



THE STATE OF
**FINANCING
DEVELOPMENT**
IN THE ARAB REGION



UNITED NATIONS
الأمم المتحدة
ESCWA

Distr.
LIMITED
E/ESCWA/EDID/2018/TP.2
5 June 2018
ORIGINAL: ENGLISH

ECONOMIC AND SOCIAL COMMISSION FOR WESTERN ASIA (ESCWA)

**THE STATE OF
FINANCING DEVELOPMENT
IN THE ARAB REGION**



UNITED NATIONS
Beirut 2018

18-00252

**© 2018 UNITED NATIONS
ALL RIGHTS RESERVED WORLDWIDE.**

No part of this publication may be reproduced or transmitted in any form or by any means, including photocopying or by using any information storage and retrieval systems.

Requests to reproduce excerpts, figures or data or to photocopy any material should be addressed to the United Nations Economic and Social Commission for Western Asia (ESCWA), UN House, Riad El Solh Square, P.O. Box: 11-8575, Beirut, Lebanon.

The designations employed and the presentation of the material in this publication do not imply the expression of opinion on the part of the Secretariat of the United Nations concerning the status of any country, territory, city or area, or of its authorities, or concerning the delineation of its frontiers or boundaries.

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

Symbols of United Nations documents are composed of capital letters combined with figures. Mention of such a symbol indicates a reference to a United Nations document.

United Nations publication issued by ESCWA.

Keywords: 2030 agenda on Sustainable Development, Sustainable Development Goals, Financing for Development, Domestic Resource Mobilization, International and Domestic Private Finance, International Development Cooperation, Official Development Assistance, Multilateral Trade, Preferential Trade Arrangements, Regional Integration, Illicit Financial Flows, Trade Misinvoicing, Tax Evasion, Informal Economy, Trade-Based Money Laundering, Debt and Debt Sustainability.

JEL classification codes: E26, F13, F14, F23, G380, H23, H26, O17, O24, P48.

Printed at ESCWA, Beirut.

E/ESCWA/EDID/2018/TP.2

Photo credits: © Shutterstock; Getty-images.

“We can choose to bemoan the lack of financing for the 2030 Agenda in a world awash with so much unproductive and unrewarding finance or we can grasp the opportunity to reshape finance according to our urgent collective needs.”

António Guterres, United Nations Secretary General, 18 September 2017

FOREWORD

Financing is the bloodline of the 2030 Agenda on Sustainable Development and the key to achieving its 17 goals, 169 targets and indicators of achievement. Yet, three years after the adoption of the Addis Ababa Action Agenda (AAAA), the Arab financing gap continues to rise unabated with trillions needed in terms of quality investments of all kinds. The cost of conflict and the region’s post-conflict reconstruction adds to the anguish and risks diverting attention away from the 2030 Agenda. Financing for development is neither happening at the pace nor magnitude that can turn conflicts, poverty, inequality and other socio-economic hardships into an issue of the past, let alone realize sustainable development through Arab common action.

We can all seize this challenge to address the weaknesses in the financing architecture, its delivery channels and infrastructure. We can work to overcome insufficient public finance and market failures across the international monetary, financing and multilateral trading systems to unleash their full financing potential, especially at a time when more than \$50 trillion in global savings are not being effectively channelled into sustainable, productive and financially rewarding ends.

For these reasons, the United Nations embarked upon an ambitious reform agenda to deliver on the 2030 Agenda. Based on this reform, regional commissions emerge as the United Nations development system policy backbone: a connective link between global and local levels that provides regional perspectives and analytical

policy advocacy to address regional financing for development challenges and support the development of a wide range of regional norms, standards and conventions.

Through this first edition of The State of Financing Development in the Arab Region, the United Nations Economic and Social Commission for Western Asia (ESCWA) seeks to furnish all stakeholders (governments, civil society, business associations, regional development funds and non-governmental organizations) with a thought-provoking regional assessment of the Arab region’s financing for development (FfD) exposure. It is important to conjure a common diagnosis of the ails so that swift collective action can ensue to avert any further race to the bottom as far as financing development is concerned.

The choices we make today, and in no less measure those based on the report’s findings, will be critical for tomorrow’s financing decisions and sustainable development outcomes. It remains, nonetheless, the collective responsibility of all stakeholders to test the viability of the new global FfD framework. This remains critical to appreciate both its viability and influence on regional financing contexts and national propensities to finance development. We must act to ensure that we do not reach a point where corrective actions are no longer durable or are preempted as financing needs further amplify.

Mohamed Ali Alhakim
*United Nations Under-Secretary-General
and Executive Secretary of ESCWA*

ACKNOWLEDGEMENTS

This report has been prepared by the Financing for Development Office (FfDo) at ESCWA. It is the product of a concerted and dedicated effort by the report's team led by Hisham Taha, Economic Advisor and Head of the FfDo, with the support and contribution of Angelic Salha, Maya Hammoud, Maya Dah, Brook Anderson and Joumana Ibrahim.

We gratefully acknowledge the substantive contributions of Baker Raymond, President of Global Financial Integrity, Christine Clough and Joseph Spanjers; and the invaluable interventions from the High-Level Panel on Financing for Development by H.E. Wissam Fattouh, Secretary-General of the Union of Arab Banks; H.E. Samir Hammoud, Chairman of the Banking Commission of Lebanon; H.E. Ambassador Gamal Bayoumi, former Assistant Minister of Foreign Affairs of Egypt and President of the League of Arab States Investors Union; and H.E. Nicolas Tueni, Minister for Combating Corruption in Lebanon.

The report has also benefitted from the constructive deliberations of the representatives of the Governments of the member-States of ESCWA at the Twelfth Session of the Committee on Financing for Development. The report team is equally grateful to the contributions and suggestions expressed, with respect to an earlier version of the report, by Ali Awdeh, Director of Research at the Union of Arab Banks; Paul Cochrane, Director and Co-founder of Triangle Consultants; Ali Zbeeb, President of the Development Association for Nurturing Arab Leadership and Innovation; Jassem Ajaka, Professor at the Lebanese University and former

Advisor to the Minister of Economy and Trade in Lebanon; and Thouka al-Khalidi, former Director of the Economic Globalization Division at ESCWA.

We would like to acknowledge with appreciation our collaboration with the Department of Economic and Social Affairs in New York and the United Nations Economic Commission for Africa, namely, Gamal Ibrahim, Chief of Finance and Private Sector Section; Khalid Hussein, Chief of Forecasting Section; and colleagues at the United Nations Regional Commissions' Office in New York for the opportunity to present the report's preliminary findings at the United Nations General Assembly (Second Committee) Dialogue with the executive secretaries of the regional commissions.

The report team would like to acknowledge with appreciation the detailed thematic reviews undertaken by ESCWA colleagues, namely Ahmed Kamaly, Adel el-Ghabri and Karim Khalil, the support provided by the ESCWA Conference Services Section, including Maya Mansour, and the steadfast encouragement of Mohamed El Moctar Mohamed El Hacene, Director of the Economic Development and Integration Division.

Our sincere gratitude is extended to Mohamed Ali Alhakim, Under-Secretary-General of the United Nations and Executive Secretary of ESCWA, for the valuable guidance to the FfDo and, equally, to Khawla Matar, Deputy Executive Secretary, for the invaluable support in bringing this first edition of the report to fruition.

EXECUTIVE SUMMARY

The FfD outlook for the Arab region remains turbulent. The prognosis stems, in no little measure, from a strained socioeconomic fabric that risks being frayed by the biases of the status quo. The ability of Arab societies to withstand, adapt and recover from cascading global and regional crises is withering. Yet, it is this very region that demonstrates a unique form of resilience as it continues to finance development both within the region and in other parts of the world.

A compelling finding drawn from the analysis of direct and indirect FfD exposures reveals that between 2011 and 2016, for every \$1 gained/mobilized through prime cross-border FfD channels, the region lost/returned \$2.5 to other regions, including high-income bracket economies.¹ The situation challenges the dominating development narrative as the region appears to be witnessing a FfD reflux.² Substantial resources are flowing out of rather than into the region, constituting a leakage or, at best, an opportunity lost to finance the region's own reconstruction and sustainable development imperatives.

The Arab region continues to contend with escalated levels of violence and conflicts and is witnessing the largest crisis of forced displacement since World War II. Today, over 148 million people in the region live in conflict-affected or unstable environments of varying intensity.³ Particularly vulnerable are the 29 million forcibly displaced⁴ and the more than 56 million people dependent on humanitarian assistance.⁵ Under current trajectories, the region may well be set to consume half of the projected increase in global humanitarian financing by 2030.

The cost of conflict is rising unabated, with an estimated \$752–\$856 billion lost

in terms of economic activity as well as material damage to productive capacities. The rising death toll constitutes a more critical concern to reconciliation given that no price tag can be placed on the loss of life that remains largely unaccounted for in empirical assessments. Excessive military expenditure, running at two-and-a-half times higher than the global average share in output growth, coupled with the hefty reconstruction bill for war-torn economies, risks further diverting attention away from the financing requirements of neighbouring countries that are, or have been, affected by conflict.

A regional race to the bottom to spur growth and counter underinvestment in critical social infrastructure is not only fuelling beggar-thy-neighbour dispositions, but is also breeding harmful tax competition and fiscal incentives that erode the tax base and consequently potential tax revenue. Domestic resource mobilization efforts are, nonetheless being pursued to broaden the tax base (mostly through regressive redistribution), remove tax exemptions and rationalize inefficient fossil-fuel subsidies (both in terms of consumption and production patterns). However, the resources mobilized domestically may fall short of achieving the Sustainable Development Goals (SDGs) if the informal sector remains unintegrated in the formal economy and insulated from the overall planning and implementation of the SDG reform agenda.

The regions' fiscal space continues to be strained in reaction to the pace of consolidation needed to reduce long-standing fiscal vulnerabilities and break the cycle of poverty regeneration. Severe pressures on public finances along with the implementation of de-risking practices, including losses in Arab banking correspondent relations, are

having a toll on both financial inclusion and efforts to bridge the small and medium enterprise (SME) financing gap (by 2017, unmet SME credit demand amounted to \$159 billion).⁶ Savings from low oil prices and reduced subsidies allowed room to increase spending on infrastructure, health care, education and social services. However, the pace of consolidation remains imperilled by chronic current account imbalances and oil price rises and, on a more systemic level, as some key oil producers become importers by 2030.

The region is bearing the brunt of the double jeopardy arising from commodity price volatilities and a decline in terms of trade. Both have contributed to the displacement of \$97.6 billion out of the region between 2011 and 2016. The protracted delivery of the 0.7 per cent target for official development assistance (ODA), for its part, is undermining the global FfD framework as large portions of aid budgets (11 per cent of Donor Assistance Committee [DAC] allocations) are diverted to cover in-donor refugee costs.

The threat of a “lost generation” of Arab youth looms large as more than 92 million decent jobs need to be created by 2030 (equivalent to an annual investment bill of \$220 billion).⁷ However, with long-term investments subdued (nearly 63 per cent short of their record highs) along with lower-than-potential international private finance (as reflected by profit repatriation intensities for foreign direct investment [FDI], which have outpaced FDI inflows), inequalities are set to become more acute within the different segments of Arab societies. This comes at a time when oil-rich Arab economies are investing almost \$3 trillion in sovereign wealth funds outside the region. Resource-rich economies are also financing the public debt of many developed economies, including through their holdings of United States of America Treasury securities, which exceeded the entire external

debt stock owed by their non-oil Arab counterparts.

Significant shifts in the patterns of migration, both legal and illegal, are ensuing in the search for jobs to secure the vital flow of remittances, a bloodline for more than 24 million migrant families in order to meet basic household needs and ameliorate living conditions. The current norm, whereby 2.8 times more remittances are sent out of the Arab region than the dollar equivalents retained in the region, may prove economically and socially unsustainable. Equally, high-cost corridors are depriving the region of \$1.7 billion in annual development finance and, to the extent that their transfers are not monitored, risks creating a security hazard or a tax-relevant opportunity lost.

The Arab region’s FfD resilience is also undermined by \$60 billion worth of leakages arising from fraudulent non-oil trade misinvoicing, including those stemming from illegal settlements and Israeli-occupied territories in the West Bank, Gaza Strip and East Jerusalem. Illicit financial flows (IFFs) associated with drug trafficking, illicit trade in small arms, light weapons and antiques and undeclared oil trade activity on the part of non-state actors continues to impede financial deregulation and erode domestic resource mobilization capacity.

Considering these conditions, the new global FfD framework remains a normative ideal that is being continuously challenged by the region’s FfD idiosyncrasies. In fact, between 2011 and 2016, the region seems to have turned into:

- A net exporter of both capital and primary income (for every \$1 of FDI the region generated, a corresponding \$1.8 left the region);
- A lender of first resort (with the net stock of claims and liabilities/outflows lending to international banking and non-financial institutions amounting to \$223 billion);

- A debt service financier (for every \$1 of debt inflows the region received, a corresponding \$1.5 was paid back in arrears on outstanding debt stocks);
- A medium for illicit transfers (since 2014, IFFs outpaced the region’s combined inflows of FDI and ODA; and between 2011 and 2015, for every \$1 of total trade proceeds, 8 cents are lost due to trade-based money laundering);
- A net exporter of private capital, namely, remittances (for every \$1 of remittances generated and retained in the region, \$2.8 are sent elsewhere with 7 cents on the dollar lost to high-cost corridors);
- An ODA grantor (Arab ODA represents, on average, 83 per cent of non-DAC ODA and for every \$1 the region received

in ODA, 65 cents are returned through bilateral and regional funds).

To put these numbers into perspective, according to the 2016 Arab Sustainable Development Report, the Arab region was said to require \$3.6 trillion in gross fixed capital formation to finance the SDGs. At the time, this hefty bill did not account for the negative net resource transfers (NRTs) or the financing reflux witnessed by the region. If current trends continue however, the Arab region will be required to conjure an additional \$2.3 trillion by 2030 to achieve the SDGs. Put differently, if the region’s negative FfD exposure is reversed, the Arab region could well be placed on a path to meet most of its SDG bill and continue to finance sustainable development in other regions.