

Much ink has been devoted to squaring off the Sustainable Development Goals (SDGs). Now begins the unwavering search for financing for development (FfD). Should ends not meet, the 2030 Agenda risks becoming stone broke and would be left to oscillate between two acronyms (SDGs–FfD).

A contingency, however undesirable, would amount to yet another missed opportunity to turn the Arab region from an imperilled mosaic into an arc of prosperity.

How can SDGs be regionally adapted and financed? What is the right mix to muster and harness development finance? What are the returns on traditional versus innovative financing? How can domestic finance be leveraged? How can regional and international public and private financing be mobilized, blended and effectively channelled?

Getting the answers right is important, if not a sustainable development imperative. By assessing the state of the Arab region's FfD exposure, this report provides answers and insights as to how the region maintains a unique form of resilience as it continues to finance sustainable development both within the region and in other parts of the world.



THE STATE OF FINANCING DEVELOPMENT IN THE ARAB REGION



“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 – Secretary-General of the United Nations |

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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

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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.

¹ If the terms of trade effect is included the region loses \$2.7 with every \$1 gained.

² This conclusion resonates with similar findings suggesting that “rich countries aren’t developing poor countries; [but rather] poor countries are developing rich ones” (Hickel, 2017).

³ ESCWA, 2017a. ESCWA calculations based on data from UN DESA, *World Population Prospects 2017*.

⁴ ESCWA calculations, based on data from United Nations High Commissioner for Refugees (UNHCR), 2017a; United Nations Reliefs and Works Agency for Palestine Refugees in Near East (UNRWA), 2017; Internal Displacement Monitoring Centre and Norwegian Refugee Council, 2012 (for IDPs in the Syrian Arab Republic in 2011, since UNHCR’s support to IDPs in the country only started in 2012).

⁵ Based on data from United Nations Office for the Coordination of Humanitarian Affairs (OCHA), 2016a, 2016b, 2016c, 2017a, 2017b, 2017c, 2017d, 2018.

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);

⁶ SME Finance Forum, 2018.

⁷ United Nations Development Programme, 2011.

- 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.