuli, several interest rate rises and higher oil prices, the United States economy continues to expand at a robust pace. Japan recorded its highest annual growth rate since 1996, with real GDP increasing by 2.7 per cent in 2004.[3] However, following very strong growth in the first quarter of 2004, the economic recovery lost considerable momentum in the course of the year, when private consumption, business investment and net exports slowed down. While the financial system and the corporate sector have strengthened, several structural weaknesses, such as deflation and high fiscal deficits, continue to persist. Given the importance to Japan of the external sector, risks for the current economic upturn are related to further rising oil prices, an accelerated appreciation of the yen against the dollar and a sharp decrease in demand from China and the United States. Recovery in EU-15 region remained sluggish in 2004, with real GDP increasing by 2.2 per cent. While the Ireland and the United Kingdom continued to experience strong growth, the pace of recovery was particularly slow in Germany and Italy. In most EU-15 countries output expansion was largely driven by strong external demand, while consumer spending continued to be weak mainly because of persistently high unemployment rates. Given the strong appreciation of the euro in the last quarter of 2004, the surge in oil prices and relatively low consumer and investor confidence, the pace of economic expansion in the EU-15 region is likely to remain slow. In contrast GDP growth in the 10 new member countries of the European Union accelerated to 5 per cent in 2004.

The overall robust growth performance of developed economies in 2004 was accompanied by strong output expansion in developing countries, which achieved an average real growth rate of 6.2 per cent, and in the economies in transition, where annual growth amounted to 7.1 per cent. Growth was exceptionally strong in a number of large developing countries in Latin America, East Asia and South Asia. The Chinese economy continued to grow at an extraordinary pace in 2004, with real GDP increasing by 9.2 per cent. Other East Asian countries benefited significantly from that economic boom, as output expansion was accompanied by a strong increase in China's import demand. Overall, East Asia was the fastest growing developing region of the world in 2004, reporting real GDP growth of 7.2 per cent. In South Asia growth remained above 6 percent, driven by strong domestic and external demand. India, by far the largest economy

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[1] United Nations publication, Sales No. 05.II.C.2.

[2] Out of these 13 countries, nine are in Africa, two in Western Asia and one in East Asia and Latin America, respectively.

[3] Japan's growth rate is taken from the Statistics Information Site of the Economic and Social Research Institute, Cabinet Office, Government of Japan.

in South Asia, registered real GDP growth of 6.4 per cent, slightly below the 2003 rate. After several years of weak growth, real GDP in Latin America and the Caribbean expanded by 5.4 per cent in 2004. Argentina and the Bolivarian Republic of Venezuela had the highest growth rates in the region, as both countries had recovered from economic crisis. Brazil in turn recorded its highest growth rate in the last decade, with GDP increasing by 5.2 per cent in 2004. In Africa, favourable external conditions and improved political and macroeconomic stability in a number of countries contributed to GDP growth of 4.5 per cent. Although this rate is an improvement over that of previous years, it still falls significantly short of the 7 per cent benchmark set for the attainment of the Millennium Development Goals.

TABLE 1. MAJOR ECONOMIC INDICATORS, 2002-2005

	2002	2003	2004	2005[a/]
Real GDP growth rates (annual percentage change)[b/]				
ESCWA region[c/]	1.8	5.7	4.8	5.2
World	1.7	2.5	4.0	3.25
Developed economies	1.3	2.2	3.4	2.5
EU-15	1.1	1.1	2.2	2.0
Japan	(0.4)	2.5	2.7	1.75
United States	2.2	3.1	4.2	3.0
Economies in transition	4.0	7.0	7.1	6.0
Developing countries	3.4	4.6	6.2	5.5
Africa	2.9	4.0	4.5	4.75
Eastern and Southern Asia	5.7	6.2	7.0	6.5
Western Asia[d/]	3.1	5.0	5.5	4.5
Latin America and the Caribbean	(0.3)	1.7	5.4	4.0
Inflation (annual percentage change in consumer prices)[b/]				
ESCWA region[c/]	2.1	3.4	4.9	..
Developed economies	1.3	1.7	1.9	1.5
EU-15	2.0	2.1	2.2	2.0
Japan	(0.9)	(0.3)	(0.2)	0.25
United States	1.6	2.3	2.6	1.75
Economies in transition	9.3	12.2	10.3	9.0
Developing countries	6.2	6.3	5.6	5.5
Africa	7.8	11.2	11.8	10.25
Eastern and Southern Asia	2.1	2.8	4.3	4.25
Western Asia[d/]	15.8	8.9	4.4	5.75
Latin America and the Caribbean	9.2	10.5	6.5	6.0
Unemployment rates (percentage)[e/]				
Developed economies	6.8	7.4	7.2	
EU-15	7.7	8.1	8.1	8.0
Japan	5.4	5.3	4.7	4.75
United States	5.8	6.0	5.5	5.25
Economies in transition	9.4	8.4	8.3	..
East Asia	3.1	3.3	3.3	..
South-East Asia	7.1	6.5	6.4	..
South Asia	4.8	4.8	4.7	..
Latin America and the Caribbean	9.0	9.3	8.6	..
Middle East and North Africa	11.9	11.7	11.7	..
Sub-Saharan Africa	10.8	10.0	10.1	..
Short term interest rates (LIBOR per annum on 3-month deposits)[f/]				
United States dollar	1.79	1.22	1.61	..
Euro	3.32	2.33	2.11	..
Japanese yen	0.08	0.06	0.05	..

TABLE 1 (*continued*)

	2002	2003	2004	2005[a/]
Exchange rates (nominal exchange rates yearly average)[f/]				
Euro (dollar per national currency unit)	0.945	1.132	1.227	..
Japanese yen (national currency units per dollar)	125.2	115.9	108.7	..
World trade volumes (annual percentage change)[b/]				
Exports	3.0	6.8	10.9	8.5
Imports	1.0	5.6	10.2	7.7

Note: Parentheses ( ) indicate a negative figure.

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

a/ Forecasts.

b/ *Sources*: *World Economic and Social Survey 2004* (United Nations publication, Sales No. 04.II.C.1) and *World Economic Situation and Prospects 2005* (United Nations publication, Sales No: E.05.II.C.2), except for ESCWA region. (Estimates projected by Project LINK.) Japan's 2004 growth rate, significantly lower than projected, is taken from the Japanese Government Cabinet Office (see footnote 3).

c/ *Source*: See Chapter 2. Forecasts by ESCWA staff. Iraq and Palestine are excluded.

d/ This regional classification of Western Asia includes the neighbouring countries of the ESCWA region, i.e., Cyprus, the Islamic Republic of Iran, Israel, and Turkey.

e/ *Sources*: For developed economies, EU-15, Japan and the United States, *World Economic Situation and Prospects 2005*. (Estimates projected by Project LINK.) For other regions, *Global Employment Trends* (International Labour Office, ILO, January 2004) and *Global Employment Trends* (International Labour Office, February 2005).

f/ *Sources*: EconStats (2005) (www.econstats.com).

The majority of developing countries, including most ESCWA member countries, benefited from the combined effects of the major macroeconomic developments of 2004. These include: strong price increases for oil and most non-oil commodities; relative stability in international financial markets despite large fluctuations among major currencies; and a generally favourable global investment and trade climate based on limited inflation pressures in industrial countries and lower levels of inflation in most developing regions (see table 1). The sharp rise in oil prices throughout 2004 led to improved terms of trade and high windfall revenues for oil-exporting countries, and its adverse impact on the global economy has so far been limited. Up to now neither the surge in oil prices nor the substantial price increases for other commodities, such as minerals, ores and metals, has triggered significant second round effects on prices in the developed economies. Inflation rates in those countries remained relatively low in 2004, ranging from minus 0.2 per cent in Japan to 2.6 per cent in the United States.

In this context it is important to highlight a crucial difference between the oil crises of the 1970s and 1980s and the recent experience of surging oil prices. In the first case, supply shortages were the primary cause of the increase in oil prices; in the second case, a combination of four different factors drove prices higher: strong global demand; lower excess capacity; uncertainties about future supply; and speculative activities. In addition, current oil prices, when measured in real terms, are still far below the levels observed during past crises.

In the light of only modest inflationary pressures and strong growth, the United States Federal Reserve decided to tighten its monetary policy gradually, raising nominal interest rates by a total of 125 basis points in 2004. Facing weak economic growth in the euro zone, the European Central Bank left key interest rates unchanged throughout the year, while interest rates in the United Kingdom were also raised. The Bank of

Japan continued to pursue a zero-interest rate policy, as core consumer price inflation was still negative. Overall, interest rates in the developed economies moved upward in 2004, but remained low from an historical perspective. That year the implied low cost of borrowing and financing, as well as abundant liquidity, facilitated global investment activities, thereby contributing to the acceleration of global growth. In addition, higher degrees of macroeconomic stability in developed and developing economies helped to reduce the negative impact of global disturbances on individual countries and contributed to the stability observed in international financial markets. For most non-oil-exporting developing countries, the strong pickup in non-oil commodity prices provided the basis for growth in 2004, outweighing the negative effects of higher oil prices. In fact, prices of all major commodity groups – food, tropical beverages, vegetable oilseeds and oils, agricultural raw materials, minerals, ores, and metals – increased in 2004, and most are now significantly above their level in 2000.

However, despite the largely benign outcomes in 2004, several global imbalances continue to threaten the stability of the international economy, thereby posing serious risks for the economic development of the ESCWA member countries. Moreover, significant structural weaknesses, such as high rates of unemployment and under-employment and high debt burdens, remain in many countries, both industrial and developing.

On the macroeconomic front there is growing concern regarding the continued rise of the United States twin deficits – the current account deficit and the fiscal deficit – and its possible implications for exchange rate adjustments. Many fear that on international financial markets these deficits might increasingly be viewed as unsustainable, and that this perception could lead to an abrupt adjustment in exchange rates and stock market valuations. In addition, the heated international debate about the main reasons for the large and ever-widening United States current account deficit has raised concerns about a protectionist backlash, in the form of anti-dumping measures and other non-tariff trade barriers, hampering progress in international trade negotiations. The predominant view among international observers is that the United States current account deficit is so great that a depreciation of the dollar against other major world currencies will not alone suffice substantially to reduce the existing imbalances. Instead what is needed is a reduction of the public sector deficit that currently forms the major source of dissaving in the United States, as well as a significant increase in private savings.

Another major risk for the world economy is related to developments in the oil market. Exceedingly high and very volatile oil prices may eventually lead to accelerated inflation in industrial countries. This would require more contractive monetary policies than currently forecast, in the form of sharp rises in nominal interest rates, which would dampen household and business capital spending and cause an economic slowdown in industrial countries. The negative effects of such a scenario would likely be transmitted to most developing countries via international goods and capital markets. Confronted with lower demand for exports, worse financing conditions and possibly significant capital outflows, countries could face serious economic crises, especially those with high foreign debt burdens (e.g. Lebanon). However, a mitigating factor here would be the redistributive effect of high oil revenues on world income in favour of oil-exporting countries, which would increase foreign exchange earnings and stimulate demand in various economies of the latter group.

In addition, the strong expansion of global liquidity has, according to some observers, already created a speculative bubble on international asset-price markets, which puts the international economy further at risk.

As shown in table 1, economic recovery in the last two years was accompanied by only slight improvements in global unemployment rates, indicating a crucial structural weakness in the recent economic upturn: "jobless growth". High rates of unemployment and under-employment persist in many industrial and developing countries, and the situation is most dramatic in the ESCWA region. Policy-makers must therefore give top priority to the creation of more dynamic and socially balanced labour markets, particularly in the light of the high number of new entrants and the large informal sectors in some ESCWA member countries.

Finally, high levels of public debt and poor structuring of thereof lead to significant economic vulnerabilities for developing countries. The ESCWA region, especially Iraq and Lebanon, is burdened with very high public debt stocks. These countries have benefited from the generally benign environment in international financial markets in 2004, but the high level of debt service in Lebanon, despite successful restructuring through the Paris Club, substantially constrains government activities, especially investment in physical and human capital, and thus represents a major obstacle for equitable economic development there. Moreover, the highly indebted countries face the risk of rapidly increasing costs of capital, as nominal interest rates rise around the globe. An aggressive tightening of monetary policy in industrialized countries, especially the United States, could eventually result in massive capital outflows and thereby trigger a financial crisis in these countries.

2. *Prospects for 2005*

Assuming that the above-mentioned risks and uncertainties do not materialize, global economic growth is expected to slow down modestly to 3.25 per cent in 2005. The *World Economic Situation and Prospects 2005* assumes that all major regions of the world except for Africa will register a lower growth rate than in 2004. However, as indicated in the projections presented in table 1, the growth picture, especially in developing countries, still looks quite favourable. Along with decelerating global growth, the growth of international trade is expected to slow. In the light of decreasing global demand, average annual prices of most non-oil commodities are likely to fall modestly. Existing geo-political and macroeconomic uncertainties and continued strong demand may cause oil prices to remain high and volatile throughout 2005. One of the key global policy issues in 2005 is management of the transition towards higher interest rates, which would temper potential bubble-creation and secure stability on international capital markets. If inflationary pressures and expectations are contained, it seems likely that no abrupt global changes in the costs of borrowing and financing will occur. A gradual tightening of monetary policy in the United States is of particular importance for ESCWA member countries, as almost all of them have pegged their national currencies to the dollar. Such tightening might therefore lead towards currency appreciation.

B. DEVELOPMENTS IN THE OIL SECTOR

1. *World demand and supply*

The world economy has been on a path to recovery, and surging demand from developing countries, mainly in Asia, has continued. Accordingly, world demand for oil grew steadily in 2004. The continuing rapid economic expansion in China and the resilient economic recovery of North America drove the increase in demand. The International Energy Agency estimated that world oil demand for 2004 grew by 3.2 per cent to 82.4 million barrels per day (m/b/d).[4] Countries not members of the Organization for Cooperation and Development in Europe (OECD) accounted for about 40 per cent of total world oil demand, contributing three quarters of total world oil demand growth in 2004.

Demand growth in 2004 exceeded the expectation of early demand forecasts. Oil prices were already higher at the beginning of the year, and this was perceived as a potential brake on the world economy and the demand for energy products. The oil producers, particularly those of the Organization of Petroleum Exporting Countries (OPEC), were cautious about demand prospects after the second quarter of 2004. In addition to the global demand slowdown, the disappearance of short-term elements which had contributed to

[4] International Energy Agency, *Oil Market Report*, January 2005.

the surging oil demand of the first quarter of 2004, such as the demand for heating oil and the stoppage of Japanese nuclear power plants, was expected to cause a downward correction in world demand. OPEC decided to reduce the production quota beginning April 2004 from 24.5 m/b/d to 23.5 m/b/d, a further reduction beyond that reflected in its decision of November 2003.

However, oil demand growth persisted beyond the second quarter of 2004, while supply-side factors, such as the disruption in production in the United States Gulf of Mexico region caused by Hurricane Ivan in September 2004, further tightened the supply of oil, and geo-political tensions, including civil strife in Iraq, Nigeria and the Bolivarian Republic of Venezuela, threatened its stability. Moreover, bottlenecks in the refining- and distribution-industry caused a tight supply and demand condition throughout 2004. Observing the situation, OPEC reversed its stance and increased its production quota in two stages to 26.0 m/b/d in August 2004. Non-OPEC oil producers followed, and oil production was approaching maximum available capacity towards the end of 2004.

To maintain a sizeable level of spare capacity, oil producers have gradually increased exploration and development activity. The worldwide rig count stood at 2,555 in December 2004.[5] This was the highest count since April 1986 and it has continued on an upward path since the low point of 1,171 in May 1999. However, the problem caused by the years of disinvestment that resulted in the present supply constraints upstream was not resolved in 2004 and is not expected to be in the short term. Over the last decade, spare capacity has slowly declined, as average increments in world oil demand exceeded the increase in non-OPEC oil production. The already limited spare capacity, estimated at 2.0 to 2.5 m/b/d at the beginning of the year, was not enough to cope with the rise in demand.

Constraints were also seen in the midstream and downstream stages of oil supply. At one point in 2004, the refining system in the United States was unable to produce the volume of gasoline required both for consumption and for inventory building. Refining margins widened, reaching historical levels as a result. The refiners responded by stretching the refineries to maximum limits over several months to avert gasoline shortages. The expansion of the midstream and downstream stages is deemed more difficult as it is more regulated than the upstream stage, and concerns regarding supply capacity and its structure evidently became a major factor affecting the hovering oil prices during 2004.

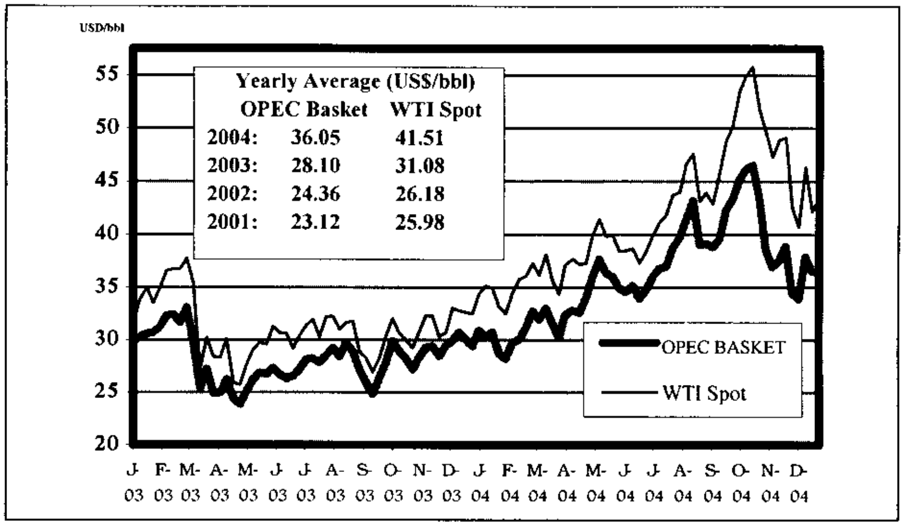
2. *Oil price developments*

Oil prices were on an upward swing throughout 2004, with accelerating fluctuation towards the two peaks in August and October (see chart 1). This trend in price dynamics continued into the first quarter of 2005. The yearly average West Texas Intermediate (WTI) spot price was $41.51/b, and that of the OPEC reference basket was $36.05/b. The spread between these two benchmark prices widened from the historical $3-$4 to $6-$10 during the year. The WTI spot price increased by 51.2 per cent from $35 in early 2004 to about $53 during the October peak and averaged about $46 by end of year.

Oil price developments in 2004 can be explained in the context of the driving forces behind the short- and long-term price determination, as well as fundamental reasons categorized into economic, geo-political, and incidental events that underlie this exuberant price movement.

[5] Baker Hughes, worldwide rig counts. For details, see http://www.bakerhughes.com/investor/rig.

Chart. Crude oil prices (US$/bbl) 2003-2004



Source: OPEC; Energy Information Administration.

The major reference prices of oil markets (Brent and WTI) are determined by a constellation of spot, physical forward, derivative and futures markets, but because of greater liquidity, the futures market dominates. Production capacity plays a role in the short to medium terms, whereas oil reserves affect long-term price determination. There is a difference between the two that calls for emphasis. When production capacity is stretched to the limit as it was during 2004, it affects short-term prices, pushing them upward. On the other hand, long-term prices are affected by the geo-political questions that are transient in nature because there is little likelihood that they can be resolved in the short term. Hence the forward curve is shifted upward and the price is set at a certain level for the coming few years. Moreover, long-term prices can be affected by the emergence of a belief regarding the geo-physical scarcity, which holds that production has peaked and will inevitably decline. This fear of a future shortage drives the forward curve upwards.

In this context, the following fundamental factors were all pulling in the same direction over a short period: (a) the increase in global oil demand brought about by the remarkable increase in demand in China, other parts of Asia, the United States and Latin American countries; (b) a contraction in surplus production capacity linked to the unexpected rise in demand; (c) the "exuberant irrationality" of speculation by major financial institutions, hedge funds and individual hedgers, all anticipating forthcoming tightness in the oil market and henceforth preferring to invest in the oil futures market instead of the other financial products; (d) the geo-political uncertainties referred to in the previous subsection and the Russian Federation's dispute with Yukos; and (e) other incidental causes, such as labour strikes (e.g., one in Norway) and hurricanes.

Oil prices in terms of the present OPEC reference basket are estimated to range from \$35-\$42 for 2005, and \$32-\$38 in 2006. The global demand is expected to ease in the coming two years as a result of high prices that may turn out to be of the order of 1.5-1.7 m/b/d both in 2005 and in 2006 (a growth of 2 per cent per annum). Supply is expected to be less tight on account of gradual increases in crude output from oil producers and structural improvements in mid- and downstream supply capacity in major consuming countries. While geo-political uncertainty is likely to continue, the series of short-term supply disruptions seen in 2004 is not likely to occur every year. However, the world economy continues to stay in a low interest rate regime (despite gradual rises in United States rates), and active speculative forces will continue to result in fluctuating oil prices.

3. *Crude oil production in the ESCWA region: OPEC States, non-OPEC States and Iraq*

Oil production in the ESCWA region soared by 6 per cent from its 2003 level generating 19 m/b/d. The unexpected surge in global oil demand in 2004 led the oil economies to use their thin volumes of spare capacity to meet demand requirements. In terms of oil production and spare capacity use and expansion, the ESCWA region is divided into two groups and Iraq. The first group, composed of some OPEC States (Kuwait, Qatar, Saudi Arabia and the United Arab Emirates), produced 9 per cent more crude oil than its average production in 2003. By making use of national and international oil companies and contractors, this group can press ahead with new oil fields, expand secondary fields and/or redevelop major infrastructures. The second group is composed of smaller non-OPEC countries (Egypt, Oman, Syrian Arab Republic and Yemen). Oil production in these countries decreased in 2004 by 5 per cent, and they are struggling to maintain production levels. Finally there is Iraq, whose production increased by 53 per cent and whose progress in upstream operations depends on sound security and political stability (see table 2). Looking forward to 2005, OPEC producers pledged in December 2004 to decrease crude oil output by 1 m/b/d, while non-OPEC countries will struggle to maintain the production levels reached in recent years. The persistence of high oil prices will not generate benefits alone, as it will delay economic reform activities advocated by many ESCWA member countries.

In 2004 Saudi Arabia benefited from higher oil prices and its large spare production capacity to increase its average daily production by an estimated 3 per cent, in excess of its current quota level of 8.775 m/b/d (effective 1 November 2004). Against this backdrop, it insisted on maintaining reasonable spare capacity of no less than 1.5 m/b/d.[6] In June 2004, OPEC met and agreed to raise crude oil output by 2 m/b/d in an effort to lower prices. Production increases in Saudi Arabia, and in Kuwait (7.7 per cent), Qatar (5.1 per cent), and the United Arab Emirates (5.2 per cent), were able to compensate for lost production from Indonesia, the Islamic Republic of Iran and the Bolivarian Republic of Venezuela. As at late 2004, when output from the Abu Safa oilfield doubled to 300,000 barrels per day (b/d), Saudi Arabia reduced by 50 per cent its donation to Bahrain, which used to receive oil from Saudi Arabia by pipeline from Abu Safa.[7]

With support from international oil giants, Saudi Arabia resolved to expand gas exploration and the production of condensates. Moreover, Qatar, which contains the third largest natural gas reserves, is emerging as a major exporter of liquefied natural gas (LNG). Increasing natural gas liquids and exports of condensates that are not subject to OPEC quotas, as well as the replacement of domestic oil consumption with gas, are becoming major revenue diversification options for several oil-producing countries in the region.

According to OPEC secondary sources, oil production in 2004 varied among non-OPEC countries. In the case of Egypt, production decreased by 5 per cent because of the decline in reserves and the increased use of compressed natural gas as fuel for motor vehicles. Given major recent discoveries and the doubling of production between 1999 and 2003, natural gas will be the main growth engine of Egypt's energy sector in the foreseeable future. The rapid rise in gas reserves is more than sufficient for domestic needs and thus increases the potential of gas exports, which may offset the impact of declining oil exports on the country's balance of payments. While Oman's oil production fell by 7 per cent from its 2003 output because of persistent technical problems, the country managed to increase proven natural gas reserves in 2004 by intense exploration.[8] The Syrian Arab Republic and Yemen have also witnessed a small decrease in average

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[6] According to a statement made by the Minister of Petroleum and Mineral Resources of Saudi Arabia, Mr. Ali Al-Naimi Zawya, on 30 November 2004.

[7] Energy Information Administration, *Saudi Arabia Country Analysis Brief*, January 2005. However, recent official trade statistics for Bahrain do not show any decline in its oil export revenues during the last three quarters of 2004.

[8] Energy Information Administration, *Oman Country Analysis Brief*, January 2005.

oil production of 6 per cent and 5 per cent, respectively. Technological problems and depleting oil reserves caused output to decline in the Syrian Arab Republic, which, against this backdrop, is planning to increase its production of natural gas and to substitute gas for oil in power generation in coming years. In March 2003, it lost a major source of revenue when its pipeline with Iraq was closed because of the war.

Industry operations in Iraq, which are constantly prone to disruptions caused by political instability, remain highly volatile with regard to production, refining and export activity. During the war, seven Iraqi oil wells were set on fire, out of a total of about 1,500 wells. Major rehabilitation of the oil infrastructure has led to a 53 per cent resumption of crude oil production, which averaged about 2 m/b/d in the first 10 months of 2004. This helped Iraq to achieve an export level of 1.5 to 1.7 million barrels.[9] One major challenge to maintaining oil production capacity is Iraq's battle with 'water cut', especially in the south, on account of the damage caused by the seepage of water into oil reservoirs. Recent estimates indicate the need for $10-$20 billion in foreign investment in order to attain an output of 4 m/b/d.[10]

TABLE 2. OIL PRODUCTION IN THE ESCWA REGION, OPEC AND THE WORLD, 2000-2005
(Thousands of barrels per day)

Country	2000	2001	2002	2003	2004	2005 Quota-based a/, b/	2005 c/	Change (2003-2004)	Percentage change (2003-2004)
Bahrain d/	190	190	190	200	200	200	200	0	0.0
Kuwait	1 996	1 947	1 885	173	2 340	2 167	2 254	167	7.7
Oman	960	960	900	820	760	730	730	(60)	(7.3)
Qatar	648	633	648	743	781	700	741	38	5.1
Saudi Arabia e/	8 095	7 889	7 535	8 709	8 982	8 775	8 879	273	3.1
United Arab Emirates	2 175	2 115	1 988	2 243	2 360	2 356	2 358	117	5.2
GCC countries	14 064	13 734	13 146	14 888	15 423	14 928	15 161	535	3.6
Egypt	800	760	750	750	710	700	710	(40)	(5.3)
Iraq f/	2 810	2 594	2 000	1 322	2 018		3 250	696	52.6
Syrian Arab Republic	520	520	510	540	510	490	490	(30)	(5.6)
Yemen	450	470	460	440	420	420	420	(20)	(4.5)
More diversified economies	4 580	4 344	3 720	3 052	3 658	4 860	4 870	606	19.9
ESCWA region	18 644	18 078	16 866	17 940	19 081	19 788	20 031	1 141	6.4
Total OPEC crude oil production	28 000	27 200	25 400	27 000	29 100			2 100	7.8
Total world oil supply	77 000	77 200	76 700	79 300	82 800			3 500	4.4
ESCWA share of world total	24.2%	23.4%	22.0%	22.6%	23.0%				

Note: Parentheses ( ) indicate a negative figure.

a/ Based on OPEC quota for OPEC countries and 2005 estimated production for non-OPEC countries, from OPEC, *Monthly Oil Market Report*, February 2005, table 26.

b/ Excluding Iraq, which is exempted from OPEC quota.

c/ For Kuwait, Qatar, Saudi Arabia, and the United Arab Emirates: production based on average between actual 2004 production and production quota as of November 2004.

d/ Including Bahrain's share of the Abu Safa oilfield.

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

f/ Data for 2000-2004 from *OPEC Oil Market Report*, various issues; 2005 figure based on official medium-term target.

[9] The Iraqi Strategic Review Board, *National Development Strategy, 2005-2007*, September 2004.

[10] Energy Information Administration, *Iraq Country Analysis Brief*, November 2004.

4. *Oil revenues and the macroeconomic impact of windfall revenues from oil*

Despite varied performance in oil production, all oil-exporting countries in the ESCWA region have experienced a boost in gross oil export revenues (see table 3). Total gross oil export revenue for the region was estimated at $212.6 billion in 2004, a 28.7 per cent increase over 2003. In countries other than Qatar, this led to an increase in the share of oil exports in the total value of exports for 2004, as follows: 92.8 per cent for Kuwait, 76.7 per cent for Oman, 70.6 per cent for the Syrian Arab Republic and 41.5 per cent for the United Arab Emirates. In Qatar, the share of oil exports in the total value of exports has declined continuously in recent years as its exports of LNG have substantially increased. The share decreased from 56.8 per cent in 2000 to 41.8 per cent in 2004.

The windfall gain was reflected in Government revenues, particularly in GCC countries, and resulted in an historically high level of fiscal surpluses there. Saudi Arabia produced a pro-development, expansionary Government expenditure package for 2005. Other GCC countries are also on an expansionary path in their budgeted expenditure projections, but on a more moderate scale. Continuing economic diversification policies, particularly development in the financial sector and expanding service sectors, such as tourism, trade, and real estate, have made it possible for GCC countries to channel windfall revenues from oil into expanding domestic demand. However, the long-term sustainability of the current expansionary economic phase in oil-exporting economies is still in question, given the need for greater expansion in non-oil sector development.

TABLE 3. GROSS OIL EXPORT REVENUES IN THE ESCWA REGION, 2000-2005
(Billions of US dollars; current prices)

Country	2000	2001	2002	2003	2004a/	2005b/ High	2005c/ Low	Change (2003-2004)	Percentage change (2003-2004)
Bahraind/	4.48	3.68	3.96	4.68	5.38			0.70	14.99
Kuwait	18.17	14.95	14.06	18.63	25.56	32.17	28.46	6.93	37.18
Oman	8.90	7.70	7.52	7.91	10.30	12.14	10.47	2.39	30.19
Qatare/	6.59	5.61	5.63	6.72	7.07	7.95	6.88	0.35	5.24
Saudi Arabiaf/	70.65	59.61	63.62	86.00	106.00	116.33	101.27	20.00	23.26
United Arab Emirates	21.63	17.75	16.68	22.11	30.00	37.50	32.61	7.89	35.67
GCC countries	130.42	109.30	111.46	146.05	184.31	206.09	179.69	38.26	26.19
Egypt	2.56	2.60	2.48	3.55	4.64	2.40	2.08	1.09	30.73
Iraq	17.42	12.47	9.19	8.35	16.20	21.54	18.76	7.85	94.00
Syrian Arab Republic	3.56	4.06	4.28	3.72	4.02	4.28	3.77	0.30	8.00
Yemen	3.40	2.91	3.15	3.46	3.80	4.43	3.84	0.34	9.86
More diversified economies	26.93	22.04	19.10	19.08	28.66	32.64	28.45	9.58	50.21
ESCWA region	157.35	131.34	130.56	165.13	212.97	238.74	208.14	47.84	28.97

a/ ESCWA estimates based on official sources.

b/ ESCWA estimate and forecast relying on assumptions of high realization price per barrel.

c/ ESCWA estimate and forecast relying on assumptions of low realization price per barrel.

d/ Including Bahrain's share of the Abu Safa oilfield. Bahrain's gross oil import expenditures are estimated at $2.06 billion in 2003 and $2.5 billion in 2004.

e/ Qatar's non-crude oil exports, mainly LNG, have been increasing substantially. Gross export revenue for LNG is estimated at $6.9 billion for 2004.

f/ Including a 50 per cent share of the Neutral Zone.

The effects of the windfall were observed in the more diversified economies (MDEs) through increasing revenue transfers, such as workers' remittances, intraregional capital investments and tourism receipts. Although, structurally, many MDEs are acting under external and internal constraints to economic expansion, such as high levels of public debt and weak net export capabilities, the relaxed external constraint helped domestic demand expansion in 2004 (see section D).

C. PUBLIC DEBT IN THE ESCWA REGION

As to the sustainability of public debt, the ESCWA region is characterized by a high degree of heterogeneity. In general, GCC countries maintain stable financial positions with low or modest external debt levels and debt-to-GDP ratios. At the same time, they have accumulated large amounts of foreign assets.[11] MDEs of the region, in contrast, face larger public debt burdens and much bigger challenges in their efforts to maintain sustainable paths of indebtedness. Public debt and debt service ratios are particularly high in Iraq, Jordan and Lebanon, hampering the growth prospects of these countries and increasing their vulnerability to adverse shocks.

1. *Public debt in GCC countries*

In the light of the surge in oil revenues throughout 2004 and the continuing upward price trend in the first months of 2005, it is expected that significant budget surpluses in most GCC countries will lead to a further strengthening of their financial positions. As was the case in 2004, the 2005 budgets of GCC countries are generally based on conservative oil price projections. For instance, Oman has based its 2005 budget on an average expected price of $23 a barrel for Oman crude, while Qatar's new budget is based on a price of $27 a barrel. If the current recovery of the global economy continues, it is likely that average oil prices in 2005 will be significantly above projections by GCC Governments, leading to higher than expected fiscal revenues and substantial budget surpluses.

In Saudi Arabia, which is the most highly indebted GCC country, total Government debt had increased to almost 75 per cent of GDP by the end of 2003. However, only about 23 per cent of total debt is owed to external creditors, and in 2004 a substantial part of the budget surplus – estimated at about $26 billion – was used to pay down public debt. Accordingly, total public debt is estimated to have decreased substantially from $176 billion at the end of 2003 to $164 billion at the end of 2004. Qatar has accumulated a relatively large external debt stock in recent years, having undertaken massive investment in infrastructure projects, mainly in the oil and gas sectors. The Economist Intelligence Unit (EIU) *Country Report* for January 2005 estimates Qatar's total external debt in 2004 at about $18 billion, implying an external debt-to-GDP ratio of 76 per cent. However, given the continuing buoyancy of oil prices, high GDP growth rates in recent years and the fact that external borrowing is primarily related to high-yielding investment projects, Qatar's external financial position can be considered as very stable so long as oil and gas prices remain high. Bahrain's external debt stock also increased over the past years, and the external debt-to-GDP ratio stood at 60 per cent at the end of 2004. As in the case of Qatar, the relatively high level of external debt will not pose a problem for Bahrain's economic development so long as oil prices remain buoyant. Finally in Kuwait, Oman and the United Arab Emirates, the external debt-to-GDP ratio is between 20 and 30 per cent, which is considered low by international standards.

2. *Public debt in MDEs*

Overall, the public debt situation in MDEs of the region improved slightly in 2004, mainly because of strong economic growth and the positive impact of regional and global interest rates. However, high external

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[11] According to a report issued by the Council of Saudi Chambers, the volume of money invested abroad by Gulf countries reached $1,400 billion in 2004, of which Saudi Arabia accounted for half.

debt levels and debt service requirements remain some of the greatest obstacles to development, especially in Iraq, Jordan, Lebanon.[12]

In Egypt, which is classified by the World Bank as a less-indebted country, the level of external debt remains modest, amounting to $29.5 billion in September 2004. The slight increase of the external debt stock last year can be attributed to the depreciation of the dollar against the currencies of major creditors. The corresponding external debt-to-GDP ratio is 36.9 per cent. Short-term external debt represents only a small fraction (6.9 per cent) of total external debt. The ratio of debt-service-to-exports fell continuously from 12.2 per cent in 2002 to 9.6 per cent in September 2004, mainly because of higher commodity exports, travel receipts and Suez Canal dues. Total domestic debt, in contrast, increased substantially in past years and reached 433.8 billion Egyptian pounds (LE) in September 2004, corresponding to 87.1 per cent of Egypt's GDP. As rising domestic debt-servicing commitments increasingly crowd out private sector borrowing and investment, the Egyptian Government faces the challenge of cutting down its currently large fiscal deficits.

International observers estimated that the external debt of the Syrian Arab Republic at the end of 2004 amounted to $22 billion, corresponding to approximately 100 per cent of GDP, whereas official national sources reported much lower figures. In January 2005, the Syrian Government reached an important debt cancellation agreement with the Russian Federation. According to this agreement, the Russian Federation is willing to write off 73 per cent, or $9.8 billion of the Syrian Arab Republic's net debt to it.

In Yemen total external debt has risen over the last few years because of substantial budget deficits. This process appears to have accelerated in 2004, and the EIU *Country Report* for February 2005 estimates Yemen's total external debt at about $6.6 billion, corresponding to approximately 47 per cent of GDP.[13] The major portion of total debt is owed to multilateral creditors, primarily the World Bank, and to the Russian Federation. Given Yemen's low income and its weak institutional capacities, the prevailing debt-to-GDP ratio is considered relatively high. Moreover it is likely that the country will face a significant decline in oil production and budgetary oil revenues over the next decade. As a consequence, Yemen's external debt situation may become unsustainable in the medium term, if no policy adjustments are made. In the light of Yemen's severe social problems, it is essential to design a pro-poor fiscal adjustment strategy that does not hinder economic growth, but promotes a more equitable distribution of resources and contributes to progress towards meeting the Millennium Development Goals.

In Jordan, favourable economic conditions and major efforts by the Government to achieve primary balance surpluses and to pursue active debt restructuring procedures have resulted in a substantial reduction of the public-debt-to-GDP ratio in recent years. In 2004, total public debt increased slightly from 7,071 to 7,293 million Jordanian dinars. External debt represents 73.3 per cent of total public debt. About 90 per cent of external debt is long-term with a maturity of over 15 years. Strong GDP growth caused the debt-to-GDP ratio to decrease from 100.2 per cent in 2003 to 95.1 per cent in 2004. The Jordanian Government continued its efforts to restructure the public debt stock, gradually replacing external sources by domestic ones. Although the appreciation of major world currencies (euro, yen, pound sterling) against the dollar had a negative effect on the external debt stock, the external debt-to-GDP ratio fell significantly from 76.4 per cent in 2003 to 69.7 per cent in 2004. Furthermore, the Government has continued to sign debt-swap agreements with Paris Club member countries, transferring funds to development projects in the Kingdom. Overall, Jordan's external debt situation has significantly improved over the last decade. If economic growth continues to be strong in the next years, the Jordanian Government may reach its objective of reducing the public-debt-to-GDP ratio to 80 per cent by the end of 2006. However this objective could in reality prove to be too ambitious.

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[12] No reliable data concerning public debt are available for the Occupied Palestinian Territory.

[13] In a recently released *Country Report* on Yemen, the International Monetary Fund projected an official external debt of $5.1 billion in 2004. The corresponding external debt-to-GDP ratio is 39.3 per cent.

In Lebanon persisting high levels of public debt force the Government to direct a large part of its expenditure towards debt service. Moreover, with the Lebanese pound (LL) pegged to the dollar, the prevailing very high debt-to-GDP and debt-to-exports ratios make the Lebanese economy extremely vulnerable to adverse shocks. Owing to a strong increase in Government revenues and enhanced expenditure discipline, Lebanon reported a primary budget surplus of LL 995,296 million in 2004, corresponding to 3.3 per cent of GDP. However, the primary surplus achieved fell significantly short of the 6 per cent target specified under the Paris II agreement. The total fiscal deficit amounted to 10.3 per cent of GDP, falling from 14.5 per cent in 2003. As a result, total public debt increased by 7.5 per cent in 2004 and reached $35.9 billion at the end of the year. While domestic debt was slightly below its 2003 level, external debt grew by 18.1 per cent in 2004, partly because of the depreciation of the dollar against the currencies of major creditors. Altogether, foreign debt accounted for 51 per cent of total debt at the end of 2004. Strong expansion of GDP in 2004 caused the public-debt-to-GDP ratio to fall slightly to 180 per cent, but is still one of the highest in the world. As a result of high debt stock, 48 per cent of total Government expenditures went to debt service payments in 2004. The high growth rate of 2004, higher fiscal revenues and lower interest rates implied that the prevailing debt and its service were possibly manageable just prior to the assassination of former Prime Minister Rafiq Hariri in February 2005. However, given the political uncertainty following the assassination and its impact on the short-term economic outlook, the Government and the Central Bank of Lebanon face enormous challenges in the task of keeping public debt on a sustainable path. The related policy agenda will need to address reforms of the tax system, with the aim of broadening the tax base and making it more direct and progressive; reforms of the loss-making *Electricité du Liban* and of the social security systems; improved fiscal-monetary coordination; and prudent management of the existing debt stock. This comes at a time when high unemployment levels and fierce political tensions permit little flexibility in policy-making.

In Iraq, excessive levels of public debt and massive war reparations related to the war over Kuwait are major obstacles to the reconstruction of the country. The agreement reached in November 2004 with the member countries of the Paris Club represents a significant step to ensure long-term sustainability of Iraqi debt. According to this debt treatment, the total debt stock owed to the Paris Club will be reduced by at least 80 per cent in three phases. The last two of these phases are subject to approval and to completion of standard International Monetary Fund (IMF) programmes. As a result, the agreement reduces total Iraqi debt to this group of creditors from $38.9 billion[14] to $7.8 billion. The remainder of Iraq's external debt stock (approximately $80 billion) is owed to official bilateral and private creditors, mainly from Arab countries. In order to generate financial resources for promoting economic and social development, it is indispensable that the Iraqi Government reaches further debt relief agreements, as well as a rapid and comprehensive solution to the issue of reparation obligations which are estimated significantly to surpass the external debt stock.

D. Economic developments in the ESCWA region

1. *Growth and living standards in 2004*

Despite the turbulent political conditions in Iraq and the Occupied Palestinian Territory, 2004 was another good year in terms of overall economic growth for Western Asia (see table 4). The combination of high oil production and prices, low interest rates and ample liquidity in both the public and the private sectors were fundamental causes of the strong economic growth rates. While discussion of macroeconomic developments in the region awaits fuller analysis, a brief description of the major macro- and socio-economic development in the region is provided in this section. GDP in constant 2000 prices in the region (excluding Iraq and Palestine) grew by 4.8 per cent; although this represents a decline from the high 5.7 per cent achieved in 2003, it is still a considerable improvement when compared with growth rates of recent years.

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[14] The Iraqi Strategic Review Board's *National Development Strategy 2005-2007* assesses the Iraqi debt stock owed to the Paris Club at $42 billion.

TABLE 4. REAL GDP AND GROWTH RATE ESTIMATES IN THE ESCWA REGION
AT CONSTANT 2000 PRICES, 2001-2005
(Millions of US dollars and percentage)

						Percentage change					
Country/area	2001	2002	2003	2004[a/]	2005[b/]	2000	2001	2002	2003	2004[a/]	2005[b/]
Bahrain	8 340	8 772	9 367	9 835	10 524	5.3	4.6	5.2	6.8	5.0	7.0
Kuwait	37 084	36 943	39 160	40 335	42 553	1.9	0.6	-0.4	6.0	3.0	5.5
Oman	21 333	21 825	22 31	23 032	24 068	5.5	7.5	2.3	1.9	3.6	4.5
Qatar	18 561	19 924	20 908	22 163	23 271	9.1	4.5	7.3	4.9	6.0	5.0
Saudi Arabia	189 726	189 973	203 613	214 404	225 125	4.9	0.6	0.1	7.2	5.3	5.0
United Arab Emirates	72 666	74 061	79 245	82 415	87 360	12.3	3.5	1.9	7.0	4.0	6.0
GCC countries	347 711	351 499	374 525	392 184	412 901	6.2	1.9	1.1	6.6	4.7	5.3
Egypt	101 358	104 500	108 784	114 67	121 653	3.4	3.2	3.1	4.1	5.5	6.0
Jordan	8 862	9 289	9 591	10 118	10 624	4.1	4.9	4.8	3.3	5.5	5.0
Lebanon	16 785	17 121	17 635	18 516	18 887	0.0	2.0	2.0	3.0	5.0	2.0
Syrian Arab Republic	20 295	21 156	21 714	22 301	23 081	0.6	3.8	4.2	2.6	2.7	3.5
Yemen	9 967	10 326	10 729	11 083	11 437	4.4	4.7	3.6	3.9	3.3	3.2
MDEs	157 267	162 392	168 453	176 786	185 683	2.8	3.3	3.3	3.7	4.9	5.0
ESCWA region[c/]	504 978	513 891	542 978	568 970	598 584	5.1	2.3	1.8	5.7	4.8	5.2
Iraq[d/]	21 579	19 788	15 474	24 789	27 343	2.3	3.4	(8.3)	(21.8)	60.2	10.3
Palestine[e/]	4 153	4 002	4 247	4 315	4 332	(5.5)	(6.5)	(3.6)	6.1	1.6	0.4
Total ESCWA region	530 710	537 681	562 699	598 074	630 259	4.9	2.3	1.3	4.7	6.3	5.4

Source: ESCWA staff calculation involving rescaling and estimation, based on national and international sources.

Note: Parentheses ( ) indicate a negative number.

a/ ESCWA estimates, February 2005.

b/ ESCWA projections, February 2005.

c/ Excluding Iraq and Palestine.

d/ Data for Iraq based on official figures up to 2001, and 2002-2005 estimates based on Iraq Ministry of Planning, *Iraq National Development Strategy 2005-2007* and EIU, *Country Report*, March 2005.

e/ Data for Palestine based on official figures up to 2002 from the Palestine Central Bureau of Statistics. Growth rates for 2003-2006 taken from the World Bank report, *Disengagement: the Palestinian Economy and the Settlements*, June 2004.

Two subregions of ESCWA (MDEs and GCC) are expected to enjoy an upturn in real GDP levels in 2005 (see table 4). The cyclical upswing in 2004 is expected to continue in 2005, and forecasts indicate a good overall real 5.2 per cent growth rate for all countries, not including Iraq and Palestine, on account of buoyant oil revenues, rising regional tourism, repatriated capital inflows and the current boom in the stock and real estate markets. The wealth effect associated with the latter two factors currently contributes to the expansion of domestic and regional demands and will continue to do so in the coming year.

Despite this rapid economic expansion stemming from the rise in oil production and prices and a general rise in the price of other commodities, such as steel and construction materials, ESCWA member countries experienced low or manageable inflation rates in 2004 (see table 5). The exceptions were Egypt, Iraq and Yemen, where the inflation rate is estimated at 10.8 percent, 31.7 per cent and 14.5 per cent, respectively. The national currencies of most ESCWA member countries, except Egypt, the Occupied Palestinian Territory and Yemen, are pegged to the dollar, officially or effectively. The policy resulted in a reduction in inflation to industrial-country levels, although the depreciation of the dollar against the euro remained an inflationary factor. Rapid domestic demand expansion caused the inflation rate in Bahrain and Qatar to increase in 2004, but to a manageable level. In Egypt the adoption of a floating exchange rate led to an effective devaluation and to accelerated inflation transmitted through the external factor. In Iraq inflation remains hanging at double-digit levels on account of the rising reconstruction demand and bottlenecks in supply. In addition, higher costs for the provision of security added to the cost of supplies, shortages of energy products increased, and the cost of transporting several commodities rose rapidly. These factors together resulted in soaring inflation. Broad inflationary pressures are expected to grow gradually in 2005, following the trend in industrial countries, given the rise in prices of foodstuffs and raw material imports and the continuing domestic demand expansion in response to windfall revenues from oil.

Combining the dynamics of economic expansion, prices and population, living standards in the ESCWA region (excluding Iraq and Palestine), in terms of real GDP per capita, are estimated to increase on average by 2.3 per cent, while average population growth is estimated at 2.4 per cent (see table 6). Living standards continue to be distinctly different in the GCC and MDE subregions. Average real GDP per capita in GCC countries is expected to stay above $11,500 in 2005, whereas in MDEs it is expected scarcely to exceed the $1,500-level.

TABLE 5. RATES OF INFLATION IN THE ESCWA REGION, 2000-2004
(Percentages)

Country/area	2000	2001	2002	2003	2004[a/]
Bahrain	(0.68)	(1.18)	(0.50)	1.59	6.47
Kuwait	(0.60)	1.30	0.89	0.98	1.26
Oman	(1.11)	(0.41)	(0.21)	(0.62)	1.45
Qatar	1.68	1.44	0.24	2.26	6.80
Saudi Arabia	(1.00)	(1.11)	0.20	0.61	0.20
United Arab Emirates	1.37	2.71	2.90	3.08	3.70
Egypt	2.70	2.30	2.70	4.20	10.80
Iraq	5.00	16.40	19.30	33.62	31.69
Jordan	0.68	1.82	1.79	2.31	3.42
Lebanon	(0.89)	1.30	4.25	3.04	2.16
Palestine	5.54	1.22	5.69	4.40	3.92
Syrian Arab Republic	(8.26)	4.00	(0.96)	0.97	2.00
Yemen	7.60	14.60	4.50	12.10	14.50

Sources: ESCWA staff calculations based on official sources.

Note: Parentheses ( ) indicate a negative figure.

a/ 2004 estimates based on official quarterly figures, except that for the Syrian Arab Republic, which is based on figures from EIU. For Yemen, the figure is taken from International Monetary Fund (IMF), *Yemen Country Report*, March 2005.

In terms of yearly per capita growth in 2004, MDEs experienced an increase of 2.7 per cent over the 2003 rate of 1.5 per cent. Meanwhile there was an increase in growth in the GCC cluster of 1.6 per cent, which was lower than last year's growth and is attributable to more moderate real GDP growth in 2004. The fluctuation in real GDP per capita seen in GCC countries reflects the volatile nature of oil-dependent economies with a high population growth. Moreover, the population structure of the GCC economies is rather complicated: firstly because it comprises foreign expatriate workers and their families; and secondly because it has a growing concentration of particular cohorts which are usually about to enter the labour market. Although the level of real GDP per capita is high enough in GCC countries, issues of equity remain with respect to the disparity in living standards between nationals and expatriates and among generations.

The surge in real GDP growth in MDEs pushed overall per capita income growth to its highest rate of 2.7 per cent. The improvement in Egypt, Jordan and Lebanon is remarkable. In the MDE cluster, the difference in living standards between urban dwellers and rural populations remains crucial, and ESCWA believes that intergender income differentials remain significant as well. Also, chronic unemployment and under-employment, particularly for younger cohorts and females, have widened intergenerational and intergender income-gaps.

There is a sign of slow convergence in real GDP per capita within each subregion and in the ESCWA region as a whole. However, there is no sign of clear "catching-up" in living standards among ESCWA member countries. This absence of regional anchors and followers is one sign of the lack of regional integration and potential benefits from it. This can be best achieved by increasing intraregional foreign direct investment and by maximizing the complementary role of GCC countries and MDEs.

Political instability and shocks to GDP in both Iraq and the Occupied Palestinian Territory have, over time, led to massive unemployment, deteriorating living standards and widespread poverty (see subsection 4 below). Wars and domestic conflict have also increased burdens of dependency, as well as the numbers of female-headed households; rising dependency rates and increased burdens on single-family households have increased intergender income gaps.

TABLE 6. PER CAPITA REAL GDP AND GROWTH RATE ESTIMATES IN THE ESCWA REGION AT CONSTANT 2000 PRICES, 2001-2005
(US dollars and percentage)

						Percentage change			
Country/area	2001	2002	2003	2004[a/]	2005[b/]	2002	2003	2004[a/]	2005[b/]
Bahrain	12 176	12 604	13 268	13 737	14 476	3.5	5.3	3.5	5.4
Kuwait	15 848	15 153	15 509	15 478	15 837	(4.4)	2.3	(0.2)	2.3
Oman	8 633	8 755	8 854	9 089	9 376	1.4	1.1	2.7	3.2
Qatar	28 912	29 044	28 524	28 523	28 623	0.5	(1.8)	0.0	0.4
Saudi Arabia	8 590	8 367	8 729	8 952	9 161	(2.6)	4.3	2.6	2.3
United Arab Emirates	20 833	19 718	19 659	19 238	19 431	(5.4)	(0.3)	(2.1)	1.0
GCC countries	10 964	10 725	11 070	11 248	11 513	(2.2)	3.2	1.6	2.4
Egypt	1 478	1 495	1 526	1 580	1 643	1.1	2.1	3.5	4.0
Jordan	1 733	1 766	1 772	1 819	1 863	1.9	0.4	2.7	2.4
Lebanon	4 888	4 935	5 033	5 231	5 280	1.0	2.0	3.9	0.9
Syrian Arab Republic	1 177	1 196	1 198	1 200	1 212	1.7	0.1	0.2	1.0
Yemen	539	541	545	545	545	0.4	0.7	0.1	0.0
MDEs	1 393	1 407	1 427	1 465	1 506	1.0	1.5	2.7	2.8
ESCWA region[c/]	3 492	3 468	3 576	3 658	3 760	(0.7)	3.1	2.3	2.8
Iraq	836	745	567	884	949	(10.9)	(24.0)	57.4	7.4
Palestine	1274	1 189	1 222	1 203	1 170	(6.7)	2.8	(1.5)	(2.7)
ESCWA region	3 056	3 019	3 081	3 195	3 288	(1.2)	2.1	3.7	2.9

Source: ESCWA staff calculations based on table 4 and total population estimates from *World Population Prospects, 2004 Revision* (http://esa.un.org/unpp).

Note: Parentheses ( ) indicate a negative figure.

a/ ESCWA estimates, February 2005.

b/ ESCWA projections, February 2005.

c/ Excluding Iraq and Palestine.

2. *Growth in GCC countries*

Overall real growth in GCC countries decelerated to a lower rate of 4.7 per cent compared with the high 2003 rate of 6.6 per cent. The essential background to this rise in the real GDP level is the high oil and natural gas production and revenues. Moreover, non-oil sectors performed well in 2004, boosted by the transport, telecommunications, real estate, banking and financial sectors. Other factors contributing to the high growth were high domestic liquidity and low interest rates, which enhanced domestic demand expansion. Qatar is estimated to have attained the highest GDP growth rate among GCC countries, at 6.0 per cent, followed by Saudi Arabia, estimated at 5.3 per cent. Meanwhile, the lack of strong domestic demand growth produced relatively moderate rates of 3.0 per cent and 3.6 per cent in Kuwait and Oman, respectively. The lagged effect of the 2003 and 2004 oil revenues is expected to be translated into expansionary fiscal strategies and further expansion in domestic private demand in forthcoming years, and there are increasing signs of new investment projects and public programmes to be commissioned. In the private sector, more bank lending and the inward-looking investment capital outlook will increase liquidity. All these factors will stimulate GCC growth to the higher rate of 5.3 per cent in 2005.

GDP growth in 2004 was mostly supported by the expansion of domestic demand. The rise in oil prices and active world demand for other goods caused most countries to experience an impressive increase in exports. That same year, however, as the wealth effect of windfall revenues from oil set in, imports in most countries rose extensively. Except for Kuwait and Qatar, domestic demand expansion resulted in a decrease in net exports from the previous year. Accordingly, the contribution of external demand to GDP growth tapered off moderately.

From the decomposition estimates of GDP expenditure growth in 2004, three patterns emerge for growth in GCC countries. The first pattern is an investment-expenditure-led growth, which pertains to Bahrain and Qatar. To a great extent both countries turned their previous year's windfall revenues into investment in infrastructure. Moreover, both countries' investment-to-GDP ratios have been moving upwards for the last few years. Robust economic performance is expected for both countries in 2005. The preliminary forecasts of real GDP growth in 2005 are 7.0 per cent for Bahrain and 5.0 per cent for Qatar.

The second pattern is one of a consumption-led growth, which pertains to the performance of Oman, Saudi Arabia and the United Arab Emirates. Income growth during 2003 resulted in the growth in consumption expenditure in those countries. The windfall effect on investment is time-costly, considering the size of those economies, but consumption alone is insufficient to support the acceleration of economic expansion. However, consumption growth is a result of increasing confidence among consumers in their economies. In 2004 expectations became more robust on the demand side in this class of economies, despite the tailing off of GDP growth in Saudi Arabia and the United Arab Emirates. For 2005, a lagged increase in investment expenditure is expected, as well as continuing consumption growth. The preliminary forecasts of real GDP growth in 2005 are 4.5 per cent for Oman, 5.0 per cent for Saudi Arabia and 6.0 per cent for the United Arab Emirates.

The third pattern shows external demand-led growth and pertains to the performance of Kuwait. In this case, the windfall-effect from oil is yet to set in, as domestic demand expansion is still relatively small. Because of a tense security situation in neighbouring countries in recent years, Kuwait has had the lowest investment-to-GDP ratio of all GCC countries. However, as the security situation improves, Kuwait is gradually expanding domestic demand in terms of both consumption and investment expenditures. For 2005, both domestic and external demand are expected to contribute positively to growth, and the preliminary forecast for real GDP growth is 5.5 per cent.

3. *Growth in MDEs*

For MDEs, the upswing in GCC countries was contagious. A combination of favourable external factors, such as low interest rates on the dollar, the expansion of regional tourism and a stable increase in worker's remittances and other income transfers, resulted in healthy domestic demand growth. This pushed the GDP growth rate to 4.9 per cent in 2004, the highest rate attained since 2000.

The best outperforming economies are Egypt, Jordan, and Lebanon. Real GDP growth for 2004 is estimated at 5.5 per cent for both Egypt and Jordan, and 5.0 per cent for Lebanon. At the start of the year, the negative effect of increasing energy costs had been a source of concern in those countries. However, the combination of capital inflows, income transfers and workers' remittances, and revenue from tourism somehow neutralized the impact of greater oil import demand on these economies. Moreover, following the lifting in April 2003 of the sanctions on Iraq, intraregional trade continued to grow for reconstruction needs and durable consumer goods. The outlook for economic growth for this subregion is even better for 2005. The preliminary forecast for real GDP growth in MDEs (not including Iraq and Palestine) is 5.0 per cent. Against this backdrop, more regional stability and the resumption of economic links with Iraq will increase intraregional trade and support development of industrial and financial sectors, while attracting international and regional investments to these countries. Continued instability in Iraq is diverting significant amounts of its private capital towards neighbouring Jordan and the United Arab Emirates, thus contributing to their rapid growth rates.

The rapid expansion of domestic demand also stimulated GDP growth in MDEs during 2004. The economies in this cluster are chronically weak in external balance positions, and the net export contribution to GDP growth is generally negative or limited. However, a continuous reduction in Egypt's trade deficits caused external demand to contribute positively to its GDP growth in 2004. Keeping pace with its overall good economic performance during previous year, Egypt's real growth rate further increased in 2004, driven by the surge in non-oil exports following the currency's depreciation against the dollar and the euro. For Jordan and Lebanon, rapid increases in exports were countered by more rapid increases in imports, as domestic demand expanded and the contribution of external demand to GDP growth remained negative.

From the decomposition estimates of GDP expenditure growth in 2004, two patterns emerge for growth in MDEs: consumption-led growth and investment-led growth. Consumption-led growth was apparent in Egypt, Jordan and Yemen. In Egypt and Jordan consumption is a cyclical element in the expenditure component, as both countries are still constrained in pursuing active investment. The contribution of investment expenditure is stable but moderate, and the trend continued in 2004. Yemen saw an expansion of domestic demand, mostly consumption, as a result of windfall revenues from oil and the ensuing wealth effect. Although the pattern of GDP growth shows fragility, the economies of Egypt and Jordan are expected to expand further in 2005. The expected increase in exports will sustain domestic demand, and the low inflation predicted may sustain consumer confidence, gradually increasing investment. The preliminary forecast of real GDP growth in 2005 is 6.0 per cent for Egypt and 5.0 per cent for Jordan. However, it will be difficult for Yemen to sustain domestic demand for its decreasing oil production and weak non-oil exports. Also, as investment did not expand quickly enough in 2004, the present demand expansion may quickly be dispersed. Assuming continued favourable external conditions, the preliminary forecast for real GDP growth for Yemen in 2005 is 3.2 per cent.

Investment has led growth in both Lebanon and the Syrian Arab Republic, though at different tempos. The contribution of the increase in investment expenditure to GDP growth is moderate in the Syrian Arab Republic. It is impressive in Lebanon, where the rapid domestic demand expansion is noteworthy as the country's trade deficits expanded rapidly in 2004. However, as Lebanon is under foreign exchange constraints, and the most significant risk to its economy remains the large public debt. Recent domestic demand expansion is not likely to be sustained at the pace of 2004. The preliminary forecast of real GDP growth in 2005 is 2.0 per cent for Lebanon. The economy of the Syrian Arab Republic, hard hit by the Iraqi war and its aftermath and external pressures during 2003 and 2004, remained relatively stagnant with real GDP growth at 2.7 per cent in 2004. The Syrian economy is expected to expand moderately, and the preliminary forecast shows real GDP growth in 2005 standing at 3.5 per cent.

4. *Conditions in Iraq and Palestine*

Tension and political instability will continue to overshadow prospects for steady economic growth and development in the conflict zones of the region, Iraq and the Occupied Palestinian Territory. The current shocks to GDP have led to sliding levels of per capita income and caused widespread poverty. After a period of zero or even negative growth rates, the Iraqi economy showed signs of recovery from a very low base of minus 21.8 per cent real growth rate in 2003 to 60.2 per cent in 2004. In addition, per capita GDP witnessed an immense improvement of 57.4 per cent, up from its recent negative levels in preceding years. The recent Paris Club agreement called for Iraq's debt stock to member countries to be reduced to $7.8 billion. A feasible scheme for rehabilitation will need substantial financial input, which neither oil revenues nor donors can supply in the meantime. Extreme poverty and rampant unemployment will continue to prevail in 2005 as debt, reparations and oil-capacity constraints shackle a self-sustaining process of economic growth.[15] Once security issues are resolved in Iraq, the whole region, specifically Jordan, Kuwait and the Syrian Arab Republic, will benefit from strong trade relationships. The Palestinian economy has been restricted to access to Israeli goods and labour markets, which resulted in real GDP growing at a meagre 1.6 per cent compared with the previous year's rate of 6.1 per cent, and per capita income of minus 1.94 per cent. The building of Israeli settlements and the 'separation wall' in the West Bank has split the local market and made it difficult for business and labour to undertake economic activities. Accordingly, the obstacles to economic growth remain formidable, as the conflict is aggravated by the occupation and the resulting security measures. Therefore, the prevalence of similar political conditions, and the occupation, may cause the current stagnation to continue in 2005. That said, economic rehabilitation in both Iraq and Palestine awaits the unfolding of security and political events in both.

5. *Economic policy*

With favourable external conditions in place during 2004, economic policy in the ESCWA region focused on demand management and on development under weaker financial constraints. The currency peg in force in most ESCWA member countries reduced inflation to industrial-country levels and maintained it at a manageable rate (see subsection 1, above). A solid foreign reserves position at central banks brought greater economic stability to Egypt, Jordan, Lebanon and Yemen, where external vulnerability remained. Although the direct role of monetary policy in demand management is limited, the indirect effect of pegging a national currency in creating healthy domestic demand should be apparent in most ESCWA member countries in 2004.

In parallel to the United States Federal Reserve's five-stage interest rate rises, which started on 30 June 2004, central banks in GCC countries and the Central Bank of Jordan turned to tighten their monetary positions by raising official interest rates. The move contributed to moderate monetary growth in the region, but was not sufficient to slow rapid asset price rises, mainly of stocks and real estate. The region's stock markets experienced historical highs in 2004, and the trends continued into early 2005. Exchange rate management continued to be a crucial policy target in Egypt, Lebanon and Yemen. With

[15] See "World economic situation and prospects 2005: analysis and forecast for Western Asia" (paper presented at the Project Link meeting held from 22 to 24 November 2004), section IV, pp. 17-22, for two different scenarios which are expected to unfold in Iraq during 2005. They are based on either an accelerated or a slow disbursement of donor funds (http://www.escwa.org.lb/divisions/ead/main.htm).

improving external conditions, Egypt successfully brought back the value of its currency from LE5.8/$1 to LE6.2/$1 towards the end of 2004. Lebanon kept its exchange rate at about LL1,500/$1. Yemen also succeeded in stabilizing the exchange rate at about 185 Yemeni rials per dollar, while Iraq managed its exchange rate at about 1460 Iraqi dinars to the dollar.

Sustainable domestic demand creation with economic diversification on the production side is a challenge for oil-exporting ESCWA member countries. Windfall revenues from oil on their own are not necessarily creating domestic demand, as oil revenues can migrate into foreign asset accumulation. Ongoing economic reforms and liberalization contributed to healthy demand expansion in most GCC countries in 2004. However, in order to sustain long-term economic growth, active development strategies are required. In line with the revenue increases forecast, most GCC countries took prudent stances in their 2005 budgets by boosting demand without overstretching their budgets. Other oil-exporting ESCWA member countries are not inclined rapidly to increase Government expenditure. However, in the United Arab Emirates, public investment is largely generated at the Emirate level, and the Emirates have been expanding investment significantly, especially in Abu Dhabi and Dubai. Although most budgets became more development-oriented, results are likely to remain dependent on external conditions, particularly regarding oil revenues.

6. *Employment conditions*

Job creation continued to be the common challenge for all ESCWA member countries. Worldwide, the region has the highest number of new entrants into the labour market every year, because of both demographic pressures and the number of female entrants. For MDEs, unemployment will remain high, and a difficult situation remains with respect to retaining educated and skilled nationals to develop the economy. For GCC countries, development of national human resources in tandem with creation of private sector employment opportunities remains a priority. Unemployment among women also remained an issue in the ESCWA region, particularly in a certain cohort, where the rate was reported to be substantially higher than for men.[16]

Within MDEs unemployment rates are expected to remain high, as labour supply growth rates tend to be on the increase as well. Recent official unemployment figures remained high. According to official figures for 2003, the unemployment rate stood at 9.9 per cent in Egypt,[17] 14.5 per cent in Jordan, 6.3 per cent in the Syrian Arab Republic[18] and 11 per cent in Yemen. The two-year economic boom in the region slightly improved the situation, particularly in Jordan, as labour forces continued to grow at alarming rates. Given a massive pool of under-employed labour, whose employment opportunities are temporary or do not match their skills, the potential economic and social losses for MDEs continued to be substantial. Active labour policies from the human resource development (HRD) side are still hampered by the lack of employment opportunities in the public and private sectors. Employment prospects in the public sector have already been saturated in countries in the MDE cluster, with the exception of the Syrian Arab Republic, because of public budget constraints. Accordingly, effective public-private partnerships in this area, including both HRD and employment initiatives, are urgently needed.

[16] For example, the unemployment rate among women was reportedly 21 per cent in 2003 in Saudi Arabia, which is twice as high as the total average (*Arab News*, 10 October 2004).

[17] Central Bank of Egypt, *Monthly Economic Bulletin*, March 2005, citing the Ministry of Planning as the original source.

[18] ESCWA has reservations about this low unemployment rate, as the corresponding rate for 2002 was 11.7 per cent, while the real Syrian GDP growth rate was 2.6 per cent only for 2003 (see table 4). Additionally, in March 2005, the semi-official website www.syria-report.com reported an unemployment rate of 16 per cent. There are also other studies by Syrian economists indicating a high rate of unemployment.

In GCC countries workforce nationalization strategies designed to increase the proportion of nationals among persons employed in the private sector are yet to be effective. The assignment of quantitative restrictions (quotas) at the firm level with respect to national and foreign employees has, in recent years, produced some achievements in increasing the proportion of nationals employed in the private sector. However, questions were raised as to the sustainability of the quotas in many areas, because the fundamental issue of the mismatch between qualifications of nationals and demands of the private sector still prevailed. Active HRD policies to rectify this mismatch have been implemented through institutions such as Bahrain's Vocational Education and Training system, Saudi Arabia's General Organization for Technical Education and Vocational Training and the Human Resources Development and Employment Authority of the United Arab Emirates. Also, Bahrain and Saudi Arabia embarked upon labour law reform in 2004.

Estimates of unemployment in Iraq indicate that the absolute number of the openly unemployed rose dramatically in 2004 to 3.2 million. The deteriorating security situation and minimal inflows of capital and technology were still hampering effective job creation in the private sector. Restructuring the public sector, including ex-military personnel, resulted in a substantial increase in the unemployed population, while slashing tariffs to a mere 5 per cent increased cut-throat competition in the private sector, causing massive business closures and labour lay-offs. 2005 will be a critical year for Iraq, which may lose much of its potentially skilled workforce if the present situation of high insecurity continues. In the Occupied Palestinian Territory, unemployment rates are currently the highest in the region, estimated at 28.6 per cent in second quarter 2004. Although the Territory's economy showed some improvement, the situation was still severe. As reconstruction needs are high, active international support to the Territory, including active labour policies, is a matter of urgency.

7. *External sector*

(a) *Merchandise trade*

The total gross value of merchandise exports, including re-exports, of ESCWA member countries in 2004 was estimated at $297 billion, of which 86 per cent originated from the GCC cluster. Total gross exports from the region increased by 24 per cent over 2003, mainly because of the increase in the value of oil exports, and exports from MDEs, especially Egypt, Jordan and Lebanon, also showed an impressive rise.

Crude oil and other oil-related products remained the main commodities exported from the ESCWA region. It is estimated that crude oil, gas and related products made up 70.9 per cent of total exports in 2004. Regarding non-oil exports, including re-exports, it should be noted that those from GCC member countries grew consistently at 13.8 per cent in 2004. Egypt's non-oil exports were stimulated by its robust performance in the export of metal products such as steel. Lebanon's export growth is still weak, but an impressive rise was seen in the electronic instruments sector. Apparel and clothing continued to lead export growth in Jordan in 2004.

The recovery of oil production in Iraq resulted in the country's rapid growth in export earnings, though its non-oil exports are yet to become active. A slow recovery in exports from the Occupied Palestinian Territory is estimated, and the amount has not yet reached the pre-2000 level.

The expansion in domestic demand resulted in a 22 per cent increase in total gross imports into the ESCWA region to a total of $194 billion. Imports of GCC States accounted for 70 per cent of the total. For oil-importing ESCWA member countries, rapid growth in imports is partly reflected in the rise in the price of crude oil and related products. High rates of growth were also recorded in imports of capital goods, such as electrical machinery, equipment and transport vehicles, in Egypt, Jordan and Lebanon.

The estimation of Iraqi imports was based on trading partners' data, which show an impressive increase in exports to Iraq. Despite continuing security concerns, demand for imported goods is very strong for reconstruction purposes. The flow of goods into the Occupied Palestinian Territory is also on the increase, as suggested by trading partners' data. However, the level was still significantly lower than that of peak year 1999.

TABLE 7. TOTAL EXPORT FLOWS OF ESCWA MEMBER COUNTRIES, 2001-2004
(Millions of US dollars at: current prices (FOB))

Country/area	2001	2000-2001 percentage change	2002	2001-2002 percentage change	2003	2002-2003 percentage change	2004[a/]	2003-2004 percentage change
GCC countries								
Bahrain	5 577	(10.0)	5 794	3.9	6 632	14.5	7250	9.3
Kuwait	15 234	(16.7)	14 184	(6.9)	18 366	29.5	24 680	34.4
Oman	11 074	(2.2)	11 172	0.9	11 669	4.4	13 430	15.1
Qatar	10 871	(6.2)	10 978	1.0	13 382	21.9	16 897	26.3
Saudi Arabia	68 064	(12.3)	72 561	6.6	93 368	28.7	120 800	29.4
United Arab Emirates	48 414	(2.9)	52 163	7.7	65 835	26.2	72 500	10.1
Subtotal	159 234	(8.9)	166 852	4.8	209 252	25.4	255 557	22.1
More diversified economies								
Egypt	4 114	(12.4)	4 688	14.0	6 189	32.0	7 550	22.0
Iraq	12872	(31.3)	9 990	(22.4)	9 711	(2.8)	17 700	82.3
Jordan	2 294	20.8	2 770	20.7	3 082	11.3	3 950	28.2
Lebanon	889	24.5	1 045	17.5	1 524	45.8	1 747	14.6
Syrian Arab Republic	5 414	12.3	6 756	24.8	5 816	(13.9)	5 650	(2.9)
West Bank and Gaza Strip[b/]	290	(27.6)	240	(16.9)	260	7.9	280	7.7
Yemen	3 366	(11.4)	3 684	9.4	3 934	6.8	4 350	10.6
Subtotal	29 239	(16.6)	29 174	(0.2)	30 516	4.6	41 227	35.1
Total Western Asia region	188 473	(10.2)	196 026	4.0	239 768	22.3	296 784	23.8

Sources and methodology: Foreign trade statistics obtained from national statistical sources have been processed because the original figures are denominated in national currency units. They are converted to dollars at the exchange rate cited in the official sources. If no exchange rates are designated in those sources, the relevant official exchange rates given in *International Financial Statistics*, published by IMF, are used for the conversion.

Note: Parentheses ( ) indicate a negative figure.

a/ For Bahrain, Egypt, Iraq, Oman, Saudi Arabia, the Syrian Arab Republic, the West Bank and Gaza, the United Arab Emirates and Yemen, the figures for 2004 are estimations based on trading partners' data, press releases on trade figures and other relevant information.

b/ Figures are estimations based on trading partners' data and other relevant information.

The largest export destination for all ESCWA member countries combined continued to be Japan and developing Asian countries. For the first 10 months of 2004, the proportion of total exports to this region stood at 47.5 per cent, a slight decrease from 49.1 per cent in 2003. Exports to the United States and EU-15 countries increased moderately to 14.0 percent and 14.3 per cent, respectively, in the same period. Furthermore the largest share of imports into the region originated in EU-15 countries, and 32.3 per cent of total imports for that period came from there. The share of imports from Japan and developing Asian countries was 32.2 per cent; and from the United States, 8.3 per cent. The past few years witnessed ESCWA member countries shift their centre of gravity in trade from the West to the East, in exports as well as imports. Although the shift decelerated during the last two years, rapid economic expansion in both China and India suggests that a moderate shift will be likely in 2005.

TABLE 8. TOTAL IMPORT FLOWS OF ESCWA MEMBER COUNTRIES, 2001-2004
(Millions of US dollars at current prices (CIF))

Country/area	2001	1999-2000 percentage change	2002	2000-2001 percentage change	2003	2001-2002 percentage change	2004[a/]	2002-2003 percentage change
GCC countries								
Bahrain	3 681	(20.6)	3 956	7.5	4 680	18.3	5 350	14.3
Kuwait	7 398	9.8	8 316	12.4	9 758	17.3	10 426	6.8
Oman	5 933	6.9	6 296	6.1	6 801	8.0	9 150	34.5
Qatar	3 758	15.5	4 052	7.8	4 897	20.9	5 450	11.3
Saudi Arabia	31 223	3.3	32 334	3.6	36 965	14.3	43 050	16.5
United Arab Emirates	37 293	6.5	42 652	6.5	51 962	4.9	62 700	20.7
Subtotal	89 286	5.0	97 606	9.3	115 063	17.9	136 126	18.3
MDEs								
Egypt	12 633	(9.4)	12 524	(0.9)	10 938	(12.7)	12 300	12.5
Iraq	11 152	1.3	9 817	(12.0)	9 934	1.2	17 100	72.1
Jordan	4 871	6.0	5 076	4.2	5 743	13.1	8 128	41.5
Lebanon	7 291	17.1	6 445	(11.6)	7 168	11.2	9 397	31.1
Syrian Arab Republic	4 747	17.7	5 070	6.8	5 092	0.4	5 500	8.0
West Bank and Gaza Strip[b/]	1 516	(36.4)	1 250	(17.5)	1 440	15.2	1 620	12.5
Yemen	2 600	4.7	3 083	18.6	3 557	15.4	3 850	8.2
Subtotal	44 810	0.3	43 265	(3.4)	43 872	1.4	(57 895)	32.0
Total ESCWA region	134 096	4.7	140 871	5.1	158 935	12.8	194 021	22.1

Sources and methodology: Foreign trade statistics obtained from national statistical sources have been processed. The original figures are denominated in national currency units, and they are converted to US dollar with the exchange rate cited in the official sources.

Note: Parentheses ( ) indicate a negative figure.

a/ For Bahrain, Egypt, Iraq, Oman, Qatar, Saudi Arabia, the Syrian Arab Republic, the West Bank and Gaza, the United Arab Emirates and Yemen, the figures for 2004 are estimations based on trading partners' data, press releases on trade figures and other relevant information..

b/ Figures are estimations based on trading partners' data and other relevant information.

Gross total exports were responsible for 7.1 per cent of intraregional trade for the first 10 months of 2004, a decline from 7.9 per cent in 2003. The share of intraregional trade in terms of the region's gross total exports was 7.1 per cent for the first 10 months of 2004, a decline from 7.9 per cent in 2003. Two developments have emerged to characterize recent intraregional trade. Firstly, Iraq was established as an important trading actor, particularly for Jordan and Lebanon. 18.9 per cent of Jordan's total exports went to Iraq, and 15 per cent of Lebanon's. The growth in intraregional trade with Iraq is still moderate, compared with the growth of exports to Iraq from developed countries, but it is expected to increase steadily, as the country is key to the prospective deepening of intraregional trade links. Secondly, the GCC customs union has also affected trading patterns in the region. In most GCC countries, the intraregional concentration of trading partners became more dispersed by 2004. Saudi Arabia's traditional concentration of trade with the United Arab Emirates became more diversified as trading volume with other countries, such as Jordan and Yemen, increased. Oman's traditional concentration with the United Arab Emirates was diversified as trading volume with Saudi Arabia increased, and the United Arab Emirates also tended towards greater diversification as trade increased with Yemen. One explanation for the diversification of intraregional trading partners is that the GCC customs union eliminated the arbitrage opportunities of intra-GCC re-exporting activities. The customs union therefore contributed to more efficient trade within GCC countries and to activating intraregional trade by diversifying trading partners.

(b) *Trade policy development*

Along with recent world trends, trade policy development in the ESCWA region is motivated by the development in bilateral or multilateral trade agreements. Since it first announced the initiative in 2003, the United States has actively pursued the US-Middle East Free Trade Area.[19] Under this initiative, Bahrain signed a Free Trade Agreement (FTA) with the United States in September 2004. Until then Jordan had been the only ESCWA member country to hold FTA with the United States. Oman, Qatar and the United Arab Emirates are currently planning to negotiate similar FTAs with the United States. However, the Bahrain-US FTA was initially disputed within GCC member countries because of uncertainty as to its effect on the GCC customs union. The issue was not settled during the GCC summit of December 2004. Despite the remaining uncertainty over the validity of Bahrain's bilateral FTA, GCC itself is actively seeking FTAs with EU and China. The process of establishing the US-Middle East Free Trade Area, however, ruled out any US-GCC FTA for the time being, as the US-Middle East Free Trade Area aims to establish a network of bilateral FTAs centered round the United States. Also the initiative states that one of the essential conditions for the start of FTA negotiations is membership of the World Trade Organization (WTO). Saudi Arabia, the largest GCC economy has yet to conclude its negotiations for accession to WTO. The last hurdle in the accession process, the bilateral pact with the United States, had not be cleared in 2004 with respect to issues such as intellectual property rights and liberalization of financial services. Saudi Arabia's accession is now expected to take place by the end of 2005. It will make a significant impact on the ESCWA region in actual trade in goods and services, and provide further evidence of commitment to the furthering of trade liberalization, along with internationally recognized rules and standards in the future.

In December 2004, Egypt reached an agreement with the United States to create qualifying industrial zones (QIZs), reversing a former position. The expiration of the WTO Agreement on Textiles and Clothing (ATC) created an increasingly competitive market in those goods and rendered QIZ-status more advantageous with respect to market access for other goods exported to the United States.. Egypt was interested in emulating the remarkable export growth in textiles and clothing from Jordanian QIZs to the United States witnessed during the preceding four years. It is currently seeking to realize the potential for exports to the USA through its own QIZs, though such development will more likely follow a pattern of export growth different to Jordan's (see box 1).

[19] The United States seeks a similar initiative with Southeast Asian countries with the Enterprise of ASEAN Initiative, which was announced in 2002.

Box 1. Expiration of WTO/ATC, and QIZs

Until the expiration of WTO/ATC at the end of 2004, international trade in textiles and clothing had been governed by special restrictive measures involving import quotas. With the expiration of the agreement, countries that imported textiles and clothing, mainly developed countries, eliminated those import quotas with regard to WTO member countries. Elimination of quotas is expected to engender strong competition among exporters of textiles and clothing products. It is also expected to change geographical flows of those goods: 1) acting as an incentive to relocate supply units (particularly those assembling finished garments) from countries that benefited from quotas to some countries that are no longer subject to restrictions; and 2) because powerful retailers in developed countries will consolidate suppliers that had been spread over different countries under the quota system, in order to benefit from economies of scale. The expected strong competition and resulting locational consolidation of suppliers will pose serious challenges to existing exporters of textiles and clothing. The appropriate adjustment policy for exporters of those goods may have a strong influence on production and export systems in some developing countries, as the textile and clothing sectors had traditionally occupied cardinal positions in the industrialization processes of such countries. Indeed, exports of those products are an essential source of foreign exchange for many developing countries. The need for adjustment during the post-ATC period is well recognized in Egypt and was the main motivation for its decision to start negotiating a QIZ protocol.[20]

QIZs are designated industrial zones, from which products that satisfy certain conditions with respect to material inputs and local contents can enter the United States freely, without quotas or duty being imposed on them. The scheme was introduced in 1996 as part of the Middle East peace process by US Presidential Proclamation 6955. Among ESCWA member countries, Egypt and Jordan are eligible to negotiate QIZ protocols. Jordan's QIZs, first set up prior to 2000, contributed to the rapid growth of exports (see table 7). Garments from QIZs were the driving force of this growth .

Given the restricted water supply, it would be costly for Jordan to develop a fully integrated set for its textile industry that includes the production of fibers, yarns, grey fabrics, and the dyeing, printing, finishing of fabrics. Jordan's textile industry in QIZs is thus concentrated on assembly for finished or semi-finished garments. Consequently, imports of fabrics and other textile materials also increased rapidly, and the sector's trade-surplus margin had been narrow until 2004 (see table 9).

TABLE 9. TRADE IN TEXTILES AND TEXTILE ARTICLES (HS CODE XI): EGYPT AND JORDAN
(Million US dollars)

	Egypt		Jordan	
	Exports	Imports	Exports	Imports
1998	939	511	49	110
1999	882	430	52	99
2000	925	284	80	134
2001	717	266	173	198
2002	803	246	282	248
2003	902	276	361	297
2004	1 008	445	533	399

Source: CAPMAS (Egypt: available in the Monthly Digest of the Ministry of Foreign Trade and Industry at http://www.mfti.gov.eg/), Department of Statistics (Jordan: available at "External trade" (http://www.dos.gov.jo/)).

Egypt has a more solid base for its textile industry, from the production of cottons to finished garments. Its recent trade in the textile sector has always been in surplus, with a reasonably wide margin between exports and imports (see table 9). Therefore, if QIZs are to be successful for export growth in textile products, domestic linkage effects in Egypt would be greater than in Jordan. To use this potential fully, however, Egypt's textile industry needs to upgrade its domestic supply chains, to raise productivity in each step of the process (spinning, weaving, dyeing/printing, cutting, assembling) and to improve its overall competitiveness. However, with the abolition of quotas under ATC, supplies from lower-cost producers such as China and India will pose serious threats to both Egyptian and Jordanian exports of textiles and garments from their respective QIZs.

[20] QIZ Unit, Ministry of Foreign Trade and Industry (http://www.qizegypt.gov.eg).

(c) *Workers' remittances and revenues from tourism*

Outflows of workers' remittances from GCC countries stood at $14.2 billion in 2003, and a preliminary estimate for 2004 is $15.5 billion. These remittances flowed into the MDE cluster of the ESCWA region, as well as the South and Southeast Asian countries from which foreign workers originated. The inflow of remittances to Egypt grew at 12.8 per cent in 2004 to $3.3 billion, while the inflow into Jordan is estimated at $2.1 billion with a 3.5 per cent growth over the year. Given the growth of merchandise imports and the development of central banks' foreign reserves during 2004, Lebanon and Yemen also showed growth in current transfer inflows, which include workers' remittances. Figures from the Central Bank of Egypt[21] suggest that 39.5 per cent of the inflows of such remittances originated from ESCWA member countries in 2004, whereas 40 per cent were from the United States alone. Therefore, the rapid growth in oil revenues in GCC countries and economic recovery in developed countries are the main factors behind the increase in the inflows of workers' remittances into the MDE sub-region in 2004.

Trade in services, mainly tourism and transport, is also crucial for the foreign exchange earnings of the MDE cluster. Egypt's gross revenues from tourism stood at $6.1 billion in 2004, showing 33.6 per cent growth over the previous year, and Suez Canal dues totalled $3.1 billion. The combined amount of both exceeds the amount for Egypt's merchandise exports, estimated at $7.5 billion. The tourism sector played a crucial role in lessening foreign exchange constraints in other countries in the sub-region. GCC countries also initiated efforts in the sector, and tourism in the United Arab Emirates, Dubai in particular, was booming. Recent uncertainties in both Iraq and Lebanon had serious negative effects on tourism in these countries, and much tourist activity shifted to Jordan as a result. At present net travel receipts continue to be negative in the GCC countries, except Bahrain.

(d) *Foreign direct investment*

Foreign direct investment (FDI) inflows to the ESCWA region have been increasing rapidly since 1999, rising from $0.53 billion in 1999 to $2.64 billion in 2001, declining to $2.27 billion in the following year and then rising by 25.1 per cent to $2.85 billion in 2003. However, the more than five-fold growth between 1999-2003 was overshadowed by the mere 0.44 per cent share of ESCWA member countries in global FDI inflows during 2003. In addition, FDI to ESCWA member countries represents a meagre 1.75 per cent of total FDI to developing countries that year. The United Nations Conference on Trade and Development (UNCTAD) Inward FDI Performance and Potential Indices, which convey the competitive advantage of host economies in attracting FDI, show that for 2000-2002 Jordan was the front-runner among other ESCWA member countries for which data are available. Nevertheless, countries within ESCWA that have adopted 'one-stop-shops' and built infrastructures to receive FDI on a large scale, such as the United Arab Emirates, appear to be attracting substantial volumes of FDI in their respective free zones, though data relayed may not always be sufficiently comprehensive. According to UNCTAD data, the Syrian Arab Republic and Yemen were still "under-performing" in attracting FDI during that same period, while the performance of other ESCWA member countries was classified as "below potential" compared with the rest of the world.

Reform measures are in progress in the ESCWA region. Several significant developments pertaining to the policy and legal frameworks of FDI, the most important of which are summarized in this section, took place in 2004 and 2005. Some ESCWA member countries succeeded in introducing new rules and updating and amending the existing ones. The Saudi Arabian General Investment Authority, for instance, recently introduced a new law on foreign investment which complies with WTO regulations, granting greater latitude to foreign ownership of businesses. Moreover, the minimum investment conditions previously imposed on

[21] Central Bank of Egypt, *Monthly Statistical Bulletin*, April 2005, table 32. http://www.cbe.org.eg/Monthly%20Statistical%20Bulletin.htm

foreign investment are cancelled as part of the effort to comply with WTO entry requirements. Jubail City[22] now represents the main industrial vision of the Saudi Arabian Government, which has plans to open 24 industrial cities as part of its long-term vision of economic and industrial diversification. Egypt has taken further steps in liberalizing its economy. In late 2004 it reduced the average tariff rate on imports by 60 per cent and launched a new foreign exchange inter-bank market, a crucial step in currency-market liberalization. This helped to strengthen the pound and attract foreign investors who are concerned with steady exchange rates. It is moreover planning to reduce tax rates on corporations and personal income as well. In early 2005 the political uncertainties in Lebanon led the Central Bank of Syria to take major steps in banking incentives offered to clients from the Syrian private sector. It lowered interest rates on short-term deposits and raised them on long-term ones, and authorized banks to lend in foreign currencies to local importers who are now permitted to open letters of credit in foreign currency against collateral. This move was designed to attract Syrian funds deposited in Lebanon to the Syrian Arab Republic. According to the Inter-Arab Investment Guarantee Corporation, the volume of intra-Arab investments for at least 16 Arab countries enjoyed a 27.6 per cent increase in 2003 and stood at $3.7 billion. Lebanon witnessed significant inflows to the real estate sector in the last two years. It was the first recipient of Arab investments totalling $850 million, 23.8 per cent of total intra-Arab investments during 2003. Saudi Arabia and the United Arab Emirates followed, receiving $650.2 million and $562.2 million, respectively. On the other hand, Saudi Arabia took the lead among other Arab countries in exporting investments and injected $1.36 billion (36.45 per cent of the total) into fellow Arab countries, followed by United Arab Emirates ($843 million) and Kuwait ($651 million).[23]

The political risk and turmoil associated with the ESCWA region are still considered to be the major factors that drive away investors, not forgetting the history of bureaucracy and state-dominated economies which also deterred foreign investment. The persistence of the status quo has undermined the integrity of the economic cycle and increased leakages. Striving towards greater long-term security in the region as part of a strategy to attract FDI is hence as important as providing fiscal and financial incentives to investors, liberalizing trade and establishing strong interregional integration; if not more so.

E. CONCLUSIONS

ESCWA member countries scored several successful economic goals in 2004. However, it is still too early to say whether lesser vulnerability to external conditions for MDEs and healthy domestic demand expansion in GCC countries were the result of policy reforms over recent years. This boom year that stemmed from the rise in oil prices and production, worldwide low inflation and abundant liquidity has had positive spillover effects, such as the increase in the regional flows of people, goods, income and capital within the region. However, to date, the desired response in terms of a major reduction in unemployment has not been realized.

However, it should be noted that the region is still heavily oil-dependent. The level of oil prices was at an historically high level in nominal terms, but not in real terms. Oil prices remain extremely volatile, making it more difficult to smooth consumption and expenditure over the long term. If oil prices fall from the present level, the region's economy will slow down dramatically as structural economic difficulties resurface once again.

Counter-cyclical economic policy must be prepared for the region to meet the probable fall in oil prices and a possible economic downturn, though that is not expected to happen in 2005. ESCWA member countries need to address structural issues in order to make short-term policies more effective. Structural

[22] Jubail City has been cited by *FDI Magazine*, a subsidiary of the *Financial Times*, as the city with the best economic potential in the Middle East because of its burgeoning industrial hub and its steady GDP growth rate of 4 per cent per annum for the last 10 years. The city attracts nearly half of foreign investment going into Saudi Arabia.

[23] Inter-Arab Investment Guarantee Corporation, *Report on Investment Climate in Arab Countries*, 2003.

issues and priorities vary from country to country, but three main themes must be seriously considered with regard to regional integration. The first is the promotion of intraregional FDI from GCC countries to MDEs. This will eventually create employment opportunities in MDEs and will, by implication, contribute to a workforce nationalization policy in the private sector in GCC countries. A regional strategy must be formed in relation to the private and public sectors to seek the best mix of comparative advantages in human resources, technical expertise and financial capital across borders within the ESCWA region. The second theme is the need for more active economic diversification in GCC countries. The diversification strategy should be considered within the framework of regional integration. The third is the timeliness of an examination of whether the dollarized economies of the region can untie their currencies. The dollar-peg exchange rate policy produced manageable inflation rates in GCC member countries, and in Jordan and Lebanon, in 2004. On the other hand, if the dollar continues to depreciate against the euro and Japanese yen, that policy may lay the ground for inflationary pressures in 2005. However, there are early signs that the dollar marginally appreciated during the first five months of 2005. The situation of the international financial community, however, indicates that there may be a change soon. The United States has repeatedly asked China to float its currency, the renminbi (RMB). If this happens, the status of the dollar as the world's key vehicle currency will be weakened further. The strong merit of the dollar as the reserve currency of central banks lies in part in the liquidity of United States Treasury bonds, and this will continue to be a strong advantage of the currency over the euro, yen or RMB. However, the ESCWA region must prepare for the change in order to avoid the potential losses that could stem from a new international financial architecture.

II. STRATEGIES FOR DEVELOPMENT OUT OF CRISIS CONDITIONS

Introduction

Nearly every macroeconomic indicator for the region exhibited healthy signs, except for employment. Over the last two years, the response of job creation to economic growth was weak, yet job creation and decent jobs matter the most to the broader welfare of the region. Reasons for this failure could easily be related to the fact that regional production is not labour-intensive or that imported technology is labour-saving. However even that would not explain why so few jobs are being created relative to economic growth. Rough estimates indicate that there was a half a percentage point reduction in the unemployment rate associated with a real economic growth rate of nearly 6 percent in 2003. The response of unemployment to growth was equally slow in 2004.

Oil revenues dichotomize an economy. A highly capitalized oil sector creates few jobs relative to the capital invested in it, and decent job expansion occurs in the public sector. Growth in the latter sector is never enough to absorb the high rate of new entrants into the labour force. The rest of the economy leans ever more heavily towards the service and informal sectors and, in general, these sectors pay out poverty wages far below the subsistence income of nationals. Deepening labour market segmentation enhances short-term incomes in all economic sectors, making the present more valuable than the future. But inter-temporal preferences are above all underpinned by geo-political risk factors related to institutional rigidity and the inherent unevenness of development among member countries. The wealth and income divide between rich and poor is highest in this region. Voluntary redistribution, which would allow a lesser concentration of private wealth and greater interest in regional development via a stronger demand side, is highly unlikely. The role of economic policy and, more specifically, fiscal policy is to find the appropriate regime that mediates disparate developments and puts back a focus of interest in national and regional economies. Accordingly, this chapter is devoted to fiscal and monetary policies and industrialization.

The high rate of regional unemployment is the accumulated product of about two decades of cyclical contraction. From the early 1980s until 2003, the economies of the ESCWA region have been performing way below potential. While real GDP per capita for the region as a whole was growing annually at a respectable rate during the 1970s (4.33 per cent), it declined at the annual rate of 3.43 per cent during the 1980s, and grew at the staggeringly low rate of 0.34 per cent during the 1990s. A chronically high rate of unemployment was associated with this prolonged contraction in economic activities; it is currently higher than in any other region in the world (estimated at almost 16 per cent).[24]

Conventional wisdom attributes this long-term economic stagnation to external shocks arising from volatile oil prices, regional wars and the ongoing Arab-Israeli conflict, and holds that a revival of the region's economy requires, first and foremost, an end to the military and political conflicts in the region and the creation of an environment conducive to both domestic and foreign investment.[25] As true as this assertion may be, it is not terribly useful as a guide to understanding what happens in the interface between external shocks and economic activities. What must be understood is that an economic contraction may be triggered by an external shock, but its magnitude and duration are decidedly determined by the adequacy of economic policy and the efficiency of institutions. The prolonged and substantial economic contraction therefore raises serious questions regarding the whole macroeconomic constellation in the ESCWA region, in terms of both institutions and policies. To what extent is the problem of unemployment in some member countries an outcome of an inadequate macroeconomic policy that targets low rates of inflation with no regard for unemployment? To what extent is the problem of stagflation in Egypt, the Syrian Arab Republic and Yemen an outcome of a policy-mix of increasing short-term interest rates and sharp devaluations? To what extent has the adverse impact of a chronically high rate of unemployment aggravated the contraction

[24] These figures are taken from the *Survey of Economic and Social Developments in the ESCWA Region, 2003-2004* (United Nations publication, Sales No. 04.II.L.7).

[25] This assertion is often repeated in papers presented at conferences organized by academic and international organizations. See *Forum, Newsletter of the Economic Research Forum for the Arab Countries, Iran and Turkey*, 2004, various issues.

triggered by an external shock, and thus created a negative, debilitating path of dependence that weighs heavily on the region's economy?

These questions, which are related to industrialization and trade, are explored with the aim of suggesting a new macroeconomic configuration that may help the region to overcome the problem of unemployment and to jump from lower to higher paths of growth and development. Failure to do so will reduce the opportunity offered by the relative abundance of capital to a time-bound gain that will start to erode once the high price of oil drops. This chapter is composed of two parts. Part I presents a brief description of the macroeconomic structure in a typical ESCWA member country. It demonstrates that such a country lacks the ability to cushion the economy from the adverse effects of both external and internal shocks. It also highlights the need for regional coordination in tackling the fundamental problems facing the region. Finally it suggests a new macroeconomic framework based on reform of the monetary and fiscal arrangements within each country, and on coordination in exchange rates and monetary and fiscal policies at the regional level. Part II reviews the basic structure of industrial development and trade, and measures the likely impact of risk on growth. The chapter concludes with a set of feasible policy recommendations.

A. THE MACROECONOMIC CONSTELLATION

1. *The ineffectiveness of monetary and fiscal policies in the present institutional structure of the ESCWA economies*

Clearly, there are great differences among the economies of the region, especially between the rich, oil-exporting GCC countries and MDEs. Yet most of those economies have two important features in common. Firstly, almost all have adopted a fixed exchange rate regime by tying their currencies to the dollar. Secondly, most of the countries suffer from what is known in economic literature as the "original sin", i.e. they are unable to borrow abroad in their own currencies, but must do so mainly in the three strongest international currencies[26] and, as a consequence have to bear the cost of servicing large debts in foreign currencies. Given that the majority are moving towards a relaxation of financial market regulations to allow for greater capital mobility, these features constitute an environment in which macroeconomic policy cannot provide adequate protection against external shocks.

As is well known, a fixed exchange rate regime and free capital mobility render monetary policy ineffective. A monetary authority committed to a fixed exchange rate cannot lower the interest rate to fight unemployment or raise it to fight inflation. The interest rate is already devoted to maintaining the fixed exchange rate system.[27] To put things in proper perspective, we need to invoke Robert Mundell's concept of the "impossible trinity": free capital movement; a fixed exchange rate; and an effective monetary policy. Accordingly, a country must pick two out of the three. It can fix its exchange rate and retain the use of monetary policy, but only by maintaining control on capital flows. It can leave capital movement free and retain the capacity to use monetary policy, but only by letting the exchange rate fluctuate; or it can choose a

[26] Original sin is measured by calculating the ratio of the stock of international securities issued by a country in its own currency to the total stock of international securities issued by the country. A country that issues all its securities in own currency would be accorded a value of 0 (zero), while a country that issues all of them in foreign currency would be given a value of 1 (one): the higher the value, the greater the sin. The index of securities in a given currency to the total of securities issued by the country of this currency. A ranking of economies shows zero indices for the countries of the North and countries of the South show high indicators. Broad empirical studies show that original sin significantly increases economic volatility. (See Barry Eichengreen, Ricardo Hausmann and Ugo Panizza: "Original sin: the pain, the mystery and the road to redemption").

[27] Under a fixed exchange rate regime and free capital mobility, the real exchange rate is approximately determined by: $E = E_0 + \alpha (R - R_f)$. E_0 is the foreign exchange rate speculators' belief about the long-term equilibrium value of the real exchange rate; $R - R_f$ is the difference between the domestic and the foreign real interest rates; and α is a parameter denoting the speed of adjustment. If the monetary authority wants to fix E at a certain level E* then the domestic rate has to equal $R = R_f + (E_0 - E^*) / \alpha$. Thus the monetary authority cannot change R so as to influence domestic activities. R is devoted entirely to maintain the external balance.

fixed exchange rate system and free capital mobility, but only by abandoning any ability to use monetary policy to protect the economy from internal or external shocks. Clearly, most ESCWA member countries have adopted the last option. It should be noted, however, that by tying their currencies to the dollar they ended up paying the price of this option without realizing its benefits. They have forsaken the use of monetary policy without really acquiring a nominal anchor to stabilize their currencies. The continuous fluctuation of the dollar has increased the costs associated with fluctuations in exchange rates typical of a flexible exchange rate regime. Needless to say, the oil-exporting countries have suffered huge losses on account of the recent considerable erosion in the value of the dollar.

As things stand today in most ESCWA member countries, fiscal policy is no more effective than monetary policy in cushioning the economy against the adverse impact of shocks. As shown in tables 10 and 11, direct taxes (personal and corporate income taxes) do not generate much revenue in most of these countries. The heavy reliance on indirect taxation (trade, sales and excise taxes), as in MDEs, tends to handicap fiscal policy, as it impedes the automatic stabilizer function of taxes and creates a situation whereby budget deficits cause inflation and vice versa.

TABLE 10. DISTRIBUTION OF TAX REVENUE AS PERCENTAGE OF GDP IN SELECTED ESCWA MEMBER COUNTRIES

	Direct taxes[a/]			Indirect taxes[b/]		
Country	2000	2001	2002	2000	2001	2002
Bahrain	1.3	1.6	1.4	2.1	2.1	1.7
Egypt	5.5	5.2	4.8	8.8	8.1	7.4
Jordan	2.7	3.2	3.0	12.9	12.4	11.7
Kuwait	0.3	0.4	0.3	1.1	1.0	1.0
Lebanon	..	..	..	11.4	11.2	14.8
Oman	3.4	5.5	5.2	1.4	0.9	1.0
Syrian Arab Republic	7.9	8.6	10.1	8.6	7.7	8.0

Sources: Calculated from IMF, *Government Finance Statistics Yearbook* (2005) and from the *National Accounts Studies of the ESCWA Region*, bulletin No. 21 (E/ESCWA/STAT/2001/6).

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

a/ Direct taxes include taxes on income, profits, and capital gains.

b/ Indirect taxes include taxes on goods and services, excise, and international trade.

TABLE 11. DIRECT AND INDIRECT TAXES AS PERCENTAGE OF TOTAL REVENUE

	Direct taxes		Indirect taxes	
Country	1990	1999	1990	1999
Egypt	19	22	28	30
Jordan	16	10	48	50
Kuwait	1	1	2	3
Lebanon	..	11	..	48
Oman	23	19	3	8
Syrian Arab Republic	31	34	38	29
Yemen	26	18	27	19
Middle income countries	22	19	39	44
Lower middle income countries	23	18	43	46
East Asia	31	25	42	41
MENA*	21	18	32	33

Source: World Bank, *World Development Indicators 2002*.

Note: Two dots (..) indicate that data are not available.
(*) indicates Middle East and North Africa.

An expansionary fiscal policy creates a budget deficit, which in turn causes inflation.[28] A high rate of inflation, in turn contributes to an increasing budget deficit because, as inflation boosts nominal income, the growth in government spending outstrips the growth in government revenue (shrinking tax base). In ESCWA member countries, as in most developing countries, this is usually the case because the nominal income elasticity for government revenue tends to be low, whereas that for government expenditure is high, because indirect taxes tend to cause nominal income growth to lag.[29]

The combination of relatively high interest rates and very high unemployment shown in table 12 illustrates what happens when monetary policy is used to maintain the exchange rate rather than to fight unemployment. The same table shows relatively low inflation rates in most countries.[30] This should not be construed as an indication of the success of the exchange rate regime in stabilizing prices. Frequent and sudden large depreciations in some MDEs have generated powerful bursts of inflationary pressures, and the recent volatility of the dollar has caused big, unfavourable changes of the terms of trade for all GCC countries, although the shift was mitigated by rising oil prices.

TABLE 12. UNEMPLOYMENT, INFLATION, AND INTEREST RATES
(Percentages)

Country	Unemployment rate[a/]	Inflation rate[b/]	Interest rate
Bahrain	16.36	6.47	8.1
Egypt	9.9	10.8	13.4
Iraq[c/]	26.8	31.69	12.63
Jordan	14.5	3.42	8.39
Lebanon[d/]	8.4	2.16	10.95
Palestine	28.6	3.92	..
Qatar	12.62	6.8	..
Saudi Arabia	14	0.2	..
Syrian Arab Republic	6.3	2	9
Yemen	10.6	14.5	18
United Arab Emirates	2.3	3.7	..

Source: ESCWA staff calculations based on official sources and IMF, *International Financial Statistics Yearbook*, 2004.

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

a/ Unemployment figures are latest official figures available.
b/ Inflation rates are for 2004.
c/ Interest rates are lending rates in July 2004.
d/ Lebanon's unemployment rate is the average for the period 1996-2001.

[28] Inflation is caused by monetizing the deficit. This is usually the case since external borrowing would exacerbate an already serious problem of external debts, and internal borrowing is confined largely to that from commercial banks as the market for government bonds is not fully developed. Note that inflation puts pressure on the exchange rate to depreciate.

[29] Frequently, the revenue from tariffs is depressed because of both the lag in adjustment in the tax base and the lag in adjustment in the exchange rate. The lag in revenue derived from sales and excise taxes usually reflects some government policies. During periods of inflation, governments often impose price controls over a wide range of basic consumer goods or exempt those goods from taxation altogether.

[30] It should be noted that very high rates of inflation, e.g. above 40 per cent, do indeed harm economic growth. There is no empirical evidence, however, that moderate rates of inflation hinder growth. See David Romer, *Advanced Macroeconomics*, 2nd edition (McGraw Hill, 2001).

Two features of the main macroeconomic indicators of tables 13 and 14 are noteworthy. Firstly, figures of government budget balances show clearly that none of the countries has used expansionary fiscal policy to battle unemployment. Budget surpluses and deficits are due mainly to the cost of servicing the external debt. Secondly, there is no evidence of the twin-deficits mechanism in any of the countries; budget deficits did not generate current account deficits, but rather reduced investment. This is evident from the recent improvement in the currents accounts in most countries.

TABLE 13. GOVERNMENT BUDGET BALANCE*
(Percentage of GDP)

	2000	2001	2002
Bahrain	5.4	6.2	5.7
Egypt	1.3	(1.8)	(1.9)
Jordan	2.0	1.7	1.8
Kuwait	12.3	1.4	(3.3)
Lebanon	(14.9)	(13.3)	(10.4)
Oman	(4.1)	(2.0)	0.1

Source: IMF, *Government Financial Statistics Yearbook*, (2004).

Note: Parentheses ( ) indicate a negative figure.
*A positive number indicates surplus; a negative number indicates deficit.

TABLE 14. CURRENT ACCOUNT BALANCE*
(Percentage of GDP)

	1993	1996	2000	2002
Bahrain	(6.5)	4.3	9.8	5.9
Egypt	4.9	(0.3)	(1.1)	0.7
Jordan	(11.1)	(3.7)	0.7	5.1
Kuwait	10.4	22.8	36.4	10.2
Oman	(9.5)	2.2	17.3	10.6
Saudi Arabia	(14.6)	0.5	8.3	6.2
Syrian Arab Republic	(1.5)	0.2	5.5	..
Yemen	(25.6)	0.7	15.8	6.3

Source: ESCWA.

Note: Parentheses ( ) indicate a negative figure.
*A positive number indicates surplus; a negative number indicates deficit.

Naturally, the negative impact of more than two decades of high unemployment is not confined to loss of income. Loss of income is, in the words of Arthur Okun, "merely the tip of the iceberg that forms in a cold economy". Chronic unemployment also results in the decline in labour productivity, as firms facing a fall in demand are discouraged from investment. In sequence, the economy gradually acquires a smaller, older and less efficient capital stock. Table 15 shows a general drop in labour productivity in selected ESCWA member countries. Another lasting imprint left by chronic unemployment on the economy is the increase in inequality. As unemployment rates rise, they rise most rapidly among the most disadvantaged groups. However, various empirical studies have shown that unemployment increases inequality throughout the income distribution, not just at the bottom.[31] Table 16 shows the increase in inequality in selected ESCWA member countries during the last two decades of high unemployment.

TABLE 15. LABOUR – PRODUCTIVITY GROWTH IN SELECTED ESCWA MEMBER COUNTRIES (1980-2001)
(Percentage)

Country	Labour productivity growth
Iraq	(6.9)
Jordan	(1.5)
Saudi Arabia	(2.9)
Syrian Arab Republic	(0.2)
Yemen	0.2
United Arab Emirates	(2.4)

Source: International Labour Organization, *Key Indicators of the labour market* (London, Routledge, 2003).

Note: Parentheses ( ) indicate a negative figure.

TABLE 16. CHANGES IN THE DISTRIBUTION OF INCOME IN SELECTED ESCWA MEMBER COUNTRIES IN PERCENTAGES (1965-1993)

	Gini Coefficients*				
Country	1965	1975	1980	1985	1993
Bahrain				50.26 a/	51.09 b/
Egypt	41.97	38.44	42.56	42.28	48.06
Jordan	49.45	49.36	45.12	48.88	45.52
Kuwait	49.90 c/	53.10	49.39	51.27	53.97
Iraq			40.34	41.26	47.57 d/
Oman					50.94
Qatar					54.07 e/
Syrian Arab Republic					54.56
Saudi Arabia					53.67 f/

Source: University of Texas Inequality Project (http://utip.gov.utexas.edu/data.htm).

Note: * The Gini coefficient is a statistical measure of the concentration (or inequality) of income of a population. Its values range from 0 (zero), corresponding to a perfectly equal distribution, to 1 (one), indicating complete concentration of income in one individual.

a/ 1990.
b/ 1991.
c/ 1968.
d/ 1991.
e/ 1994.
f/ 1990.

[31] Alan S. Blinder, *Hard Heads, Soft Hearts* (United States, Addison-Welsley Publishing Company, Inc, 1987).

(a) *Regional coordination*

The preceding exposé shows that the monetary and fiscal arrangements in the ESCWA economies are far from optimal and provide no protection from the negative impact of external shocks, especially those caused by a sudden drop in the price of oil. It would be unrealistic to suggest that this situation will improve overnight as a result of a few changes in the exchange rate regime and the tax system. Realistically, improvement requires a comprehensive reform of the financial markets and the whole fiscal system. One of the principal ideas behind this section is that no country in the region is capable, by itself, of carrying out these reforms, i.e. of creating an environment that facilitates financial intermediation and ensures fiscal stability, to attract investment and act as a buffer against negative shocks. This would require new and serious regional coordination efforts by all or several countries. Such coordination is urgently required concerning the question of a new suitable exchange rate arrangement to replace the currency peg used by various countries (see chapter I, section D). Clearly, there are two options available: either the present system could be strengthened by modifying the arrangement, e.g., by tying the domestic currency to a basket of currencies instead of the dollar alone, or using a currency board, etc.; or the present system could be abandoned altogether in favour of freely floating exchange rate.

The first option, whatever form it takes, will continue to cripple monetary policy and therefore not do much to improve the present situation. More tellingly, the experience of the three currency crises of the 1990s[32] clearly demonstrated that a fixed-exchange-rate system is unstable for a country suffering from a serious unemployment problem: private traders realize that the mounting pressure of unemployment will eventually force authorities to choose employment over exchange-rate stability. The traders then sell the currency early, before it drops in value, thus generating a speculative run on it.

Obviously, the way to overcome such difficulties is to choose the second option. This change in approach will accomplish two important and related objectives. Firstly, it will allow monetary policy to be used as a measure to deal with unemployment and, secondly, it will allow the exchange rate to act as a shock absorber.

This is hardly a ground breaking analysis. It is indeed standard material, and one may reasonably ask why these ideas have not been widely implemented in the region. One explanation is that very few member countries are capable of making the change by themselves. None has a big, diversified market that could withstand destabilizing speculation against its floating currency while others maintained their currency pegs. It is generally recognized that such a change needs regional coordination. It is assumed, however, that harmonization of economic policy should follow regional integration regarding trade in goods and services and movements in capital and labour, with the emphasis on trade liberalization involving across-the-board removal of tariffs through the formation of a free trade area or custom union. The standard test of success for such schemes is to measure the extent to which "trade creation" among member markets outweighs "trade diversion" from other markets; in other words, the extent to which the scheme moves the region towards freer (and greater) trade. It assumed that such measures are most likely to succeed if they are introduced into an environment of full employment of labour, full use of capacity and, apart from tariffs, the absence of serious distortions in the member markets.

These assumptions do not apply to most ESCWA member countries, which suffer from chronic unemployment and under-employment, excess capacity, inadequate use of resources and widespread distortions in most markets. Under these conditions, the effects of regional integration based mainly on trade liberalization are at best limited, at worst harmful, and accentuate economic disparity among member countries.[33] By contrast, the success of the Association of Southeast Asian Nations and of regional

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[32] The European crisis of 1992-1993, the Latin American crisis of 1994 and the Asian crisis of 1997-1998.

[33] For an analysis of the difference between developed and developing countries in regard to the impact of liberalization of trade, see Peter Robson, *The Economics of International Integration*, 3rd edition (London, Allen and Irwin, 1987).

integration in post-apartheid southern Africa is attributed at least in part to the fact that the architects of both schemes rejected the concept of trade liberalization as the chief organizing principle. For the ESCWA region this would imply that an effective regional scheme calls for an approach which emphasizes creating conditions better suited to tackling the biggest problem, unemployment. In this connection, the recent effort to establish the Greater Arab Free Trade Area (GAFTA) will depend to a large extent on the success of regional coordination aimed at rationalizing production structures, creating new opportunities for profitable domestic, regional and foreign investment, and ensuring macroeconomic stability through coordination of economic policies.

(b) *New macroeconomic constellation*

It has become more and more obvious that the activation of fiscal and monetary policies guided by the principle of creating a new macroeconomic environment that can absorb shocks requires reform at the country level and coordination at the regional level. This section explores these issues under three headings: elements of fiscal and monetary reform, monetary union and regional management of risk.

(i) *Elements of fiscal and monetary reform*

In most ESCWA member countries certain features of the structure of government taxes and expenditures features are detrimental to both efficiency and equity. Many countries have state-owned enterprises (SOEs) that are likely to be less efficient than if they were privately owned. SOEs often operate with soft budgets, whereby any losses incurred are funded out of the national budget. This causes a drain on scarce government revenues, which cannot be used for other purposes, and leads to an inefficient allocation of resources.[34] The tax system in most member countries is performing neither the function of an automatic stabilizer nor that of a redistributive instrument. It urgently needs comprehensive reform designed to enhance governmental legitimacy by focusing on efficiency and equity. The imposition of hard budget constraints on public enterprises would boost the efficiency of government activities. Equity of the economic system could be strengthened by reforming the tax system, increasing its reliance on mildly progressive income taxes, restructuring the property tax and introducing presumptive taxes. Capacity-building in tax administrations would also be necessary.

Tax harmonization is also urgently needed at the regional level. As trade barriers are partially removed by the implementation of GAFTA, expansion of joint-venture investment and intraregional trade will depend more and more on the abolition of tax obstacles to cross-border activities. Capital tax differentials among the countries would cause capital to flow from the high-tax to the low-tax economies. This tax-induced distortion in the capital market would lead to an inefficient regional allocation of investment and possibly to tax competition, which would arise if members attempted to attract capital by offering tax incentives. Similarly, differences in the rates of indirect taxes among member countries would cause distortions in intraregional trade flows. Removing these distortions calls for an agreement among member countries on the choice of jurisdictional tax principle for both direct and indirect taxation, i.e. residence vs. source principle for the former, and origin vs. destination principle for the latter.[35] Measures consistent with these choices will then be adopted in order to remove differentiated treatment.

[34] This does not include SOEs that promote the production of positive externalities. Such enterprises contribute to reaching the socially optimal level of production better than if they were in private hands and should therefore be subsidized.

[35] For direct tax there exist two alternative jurisdictional principles: the residence principle under which taxation is applied to the total income of each resident regardless of the place where the income is earned, and the source principle, under which tax is applied to all income earned within the taxation jurisdiction whether by residents or non residents. Similarly, there are two jurisdictional principles for indirect taxes. Under the origin principle, the tax is imposed on the domestic production of goods, whether they are exported or not, but not on imports. Under the destination principle, the same tax is imposed on imported goods as on domestically produced goods destined for consumption by domestic consumers, whereas domestically produced goods destined for consumption by foreigners are not subject to the tax. For more details, see Robson, op. cit., pp. 117-118.

The conditions of financial markets, with respect to the degree of financial deepening of the domestic economy and of integration with world markets, vary greatly among the ESCWA member countries. In GCC countries markets are quite mature, whereas, in MDEs, they are still in their infancy. Reform in the latter markets should aim to remove all the institutional impediments responsible for financial repression, and create a well functioning capital market that could stimulate both saving and investment and encourage new private sector enterprises to emerge and prosper.

(ii) *Monetary union*

Because the exchange rate arrangements in force in ESCWA member countries are performing neither the function of nominal anchor nor that of shock absorber, intraregional trade is conducted mainly by foreign exchange, facilitated partly by the Arab Monetary Fund and its trade financing scheme, the Arab Trade Financing Program. In some countries, foreign currency, mainly the dollar, is increasingly used for domestic payments, creating a dual-currency system. Such a system tends to reduce the ability of commercial banks to transform debt maturities because of currency mismatching in portfolios. This will discourage them from extending long-term loans, which are essential for investment and growth. These are some of the reasons why financial intermediation in the region is lagging. This is evidenced in table 17, which shows that in every ESCWA member country domestic credit to the private sector as a percentage of GDP is less than the world average. Note that in 1999 the world ratio was greater than the highest ratio in ESCWA by a factor of 1.3 and greater than the lowest by a factor of 19.

TABLE 17. DOMESTIC CREDIT TO THE PRIVATE SECTOR
(Percentage of GDP)

	Egypt	Jordan	Kuwait	Lebanon	Oman	Saudi Arabia	Syrian Arab Republic	United Arab Emirates	Yemen	World	East Asia
1990	30	72.3	52.1	79.4	22.9	54.7	7.5	37.4	6.1	79.5	74.0
1999	60.6	73.5	73.8	90.8	38.6	58.2	8.0	55.9	6.2	118.1	116.5

Source: World Bank, *World Development Indicators 2004*.

The monetary situation in the region therefore needs major improvements in order to allow for financial deepening at the country level, to finance intraregional trade and gradually to reduce dependence on foreign exchange. Section I, above, demonstrated that regional monetary coordination is the only viable alternative to maintaining the present arrangement. The ultimate aim of such coordination would be the creation of a single currency area, i.e., a currency union or block, within which member countries used either a single currency or different currencies linked through permanently fixed exchange rates. It would have the advantage of reducing the cost of monetary transactions among member countries and fostering macroeconomic stability. A successful currency union would encourage economic agents to view the entire area as a single market and allow them to benefit from greater economies of scale in production. The disadvantage of the currency union would be to deny each member country the individual use of monetary policy for stabilizing purposes. However, as ESCWA member countries are not using active monetary policies to manage aggregate demand, monetary union would not rob participant economies of a large degree of monetary autonomy, but would rather reduce the potential for instability. GCC countries have recognized the advantage of monetary coordination and have gone a long way towards creating a monetary union aimed ultimately at creating a common currency.[36] Broadening this effort to include MDEs is essential to ensuring

[36] GCC countries set a timetable of achieving a unified anchor for their currency by 2003; reaching agreement on convergence criteria by 2005; and adopting a common currency by 2010. It is generally believed that they have progressed well in implementing this timetable. (See the speech delivered by the Governor of the Saudi Arabian Monetary Agency, September 2003).

greater regional monetary stability. Considerable economic differences between the two blocks might be regarded as an obstacle to their successful monetary coordination. This reasoning is in line with the traditional view, which puts more emphasis on the symmetries of the participants as a pre-condition for a monetary union or common currency. In contrast the modern view, focused on the European monetary integration, holds that the integration of asymmetric participants is key to a successful regional monetary framework, i.e., it depends fundamentally on the strongest partners showing the capacity to intervene in favour of the weaker ones.

(iii) *Regional management of risk*

Successful coordination in fiscal and monetary affairs and the pooling of regional resources can result in a leverage effect for protection against external shocks. External vulnerability be can managed by the complementary mechanisms of self-insurance and by transferring the risk abroad. A regional stabilization fund could provide countries with a self-insurance scheme. By contributing to the fund in good years, governments could reduce the need to cut expenditures in bad years. By stabilizing expenditures, such a fund would help to stabilize aggregate demand and relative prices.[37]

Similarly, a combined regional effort could take advantage of the world hedging markets, which for a fee provide insurance against unexpected revenue fluctuation. However, managing a hedging programme at the country level is very costly, as individual countries lack adequate institutional and policy frameworks capable of dealing with the program's complexity. Self-insurance mechanisms, such as revenue stabilization funds, can ensure against revenue *instability* or *volatility,* whereas hedging instruments can insure against revenue *uncertainty.*[38] A regional stabilization fund could increase the region's international creditworthiness and thus improve its access to world financial markets, which would reduce the cost of its hedging programme.

It is worth recalling that in the ESCWA region, short-term returns on investment are not lacking. On the contrary, it is long-term returns on investment in infrastructure, plant and equipment that are not forthcoming. Therefore, using insurance to smooth consumption and returns over longer periods provides the necessary platform for development projects to be based on a more diverse economy and higher regional productivity. However, highly skewed wealth and income distribution within individual member countries, uneven development among them, and varying degrees of contradictory international geo-political ties all coalesce to delay regional coordination. They coexist and reinforce each other, making it difficult analytically to pin the blame on a single factor. All three are product of a single historical condition, from which the nation state came into being. Blaming the "outside" or the "inside" is a mere analytical exercise removed from an historical process in which national entities take shape by means of many intervening forces that remove the differences between what is national and what is extra-national. The debate for faulty development at times spirals into an ethical treatise and, more often than not, the blame will be laid on a huge segment of the population that is neither politically nor economically empowered. The role of policy as stated above is to bridge intercountry and intraregional differences.

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[37] An example of a stabilization fund is the Chilean Copper Stabilization Fund, which was founded in 1985 to stabilize export revenue. See Santiago Montenegro, "Macroeconomic risk management in Nigeria: dealing with external shocks". *Findings, Africa Region, No. 30.* (World Bank, January 1995). Two examples within the ESCWA region are Oman's General Reserve Fund and Kuwait's Reserve Fund for Future Generations.

[38] Ibid.

B. INDUSTRIALIZATION AND TRADE DEVELOPMENT IN THE ESCWA REGION

For many developing countries, including the ESCWA region, development remains an industrialization issue. Based on regional long-term trends, developments in the manufacturing industry have not been promising. Earlier research in ESCWA found that technology has made no significant incremental contribution to economic growth over the past decade. Moreover, the share of imports of industrial equipment, such as tools and dye, has been steady and extremely small relative to total imports. Industrial development, particularly of the desired labour-intensive type, is yet to materialize and support economies of scale. This part of the chapter covers industrial and trade developments in the region in the light of constraints imposed by geo-political risk. It briefly describes the state of industrial development and level of trade integration. An attempt is made to sequence the order of priorities in trade and industrial policy options available to the member countries, specifically measures that promise the strongest growth and development stimuli.

1. *Overview of industrial development in the ESCWA region during the period 1991-2001*

(a) *Industrial development in more diversified and oil economies*

Most of the diversification in MDEs in the ESCWA region takes place in primary-sector (agriculture, fishing, forestry, mining, quarrying and fuel) and non-tradable goods, while manufacturing industries are underdeveloped. In the oil economies the primary sector is even more present than in MDEs, where it dominates, while the manufacturing sector is less so. In 2003, the GDP share of the primary sector in the biggest economies of that group, Egypt and the Syrian Arab Republic, accounted for 24.5 per cent and 45 per cent, respectively. The primary sector also dominates economic activity in Yemen (46.8 per cent), but plays a subordinate role in Jordan (5.5 per cent) and Lebanon (6.3 per cent). During the 1990s, agriculture's share of GDP shrank in many ESCWA member countries, especially the Syrian Arab Republic and Yemen, but both countries increased economic activity in mining, quarrying, and fuel. The manufacturing share of GDP varies considerably. In 2003, it accounted for 24.5 per cent in Egypt, 16.2 per cent in Jordan, 3.6 per cent in the Syrian Arab Republic, and 4.9 per cent in Yemen. A non-uniform structure also characterizes services. In 2003, Lebanon had the greatest finance, insurance, and banking sector, accounting for 22.6 per cent of GDP, followed by Bahrain where the sector accounted for 20 per cent.[39]

In 2003, primary sector activities accounted for 26.2 per cent in Bahrain, 47.4 per cent in Kuwait, 44.3 per cent in Oman and 60.5 per cent in Qatar, 43.1 per cent in Saudi Arabia and 35.3 per cent in the United Arab Emirates. During the 1990s, all oil economies, except for Bahrain and Qatar, increased their GDP share of manufacturing. The strongest structural shift occurred in Oman, from 4.2 per cent in 1993 to 8.25 per cent in 2003. Oil economies also tend to have smaller GDP shares of services, especially finance and insurance, which accounted for less than 10 per cent of GDP in Gulf countries in 2001.[40]

(b) *Structure of industrial development in selected ESCWA member countries (Egypt, Jordan, and the Syrian Arab Republic)*

In 1992, Egypt, Jordan, and the Syrian Arab Republic exhibited similar industrial production profiles, in which chemicals had on average the highest share of industrial production, followed by food and textiles.

[39] *National Accounts Studies of the ESCWA Region*, Bulletin No. 24 (E/ESCWA/SCU/2004/5).

[40] Ibid.

In 2002, chemicals accounted on average for 22.6 per cent of GDP, food for 26.1 per cent, and textiles for 13.2 per cent.[41]

During the 1990s, the structure of industrial development became diversified in Egypt, Jordan and the Syrian Arab Republic, at least when measured by sums of the variances across the individual industries for 1992 and 2002. The most dynamic sector during the 1990s was the food industry, which grew in all three economies. Between 1992 and 2002, the food industry in Egypt and Jordan grew by 35.7 per cent and 62.4 per cent, respectively. Strong growth in all three economies occurred also in metal products, including machinery and equipment. Egypt experienced the fastest growth, increasing the relative weight of this sector from 17.5 per cent in 1992 to 21.5 per cent in 2002. The data further suggest that all three economies have exhausted their growth potential in chemical industries. Although this sector dominates the industrial profile, its share shrank notably in all three economies between 1992 and 2002. In fact, chemicals' share of industrial output still ranked first in 1992, but was replaced by food in 2002. Assessed on basis of today's data, Egypt has the greatest specialization advantages in metal-processing sectors, Jordan in food and the Syrian Arab Republic in textiles.

(c) *Technology and competitiveness of manufacturing in the ESCWA region*

The United Nations Industrial Development Organization (UNIDO), in its annual Industrial Development Report, reports the share of medium and high tech (MHT) as a percentage of manufacturing value added (MVA) (see table 18). It also reports a so-called competitive industrial performance (CIP) index. CIP is a composite indicator that attempts to capture MVA per capita, manufactured exports per capita, industrialization intensity and export quality.

UNIDO research suggests a mixed picture with respect to the use of MHT in manufacturing. Among MDEs, Egypt uses the most: MHT accounted for more than 40 per cent of its MVA in 2000. MHT still accounts for 28.8 per cent in Jordan, but only 9.3 per cent in Lebanon, the Syrian Arab Republic and Yemen. Compared with that of other developing countries in Latin America, East Asia, the Middle East and North Africa, Egypt's MHT-share of MVA ranks above the 80th percentile; Jordan's, about the 66th; and that of Lebanon, the Syrian Arab Republic and Yemen, below the 10th percentile.

The MHT and CIP indexes are highly correlated. It is hardly surprising that Egypt and Jordan score the highest CIP values. However, although Jordan employs less MHT than Egypt, Jordan's CIP value of 0.253 in 2000 is slightly greater than Egypt's 0.238. In terms of percentiles again, Egypt and Jordan rank in the 71st and 76th, respectively, from a list of 90 countries analyzed by UNIDO.[42] Lebanon's 2000 CIP score of 0.182 places it in the 43rd percentile. Syria's value of 0.152 corresponds to the 33rd percentile. Yemen's value of 0.074 is the lowest, placing it below the fifth percentile.

The oil-economies show no uniform pattern either. In 2000, Saudi Arabia had an MHT-share of MVA of 65.3 per cent, placing it above the 98th percentile. The UNIDO estimate for Bahrain, Oman, and Qatar is 14.1 per cent, corresponding to the 38th percentile. Kuwait, with 7.5 per cent, has the lowest MHT-share, corresponding to the sixth percentile. Among the oil-economies, UNIDO identifies Bahrain as the country with the most competitive industrial sector in 2000, followed by Kuwait and Qatar. All ranked above the 70th percentile. Saudi Arabia's CIP score of 0.192 places the Kingdom slightly above the median (52.4). Oman, with 0.145, receives the lowest CIP value, ranking its industrial competitiveness at the 30th percentile.

[41] Industry data from UNIDO are available only for Egypt, Jordan and the Syrian Arab Republic.

[42] The comparison by rank is conducted with respect to the developing world only.

TABLE 18. MANUFACTURING VALUE ADDED (MVA) AS PERCENTAGE OF GDP AND SHARE OF MEDIUM AND HIGH TECH AS A PERCENTAGE OF MVA

		MVA as percentage of GDP	MHT as percentage of MVA	CIP
Egypt	1980	15.2	32.4	0.133
	1990	16.9	34	0.2
	2000	20.2	40.9	0.238
Jordan	1980	13.1	17	0.173
	1990	16.1	29.5	0.253
	2000	17.7	28.8	0.253
Lebanon	1980	15.2	10.5	..
	1990	13.1	10.5	..
	2000	8.1	9.3	0.182
Syrian Arab Republic	1980	12.4	10.5	0.11
	1990	20.4	10.5	0.213
	2000	29.4	9.3	0.152
Yemen	1980	8.8	10.5	0.179
	1990	9.6	10.5	0.066
	2000	8.6	9.3	0.074
Bahrain	1980	8.2	12.9	..
	1990	16.7	10	0.209
	2000	22.1	14.1	0.294
Kuwait	1980	6.3	16.2	0.224
	1990	11.6	6.4	0.166
	2000	20	7.5	0.258
Oman	1980	0.8	12.9	0.141
	1990	2.9	10	0.117
	2000	3.7	14.1	0.145
Qatar	1980	7.7	12.9	..
	1990	12.9	10	0.224
	2000	14.7	14.1	0.243
Saudi Arabia	1980	3.9	20.6	0.103
	1990	7.6	52.7	0.185
	2000	8.7	65.3	0.192
United Arab Emirates	1980	3.6	12.9	..
	1990	7.5	10	0.173
	2000	..	..	..

Source: UNIDO 2004.

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

(i) *Trade development*

The ESCWA region is characterized by low levels of trade among member countries, which recently accounted for 7-8 per cent of total trade on average. Trade with EU accounted for 13 per cent in the median year of 2001. Trade within the ESCWA region and extraregional trade with EU showed no significant trend in the 1990s, but the relative volume of trade with EU is variable because of the importance of oil which is volatile.

Individual ESCWA members differ substantially with respect to their reliance on intraregional trade. Among MDEs, Lebanon's exports to the region accounted for 44 per cent of its total exports in 2000. Those from Jordan and the Syrian Arab Republic accounted for 22 per cent and 13 per cent, respectively. Egypt and Yemen shipped only 7.7 per cent and 4.5 per cent of their exports to the region. With respect to MDE trade with EU, 40 per cent of Egypt's total exports in 2000 went to Europe. Only 18 percent of Lebanon's exports were to EU, while the Syrian Arab Republic shipped 56.8 per cent of its exports there. EU plays a minor role as a trade partner for Jordan and Yemen, which shipped less than 5 per cent of their total exports there in 2000.

Another distinct pattern is that most MDEs conduct most of their intraregional trade with the oil-economies. Egypt shipped 63 per cent of its intraregional exports to the Gulf in 2000. Jordan and Lebanon's export share to the oil economies that year accounted for 80 per cent and 73 per cent, respectively. Yemen's share was 96 per cent. Only the Syrian Arab Republic relied slightly more on MDEs, shipping only 48 per cent of its exports to the oil economies.

Because of the dominance of oil, the oil-economies' share of intraregional exports is on average much lower than that of MDEs. In 2000 all oil-economies shipped less than 10 per cent of their exports to the ESCWA region. That year, no MDE member of ESCWA was among the ten most important export partners of any oil-economy, whereas an oil-economy was very likely to be one of the ten most export partners of any MDE.

The oil-economies trade mainly among themselves. In 2000, all oil-economies shipped more than 60 per cent of their intraregional exports to other oil-economies. In the case of Oman and Qatar, the intraregional export share to other oil-economies accounted for even more than 90 per cent. Still more than 80 per cent of intraregional exports from Bahrain and the United Arab Emirates remained in the Gulf region. Figures for Kuwait and Saudi Arabia were 63 and 74 per cent, respectively.

(ii) *Trade and development in the ESCWA region*

A substantial portion of exports is conducted in primary products. Data from the International Trade Centre (ITC) indicate that primary products and natural-resource-intensive manufacturing accounted for the majority of exports in Lebanon (56.9 per cent), the Syrian Arab Republic (91 per cent) and Yemen (99.7 per cent). Egypt's share was 48.6 per cent, and Jordan's, 28.1 per cent, was the lowest. With respect to embedded technological and human development exports, ITC estimated that 64.4 per cent of Jordan's manufacturing exports for 1999 were technological and human-capital-intensive. Shares for Egypt and Lebanon were 18.4 and 35.1 per cent, respectively. Most of Egypt's manufacturing exports were labour-intensive, accounting for 33 per cent of total manufacturing exports. The Syrian Arab Republic and Yemen, with 2.3 and 0.3 per cent, had the lowest shares of technological and human-capital-intensive manufacturing exports.

The reliance on primary products and natural-resources-intensive manufacturing is of course even stronger in the Gulf economies. In 1999 this share exceeded 75 per cent in all oil economies except for Bahrain (62.2 per cent). In Kuwait and Qatar, shares were even above 90 per cent. Saudi Arabia's share was 88.9 per cent. Among the oil economies, Bahrain, with 19.5 per cent, has the highest share of technological and human-capital-intensive manufacturing exports, followed by Oman (13.5 per cent), Saudi Arabia (10.6 per cent) and the United Arab Emirates (14.9 per cent). Technological and human-capital-intensive manufacturing exports account for less than 10 per cent in Kuwait and Qatar.

Although technology-intensive production is on average low in the ESCWA region, according to ITC data for the second half of the 1990s, its share has been generally growing, though from a very low base. The only two exceptions are Iraq and the Syrian Arab Republic. ITC data for the same period further suggest, however, that human-capital-intensive manufacturing is often shrinking, namely in Egypt, Iraq, Kuwait, Lebanon, Qatar and Yemen.

TABLE 19. STRUCTURE OF MANUFACTURE EXPORTS AT CURRENT PRICES
(In millions of US dollars, FOB)

		Primary products	Natural resources international manufacturing	Labour-Intensive manufacturing	Tech.-intensive manufacturing	Human-capital-intensive manufacturing
Egypt	Value (1999)	956	195	781	261	174
	Growth (1995-1999)	(12)	(6)	(1)	13	(4)
	Share in exports	40.4	8.2	33	11	7.4
Jordan	Value (1999)	117	11	34	253	40
	Growth (1995-1999)	2	(4)	(4)	2	14
	Share in exports	25.7	2.4	7.5	55.6	8.8
Lebanon	Value (1999)	97	175	38	70	98
	Growth (1995-1999)	(7)	23	2	3	(2)
	Share in exports	20.3	36.6	7.9	14.6	20.5
Syrian Arab Republic	Value (1999)	2 478	29	186	19	43
	Growth (1995-1999)	(4)	43	10	(11)	59
	Share in exports	89.9	1.1	6.8	0.7	1.6
Yemen	Value (1999)	1 772.8	3.6	0.4	3.6	1
	Growth (1995-1999)	(1)	36	(16)	..	(10)
	Share in exports	99.5	0.2	0	0.2	0.1

Source: UNCTAD; WTO, ITC, 1999.

Note: Parentheses ( ) indicate a negative figure.
Two dots (..) indicate that data are not available.

Primary sector economic activities dominate the ESCWA region. Diversification and specialization are most visible in non-tradable goods (finance, insurance and tourism). The manufacturing and industrial base is often small and not MHT-intensive although, on average, manufacturing tends to be slightly more MHT-intensive in the oil-economies.

On the surface it may appear that industrial development has progressed only very slowly during the 1990s, with increasing value added shares of manufacturing, increased specialization and more diversified GDP structures. Yet these figures lump together developments in the oil and manufacturing sectors, giving rise to serious doubts about this assessment. What can be said with certainty, however, is that the dominance of the primary sector still leaves the ESCWA region with a big untapped industrial development agenda.

(d) *Development policy under risk*

The general impact of geo-political constraints

Geo-political country risk represents one of the most severe obstacles to sustainable economic development in the ESCWA region. It discourages the accumulation of human and physical capital, which in turn prevents positive socio-economic spillover effects, such as industrial modernization, trade specialization, tax base enlargement, job creation and labour market flexibility. It may even trigger a vicious cycle: risks constrain economic policy, which undermines economic activity, which in turn feeds back into geo-political risk.

Previous research in ESCWA developed various starting points for economic policy to accelerate development and growth in the region. Impromptu economic reform may counsel removing all tariff and non-tariff barriers to trade (especially red tape), liberalizing prices and exchange rates and deregulating and minimizing the State. In view of the risks, however, the region may be less in need of the invisible hand of the market than the visible hand of the developmental state, which must finance and/or effectively regulate necessary and substantial parts of the public and institutional infrastructure. The developmental state must oversee demand stabilization programmes; provide investment guarantees, education, health care and employment programmes; and stimulate private sector development. For that to be realized, a long-term developmental vision is needed, which marries economic, social and institutional paths for progress, as well as effective, growth-promoting macroeconomic policies and widespread social development programmes. Concrete analyses of socio-economic conditions, as well as consultations with the public, are also required for building a broad national consensus on those future development policies and programmes.

Yet these measures will not work economic miracles when policy-makers operate under constraints imposed by external risk and, more to the point, the institutions that regulate economic development are themselves, in part, a product of the hazardous political environment. Social conflict, unresolved refugee problems, trade embargos and the potential for war undermine the development of institutions mandated with regulating the pace of development in a supposedly conflict-of-interest-free atmosphere. The ESCWA region does not meet many of the solid institutional requirements that drive growth and development. The issue of public- versus private-sector-based development should be gauged with a view to its impact on an already deep income inequality through redistributive schemes. Growth alone without jobs and better income will not suffice. There is therefore legitimate reason to conclude that, in order for the ESCWA region to catch up with more developed ones, major institutional reforms, principally the political empowerment of the individual, need to be addressed. In addition, state institutions will require a further shift into areas of social design, including a strategy for economic and social development that emphasizes greater recourse to industrial development with job creation, which bridges regional developmental differentials. Without that, domestic socio-political risk will continue to overshadow and undermine economic progress. State institutions will need to refurbish their expertise and be accountable to elected bodies in order to ensure transparency in decision-making.

(e) *Growth potential of ESCWA member countries*

Various think tanks increasingly attempt to measure country risk, and the spectrum of what different organizations associate with country risk is typically broad. Indicators range from concepts of socio-economic freedom, market attractiveness, competitiveness, human rights, corruption levels, and the regulatory quality of economic policy.[43] A widely used standard for country risk is the International Country Risk Guide (ICRG) index, which is a composite of political, economic, and financial risk. Earlier research in ESCWA has shown that sizeable losses are associated with political risks.[44] MDEs constantly receive less favourable political ratings than the oil-economies. However, it should be noted that the risks to the ESCWA region involve open conflict and a strong "neighbourhood effect" that affect the course of development by causing undue fragility and greater downside risks.

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[43] See www.countryrisk.com for brief information, about and links to, various think tanks dedicated to the assessment of country risk.

[44] See *Analysis of performance and assessment of growth and productivity in the ESCWA region*, Issue 1, 2003 (E/ESCWA/EAD/2003/3). See also IMF, *Outlook 2003*.

Estimates of the effects of geo-political risk with respect to GDP per capita growth and selected industrial and trade-development related indicators are provided.[45] It was estimated that when the ICRG index is set to ninety (low risk), growth shoots up to about 7 per cent. These are rough measures that are based on the composite index and, therefore, the figures are only indicative of the substantive weight of risk and not accurate measures of elasticity.

The figures in table 20 clearly suggest that all countries would benefit substantially from "very low" geo-political risk. The statistical stability premium, derived from a cross-sectional perspective, corresponds to roughly three percentage points above GDP per capita growth. The simple simulation further suggests that gross fixed capital formation and gross domestic savings could increase by 4.0 and 3.6 percentage points, respectively. The increase of MVA is estimated to be on average 1.7 percentage points; the increase of the dollar value of MVA per capita, $445, of which roughly one third has the potential to be exports. It is also suggested that the use of MHT in manufacturing could increase by almost 20 percentage points; the share of MHT embedded in manufacturing exports, by 14 percentage points. Total foreign trade share and exports of manufactured goods as a percentage of merchandise exports are estimated to increase by 24 and 22 percentage points, respectively. All these are possible benefits of a low risk environment.

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[45] The regressions are: Gross fixed capital formation (GCF), gross domestic savings (GDS), manufacturing value added as a percentage of GDP (MVA), MVA per capita (MVACAP), MHT as a share of MVA (MHT IN MVA), foreign trade share (FTS), share of manufactured goods of total merchandise exports (MANUEXP), value of manufactured goods exported per capita (MANUEXPCAP), share of MHT of manufactures exports (MHT IN MANUEXP), and competitive industrial performance Index (CIP).

In a first step, each of the above dependent variables (DV) was estimated using a pooled regression containing for each country annual observations between 1990 and 2002:

$$DV = \beta_0 + \beta_1 \cdot ICRG + \beta_2 \cdot LNYCAP + \beta_3 \cdot IA + \beta_4 \cdot GULF + \varepsilon$$

where

ICRG = Average value of International Country Risk Indicator between 1990 and 2002

LNYCAP = Average value of natural logarithm of per capita income between 1990 and 2002

IA= Multiplicative Interaction term between ICRG and LNYCAP

GULF= Dummy for Oil-Economy

The regression equations were estimated over all developing countries in East Asia and the Pacific, Latin America and the Caribbean, Middle East and North Africa using Huber's method for robust regression in order to better control for outliers. Huber's constant was set equal to 1.345.

The regression equations were then used to predict the development potential assuming that the ICRG-index had been constantly equal to ninety (corresponding to the midpoint of the "very low risk" range). The development potential was simply calculated as

$$DV = \beta_0 + \beta_1 \cdot 90 + \beta_2 \cdot LNYCAP + \beta_3 \cdot IA + \beta_4 \cdot GULF + \varepsilon$$

$$- \underline{DV = \beta_0 + \beta_1 \cdot ICRG + \beta_2 \cdot LNYCAP \cdot (1 + 0.0691) + \beta_3 \cdot IA + \beta_4 \cdot GULF + \varepsilon}$$

= *Potential*

TABLE 20. AN ESTIMATION OF THE OPPORTUNITY-COST OF HIGH GEO-POLITICAL RISK IN THE ESCWA REGION (1990-2002)

Potential	GDP per capita growth (%)	Gross fixed capital formation[a/]	Gross domestic savings[a/]	(MVA)[b/]	Incremental MVA per capita ($)	Potential share of MHT in MVA	Potential increment in foreign trade share	Value of MANUEXP[a/]	Incremental MANUEXP per capita ($)	Potential percentage point incremental share of MHT in MANUEXP
Bahrain	2.4	4.2	4.3	2.5	438.1	20.3	16.5	25.8	152.8	9.6
Egypt	3.2	2.6	1.7	0.1	342.9	12.7	30.9	9.9	107.8	18.3
Iraq	..	..	..	..	..	..	..	..	..	..
Jordan	3	3	2.4	0.7	367.3	14.4	27.5	13.9	119.5	16.3
Kuwait	2.4	4.6	4.7	2.8	468.5	22	16.2	28.4	164.3	9.3
Lebanon	4.7	5.1	3.7	1.1	599	25.2	41.9	22.4	193.2	24.3
Oman	2	3.3	3.3	1.8	344.5	15.3	14.9	19.7	119.7	8.8
Qatar	..	..	..	..	..	..	..	..	..	..
Saudi Arabia	2.4	4.1	4	2.2	425.8	19.5	17.7	24.1	147.3	10.3
Syrian Arab Republic	3.5	8.2	8.8	5.8	800.2	39.4	18	54	286.7	10.1
United Arab Emirates	2.1	1.8	1.3	0.2	229	8.5	19.7	7.4	73	11.7
West Bank and Gaza	..	..	..	..	..	..	..	..	..	..
Yemen	4	3.4	2.1	0	439.8	16.9	38.7	12.3	137.4	22.7
Average[c/]	3	4	3.6	1.7	445.5	19.4	24.2	21.8	150.2	14.1

Source: ESCWA calculations.

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

a/ Indicates percentage point increases to average rates of gross fixed capital formation, gross domestic savings and percentage value of manufactured-goods exports to total merchandise exports, respectively.

b/ Indicate percentage point increase to the percentage share of MVA.

c/ Indicate unweighted.

Growth potential of ESCWA member countries given trade development and industrial capacity

Table 21 shows the results of four simple empirical models that were specifically designed to test the impact of risk on industrialization and trade. Model (1) explains growth with regional dummies, the natural log of per capita income (LNYCAP), and the ICRG-index. Model (2) adds to Model (1) the manufacturing value added share (MANU) whereas Model (3) adds to Model (1) the foreign trade share (FTS). Both variables add significantly to Model (1), but the coefficient for FTS carries a negative sign whereas MANU carries a positive sign. MANU is also more robust than FTS, which is no longer significant in Model (4) when both MANU and FTS are added to Model (1).

TABLE 21. REGRESSION RESULTS TO DETERMINE WHETHER TRADE DEVELOPMENT OR INDUSTRIAL CAPACITY-BUILDING SHOULD BE PRIORITIZED

GDP per capita growth rate	Model (1)	Model (2)	Model (3)	Model (4)
Intercept	(3.26) (2.86)*	(3.18) (2.44)*	(3.92) (3.37)*	(3.64) (2.76)*
ESCWA	(1.46) (2.44)*	(1.45) (2.0)*	(1.19) (1.93)**	(1.37) (1.88)**
East Asia and Pacific	0.25 (0.5)	(0.03) (0.06)	0.64 (1.18)	0.16 (0.26)
Latin America and the Caribbean	(1.28) (3.23)*	(1.1) (2.47)*	(1.39) (3.5)*	(1.15) (2.6)*
GDP per capita	(0.08) (0.58)	(0.42) (2.36)*	0.1 (0.78)	(0.35) (1.91)**
ICRG	0.09 (6.13)*	0.12 7.25*	0.1 6.58*	0.12 7.07*
Value added of manufacturing		0.09 3.32*		0.09 2.91*
Foreign trade share			(0.01) (2.34)*	0 (1.19)
R2	0.14	0.18	0.14	0.17
N	499	436	489	433

Source: ESCWA computations based on regression results.

Note: Parentheses ( ) indicate a negative number.
(*) indicates significant at 5 per cent.
(**) indicate significant at 10 per cent.

2. *Policy options and concluding remarks*

Which policy should be prioritized in circumstances of geopolitical risk: trade development or industrial capacity-building? Statistical evidence suggests that industrial capacity-building should be of greater political concern than trade development, which is a conclusion well in line with the classic infant industry argument. Many economists increasingly contend that the presumed spillover effects associated with export-led growth are overrated.[46] What matters most for economic growth is still just investment in productive resources, of which openness is only one among many means. Of course, the ESCWA region would benefit from global integration and more trade competition in the long run, but these are not necessarily compatible with the need for short-term social stability. Exports should represent a means for development, not the end.[47]

This brings to light that industrial capacity-building must be a greater priority in the ESCWA region than global trade development. An overly hasty openness strategy may come at high short-term social costs that the region is unable to internalize. The problem may be described as fewer exports than imports. A substantial amount of factor labour in the region is bound up in the primary sector, which except for fuel can barely compete on world markets. Aggressive trade liberalization may lay off more labour in the primary

[46] Dani Rodrik, *The New Global Economy and Developing Countries: Making Openness Work*, No. 24 (Washington D.C., Johns Hopkins University Press for the Overseas Development Council, 1999), p. 33.

[47] Ibid., p. 32.

sector than the manufacturing sector can absorb. In view of increasing labour-force growth, if the pattern is repeated in other sectors, unemployment may intensify in the absence of a solid safety net.

Accordingly, labour mobility from the primary sector to the secondary and tertiary sectors must be supported by public investment in social security, education, physical and institutional infrastructure. Given the tight fiscal constraints in many places, however, global trade integration may be too lofty an ideal. However, deeper regional integration, especially beyond trade integration, is urgently needed. ESCWA member countries do not suffer from too much interregional trade, but from too little: it accounts for only 7 per cent of total trade. The evolution of industrial capacity clusters and networks must be developed through greater policy cooperation among member countries, especially through the harmonization of simple and transparent administrative procedures and regulations, as well as greater commitment to joint infrastructure projects in order to support the diffusion of positive externalities.

Because the region is highly fractionalized, both politically and economically, it is perceived not as a regional market but rather as a cluster of insulated economies. Geo-political risk and media coverage endorse this picture daily, and it is therefore particularly important for the region to reinvent itself, creating a new supranational identity that helps to promote it. It needs a "regionalization of national economies" package, the components of which should be: (a) the harmonization of administrative procedures and regulations, including special incentives such as investment guarantees; (b) the establishment of supranational authorities, similar to the European Commission, in which national identities can grow; and (c) a common and more effective marketing strategy for the region. Policies similar to the Chinese special economic zones, which not only mobilized productive resources but also helped to promote China politically, would also help the ESCWA region. A similar principle applies to increasing the region's industrial capacity. Small entities may have benefited in autarchic conditions, but in a regional context, where cooperation in production is inhibited by relatively higher costs and weak infrastructure, it is necessary to be big, state-supported and competitive, and to present one economic region with regional, rather than national, business opportunities. However, such policy reforms will take place only if the region receives greater international support through economic and political cooperation.

For the most part, the region requires a greater industrial division of labour, especially among MDEs. Recently, the Gulf economies increased investment activity in MDEs, especially in Lebanon, in particular in the non-tradable sectors of real estate development and tourism. While such intraregional activities may have the potential to serve as a role model for future intra- and interregional cooperation, especially if economic policy is supported with complementary public investments, i.e. in infrastructure, they are clearly not enough to stimulate the wider region. One also must take into account that the increased investment interest is less the result of an improved investment climate than the outcome of the deterioration of business opportunities elsewhere after the terrorist attacks of 11 September 2001. Furthermore, such investment may have been stimulated by the perception of greater stability in Lebanon until 2004.

III. SOCIAL DEVELOPMENTS IN THE ESCWA REGION

A. INTRODUCTION

In the social sphere, the region is still caught in a tangled web of poverty, unemployment, and violent conflict. Each reinforces the other and interacts with other negative parameters at work: weak and ageing social protection systems; non-participatory modes of governance; segmentation; modest growth; and a shock-therapy approach to economic reform. The result is a serious aggravation of social vulnerability across a wide range of social strata.

Unfortunately, there are no positive signs that the resulting risks, uncertainties and deprivations are on the wane; nor are there indications that the peoples of the ESCWA region are noticeably more able to mitigate (to protect and defend against) these factors or cope with the negative consequences.

Policy- and decision-makers in the region must acknowledge synergies between incomes, poverty reduction, social development and economic growth. It is true that economic growth may promote poverty reduction and social development. It is equally true, however, that growth processes which are tainted by deplorable social conditions, widespread poverty and glaring inequalities are liable to culminate, not in sustained growth, but in social turmoil, conflict and, perhaps, social and political disintegration.

When Iraq's unemployment figures were reviewed, warnings were expressed that "the underlying demographic dynamics reveal a ticking time bomb. Poverty, unemployment and the deterioration in social conditions can foster violence and prove fertile ground for dissension and insurgency".[48] Such warnings may also apply to countries with lower unemployment rates if poverty and unemployment are not adequately addressed.

B. DEMOGRAPHIC FRAMEWORK OF SOCIAL DEVELOPMENT IN THE ESCWA REGION

1. *Key features of the existing demographic base/framework*

Populations of the 13 member countries of ESCWA reached 191.7 million in 2005, but the demographic field is dominated by the populations of five countries: Egypt, Iraq, Saudi Arabia, the Syrian Arab Republic and Yemen (see tables 22 and 23). The populations of Egypt, Iraq and Saudi Arabia, together with those of the Syrian Arab Republic and Yemen, add up to 167.4 million, or 87.3 per cent of the total population of the region. The population of the remaining 8 countries is spread over what is left of the region's demographic field, ranging between Bahrain's at the lower limit to Jordan's at the top. The ratio of these two demographic boundaries to the smallest population of the first group is 3.8 per cent for Bahrain and 29.9 per cent for Jordan. This intraregional demographic distribution highlights the fact that the regions' path of social development and well-being, as a whole, will be greatly affected and coloured by how well the concerns of the populations of the first five countries referred to above are addressed, with respect to social, economic and political/governance.

The population of the region is still relatively young, a fact which poses serious challenges for all key stakeholders: policy-makers, decision-makers and the working population (see box 2). The population below 15 years of age forms 36.7 per cent of total. The age group 15-24 constitutes 20.4 per cent of the entire population, and 32.3 per cent of the 15-years-of-age-and-above category. The two age groups, below 15 and 15-24 years of age, in themselves, make up 57.1 per cent of the total population.

[48] Nasser Saidi, "Labour and employment in reconstruction and development: Iraq in transition, liberalization and reform", paper presented at the ILO International Employment Conference: Jobs for the Future of Iraq (Amman, December 2004), p. 4.

TABLE 22. MID-YEAR ESTIMATES OF POPULATIONS BY BROAD AGE GROUP IN ESCWA MEMBER COUNTRIES FOR 2005
(*In thousands*)

				Age group			
Country	Total	%	Rank	0-14	15-24	25-64	65+
Bahrain	727	0.38	13	198	109	398	22
Egypt	74 033	38.6	1	24 838	15 441	30 209	3 544
Iraq	28 808	15.0	2	11 810	5 808	10 384	805
Jordan	5 703	3.0	6	2 119	1 139	2 260	183
Kuwait	2 687	1.4	10	653	415	1 571	48
Lebanon	3 577	1.9	9	1 025	657	1 632	263
Oman	2 567	1.3	11	886	538	1 078	66
Palestine	3 702	1.9	8	1 684	721	1 184	114
Qatar	812	0.42	12	177	112	514	10
Saudi Arabia	24 573	12.8	3	9 161	4 547	10 147	717
Syrian Arab Republic	19 044	9.9	5	7 020	4 370	7 057	598
United Arab Emirates	4 496	2.3	7	989	783	2 677	48
Yemen	20 975	10.9	4	9 722	4 497	6 275	480
Total	191 704	100.00		70 282	39 137	75 386	6 898

Source: ESCWA, *Social Statistics Data Set 2005*, based on *World Population Prospects, 2004 Revision*.

The age groups 25-64 and 65-plus are the largest and smallest age groups, respectively. The former group comprises 75.39 million persons, constituting 39.3 per cent of the region's population, while the latter group, with 6.9 million, forms only 3.6 per cent.

Table 23 shows the wide intraregional variations, which naturally affect the mix and priorities of social policies of individual member countries. For example, Qatar has the lowest share of persons below 15 years of age; Yemen, the highest. Lebanon has the highest share of persons above 65 years of age; the United Arab Emirates, the lowest.

The demographic structures of GCC countries, with the exception of Oman and Saudi Arabia, have peculiarities of their own. These countries are distinguished from others in the region by a noticeably high proportion of persons in the age group 25-64. One can safely attribute this to the large presence of migrant workers, who are currently estimated at 63 per cent of the total population in Kuwait, 74 per cent in Qatar and 79 per cent in the United Arab Emirates.[49] A significant number of migrant workers in these and other ESCWA member countries come from outside the region, making it a net importer of labour despite the prevalence of high unemployment rates in some countries.

TABLE 23. PERCENTAGE DISTRIBUTION OF POPULATIONS AT MID-YEAR BY BROAD AGE GROUP IN ESCWA MEMBER COUNTRIES FOR 2005
(*In thousands*)

	Age groups					
Countries	0-14	15-24	25-64	65+	15+	(15-24)/(15+)
Bahrain	27.2	15.0	54.7	3.0	72.8	20.6
Egypt	33.5	20.9	40.8	4.8	66.5	31.4
Iraq	41.0	20.2	36.0	2.8	59.0	34.2
Jordan	37.2	20.0	39.6	3.2	62.8	31.8
Kuwait	24.3	15.4	58.5	1.8	75.7	20.3

[49] Data based on an internal memorandum by the Social Policy Team, ESCWA, "Analysis of social vulnerability and its main causes in the region" (Beirut 2005), p. 3.

TABLE 23 (*continued*)

Countries	Age groups					
	0-14	15-24	25-64	65+	15+	(15-24)/(15+)
Lebanon	28.7	18.4	45.6	7.4	71.3	25.8
Oman	34.5	21.0	42.0	2.6	65.5	32.1
Palestine	45.5	19.5	32.0	3.1	54.5	35.8
Qatar	21.8	13.8	63.3	1.2	78.2	17.6
Saudi Arabia	37.3	18.5	41.3	2.9	62.7	29.5
Syrian Arab Republic	36.9	22.9	37.1	3.1	63.1	36.3
United Arab Emirates	22.0	17.4	59.5	1.1	78.0	22.3
Yemen	46.4	21.4	29.9	2.3	53.6	39.9
Total	36.7	20.4	39.3	3.6	63.3	32.3

Source: ESCWA, *Social Statistics Data Set 2005*, based on *World Population Prospects, the 2004 Revision.*

Box 2. Salient social and economic functions of the different age cohorts

The age group below 15 years of age is the youngest segment of the non-working population. It is, by definition, the most vulnerable and is almost totally dependent on others for its well-being. It embraces the under-5's and forms the bulk of the region's child population. This group and the age cohort 15-17 represent the region's future adult population. Consequently, the well being of that population depends considerably on how well the rights to life, survival, development, protection and participation of this age group are respected.

It has become conventional in employment surveys to consider the whole age group of 15 years of age and above as the working-age population. This group provides the region with the bulk of its workforce. The working members of the group are supposed to finance their own consumption needs, as well as those of its non-working members, the aged and those below 15 years of age. The active participation of this group in productive work and in social and political life is a key determinant of the welfare of the entire population.

The age group 15-24 is especially significant in the region's development because it hosts: (a) most of the school-age population above the primary level; (b) a significant share of the new entrants to the labour force; and (c) the vast majority of would-be labour-market entrants with university degrees.

The age cohort 25-64 provides the region with the bulk of its working age population. The welfare of the region depends much on the active participation of this age cohort in economic activity, and its productivity.

The age group 60+ contains the bulk of the aged, and hence an important segment of the region's vulnerable population. Ongoing demographic changes in the region have caused an increase in the share of this age cohort in total population. The structure of demand will change as a result of this development. This change must be well reflected in the structure of public expenditure on social services. Indeed, societies of the region have a solemn obligation to ensure respectable lives for their aged, as development and modernization weaken extended family bonds and commitments in favour of the nuclear family.

2. *The shape of the future*

Demographic developments in the ESCWA region broadly resemble those of MENA and the Arab region. The analysis of demographic trends confirms that population growth rates in MENA and Arab countries have passed their upper limits and are now on a downward trajectory.[50] This downturn has significant implications for social and economic developments in the region. The demographic structure will gradually shift in favour of adults of working age (ages 15-64), steadily pushing up their respective shares in the region's populations. Regional labour markets, like those in MENA, "will have to cope with a rising tide of first-time job seekers, on top of those already unemployed and seeking work".[51] ESCWA member countries will therefore have to design appropriate policies to absorb heavy pressure for employment by the young in the labour force on the one hand, and the potential increase in demand for goods and services favoured by them on the other.[52]

Violent conflict is also exerting its toll on the region's demographics. Violent shocks associated with the current armed confrontations in Iraq and Palestine are creating new demographic and, consequently, social realities. The first, most obvious outcome is the increase in mortality rates among all age groups. A survey conducted in 2003 in Iraq estimated the risk of death to be 2.5 times higher after the invasion compared with the pre-invasion period. When the survey excluded the deaths in the city of Falluja, which accounted for two thirds of all violent deaths, the risk of death was 1.5 times higher after the invasion.[53] An increase in the number of orphans and households headed by single persons, especially females, is a natural outcome of this rise in mortality rates. In addition, the concomitant intrarregional population displacements have definitely introduced sudden and unexpected changes in the demographic structures of both host and home countries. Demographically, host countries are facing sudden expansions in their working-age populations and, consequently, an unexpected surge in demand for employment opportunities and housing, while home countries experience a depletion in their stocks of young, skilled and qualified labour forces.

C. POVERTY CONDITIONS IN THE ESCWA REGION

1. *On definitions of poverty*

Over the years, the conceptualization of poverty has shown remarkable progress, reflecting to a large extent the advances in economic discourse. Initially, it focused distinctly on command rather than on market purchased goods, especially on nutritional elements. It then evolved over the years to define itself in terms of deprivation of rights and of failure to have the opportunities to achieve conditions of well-being.[54]

Three definitions, which are currently much in use, reflect changes over time in the way poverty is viewed. Traditionally, poverty was defined as "the inability to attain a minimal standard of living",[55] the standard of living being measured in terms of consumption needs or the income required to satisfy them. Later, the perspective shifted, and poverty was defined in terms of basic needs, as the "deprivation of material requirements for minimally acceptable fulfilment of human needs, including not only food, but covering also the need for basic health and education and essential services that have to be provided by the

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[50] See Tarik M Yousef, "Macroeconomic aspects of new demography and employment in the Middle East", paper presented to the Annual Bank Conference on Development Economics-Europe, Paris 2004, p. 4. See also *Unlocking the Employment Potential in the Middle East and North Africa, Toward a New Social Contract* (World Bank, Washington D.C., 2004), p. 4, and ESCWA, *Population and Development: The Demographic Profile of the Arab Countries*, pp. 1-4.

[51] Yousef, loc. cit., p. 4.

[52] Housing for young married couples and related infrastructure and goods, loom high in this latent demand.

[53] See Les Roberts and others, "Mortality before and after the 2003 invasion of Iraq: cluster sample survey", *Lancet*, vol. 364, p. 1857.

[54] For a succinct review of the evolution of the poverty concept see Ravi Kanbur and Lyn Squire, "The Evolution of Thinking About Poverty", *Frontiers of Development Economics*, Gerald M. Meier and Joseph E. Stiglitz, eds. (New York, Oxford University Press, 2000) pp. 183-226.

[55] World Bank, *World Development Report 1990*, (New York, Oxford University Press 1990) p. 26.

community to prevent people from falling into poverty".[56] According to the third definition, "poverty must be seen as deprivation of basic capabilities", capabilities being the "substantive freedoms he or she enjoys to lead the kind of life he or she has reason to value".[57]

This change, over time, in focus from input to outcome reflects the acknowledgment that poverty is multidimensional in character. Our improved understanding of poverty and our recognition of its multidimensionality have produced two significant results: firstly, an expansion of the scope of strategies and the set of policy instruments employed to combat poverty and reduce the hardships burdening the poor; and secondly, the wide acknowledgement that these strategies and policies are synergistic, in the sense that the outcome of policy interventions adds up to more than the mere sum of individual components' effects.

2. *Measures of Poverty*[58]

Measures of poverty can be put into three categories: (a) money metric measures; (b) non-money metric measures; and (c) composite measures.[59]

(a) *Money-metric measures of poverty*

Money-metric (or economic) measures of poverty depend upon a conceptualization of poverty as a deficiency in income or consumption, i.e. as failure to possess the income or consumption power to ensure the satisfaction of current basic needs or the attainment of a minimum standard of living. An income or consumption cut-off point, usually referred to as the poverty line, is a threshold below which a given household or individual is classified as poor.

Money-metric measures of poverty raise several problems. Concepts of a minimum standard of living or basic necessities are cultural and vary as time progresses. They therefore do not allow for proper comparisons between societies or within the same society either at a fixed time or over longer periods. Additionally, such measures are limited to the input and ignore the outcome. They totally neglect the issue of vulnerability and risk and fail to capture the non-pecuniary deprivations of poverty, such as social exclusion, bad governance, crime and insecurity.

Two types of poverty line are used to measure income poverty: the national poverty line, which measures poverty at the country level and assesses changes in it over time,[60] and the international poverty

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[56] UNDP, *Human Development Report 1997* (New York, Oxford University Press, 1997), p. 15.

[57] Amartya Sen, *Development as Freedom*, (Oxford, United Kingdom, Oxford University Press, 2001), p. 87.

[58] Extensive reviews of poverty measures can be found in: Andrew Sumner, "Economic well-being and non-economic well-being: a review of the meaning and measurement of poverty", research paper, World Institute for Development Economics Research, United Nations University, Helsinki; Julian May, "An elusive consensus: definitions, measurement and analysis of poverty", *Choices for The Poor*, ed. Alejandro Grinspun (New York, UNDP 2001), pp 23-54; Aline Coudouel, Jesko S. Hentschel, and Quentin T. Wodon, "Poverty Measurement and Analysis", *A Sourcebook for Poverty Reduction Strategies*, ed. Jeni Klugman (New York, World Bank, 2002), pp. 29-45.

[59] May, loc. cit., pp. 32-41.

[60] Three commonly used methods for estimating the poverty line are: (1) direct caloric intake method: considers as poor any household not meeting the nutritional requirement of 2,122 kilocalories per day per person; (2) food energy intake: to find the value of per capita consumption at which a household can be expected to fulfil its caloric requirement; the poverty line is defined by the level of per capita consumption at which people can be expected to meet the requirement; it provides a monetary rather than purely nutritional concept of poverty; (3) cost of basic needs method the poverty line is defined as the value of consumption needed to satisfy minimum subsistence needs. These steps are followed in its calculation: the first step defines a bundle of food items meeting a given nutritional requirement; the second step consists of estimating the cost of the food bundle; and the third step focuses on estimating a reasonable allowance for non-food consumption, once the food component of the poverty line has been estimated. For more information on methods of measuring national poverty lines, see Coudouel, Hentschel, and Wodon, op. cit., pp. 408-409; and UNDP, *Human Development Report 1990*, Oxford University Press, New York 1990, pp. 13-15.

line, which is used for international/cross-country comparisons.[61] The national poverty line tries to capture the living conditions of the poor and takes basic minimum needs of food as its base. In so far as they are embedded in the consumption habits of the people, country-specific poverty lines are more appropriate than international poverty lines and better reflect the situation of the poor in the country concerned.

Two international poverty lines are commonly used: a lower one of $1 dollar a day per capita for low income countries and an upper one of $2 a day per capita consumption for lower-middle-income countries both measured in constant purchasing power parity (PPP) prices of 1985 or 1993.[62]

It has become standard practice to calculate the poverty line based on consumption rather than income, in an attempt to solve the problems associated with incorrect reporting of the latter in cases such as over-declaration of income from self-employment, where revenue is reported rather than profit; seasonal variation of income; and underreporting to minimize tax payments. Whether national poverty lines are calculated on the basis of income or consumption, they do not capture intra-household distribution of income or expenditure, nor do they take into account differences in household composition and size. Consumption of own production and freely provided goods and services need to be included, and adjustments are needed for gifts, donations, transfers and subsidized goods.

Both national and international poverty lines assume a standardized consumption basket for all households in spite of their composition and size. The international poverty line presupposes uniform price levels in all countries for the goods in the basket, and the national poverty line makes a similar assumption for all regions of the country concerned. This leads to an overestimation of poverty in countries, or regions within a country, where prices for the goods in the basket are low; and to an underestimation of poverty where prices of such goods are high.

(b) *Non-money metric measures*

Non-money-metric measures focus on outcome rather than input, measuring poverty in terms of non-economic aspects of well being such as health, education, environment, empowerment and participation. Mortality rates, enrolment rates, access to improved water and participation in general elections are all examples of such indicators. A single indicator is used if it can summarize well a host of failures or achievements on many fronts. Mortality rates, for example, may reflect quality and accessibility of health services, standards of living, gender education, and nutritional status. However, a number of objections have been raised to these indicators. Firstly, many fail properly to reflect the outcome they purport to measure: school enrolment rates, by themselves, do not provide an indication of attendance, quality of teaching or actual learning achievements. Secondly, any single indicator overlooks important dimensions of poverty, e.g., enrolment rates do not capture participation in civil and political life, access to water facilities, and gender education. Thirdly, some indicators are beset by problems of definition; and most, if not all, are hampered by inadequate information management systems. While some non-money-metric indicators are useful in international comparisons, most are not suitable for measuring and analysing poverty within a country. Finally, for many indicators, there is no general consensus as to the cut off point below which a household or a person is considered poor.

(c) *The composite measure*

The composite measure aims to capture failures in function and opportunities through combining in one index a number of indicators, some of which can be money-metric. In this way the multidimensional and interactive nature of poverty is explicitly admitted in poverty measurement. The composite index allows

[61] World Bank, *World Development Report 2000/2001* (New York, Oxford University Press, New York 2000), p. 17.

[62] Ibid.

countries and development agencies to devise the indices that best meet their purposes, or the ones which they feel are capable of more aptly portraying the living conditions or binding human deprivations of societies and communities under investigation.[63] The United Nations Development Programme (UNDP) Human Development Index (HDI) and Human Poverty Index (HPI) are currently the most widely used composite indicators.[64] Both measure the average achievements or deprivations in a country through using the same dimensions, i.e., longevity, knowledge, and decent standard of living, but differ in choice of indicators representing these dimensions.

HDI divides countries into three human development (HD) categories: high, medium and low. Longevity is measured by life expectancy at birth; educational attainment by adult literacy and combined primary, secondary and tertiary enrolment; and standard of living by GDP per capita (in PPP$). With HPI, longevity is represented by the percentage of people expected to die before the age of 40; knowledge by adult literacy; and standard of living, by a composite of three variables: the percentage of people with access to health services, the percentage of people with access to safe water, and the percentage of malnourished children under five.

Composite measures are subject to the limitations of non-money metric measures described in the subsection 2(b), above. In addition, as a combination of several indicators, they face the problem of subjectivity and arbitrariness through the choice of weights used to combine the various components in one index. With composite measures one can rank countries and regions or districts within a country; however, they do not allow the isolation of the poor from the non-poor.

3. *Poverty in the ESCWA region*

(a) *Income measures of poverty*

Income poverty measures highlight the fact that poverty is still a serious challenge for both policy- and decision-makers. Household surveys reveal clear signs of widespread poverty: the proportion of the population living below the poverty line was given as 16.7 per cent in Egypt from 1999 to 2000 and 11.7 per cent in Jordan in 1997 survey.[65] In Yemen, a 1998 survey showed that 17.6 per cent of its population lived below the food poverty line, and 41.8 per cent were below the consumption poverty line, i.e. unable to meet their food and non-food requirements.[66] In Iraq, a World Food Programme (WFP) survey conducted in 2003 revealed that 54 per cent of households in 16 out of Iraq's 18 Governorates were poor and 11 per cent were extremely poor (below the poverty line).[67] The Palestine Poverty Report of 1998 estimated that almost a quarter (23 per cent) of households fell below the poverty line with 14 per cent in deep poverty.[68] One researcher stressed that poverty rates in Palestine have doubled since the onset of the intifada in 2000.[69]

The international poverty line confirms widespread poverty in Egypt and Yemen but paints a much less dismal picture for Jordan than its own national poverty line.[70] 43.9 per cent of Egypt's population and

[63] May, loc. cit., pp. 38-41.

[64] *Human Development Report 1997*, op. cit., pp. 15-20.

[65] World Bank, *World Development Report 2005* (New York, Oxford University Press, 2005), pp. 258-259.

[66] Republic of Yemen, *Poverty Reduction Strategy Paper 2003-2005* (Yemen, 2002), p. 32.

[67] *Baseline Food Security Analysis in Iraq*, WFP Iraq Country Office, Amman 2004, p. 32.

[68] Alf Morten Jerve, "Lebanon and Palestine", *Choices for The Poor*, op. cit., p. 311.

[69] E/ESCWA/SDD/2003/25 (in Arabic), p. 36.

[70] World Bank, *World Development Report 2005*, op. cit., pp. 258-259.

45.2 per cent of Yemen's were under the $2 day-poverty line in 2000 and 1998, respectively, while only 7.4 per cent of Jordan's population lived under that line in 1998. When a $1 dollar a day poverty line is used, figures fall to 3.1 per cent for Egypt, 15.7 per cent for Yemen and less than 2 per cent for Jordan. Accordingly, it is believed that the standard international poverty line of less than $1 a day underestimates the spread of poverty in the ESCWA region.

(b) *Non-money-metric measures: health and education indicators*

Different non-money metric indicators transmit inconsistent signals with respect to poverty and deprivation in ESCWA member countries: Table 24 shows that, generally speaking, the populations adequately enjoy the right to survival. Life expectancy at birth is higher than the world average in all countries except for Yemen; under-five-mortality rates are considerably lower in all countries, and infant mortality rates are lower in most.

TABLE 24. SURVIVAL INDICATORS IN ESCWA MEMBER COUNTRIES[a/]

HDI rank	Country / Year	Life expectancy at birth (years) 2000-2005	Infant mortality rate (per 1,000 live births) 2002	Under-five mortality rate (per 1,000 live births) 2002	Maternal mortality rate, ratio adjusted (per 100,000 live births) 2000
40	Bahrain	74	13	16	28
120	Egypt	68.8	35	41	84
	Iraq[b/, c/]	68.6	102	125	250
90	Jordan	70.9	27	33	41
44	Kuwait	76.6	9	10	5
80	Lebanon	73.5	28	32	150
74	Oman	72.4	11	13	87
102	Palestine	72.3	23	25	100
47	Qatar	72.2	11	16	7
77	Saudi Arabia	72.1	23	28	23
106	Syrian Arab Republic	71.9	23	28	160
49	United Arab Emirates	74.7	8	9	54
149	Yemen	60	79	107	570
	High human development	77.5	9	11	
	Medium human development	67.3	45	61	
	Low human development	49.1	104	164	
	Developing countries	64.6	61	89	
	World	66.9	56	146	

a/ *Source*: United Nations Development Programme (UNDP), *Human Development Report 2004* (Oxford University Press, 2004, New York), pp. 168-171.

b/ UNICEF, *The State of the World's Children 2005* (United Nations publication, Sales No. 05.XX.1), pp. 107 and 132.

c/ Figures for Iraq's first three indicators are for 2003.

Education indicators highlight the fact that the region is still far from being knowledge rich. Literacy rates in 2003 were at 62.1 per cent for adults, defined as 15 years and above, and 75 per cent for youth defined by the age group 15-24 years.[71] Table 25 shows the wide disparities in performance between

[71] ESCWA, *Statistical Abstract of the ESCWA Region*, 23rd issue, E/ESCWA/SDD/2003/29, pp. 43-46.

countries. Adult literacy rates in only five countries are higher than the average for medium HD countries, and Egypt and Yemen fall below the world average. However, youth literacy is in a better state than adult literacy. It is worth noting that the data on net enrolment in primary education indicate that large segments of the eligible population in five countries are outside the schooling system and face a high probability of remaining deprived of the right to education throughout their entire lives.

TABLE 25. EDUCATION INDICATORS IN ESCWA MEMBER COUNTRIES

HDI rank	Country / Year	Adult literacy rate (%) ages 15 and above 2002	Youth literacy rate (15-24) 2002	Net primary enrolment ratio (%) 2001/02
40	Bahrain	88.5	98.6	91
120	Egypt	55.6	73.2	90
	Iraq			
90	Jordan	90.9	99.4	91
44	Kuwait	82.9	93.1	85
80	Lebanon			90
74	Oman	74.4	98.5	75
102	Palestine	..	..	95
47	Qatar	84.2	94.8	94
77	Saudi Arabia	77.9	93.5	59
106	Syrian Arab Republic	82.9	95.2	98
49	United Arab Emirates	77.3	91.4	81
149	Yemen	49	67.9	67
	High human development	..	..	..
	Medium human development	80.4	93	..
	Low human development	54.3	69.3	..
	Developing Countries	76.7	88.1	..
	World	63.6	..	..

Source: UNDP, *Human Development Report 2004*, op. cit., pp. 176-179. (*ESCWA figures for adult and youth literacy rates for 2003 differ slightly from those in the table; HDR figures used to facilitate international comparison.*)

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

(c) *Composite indicators*

Multidimensional measures of poverty support the conviction that poverty alleviation and deprivation reduction must be given a central place. Review of three of these measures – HPI, HDI and the Arab Human Development Index (AHDI) – does not lead to encouraging conclusions about the state of poverty or level of social achievements in the region (see table 26). HPI for developing countries published in the 2004 HDR ranges from a minimum value of 2.5 per cent to a maximum of 65.5 per cent, ranking Barbados and Burkina Faso at 1 and 95, respectively.[72]

The table also shows the ranking of ESCWA member countries for which AHDI was calculated and provides further insight into their socio-economic performance. When their GDP per capita is compared to their HDIs, all high achievers, plus Saudi Arabia and Egypt, come out with a negative result. This signifies that the social results of development, as measured by non-money metric indicators of well being, are not

[72] UNDP, *Human Development Report 2004*, Oxford University Press, New York 2004, pp. 147-149.

commensurate with the level of the money-metric measures of development. Saudi Arabia shows the largest negative difference, while Lebanon and Palestine have the largest positive differences.

TABLE 26. HUMAN POVERTY INDEX (HPI) AND HUMAN DEVELOPMENT INDEX (HDI) FOR ESCWA MEMBER COUNTRIES

Country	HPI value (%)	HPI rank	HDI value	HDI rank	GDP per capita (PPP $) rank minus HDI rank	Category of HDI
Bahrain			0.843	40	(4)	High
Egypt	30.9	47	0.653	120	(12)	Medium
Iraq						
Jordan	7.2	7	0.75	90	14	Medium
Kuwait			0.838	44	(6)	High
Lebanon	9.5	14	0.758	80	21	Medium
Oman	31.5	50	0.770	74	(32)	Medium
Palestine			0.726	102	21	Medium
Qatar			0.833	47	(21)	High
Saudi Arabia	15.8	30	0.768	77	(33)	Medium
Syrian Arab Republic	13.7	25	0.71	106	4	Medium
United Arab Emirates			0.824	49	(26)	High
Yemen	40.3	67	0.482	149	16	Low

Source: UNDP, *Human Development Report 2004*, op. cit., pp. 139-142 and 147-149.

Note: Parentheses ( ) indicate a negative figure.
Two dots (..) indicate that data are not available.

The Arab Human Development Report 2002 expressed dissatisfaction with HDI as a measure of human development and supported the opinion that it not only fails to "capture the rich content of the HD concept" but has also "reduced it to nothing more than human resources development".[73] It then proposed another measure to cover what it identified as the three key deficits in the Arab region: the freedom deficit; the women's empowerment deficit; and the human capabilities/knowledge deficit relative to income. In contrast to HDI, the new Arab Human Development Index (AHDI) is composed of the following six indicators: life expectancy at birth; educational attainment; freedom score; gender empowerment measure; internet hosts per capita; and carbon dioxide emissions per capita. This index was used to rank 111 countries starting with 1 for the country with the highest AHDI rating. Table 27 shows the differences between the two indexes On moving from HDI to AHDI, the position of ESCWA member countries, with the exception of Jordan, deteriorated, albeit with varying extent.

TABLE 27. ARAB HUMAN DEVELOPMENT INDEX (AHDI)

Country	HDI ranking 1998	AHDI ranking
Bahrain	..	..
Egypt	75	92
Iraq	80	110
Jordan	60	68
Kuwait	29	70

[73] UNDP/Regional Bureau of Arab States, *Arab Human Development Report 2002* (United Nations publication, Sales No. 02.III.B.9), p. 21.

TABLE 27 (*continued*)

Country	HDI ranking 1998	AHDI ranking
Lebanon	54	73
Oman	..	..
Palestine	..	..
Qatar	..	..
Saudi Arabia	..	..
Syrian Arab Republic	70	103
United Arab Emirates	34	74
Yemen	..	..

Source: UNDP, *Arab Human Development Report 2002 2002* (United Nations publication, Sales No. 02.III.B.9), pp. 166-167.

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

4. *Characteristics of income poverty in some ESCWA member countries*

Meaningful and effective policies and strategies for poverty alleviation in any region or country need to be based on a good understanding of the poor. Unfortunately, poverty is not adequately monitored in ESCWA member countries, and one therefore cannot draw a meaningful profile of the region's poor. Nevertheless, a review of available country surveys for Iraq, Palestine and Yemen provide informative glimpses.

(a) *Profile of poverty in Iraq*

In 2003, the World Food Programme conducted a survey on food security in Iraq covering 16 out of 18 Governorates. Results for these 16 Governorates show that:[74]

(a) 11 per cent of all households are extremely poor, 43 per cent are poor, 44 per cent are middle and 2 per cent are better off. These figures indicate that 54 per cent of all households fall below the poverty line;

(b) Poverty is to a large extent a rural phenomenon with the rurally located heads of households constituting 55.8 per cent of the extremely poor heads of households, 48.6 per cent of the poor, 39.5 per cent of middle and 38.2 per cent of the better off. In rural areas, the extremely poor have limited assets, including land. Absence of a vibrant economy, limited employment opportunities and the virtual non-existence of a credit system or insurance services contribute to access problems resulting in relatively high levels of food insecurity;

(c) Regional disparities in the incidence of poverty are striking. Nineva has the highest rates of extreme poverty (23 per cent), almost twice the national average followed by Thi Qar (17 per cent) and Kerbala (16 per cent);

(d) Poverty in Iraq has a gender attribute. 28 per cent of all female-headed households are extremely poor, while this figure is reduced by more than one half (13.4 per cent) for male-headed households;

(e) Unemployment rates are generally high in Iraq, and the magnitude of the problem is greater in extremely poor households. About 50 per cent of the adults in extremely poor households (16-60 years old) are unemployed and of those 80 per cent are women;

[74] *Baseline Food Security Analysis in Iraq*, op. cit., pp. 27-33.

(f) Illiteracy is a major characteristic of the extremely poor and the poor. 40 per cent of adults in extremely poor households and 30 per cent of adults in poor households are illiterate;

(g) Poverty is strongly correlated to education. Households which have at best only primary education constitute 82.2 per cent of all extreme poor households, 72.8 per cent of all poor households, 62.1 per cent of middle-income households and 60.8 per cent of the better off;

(h) 36 per cent of all children, between one and five years of age, living in extremely poor households are chronically malnourished, while the national average for chronically malnourished children of this age group is 27.6 per cent.

(b) *Profile of poverty in Palestine*

The Palestine Poverty Report, published in 1998, estimated that almost a quarter, i.e. 23 per cent of the households, fell below the poverty line, with 14 per cent in 'deep poverty'. The most salient findings of the Poverty Report are:[75]

(a) Regional disparities are striking, with South Gaza exhibiting a poverty rate of 51 per cent, compared with a low 3 per cent in Jerusalem;

(b) The incidence of poverty is highest among refugees, especially in the Gaza strip; in the West Bank poverty is mainly a rural phenomenon;

(c) The incidence of poverty is higher among larger households, among households with less education and formal skills, as well as among those headed by women;

(d) Poverty among the working population is high, reflecting a problem of low wages and irregular employment, and not only unemployment as such;

(e) The low incidence of poverty is associated with employment in Israel, as well as with remittances to households from abroad.

(c) *Profile of poverty in Yemen*

According to the 1998 Survey of Poverty in Yemen:[76]

(a) 17.6 per cent of the Yemeni population live under the food poverty line, whereas 41.8 per cent are incapable of obtaining their food and non-food requirements (including clothing, shelter, health, education and transport);

(b) Poverty in Yemen has a rural attribute, despite the rapid growth of urbanization; Yemenis are, to a large extent, rural dwellers. The rural areas embrace about 83 per cent of the poor and 87 per cent of those who suffer from food poverty. The percentage of the rural population who are poor amounts to 45 per cent as compared to 30 per cent for the urban population;

(c) There is an obvious disparity between the different Governorates. Half of the poor are concentrated in 4 Governorates: Taiz, Ibb, Sana'a and Hudeidah. The highest poverty incidence rates are found in Taiz where 56 per cent of the Governorate's population is poor, followed by Ibb (55 per cent),

[75] Morten, loc. cit, p. 311.

[76] Republic of Yemen, *Poverty Reduction Strategy Paper 2003-2005*, op. cit., pp. 32-39.

Abyan (53 per cent) and then Lahj (52 per cent). The incidence of poverty is lowest in Al-Baidah where 15 per cent of the Governorate's population is poor;

(d) Poverty in Yemen is strongly linked to level of education. About 87 per cent of the poor are among the groups that suffer from illiteracy or incomplete primary education linked to lack of gainful employment opportunities. Poverty among families that have an illiterate head of household is high, at 47.3 per cent, followed by families with a head of household who reads and writes or has completed primary education (38.6 per cent). The rate drops to 22 per cent among the families with a provider who has obtained post secondary school education;

(e) About 84 per cent of the poor work in the private sector of which 47.3 per cent work in agriculture.

(d) *Key features of poverty distilled from profiles*

Based on the foregoing profiles and the similarities among ESCWA member countries, it is possible to deduce characteristics that are common to all:

(a) Poverty is to a large extent a rural phenomenon;

(b) Regional disparities in the incidence of poverty can be significant;

(c) Poverty has a gender attribute, with female-headed households generally poorer than male-headed households;

(d) Unemployment rates are disproportionately high among poor households;

(e) Poverty is directly linked to lack of gainful employment opportunities;

(f) Poverty is strongly correlated to education, with illiteracy rates among heads of extremely poor households being significantly higher than the national average.

D. Unemployment in the ESCWA region

1. *Definition of employment/unemployment*

Definitions

The standard ILO framework divides a population into four categories: employed, unemployed, economically active and working-age. The employed comprise all persons above a specific age who during a specified brief period of either a week or one day were in paid employment or self-employment.[77] Unemployment is defined as covering "all persons above a specified age who during the reference period were: without work, currently available for work, and seeking work".[78] The labour force, or economically active population, comprises "all those persons who during the specified reference period are classified either as employed or unemployed, i.e. who supply labour".[79] By default, the working-age population is classified as all persons above a specific age who are employed, unemployed, or outside the labour force, based on the respondent's activities during the so-called "reference period".

[77] International Labour Organization (ILO), *Yearbook of Labour Statistics 2003* (Geneva, ILO, 2003), p. 63.

[78] Ibid, p. 475.

[79] Ibid, p. 3.

Box 3. Note on definitions and measurement

The above indicators, though useful, need to be employed in analytical exercises with a proper understanding of their conceptual dimensions. Firstly, the definitions reveal that employment/unemployment rates are very sensitive to how "without work," "currently available for work," and "seeking work" are defined. Some employment surveys are satisfied with one hour of work during the defined reference period as evidence of being employed. Other surveys demand a minimum of two or more hours of work during the reference period, to regard a person as "with work", i.e. as employed. The reference period is normally taken as one week, but there are no definite and strict rules for this to be always the case. Secondly, limited recourse to employment bureaus or employment placement services, in many developing countries, render the concept of seeking work quite subjective coloured by the respondent's culture, values and state of mind. Thirdly, employment/unemployment rates have as framework the economically active population while the participation rate has the working age population as a base. Because of different denominators, the two rates are not necessarily in tandem and might yield inconsistent conclusions, or pictures of reality, if reviewed or analysed independently of each other. Fourthly, it is quite clear from the definition, that employment/unemployment rates, by themselves, do not provide a clue as to the adequacy of income earned or how well labour has been used. For that reason, it has become a widely recommended practice, especially in developing countries, to review the employment/unemployment rate in conjunction with an under-employment rate to account for cases where the employed work less than the normal working hours of the reference period, receive lower incomes in comparison with the level of work or effort exerted, or are in jobs mismatching their qualifications.

From the above definitions, two analytically useful indicators are derived: the employment/ unemployment rate and the rate of economically active population or what is also often called the labour force participation rate. The first is defined as the number of employed/unemployed persons divided by the number of economically active population. The second is taken to mean as the economically active population divided by the working age population.

2. *Unemployment, participation and labour force in ESCWA region*

(a) *Unemployment in ESCWA member countries*

Unfortunately, officially published data in ESCWA member countries are rather scanty, and the region has no strong tradition of regularly monitoring unemployment. Egypt and Jordan have been conducting annual surveys for about a decade. Iraq started to carry out unemployment surveys only in 2003. Whatever data are available for other countries of the region come from surveys conducted prior to 2003. Available information warns of high unemployment: rough estimates for 2003 put the overall regional unemployment rate at 16 per cent, and youth unemployment at anywhere between 25 and 30 per cent. These rates become more alarming when put within the context of the increasing role of young first-time job seekers entering the labour market (see table 28).

Unemployment rates differ widely, with the disaster zones, Iraq and Palestine, being the worst hit. Open unemployment in Iraq, excluding the Kurdish Autonomous Region (KAR), was 28.1 per cent in 2003 and 26.8 per cent for the first quarter of 2004, while in Palestine it was 28.6 per cent in 2004. Five other countries, Bahrain, Jordan, Kuwait, Qatar and Yemen, have also double-digit unemployment rates, albeit in all cases lower than 20 per cent (table 28). Needless to say, the persistence of such inordinately high unemployment rates arrests and even reverses skills development, erodes self-esteem, encourages socially deviant behaviour, exacerbates poverty, undermines political and economic stability and fuels social tensions. Indeed, as unemployment undermines the social fabric, its aggregate cost to society becomes much larger than the direct and immediate loss of income, the decline in output and the payment of unemployment benefits.

TABLE 28. UNEMPLOYMENT RATES IN ESCWA MEMBER COUNTRIES
(Percentages)

Country	Year	Unemployment rate
Bahrain[a/]	2001	16.4
Egypt	2003	9.9
Iraq[b/]	2003	28.1
Iraq[b/]	2004	26.8
Jordan[c/]	2003	14.5
Kuwait[a/]	2002	15.1
Lebanon	..	..
Oman	..	..
Palestine	2004	28.6*
Qatar[a/]	2001	12.6
Saudi Arabia[a/]	2002	5.2
Syrian Arab Republic[b/]	2003	6.3
United Arab Emirates[a/]	2000	2.3
Yemen	2004	10.6

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

(*) indicates that data are for the first quarter only.

a/ *Source:* ILO, http//laborsta.ilo.org.

b/ *Source* for Iraq data: Central Organisation for Statistics and Information Technology, *Results of the Employment and Unemployment Survey 2003*, Ministry of Planning and Development Cooperation Baghdad, May 2004, pp. 17-27.

c/ *Source* for Jordan data: Household Survey Directorate, *Employment and Unemployment Survey 2003 Annual Report*, Department of Statistics of the Hashemite Kingdom of Jordan, Amman 2004, p. 22.

d/ World Bank, *Yemen Economic Update*, World Bank, Winter 2003.

(b) *Participation and under-employment*

Two dimensions of the employment-unemployment nexus – low participation and high under-employment – aggravate the negative effects of unemployment on social conditions. Unfortunately, available information sources, with the exception of Iraq, provide data only for the second of the two indicators. Published information on ESCWA member countries reveals a low participation of the working-age population in economic activity, particularly among females (see table 29).

Low participation rates in the ESCWA region have three significant implications for policy-makers. In the first place, especially where the young are concerned, they result in high dependency ratios, meaning that the standard of living of an entire population is set by the earnings of only a small proportion of it. Secondly, a rise in the participation rate will create heavy pressure for job opportunities. Thirdly, a marked increase in participation rates is likely to be triggered by a structural rise in female participation rates; this will give rise to a labour force strongly coloured by the topography of its female part,[80] a fact that deserves special consideration in the design of employment and labour policies.

[80] This increase in female participation rates will also have a noticeable impact on the structure of demand and consumption.

TABLE 29. RATES OF THE ECONOMICALLY ACTIVE POPULATION IN ESCWA MEMBER COUNTRIES

		Activity rates of age group 15+ (%)		
Country[a/]	Year	Total	M	F
Bahrain	2001	47.4	64.6	24.1
Egypt	2001	44.9	68.6	20.2
Iraq[b/]	2003	44.1	73.7	14.1
Jordan[c/]	2003	37.4	63.2	11.2
Kuwait	..	..	..	..
Lebanon	..	..	..	..
Oman	2000	36	59.3	12.7
Palestine	2002	38.1	65.5	10.4
Qatar	..	..	..	..
Saudi Arabia	2001	..	..	..
Syrian Arab Republic	2002	31.9	48.9	14
United Arab Emirates	..	..	..	..
Yemen	..	..	..	..
Australia	2002	63.4	72	55.1
Germany	2002	57.1	65.8	48.9
Portugal	2002	61.8	70.3	54
United Kingdom	2002	37.2	45	30.5

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

a/ *Source* of data for all countries except Iraq: (Geneva, ILO, 2003), pp. 9-27.

b/ *Source* for Iraq data: *Results of the Employment and Unemployment Survey*, op. cit., pp. 17 and 27.

c/ Household Survey Directorate, *Employment and Unemployment Survey 2003 Annual Report*, Department of Statistics of the Hashemite Kingdom of Jordan, Amman, January 2004, pp. 19-23.

3. *Characteristics of unemployment in the ESCWA region*

Meagre information, both quantitative and qualitative, renders any attempt to draw a comprehensive and detailed topography of the region's unemployed a futile task. Nevertheless a review of the results of available country surveys for Jordan and Iraq provides useful insights as to the scope and magnitude of challenges faced by policy- and decision-makers of member countries in their endeavours to address the unemployment problem.

(a) *Profile of Jordan's unemployment*

Table 30 provides an overall picture of unemployment in Jordan in 2003. It should be noted that first-time job seekers are less than one third of the unemployed (27.3 per cent). Female first-time job seekers form 58.8 per cent of female unemployment, probably reflecting some gender bias or a sudden surge in female participation or both.[81] Unemployment in Jordan has a clear gender bias, which is quite marked in both rural and urban areas.[82]

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[81] Household Survey Directorate, *Employment and Unemployment Survey 2003 Annual Report*, Department of Statistics of the Hashemite Kingdom of Jordan, Amman, January 2004, p. 141.

[82] A high female unemployment rate coupled with a low female participation rate is tantamount to a low proportion of employment within the female working age population.

TABLE 30. PARTICIPATION, UNEMPLOYMENT AND EMPLOYMENT RATES IN JORDAN FOR 2003
(*Percentages*)

	Total	Urban	Rural
Labour force participation			
Total	37.4	38.1	35.1
Male	63.2	64.1	59.8
Female	11.2	11.7	9.6
Unemployment rate			
Total	14.5	13.5	18.3
Male	13.4	12.5	17
Female	20.8	19.5	26.9
Employed to working age population			
Total	32.0	33.0	28.7
Male	54.7	56.1	49.6
Female	8.9	9.4	7.0

Source: *Employment and Unemployment Survey 2003 Annual Report*, op. cit., pp. 19-23.

Youth constitutes the bulk of the unemployed with the bulge being distinctly high for females. The age group 20-24 makes up 41.2 per cent of the unemployed population; the age group 15-19, 17 per cent. Among the female unemployed population, the first age group accounts for 54.6 per cent of the total and the second 3.6 per cent; while these two rates for the male population are 37.6 per cent and 20.7 per cent respectively.[83] Unemployment rates decrease markedly as the population ages (see table 31).

Unemployment is concentrated among those with modest education. The unemployed with "less than secondary education" account for 56.2 per cent of total unemployment. Disaggregation of unemployment by sex reveals that the category of "less than secondary education" accounts for 67.6 per cent of total male unemployment; while for females unemployment is more prominent among the highly educated with the category of females with "bachelor and above" forming 44.9 percent of total female unemployment.[84]

TABLE 31. UNEMPLOYMENT RATES FOR JORDANIAN PERSONS 15+ BY AGE GROUP

Age group	Total	Male	Female
15-19	37	36.9	38.9
20-24	28.2	24.8	43.6
39-25	10.5	9.5	15.1
40-54	5.3	5.7	2.8
55-64	3.1	3.1	2.3
65+	1.6	1.7	0

Source: *Employment and Unemployment Survey 2003 Annual Report*, op. cit., p. 23.

The survey does not reveal significant regional variation in unemployment rates. Amman enjoys the minimum unemployment rate of 12 per cent. Mafraq has the highest unemployment rate (20 per cent), which is 66.7 per cent above the minimum.[85]

[83] Household Survey Directorate, op. cit., p. 141.

[84] Ibid., p. 139.

[85] Ibid., pp. 43-44.

(b) *Profile of Iraq's unemployment*

Available data indicate that unemployment and its ramifications pose a serious problem in Iraq. Table 31 shows the percentage of the economically active population of Iraq, excluding KAR, who were openly unemployed in 2003. Low participation is the reason for the seemingly low unemployment rates for females. The negative impact of high unemployment rates in Iraq, excluding the KAR, is aggravated by the existing low participation rates. Most of the unemployed are young: 21.3 per cent of them belong to the age group 15-19, and 27 per cent to the age group 20-24.[86]

TABLE 32. PARTICIPATION, UNEMPLOYMENT AND EMPLOYMENT RATES IN IRAQ FOR POPULATION 15+ FOR 2003

	Total	Urban	Rural
Labour force participation:			
Total	44.1	41	49.9
Male	73.7	71.3	78.6
Female	14.2	10.7	20.9
Unemployment rate			
Total	28.1	30	25.4
Male	30.2	31	28.9
Female	16	22.3	6.7
Employed to working age population			
Total	31.7	28.7	37.2
Male	51.4	49.2	55.9
Female	11.9	8.3	19.5

Source: Central Organisation for Statistics and Information Technology, *Results of The Employment and Unemployment Survey 2003*, Ministry of Planning and Development Cooperation, Baghdad, 2004, pp. 17 and 27.

Regional inequalities in unemployment rates are striking. The survey's results reflect wide variations by Governorate. At the aggregate level, the ratio of the maximum value to the minimum value of this indicator is 3.3, ranging from 46.2 per cent for Thi Qar to 14.0 per cent for Kerbala. For male unemployment rates, the range is 44.5 percentage points varying between 48.8 per cent for Thi Qar and 3.9 per cent for Misan. For females the unemployment rate has a maximum value of 26.5 percent in Baghdad and a minimum value of 4.4 per cent in Wasit yielding a range of 22.1 percentage points.[87]

Self-employment is the major occupation for heads of households in Iraq. The 2003 WFP survey revealed that 29.9 per cent of all households do not work, and out of the remaining households, 23.7 per cent of the working heads-of-household are self-employed in farming activities, and 22.1 per cent are self-employed in non-farming activities.[88]

Under-employment in Iraq exacerbates the negative impact of unemployment on the living conditions of Iraqi households, particularly their female members. Results of the 2003 Employment and Unemployment Survey reveal that the major types of under-employment in Iraq, excluding the three Kurdish Autonomous Governorates (KAG), are low working hours and low income, while under-employment caused by mismatch of occupational skills is of relatively little significance (see table 33). The survey points out

[86] Central Organisation for Statistics and Information Technology, *Results of The Employment and Unemployment Survey 2003*, Ministry of Planning and Development Cooperation, Baghdad, 2004, p. 38.

[87] Ibid., p. 17.

[88] *Baseline Food Security Analysis in Iraq*, op. cit., p. 64.

that rural areas suffer more than urban areas from low working hours and low income under-employment with rates of rural females coming out as the higher than rural averages for the two types.

TABLE 33. UNDER-EMPLOYMENT RATES IN IRAQ FOR 2003

	Total	Urban	Rural
Under-employment rate due to low working hours			
Total	23.5	15.7	36.3
Male	19.4	14	29.2
Female	40.2	26.4	62.5
Under-employment rate due to mismatch of occupational skills			
Total	5.6	7.3	2.8
Male	6.3	7.9	3.4
Female	2.8	4	0.4
Under-employment rate due to low income			
Total	21.2	13.3	32.8
Male	17.6	13.6	24.1
Female	29.2	13.6	53.4

Source: Central Organisation for Statistics and Information Technology, *Results of The Employment and Unemployment Survey 2003*, Ministry of Planning and Development Cooperation, Baghdad, 2004, pp. 21-25

(c) *Key features of unemployment distilled from profiles*

Based on the foregoing review and the similarities among ESCWA member countries, it is possible to deduce characteristics that are common to all:

(a) Youth constitute the bulk of the unemployed;

(b) Many of the unemployed are first-time job seekers without any work experience;

(c) The ratio of working females to females of working age is very low;

(d) Most of the unemployed do not have higher education qualifications;

(e) Regional disparities in unemployment rates exist and in some cases are quite flagrant;

(f) Self-employment is a major occupation in countries with alarming rates of unemployment;

(g) In some countries under-employment is as much of a concern as unemployment for policy-makers.

E. POLICIES FOR CONTAINING POVERTY AND ENHANCING SOCIAL DEVELOPMENT

When poverty is not restricted to income but is viewed broadly as the failure of the "capability" to be free from hunger or to live a healthy and active life, etc., two basic channels can be identified: the personal income channel and the social provisioning channel.[89]

[89] S.R. Osmani, "Exploring the employment nexus: topics in employment and poverty", Task Force on the Joint ILO-UNDP Programme on Employment and Poverty, 2003. (While suggesting channels for poverty-reduction, Osmani does not mention the redistribution parameter in the social provisioning channel.)

1. *The personal income channel*

The personal income channel is centred on two sets of policies: (a) employment-friendly, growth-generating policies; and (b) policies that match opportunities to employability.

Sustained improvements in the conditions of the region's poor must be underpinned by sustained output growth. This results from increases in job opportunities and/or gains in labour productivity. It provides the basis for a sustained increase in income of the poor and simultaneously ensures a revenue base for a sustained flow of finances for social provisions and development. Redistribution, while important, is liable to collapse or fall short of its commitments as a source of finance for social provisions and transfers of income to the poor, if growth falters and incomes keep dwindling.

Factors ranging from insecurity and violence to a premature shock-therapy-approach to economic reform led to the existing state of unemployment and poverty in the ESCWA region. Modest or inadequate growth is certainly a common denominator among most member countries experiencing high unemployment rates. Policies and strategies that put them once again on a rapid growth trajectory are necessary, though not sufficient, sustainably to reduce and eventually to eliminate poverty and unemployment. The answer is rapid growth associated with redistribution and, more significantly, with an adequate and sustained increase in work opportunities.

It is one thing to ensure that growth generates adequate employment opportunities, and another for the poor and the unemployed to be able to make proper use of them. Pro-poor employment generation policies for areas of high unemployment must guarantee that emerging work opportunities correspond to the capacity of the unemployed and the poor to access matching job opportunities locally.

(a) *Employment-friendly growth*

Growth must be labour-intensive to be employment-friendly. Most, if not all, ESCWA member countries are neither creators of knowledge nor designers of production techniques nor producers of machinery and equipment. For that they depend almost totally on the developed world, where production techniques match resources and skills. Countries of the region are thus restricted in their choice of techniques for many leading sectors and industries, in which production techniques of new investments must be capital- and knowledge/know-how-intensive. Therefore, countries have little choice when addressing the unemployment problem but to follow a two-track growth policy, namely a capital-intensive path and a labour-intensive one. The first path focuses on the growth of capital-intensive sectors, such as petrochemical and information technology industries. It employs capital- and know-how/knowledge-intensive techniques in its new investments, and such techniques require highly skilled and qualified professionals. The second path encourages output growth in labour-intensive sectors, such as agriculture and small-scale industry and businesses, and selects labour-intensive techniques for new investments, both of which open up employment opportunities primarily for unskilled and less-skilled labour.

(i) *Public works*

Direct job creation through public works programmes and infrastructure investments should be a key component of labour-intensive-path strategies to ease the plight of the poor. Such programmes are certainly very useful in labour-abundant countries, such as Egypt, Iraq and Yemen, and can be used to address poverty in locations suffering from high unemployment and under-employment. A wide spectrum of labour-intensive techniques for construction of infrastructure facilities has always existed, and countries can choose the techniques best suited to national resource and skills. Infrastructure projects that involve large construction works, like dams or housing schemes, are usually local-resource-intensive and can therefore exert significant multiplier effects on total employment. Local communities can be engaged in all stages, including management and operation, of small projects with short gestation periods such as well digging, which address transitory and seasonal poverty and unemployment. Communities can even be asked partially to finance the cost. The advantage of these programmes, whatever their size, lies not only in their employment-generation capacity but also in their contribution to the expansion of the asset base of the poor.

(ii) *Microenterprises and self-employment (improving the asset base of the poor and the unemployed)*

Technological advances and large scale production have not completely eliminated opportunities for small-scale production of some goods and services. Thus, there are always opportunities for the poor and the unemployed to employ themselves. Promotion of self-employment and microenterprises is increasingly regarded as an integral part of the strategy and policy package for reducing poverty and unemployment in developing countries. In highly populated ESCWA member countries, self-employment is an important income-generating activity for the poor (see section D, above). Increasingly, it is seen by educated youth as a second-best alternative to immigration. Given the region's small and segmented markets, there might be more room for microenterprises there than in other developing economies.

Appropriate policies, institutions and regulations are required to expand opportunities for productive and remunerative/rewarding self-employment. Accordingly some microenterprises should graduate from the informal sector and expand into well-sized modern enterprises. To that end, substantive changes are required to improve the asset base of current and would be entrepreneurs, including land redistribution, favourable rental/tenancy arrangements for the poor and access to education and training.[90] Central to the expansion of microenterprises is the presence of well governed and smooth functioning financial markets friendly to microentrepreneurs, which give preferential treatment to the young and innovative and where venture capital facilities form an integral part of the institutional structure.

(iii) *Youth employment*

Employment policies in the ESCWA region need to give youth employment top priority, addressing it through an integrated set of sustainable policies which first intervene at an early stage. Such policies should ensure that school leavers are equipped with fundamental skills that are recognized and valued by employers,[91] and include programmes that imbue youth with proper work habits and appropriate work discipline. They need also to incorporate special programmes for the employment of poor students during holidays and vacations to enable them to pursue their studies, and programmes to encourage youth employment by offering wage subsidies to employers. ESCWA member countries can benefit well from the experience of countries such as Australia and Germany in the implementation of apprenticeship programmes that combine paid work with training to provide the skills and nationally recognized qualifications needed for employment.[92] Policies should encourage, through proper incentives, the training of young new recruits by small businesses and the establishment of private group-training companies to cater for the training needs of small business that cannot train such recruits on their own.

[90] Rahman Azizur Khan, "Issues in employment and poverty", discussion paper (ILO 2001), p. 6.

[91] Ibid., p. 33.

[92] Harasty, Claire (ed.), "Successful Employment Market Policies in Europe and Asia and the Pacific", Employment Strategy Papers (Geneva, ILO 2004), p. 34.

(b) *Matching the structure of opportunities with the structure of "capabilities"*

The second challenge of employment strategy is to ensure a "correspondence" in time and space "between the structure of opportunities that are opened and the structure of capabilities possessed by the poor".[93]

Improving employability invites a host of interventions. Expansion of the asset or resource base of the poor is the umbrella under which all the different sets of interventions congregate. The World Development Report 2000/2001 identifies these assets as: (a) human assets (e.g., capacity for basic labour, good health and skills); (b) natural assets (e.g., land) (c) physical assets (e.g., physical capital and access to infrastructure); (d) financial assets (e.g., savings and access to credit); and (e) social assets (e.g., informal or formal social security and power).[94] Interpretation of the last element can be broadened to include the institutional set-up/assets.

Improving the human capital of the poor

Expansion of the stock of human capital is a basic prerequisite for a sustained increase in productivity and, hence, personal income. Despite the advances made in that regard in the ESCWA region more is needed in terms of policies to improve the employability of its unemployed population. Such policies must aim to improve the quality of formal education, eradicate illiteracy and develop skills.

The need to upgrade education systems and institutions has already been well covered in former ESCWA surveys and Arab Human Development Reports. Illiteracy in member countries is a problem, although to a lesser degree than in many other developing countries. However, the illiterate form the largest group among the unemployed and the poor. Therefore, the importance of literacy and training in improving the productivity and occupational mobility of the labour force, especially the poorer segments of it, needs to be further emphasized. Basic literacy and numeracy skills are vital in order better to access and process information. Appropriate training would effectively reduce the mismatch between skills and job opportunities in the short term. Given the high unemployment among the region's youth, the special needs of the illiterate members of this age cohort should be given special focus in the design of an informal schooling system and its curricula.

Stagnation and/or modest growth in recent years in a number of ESCWA member countries has reduced the focus on training. Social policies for the region should act to redress this trend and give training the same prominence as academic and formal education. Policy should aim to promote the expansion of opportunities for all types of training: e.g. vocational education, on-the-job-training, self-learning and short- and long-term training. Incentives, such as tax-cuts, subsidies and grants, must be offered both to service providers and to trainees, and training programmes should be designed to match local demand and skills.

(c) *Improving physical/geographic accessibility of job opportunities*

Mobility of labour

Cross-border labour movement has contributed much in ameliorating unemployment and poverty problems, both directly through the provision of employment opportunities and indirectly through money transfers to home countries. Improving the mobility of labour requires supportive institutional and physical infrastructure. In the first place, rules and regulations that restrict intraregional and intranational labour movement need to be relaxed, including visa regulations, work and residence permits and labour laws, social

[93] S. R. Osmani, "Exploring the Employment Nexus: Topics in Employment and Poverty," op. cit., p. 15.

[94] World Bank, *World Development Report 2000/2001*, op. cit., p. 34.

security schemes and wage legislation. A supportive institutional infrastructure also assumes the existence of viable, dynamically responsive employment services, including both labour placement and market information systems, to match job seekers with notified vacancies at minimum waiting periods and search costs. Such information makes placement systems function more efficiently.[95] A national information system can be operated through a multi-tiered network, at the national, Governorate and municipal, and district and neighbourhood level.

Ideally job opportunities should be made available where job seekers are. Development of a good transport infrastructure that allows workers to commute easily to the workplace must go hand in hand with the expansion of work opportunities and their overall spread within the countries of the region. Nevertheless, accepting a job might demand migration, which causes dislocation costs for the worker and his family. In deciding to take a job, the person weighs benefits against costs. Grants, subsidies or credit can be employed to cover financial costs of migration. It must also be emphasized that the existing housing deficit in some countries of the region might become an even more serious deterrent to mobility than it is now, as well as a potential source of wage inflation. In this connection, public housing schemes as well as mortgage systems should be encouraged in order to meet housing needs.

2. *The social provisioning channel*

The social provisioning channel is mainly concerned with social protection. Social protection is traditionally defined as public measures to provide income security for individuals. Current definitions link it more explicitly to risk, vulnerability and poverty. The circles of the World Bank present it as a set of public interventions that assist individuals, households and communities better to manage risk and provide support to the critically poor.[96]

Whatever the definition, social protection must be presented as a springboard to help the poor out of poverty. It must be viewed as an investment in human-capital formation rather than as a government or business cost with negligible returns, as well as a means to strengthen and not erode the asset base of the poor. It must be acknowledged as important in reducing social segmentation, enhancing national integration and accelerating nation building. Finally it must enable the marginalized and deprived better to handle risk and to reduce vulnerability.

Poverty and increased vulnerability among large segments of society mean that social protection must be thrust again onto regional and national agendas. Existing public protection systems have almost stagnated, and market based protection systems can be enjoyed, without public subsidies, only by a privileged wealthy minority. Meanwhile frequent and persistent collective shocks, (violent conflicts, military confrontations, civil unrest) and widespread poverty are pushing up demand for greater social protection. Given the poor performance of public systems, dependence on traditional informal social protection systems and loyalty to traditional social formations are increasing.[97] This consolidates social segmentation and slows the pace of social integration and nation building. In some ESCWA member countries, traditional informal social formations have reached their limits in providing protection for its vulnerable. The disintegration of such systems in the absence of a viable replacement can give rise to worse forms of social havoc.

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[95] Harasty, op. cit., p. 38.

[96] Robert Holazman and Steen Jorgenson, "Social risk management: a new conceptual framework for social protection and beyond", *Social Protection Discussion Papers Series* (The World Bank, 2000), p. 3.

[97] Traditional informal protection systems and traditional social formations include the extended family, the tribe, the sect and the ethnic group.

More resources, used more efficiently and effectively, are required to expand the scope of social protection. There are several ways to generate the required resources other an increase in public debt. In the short run, proportionately more funds could be reallocated to social protection interventions from various areas of the public budget, e.g., defence and debt servicing. In the long run, growth would increase the resources available for social protection programmes and obviate any recourse to restructuring. With or without growth, redistributive measures (e.g. progressive taxation or reduction of tax exemptions) increase the ratio of public spending to GDP and thus devote more resources to social protection programmes, without widening the gap between public expenditures and revenues.

If policy-makers in ESCWA member countries are to design protection programmes to deal with the realities of high unemployment, the emerging informal employment sector, and the poverty and vulnerability described throughout this *Survey*, they must consider measures such as labour market interventions (workers protection and programmes and incentives that promote employment), contribution-financed social insurance programmes (pensions, unemployment insurance, family benefits and sick pay), publicly funded expenditure programmes (transfers in cash or kind, subsidies and free basic social services). It must be emphasized at this point that the revitalization of redistribution through taxation or voluntary transfers will increasingly be an imperative of an expanded social protection scheme.

(a) *Labour market interventions*

Labour market interventions are rules and regulations that aim to protect workers. They basically focus on rights at work and cover a wide range of standards and principles, including safety at work, minimum wages, the right to collective bargaining, harmful and exploitative child labour, and regulations against various forms of discrimination.

Although ESCWA member countries share common tendencies, they differ in legislation governing workers' protection, including its scope and its enforcement.[98] There is increasing evidence that some of these rules are imperfectly enforced in the private sector and in labour-importing countries with respect to jobs filled by low-paid expatriate workers. Countries need to revisit their labour laws and regulations to assess congruence with labour standards set in international conventions and identify the changes that need to be introduced in legislation, regulations and enforcement mechanisms and institutions so as to ensure effectiveness and comprehensive coverage.

(b) *Contribution-financed social insurance programmes*

In most ESCWA member countries, only government and public sector employees are totally covered by pensions or other insurance programmes. Most private sector workers do not enjoy any form of social insurance, and those engaged in the informal sector – i.e. the majority of the employed – lack either employment contracts or social security coverage, or both. The informal sector in ESCWA member countries includes people in establishments of less than 10 employees, casual labourers, self-employed workers (including small farmers), farm labour and the majority of migrant/expatriate workers. There is also increasing evidence that even some large firms in the region are hiring informally, without contracts or social insurance, thus adding to the growing informalization of labour markets in the region.[99] Severance pay and unemployment insurance are absent not only from the informal sector but also from the protection systems of large establishments in many ESCWA member countries.

Given the above, the progressive informalization of the labour market must be reversed through legislative measures, and existing social insurance programmes must be upgraded. The programmes should

[98] *Unlocking the Employment Potential in the Middle East and North Africa* ..., op. cit., pp. 137-141.

[99] Ibid., pp. 106-111

aim to cover large segments of informal labour without any form of discrimination as to sector, gender or nationality. Programmes for severance pay and unemployment insurance must be introduced in member countries, and pensions and other types of insurance benefits must be reviewed regularly to ensure their relevance to standards of living and real purchasing power. Enforcement of such programmes will require adequate institutions and funding schemes. ESCWA member countries should initiate a number of detailed studies to determine costs, priorities, feasible coverage and modalities of implementation of those funding schemes.

(c) *Publicly funded expenditure programmes*

These programmes comprise publicly funded social protection schemes requiring no contributions whatsoever from beneficiaries. They fall into three basic categories: public works, safety nets and basic social services.

Public works programmes improve the incomes of the poor and vulnerable through direct creation of work opportunities (see 1 (a) (i), above).

Safety nets are basically transfers of income, or substitutes for income, that redistribute resources to the needy in society and help households to manage risk. They usually take up the slack where households cannot participate in social insurance schemes or when benefits from those are exhausted. They include cash transfers, food-related programmes, prices and other subsidies, and fee waivers for health, education and other services, and social funds.[100]

Basic social services include basic education, primary health care and nutrition and safe water and sanitation.[101] Policy- and decision-makers in the ESCWA region must keep in mind the synergies associated with such services to ensure the proper planning thereof. An example of such a synergy is the effect of greater access to education on the life cycles of women. Studies have shown that educated women are likely to marry later in life, to space out their pregnancies, to have fewer children and to provide physical care for them. Studies have also shown that children of educated mothers are better nourished, better educated and have a longer life expectancy at birth than children of uneducated mothers.[102]

Free basic services for all should be regarded as a key building block for human and social development in ESCWA region. Universal access to basic social services provides a good start in life and is a key to breaking the intergenerational cycle of poverty. Investment in basic social services is investment in children. Children deprived of proper health, adequate nutrition, basic education, parental care and social protection suffer lifelong damage to their physical, emotional, psychosocial and intellectual capacities. They grow into adults with poor productivity, impaired earning ability, modest psychosocial integrability, higher morbidity and shorter life expectancy. These adults will, in all probability, bequeath to their offspring the same deprivations that they suffered from as children. Poverty reduction must start with children. Policy- and decision-makers need to realize that: "Child development is a succession of events for which there is seldom a second chance. Biological and intellectual growth cannot wait until a family escapes from poverty".[103]

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[100] www1.worldbank.org/sp/safetynets/.

[101] For more details see UNICEF, *Implementing the 20/20 Initiative* (New York, UNICEF, 1998), pp. 18-19.

[102] UNICEF, *Poverty and Children* (New York, UNICEF, 2001), p. 14.

[103] UNICEF, *Poverty Reduction Begins with Children* (New York, UNICEF, 2000), p. 2.

IV. SUSTAINABLE MANAGEMENT OF NATURAL RESOURCES AND ENVIRONMENT

A. INTRODUCTION

In 1992, the United Nations Conference on Environment and Development (UNCED), integrated environment and development concerns into the concept of sustainable development (SD), which targets the fulfillment of basic needs, improved living standards for all, better protected and managed ecosystems and a safer, more prosperous future. Consequently SD integrates the three development pillars – social, economical and environmental – as interdependent and mutually reinforcing.

The programme of action endorsed by the UNCED "Agenda 21" focused on the importance of sustainable management of natural resources and environmental issues as essential for most SD objectives and processes.[104] In 2002, the World Summit on Sustainable Development endorsed the objectives of the Johannesburg Plan of Implementation (JPOI).[105] These objectives are directly linked to the Millennium Development Goals,[106] particularly Goal 1: "Eradicate extreme poverty and hunger" and Goal 7: "Ensure environmental sustainability".

SD in the ESCWA region comes up against various natural resource crisis conditions, particularly with regard to water, land and energy resources. The main obstacles to achieving SD of water resources include chronic scarcity, deteriorating quality, unsustainable use, low awareness levels of integrated water resources management (IWRM); and potential conflict over shared resources. With regard to land in the region, more than 90 per cent of the land lies in the hyperarid or desert zone, while the remainder is classified as dryland. As a result, cultivated land represents only 5 per cent of the total land area, and there is very limited scope for significant expansion. Meanwhile about 73 per cent of the land is lightly to severely degraded because of overgrazing, wind and water erosion, inefficient use of water resources and military operations.

On the other hand, with regard to energy, the region enjoys tremendous conventional and renewable resources. Oil and gas contribute heavily to GDP in most member countries. However, in addition to the possible depletion of such resources within few decades, prevailing energy production and consumption patterns are inefficient. About 20 per cent of the population in rural and urban poor areas lack adequate access to energy services, which hinders their development opportunities.

In view of the above, this chapter will give an overview of the current status of core crisis features and major challenges to SD and discuss prospects for the future development of water, land and energy resources sectors, as well as their role in poverty alleviation and human settlements. In addition it will give a brief environmental profile of the region.

B. SUSTAINABLE MANAGEMENT OF WATER RESOURCES: KEY ISSUES AND CHALLENGES

1. *Overview of the water situation*

(a) *Background*

The ESCWA region is one of the most arid areas in the world. It constitutes 3.6 per cent of its total surface area and is inhabited by 2.8 per cent of its population. Yet the region has only about 0.3 per cent of the world's fresh water resources. Its average per capita share of water is already below the internationally

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[104] *Agenda 21 – The United Nations Programme of Action from Rio* (United Nations publication, Sales No. 93.I.11), chapters 3, 4, 7, 9 and 14.

[105] *World Summit on Sustainable Development; Johannesburg Plan of Implementation*" (A/CONF/199/20) and www.johannesburgsummit.org.

[106] *United Nations Millennium Declaration* (www.un.org/millennium/summit).

accepted water poverty/scarcity threshold of 1,000 m^3/c/a (see table 35). A secure and sustained supply of water in ESCWA member countries involves a wide range of challenges covering economic, social, ecological and security aspects. In view of finite supplies and increasing demand, water scarcity continues to be a major concern for most member countries. However, their reactions to this question have been mixed. Some countries have developed comprehensive strategies and policies to avert the looming crisis, while others are still lagging behind. All in all, success in meeting the water scarcity challenge is limited. Much remains to be done in order to respond responsibly and commensurately to the region's water problems.

(b) *Availability of water*

The availability of water within the region varies from country to country not only in terms of volume but also in terms of the source of this water (see table 34). The northern member countries (Egypt, Iraq, Lebanon and the Syrian Arab Republic) rely mainly on surface water from major international rivers. The remaining countries, which lie within the boundaries of the Arabian Peninsula, depend essentially on groundwater, supplemented heavily in GCC countries by non-conventional sources. The total volume of conventional (renewable) water sources for all member countries combined is estimated at 162,549 b/m^3, with surface water and groundwater constituting 148,401 b/m^3 (91 per cent) and 14,148 b/m^3 (9 per cent), respectively. The amount of water currently produced from non-conventional sources (15,595 b/m^3) already exceeds the volume of groundwater extracted. Furthermore 60 per cent of this non-conventional water is derived from agricultural drainage from Egypt and the Syrian Arab Republic alone, which, if currently unavailable data from Iraq are considered as well, would indicate the importance of this source of water. Production of desalinated water in the region is significant, especially in GCC countries, where 96 per cent of such water is produced. The region has out of necessity become a world leader in water desalination. Annual actual production of desalinated water increased by about 25 per cent between 1990 (1,925 b/m^3) and 2002 (2,551 b/m^3). Recently, Jordan, Palestine and Yemen have given serious consideration to the option of desalinating seawater and brackish water to augment their water supplies. The reuse of treated wastewater is also gaining momentum as a viable alternative to supplement conventional water sources for the agricultural sector and, to a limited extent, the industrial sector. Water harvesting has been widely used in Jordan, Palestine and Yemen as solution to water shortages, but reliable data on this issue are still hard to obtain.

TABLE 34. AVAILABLE WATER RESOURCES IN THE ESCWA REGION IN MILLION CUBIC METERS (2002 DATA)

	Renewable water resources			Non conventional water resources			
Country	Surface water	Groundwater	Total	Desalination	Wastewater	Agricultural drainage	Total
Bahrain	0.2	100.0	100	92	22	..	114
Egypt	55 500	1 384	56 884	66	1 400	7 500	8 966
Iraq	73 100	2 000	75 100	7	450	..	457
Jordan	423	370	793	10	75	..	85
Kuwait	0.1	160	160	412	30	..	442
Lebanon	2 200	500	2 700	2	2	..	4
Oman	918	376	1 294	86	26	..	112
Palestine	30.0	185	215	0.7	0.5	..	1.2
Qatar		85	85	138	44	..	182
Saudi Arabia	5 000	3 000	8 000	1 050	310	..	1 360
Syrian Arab Republic	9 540	4 8590	14 399	2	1 000	1 930	2 932
United Arab Emirates	190	129	319	676	226	..	902
Yemen	1 500	1 000	2 500	9	29	..	38
Total	148 401.3	14 148	162 549.3	2 550.7	3 614.5	9 430	15 595.2

Source: Data compiled by ESCWA from national reports.

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

(c) *Water demand*

Population growth in the ESCWA region, currently estimated at 2.5 per cent compared with a world average of 1.7 per cent, has persisted in most member countries for several decades and is expected to continue in the near future. At the current rate of growth the total population, estimated in 2002 at 178.1 million, is expected to reach 285.3 and 412.67 million by 2025 and 2050, respectively. The per capita water available from conventional sources, which is already below the poverty threshold, is thus expected to decline even further. In fact, the per capita availability of water has already fallen below the Water Stress Index level of "*absolute water scarcity*"[107] in nine ESCWA member countries (Bahrain, Jordan, Kuwait, Oman, Palestine, Qatar, Saudi Arabia, the United Arab Emirates and Yemen). Seven of these countries have < 200 m^3/c/a, and it is expected that the region as a whole, with the sole exception of Iraq, will experience absolute water scarcity by the middle of this century, as indicated in table 35. This clearly shows that there will not be enough water to support the current pattern of development activities and to achieve sustainability in the region, and it would thus appear that most countries of the region face particular challenges and constraints in meeting the Millennium Development Goals and JPOI objectives.

TABLE 35. ANNUAL PER CAPITA SHARE OF WATER FROM RENEWABLE WATER RESOURCES (M^3/C/A) – 2002 DATA PROJECTED TO 2025 AND 2050

	Bahrain	Egypt	Iraq	Jordan	Kuwait	Lebanon	Oman	Palestine	Qatar	Saudi Arabia	Syrian Arab Republic	United Arab Emirates	Yemen	ESCWA
2002	144	814	2 829	151	66	778	519	64	124	352	814	85	131	913
2025	113	600	1 863	91.5	50	589	239	30	113	198	590	92	51	576
2050	99	500	1 402	68	40	538	148	19	102	134	445	86	24	398

Source: Based on data obtained by ESCWA member countries during a 2004 survey.

2. *Main challenges to achieving sustainable management of water resources*

(a) *Excessive water consumption in agriculture with low economic return*

The agriculture sector is the principal consumer of water in ESCWA member countries, with an annual consumption of about 85 per cent of the total water supply for the entire region recorded in 2002. When the 2002 water requirements for all purposes, along with those projected for 2025 and 2050, are compared with the annually renewed groundwater and surface water sources, serious questions arise concerning not only the long-term economic and environmental sustainability of existing water resources, but also the pace of water resource development and use. Under existing conditions, it is unlikely that the expansion of irrigated agriculture can proceed without causing major water shortages, a situation which is already emerging in some member countries.

[107] **(Water Stress Index (Water Barrier Index)**

Annual renewable freshwater (cubic meters / per capita/ per year)	**level of water stress**
> 1,700	Occasional or local Water stress
1,000-1,700	Regular water stress
500-1,000	**Chronic water scarcity** (lack of water begin to hamper economic development and human health and well being)
< 500	**Absolute water scarcity**

(b) *Over-extraction of groundwater*

Depletion of groundwater brought about by continuous over-extraction is another challenge in most ESCWA member countries. Because many of the renewable aquifers are located in coastal areas, over-pumping has resulted in a deterioration in the quality of groundwater as seawater intrudes and saline waters rise from deeper aquifer layers. Increasing pollution in the vicinity of urban and industrial zones also seriously limits the availability of fresh water.

(c) *Insecurity related to surface water resources from major rivers*

ESCWA member countries that have a relatively higher per capita share of water depend on surface water from internationally shared major river systems. Yet these rivers originate outside the region, and the present situation of potential conflict with non-member upstream countries that control the flow of water casts doubt on the availability of this fresh water for future generations, particularly in Egypt, Iraq and the Syrian Arab Republic, and also with regard to the Yarmouk and Jordan rivers.

Geo-political conditions exert a strong influence on the issue. Only a few agreements or protocols have been concluded in the region. It is particularly significant that Turkey has launched the gigantic integrated development programme for the Tigris and the Euphrates, the Southeastern Anatolia Project (known as GAP), without consulting the other riparian States at any stage. By contrast, the Nile Basin Initiative and the recent agreement between Lebanon and the Syrian Arab Republic and on the Orontes and El-Kabir rivers are good examples of cooperation and coordination in shared water resources management.

(d) *Increasing urbanization*

The ESCWA region is one of the fastest growing regions in the world in terms of both population and urbanization. The challenges are particularly formidable because many cities in the region experience chronic water losses on account of high leakage rates ranging from 30-50 per cent, caused by old distribution systems and lack of maintenance. In addition, the water is of poor quality and requires further treatment at additional cost to bring it up to World Health Organization (WHO) standards, although some countries have developed national drinking water standards. Cost recovery represents another challenge to water utilities, as water is heavily subsidized in most urban centres and therefore cannot generate highly needed funds for the maintenance of water systems. Government subsidies differ from country to country and are reflected in the wide range of water tariffs, but, in many countries, charges remain far below the costs of supply.

(e) *Weakness of financial, human, and technical capacities*

Limited financial and human resources and technology transfers remain a major concern. As such they impede the effective management and development of the water sector in many member countries. The increasing rate of consumption is creating additional burdens on the annual budgets of Governments. The water sector requires considerable investment beyond the capacity of such budgets, particularly in slow-developing economies, and those countries seek foreign loans or grants to finance some of their development activities. In GCC countries, a considerable investment is being allocated for the building of giant desalination projects for water and electricity, based on public-private partnerships. While such partnership options are being explored in the water supply sectors, it is still difficult to mobilize the necessary funds because of low rates of return on investment, inadequate water tariff structures, policies that do no attract FDI, and inadequate laws regulating private sector investment in public utilities.

3. *Water strategies and priority areas for action*

Achieving the Millennium Development Goals and JPOI objectives will require a change of focus towards more country-level activities of an operational nature. This, in turn, requires more coordination and cooperation at country, regional and international levels for prioritizing the water agenda and including it in national development strategies. Water sector planning must also be closely coordinated and harmonized with broader development planning. These plans and strategies must be practical and action-oriented so that they can contribute significantly to improving the socio-economic conditions of each country and, consequently, the ESCWA region as a whole. In that connection, practical measures for mainstreaming water in national development strategies should include:

(a) Implementing pro-poor policies in the water sector, with particular attention to questions relating to slums in urban zones and to remote rural areas where sustained agricultural development is difficult;

(b) Adopting a multi-sectoral, multi-stakeholder approach to water resources planning;

(c) Devising and implementing mechanisms for cross-ministry, cross-sectoral coordination in this planning;

(d) Targeting subsidies to the poor in water supply and sanitation schemes and making them transparent.

At the same time, all ESCWA member countries have to focus on developing, implementing and monitoring national IWRM strategies by the end of 2005 in accordance with JPOI objectives. Each country must make sure that no one is excluded from municipal water supplies, particularly the poorest communities. All this should be comprehensively incorporated into national IWRM plans, with due attention given to promoting water demand management measures. Such policies must be strongly enforced, a task that requires strong political will. Serious partnership is needed among all parties, in addition to external support. In addition cheaper, local technologies should be adopted, costs of infrastructure considered and community involvement enhanced in all aspects of planning and programming in the sanitation sectors. Finally, it is important to have nation-wide awareness campaigns to ensure commitment from the population and a willingness to pay by all beneficiaries, especially privileged and powerful ones.

C. CONSERVING CULTIVABLE SOIL AND COMBATING DESERTIFICATION

1. *Current status and core crisis*

Cultivated land is very limited in the ESCWA region. The total land area is about 482.2 million ha and only some 5 per cent of this land, or about 22 million ha, is cultivated, of which 20 million ha is located in the five largest countries (Egypt, Iraq, Saudi Arabia, the Syrian Arab Republic and Yemen). The amount of cultivated land per agricultural worker is about 1.4 ha, and only 0.1 ha per capita for the total population. Given the harsh climatic conditions of the region and the limited availability of water for irrigation, the scope for significantly expanding this cultivated land is limited: the land gained through this expansion would likely be of lower potential value, and the possibilities for increasing food production are therefore limited. It is estimated that over the last 20 years, the region's cultivated land expanded annually at about 170,000 ha only, compared with an average of 4 million ha for the world. Egypt and Saudi Arabia accounted for more than 80 per cent of this expansion.

Proportions of cultivable land, i.e. cultivated land, pastureland and forests, vary between a high of 60 per cent of total land in the Occupied Palestinian Territory and a low of about 3 per cent or less in Egypt, Oman or Saudi Arabia. The average for the region is about 15 per cent. The cultivable land is scattered all over the region and varies in size from tiny patches and oases to large, fertile areas like the Mesopotamian plain of Iraq, the Jordan valley, the Bekaa valley in Lebanon, the wheat arc of the northern Syrian Arab

Republic, or the Batinah and Tihama coastal plains located, respectively, in Oman and across Saudi Arabia and Yemen.[108]

Limited rainfall and high temperatures cause much of the already scarce water to be lost through evaporation and evapotranspiration. Consequently, more than 90 per cent of the land is classified as hyperarid or desert zone; the remaining area is classified as dryland. Irrigation, practiced on about 50 per cent of the cultivated area in the region,[109] plays an important role in agricultural production, value added, and employment. Although dry, the drylands of the region provide a wide array of goods and services. They support the flora, fauna and people in important ways, providing food, forage nutrients and genetic plant materials. They store carbon in the soil and are a critical source of mineral fuels, especially natural gas and petroleum. Finally, they attract tourists and support recreational activities.[110]

About 73 per cent of the land is lightly to very severely degraded, making land degradation a major threat. Degradation consists in depletion of soil nutrients and groundwater aquifers; salinization of soils; pollution from agrochemicals and urban and industrial wastes; soil erosion; and degradation of the vegetative cover. Degradation is further exacerbated by adverse climatic conditions, rapid population growth and widespread urbanization.

The key factor identified as the cause of widespread damage almost everywhere in region is overgrazing. This is followed by agricultural activities and deforestation, which lead to the destruction of the vegetative cover. As a result, much of the land is now vulnerable to wind and water erosion: according to estimates by the United Nations Environmental Programme (UNEP), over 80 per cent the land on the Arabian Peninsula is highly susceptible to wind erosion.

The other main sources of land degradation are inefficient use of scarce water resources and poor irrigation and drainage leading to a build up of salt in the land (salinization). This is already a major problem in parts of Egypt, Iraq and the Occupied Palestinian Territory. Meanwhile, political tensions and subsidies[111] to farmers contribute significantly to land degradation.[112]

2. *Requirements for the sustainable management of land resources*

JPOI outlines a set of recommended actions that support the protection and management of natural resources. These actions, if implemented, could ensure the swift achievement of the Millennium Development Goals of halving poverty by 2015. Some of those actions, which have the potential to play a catalytic role in the better management and conservation of the land resources of the ESCWA region, are:

(a) Development and implementation of integrated land and water management strategies based on the sustainable use of resources and on assessments of socio-economic and environmental potentials;

(b) Promotion of programmes to enhance the productivity of land and the efficient use of water resources in agriculture and to address poverty resulting from land degradation;

[108] FAOSTAT Data, 2004 (http://faostat.fao.org/faostat).

[109] TERRASTAT Data (www.fao.org/ag/agl/agll/terrastat/wsr.asp).

[110] Robin P. White and Janet Nackoney, "Drylands, people, and ecosystem goods and services: a web-based geospatial analysis" (Washington D.C., World Resources Institutes (www.wri.org), 2003).

[111] Subsidies have a distorting effect and as such tend to encourage over-use or over-production. When the prices of major inputs are lowered, farmers tend to over-use them, resulting in over-pumping of groundwater, heavy use of chemical fertilizers, etc., beyond sustainability. Conversely, if the price of commodities is increased, farmers have an incentive to over-exploit resources in order to produce more. Ultimately, all of these lead to more land degradation.

[112] United Nations Environment Programme (UNEP), Global Environment Outlook 3: Past, Present and Future Perspectives (London, Earthscan/James and James/2002).

(c) Integration of measures to prevent and combat desertification and to mitigate the effects of drought through relevant policies and programmes.

3. *Areas of concern and prospects for the future*

The pressures on land resources described above are leading to frequent droughts, the spread of desertification, limited areas available for agriculture and increasing water scarcity. Additional challenges and constraints identified by ESCWA are poor governance, weak legislative and institutional frameworks and lack of public awareness. These require a new strategy and a holistic approach to the planning and implementation of action plans related to land issues.

By the end of 2002 Bahrain, Egypt, Jordan, Saudi Arabia, the Syrian Arab Republic and Yemen had completed or adopted their national action plans dealing with land problems. Most of the remaining countries, including Lebanon and the United Arab Emirates, also strived to incorporate integrated land resources management into policy measures designed to achieve SD.[113] As a result these countries have established national coordinating bodies to address issues related to soil conservation and land and water resources management as related to sound water resources management, rangeland management, awareness raising and capacity-building. However, much remains to be done, and most countries still need either adequate technical assistance, financial resources, or both, in order to design and implement well-targeted programmes for faster transition to better stewardship of land resources.

Over the years, ESCWA has pursued an active role to improve the sustainable management of natural resources, including IWRM, and to promote the implementation of programmes to combat land degradation and desertification and to control land and water pollution. Member countries must now set new priorities and adopt innovative strategies to bring the issues described above to the forefront of all national and regional policy objectives, as called for in recent ESCWA forums and publications. ESCWA will continue to raise awareness and support the effort of its member countries to achieve the following:

(a) Development and implementation of appropriate strategies, tools and methods to assess and quantify the nature, extent, severity and impact of natural resources degradation and to build national and regional assessment capacities to enable the design and planning of interventions to mitigate this degradation;

(b) Address the issue of rational use of resources in agriculture, especially to assess the efficiency of on-farm water use with a view to providing alternate tools for assessing and policy options for improving the efficiency of water use at the farm level.

D. ENERGY FOR SUSTAINABLE DEVELOPMENT

1. *Overview of the ESCWA energy sector*

(a) *Background*

The energy sector plays an important role in the economic and social development of ESCWA member countries. It satisfies the energy needs of the different sectors and contributes to GDP through oil and gas export revenues. The sector is characterized by a huge oil and gas sub-sector, as well as a large electric power sub-sector dominated by thermal power generation. On the end-use side, the sectors consuming the most energy in the region are the transport, residential, industry and power sectors. However, prevailing energy production and consumption patterns are inefficient, and almost 21 per cent of the population, particularly in rural and remote areas, do not have access to energy services or are highly under-serviced, which seriously limits their ability to improve their living conditions.

[113] Data are not available for Iraq and the Occupied Palestinian Territory.

(b) *Characteristics of the sector*

Table 36 shows energy resources and production for the region. While the region is rich in gas and oil, some ESCWA member countries lack these resources. On the other hand, they all enjoy varying amounts of renewable energy resources, which unfortunately have not so far been fully exploited.[114] The following is a summary of the main characteristics of the main energy sub-sectors.

(i) *Oil and gas*

Oil and gas is the largest economic sector in the Gulf countries and the region as a whole, and it makes available a tremendous number of job opportunities in different fields. The region's crude oil reserves reached 602 billion barrels in 2003, accounting for 52.4 per cent of world oil reserves. Crude oil production was about 18.7 m/b/day in 2003, accounting for 24.3 per cent of world oil production. The capacity of the oil refinery industry that year was 5,499 thousand barrels a day, with the highest capacities in Kuwait and Saudi Arabia, while total crude oil exports counted for 12.38 m/b/day, mostly from Kuwait, Oman, Saudi Arabia and the United Arab Emirates.[115]

The region accounts for about 26.4 per cent of world natural gas reserves and 8 per cent of production (about 211 b/m^3). Although the primary consumption of natural gas in the region is increasing – Egypt, Saudi Arabia and the United Arab Emirates being the highest consumers with a collective consumption of 74 per cent – production exceeds total consumption. Consequently, the power sector has been working towards an increase in the proportion of natural gas in its fuel supply. Meanwhile countries, encouraged by increased reserves and demand, have developed intraregional agreements for implementing natural gas pipeline projects.

TABLE 36. RESERVES AND PRODUCTION OF ENERGY RESOURCES IN ESCWA MEMBER COUNTRIES (2003)

	Reserves		Energy Production 1000 barrel oil equivalent/day			
Country	Crude oil (billion barrel)	Natural gas (million m^3)	Total[a/]	Crude oil and NGL	Natural gas[b/]	Hydro
Bahrain	0.1	92	426	200	226	–
Egypt	3.7	1 755	1 396	815	516	65.0
Iraq	110.6	2 808	1 570	1 295	255	20
Jordan	–	7	5.5	–	5.5	–
Kuwait	96.5	1 557	2 319	2 140	179	–
Lebanon	–	–	6	–	–	6.0
Oman	5.9	849	1 254	853	401	–
Palestine	–	85	–	–	–	–
Qatar	16.9	25 667	1 450	745	705	–
Saudi Arabia	262.8	6 646	10 347	9 200	1 147	–
Syrian Arab Republic	3.2	371	721	538	165	18
United Arab Emirates	97.8	6 060	3 626	2 446	1 180	–
Yemen	4.0	453	831	459	372	–
Total ESCWA	601.5	46 350	23 951.5	18 691	5 151.5	109

Source: OAPEC, *Annual Statistical Report* 2004.

a/ Indicates crude oil + natural gas + hydro.

b/ Indicate inclusion of flare and re injected gas.

[114] E/ESCWA/ENR/2002/1 (in Arabic).

[115] Organization of Arab Petroleum Exporting Countries (OAPEC), *Annual Statistical Report 2004*.

(ii) *The electric power sector*

The electric power sector in the region has been greatly developed in the course of the last two decades. In 2003 total installed electrical generation capacities reached 96,736 MW, with thermal power stations accounting for more than 92 per cent,[116] while total generated electricity came to about 43,768 GWh. Saudi Arabia accounted for more than 37 per cent of the total of generated electricity, followed by Egypt (20 per cent), Kuwait and the United Arab Emirates. Consumption patterns differ tremendously among member countries. depending upon their available resources and pricing policies and the spectrum of economic activities.

An added value of the electric power sector is its reasonably strong industrial base for electric transformers, cables, switch boards, etc. This, in addition to the contracting companies in the sector, creates reasonable job opportunities and contributes to GDP in several countries. Furthermore, the electricity sector has achieved remarkable progress in regional integration through the electric grid interconnection projects constructed and operated from 1992 to 2004.

2. *Key challenges and issues relating to achieving energy for sustainable development*

The important role of energy was emphasized at the ninth session of the United Nations Commission on Sustainable Development.[117] Five key challenges and issues with regard to achieving energy for SD were identified at that meeting.[118] They are summarized below, together with the status of response in the region.

(a) *Enhancing access to modern energy services*

Lack of energy correlates with many indicators of poverty, including poor education, inadequate health care and hardships imposed on women and children and in large poor communities. Since 1992, ESCWA member countries have extended energy services to new groups of consumers in urban and rural areas. However, many rural and remote areas are still suffering from a lack of reliable supplies. Access to modern energy services can catalyze the creation of microenterprises, livelihood activities and locally owned businesses, and energy must therefore be available, in sufficient quantities and at affordable prices, to support economic development.

(b) *Energy efficiency*

Improved energy efficiency can help to reduce costs, preserve natural resources and protect the environment. In almost all energy end-use sectors, the focus is on improving the efficiency of equipment that provides the services, such as heating equipment, appliances, lighting and motors. Supply-side energy management focuses on performance-based improvements resulting in more efficient energy generation and improved industrial processes. Increased efficiency in large-scale energy production is of utmost importance, especially in refinery processes and electricity generation. Several ESCWA member countries have adopted policies and programmes to encourage energy efficiency in various economic sectors. This has resulted in a reasonable improvement in energy-use efficiency, particularly in the residential, industrial and electric power sectors. Consequently growth rates of primary energy consumption were also reduced, and several codes of practice for efficient energy use were issued.[119]

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[116] OAPEC, *Annual Statistical Report 2004*, Kuwait.

[117] United Nations, *Commission on Sustainable Development Report on the ninth session* (E/2001/29).

[118] "Energy and sustainable development: options and strategies for action on key issues: report of the Secretary-General" (E/CN.17/ESD/2001/2), paras. 12-57 and 78-86.

[119] E/ESCWA/ENR/2002/3 (in Arabic).

(c) *Promoting the use of renewable energy resources*

Renewable energy technologies can contribute to meeting the basic energy needs and to supporting poverty alleviation and SD. Several renewable energy technologies have been developed, including large-scale wind and solar electricity generation technologies. Several barriers, including costs, have prevented their use on a wide scale to satisfy energy services. Except for the use of solar water-heating applications in the domestic sector, there has been limited progress in promoting the use of renewable energy technologies in the ESCWA region. Egypt and Jordan have achieved reasonable success and built capacities in the field. In Egypt, a large-scale wind farm is currently in operation (145 MW), and serious steps were taken to build a combined cycle solar/thermal power plant (of about 126 MW).[120] Recently, the United Arab Emirates set up the first wind-power plant in the Arabian Peninsula with a capacity of 852 kW. The renewable energy applications in the region in 2003 saved about 1.5 million tons of oil equivalent per year in fossil fuels (about 30,000 b/d).

(d) *Developing cleaner fossil fuel technologies*

Fossil fuels will continue to play a dominant role in the energy mix in the decades to come. The challenge lies in their efficient use and in the reduction of their environmental impact at the local, regional and global levels. The move to advanced and cleaner fossil fuel technologies is crucial to that end and to supporting SD. The share of natural gas in the energy mix of ESCWA member countries increased in the last decade, reaching 45.8 per cent of total energy consumption in 2003, particularly in electricity generation plants. Advances have been realized in the use of liquefied fuels, the elimination of leaded gasoline and the reduction of the amount of sulfur in both gasoline and diesel. Meanwhile, the oil and gas sector has adopted various advanced and cleaner fuel technologies in its operations.

(e) *Energy and transport*

The impact on the environment of energy use in transport is one of the key challenges to SD. Globally there is an ongoing process to convert vehicles to use cleaner fuels, such as unleaded gasoline and low-sulfur diesel, and more efficient technologies, and to implement more efficient demand management in transportation. Almost all ESCWA member countries took measures to move to unleaded gasoline and low-sulfur diesel and to implement regular vehicle inspections. In Egypt, a pilot programme implemented in 1996 supports the switch to natural-gas powered vehicles in Cairo, and more than 47,000 such vehicles are already in use.[121] In the United Arab Emirates, Abu Dhabi recently launched a pilot project using natural gas as fuel for vehicles, targeting 50 vehicles for conversion into bi-fuel operating mode.

3. *Strategies and priority action areas with regard to energy for sustainable development*

JPOI called upon countries to: (a) improve access to reliable, affordable, economically viable, socially acceptable and environmentally sound energy services and resources; (b) encourage and promote the development of 10-year programmes in support of regional and national initiatives to accelerate the shift towards sustainable consumption and production; and (c) protect and manage the natural resources base of economic and social development.

In addition, in 2003 the Arab ministers responsible for energy and for the environment adopted the Abu Dhabi Declaration on Environment and Energy, which focuses on: (a) the right of Arab countries to develop and use their energy resources, while securing oil and gas flows to international markets; (b) the

[120] E/ESCWA/SDPD/2003/15 (in Arabic).

[121] Ibid.

importance of achieving SD and alleviating poverty in the region, by increasing energy access, using a mix of available conventional and renewable energy resources; (c) the need to develop national strategies to promote the sustainability of the Arab energy sector; and (d) the need to develop and implement policies and programmes to change the current unsustainable energy production and consumption patterns.

In response to the above, member countries should devise policy frameworks appropriate to national circumstances to support the following:

(a) Integrating sustainable energy strategies and objectives into national development policies and plans, including sectoral energy policies;

(b) Improving energy-sector management and energy efficiency, reviewing tariffs and increasing public and private sector investments in the sector's activities;

(c) Responding to the rapidly increasing demand on energy caused by rapid population growth and increased economic development activities;

(d) Changing unsustainable energy patterns by improving energy production and consumption efficiencies and enhancing access to modern energy supplies, in rural and remote areas;

(e) Expanding the use of cleaner fuel technologies especially regarding electricity generation, and the fuels for the transport sector;

(f) Introducing and gradually increasing the application of renewable energy technologies, as appropriate in accordance with the availability of resources and the situation of the energy sector in each country;

(g) Enhancing sub-regional, regional and international cooperation in all energy sub-sectors;

(h) Promoting capacity-building programmes at the local, national and regional levels on relevant issues of energy for SD to support job creation and poverty alleviation;

(i) Expanding information exchange on technology options, their costs and availability for application;

(j) Mobilizing funds for technology transfers required SD to achieve the above.

E. Environmental profile and issues

The environmental component of SD concerns the physical resources and ecosystem services needed for the social and economic development of the ESCWA region. Much of the environment is still being degraded, and the impact and trends of environmental change need to be assessed to ensure environmental security and sustainability. This analysis presents a regional overview of the main environmental themes. It also highlights the issues that are considered of paramount importance in the region, particularly the impact of wars on the environment, environmental monitoring and environmental legislation. Finally it presents the relevant prospects and priority areas.

1. *Regional overview of main environmental themes*

(a) *Quality of surface and groundwater resources*

Reasons for the deterioration in the quality of both surface water and groundwater resources in the ESCWA region are dealt with in section B, above.[122]

Environmental considerations associated with the use of non-conventional water resource technologies have not been given adequate attention by concerned institutions. Reuse of treated domestic wastewater for agricultural purposes is one of the major, additional, non-conventional resources in many countries in the region. In the future, most member countries will use this resource to ever greater degrees, as the water shortage is expected to reach to 377 b/m^3 by 2025. The amount of wastewater produced in the region is estimated at 8 bm^3/year, of which about 2.8 b/m^3/year is treated using mainly primary and secondary treatment. Treated wastewater reused for irrigation purposes is estimated at 40 per cent of the total amount treated, and the remainder is discharged into seas, rivers or groundwater storage.[123] Health hazards that may arise from the use of this resource in irrigation must be given special attention. The major concern in municipal wastewater re-use is the existence of pathogenic microorganisms, and some countries have experienced an increase in disease among workers and consumers. Another concern is the severe health risks caused by the mixing of industrial wastes, which include concentrations of trace elements such as cadmium, lead and mercury, with domestic wastewater in drains where such water is used for irrigation purposes. The health risks can be reduced by raising awareness, promoting proper practices and matching the type of crop with the level of treatment of the wastewater.

Water desalination is another very common non-conventional water resource in most member countries. Desalination plants can cause water pollution and lead to a deterioration in the condition of ecosystems. The most significant among the various types of pollution is caused by reject brine, which contains high salt concentrations and other pollutants such as heavy metals, residual chlorine, acids and other contaminants. Management of the discharge and reduction of pollution loads will reduce the environmental impact on both the inland and the coastal plants.

(b) *Marine and coastal water resources*

Coastal water is the region's main source of drinking water (through desalination) and cooling water for industries, as well as one of the main sources of high quality protein and eco-tourism development. Yet the coastal zones face environmental problems and pollution caused by urbanization and the ensuing pollution from sewage and solid wastes, industrial pollution and oil spills, agricultural drainage, physical alteration and destruction of habitats, and serious pollution caused by conflicts and wars. The region's fisheries are a major source of protein and revenue for almost all of its countries. However, per capita catches have been falling despite the rapid increase in fish production, because of, among other things, deteriorated ecological conditions.

Most countries recognized the need for environmental impact assessments and integrated coastal zone management through the Mediterranean Action Plan, the Conservation of the Environment in the Red Sea and Gulf of Aden and the Regional Organization for the Protection of the Marine Environment in the Gulf. However, despite all these efforts, the lack of regular and continuous monitoring of chemical and biological

[122] For more details, see *World Summit on Sustainable Development: Assessment Report for the ESCWA Region* (E/ESCWA/ENR/2002/19/SUMMARY) and *Updating the Assessment of Water Resources in ESCWA Member Countries* (E/ESCWA/ENR/1999/13).

[123] ESCWA, *Presentation and Discussion of the Outcomes of the Study of Specifications and Measures Related to the Use of Treated Wastewater for Irrigation in ESCWA Member Countries* (E/ESCWA/SDPD/2004/IG.2/4(Part I)/Add.3.

variables of coastal water, limited integration within national policies and legislation, and regional wars and political instability mean that the region is still facing difficulties.

(c) *Air quality*

In the ESCWA region, concentrations of the principal air pollutants in major cities often exceed WHO guidelines, mainly because of emissions from industries, power plants and the transport sector. Thus the burning of fossil fuels is the main cause of atmospheric air pollution and the main source of CO_2 emissions. The total suspended particulates (TSP) concentration in the air is much higher than maximum allowable limits. More and more vehicles, poor traffic management, ageing cars and congested roads in major cities are other major sources of air pollution in the region. Many of those vehicles are in poor condition and produce significantly higher emissions of hydrocarbons and NO_x than new ones. In addition, transboundary air pollution is one of the major emerging issues. In Gulf countries, total annual per capita atmospheric emissions loads are about 3.85 tonnes, of which 28 per cent is CO, 27 per cent are SO_x and 23 per cent are particulates.[124]

In the energy sector several programmes for energy efficiency and conservation were implemented, particularly in the industrial, power and transport sectors. They resulted in the upgrading of energy efficiency, particularly in the power sector where reductions in the specific fuel consumption reached more than 30 per cent in some countries. Meanwhile, several countries in the region have directed efforts to promoting renewable energy applications (e.g. solar, wind and biomass).

(d) *Biodiversity*

The region has wide variations in terrestrial and aquatic ecosystems. Main terrestrial habitats include Mediterranean forests, rangelands and deserts. Marine ecosystems include mudflats, mangrove swamps, sea grass and coral reefs. There are up to 12,000 marine species in the Mediterranean, representing 8-9 per cent of the world's wealth of sea species. Substantial numbers of vertebrates are threatened with extinction: human population growth and greater resource consumption have dramatically increased habitat destruction and fragmentation in most countries over the past three decades. Degradation of unique terrestrial and aquatic ecosystems and loss of genetic resources are the main biodiversity issues in Western Asia.[125]

At the regional level, between 1993 and 1999, there were more than 30 meetings to promote cooperation in ecosystems conservation in the Arab region. The Council of Arab Ministers for Environmental Issues a comprehensive policy initiative on biodiversity in 1997. Also, most ESCWA member countries have contributed to the United Nations Convention on Biological Diversity,[126] the Ramsar Convention on Wetlands, and others.[127]

2. *Key issues in the region*

(a) *Impact of wars on the environment*

For the past decades the region has been plagued by wars, which has caused major environmental problems. Oil well fires polluted marine resources and the atmosphere, and oil spills contaminated the soil. In Iraq, there are many serious environmental issues linked to the wars, especially in major urban areas such

[124] *World Summit on Sustainable Development: Assessment Report for the ESCWA Region*, op. cit.

[125] UNEP, *Global Environment Outlook 3…*, op. cit.

[126] United Nations, *Treaty Series*, vol. 1760, No. 30619.

[127] *World Summit on Sustainable Development: Assessment Report for the ESCWA Region*, op. cit.

as Baghdad and Basra, dating back to the early 1990s. These include physical damage to infrastructures (e.g., water and sanitation systems), serious contamination from the release of potentially hazardous substances from targeted military and industrial infrastructures, air pollution from oil-field fires and severe damage to ecosystems and landscapes from military activities. This will add to other pre-conflict chronic environmental stresses, such as inadequate concern for hazardous waste.[128]

In Palestine, there are many environmental problems as a result of the ongoing conflicts over the Occupied Palestinian Territory. There are serious concerns regarding the deterioration of water quality in many areas. Soil and groundwater pollution is caused mainly by agricultural practices (e.g., use of inorganic fertilizers and pesticides), localized industrial activities (organic pollutants and heavy metals) and inadequate and improper disposal of wastewater and solid wastes including hazardous materials.[129]

(b) *Environmental monitoring and lack of credible information*

The ESCWA region suffers from a serious and persistent inadequacy of the valid environmental information needed to serve as the basis of any efforts to realize SD. Most environmental studies are based on short record data, or on snap-shot surveys related to specific and short-term projects. However, despite such limited environmental information and monitoring data, member countries need to harmonize their definitions, classifications and monitoring methods with international standards. Also, continuity in the monitoring of parameters is required to detect trends and variability in both the short and long terms.[130]

(c) *Compliance with and enforcement of environmental legislation*

Most ESCWA member countries have based their environmental management strategies on legal requirements and legislation that are often inadequate, technically inappropriate and economically unaffordable. The lack of comprehensive and effective systems to enforce legislation in many countries has led to marginal compliance with environmental laws and regulations. The most widely used regulations are ambient standards, which define the levels of pollutants in the receiving medium. However, such standards do not cover the wide range of chemical pollutants emitted into the environment. In addition, most countries lack requirements for the reporting of information through self-monitoring, inspection and self-reporting programs.[131]

3. *Prospects and priority areas of concern*

In view of the foregoing environmental profile of the region, member countries need to promote sectoral and intersectoral policies and actions to reduce the impact of the natural resource sectors on the environment, including:

(a) Adoption of IWRM, including demand management approaches, development of renewable and non-conventional resources, and stakeholder involvement in planning and implementation of water policies and strategies, particularly in local communities and among the public at large;

(b) Capacity-building and the improvement of institutional set-ups, effectively to manage land and water resources and protect biodiversity. Also, there is a need to intensify efforts to develop water and land

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[128] UNEP, *Desk Study on the Environment in Iraq* (UNEP, 2003).

[129] UNEP, *Desk Study on the Environment in the Occupied Palestinian Territories* (UNEP, 2003).

[130] E/ESCWA/SDPD/2004/WG.5/3 (in Arabic).

[131] "Overview of compliance and enforcement of environmental legislation in the ESCWA region" (E/ESCWA/ENR/1999/WG.4/3).

related technologies for irrigation and water desalination technologies, using solar energy technologies, and to develop pollution control measures, including integrated pest management and chemical-pollution-control programmes. Countries should establish surface- and groundwater-quality monitoring networks at the national level to monitor pollutants and to set mitigation measures to protect the scarce water resources available;

(c) Adoption of integrated coastal area management for SD of marine environment and resources, including fisheries and aquaculture at national and regional levels;

(d) Improvement of existing air quality monitoring and control programmes for sources of mobile and stationary emissions and establishment of new ones. To that end, financial resources and state-of-the-art equipment and qualified personnel are needed for data analysis and interpretation. National strategies need to be established to improve fuel consumption and energy efficiency, and to promote cleaner production schemes in industry to reduce Co_2 emissions and other ozone-layer depleting gases;

(e) Integration of social, economic and environmental agendas, as well as institutional reforms and legal instruments, including national and regional agreements, to improve governance for SD.

V. CONCLUSION

Development under risk represents a collective challenge to the region. Because each and every member country would stand to gain from the spillover effects of political or oil shocks, concerted action should be the *modus operandi* for handling the possibility of further crisis. Bringing the interests of various social groups in the region closer together via institutional reform should at this time mark the starting point of a sequence of measures designed to empower the individual politically and economically. In order of priority: the prevailing unemployment problem has to be tackled in the short term by redeploying idle public resources to lesser endowed regions within a country, and in the long term by gearing up regional investment meant to expand production and employ regional labour.

Given the uneven pace of development in the region, any benefits that might arise from the losses of others would not last. The long-term trends indicate that negative external shocks and the "neighbourhood effect" harm everyone. Some countries may have realized gains from merchandise trade resulting from the conflict in Iraq, but on the flip side the long-term growth rates of nearly all ESCWA member countries have been below the global average for the developing world. Furthermore, when the greater downside risks caused by the social and political spillover effects of conflicts are considered, the probability of a major slide increases. In a region whose principal economic drawback remains low rates of investment in infrastructure, plant and equipment, factors that rely heavily on stability over the long term, the losses from conflict remain irredeemable. Concerted regional efforts are required to promote a combination of regional stability and long-term investment projects.

The current unemployment rate in the ESCWA region stands in absolute contrast to the right to work as defined by the Universal Declaration of Human Rights. It is estimated at about 15 percent, while the world total unemployment rate is at 6.2 per cent. Although the first step in tackling the unemployment issue should be the collection of consistent employment data, labour market data are anything but consistent. When labour demand follows steadily from high rates of investment and from more labour-intensive capital accumulation in certain sectors, it becomes easier to deal with the cultural ethos standing in the way of women's participation in the labour force. So far, neither of these conditions has been met.

The major findings and recommendations of this year's *Survey* can be summarized as follows.

A. ECONOMIC RECOMMENDATIONS

1. *The macroeconomic scene*

The existing exchange rate arrangements in most ESCWA member countries have the worst aspects of the two polar types of exchange rate regime. Pegging the local currencies to the dollar renders monetary policy completely ineffective, as in a fixed exchange rate regime. On the other hand, the continuous fluctuation of the US dollar has the potential to increase costs associated with fluctuations in exchange rates, as is typical of a flexible exchange rate regime.

The combination of a fixed exchange rate regime, a tax system that relies heavily on indirect taxes, the increasing pressure of external debt and free capital mobility renders fiscal policy quite ineffective and makes monetary policy stifle economic growth.

The prolonged contraction in economic activity, together with chronically high rates of both unemployment and under-employment, has discouraged investment and consequently reduced the productivity of labour. Furthermore, it has fostered income inequality and the spread of poverty. This has disenfranchised sizeable social strata and helped to create a fertile environment for political unrest.[131]

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[131] In a region beset by a very regressive profile of income distribution, both within and across countries, political unrest should not be treated entirely as an external factor. Rather, political unrest should be seen partly as *endogenous* to the economic system. The experience of the Republic of Korea and Taiwan (Province of China) has demonstrated that the success of their development effort was partly due to their success in linking the process of growth with the process of redistributing income and increasing equality across society. Economic growth was instrumental, therefore, in reducing social tension and reforming the political system.

A new macroeconomic environment should be created so as to allow the autonomous adoption of an economic policy, the main objective of which is a low rate of unemployment: a more important objective than merely preventing inflation. This new environment cannot be created unless two important tasks are successfully undertaken; fiscal and financial reform at the country level and monetary coordination and fiscal harmonization at the regional level.

Fiscal reform should aim to enhance government legitimacy by paying more attention to equity and efficiency. The tax system should be reformed by increasing its reliance on mildly income-progressive taxes, restructuring the property tax and introducing presumptive taxes. Efficiency of government activities could be increased by the imposition of hard budget constraints on public enterprises. Reform in the financial sector should aim to remove all the institutional impediments responsible for the financial repression that currently exists in some countries in the region, and to create well functioning capital markets. Such markets can stimulate investment and encourage new private sector enterprises to emerge and to prosper.

In addition to having sub-optimal exchange rate arrangements, no country in the ESCWA region is capable of defending its currency under the present conditions of free capital movement, intensified international speculative activities and the absence of a single globally denominated currency. After considering all other options, it was found that the most promising is monetary coordination among all ESCWA member countries aimed at adopting a unified exchange rate regime is the most promising. The first step would be the linking of the various currencies in the region in a common bloc floating vis-à-vis the rest of the world. This would achieve two objectives. Firstly, it would stabilize intraregional trade by pre-empting relative shifts in the intraregional exchange rates structure. Secondly, it would insulate the domestic economies from external developments, thereby permitting monetary policy to concentrate on the problem of unemployment. Monetary coordination could move gradually towards the ultimate goal of creating a common supranational currency.[132]

Monetary coordination will not succeed without fiscal harmonization among the countries. As other trade barriers are removed by GAFTA, expansion of joint-venture investment and intraregional trade becomes increasingly dependent on the abolition of tax, administrative and institutional obstacles to cross-border activities within the region. Tax differences among the countries would cause capital to flow from the high-tax to the low-tax economies. This tax-induced distortion in the capital market would lead to an inefficient regional allocation of investment and possibly tax competition. Removing these distortions calls for tax harmonization among ESCWA member countries.

Successful coordination in fiscal and monetary affairs will enable the region to acquire the skills successfully to manage external shock. A regional stabilization fund could provide the countries with a self-insurance scheme. By contributing to the fund in good periods governments can reduce the need for spending cuts in bad ones. By stabilizing expenditures, such a fund helps to stabilize relative prices and aggregate demand. The fund can also be used to transfer risk abroad by taking advantage of the world hedging market, which for a fee provides insurance against unexpected revenue fluctuations.

2. *The industrial scene*

Economic activities in the primary sector dominate the ESCWA region. GDP shares of manufacturing and services vary considerably. All ESCWA economies increased the GDP share of manufacturing during the 1990s, except for Lebanon and Qatar. MDIs have similar production profiles. Food processing is one of the most dynamic manufacturing industries in the ESCWA region, while the growth potential of chemicals

[132] GCC countries have gone a long way towards creating a monetary union and a common currency. Coordination between GCC and the other countries in the region is essential, however, to create a more cohesive regional monetary bloc.

appears less dynamic. Despite similar production profiles, however, Egypt, Jordan and the Syrian Arab Republic have become more specialized since 1990. The share of MHT in manufacturing varies considerably among ESCWA member countries. In comparison with a wider sample of developing countries, the level of MHT embedded in manufacturing ranges from the 98th percentile to below the fifth. The region's industrial competitiveness is highly fractionalized as well.

3. *Trade development*

Intraregional trade, at 7-8 per cent, is generally low. There are no indicators for a trend in intraregional trade or trade with EU countries. Individual countries differ considerably with respect to their reliance on trade with other ESCWA member countries. MDEs barely trade among themselves. As a result of unequal endowment with oil-resources, most intraregional trade takes place either with or among oil economies. Trade takes place mainly in primary products. Most countries could increase exports in goods produced with MHT during the 1990s. However, exports of human-capital-intensive goods declined in other places because of high competition.

4. *Other policy options*

In the ESCWA region, industrial capacity-building must have greater priority than global trade development. In a cross-sectional analysis, manufacturing indicators correlate more favourably and robustly with growth than trade shares. Aggressive trade openness may lay off labour in the primary sector faster than other sectors can absorb it. Labour migration must be supported by public investment in social security, education, physical and institutional infrastructure. Given the tight fiscal constraints in many places, global trade integration may be too lofty an ideal. However, deeper regional integration, especially beyond trade integration, appears to be urgently needed. The evolution of industrial capacity clusters and networks must be developed through greater policy cooperation among members countries, especially through the harmonization of simple and transparent administrative procedures and regulations, as well as greater commitments to joint infrastructure projects in order to support the diffusion of positive externalities. Because the region is highly fractionalized, politically and economically, it is often not perceived as a regional market but rather as a cluster of insulated economies. Geopolitical risk and media coverage endorse this picture daily, which makes it particularly important for the region to reinvent itself with a new supranational identity that helps to promote its image for investors. It needs a "regionalization of national economies" package, which in turn needs greater support from the international community. Given the geopolitical risk constraints, greater policy reforms will take place in the region only with stronger international support through greater economic and political cooperation.

5. *The social situation*

In the social sphere, the region is still trapped in a tangled web of poverty, unemployment, and violent conflict. Each reinforces the other and interacts with other negative parameters at work – weak/waning social protection systems, non-participatory modes of governance, segmentation, modest growth and a shock-therapy-approach to economic reform – leading to a serious aggravation of the vulnerability of most of its peoples.

Available data point out that poverty, in its different conceptual configurations, still poses a serious challenge for both policy- and decision-makers. Poverty lines reveal clear signs of widespread income poverty. Although a number of non-money metric measures of poverty, such as life expectancy at birth and child-mortality rates, portray better living conditions than the money-metric measures, the region is still far from knowledge rich. Besides, the region's performance as evaluated by composite indicators is not encouraging. Among those with available statistics, only two countries, Jordan and Lebanon, ranked relatively well on HPI.

Unemployment in the region is still high, running to double-digit figures at the regional level and in specific countries. High youth unemployment, low female participation and widespread under-employment exacerbate the negative effects of unemployment on socio-economic conditions in the region.

International disparities provide another threat to stability. Statistical evidence in some countries highlights the fact that national averages conceal wide disparities in unemployment and poverty rates between the different regions of the same country.

6. *Policies for social development*

In the ESCWA region, policies for the reduction of poverty, both in terms of income and capability, are inseparable from those needed to reduce unemployment. Such policies need to follow two channels.

(a) *The personal income channel*, whereby growth of the economy translates into decent work opportunities with higher personal income for the poor and vulnerable, who can then use their income to enhance their capabilities. It is centred on two sets of policies: (i) employment-friendly growth policies; and (ii) policies that match opportunities to employability. Employment-friendly growth assumes a path of labour-intensive growth, with emphasis on labour-intensive sectors such as agriculture; labour-intensive investments such as public works programmes and infrastructure, including public housing schemes; and labour-intensive modes of production such as self-employment and microenterprises. Given the current state of affairs, enhancing the employability of the poor demands special focus on upgrading the human capital of the poor and improving the physical accessibility of job opportunities. Policy- and decision-makers need to give priority to eradication of illiteracy, development of skills and facilitation of enhanced intraregional and intranational labour mobility;

(b) *The social provisioning channel*, whereby resources generated by growth and redistribution are used by society to provide services to the poor and vulnerable so as to enhance their various capabilities. ESCWA member countries need to rely more heavily on public protection systems to deal with the existing realities of high unemployment, widespread poverty, extensive informal employment, recurrence and persistence of macroeconomic or collective shocks. Labour standards and contribution-financed social insurance programmes should be upgraded and their coverage expanded to large segments of the informal sector. Member countries need to consider expanding the role of publicly funded social protection programmes to alleviate the effects of poverty. Free basic services for all should be regarded as a key building block and a well-entrenched principle.

B. SUSTAINABLE DEVELOPMENT: ISSUES OF THE ESCWA REGION

SD rests mainly on the social, economic and environmental pillars. The environmental component provides the physical resources and ecosystem services needed for social and economic development of the countries of the ESCWA region. Much of the environment is still being degraded, and therefore the impact and trends of environmental change need to be assessed and documented to ensure environmental security and sustainability.

The quality and quantities of both surface water and groundwater resources that can be replenished are being affected by development activities and water-use practices. The deterioration in quality is attributed mainly to increased discharge of untreated and partially treated domestic and industrial wastewater, discharge from agricultural drainage containing fertilizers and pesticides, improper management of solid wastes and over-exploitation of groundwater resources. Stakeholders within the region have recognized the importance of conserving and protecting the ecosystem by promoting more efficient use of non-renewable groundwater sources by the irrigation sector; ensuring adequate treatment of all domestic and industrial wastewater; regulating the disposal of hazardous waste; and taking proper measure for water pollution control. ESCWA member countries are also developing policies to increase water supply and promote conservation. However, more needs to be done to avoid serious water-supply shortages in the future. Indeed, the ESCWA region is one of the most parched regions worldwide. Given its high population growth and rapid urbanization, its water supplies face serious challenges, in terms of both volume and quality. Without advance preparation, adequate investment and effective water management policies, water supply crises will be difficult to avert in the ESCWA region.

Accordingly, all ESCWA member countries need to focus on developing, implementing and monitoring the application national IWRM strategies in accordance with JPOI objectives. Member countries need support to achieve this goal by the end of 2005. Each country has to make sure that no one is excluded from municipal water supplies, particularly the poorest communities. All of this should be comprehensively incorporated into national IWRM plans with due attention paid to promoting water demand management measures. Such policies will need strong enforcement and serious partnerships between all parties. In addition, cheaper indigenous technologies should be considered, while community involvement should be enhanced in all aspects of planning and programming in the water and sanitation sectors. Finally, it is important to have nation-wide awareness campaigns to ensure commitment from population and willingness to pay by all beneficiaries, especially privileged and powerful ones.

The coastal zones in the region face environmental problems and pollution caused by urbanization and pollution from sewage and solid wastes, industrial pollution and oil spills and agricultural drainage. In addition, the ESCWA region is facing other environmental challenges, including physical alteration, destruction of habitats and serious pollution due to conflicts and wars. Most countries, however, have recognized the need for integrated coastal zone management through several action plans. Yet the region is still facing some constraints on account of the lack of regular and continuous monitoring of chemical and biological variables of coastal water, limited integration within national policies and legislation, and threats caused to regional wars and political instability. Rising populations, sea-transport and trade will continue to pose a challenge to policy measures intended to strike a relevant balance between the requirements of population growth and economic growth on the one hand, and the need to maintain healthy environmental standards in coastal zones and surface-water-covered zones on the other. Maintaining the region's stock of fisheries is just as important in this regard.

Emissions, mainly from industries, power plants and the transport sector cause concentrations of the principal air pollutants in major cities in the region often to exceed WHO guidelines. The burning of fossil fuels is the principal cause of atmospheric air pollution and the main source of CO_2 emissions. The TSP concentration in the air is much higher than maximum allowable limits. More and more vehicles, poor traffic management, ageing cars and congested roads in major cities are other major sources of air pollution in the region. In the energy sector, several programmes for upgrading energy efficiency were implemented and resulted in a significant reduction in fuel consumption. ESCWA has been supporting intraregional coordination and cooperation mechanisms for promoting both energy efficiency and renewable energy applications. Environmental benefits of these practices include higher efficiencies, which reduce emissions and air pollution, and a reduction in the need for installed power, which leads to reduced stress on coastal and marine resources. Stronger actions are needed by member countries to build their respective environmental monitoring and policy institutions in order to implement regulations more effectively.

For the past decades the region has been plagued by wars, which has caused major environmental problems, including physical damage to infrastructures, serious contamination from the release of potentially hazardous substances from targeted military and industrial infrastructure, air pollution from oil-field fires and severe damage to ecosystems and landscapes from military activities, including long-term environmental damage from the use of depleted uranium in Iraq. There are many environmental problems also arising as a result of the ongoing conflicts in the Occupied Palestinian Territory. The continuous degradation of water quality in many areas there is a cause for serious concern. Soil and groundwater pollution is brought about mainly by agricultural practices, localized industrial activities and inadequate and improper disposal of wastewater and solid wastes including hazardous materials. Accordingly, special measures and targeted programmes for SD are urgently needed to address the potential environmental disaster in countries of the ESCWA region afflicted by war and civil conflict.

The ESCWA region suffers from a persistent inadequacy of valid environmental information. Development of strategies involving important policy instruments, such as economic incentives for environmentally friendly technologies, and the implementation of the polluters-pay-principle and other enforcement mechanisms will improve the environmental monitoring systems in the region. Furthermore, most member countries have based their environmental management strategies on legal requirements and legislation that are often inadequate, technically inappropriate and some times economically unaffordable.

Accordingly, capacity-building is required to develop more effective institutions that will formulate more effective and appropriate legal environmental codes. These must be implementable in a region that continues to suffer from rapid desertification and related soil erosion, declining water tables decline and deteriorating water quality, coastal management problems and urban air pollution. Achieving SD and improving the quality of life within the ESCWA region will require effective programmes and interventions. These should contain the environmental crisis of development in the ESCWA region by raising living standards and addressing the salient social aspects of life in this turbulent area. Furthermore, the problems of poverty and unemployment, as well as those related to the conservation of resources, must be urgently addressed. Without an effective discussion of socio-economic problems, the region's resources will be exhausted as the population grows rapidly in size and more serious long-term crises ensue.

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