ECONOMIC AND SOCIAL COMMISSION FOR WESTERN ASIA

SURVEY OF ECONOMIC AND SOCIAL DEVELOPMENTS IN THE ESCWA REGION 2007-2008

SUMMARY

United Nations

Distr.
GENERAL
E/ESCWA/EDGD/2008/2
19 March 2008
ORIGINAL: ENGLISH

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New York, 2008

08-0099

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In 2007, real gross domestic product (GDP) in the ESCWA region was an average of 5.4 per cent. It was 5.9 per cent in 2006 and is forecast to be 5.7 per cent in 2008. The region witnessed a steady growth in domestic demand, with the exception of Palestine where the ongoing military conflict continued to claim the lives and livelihood of civilians, particularly in the Gaza Strip. In the current oil boom cycle, business and consumer confidence continued to be buoyed by high oil prices, and by the concomitant effects of oil revenue and affluent consumption. However, rising prices, particularly of basic commodities, including food staples, became apparent in a region that is overwhelmingly dependent on food imports. There was a surge in the price of food items, construction materials and housing rents throughout the ESCWA region in both its constituent subregions, namely the countries of the Gulf Cooperation Council (GCC) and the more diversified economies (MDEs). The overwhelming majority of ESCWA member countries earn foreign exchanges in United States dollars and peg their national currencies to that currency. Consequently, owing partly to the falling dollar and partly to price mark-ups, the inflation rate in the ESCWA region increased to an average of 7.9 per cent in 2007, from 7.5 per cent in 2006. In the absence of full indexation of wages to the inflation rate, the steep rise in the cost of living was detrimental to the poorer strata of the population. In particular, the international rise in the price of wheat drove up bread prices. Against the recommendations of the previous issue of the Survey (2006-2007), some ESCWA member countries reduced subsidies on bread and other essential commodities, which adversely affected the poor. Meanwhile, while hyperinflation in Iraq tapered towards the end of 2007, the humanitarian situation of that member country remained alarming, with rising cumulative five-year estimates of the death toll resulting from the conflict and a sizeable portion of the population forced into exile.

Customarily, the Survey comprises two parts, namely: a first part that covers recent socio-economic developments; and a second part that explores in depth a topical social and developmental issue. Within the context of the latter, the thematic part has focused since 2005 on economic and social issues in line with development as a human right, with the Millennium Development Goals (MDGs) as guiding principles. The previous issue of the Survey dealt with the lessons learnt from the first oil boom and situated policy advice in a rights-based context. This year’s Survey builds on this argument and focuses on two significant social and economic concerns, namely, capital flight and unemployment. These have long delayed the right to development in the ESCWA region, thereby hindering the achievement of MDGs. From the perspective of individuals, it can appear rational to emigrate or invest away from a region that is plagued with long-term and intertwined economic and security concerns. However, perhaps more perplexing is that, to date, regional and international forces have not sought to reshape the regional context into one aimed at retaining financial and human resources. Comparative developmental experience shows that a better developmental framework can be achieved by integrating social policies in the core function of the State and by reinvesting more of the rents into upgrading regional labour and capital. However, for more than three decades, the region has experienced capital flight; often volatile and, over a 35-year average, zero per cent real GDP per capita growth; the highest unemployment rate in the world; rising income inequality; and a lopsided economic structure that is overwhelmingly based on the export of oil. Within that context, the rentier-supported system produces few jobs and those left outside that system, which can account for half of the labour force, subsist at poverty wage levels in an informal sector. Moreover, with increasing financial liberalization, lower public investment and higher short-term capital held by private rentiers, the risks of recession could be further compounded when oil prices fall. Tangentially, oil revenues measured on the basis of the Standard International Trade Classification (SITC 3-digit level) rank very highly in terms of volatility in relation to other export commodities. In line with pro-poor and rights-based literature, policy options could therefore be defined in terms of integrated social policies, qualitative economic growth that bridges income and gender gaps, raising public-led productive investment, establishing a regional industrial hub, imposing some restrictions on capital and trade accounts that are already widely open and even making the state an employer of last resort. However, in a region that is characterized by a short-term developmental horizon, a commercial circuit of capital and ongoing military conflicts, a compact on the right to development and security, including security of persons, must represent the starting point for a turnaround for all countries in the ESCWA region to meet the MDGs.

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I. RECENT ECONOMIC AND SOCIAL DEVELOPMENT TRENDS IN THE ESCWA REGION

A. THE GLOBAL CONTEXT

1. The expansion of the global economy eased moderately in 2007 and the prospects for 2008 became significantly uncertain towards the end of the year. The credit crunch in the financial markets of developed countries, which arose from the mortgage-backed securities sector in the United States of America, significantly altered the risk assessments and behaviour of global economic actors. The complications and controversies in risk valuations, which are embodied in securitized financial products, made it difficult to adjust the balance sheets of affected financial institutions. Despite a series of interventions by central banks of developed countries, particularly the Federal Reserve System of the United States in terms of aggressively cutting interest rates, credit turmoil continued to engulf developed countries.

2. The current credit crunch, as of early 2008, has been limited to developed countries, particularly the United States, and has not yet spread into a global phenomenon. Developing countries in general, including ESCWA member countries, have not been confronted by shortages in monetary liquidity. Rather, the growth of global liquidity continued in 2007 owing to the monetary easing of the United States; steady, high commodity prices; and rapidly accumulating foreign reserves of developing countries. The international flow of funds continued to support global imbalances, represented by a substantial current account deficit of the United States. Despite the weak dollar, which again proved to be an unsteady medium of international wealth holdings, the demand for perceived low-risk United States treasury bonds and bills remained strong. Meanwhile, inflationary pressure grew intensively during 2007 as commodity prices surged across the board, including crude oil, precious metal and food crops.

3. In this global context, the ESCWA region exhibited endurance in economic expansion.[1] With growing oil revenues, accumulated foreign assets and robust expectations of regional businesses and consumers, particularly in the GCC countries, monetary liquidity and import-based affluent consumption remained buoyant and proportionately greater than the erosion in the wealth effect that resulted from the decline in dollar-held assets. However, these effects were not witnessed in Palestine and Iraq, where regional conflicts and hostilities continued to devastate human and economic development. In Iraq, despite the appearance of high economic growth driven by increasing oil revenues, extremely high levels of poverty and child malnutrition were recorded. Subsequent to five years of conflict, alarming levels of human loss have been estimated and approximately one-sixth of the population is currently in exile. Efforts aimed at bringing back security to the population must therefore become the highest current priority.

B. OIL SECTOR DEVELOPMENT

4. According to statistics by the Organization of the Petroleum Exporting Countries (OPEC), the total global demand for 2007 averaged at 85.8 million barrels per day, while total supply of crude oil averaged at 84.8 million barrels per day.[2] While supply grew slowly, owing partly to the decision by OPEC to sustain a low production quota compared to its output peak of the last quarter of 2005, market conditions remained tight in 2007 given moderate growth of demand for crude oil. The projected rebound in demand for crude oil from developed countries was successively revised down during 2007; and global demand for crude oil will continue to be led by developing countries in 2008.

5. The price of crude oil surged throughout 2007, with the OPEC reference basket at a yearly low of $47.92 per barrel on 17 January, climbing to its yearly high of $90.84 on 28 December.[3] In 2007, the average crude oil price of the OPEC reference basket was $69.08 per barrel, compared to $61.08 in 2006.

[1] The ESCWA region consists of two subregions, namely: (a) countries of the Gulf Cooperation Council (GCC): Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and United Arab Emirates; and (b) countries and territories categorized as more diversified economies (MDEs): Egypt, Iraq, Jordan, Lebanon, Palestine, Syrian Arab Republic and Yemen.

[2] Organization of the Petroleum Exporting Countries (OPEC), *Monthly Oil Market Report* (March 2008).

[3] The OPEC basket price marked historical highs of over $100 per barrel in March 2008.

Certain observers interpreted this surge as a result of financial speculation whereby crude oil futures became relatively attractive financial assets. Others, however, saw the price escalation as being caused by tight supply condition or geopolitical considerations. In 2008, the OPEC reference basket price is projected to average $75 per barrel, albeit with the usual caveat of a high margin of error that is standard with regard to oil price forecasts.

6. The total production of crude oil of ESCWA member countries declined to an estimated 18.7 million barrels per day in 2007, which represents a modest drop of 3.0 per cent from 2006. Regionally, total gross oil export revenues were estimated at $431.1 billion in 2007, which constituted an increase of 12.9 per cent from 2006. A significant development was seen in the region's natural gas sector wherein Qatar became the world's largest exporter of that commodity. Moreover, natural gas production in Egypt is set to witness further development in 2008 in the wake of plans to initiate gas exports through a pipeline to Lebanon and the Syrian Arab Republic.

C. OUTPUT AND DEMAND

7. In 2007, real GDP across the ESCWA region was an average of 5.4 per cent. It was 5.9 per cent in 2006 and is forecast to be 5.7 per cent in 2008 (see table below). Steady growth in import-based affluent consumption was observed in the region, and the incomes of the rich rose at a higher pace than those of the poor. In less developed parts of the region, the incomes of the poor declined as a result of a fall in the purchasing power of wages. In particular, latest figures show that poverty in the Gaza Strip has already reached unprecedented depths, with approximately eight out of ten households currently living below the poverty line of $594 per household per month, which constitutes a dramatic increase from the rate of 63.1 per cent in 2005. Out of these, 66.7 per cent of households in Gaza are living in deep poverty, namely, on less than $474 per month. The population in that territory are more dependent on food aid and direct assistance than in previous years, with 80 per cent of households currently receiving humanitarian aid, compared to 63 per cent in 2006.[4] While high oil prices and associated oil revenue forecasts boosted business and import-based affluent consumption, liberal pricing policies of basic commodities, including food staples, left traders unregulated in terms of raising food prices far in excess of the costs incurred in production.

8. On average, GDP growth in the GCC countries was an estimated 5.2 per cent in 2007, after registering 6.1 per cent growth in 2006. The economy of that subregion continued to depend on the oil sector, albeit with increases in non-oil output in construction, finance and business services. Moreover, the contribution of industrial development to output edged up in such sectors as aluminium, steel and petrochemicals. The rate of capital transfer outside of the region also rose significantly despite ample opportunities to absorb capital nationally and regionally.

9. GDP growth in the more diversified economies (MDEs) registered an average of 6.0 per cent in 2007, compared to 5.6 per cent in the previous year. MDEs have not been exposed to potential foreign exchange constraints, and consumer expectations have remained largely stable. Business confidence was strong in construction and business services sectors, with the exception of Palestine. Egypt, Jordan and the Syrian Arab Republic made certain strides in the industrial development of various sectors, including food processing, pharmaceutical, steel production, textile and apparel. The Syrian Arab Republic inaugurated the production of automobiles in 2007. However, investment in the industrial sectors of Lebanon and Yemen remained deficient. Despite the rise in the international price of agricultural output, this subregion remained dependent on food imports, and related agricultural incomes did not rise owing to poor investment in agriculture and associated sectors in the past, thereby further deepening the rural-urban divide.

[4] United Nations Office for the Coordination of Humanitarian Affairs (OCHA), "The closure of the Gaza Strip: The economic and humanitarian consequences", *OCHA Special Focus: occupied Palestinian territory* (December 2007).

REAL GDP GROWTH RATE AND CONSUMER INFLATION RATE, 2004-2008
(*Annual percentage change*)

Country or territory	Real GDP growth					Consumer inflation rate				
	2004	2005	2006	2007[a/]	2008[b/]	2004	2005	2006	2007[a/]	2008[b/]
Bahrain	5.6	7.9	6.5	6.3	6.5	2.3	2.6	2.1	3.3	5.2
Kuwait	10.8	11.7	6.6	6.0	6.2	1.3	4.1	3.0	5.3	6.5
Oman	5.4	6.0	7.2	5.5	5.0	1.1	1.9	3.4	5.9	7.0
Qatar	20.8	6.1	7.0	8.2	9.7	6.8	8.8	11.8	13.7	12.5
Saudi Arabia	5.3	6.1	4.3	3.5	4.1	0.3	0.7	2.2	4.1	6.0
United Arab Emirates	9.7	8.2	9.3	7.4	7.5	5.0	6.2	9.3	11.0	10.0
GCC countries[c/]	7.7	7.3	6.1	5.2	5.6	1.8	2.7	4.3	6.3	7.4
Egypt[d/]	4.6	6.9	7.1	7.3	6.7	11.0	4.7	7.3	9.6	10.2
Iraq	23.0	10.0	5.9	6.1	7.0	27.0	37.0	53.2	30.8	11.0
Jordan	8.6	7.1	6.3	6.0	5.5	3.4	3.5	6.3	5.4	6.7
Lebanon	5.0	1.0	0.1	2.0	3.0	4.0	4.7	8.2	7.0	7.5
Palestine	2.0	6.0	-8.8	-2.2	1.0	3.0	3.5	3.8	2.5	5.2
Syrian Arab Republic	6.7	4.5	5.1	4.5	4.0	4.6	7.4	10.0	5.5	6.5
Yemen	3.9	4.6	4.2	4.5	3.2	12.5	11.8	20.8	10.6	12.5
More diversified economies[c/]	6.3	6.2	5.6	6.0	5.8	11.1	9.1	13.6	11.1	9.5
Total ESCWA region[c/]	7.2	6.9	5.9	5.4	5.7	5.0	4.9	7.5	7.9	9.8

Source: ESCWA, based on national sources.

a/ Estimates in March 2008.

b/ Forecasts in March 2008.

c/ Figures for country groups are weighted averages whereby weights for each year are based on GDP in 2000 constant prices.

d/ For GDP growth rate of Egypt, 2004 stands for that country's fiscal year, namely, July 2004 - June 2005.

10. The economic circumstances of countries and territories affected by conflict, namely, Iraq and Palestine, remained difficult throughout 2007. GDP growth of Iraq, estimated at 6.1 per cent in 2007, was heavily dependent on oil exports. The ongoing conflict and lack of infrastructure hampered reconstruction and development of non-oil sectors. A recovery in domestic demand was witnessed in Iraq, which was driven by consumption, including, to a degree, imported affluent consumption. In Palestine, the blockade by Israel on the Gaza Strip in addition to continuing security instabilities and hostilities imposed a severe constraint on the economic activities of that ESCWA member. Economic activity and the livelihoods of the majority of the population were stifled by various factors, including the circumvention of the Palestinian Authority by major donor countries; harsher mobility restrictions that were imposed by Israel; withholding Palestinian clearance revenues by Israel; and delayed and partial payment of wages of public employees. Consequently, economic decline is forecast for a second consecutive year in 2007.

D. COSTS AND PRICES

11. The surge in the price of foodstuff, construction materials and housing rents were recorded throughout the ESCWA region in both the countries of the GCC and MDEs. The average consumer inflation rate for the ESCWA region stood at 7.9 per cent in 2007, which represents an increase from 7.5 per cent of the previous year. In 2007, the cost of living rose steeply in certain sectors in Bahrain, Kuwait, Oman and Saudi Arabia.

12. Despite a rise in public sector wages in GCC countries, the rapid rise in the price of basic goods in 2007 caused a partial decrease in real wages. Equally, real wages declined in MDEs and Government intervention aimed at fending off the eroding impact of inflation was less than adequate. Consequently, given rising asset and property prices, inflation as a kind of indirect form of taxation redistributed income towards asset and property owners, thereby lowering labour's share. While nominal wages can rise commensurately with inflation, regional labour representation and autonomous trade unionism remain weak.

E. EXTERNAL SECTOR

13. The external sector performance for the ESCWA region stayed strong in 2007. The total current account surplus of GCC countries was estimated at $217 billion, increasing from $193 billion in 2006. Equally, the total current account surplus of MDEs was an estimated $12.6 billion, increasing from $6.8 billion of the previous year. The current account balance of ESCWA members stabilized, with the exception of Jordan, Lebanon and Palestine, while the trade activities of the ESCWA region continued to expand and investment income, principally dollar held, from foreign assets increased, albeit tempered by the devaluation of the dollar. With the exception of Palestine, there were no signs of external fragility even in those countries with current account deficits. However, despite that favourable observation, the fiscal and monetary stances of most Governments were pinned on cautious short-term fiscal balancing, which invariably undermines the capacity of the State to invest in the long-term payoffs of the social infrastructure.

14. The exchange rates of ESCWA member countries remained stable, albeit with continuous appreciation pressures. With the notable exception of Kuwait, national currencies in the GCC subregion are pegged to the United States dollar. Kuwait abandoned that peg in May 2007, opting instead to peg its national currency to a basket of currencies of major trading partners. As a result, the Kuwaiti dinar appreciated by 5 per cent. Outside the GCC subregion, the Egyptian pound appreciated by 4 per cent, and the Iraqi dinar appreciated by 9 per cent in 2007 against the United States dollar. The depreciation of the dollar against other major currencies caused a parallel devaluation of the region’s currencies pegged to the dollar. Inflation increased owing partly to retail mark-up practices and partly as a result of the increase in import prices from Europe and Asia, which raised questions as to the effectiveness of the dollar peg in foreign exchange rate regimes. However, for overwhelmingly political reasons, the GCC Summit in December 2007 fell short of proposing any changes to the prevailing foreign exchange regime and confirmed the target date for the GCC currency union as 2010.

F. SOCIAL DYNAMICS

15. Despite evidence of the pitfalls that arise from relying exclusively on a “growth first” approach for solving social problems, ESCWA member countries continued to rely on social benefits derived from this model. In many countries of the ESCWA region, economic development is not living up to its promise of guaranteeing comprehensive social benefits. Poverty and unemployment continue to plague entire societies; such basic social services as health and education are lacking in quality or are unevenly distributed, and are largely inadequate in terms of meeting demands; and significant disparities in social indicators, including, among others, maternal health and poverty levels, continue to widen. Particularly relevant in this context is the ideological hold of uncritical thinking methods on teaching techniques, namely, learning by rote, which limits the development of human capital. There is an urgent need for an integrated social policy in which “social” issues are not viewed as residual or secondary to economic processes, but rather as a central focus and wherein public policy is informed at every stage by social equity and human rights concerns. Social policy enhances economic growth by addressing those social structures and conditions that prevent people from access, participation and full inclusion as citizens and human beings. Moreover, social policy attends to the needs of the poor and vulnerable by ensuring that people have access to social services that promote their health and well being and, by extension, their ability to work and contribute to society; promoting equal access to opportunities and participation in society and the economy; and establishing the necessary regulations and institutional mechanisms aimed at removing any barriers to inclusion and participation. More pertinently, while social investment does not exhibit immediate economic payoffs, the long-term developmental returns are evident.

16. Inequality as measured in terms of income and non-income criteria has been increasing in the ESCWA region. Despite efforts by ESCWA member countries aimed at balancing economic and social development, social dynamics remain characterized by diverging trends in income levels and the acquisition of financial and social resources across social groups. The rapid rise in housing and food prices for the poor underscores the growing cleavage between owners and non-owners of assets. Specifically, those with assets and real estate property were able to ward off the negative effect of rent hikes, while the rise in housing rents became more of an expenditure burden on the poor in most ESCWA member countries. Given the widespread notion that markets act as creators of wealth as a matter of course, it is unlikely that this schism in society will be

redressed soon. This uncritical view of the market de-contextualizes income inequality and poverty, and obscures their origins and mechanisms of reproduction over time and across countries and regions. In minimally complex market economies, exclusion from local or international markets is normally not the cause, but rather a consequence of poverty. In ESCWA economies, poverty tends to be sustained by the form of integration of specific social groups into the dominant rentier mode of social and economic reproduction. It is their modalities of economic and social integration that impose upon the poor exploitative labour regimes, including poorly-paid wage labour in the informal sector; precarious primary production; tenuous self-employment; and, potentially, degrading forms of labour. In turn, these labour regimes are associated with low productivity, low incomes and unsteady living standards. Consequently, given the lack of or negligible alternative support mechanisms, State-sponsored welfare policies must act to reintegrate the poor and vulnerable into the economic process.

17. Stagnant employment creation has been observed in the ESCWA region. The real economy and labour intensive sectors are modest in terms of size and productivity relative to the oil rent sector. The issue of unemployment and underemployment remains the region's major socio-economic predicament. The lack of employment opportunities in many ESCWA member countries appears paradoxical given that the ESCWA region continued to host a high level of immigrant labour mainly from South Asia, South-East Asia and Africa. Despite successive achievements in education, particularly the rapid growth of enrolment of women in higher education, the lack of employment opportunities persists, affecting most adversely the region's youth and women. Most experts agree that employment generation represents the most important link between growth and poverty alleviation in the ESCWA region; and its persistent weakness is symptomatic of a deep macroeconomic malaise. These employment problems are potentially destabilizing both socially and politically and, for these reasons alone, they must be addressed constructively by Governments within a regional framework aimed at promoting labour-intensive industrialization. Rent-driven economic growth on its own cannot bridge the developmental gap. Rather, a qualitatively different type of growth, or rights-based growth, is needed to bridge the gender gap, reduce income inequality and provide people with decent employment outside rentierism. Rights-based growth must benefit the poor more than the rich. Specifically, growth is rights-based when it scales down relative as well as absolute poverty. Within the context of the former, poverty cannot be reduced to an arbitrary level of income given that insufficient income is one of the implications of the structural inequalities that constitute the economic system in the countries of the region. Moreover, given the specific oil-mode of integration of this region with the global economy, the solution to these deeply-ingrained problems of poverty and inequality is primarily political, rather than economic. Within these limitations, rights-based macroeconomic policy can provide an essential contribution to the complex and inevitably contentious process of redressing structural inequalities and eliminating the symptoms of poverty in the ESCWA region, only insofar as ESCWA member countries make fighting unemployment and poverty their main objective. In the interim and until macro policies can be coordinated to create industrially generated employment, the State can always act as employer of last resort.

18. While the ESCWA region, particularly the GCC subregion, has accumulated a significant amount of financial capital during the current oil boom, it has failed to accumulate human capital given that the principal economic activity is commercial/rentier as opposed to industrial. There is a talented youth population, but the region has not capitalized on its potential. The region continues to depend on poorly-paid migrant workers in the private sector, many of whom reside in impoverished conditions and transfer a good portion of their incomes outside the region. More favourable wages and conditions of work could encourage a greater number of nationals to take up employment in the private sector, re-circulate their incomes nationally and, at the same time, reduce the region's unemployment trap. It is more beneficial to lock in transfers and buttress the regional demand component with tailor-made industrial and trade policies, which give preferential treatment to regional labour, thereby boosting prosperity indirectly by increasing the prosperity of neighbouring States.

19. Foreign workers represent both an asset and a challenge for the ESCWA region. While Governments in the GCC have reformed some policies in a bid to acknowledge the rights of foreign workers rights, these remain short of desired targets. Bahrain, Kuwait and the United Arab Emirates implemented an amnesty in 2007 for illegal foreign residents under which they could choose to legalize their status or return them to their home countries without legal prosecution. The sponsorship system for foreign workers in GCC

countries has been discussed and could be abolished or replaced by a contract-based system. It is encouraging to see the law and practice regarding expatriate labour being reconsidered. Re-circulating wages and earnings in the region's economies could certainly provide a needed boost for the demand side, which, under less favourable conditions, act as an automatic stabilizer.

20. Human resource development and vocational training of nationals persisted in GCC countries in order to raise the proportion of nationals in the labour force. More women participation into the labour markets was encouraged. Redeployed adequately, educated women can redress the shortage of skilled labour in GCC countries. With relevant institutional and legal support and the high enrolment of women in higher education, the subregion has the potential to take new strides in development and the advancement of women. However, real progress hinges on the degree of political representation, which remains modest. There is widespread development experience to indicate that overcoming widespread gender bias can lead to a virtuous cycle in social and economic development.

G. SOCIO-ECONOMIC POLICY DEVELOPMENTS

21. There are hopeful signs in some parts of the region that the integration of social policy and pro-poor macro policies are being drawn into the core functions of the State, despite the absence of autonomous civil society organizations in some instances. For example, the decision to lift fuel subsidies by the Government of Jordan coincided with a strengthening of social safety nets through income support to poor households and provided for by the National Aid Fund. However, it is too premature to gauge accurately the welfare outcome. In Bahrain, the adoption of an integrated social policy led to the consideration of a gender programme in next year's budget. While in real terms, the rights of women are considerably better served when the rentier-based system allows more political representation, matters on that specific goal remain far below aspirations. More importantly, broad pro-national and regional industrial production agendas have yet to come into play as allies of women's rights.

22. Inflation rates in the ESCWA region increased in 2007, particularly in housing and rents. Along with international price increases in world commodities, policymakers were confronted with the need to implement subsidies or consider direct transfers to the poor in order to stabilize or defuse the effect of rising prices of basic commodities. However, despite a positive stand in the balance of payments and fiscal accounts, subsidies for fuel products, wheat and other basic products were being reconsidered downwards in some MDEs. While policymakers opted to target social services and aid to the poor directly, the outcome of this approach is questionable given that the State has to keep count of the poor and, subsequently, it has to possess the means of delivery of goods in an expeditious manner. In both areas, this capacity remains in doubt at the national and regional levels, and the poor could be better served if the excess transfers to the rich were requisitioned by the State through immediate taxation. Meanwhile, pressing developmental needs presented policymakers with the imperative to remain engaged in active fiscal policies despite rising inflationary pressures. However, the developmental component of this policy, which is public investment, remained secondary in view of the shift in accent towards private sector activity and continued emphasis on building political capital. In that respect, the observations made in preceding years are equally relevant in this year's Survey, namely: the economies of the region are operating below full employment and can be said to be exhibiting anaemic financial intermediation; and, consequently, many more resources could be deployed in active public-private partnerships.

23. For most ESCWA member countries, monetary policy was not effective in terms of targeting sufficient liquidity to the poor, particularly poor women. The region's central banks had to conform to the aggressive monetary easing of the United States since September 2007. Several policy options were actively sought by the region's central banks to counter the paralleled monetary easing, including open-market operations, increases in reserve requirements, and asymmetric setting of lending and borrowing interest rates. However, the effect was limited and showed that these selective demand control measures were inappropriate. Additionally, it illustrated the need to exert more effort towards making liquidity available to the poor, rather than towards financing returns on poorly-regulated stock markets.

H. PROSPECTS

24. The ESCWA region is projected to grow at 5.7 per cent in real GDP in 2008. The inflation rate is expected to reach a higher level in 2008 to a regional average of 9.8 per cent. These projections are based on three precarious conditions, namely: (a) a high price level of international commodities and oil price; (b) domestic demand expansion led by consumption, principally imported affluent consumption goods; and (c) poorly-regulated asset markets in the region that allow unrestrained bubble formation backed by banking credit. While the economies in the ESCWA region could remain resilient in the face of accelerating inflation owing to persistently high oil prices, continuing inflation in terms of food and housing prices is anticipated to put more pressure on the poorer segments of the population. The Governments of ESCWA member countries are best advised to exert more efforts aimed at keeping provision of basic goods at stable prices, integrating social policies into the very core of State functions, creating a regional insurance programme for non-economic losses in order to boost investment, and focusing on qualitative rights-based growth rather than on growth first scenarios.

25. The current environment is and will remain effectively “decoupled” from the turmoil of world markets during the course of 2008 unless oil prices decline suddenly. While the probability of such a drop is low and difficult to assess for 2008, the consequence could be severe for the following reasons: (a) the region’s economies are still heavily dependent on oil revenues; (b) business expectations are associated with continuously rising oil revenues; and (c) a substantial proportion of regional capital is short-term held and could easily flow out at the first sign of panic. While output of the non-oil sector of GCC countries has increased, its share is too modest relative to oil to cushion the impact of a fall in oil prices. A regulatory regional framework on capital movements coordinated by the region’s central banks could become necessary in order to monitor the in- and outflows of the region.

26. Discussions on foreign exchange rate regimes in conjunction with the establishment of the GCC currency union in 2010 are expected to intensify. De-pegging or revaluation of national currencies against the dollar is a necessary, albeit insufficient condition to fight inflationary pressures. Moreover, there are serious concerns on the valuation loss of dollar-denominated assets that are held by the region’s Governments and central banks. The size of these dollar-denominated assets is estimated to be significant in GCC countries. Consensus is needed on the expected valuation loss of the foreign assets before a country de-pegs or re-values. Despite market pressures, the dollar peg regime is unlikely to be changed without strong regional or international political interventions.

II. CAPITAL FLOWS AND DEVELOPMENT IN THE ESCWA REGION

27. As expected, the significant rise in oil revenue in recent years, which began in 2002-2003, has resulted in a sharp increase in total capital flows. Over the past five years, the region’s excess savings over investment topped half a trillion dollars. This situation is markedly different from the stagnant 1980s and the 1990s and is similar to the boom of the 1970s. However, in this current boom the rate of capital outflows is significantly higher, and the rate of responsiveness of employment to the economic growth rate is substantially lower. Arab assets abroad are estimated at some $1.8 trillion and are set to grow, while the region exhibits some visible symptoms of absolute and relative poverty. The theme of this year’s Survey centres on the rising tide of capital flows and on charting the policy landscape for the appropriate links between capital flows, sustained growth and employment creation within the context of a right to development approach.

A. RESOURCE LEAKAGES INDICATIVE OF POOR INVESTMENT CLIMATE

28. For oil exporters, capital flight of a different order of magnitude has taken place in recent years. Given that capital flight involves the unrecorded export of mostly short-term capital, it acts as a gauge of the outlook of those who control money capital with respect to productive long-term investment. Towards the end of the 1990s, there was already substantial capital flight from Kuwait and the United Arab Emirates. However, capital flight became particularly pronounced with the onset of this current oil boom, especially in Saudi Arabia. In short, a significant part of the rents from the recent oil boom have leaked abroad for investment in non-transparent financial instruments. While the development implications of these resource

outflows cannot be accurately quantified, they clearly delineate the drain on resources from a region that is already characterized by low productive investment levels, high income inequality, high illiteracy rates in some member countries and vast potential to expand the physical and social infrastructure.

29. For oil exporters, the sum of capital outflows and capital flight are significant, as is to be expected from countries that have generated substantial current account surpluses in recent years. While there are only rough estimates, it is reasonable to assume that capital flight was as strong in 2005 and 2006 as it was in 2003 at the onset of the current oil boom. Nearly all member countries experienced capital flight; however, the main source since 2000 appears to be Saudi Arabia, with strong outflows equally registered by Kuwait and the United Arab Emirates.

30. The counterpart to inflows of foreign direct investment (FDI) and surpluses on current account (minus debt repayments) has been substantial accumulation of reserves by ESCWA member countries. Absolute levels of reserves are highest in Saudi Arabia. Indeed, reserve formation is particularly striking in MDEs, particularly Egypt, Lebanon, Syrian Arab Republic and Yemen. While developing countries typically keep reserves worth three months of imports, these ESCWA member countries currently hold more than one year's worth. Given that a significant part of these reserves is kept in United States Government instruments, there are significant costs for these countries in terms of low rates of return on United States debt compared to domestic debt. A sizeable part of assets held abroad vis-à-vis the regional developmental process is set to remain in the form of unrequited transfers. Moreover, ESCWA member countries and especially Saudi Arabia, which has accumulated the largest reserves, are taking a substantial exchange risk as the dollar is proving once more to be an unstable medium of wealth holding. While a choice could have been made aimed at developing and holding assets regionally under rigorous protection/regulatory frameworks, this did not occur. Most of the region's dollar-held assets abroad are devalued with the devaluation of the dollar, thereby writing off a portion of the wealth that could be bequeathed to future generations.

31. Given that financial flows are volatile and the region is subject to frequent oil price shocks, it is unsurprising that growth continues to be too erratic and, on average, too sluggish to permit an increase in both living standards and employment. Moreover, despite the current growth spell, the long-run average real per capita growth rate, which is the principal quantitative measure of development, is zero per cent for the period 1971-2005. Growth continues to be of the jobless type or one that does not commensurably lower the rate of unemployment, which is higher than in any other region of the world. Jump starting the region's economy from this slow erratic path of growth to a higher sustainable path, which could reduce substantially the level of unemployment and eradicate poverty, requires a substantial injection of financial resources capable of driving investment in both physical and human capital. This initial drive, which can be perceived as a "big push", could come principally from official sources of finance by retaining part of the oil rents, or from some capital outflows in terms of a development tax. This could be led by public investment given the significant potential for enhancing the social and physical infrastructure. Moreover, this tax would necessarily be combined with policies that recognize the need both for market-based incentives and for a greater role of the State and for institution building. Currently, most countries in the region invest less than 25 per cent of GDP, whereas the fast-growing Asian countries invest 25-35 per cent, and China invests nearly 40 per cent of GDP. In the ESCWA region, however, in addition to lower investment rates, the composition and type of investments differ from other regions. Investment is caught in a finance, insurance and real estate (FIRE) context and economic growth led is by affluent importable consumption.

32. A major change in the economic environment is needed in order to help the region to veer from the existing consumption-led path of growth to a higher and sustainable investment-led path. However, guarantees on non-economic losses over the long term have to be reworked in a regional setting. Moreover, the current weak financial intermediation has to change otherwise a greater proportion of the investment will be tied to short-term activity, given the outstanding regional security risks. This change needs to include changes in fiscal, monetary and exchange rate policies that are coordinated at a regional level and that promote the inclusion of the poor in the economic activities related to investment in increasing returns activity, employment and industrial exports. Such a change, particularly in terms of directing some of the oil rents into investment in MDEs, could bring about a process that helps to break the dependence on the volatile oil revenue in two ways, namely: (a) rapidly rising income would initially allow investment to be raised along with output, thereby raising society's total capabilities; and (b) sustained growth would attract both

domestic and foreign capital, thereby reducing the dependence on official financing at a later stage. Ideally, attenuating oil dependence can best be achieved by launching a massive regional industrialization programme and by sustaining rapid growth for a sufficiently long period in order to allow domestic savings and external private flows to replace gradually official involvement. This is a reversal of development from rent-based to industrial-based, thereby revamping the whole circuit of capital. However, in the current and weak security and institutional setup, it is tantamount to short-sightedness to speak of public investment retrenchment, fiscal discipline and a greater role for the private sector. Experience shows that the private sector was not able to fill the gap and, moreover, that liberalization increased the outflow of resources, thereby causing the degradation of nascent national industries and allowing merchants to raise their mark-ups on basic commodities, with devastating impacts on the poor.

33. Recalling that rights-based economic growth implies improvements in distribution and social welfare, these improvements must not be merely marginal or conditional on trickle-down processes. Moreover, they must be unambiguous across a broad spectrum of measures of welfare and distribution. It is growth with quality and respect for nature, especially in a region whose green saving rate has been steadily negative and in complete contrast to its highly positive monetary saving rate. Additionally, in a region that is constantly experiencing conflict, a new security compact is a necessary condition if a rights-based economic development strategy is to succeed. Security needs to be understood in three senses, namely: (a) national security, including the protection of the rights of the regional population to self-determination, especially in Palestine; (b) democratic security by promoting the citizen rights of the population in the ESCWA region and by institutionalizing democratic accountability of the State; and (c) economic security, including the right to decent employment and macroeconomic stability, which needs to be promoted through regional regulation and economic integration. When these are taken in combination, security measures will facilitate the transition to the new rights-based economic development strategy that is being proposed for the ESCWA region.

B. FINANCIAL AND TRADE POLICIES

34. With regard to the topic of this year's Survey, rights-based financial policies in the ESCWA region need to be linked to a broader industrial strategy that fosters productivity growth and the development of domestic production capability in selected areas aimed at exhibiting increasing returns when possible. Within that context, the first element is the promotion and diversification of exports, particularly in MDEs. Export growth can contribute significantly to productivity growth given that it exposes producers to the stringent test of competition in foreign markets. Moreover, export growth is essential in terms of generating healthy trade surpluses and accumulating foreign currency reserves, which supports the stabilizing exchange rates. International reserves are especially important for the GCC subregion given that they provide a buffer against declines in oil prices and help to insulate these countries against exchange rate volatility. By contrast, the absence of sizeable currency reserves obtained through trade surpluses in MDEs could compel the countries in this subregion to seek periodically more volatile forms of international finance, particularly short-term loans and portfolio capital inflows, or to borrow from international financial institutions, whose conditions could limit the pursuit of rights-based policies. For that reason, strengthening the prevailing inter-Arab financial institutions, particularly the Arab Monetary Fund (AMF), could bolster the macroeconomic stabilization of the region. However, when the region's future generations and long-term welfare and neighbourhood effects are considered, it could be rational to reverse the current rivalry and revert to more cooperative forms of coexistence.

35. Export growth in MDEs requires a competitive and stable real exchange rate, in addition to coordinated industrial policy initiatives aimed at developing the competitive advantages of these countries in strategically important sectors. Careful management of import restrictions is also necessary for long-term growth. Despite views to the contrary, this Survey reiterates the finding that "openness and trade integration, either separately or together, do not have a measurable impact on long-run growth".[5] Imports must be

[5] C.E. Weller and A. Hersh, "The long and short of it: Global liberalization, poverty and inequality", *Working Paper B14* (Centre for European Integration Studies, 2002), p. 14.

liberalized cautiously and selectively given their potentially adverse impact on the poor and on strategically significant sectors.

36. While the ESCWA economies do not lack absorptive capacity or the capacity to absorb a large inflow of resources for investment without setting off an inflationary process, rapid trade liberalization and surging imports must be avoided because they can be destabilizing even in those economies that are operating below capacity. Regulation of trade is important for two key reasons, namely: (a) import liberalization can trigger severe social and economic dislocations, particularly in such strategic sectors as agriculture, construction and new "growth" industries; and (b) experience shows that relatively autonomous late development is possible only if it is supported by strategic trade policies. Moreover, trade liberalization could have an especially severe impact on the poor for the following three reasons: (a) the gains from trade can be concentrated in enclaves or they can raise the returns for skills or assets that are beyond the reach of the poor, thereby increasing income and wealth inequality; (b) subsidized exports from rich countries, including, for example, grain, sugar, cotton, fruit, meat and dairy products, can undermine the viability of small-scale agriculture and the livelihoods of millions of rural poor; and (c) liberalization can increase predatory competition, thereby reducing economic growth, wages and the employment opportunities of the poor. Within the context of the last point, recent evidence from the region suggests that, despite the higher rent subsidized wages of the economy that serve in part as a political stabilization tool, the actual wages of the real economy tend to sink below subsistence given the low productivity of the non-oil sector and the high rate of distortion introduced by rents.

C. CAPITAL ACCOUNT CONTROLS

37. Rights-based strategies also require the regulation of the capital and financial account of the balance of payments. Unbridled liberalization of the capital account can be regionally destabilizing for four main reasons, namely: (a) liberalization promotes speculative inflows that can finance consumption rather than investment, that facilitates capital flight and increases the country's vulnerability to balance of payments crises, principally MDEs; (b) rights-based strategies require monetary policy autonomy, which is severely curtailed by international financial liberalization; (c) rights-based strategies require the State to direct investment and other resource flows to objectives that promote growth and reduce poverty, which can conflict with the short-term interests of the financial sector; and (d) capital controls are needed in order to curb tax evasion given that the tax rates required to fund rights-based programmes will be higher than abroad. Even if capital account liberalization raises growth rates in the short term, this effect tends to vanish later. In the current boom, a high proportion of capital is held short term in speculative activity, and experience shows the need for transparency and stronger regulatory measures.

38. Several forms of capital control have been used recently by such diverse countries as Chile, Japan, Malaysia, South Korea and Sweden. In these countries, the use of controls has not resulted in interruptions of economic growth; on the contrary, removing controls has resulted in financial crises and severe economic downturns, as in the case of Mexico in the early 1990s and in East Asia in the late 1990s. Whichever form they take, controls over the movement of funds across national borders is a necessary part of any general programme of economic change. Without such controls, a Government cedes the regulation of its economy to international market forces, which often translates into the forces of large international firms and powerful Governments of other countries. In the ESCWA region, an additional concern rests with an abrupt fall in oil prices and a rush of short-term held capital away from the region, which constitutes capital exodus that clearly requires some restrictions.

39. Capital controls can include restrictions on foreign currency bank accounts and on currency transfers; taxes or administrative limits on outflows of direct and portfolio investment; restrictions on foreign payments for technical assistance between connected firms; non-interest bearing "quarantines" on investment inflows; controls on foreign borrowing; and multiple exchange rates determined by the priority of each type of investment. At a minimum, they need to include the requirement that all foreign resource flows be registered or, preferably, pass through the central bank in order to measure the country's financial relations with the rest of the world and allow the central bank to regulate the external exposure of domestic banks and firms. This helps to ensure that they do not build up unsustainable financial positions for speculative reasons, which

becomes particularly tempting during a resource boom. There is sometimes an impression that there is no end in sight for the cycle and that financial investors keep pushing up prices. Additionally, it helps to reduce the scope for capital flight, including, for example through bank deposits, financial transactions, over-invoicing and other unauthorized means of capital transfers. While managing these controls burdens the monetary authorities, this task is not beyond the capabilities of most central banks. The most significant obstacle to capital controls is not technical, rather it is political.

D. EXCHANGE RATE POLICY

40. Finally, it is important to release the exchange rate system of most ESCWA member countries from the fixed parities with a falling United States dollar for the following reasons: (a) reiterating the position stated two years ago in the past Survey (2005), a shift towards managed floating against a basket of currencies will help to revalue the real exchange rate of oil-rich countries, which is especially necessary during a resource boom; (b) it will improve the match between the trading patterns and financial relations of these countries and their exchange rate systems, thereby helping to deliver macroeconomic stability; (c) it will restore the scope for monetary policy in the region; (d) it will facilitate the protection of national currencies and the control of capital flows; and (e) it will ease the transition towards the devaluation of the currencies of those countries that are adversely affected by the oil boom. In the medium and long term, monetary and exchange rate policy coordination between the ESCWA member countries is essential for the success of a regional pro-poor and rights-based economic strategy. This can be extended, in the future, to encompass a regional system of fixed exchange rates, thereby moving towards a single currency for the region that can float vis-à-vis other major currencies. This could help the region to stabilize trade and promote investment in ESCWA and, at a further remove, increase the monetary policy space available to the countries in the region.

E. REGIONAL INTEGRATION

41. One of the distinguishing features of the region is the structural inequality between the GCC countries where the resource surpluses are concentrated, and MDEs where the social needs are most pressing. Implementing a rights-based development strategy as outlined above can help to maximize social welfare in the ESCWA region as a whole. This will require a much greater degree of regional coordination of finance and investment, and monetary, fiscal and exchange rate policy. Moreover, greater integration will help to protect oil economies from the impact of oil price volatility, support economic diversification and protect the region from potentially adverse developments in the international economy. For MDEs, regional integration offers the prospect of secure access to larger and wealthier markets, improved infrastructure, better conditions for their expatriate workers in other ESCWA member countries, and more secure access to oil when this becomes necessary. Furthermore, regional integration can promote access to aid and increase security of food and fuel supplies for poor countries. This strategy for integration can also support the construction of more efficient bureaucracies in each State, which is an essential aspect of democratic governance. This, in itself, is an important gain for the region given that it could support the assertion of popular sovereignty and Government accountability to the citizenship.

42. In order to maximize the scope for success, regional coordination of production is essential, particularly in the manufacturing sector. This will require the development of supranational institutions, with the authority to regulate business practices, including, among others, accountancy rules, business registration, tax policies, cross-country claims and labour regulations; and to influence the allocation of investment funds and determine the production priorities in the region. At a further remove, regional coordination of fiscal, tax, monetary and exchange rate policies will provide the essential level playing field for the success of integration efforts. However, in the absence of policy convergence within a negotiated framework, the gains from integration are likely to be limited.

43. Any development strategy will be limited by the security concerns and the political instability in the region. The international environment in the aftermath of the terrorist attacks on the United States of 11 September 2001 (9/11) illustrated the degree of insecurity for foreign investment from ESCWA member countries, particularly from the GCC subregion. This situation could represent a catalyst for regional policy changes and incentives to reinvest in the region. This can be addressed in two ways. On the one hand, there

needs to be a decisive international effort aimed at introducing a new security compact in the region. This compact must address the key foreign relations problems in the region, particularly the occupation of Palestine, the military invasion and destabilization of Iraq, and the growing instability in Lebanon. Historically, solutions to these regional problems that are sponsored from outside the region have always remained inadequate. There is a compelling case to be made that resolving the regional conflicts requires involvement by those countries that are closest to the affected populations. This approach suggests that the interests of foreign powers need not normally play a decisive role in any ensuing negotiations. Moreover, regional powers, particularly the GCC, can offer financial incentives aimed at stabilizing the region and fostering investment, including, for example, by establishing a regional, non-economic losses insurance scheme, thereby encouraging long-term investment. While such schemes already exist informally, including, for example, the significant investment by Saudi Arabia aimed at stabilizing Lebanon, it could be institutionalized through a multilateral body that is tasked with the administration of regional insurance for investment in ESCWA member countries.

44. In order to support the development of this new regional policy compact, preferential treatment for ESCWA capital, including repatriated capital and migrant remittances, need to be secured within the region. This can be achieved by, among others, reforming the tax, procurement and firm registration procedures, which need to be exploited to the maximum extent in line with WTO rules, albeit with a priority on the interests of the region. These regulations need to be part of a regional industrial policy package aimed at raising regional investment and trade, internalizing supply chains, and supporting employment generation and productivity growth. There is no doubt that this represents a long and costly process. However, if successful, it could build the conditions for stable and rights-based development in the ESCWA region.

F. CONCLUSIONS

45. The process of delivering goals that are desirable both socially and environmentally constitutes part of regional rights-based development strategies aimed at achieving MDGs. These strategies, which have already been outlined in past issues of the Survey, are significant for three reasons. First, they are intrinsically worthwhile, given that rights-based strategies maximize the welfare impact of growth and contribute to the distribution of power and wealth. In other words, they are compatible with and conducive to the expansion of democracy. Secondly, ESCWA member countries have the potential to achieve rapid advances in social welfare, including integrated social policies, given their available resources in terms of raw materials, labour and savings. However, with respect to savings and as pointed out above, when the costs to nature are deducted from the high savings of the region, the remainder is a negative “green” saving rate, which imperils the livelihood of future generations. Rights-based growth is not concerned with growth as an end in itself, but rather on improving the standard of living of the poor and on safeguarding nature by diversifying away from oil by creating a new metabolic order that supports the survival of future generations. Finally, the current policies in most countries have led to suboptimal outcomes across a large spectrum of measures of welfare, particularly in the light of persistently high unemployment rates and precarious social safety nets. Despite the availability of investment opportunities and the need for rapid employment generation, slow progress is being made in terms of ploughing savings back into the region. While it is true that other developing countries are able to combine capital outflows and high investment rates, it must be remembered that these flows are generated in industrial activity as opposed to rentierism; and in the ESCWA region, savings can exceed investment by as much as 50 per cent, despite ample investment opportunities in social and physical infrastructure at a regional level. Oil rent, commercial activity and the geopolitical setting of this region shapes both the essence of the development agent and the current context for the investment decision-making process. At face value, changing the context implies changing oil rent into knowledge-economy rent; commercial activity into industrial activity; and, finally and least probable in the current background, instilling peace and security in the region. Unfortunately, the positions of international and regional powers are still not amenable to this sort of transformation. Consequently, in the interim, the State is compelled to fulfil its mandate under the signed covenant on human rights in order to guarantee a decent standard of living for its population through the immediate delivery of goods that are desirable both socially and environmentally.