
# Realities and Prospects in the Arab Region

## Survey of Economic and Social Developments 2019-2020

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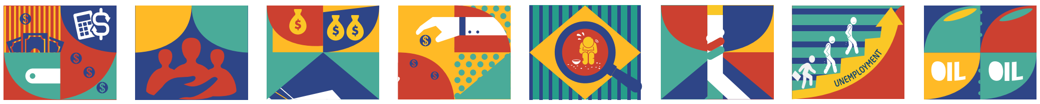
Economic and Social Commission for Western Asia

# Realities and Prospects in the Arab Region




## Survey of Economic and Social Developments

## 2019-2020

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# Preface

The Survey of Economic and Social Developments in the Arab Region is an annual flagship publication of the Economic and Social Commission for Western Asia (ESCWA). This publication is mandated by paragraph 173 of General Assembly resolution 35/56; paragraphs 2 to 4 of ESCWA resolution 270 (XXIV); and paragraphs 1 and 2 of ESCWA resolution 303 (XXVII). The publication seeks to contribute to efforts by member States to reform economic institutions and develop and implement policies based on principles of good governance, so as to enable economic planning and policymaking in support of inclusive and sustainable development. The present 2019-2020 edition focuses on analysing the most recent socioeconomic developments under a set format, with a main reporting period of January 2019 to March 2020. The publication has the following two key objectives: to analyse routinely monitored economic and social variables in the Arab region in a global context (chapters 1 to 3), and to address debt sustainability and the macroeconomic implications (chapter 4).

# Acknowledgements

The present publication was prepared under the overall direction and guidance of Moctar Mohamed El Hacene, Leader of the Shared Economic Prosperity Cluster at the Economic and Social Commission for Western Asia (ESCWA). Mohamed Hedi Bchir, Report Coordinator, led a core team comprising Ahmed Moummi, Souraya Zein, Nathalie Khaled, Niranjan Sarangi, Khalid Abu-Ismail and Jan Gaska. Research assistance and administrative support were provided by Maroun Laoun, Bilal Farhat and Arpy Atamian. The team is grateful for the data support from the ESCWA Statistics, Information Society and Technology Cluster, particularly Majed Skaini, Roy Doumit, Wassim Hammoud, and Ramzi Fanous.

The team would like to greatly acknowledge the internal peer review by Wafa Aboul Hosn, Vladimir Hlasny and Rouba Arja, and the substantive contributions made by the following ESCWA clusters: Gender Justice, Population and Inclusive Development; Climate Change and Natural Resource Sustainability; Statistics, Information Society and Technology; and Governance and Conflict Prevention. Policymakers and other stakeholders were also consulted throughout the preparation of the report, and an external expert group meeting to review and validate the draft report was held online on 15 September 2020. The participating experts were: Ali Awdeh, Head of Economic Research at the Union of the Arab Banks; Arun Jacob, Development Coordination Officer for Egypt; Aljaz Kuncic, Development Coordination Officer for Saudi Arabia; Raydan Al-Saqqaf, Coordination Officer for the United Arab Emirates; Clive Altshuler, former Senior Economist at the United Nations Department of Economic and Social Affairs (DESA); and Nizar Jouini, Head of Programme at the Doha Institute for Graduate Studies.

# Executive Summary

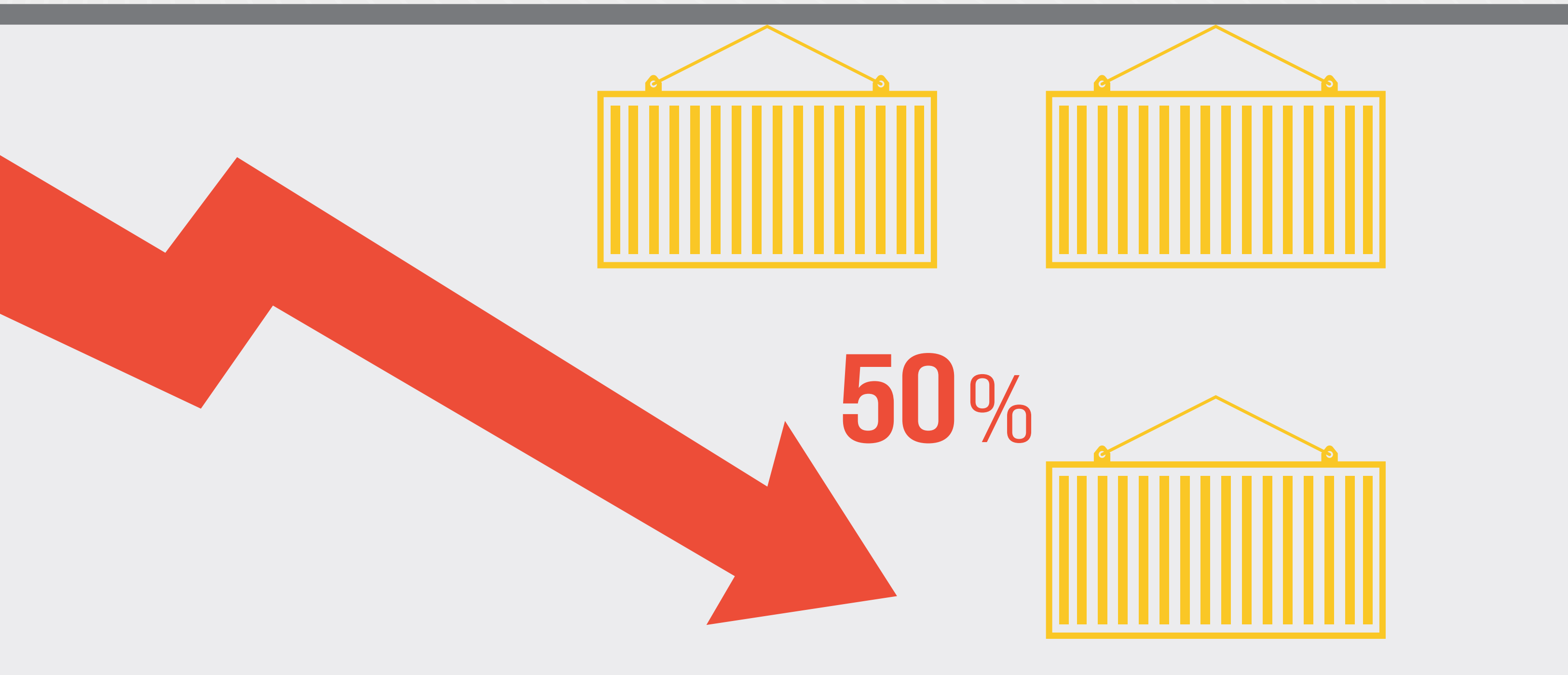

Providing an analysis of the global economic situation amid the COVID-19 pandemic is a difficult task. The outbreak has exerted tremendous pressure on the global economy, the scale of which is still unclear. Given that the pandemic will have significant repercussions in 2021 and beyond, it is crucial to understand how Arab countries are dealing with the economic impact of the virus.

The present report sets out two scenarios: a baseline scenario projecting that the economy will rebound in the first quarter of 2021; and a pessimistic scenario in which the crisis will persist throughout the first quarter of 2021. However, given the considerable advancements in research on COVID-19 vaccines, an economic rebound should be expected no later than the second quarter of 2021.

The COVID-19 shock began in the midst of a global economic slowdown. The pandemic resulted in extensive lockdowns that exerted significant pressure on the global economy, which is expected to have contracted by at least 3.2 per cent in 2020. The 2021 recovery is conditioned on the effectiveness of the stimulus packages enacted by Governments in response to the COVID-19 crisis and the speed of business recovery. Advancements in research on COVID-19 vaccines allow for moderate optimism. Consequently, the global gross domestic product (GDP) growth in 2021 is expected to rebound to 4.2 per cent, even in the pessimistic scenario. However, if the packages enacted in 2020 prevent devastating losses for companies, global GDP growth could reach 5.4 per cent in 2021 in the baseline scenario.

Inflation in 2021 is conditioned on the influence of unprecedented monetary stimulus measures enacted by Governments worldwide in 2020 to tackle the pandemic-related recession. If they succeed in stimulating demand, inflation should rise. However, oil demand from China, the world's largest crude oil importer, decreased significantly in 2020 owing to massive lockdowns and huge cuts in transport activities. In December 2020, the price of Brent crude oil increased to $48/barrel, which is still lower than its average for the period 2018-2019. However, following successful vaccination campaigns, global transport demand in 2021 should rise, further elevating oil prices and fuelling inflation globally.

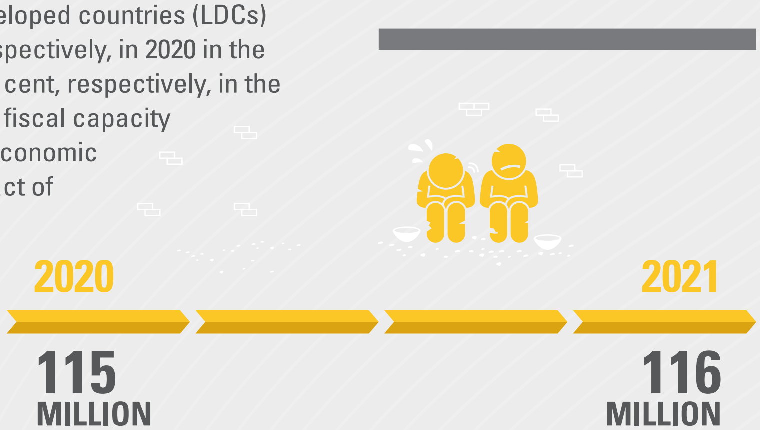
The global economic slowdown and the pandemic have significantly affected Arab countries. The region's GDP is estimated to have contracted by 3 per cent in 2020 (the baseline scenario) and exports from the region decreased by almost 50 per cent, affected by the decline in oil prices, the closure of European markets, and a reduction in tourism and remittances. Moreover, the global lockdown affected the inflow of investments and official development assistance to Arab oil-importing countries. Such developments led to tremendous pressure on businesses in the region in the absence of government assistance. Consequently, regional GDP growth is expected to reach 2.8 per cent in 2021 in the pessimistic scenario or 3.5 per cent in the baseline scenario.



The impact of the COVID-19 and oil price crises on Arab oil-exporting countries will continue into 2021, with revenues in 2020 estimated at 44 per cent of 2019 income, leading to a temporary dent in State budgets. Gulf Cooperation Council (GCC) countries were the most affected, losing around 54 per cent of their income. Their GDP is estimated to have contracted by 3.1 per cent in the baseline scenario, and by 7.1 per cent in the pessimistic scenario. However, in 2021, a rebound is expected in both oil prices and oil production, leading to GDP growth of 2.1 per cent in the pessimistic scenario, and of 2.3 per cent in the baseline scenario.

The pandemic has significantly affected Arab middle-income countries (MICs), with their economy contracting by an estimated 3.4 per cent in 2020 in the baseline scenario and by 4.5 per cent in the pessimistic scenario. These countries were affected by a drop in tourism and a decline in demand for their exports owing to the recession in European countries, one of their main trading partners. Recovery will depend on the success of the stimulus packages of their trading partners, and on whether successful vaccination campaigns will restore confidence and consumption. Lebanon in particular is witnessing exceptional socioeconomic challenges that surfaced in 2019 and were aggravated in 2020 as the economy grappled with twin deficits, high public debt, a default on the repayment of Eurobonds, a large depreciation of the local currency, and a slowdown in economic activity owing to the lockdown. In 2020, the Lebanese economy contracted by an estimated 10.2 per cent, and no functioning government had been established as at December 2020. Arab middle-income countries are expected to achieve 4.1 per cent GDP growth in 2021 in the pessimistic scenario, and 5 per cent in the baseline predicated on a rebound in European demand and successful political and economic reforms.

The economies of conflict-affected and least developed countries (LDCs) contracted by an estimated 4.3 and 3 per cent, respectively, in 2020 in the baseline scenario, and by 7.9 per cent and 5.5 per cent, respectively, in the pessimistic scenario. These countries had limited fiscal capacity to deal with lockdowns and to mitigate the socioeconomic consequences of the COVID-19 crisis, so the impact of the pandemic-related recession is more severe. Furthermore, ongoing conflicts are likely to negatively affect business confidence and the inflow of foreign direct investments. In 2021, GDP growth in Arab conflict-affected countries is expected to reach 3.1 per cent in the pessimistic scenario, and 3.9 per cent in the baseline



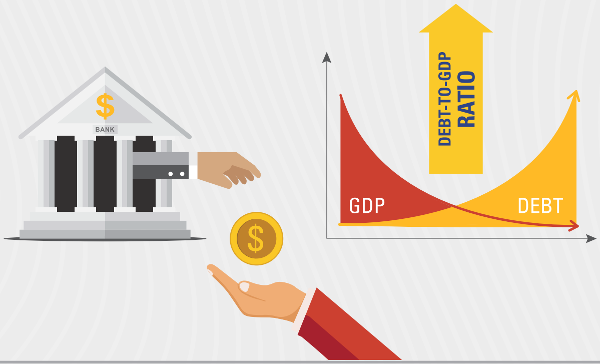
scenario. Arab LDCs rely significantly on external support to address their socioeconomic challenges, particularly balance of payment constraints and debt sustainability, so their recovery is conditioned on the successful recovery of developed economies. Since the economic damages caused by the pandemic will be more persistent in LDCs, their growth figures for 2021 are expected to be mediocre at 0.4 per cent in the pessimistic scenario, and 0.5 per cent in the baseline scenario.

In addition to a challenging economic situation, the Arab region must address social challenges, including growing poverty, increased unemployment and persisting gender inequalities, aggravated by the outbreak of COVID-19 and strict lockdown measures. The income poverty rate increased by an estimated 3 percentage points to reach 32.4 per cent in 2020, equivalent to around 115 million people, over 80 per cent of whom live in four countries, namely Egypt, the Sudan, the Syrian Arab Republic and Yemen. Moreover, the unemployment rate in the region increased by an estimated 1.2 per cent in 2020. The persistence of these problems depends on the resurgence of aid flows and remittances in 2021, and on the ability of Governments to provide social safety nets to alleviate poverty.

Socioeconomic challenges will also affect migrant workers, refugees and internally displaced persons (IDPs) in the region, particularly women. Travel restrictions and poor working conditions made migrant workers more vulnerable to various risks, including COVID-19 infections. Furthermore, the difficult living conditions of refugees and IDPs have been exacerbated by constrained economic conditions in host communities, which could deteriorate further as deep recessions hit donor countries.

With regard to gender equality, the Arab region still has a 40.05 per cent gender gap to close, the highest globally compared with other regions. Women are more likely to leave their jobs to fulfil household responsibilities during lockdown, including caring for children following school closures, which will increase gender inequality if preventive measures are not immediately and successfully enacted.

Debt levels are expected to increase in 2020 and beyond as a result of the adverse impact of COVID-19 in LDCs and MICs. LDCs are likely to benefit from the G20 Debt Service Suspension Initiative, and debt relief from the Catastrophe Containment and Relief Trust of the International Monetary Fund to mitigate the impact of COVID-19, with potential savings of $294 million. ESCWA analysis on debt evolution and its relationship to fiscal policy behaviour indicates that primary deficits have persisted in Arab LDCs and MICs. Fiscal sustainability gap analysis shows that the required primary balance for several countries is more than the actual primary balance. Consequently, there is a need for primary balance adjustment, dependent on setting a debt-to-GDP target. Moreover, linking government spending to development outcomes is a major challenge facing Arab countries' debt management authorities over the next couple of years.



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# Abbreviations and Explanatory Notes

| | |
|---|---|
| **BIS** | Bank for International Settlements |
| **CACs** | conflict-affected countries |
| **DAP** | diammonium phosphate |
| **DESA** | department of Economic and Social Affairs (of the United Nations) |
| **EIA** | Energy Information Administration (United States Department of Energy) |
| **ESCWA** | Economic and Social Commission for Western Asia |
| **FDI** | foreign direct investment |
| **GCC** | Gulf Cooperation Council |
| **GDP** | gross domestic product |
| **GECF** | Gas Exporting Countries Forum |
| **HIPC** | heavily indebted poor countries |
| **IDP** | internally displaced person |
| **IEA** | International Energy Agency |
| **ILO** | International Labour Organization |
| **IMF** | International Monetary Fund |
| **LDC** | least developed country |
| **LIBOR** | London Interbank Offered Rate |
| **LNG** | liquefied natural gas |
| **Mb/d** | million barrels per day |
| **MENA** | Middle East and North Africa |
| **MIC** | middle-income country |
| **MMBtu** | million metric British thermal units |
| **MT** | million tons |
| **MTPA** | million tons per annum |
| **ODA** | official development assistance |
| **OECD** | Organization for Economic Cooperation and Development |
| **OPEC** | Organization of Petroleum Exporting Countries |
| **SDGs** | Sustainable Development Goals |
| **SDR** | special drawing right |
| **UNRWA** | United Nations Relief and Works Agency for Palestine Refugees in the Near East |
| **VAR** | vector autoregression |
| **VAT** | value added tax |
| **WTI** | West Texas Intermediate |

**COVID-19**
pandemic

**Global recession deeper** than **2008**

**World GDP**
contraction by
**3.2%**
in **2020**

**Global growth**
contraction by **4.9%**

**Sharp decline in oil prices**

**2020**

**simultaneous demand**
and supply shocks

**Decreases**
in tourism and transport activities

**deeply affected**
employment creation

# 1 The Global Context and its Implications for the Arab Region

## Key messages

- The COVID-19 pandemic will cause a global recession deeper than the 2008 global financial crisis.
- World GDP is estimated to have contracted by 3.2 per cent in 2020, and is projected to recover in 2021 if the necessary conditions are implemented. Otherwise global growth could have contracted by 4.9 per cent.
- In 2020, the oil market underwent simultaneous demand and supply shocks that led to a sharp decline in oil prices, which reached its peak on 21 April 2020 when the price of West Texas Intermediate (WTI) oil allocated for delivery in May 2020 plunged below zero.
- The current global crisis will have a deep impact on the Arab region. The fall in global demand for energy will affect Arab oil exporters. Furthermore, decreases in tourism and transport activities will have a deep impact on growth and employment creation in many middle-income countries (MICs). The deteriorating economic situation in developed countries will also affect the inflow of investments, remittances and official development assistance (ODA) to Arab least developed and conflict-affected countries.

## A. Global context

The COVID-19 pandemic began in the context of a global economic slowdown. Growth fell from 3 per cent in 2018 to 2.6 per cent in 2019, and trade activity weakened as a result of prolonged tensions between China and the United States. In 2019, these tensions spilled over into other areas, including uncertainty resulting from the exit of the United Kingdom from the European Union, and allegations of protectionism between the United States and the European Union that led to a slump in global trade activity of 0.3 per cent from 3.9 per cent, which was the lowest value since the 2008 global financial crisis. These negative developments affected supply chains and depressed global demand, leading to a fall in manufacturing activity, especially in China, Africa and the Middle East.

Another unfortunate event was the increase in global debt amidst exceptionally low interest rates in developed countries, causing real yields on 10-year government bonds to fall below zero in six of the largest developed economies. Developed countries benefited from these conditions by pursuing a more active fiscal policy. However, these benefits could not be extended to developing countries, which still need to pay high interest on their debts. The number of low-income countries in debt distress rose from 19 to 34 between 2016 and 2019. The shift of debt composition from long-term borrowing from the Paris Club towards more expensive short-term lending led to a surge in interest payments, and increased the cost of debt servicing in developing countries. These countries entered 2020 with a lack of fiscal space, which significantly limited their ability to appropriately respond to the COVID-19 crisis.

Massive worldwide lockdowns, coupled with significant decreases in tourism and transport activity, will shape the world economy for the next few years. World gross domestic product (GDP) is estimated to have contracted by 3.2 per cent in 2020, and is projected to recover in 2021 with a growth rate of 4.2 per cent (baseline scenario). The recovery is conditioned on the speed at which economies will return to their long-term trends; the level of investor and consumer confidence; and the effectiveness of stimulus packages enacted by Governments in response to COVID-19. If these conditions are not met and a second wave of the pandemic occurs, the situation could be worse and the global economy could have contracted by 4.9 per cent in 2020 (pessimistic scenario). The recovery in 2021 will be only slightly better at 5.4 per cent, too low to compensate for the higher GDP loss witnessed in 2020.

In developed economies, growth slowed drastically from 2.3 per cent in 2018 to 1.9 per cent in 2019, even before the COVID-19 outbreak. This grim picture will not improve soon, as the United States is estimated to have contracted by almost 5 per cent in 2020 and is expected to moderately recover in 2021 with a growth rate of 3.9 per cent (8 per cent and 4.5 per cent, respectively, in the pessimistic scenario). Similarly, the European Union is estimated to have lost more than 5.5 per cent of GDP in 2020 and is expected to recover by 2.8 per cent in 2021 (-10.2 per cent and 6 per cent, respectively, in the pessimistic scenario). In developing countries, the outlook has also been revised downwards. In 2020, they are estimated to have lost 0.5 per cent of their GDP (-1 per cent in the pessimistic scenario). India is projected to avoid recession with a 1.2 per cent growth rate, owing to credit easing and fiscal stimulus in 2019 (the pessimistic scenario projects a 4.5 per cent recession). Southeast Asia is the only region to avoid recession in the baseline scenario, with 0.8 per cent growth projected despite a slump in tourist activities and disruptions to production chains (the pessimistic scenario envisages a 2 per cent recession). As Southeast Asian countries swiftly and effectively contained and managed COVID-19, they benefited from resuming production activities while other developed economies remained under lockdown.

The economic outlook for Africa and other economies in transition is affected by low commodity prices. African economies are estimated to have lost 1.6 per cent of their GDP in 2020 before recording a partial recovery in 2021, with a 3.4 per cent GDP growth rate (the slump is deeper in the pessimistic scenario at 3.2 per cent). The ability of developing countries to enact fiscal stimulus is an additional challenge as government revenues will decrease sharply owing to the commodity glut, leading to an inability to provide adequate support for societies hit by lockdown measures. Contrary to developed economies, these countries are also facing much stricter borrowing constraints, further reducing their ability to provide support for the most vulnerable.

In the context of this economic slowdown and falling commodity prices, global inflation remained low in 2019. In developed economies,

**5%** **2020**

The **United States** is estimated to have contracted by almost **5 per cent** in 2020 and is expected to moderately recover in 2021 with a growth rate of **3.9 per cent**

**5.5%** **2020**

The **European Union** is estimated to have lost more than **5.5 per cent** of GDP in 2020 and is expected to recover by **2.8 per cent** in 2021

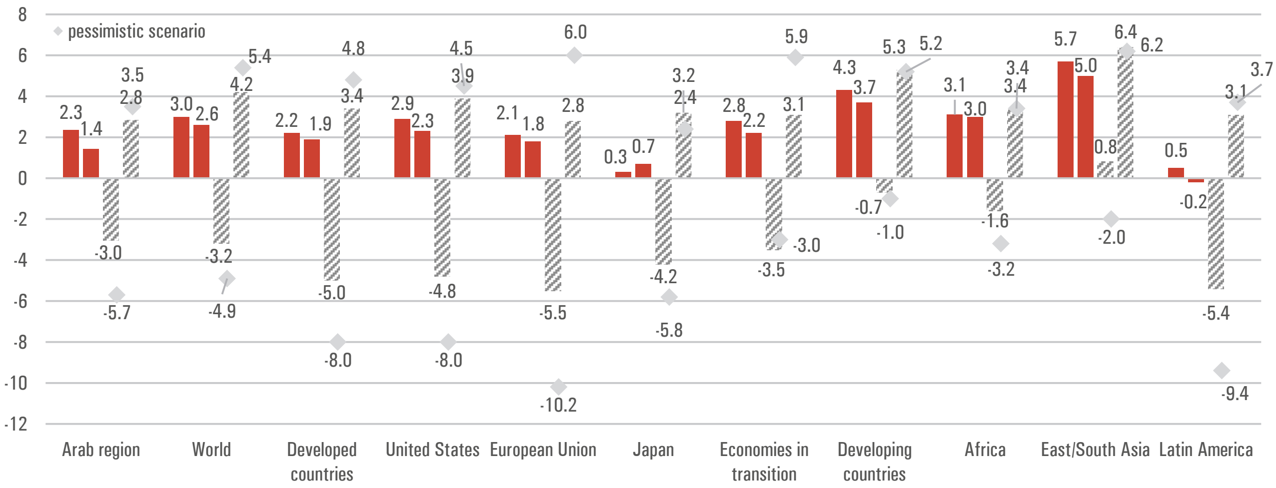
**0.5%** **2020**

**Developing countries** are estimated to have lost **0.5 per cent** of their GDP

**0.8%**

**Southeast Asia** is the only region to avoid recession, with **0.8 per cent** growth projected

Figure 1.1 **GDP in selected regions and countries, 2018-2021**




**Sources:** Based on the internal forecast received from DESA/Project LINK; and DESA, *World Economic Situation and Prospects 2020* (New York, 2020).

inflation weakened from 2.4 per cent in 2018 to 1.8 per cent in 2019. The escalation of tariffs in major economies pushed up producer prices in some sectors, but lower energy prices and low inflation in the services sector have generally reduced consumer price inflation. In some developed countries, low inflation rates coupled with declining inflation expectations have undermined the credibility of central banks to meet near-term inflation targets.

The pandemic will speed up this trend. Inflation slowed down in 2020 as a result of the slump in oil prices and the decline of global demand. In contrast, monetary stimulus, which will lead to significant increases in the money supply, may outweigh this effect in 2021, especially in developing countries where central banks would need to monetize additional expenditures given their inability to place debt on the financial markets. Consequently, after low inflation in 2020, a sharp increase in prices is expected towards 2021, provided that monetary stimuli enacted by developed countries worldwide are successful in restoring consumer and investment demand.

Interest rates were stable in the United States and the European Union in 2019, following an increase in 2018. However, bond yields fell, reflecting greater uncertainty resulting from trade tensions. Between November 2018 and February 2020, the two-year United States treasury bond yield

**1.8%**

In developed economies, inflation weakened from **2.4 per cent** in 2018 to **1.8 per cent** in 2019

**1.2%**

Two-year United States treasury bond yield decreased from **2.9 per cent** to **1.2 per cent** decreased by 1.7 percentage points from 2.9 per cent to 1.2 per cent, despite the constant target band. Increased uncertainty following the COVID-19 outbreak led to a rapid decrease in both two-year and 10-year bond yields. These developments were paired with a rapid and extensive decrease in the Federal Open Market Committee's target federal funds rate, meaning a significant expansion of open market operations and the purchase of Treasury and agencies' securities as needed. The two-year bond yield fell to near-zero, while the 10-year bond yield was around 0.7 per cent at the beginning of June 2020. Furthermore, the Federal Reserve pushed forward a large package of measures to facilitate the flow of credit, including facilities to ease the issuance of commercial papers by companies and municipalities, the provision of additional loans to depository institutions, and the purchase of loans from companies. This unprecedented set of instruments injected additional, almost unconstrained, liquidity to the market.

In 2019, the London Interbank Offered Rate (LIBOR) decreased in line with the treasury bonds rate. Between November 2018 and February 2020, LIBOR fell by 1.1 percentage points from 2.7 per cent to 1.6 per cent. Amidst uncertainty related to COVID-19, the volatility of the Treasury-Eurodollar (TED) spread (between the 3-month LIBOR and the 3-month United States Treasury Bill yield) increased, and reached 1.4 per cent in March and April 2020, levels unobserved since the global financial crisis in 2009. LIBOR also fell to 0.5 per cent, unobserved since 2015.

Low interest rates were unable to stimulate GDP and investment growth. Inflation rates worldwide remained low despite a few years of loose monetary policy. The European Central Bank's policy rate remained zero over the period 2019-2020. The yield of German bonds fell below zero at the beginning of 2019 and remained there over the period 2019-2020, reflecting investors' belief that low interest rates are here to stay over the next couple of years. Furthermore, the yield of two-year bonds fluctuated between -0.6 per cent and -0.8 per cent, leaving no space for further decreases to support companies following the COVID-19 crisis. A prolonged period of very low interest rates raised concerns among economists about the impact of these developments on efficiency.

Liu and others (2019) argue that persistently low long-term interest rates encourage market concentration, reducing business dynamism and productivity growth. Moreover, the Bank for International Settlements (2019) shows that prolonged low rates may also delay the shifting of resources from less productive sectors to more productive ones, which could result in an increase in zombie firms or overinvestment in private construction. These concerns will be even more pronounced following the 2020 stimulus packages enacted in developed economies to support businesses after the COVID-19 shock.

When exchange rates are considered, the euro continued its earlier depreciation against the dollar in 2019 and early 2020, reflecting differences in policy stance between European and American monetary authorities. It is

too early to judge whether COVID-19 has significantly affected the trend in the dollar/euro rate, but differences in developed economies' responses to COVID-19 increased the volatility of the exchange rate and presumably led to a reversal of the downward dollar/euro trend. Since late 2019, the dollar has depreciated against the Japanese yen. As in the case of the euro, the yen/dollar rates witnessed increased volatility following the COVID-19 outbreak. In contrast, the depreciation of the Chinese renminbi against the dollar was reversed following a trade deal signed in January 2020. In early 2020, the renminbi/dollar relationship remained relatively stable despite the COVID-19 turmoil.

Concerning global trade, 2019 was marked by heightened trade tensions between major actors in the global economy, which deeply disrupted the global value chain. Global trade grew at 0.3 per cent, the lowest level in a decade. Sectors with complex production chains, such as machinery, electronics and automotive industries, have been particularly affected. Some countries benefited from the redeployment of production sites, but the global economy was nevertheless negatively impacted. COVID-19 could represent an additional risk to globalization. The rapid spread of the virus that was attributed to globalization has strengthened anti-mundialization movements and intensified protectionist measures among member States of the World Trade Organization.

# B. Natural resource commodities

Oil Natural gas and phosphate

## Oil

In 2020, the oil market underwent simultaneous demand and supply shocks. In 2019, global oil demand was already low averaging an estimated 99.74 million barrels per day (Mb/d), lower than the projected demand of 100.5 Mb/d. Even before the COVID-19 shock, oil market prospects were rather grim: falling expectations of global growth amidst trade tensions decreased the global demand for oil. Political tensions in Iraq and Libya increased geopolitical uncertainty, leading to slight surges in oil prices at the turn of 2019 and 2020. Nonetheless, the assassination of General Qasem Soleimani, along with fears surrounding reduced oil demand from China, quickly contributed to the reversal of that increasing trend.

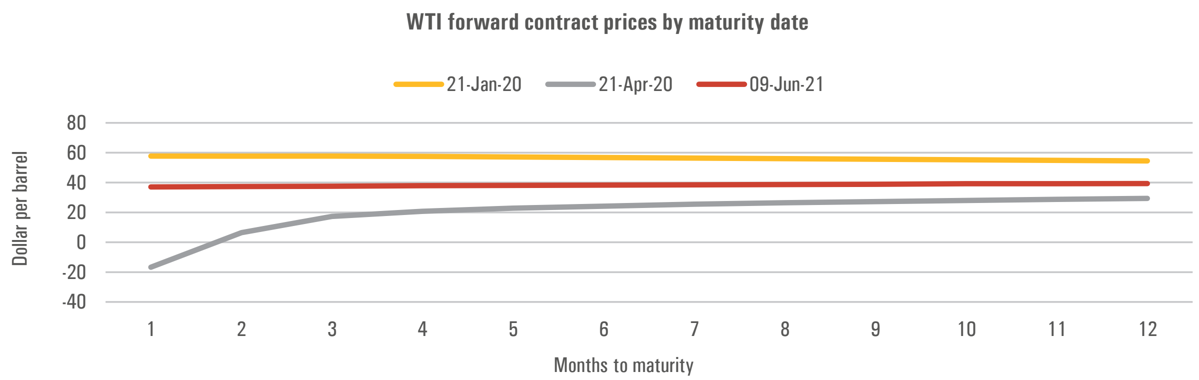
In the first quarter of 2020, oil prices reacted strongly to a demand shock resulting from the COVID-19 outbreak in China, the world's largest crude oil importer. Brent fell to $58/barrel in January and to $45.2/barrel in February. In view of market developments, the Heads of Delegation of the Organization for Economic Cooperation and Development (OPEC) Conference, held on 5 March 2020, recommended extending the duration of the proposed 1.5 Mb/d additional adjustment until the end of 2020, instead of 30 June 2020. On 9 March 2020, oil prices collapsed following a supply shock, resulting from a disagreement between the Russian Federation and Saudi Arabia. The latter promptly offered discounts to customers and announced an increase in outputs starting in April 2020. The price of Brent crude oil fell from almost $50/barrel on 5 March to below $32.02/barrel on 9 March 2020. Prices fell below $23/barrel by the end of the first quarter of 2020, and to less than $15/barrel a week later. This price war ended with an agreement on 12 April 2020, signed collectively by 23 countries, to cut global oil production by an unprecedented 9.7 Mb/d. Even though this measure stopped the rapid decrease in oil prices (in May 2020, the average price of Brent oil equalled $29/barrel), prospects for the first quarter of 2021 are unstable. Nevertheless, hopes for a quick rebound paired with monetary stimulus led to an increase in the price of Brent oil by 22 per cent between April and May 2020, the biggest percentage increase since 1999.

Given this volatility, predicting oil price developments has become increasingly difficult. To predict prices over the next few years, a vector autoregression (VAR) model was employed, including oil production, inventories and industrial production as a proxy of demand. The model predicts that oil prices will rebound slightly to $37/barrel in 2021 and $50/barrel in 2022, if the outbreak is contained and recovery follows. However, if this is not the case and a second COVID-19 wave hits the global economy, low oil prices may be here to stay in 2021 and 2022. However, if the stimulus packages employed worldwide are efficient in recovering demand, a return to pre-COVID levels may happen in 2021.

## Box 1.1 **Negative oil prices**

The price of WTI oil allocated for delivery in May 2020 plunged below zero on 21 April 2020, with significant media coverage worldwide. This was the last day of trading for May 2020 contracts, when demand plummeted owing to the lockdown across the United States, and the fact that storage facilities in Cushing, Oklahoma, where the oil was supposed to be delivered, were already full. As there was no possibility to store such a huge oil surplus, investors had to pay to get rid of contracts that could not be executed, leading to negative oil prices. The negative oil prices were a one-off event, resulting from significant mismatch between oil production, consumption and storage capacities, not from fundamental changes in the global markets, and are unlikely to persist in the long term.

**Source:** Compiled by ESCWA.




**Source:** ESCWA staff calculations based on the Yahoo Finance database (accessed on 8 June 2020).

## Table 1.1 OPEC basket prices, 2018-2022

| | | | | Forecast average | | |
|---|---|---|---|---|---|---|
| **Year** | **Monthly minimum** | **Average** | **Monthly maximum** | **Lower bound** | **Average** | **Upper bound** |
| 2018 | 56.9 | 69.5 | 79.4 | | | |
| 2019 | 58.7 | 64.1 | 70.8 | | | |
| 2020 | | | | 20.6 | 32.6 | 44.6 |
| 2021 | | | | 11.3 | 37.0 | 62.7 |
| 2022 | | | | 24.3 | 50.0 | 75.6 |

**Sources:** Figures for 2016-2018 are "OPEC reference basket prices" (accessed on 8 June 2020); figures for 2019 and 2020 are ESCWA staff forecasts (as of May 2019) where a VAR model is employed with a method of least squares (Gauss-Newton/Marquardt steps), incorporating monthly variables of OPEC reference basket price, OPEC and non-OPEC production, industrial production indices for G7 and China as a proxy of demand, United States inventories, the Consumer Price Index and dollar-trade weighted basket exchange rate, most of which are based on national statistical sources. Lower and upper bounds are 95 per cent-confidence intervals.

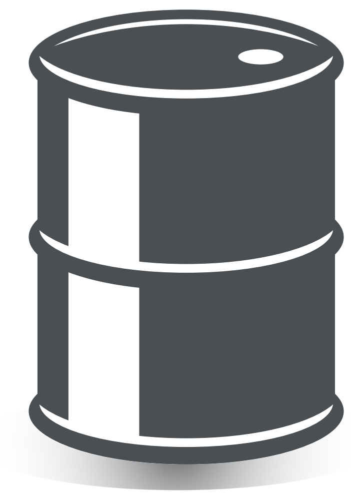
Nevertheless, in May 2020, oil production was still well below the 2019 level at 88 Mb/d, more than 12 Mb/d below pre-crisis production and 9.5 Mb/d below May 2019. The decrease in production reported among OPEC countries is quite homogenous, a 17 per cent fall on average in comparison to May 2019 and 15 per cent relative to January 2020, except Libya that is experiencing civil unrest and an almost complete halt of production activity, and Venezuela that is struggling with a highly volatile political situation and a 29 per cent fall in production. Nigeria and Equatorial Guinea are on the other side of the spectrum, with a 1 per cent and 9 per cent reduction, respectively. Non-OPEC production cuts are smaller on average, with just 7.4 per cent year-on-year production cuts, with countries such as Australia and Norway showing production growth. Canada, the Russian Federation and the United States are in the middle of this spectrum, with 18, 15 and 7 per cent cuts, respectively.

In the Arab region, Qatar was the only country to increase production between May 2019 and May 2020. Other countries cut production by 14-19 per cent, while the decline in Egypt and Iraq was smaller at around 8 per cent and 10 per cent, respectively. Oil production in Libya almost halted. Non-OPEC oil production for 2020 has been revised down by 0.10 Mb/d and estimated at 2.25 Mb/d. This downward revision was partially affected by updates in the production estimations of Norway and Latin America. Production in the United States was revised down and is estimated at 166 tb/d. Columbia, Egypt, Indonesia and Thailand are estimated to have witnessed the largest declines in oil production.[1]

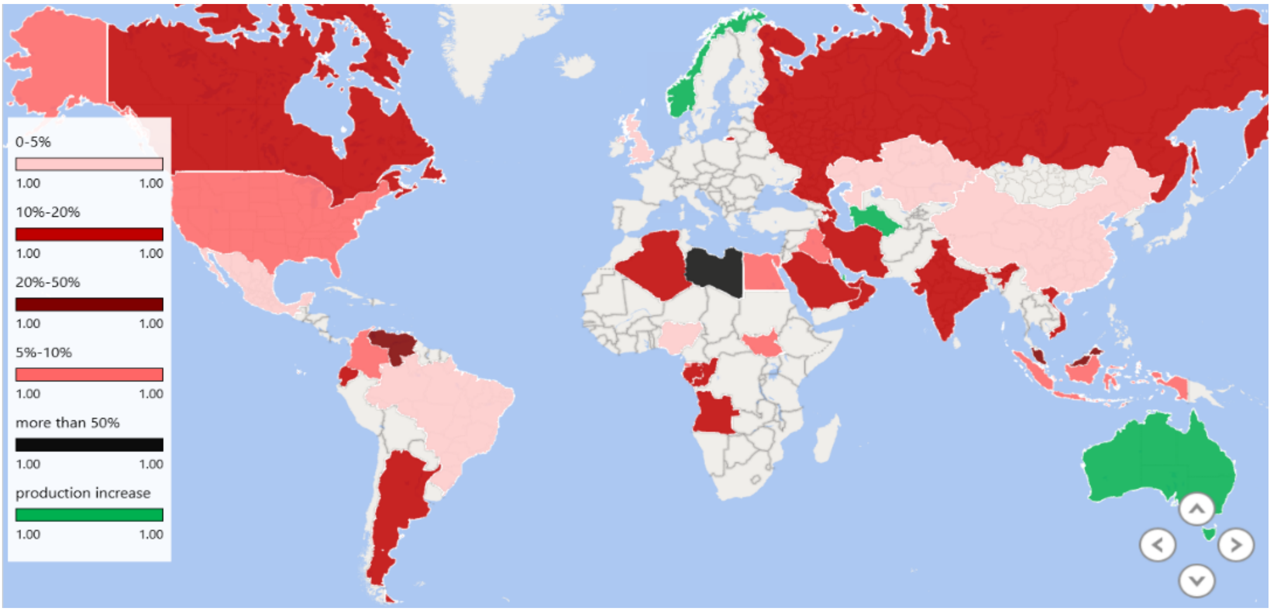
# Arab region

**Qatar** was the only country to **increase production** between **May 2019** and **May 2020.** Other countries **cut production** by **14-19 per cent,** while the **decline** in **Egypt** and **Iraq** was smaller at around **8 per cent** and **10 per cent.**

**Oil production in Libya almost halted**



## Figure 1.2 **Oil production cuts between May 2019 and May 2020**

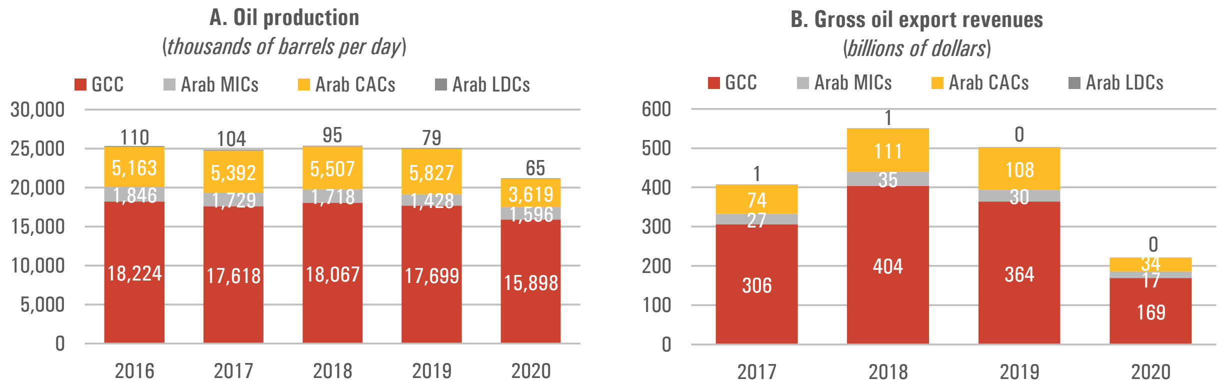



**Sources:** ESCWA staff estimations/forecasts based on national statistical sources; EIA, Short-Term Energy Outlook Data Browser (accessed on 3 June 2020).

In 2020, massive lockdowns and social distancing measures led people to avoid or minimize transport use, significantly decreasing demand for petroleum products and leading to the biggest oil glut in history. The aviation industry effectively stopped and its rebound prospects in the first half of 2021 are uncertain. Demand for oil in China in the first quarter of 2020 fell by 13 per cent. According to the International Energy Agency (IEA) projections, global demand for crude oil in 2020 was to fall by 8.3 Mb/d to 92.5 Mb/d overall, but demand in April 2020 was lower by a considerable 23.1 Mb/d, so demand is conditioned on developments over 2021. For instance, if the lockdown measures are eased and the global economy quickly rebounds, the annual decline in oil demand may be limited to 6.5 Mb/d.

The COVID-19 and oil price crises have had a devastating effect on Arab oil exporters' revenues. Average oil production over the first three months of 2020 was 15 per cent lower than in the previous year. This was already the case before OPEC's agreement signed on 12 April 2020, so further cuts are likely. With a 50 per cent fall in the average price of oil, revenues in 2020 are estimated to

Figure 1.3 **Oil production and export dynamics in the Arab region**




**Sources:** ESCWA staff estimations/forecasts based on national statistical sources; the OPEC, *Monthly Oil Market Report* (2019); the Joint Organizations Data Initiative database. Available at http://www.jodidb.org/TableViewer/tableView.aspx?ReportId=93904 (accessed on 3 June 2020); and the Organization of Arab Petroleum Exporting Countries databank (accessed on 3 June 2020).

**Note:** For 2020, only the first three months are considered. The developments over the remainder of the year will be crucial for the final result.

be at 44 per cent of 2019 income (figure 1.3B). Moreover, risks are skewed downwards given the international fear of a potential second COVID-19 wave, the highly uncertain global recovery, and a permanent fall in tourism caused by a drop in household disposable income, and strict COVID-19 regulations in the aviation sector. Furthermore, low oil prices and a lack of revenues may slow investments in the extraction sector, leading to limited production capacity in the Arab region. At the subregional level, all country groupings are significantly affected, with countries in conflict (mostly Iraq and Libya) losing 69 per cent of revenues, Arab least developed countries (LDCs) around 58 per cent, Gulf Cooperation Council (GCC) countries around 54 per cent, and Arab MICs (mostly Algeria and Egypt) around 43 per cent. The most affected, however, are GCC countries, given the importance of oil revenues for their State budgets.

# Natural gas and phosphate

Natural gas is another important hydrocarbon-related source of income for the Arab region. Algeria, Egypt, Libya, Qatar and the United Arab Emirates are members of the Gas Exporting Countries Forum (GECF), which not only collectively controls nearly 70 per cent of the world's natural gas reserves but also accounts for over 40 per cent of global production. Over the past few years, the strategic importance of natural gas for many Arab countries has increased as global demand for natural gas rose in 2019 by 1.8 per cent, which is a slowdown from 2018 but in line with average demand increase over the period 2000-2017. Furthermore, the fall in demand for natural gas in 2020 is much smaller than that of oil, and is expected to equal 4 per cent or 150 billion cubic meters.[2] Constant growth in demand for natural gas is further supported by countries' collective need countries to improve environmental sustainability in the residential and industrial sectors. Given that COVID-19 may facilitate such a transition (since the recovery funds in the European Union would benefit from green investment), the change in demand may be less negative or even positive.

Global trade in liquefied natural gas (LNG) increased in 2019 by 12 per cent, or over 50 billion cubic meters, fuelled mostly by an increase in demand from Europe, which alone absorbed 80 per cent of incremental LNG trade. In addition, this growth was mostly due to a switch from coal towards cleaner natural gas, in line with global trends and should continue in the future. The output of gas-fired power plants in Europe and the United States increased in 2019 by 11 per cent and 8 per cent, respectively, mostly replacing old coal-fired units.

The COVID-19 pandemic and the global oil crisis continue to impact the natural gas industry given the tight relationship between these two markets. In the short term, the magnitude of gas demand will be a function of three factors, namely the impact of COVID-19 on the growth of the world economy, the advantages of gas compared to other fuels in terms of prices, and the potential advantages of natural gas as a clean alternative source of energy compared to other fossil fuels. According to IEA, the decline will be most significant in Europe and North America. In Asia, which is the main destination of LNG extracted by Arab countries, the fall in demand will be somewhat smaller, about 12 billion cubic meters compared with over 40 billion cubic meters in North America and Europe.

Amidst a mild winter in Europe, COVID-19 related lockdowns and continued supply growth, the European and American prices of LNG fell to levels not seen during the last decade. In Europe, they fell by more than three-quarters over the year and half, from $7.26/MMBtu in January 2019 to $1.58/MMBtu in May 2020.

In North America, the decline was smaller because of the lower base prices in January 2019, when gas was priced at $3.08/MMBtu. By May 2020, it fell to $1.75/MMBtu. Owing to the nature of Asian LNG contracts, which are indexed to oil prices with a three to six-month lag, gas prices fell by only 16 per cent between January 2019 and May 2020. Furthermore, global spread in gas prices is tightening, limiting the opportunities for arbitrage by sellers.

In the Arab region, GECF members are the most impacted by this crisis. In 2019, Qatar remained the largest global LNG exporter with a 21 per cent share in global exports, followed by Australia and the United States at 77.8 MT of LNG. Moreover, Algeria and Egypt added more than 2 MT of additional capacity each, with the Idku facility in Egypt reaching its full potential. Oman, Qatar and the United Arab Emirates also increased their capacity, but to a much smaller extent. Qatar has proposed a plan to increase liquefaction capacity by 49 MTPA to 126 MTPA by 2027. These developments should allow Qatar to remain among the world's most significant gas exporters. Oman announced a debottlenecking exercise to increase capacity of its three trains at Qualhat, from 10.4 MTPA to 11.5 MTPA by 2021.

Before COVID-19, the global phosphate rock supply was projected to increase from 235 to 255 MT between 2018 and 2023, and phosphoric acid from 101 to 111 MT with Africa being the largest contributor. The COVID-19 crisis will reduce supply of phosphate fertilizers from China, given production disruptions and lockdowns. However, demand for phosphates is also expected to decrease in line with a fall in production activities. In 2019, global prices of both phosphate rock and diammonium phosphate (DAP) fell by about 30 per cent from $102 and $382 to $72 and $238 per metric ton, respectively, because of an increase in production capacity paired with a sluggish demand surge. This recent price decline is the continuation of a longer trend that can be attributed to dynamics in China and other countries whose imports shrank due to their Governments lowering consumption of chemical fertilizers because of growing environmental concerns. Contrary to gas and oil, the COVID-19 did not significantly change the prices of both DAP and phosphate rock between January and May 2020. Production capacity in Arab countries increased, particularly in Algeria, Egypt, Morocco, Saudi Arabia and Tunisia. In Tunisia, the production of phosphate increased to 5.5 MT in 2019 compared with 4.1 MT in 2018, owing to the reopening of the Meknassy phosphate mine (Sidi Bouzid Governorate) that had been blocked since 2013, with a projected production of 600,000 tones, and the reopening of M'dhilla II in March 2020. Arab phosphate producers may benefit from the lower prices of oil and gas, which serve as a main source of sulphur and ammonia used as raw material in phosphoric acid and DAP production.

European and American prices of LNG fell to levels not seen during the last decade

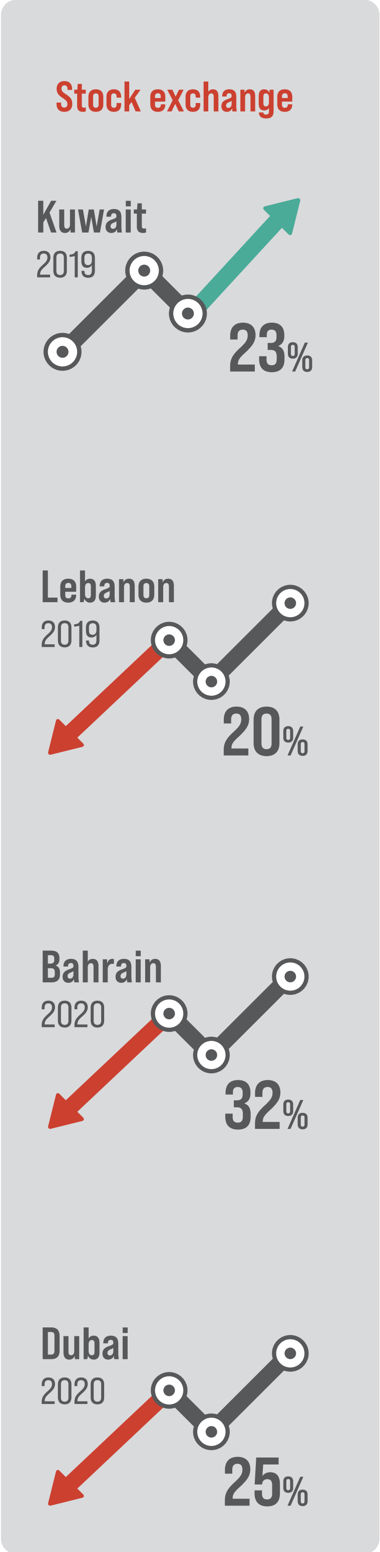
In the Arab region, GECF members are the most impacted by the crisis

# C. Financial and trade linkages to the Arab region

Most GCC stock exchanges performed well in 2019, with Kuwait leading with a 23.7 per cent increase, probably owing to the decision by Morgan Stanley Capital International to include it as an emerging market. Bahrain rose by 20.4 per cent, Dubai 9.3 per cent, and Abu Dhabi and Saudi Arabia recorded modest increases of 3.3 and 7.2 per cent, respectively. In contrast, Oman lost 7.9 per cent. The most significant event for GCC countries' stock exchange was the initial public offering of Saudi Aramco, with the valuation briefly touching $2 trillion and increasing market capitalization of the Saudi stock exchange by 389 per cent. However, Saudi Aramco's stock fell by more than 20 per cent by the end of March 2020.

Other Arab stock markets fared much worse. Shares of Lebanese companies in 2019 were among the worst investments in the world, losing 20 per cent amidst protests and a deteriorating economic situation. The Amman Stock Exchange lost 4.9 per cent, and the Tunisia Stock Market dropped 2.6 per cent. The Egyptian and Moroccan stock markets, which rose by 6.6 per cent and 9.3 per cent, respectively, were star performers compared with other Arab MICs. Moreover, compared with the S&P 500 Index that rose by 28.9 per cent, and conflict-affected countries (CACs) 40, which rose by 26.4 per cent, the performance of Arab stock exchanges was poor. Arab financial markets (except GCC countries) did not manage to attract foreign investors. With the COVID-19 pandemic, these shortcomings may become even more pronounced. However, the value of shares traded in the Arab stock exchange as a percentage of GDP is relatively low (except for Saudi Arabia) and the financial interlinkages with the rest of the world are rather weak, which may limit the transmission of the COVID-19 shock to Arab financial systems.

COVID-19 caused further drops in the market capitalizations of stock exchanges in Arab countries over the first five months of 2020, especially in GCC countries. As of mid-June, Dubai had lost 25 per cent and Bahrain 32 per cent compared with 2019. Furthermore, Beirut, Iraq and Doha markets were down in mid-June by 27, 22 and 15 per cent, respectively. These losses are from an already low base and can be attributed to the fall in oil prices in Iraq and Qatar, and the dire economic situation in Lebanon. In addition, while GCC countries have some space to execute monetary stimulus (Saudi Arabia more than halved interest rates from January 2020, the United Arab Emirates lowered them by 36 per cent and Kuwait by 37 per cent), this is not possible in the case of Lebanon that is struggling with a massive debt crisis. These developments, and the return of oil prices to long run equilibrium, should lead to some rebound of GCC stock exchanges in 2021.

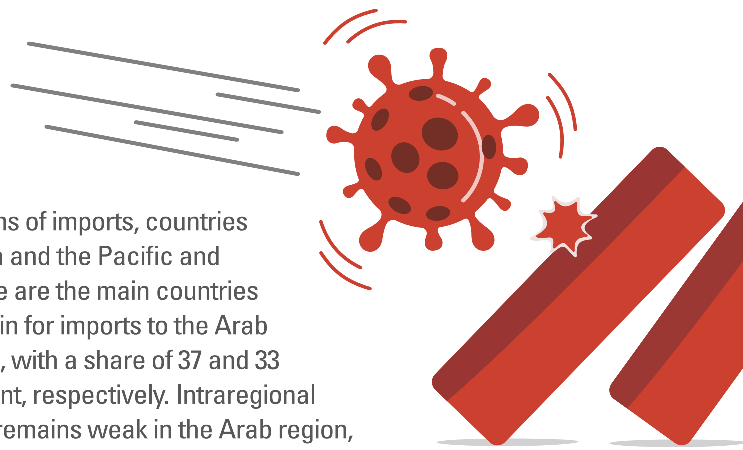


The external financial wealth of Arab countries can be explained by an evolution of total cross-border claims and total cross-border liabilities, based on data from the Bank for International Settlements. In 2019, total liabilities (Arab clients' deposits with main international banks) increased by 4.1 per cent, while total claims (borrowings by Arab clients from main international banks) increased by 7.5 per cent, indicating a decrease in the wealth of the Arab region compared with the rest of the world. However, the Arab region remained a net lender to the main international banks, with $131 billion as at December 2019. Saudi Arabia ($124.5 billion) and Kuwait ($73.9 billion) were the largest net lenders in 2019, whereas Qatar ($76.2 billion) and the United Arab Emirates ($15.4 billion) were the biggest net borrowers. However, all these numbers are smaller in 2019 than they were in 2018. Given the huge shock to oil prices in 2020, the net financial situation of Arab countries is estimated to have further deteriorated.

Financing costs in Arab countries slowly decreased over 2019 in line with a fall in the dollar three-month LIBOR. Moreover, the sudden cut in financing costs caused by the American Federal Reserve's unprecedented decision to reduce interest rates by 50 basis points on 3 March 2020 and a further 100 points on 16 March 2020 led to a parallel movement in Arab interest rates. While financing costs in GCC countries remained similar to the USD LIBOR, the spread between three-months JODIBOR (Jordan) and USD LIBOR remained at a relatively high level of 4 per cent.

Even though the financial condition of Arab banks remained stable in 2019, the pandemic will result in earning shocks that banks in Arab countries will have to manage. GCC countries will experience a slowdown in lending caused by a sharp decline in oil prices and COVID-19. As enterprises' financial indicators deteriorate, banks will need to focus on maintaining asset quality rather than on expanding their business. Nevertheless, the capital buffers of GCC banks are strong and banks should remain profitable. On the other hand, banks in countries such as Egypt, Jordan, Morocco and Tunisia will struggle to make profit given the rapid decline in tourism activity. The once thriving Lebanese banking sector is facing solvency risks owing to measures by the Lebanese Central Bank and currency depreciation, meaning that the country may be unable to meet its foreign currency obligations. Furthermore, Lebanese banks are directly affected by the Eurobond default, which represented 6 per cent of their balance sheets as of January 2020. Algeria will also face risks of downturn in oil and gas prices, and banks in other Arab MICs will have to bear the costs of decline in tourists inflow.

In terms of international trade, the Arab region continued to be a net exporter in 2019. Total exports reached around $902 billion, a 5 per cent decrease from 2018 mainly owing to a decline in oil exports in Algeria and Libya. Total imports reached around $830 billion, a 5 per cent increase from 2018. Asia and the Pacific is the main recipient of Arab exports, capturing around 46 per cent of total exports in 2019. China, India and Japan remained the main recipient of GCC countries' exports, while GCC countries and the United States were the main trading partners for other Arab countries, except Libya, Morocco and Tunisia which traded mostly with Europe. The main exported good for GCC countries is oil. The dependence of GCC countries on fuel revenues continues to be significant, ranging from 53 per cent in Bahrain to almost 91 per cent in Kuwait (as at 2018), posing huge challenges for government financing in 2021. Other Arab countries also heavily depend on commodity exports, like Mauritania which exports mineral ores, iron and copper. All Arab countries are high on the export diversification index, indicating a significant reliance on a small portfolio of products. Arab MICs exhibit a relatively more diversified range of exported goods, which makes them less prone to falls in demand and resource prices caused by COVID-19.



In terms of imports, countries in Asia and the Pacific and Europe are the main countries of origin for imports to the Arab region, with a share of 37 and 33 per cent, respectively. Intraregional trade remains weak in the Arab region, mainly owing to the similarity of traded products. In 2019, intraregional exports captured around 13.6 per cent of total exports, while intraregional imports captured 14 per cent of total imports, a slight increase from 2018.

COVID-19 has a tremendous impact on global trade, including trade with Arab countries in 2020. GCC countries are most affected by the fall in prices and demand for oil, losing on average 7.7 per cent of their real exports, which is still less than in other Arab countries.[3] The worst hit are Kuwait and the United Arab Emirates, losing 8.7 and 10.6 per cent of real exports, respectively, while Oman is estimated to have lost only 3.7 per cent of its real exports in 2020 compared with 2019. Recovery is projected in 2021, elevating the volume of exported goods back to pre-crisis levels. Among GCC countries, the change in imports is similar to the change in exports, but there are considerable differences between countries.

Imports in Kuwait and the United Arab Emirates are are estimated to have increased over 2020, leading to a deterioration in their trade surplus, while in Bahrain, Oman and Qatar imports are estimated to have fallen much more than exports, strengthening their trade balances. Arab MICs are affected by a fall in tourism and a decline in demand for their exports, as their main trading partners are witnessing a deep recession. This is expected to lead to a 17.1 per cent fall in real exports in Morocco, 17.3 per cent in Tunisia (which will be also affected by the fall in demand for phosphates),[4] while Algeria will be hurt by a fall in oil demand, losing 18.8 per cent of its real exports. Real imports will decrease more than exports, leading to improvements in the trade balance of most countries, except Algeria and Morocco. Recovery will be slow, as both exports and imports will increase by around 12 per cent in 2021.

Table 1.2 **Real export and import growth rate in the Arab region, 2019-2021**

| | Exports | | | Imports | | |
|---|---|---|---|---|---|---|
| | **2019** | **2020** | **2021** | **2019** | **2020** | **2021** |
| Bahrain | -0.7 | -7.3 | 4.9 | -2.0 | -11.9 | 7.2 |
| Kuwait | 2.0 | -8.7 | 10.9 | 2.6 | 4.6 | -4.0 |
| Oman | 1.9 | -3.7 | 6.9 | 0.7 | -15.4 | 16.1 |
| Qatar | 1.1 | -8.0 | 8.4 | -1.3 | -17.2 | 17.5 |
| Saudi Arabia | 1.3 | -7.6 | 8.6 | 0.6 | -7.5 | 2.3 |
| United Arab Emirates | -0.1 | -10.6 | 9.9 | -0.2 | 1.4 | -4.9 |
| **GCC unweighted average** | **0.9** | **-7.7** | **8.3** | **0.1** | **-7.7** | **5.7** |
| Algeria | 1.5 | -18.8 | 14.3 | -2.3 | -7.6 | 3.2 |
| Egypt | 5.7 | -11.0 | 13.9 | 4.0 | -20.6 | 22.2 |
| Jordan | 0.9 | -11.3 | 9.6 | -0.7 | -13.8 | 16.7 |
| Lebanon | 1.8 | -7.9 | 8.1 | 2.9 | -12.1 | 6.0 |
| Morocco | 2.0 | -17.1 | 14.1 | -0.5 | -11.9 | 8.1 |
| Tunisia | 2.8 | -17.3 | 13.1 | 1.5 | -19.2 | 13.2 |
| **Arab MICs unweighted average** | **2.4** | **-13.9** | **12.2** | **0.8** | **-14.2** | **11.6** |
| Iraq | 2.5 | -11.9 | 12.2 | -1.1 | -12.4 | 5.4 |
| Libya | 1.7 | -21.5 | 18.0 | 0.4 | -4.4 | 4.1 |
| State of Palestine | 3.8 | -8.4 | 10.5 | 3.4 | 2.1 | 0.9 |
| Syrian Arab Republic | 0.9 | -13.3 | 10.8 | 11.6 | 1.1 | 16.2 |
| Yemen | -1.8 | -13.8 | 9.4 | 6.1 | -11.7 | 8.4 |
| **Conflict unweighted average** | **1.4** | **-13.8** | **12.2** | **4.1** | **-5.1** | **7.0** |
| Comoros | 2.2 | -13.2 | 13.9 | 2.1 | -5.4 | 5.8 |
| Djibouti | 4.3 | -10.7 | 12.9 | 9.6 | -9.6 | 22.6 |
| Mauritania | 2.0 | -12.8 | 11.4 | 3.0 | -3.3 | 2.4 |
| Sudan | -1.2 | -10.1 | 3.5 | 0.8 | -7.4 | 3.9 |
| Somalia | -1.5 | -8.0 | 2.8 | 2.8 | 2.7 | 4.3 |
| **Arab LDC unweighted average** | **1.1** | **-10.9** | **8.9** | **3.6** | **-4.6** | **7.8** |
| **Arab unweighted average** | **1.5** | **-11.6** | **10.4** | **2.2** | **-7.9** | **8.0** |

**Sources:** DESA, based on data of the United Nations Statistics Division; and national sources.

In conflict-affected countries, already weak trade-balances are further deteriorating as real exports decreased by an estimated 13.8 per cent on average and real imports by 5.1 per cent. Iraq, the only conflict-affected country with a trade surplus, is estimated to have lost 12 per cent of its real exports owing to weak oil demand; Libya is estimated to have lost 21 per cent. At the same time, real imports decreased only slightly, and increased in the State of Palestine and the Syrian Arab Republic. In 2021, real exports are expected to rebound by 12.2 per cent on average in conflict-affected countries, while real imports are to increase by a modest 7 per cent. Similarly, the trade balance of Arab LDCs further deteriorated, with real exports losing 10.9 per cent on average and real imports falling by just 4.6 per cent in 2020. The rebound in 2021 will be slow, with an 8.9 per cent increase in exports and a 7.8 per cent rise in imports in 2021. The biggest impact of the COVID-19 pandemic is observed in the Comoros and Mauritania, with 13.2 and 12.8 per cent losses in real exports, respectively. These changes will significantly affect these countries’ ability to support citizens who lost their income sources because of the COVID-19 pandemic.

# D. Concluding remarks

The COVID-19 economic shock will exert incredible pressure on all sectors and dimensions of the global economy. It will depress global GDP growth, leading to a fall in demand for energy commodities and phosphate, affecting Arab oil exporters. Little tourism activity are taking place in 2020, affecting the revenues of Arab MICs where tourism is a key part of the economy, such as Egypt, Jordan, Morocco and Tunisia. COVID-19 losses are likely to contract the Lebanese economy further, triggering social unrest. Deteriorating economic situations in developed countries will affect the inflow of investments, remittances and ODA to Arab least developed and conflict-affected countries.

Except for wealthy GCC countries, Arab countries struggle to provide appropriate safety nets to protect their citizens against COVID-19 lockdown measures. Although global financing costs fell, most Arab countries will not benefit because of borrowing constraints. As Arab LDCs are more vulnerable to shocks resulting from global turmoil on resource markets and the fall in tourism, adequate support provided by international institutions will be crucial in lifting them out of the COVID-19 crisis.

**Deep recession** in the region


**GDP contraction** could have reached **-5.7 per cent**

**Length** of the **recession** affected by:

- GCC countries’
- Arab MICs
- Arab LDCs
- Arab CACs

**Economic recovery**

would exceed **$180 billion**

# 2 Regional Socioeconomic Trends

## Key messages

- The global economic recession, the sharp decline in oil prices, the slowdown of transport and tourism activities, and the lockdown measures imposed in all the Arab countries plunged the region into a deep recession in 2020. Growth performance could have reached -3 per cent. In the pessimistic scenario, GDP contraction could have reached -5.7 per cent.
- The length of the recession depends on factors specific to each country subgroup. GCC countries' recovery will be shaped by the demand for oil and gas and their prices. Recovery in Arab MICs is contingent on the revival of tourism activities following the pandemic. Recovery in Arab CACs depends on the pandemic's impact on conflict dynamics. In Arab LDCs, recovery hinges on the willingness of donors and expats to channel ODA and remittances.
- The 2021 recovery depends to a large extent on the success of the stimulus packages enacted in the region, which exceed $180 billion. It also depends on the economic recovery of partner countries, and the success of their incentive packages.

## A. Overview of Arab subregions

The COVID-19 crisis came at a time when the region was already registering low growth performance. In 2019, the slowdown in global demand owing to trade tensions between China and the United States, coupled with the absence of a new production agreement among OPEC+, significantly affected growth in Arab countries. The GDP growth rate decreased from 2.3 per cent in 2018 to 1.9 per cent in 2019, with some disparities among Arab subregions.

In general, 2019 was a challenging year for all Arab subregions. From an economic perspective, Arab oil exporters are still dependent on oil and gas production, despite great efforts in recent years to diversify their economies. Additional economic pressures on budgets, rising external debts, and increased social expenses have worsened fiscal deficits and limited the fiscal space. Arab oil importers focused more on fiscal reforms, notably improving tax administration, rationalizing customs duties, and reducing public expenses by rationalizing social expenditures and reforming social security and pension systems.

The COVID-19 pandemic has affected Arab subregions in various ways. As a result of the decline in global demand, exports decreased drastically by almost 50 per cent for both oil-exporter and oil-importer countries. Oil exporters have been affected by a decrease in oil prices resulting from reduced global demand and increased supply. Oil importers suffered from the closure of European markets and from a reduction in remittances. All these factors combined contributed to a decline in the GDP growth rate to -3 per cent in 2020, with some disparities between Arab subregions. GDP is expected to rebound by 2.8 per cent in 2021 as a result of stimulus packages enacted by most Governments, and the resurgence in oil prices following monetary expansion. Arab countries' central banks and ministries of finance have adopted incentive packages valued at approximately $180 billion to support affected groups and reduce the impact of the pandemic.[1] However, if these packages do not succeed, a pessimistic scenario may materialize where the Arab region might have lost 5.7 per cent of its GDP in 2020. Under this pessimistic scenario, recovery will be slightly faster (3.5 per cent instead of 2.8 per cent in 2021); however, this difference is far too low to compensate for the additional GDP lost.

Consumer price inflation in Arab countries declined to 5.4 per cent in 2019 from 6.7 per cent in 2018, resulting from a decrease in domestic demand in some countries, changes in international prices of oil and raw materials, and the fiscal reforms implemented by some Arab countries over the past two years. In 2020, inflation rates are estimated to have declined in most Arab countries because of low oil prices and the pandemic's effects on supply and demand. They are projected to rise in 2021 in view of the expected recovery of global and domestic demand and international oil prices.

# B. Gulf Cooperation Council countries

The COVID-19 pandemic is strongly affecting GCC countries. The sharp decline in global oil prices has worsened economic conditions in this subregion. GDP is estimated to have contracted by 3.2 per cent in 2020, but a gradual recovery is expected in 2021 considering anticipated improvements in global demand levels and an increase in international oil prices. If the crisis persists, the GDP loss could double and reach -7.1 per cent.

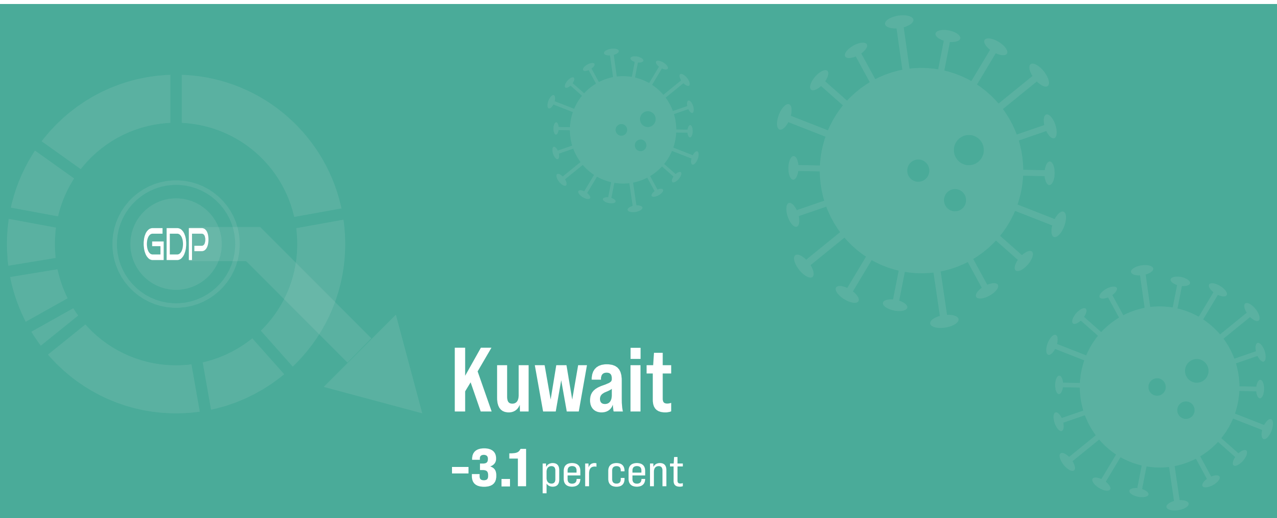

**Saudi Arabia**

**-3.3** per cent

This COVID-19 crisis came at a time when the region was already facing a downward trend. GDP growth decreased from 1.9 per cent in 2018 to 0.6 per cent in 2019, as a result of the slowdown in global demand for oil and gas in the second half of 2019. A disagreement between the Russian Federation and Saudi Arabia in 2020 led to a collapse in oil prices, and created a large stock in the oil market. The situation worsened owing to the escalation of disputes between these two oil-producing giants, with oil prices plunging 80 per cent.

GDP in Saudi Arabia was expected to grow by 1.3 per cent in 2020 following a gradual recovery in the oil sector, including a rise in crude oil production following increased production capacity at the Jazan refinery and advanced discussions with OPEC+. However, global developments related to the pandemic and the fall in oil prices plunged growth estimations down to -3.3 per cent in 2020 (-6.8 per cent in the pessimistic scenario). Moreover, global lockdowns drastically decreased global demand, notably for hydrocarbon products. Oil represents more than 40 per cent of Saudi GDP, almost 70 per cent of government revenues, and over 83 per cent of total exports. A 1.8 per cent growth rebound (3.5 per cent in the pessimistic scenario) is expected in 2021, driven by a projected increase in global oil demand, mainly from China, and by stimulus packages adopted by the Government through the Saudi Arabian Monetary Agency and the Ministry of Finance worth 120 billion Saudi riyals to mitigate the impact of the pandemic on affected sectors and to support spending levels.

In Kuwait, GDP growth dropped to an estimated -3.1 per cent in 2020 owing to declining global oil demand and decreasing oil prices in the first half of the year (-7.0 per cent in the pessimistic scenario). This situation will increase pressure on the Kuwaiti economy and the public budget. In



addition, the country has taken drastic measures against the pandemic, which have slowed economic activity in general, including flight cancellations affecting the tourism and travel sectors, shopping centre closures and a ban on gatherings, which have had a direct impact on commercial markets, health institutions, restaurants and the retail sector. The rebound in 2021 is expected to be relatively modest at 2.7 per cent in the baseline scenario, and 2.9 per cent in the pessimistic scenario.

In Qatar and Oman, GDP growth is estimated to have further declined to -2.8 and -4.2 per cent, respectively, by 2020 (-6.3 and -9.5 per cent, respectively, in the pessimistic scenario), as a result of weak energy demand, especially for natural gas. In Qatar, growth will recover gradually in 2021 to achieve a 2.4 per cent growth rate (2.2 per cent in the pessimistic scenario), driven by the resumption of oil and non-oil sectors. Moreover, increased spending on infrastructure projects under the Qatar National Vision 2030 will support growth, as the vision includes a strategy to reinforce economic diversification to achieve sustainable long-term growth. New economic and fiscal reforms will attract foreign direct investment (FDI), including a law allowing foreigners full ownership of projects, and the establishment of the Investment Promotion Agency to coordinate investment promotion and marketing activities with key stakeholders.

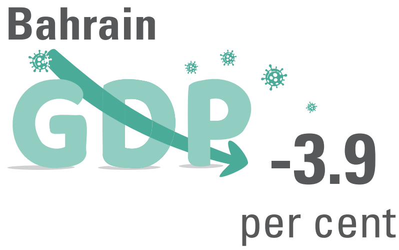
Prior to the pandemic, the GDP growth rate in Oman was expected to increase from 0.9 per cent in 2019 to 1.7 per cent in 2020, boosted by increased domestic oil production to meet increasing demand by local refineries, such as the Sohar Refinery Expansion Project. Natural gas production was also expected to increase, with the Khazan field reaching full capacity. However, as a result of the pandemic, GDP growth is estimated to have decreased to -4.2 per cent in 2020 (9.5 per cent in the pessimistic scenario), with the oil sector suffering the most because of decreases in global oil demand. The Central Bank of Oman announced a stimulus package to pump liquidity and support the private sector at a value of around $21 billion, and to reduce interest rates in view of this facilitative monetary policy. These quick actions and the gradual increase of global oil demand will help the Omani economy recover and achieve a growth rate of 3.8 per cent in 2021 (3.5 per cent in the pessimistic scenario).

**QATAR** and **OMAN**

**-2.8** and **-4.2**

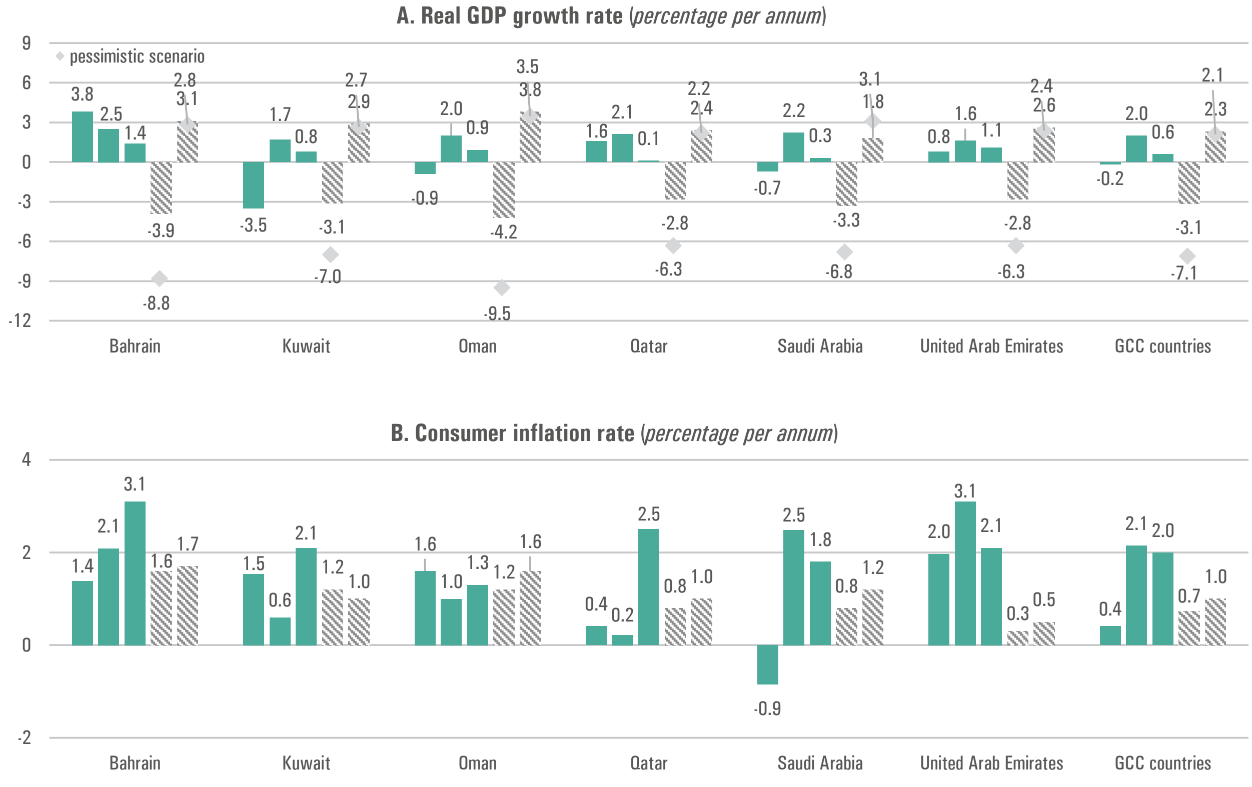
per cent

In Bahrain, growth is estimated to have decreased to -3.9 per cent in 2020 (-8.8 per cent in the pessimistic scenario), influenced by decreased global oil demand. Growth will increase to 3.1 per cent in 2021 (2.8 per cent in the pessimistic scenario). This recovery is expected to benefit from improved global demand in general and for aluminium in particular, and an increase in oil production capacity, notably owing to the expansion of the Sitra refinery owned by the Bahrain Petroleum Company.




As for inflation dynamics in GCC countries in 2019, consumer price inflation declined slightly to 2 per cent in 2019 because of the low impact of fiscal reforms in 2018, notably value added tax (VAT)

## Figure 2.1 GDP and inflation in GCC countries, 2017-2021




**Sources:** ESCWA staff estimations/forecasts based on national statistical sources; DESA, *World Economic Situation and Prospects as of mid-2020, World Economic Situation and Prospects 2020*; and ESCWA, Statistics Information Portal.

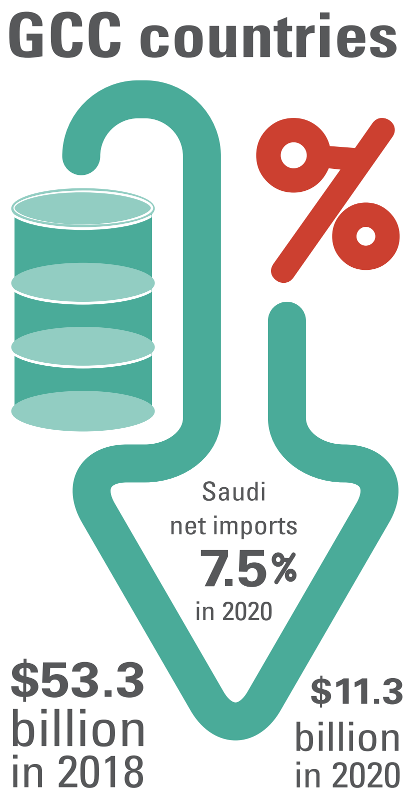
reforms in almost all GCC countries. Inflation in Saudi Arabia declined to 1.8 per cent in 2019 from 2.5 per cent in 2018 as result of a decrease in residential rents, which represent about 22 per cent of the overall general price index, and weak subsidy reforms initiated in 2018. In contrast, inflation rates increased in 2019 to 2.5 per cent in Qatar, 2.1 per cent in Kuwait, and 3.1 per cent in Bahrain owing to higher prices of food, clothing, health and education.

In GCC countries, the inflation rate is estimated to have decreased to 0.7 per cent in 2020, reflecting both the pandemic impact and the decrease in global oil prices. However, both trends are expected to be reversed in 2021, and the inflation rate is expected to rise to 1 per cent. The downward trend of oil prices since mid-2019 has affected the fiscal position of all GCC countries.

The decline in oil prices in 2019 affected total exports from GCC countries, which decreased by 8 per cent. This subregion is still a net exporter, with total exports of $651 billion and total imports of $514 billion in 2019. In terms of the geographical concentration of trade in 2019, Asia and the Pacific remains the main trading partner of GCC countries, capturing around 52 per cent of exports and around 44 per cent of imports. As for intraregional trade, exports increased by less than one percentage point to capture 14 per cent of total exports, while imports increased by more than one percentage point, reaching 15 per cent of total imports in 2019.

COVID-19 will have a significant impact on GCC countries. Their overall increase in imports is equivalent to the drop in exports, with considerable differences between countries. Saudi net imports and net exports of goods and services decreased by an estimated 7.5 per cent in 2020 owing to the pandemic's impact on global trade markets. Its net trade balance is estimated to have decreased from $53.3 billion in 2018 to only $11.3 billion in 2020. This sizable decrease had a direct impact on its current account balance, with a deficit of 3.6 per cent of GDP estimated in 2020. Kuwait and the United Arab Emirates were the worst hit, with exports decreasing by 8.7 and 10.7 per cent, respectively, in 2020. However, the global recovery in 2021 will increase the volume of exported goods back to pre-crisis levels. Imports to Kuwait and the United Arab Emirates are estimated to have increased in 2020, leading to a deterioration in their trade surplus. In contrast, imports to Bahrain, Oman and Qatar are estimated to have decreased more than the decline in exports, thus strengthening their trade balances.

The fiscal performance of GCC countries reflects high dependence on oil revenues, which significantly hinges upon oil price dynamics. Almost



all GCC countries have experienced a significant decrease in fiscal revenues. Two major factors generated this situation, namely tanking oil prices, and delays in implementing fiscal reforms, notably in Bahrain and Oman. In Saudi Arabia, the fiscal deficit declined to 4.2 per cent of GDP in 2019, down from 4.6 per cent in 2018, thanks to relatively stable oil revenues despite a tumultuous oil market by mid-2019, and the rapid implementing of a 5 per cent VAT and energy subsidy reforms, which have contributed to stabilizing its fiscal balance.

## Figure 2.2 **Trade and current account balances in GCC countries, 2017-2021 (percentage of GDP)**


**Sources:** ESCWA staff estimations/forecasts based on national statistical sources; and *World Economic Situation and Prospects 2020.*

In Oman, Bahrain and Kuwait, the fiscal balance recorded a deficit of 9.2, 4.9 and 2.5 per cent of GDP, respectively, for 2019, reflecting the struggle of these economies since 2017. They have delayed implementing fiscal reforms initiated in other GCC countries, and have increased their social expenditure. In contrast, Qatar and the United Arab Emirates recorded a fiscal surplus of 5.1 and 1.8 per cent of GDP, respectively, as a result of increased natural gas revenues, and a significant rise in fiscal revenues from non-oil sectors such as tourism and services.

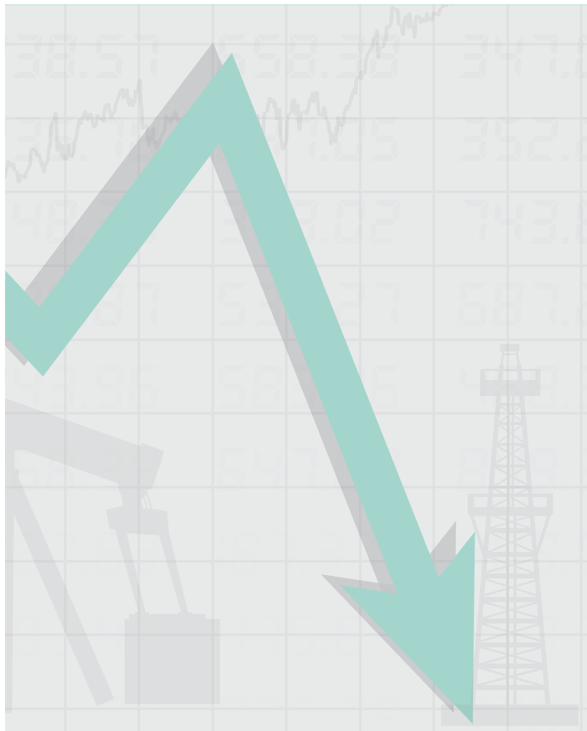
Figure 2.3 **Fiscal positions in GCC countries, 2017-2021 (percentage of GDP)**


**Sources:** ESCWA staff estimations/forecasts based on national statistical sources; and *World Economic Situation and Prospects 2020.*

The decline in oil prices had a significant effect on GCC countries' fiscal position in 2020. In Saudi Arabia, the fiscal deficit is estimated to have reached 16.3 per cent of GDP, while in 2021 the situation should improve to 4.7 per cent of GDP as a result of possible increases in oil demand and rising non-oil revenues, including VAT revenues and improvements in energy prices.

The fiscal position in Bahrain and Oman is estimated to have declined significantly to 15.7 and 17.7 per cent of GDP, respectively, in 2020 before a slight improvement forecasted in 2021. These countries have suffered from severe fiscal deficits in the last two years. The United Arab Emirates observed a slight fiscal deficit of 6.1 per cent of GDP in 2020 and will observe a deficit of 2.5 per cent of GDP in 2021, continuing the same trend of the last two years. Qatar could be the exception in this subregion, with a fiscal surplus of 5.6 per cent of GDP in 2020 and 2021. The favourable fiscal position of Qatar is mainly boosted by an abundant natural gas reserve. In Kuwait, the deficit is likely to have reached 6.3 per cent of GDP in 2020, dropping to 4.2 per cent in 2021.

## C. Arab middle-income countries



Prior to the pandemic, MIC economies were growing by 3.4 per cent on average in 2019. This trend was expected to continue in 2020 and 2021, with growth rates of 3.5 and 3.6 per cent, respectively. COVID-19 constitutes a double negative shock for the region. Firstly, the interruption of international travel for several months, and the total or partial lockdown measures, have considerably affected the tourism sector – one of the most important sectors in the region. Secondly, the recession in European countries, MICs' main trading partners, has affected the export performance of manufacturing sectors. As a result, MIC economies are estimated to have contracted by 3.4 per cent in 2020 in the baseline scenario, and by 4.5 per cent in the pessimistic scenario. Recovery will be subject to developments at the global level, and the success of fiscal and monetary stimulus by the region's trading partners. In 2021, the economies of MICS are expected to record a 4.1 per cent growth rate on average (5 per cent in the pessimistic scenario).

In terms of individual economies, the Egyptian economy is estimated to have contracted by at least 1.1 per cent in 2020 before recovering by a projected 6.1 per cent in 2021 (a contraction of 2.1 per cent in 2020 followed by 7.5 per cent growth in 2021 in the pessimistic scenario). This comes after a good performance in 2019, when the economy grew by 5.9 per cent driven mainly by tourism, gas extractives, wholesale and retail trade, real estate, and construction. Prior to the pandemic, the Egyptian economy was expected to grow by 5.7 per cent in 2020, and 5 per cent in 2021. The recovery in 2021 will be fuelled by the revival of the tourism sector following the pandemic.

In Morocco, the economy is estimated to have witnessed a 2.1 per cent contraction in 2020 before recovering by a projected 2.8 per cent in 2021 (a contraction of 3.9 per cent in 2020 followed by 3.4 per cent growth in 2021 in the pessimistic scenario). In 2019, the economy was growing at a rate of 2.7 per cent because of the good performance of the agriculture sector. The outlook of the Moroccan economy prior to the pandemic was positive, and the economy was expected to grow by 3 and 3.8 per cent in 2020 and 2021, respectively. Revised forecasts expected a contraction in 2020 before a recovery in 2021, driven by the agriculture and tourism sectors and increased external demand for local products.

Jordan has witnessed a 3.6 per cent contraction in 2020 and will observe a 3.3 per cent recovery in 2021 (a contraction of 6.7 per cent in 2020 followed by 4.1 per cent growth in 2021 in the pessimistic scenario). Jordan is still facing significant regional challenges emanating from the crisis in neighbouring Iraq and the Syrian Arab Republic, the significant influx of refugees, the disruption of trade routes, and increases in health and education costs. In 2019, Jordan had a modest growth of 0.7 per cent and was expected to record a 2.2 per cent growth rate in 2020 and 2 per cent in 2021.

Similarly, Tunisia is estimated to have witnessed a severe contraction in 2020 of 3.8 per cent (a contraction of 7.1 per cent in the pessimistic scenario). The country is affected by the deep recession in Europe, which is its main trading partner and the main source of tourism in Tunisia. The Tunisian economy is expected to recover by 3.1 per cent in 2021, subject to the recovery of its partner countries and the resumption of tourism activities (3.8 per cent in the pessimistic scenario). In 2019, the country started to reap the results of its pension funds reform implemented in the previous years, and grew at a rate of 1.4 per cent. This trend was expected to continue growing at a rate of 2 and 3 per cent in 2020 and 2021.

## Egypt

**1.1 per cent** contraction in 2020
**6.1 per cent** recovery in 2021

## Morocco

**2.1 per cent** contraction in 2020
**2.8 per cent** recovery in 2021

## Jordan

**3.6 per cent** contraction in 2020
**3.3 per cent** recovery in 2021

## Tunisia

**3.8 per cent** contraction in 2020
**3.1 per cent** recovery in 2021

## Lebanon

**10.2 per cent** contraction in 2020
**1.5 per cent** recovery in 2021

Lebanon has witnessed severe difficulties in 2020. Socioeconomic challenges surfaced in 2019 and the economy contracted by 1.1 per cent. These challenges have intensified considerably in 2020, with the economy contracting by 10.2 per cent before recording a modest recovery of a projected 1.5 per cent in 2021 (a contraction of 19.1 per cent in 2020 followed by modest growth of 1.8 per cent in 2021 in the pessimistic scenario). This contraction in growth was caused by a series of adverse events emanating particularly from weak business confidence and tight financial conditions, which led to widespread social instability starting in October 2019. This situation was further aggravated in 2020 by twin deficits, high public debt, a default on the repayment of Eurobonds in March, April and June 2020, a large depreciation in the local currency (between October 2019 and June 2020, the Lebanese pound depreciated by more than 200 per cent relative to the dollar), and a slowdown in economic activity owing to the COVID-19 lockdown. The modest recovery expected in 2021 is conditioned on successful structural reforms, restoring the trust of society and foreign stakeholders in Lebanese institutions, the success of measures to halt the deteriorating local currency and the outcomes of negotiations with IMF to obtain financial support. Even before the pandemic, the economy was expected to grow at a rate of only 0.4 per cent in 2020 and 1.4 per cent in 2021. However, the spread of the virus and the default on debt payments has aggravated the situation.

## Algeria

**2.1 per cent** contraction in 2020
**2.1 per cent** recovery in 2021

In Algeria, following the outbreak of COVID-19 and the historic fall in oil prices in April 2020, the economy is estimated to have contracted by 2.1 per cent in 2020 and is projected to recover by 2.1 per cent in 2021 (a contraction of 3.9 per cent in 2020 followed by 2.6 per cent growth in 2021 in the pessimistic scenario). These developments follow a tumultuous 2019, when large demonstrations led to the departure of President Bouteflika. In 2019, the Algerian economy grew by 1.2 per cent and was expected to grow by 2.3 per cent in 2020. However, adverse effects in the hydrocarbon market and modest growth in the nonhydrocarbon sector resulted in the economy contracting.

Inflation rates in MICs are expected to decrease or stabilize in 2021 in all countries, except Lebanon. On average, the inflation rate is expected to decline to 5.8 and 5.5 per cent in 2021, down from 6.8 and 5.88 per cent in 2019 and 2020, respectively.

In Lebanon, uncertainties and vast socioeconomic challenges, particularly the substantial depreciation of the Lebanese pound, is estimated to have increased inflation to 16.4 per cent in 2020 up from 1.4 per cent in 2019, then a decrease to 5.2 per cent is expected in 2021. The challenging situation in the country was further complicated by the Beirut Port explosion on 4 August 2020 (box 2.1).

## Box 2.1 An assessment of the implications of the overlapping crises in Lebanon

Before 4 August 2020, Lebanon was already witnessing one of the most severe economic crises in its modern history. It began with a social uprising on 17 October 2019, followed by two months of lockdown in response to the COVID-19 pandemic, and lastly the tragic explosion at the Beirut Port on August 2020 that deeply affected the country's already dire socioeconomic conditions.

According to the Rapid Damage Assessment conducted by the United Nations and the World Bank, the blast is estimated to have caused the following in the short run:

- Between 0.4 and 0.6 percentage points decline in the growth rate of real GDP in 2020 and 2021 as a result of the destruction of physical capital stock;
- An additional loss of 0.4 and 1.3 percentage points in GDP growth rate in 2020 and 2021 as a result of increased trade costs caused by the destruction of Beirut Port facilities.

These impacts further deepen the double-digit contractions in real GDP growth stemming from the pre-existing economic and financial crisis, and the repercussions of COVID-19. The explosion also had major social implications. General and extreme poverty rates hit 45 and 22 per cent, respectively, in 2020. The headcount poverty rate is estimated to have jumped from 28 per cent in 2019 to 55 per cent in May 2020. The corresponding increase in extreme poverty is from 8 to 23 per cent. This brings the total number of poor among the Lebanese population to 1.1 million and 2.7 million for the lower and the upper poverty lines, respectively. For the upper poverty line, this is an increase of 1.3 million poor from the reference growth scenario for 2020 (pre-COVID-19 and pre-explosion). The equivalent rise in the number of extreme poor is 750,000.

In addition, Lebanon has one of the most unequal wealth distributions in the region and the world, ranking twentieth globally with a wealth Gini coefficient of 81.9 per cent, and one of the highest concentrations of billionaires per capita. The top 10 per cent of adults owned 70.6 per cent, or $151.4 billion, of all estimated personal wealth ($232.2 billion) in the country in 2019, but these monetary figures are expected to have shrunk significantly in 2020.

**This crisis could be the starting point to implement much-needed policy and social reforms, including the following:**

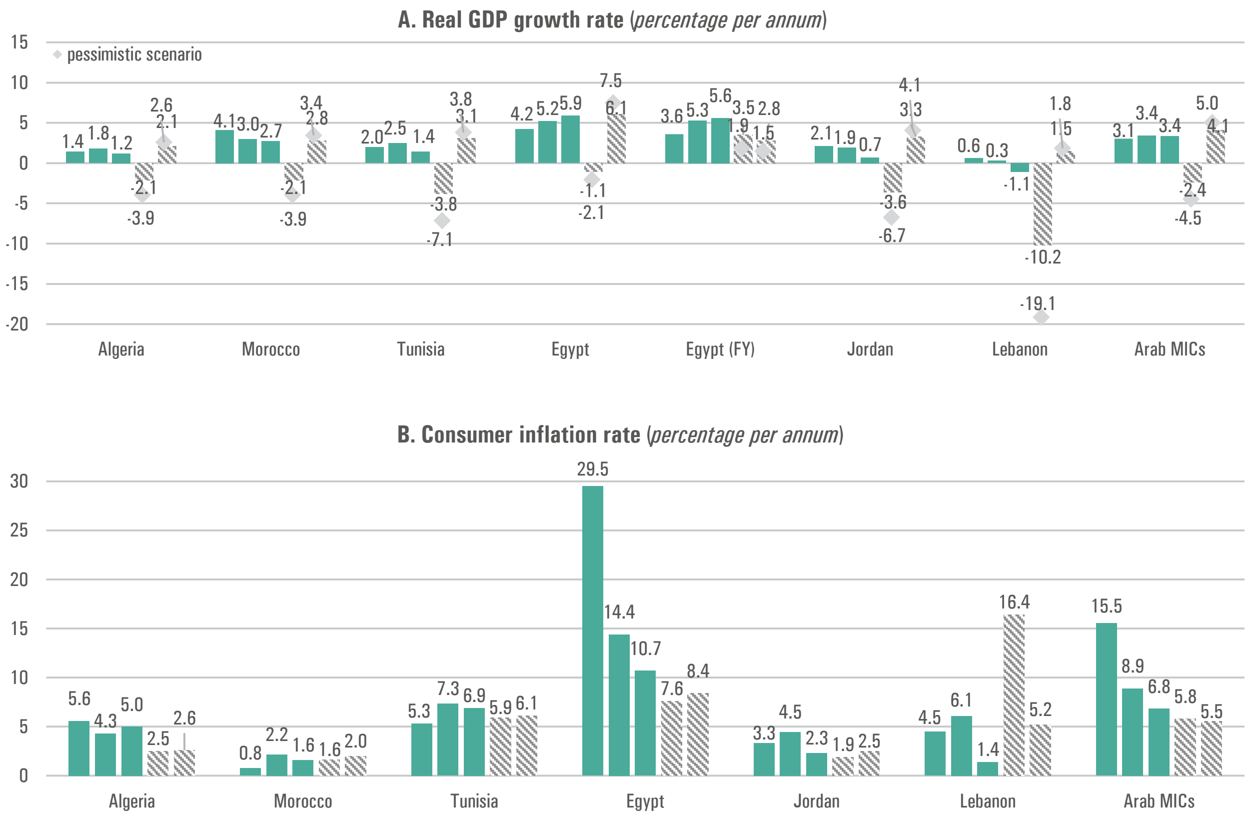
1. Establishing a national solidarity fund to tackle the country's humanitarian crisis and close the poverty gap. Lebanon should mobilize its own substantial resources, with a fair and progressive system of shared responsibility, supported by political will and strong institutional capacity to ensure societal solidarity. The solidarity fund should target the needs of vulnerable groups, including the most vulnerable affected by the explosion such as the poor, the displaced and older persons.
2. Bolstering food and health security and social protection, which urgently need donor support. Foreign assistance can play a vital role in supporting immediate responses, conditioned on ensuring it is directed towards providing adequate access to food, medication, unemployment benefits and cash.
3. Addressing this crisis requires the country to transform quickly and adopt various coping mechanisms. With shared responsibility and societal solidarity in place, especially between the wealthiest top decile and the poor, the bulk of the poverty impact can be absorbed. In Lebanon, and in other Arab MICs, the Economic and Social Commission for Western Asia (ESCWA) advocates for a solidarity fund to mitigate the expected rise in poverty as a result of the COVID-19 pandemic, and other natural or human-made disasters such as the Beirut Port explosion.
4. Enacting necessary economic governance reforms, limiting rent-seeking activities, and enhancing transparency and accountability. More transparency on income and wealth would allow the ministries of finance, social affairs and related institutions to improve poverty-targeting practices.

**Source:** World Bank, European Union in Lebanon, and United Nations, 2020; and E/ESCWA/CL3.SEP/2020/TP.8.

In Jordan and Morocco, inflation rates are controlled and are estimated to have declined in Jordan from 2.3 to 1.9 per cent between 2019 and 2020, and stabilized in Morocco at around 1.6 per cent. In Algeria, Egypt and Tunisia, inflation rates are estimated to have declined significantly following a number of reforms and measures adopted by Governments to control price increases; in Algeria, inflation is estimated to have declined from 5 to 2.5 per cent between 2019 and 2020, in Egypt from 10.7 to 7.6 per cent, and in Tunisia from 6.9 to 5.9 per cent.

Arab MICs are net importers, except Algeria. The region's total merchandise exports reached $130 billion in 2019 compared with total imports of $223 billion, and net imports of $93 billion. The region witnessed

Figure 2.4 **GDP and inflation in Arab MICs, 2017-2021**

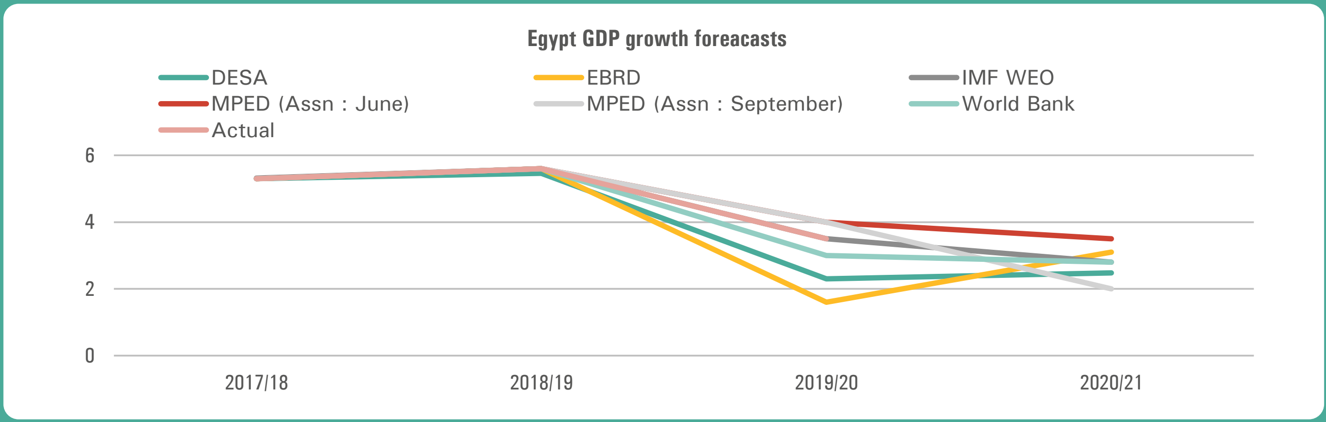



**Sources:** ESCWA staff estimations/forecasts based on national statistical sources; *DESA, World Economic Situation and Prospects as of mid-2020, World Economic Situation and Prospects 2020;* and ESCWA, Statistics Information Portal.

**Note:** FY: fiscal year.

## Box 2.2 **GDP growth in Egypt: fiscal versus calendar year**

For comparability, the growth performance of Egypt is calculated in figure 2.4A within the calendar year to allow aggregation at the regional and subregional level. Meanwhile, when the estimation is realized within the fiscal year officially used in Egypt (July to June), growth is estimated to be 3.5 per cent for fiscal year 2019/2020 and 2.8 per cent for fiscal year 2020/2021. This performance is confirmed by all international organisations and makes the country one of the best performers worldwide.




This success is largely the consequence of stabilization policies enacted between 2016 and 2019. The devaluation of the Egyptian pound by 50 per cent caused a decrease in imbalances, thus attracting FDI, remittances and international assistance. Moreover, increased interest rates contributed to the inflow of capital, which helped boost GDP growth. Rapid inflation led to a fall in real wages, improving the economy's competitiveness. Imports were cut and tourism boomed, improving the current account balance.

These advancements continued during the COVID-19 pandemic. Remittances rose by 11 per cent in June and by another 11 per cent in July 2020. FDI inflows and Suez Canal revenues remained resilient (2019/2020 revenues dropped to $5.72 billion from $5.75 billion the previous fiscal year, despite growth in traffic). Tourism was the only sector severely affected with revenues expected to drop by 73 per cent, which translates into an expected 14.3 per cent decrease in employment.

**Source:** Based on PowerPoint presentation by Arun Jacob, "Economic Briefing COVID-19 and the State of the Egyptian Economy", 14 October 2020.

an improvement in its net export position, driven mainly by Algeria whose trade consolidated at $10 billion in net exports following several years of trade deficits. The region recorded an overall improvement in its trade balance in 2019, but is still showing a significant deficit and requires substantial amounts of foreign reserves to finance its imports, which it will meet by resorting to borrowing thus placing additional pressure on its public finances.

European countries remain the main trading partners of Arab MICs, with total exports of $75 billion and total imports of $105 billion. Algeria, Morocco and Tunisia trade mainly with European countries, particularly France, Germany, Italy and Spain. France alone received between 10 and 30 per cent of exports from these countries in 2019, which import mainly from China. Egypt, Jordan and Lebanon export mainly to the United States and other Arab countries, particularly GCC and neighbouring countries. Saudi Arabia, for example, attracted 11 per cent of Jordanian exports and around 6 per cent of exports from Lebanon and Egypt in 2019. These countries import mainly from China, the United States, Europe and other Arab countries.

Intraregional trade captured a significant share of Arab MICs' trade. The region exports around 16 per cent and imports around 13 per cent to and from neighbouring countries. Intraregional trade includes petroleum, and agricultural and food products. Oil and gas products capture the largest value share.

The unprecedented decline in oil prices in 2020 is expected to have a positive impact on the trade balance of MICs, as their import bill will significantly decrease. Imports will fall more than exports, leading to improvements in the trade balance and current account of most countries. Current account deficit is estimated to have decreased to $38 billion in 2020, and trade deficit to $58 billion. In 2019, most MICs saw a deterioration of their current account balance, with the deficit increasing from $41 billion in 2018 to $50 billion in 2019. This deterioration was mainly caused by a widening trade balance deficit from $59 billion in 2018 to $63 billion in 2019.

At the country level, Egypt managed to maintain a low current account deficit in 2019 at around 2.5 per cent of GDP thanks to its reduced trade deficit (around 7 per cent of GDP). Furthermore, in 2019, FDI inflow increased by 11 per cent to $9 billion, making Egypt the largest recipient in the region in 2019. Tourism generated around 16 per cent of the country's income. The external sector's performance improved further in 2020, and the current account is estimated to have recorded a positive balance of $8.6 billion (around 2.6 per cent of GDP) driven by an improvement in the trade balance, notably owing to a contraction of the economy, reduction in imports, and a positive FDI outlook, mainly in the oil and gas, telecommunications, consumer goods and real estate sectors.

Jordan benefited from positive economic growth in neighbouring Iraq and the Syrian Arab Republic, and the resumption of many sectors, which led to an improvement in its current account in 2019. This improvement has extended to 2020, recording a $1 billion current account surplus, driven mainly by a decline in the trade deficit, which is estimated to have dropped from 32 per cent of GDP in 2019 to 28 per cent in 2020.

## Egypt

low current account deficit in 2019 at around **2.5 per cent**

## Jordan

trade deficit dropping from **32 per cent** in 2019 to **28 per cent** in 2020

The situation in Lebanon is more complex, with significant twin deficits. In 2019, the country witnessed a slowdown in remittances, particularly in the last quarter of the year when banks started imposing capital controls on cash withdrawals and transfers, coupled with a considerable drop in FDI and high debt levels (around 160 per cent of GDP in 2019). Lebanon suffered from a large current account deficit in 2019, around 25 per cent of GDP. However, after the COVID-19 outbreak and the anticipated recession, the country witnessed a significant decline in its trade deficit (from $15 billion in 2019 to $12 billion in 2020) and an improvement in its current account position (from $15 billion in 2019 to $10 billion in 2020), which is estimated to have improved to 18 per cent of GDP in 2020.

In 2019, Algeria witnessed a deterioration in its current account deficit from $17 billion in 2018 to $24 billion in 2019, and $32 billion in 2020. This deterioration is mainly driven by a worsening trade balance. The trade deficit increased from $15 billion in 2018 to $23 billion in 2019, and $25 billion in 2020 as a result of the sharp decline in oil prices and in export revenues. Merchandise exports decreased from $41 billion in 2019 to $33 billion in 2020.

In Morocco, the current account deficit decreased from 4.1 per cent in 2018 to 3.7 per cent in 2019, and 1.7 per cent in 2020. These low current account levels are caused by a FDI inflow and significant tourism revenues.

Similarly, in Tunisia, the current account deficit declined between 2018 and 2019 from 10.7 to 9.2 per cent, driven mainly by a decrease in the trade deficit. This situation improved further in 2020, as the economic contraction caused by COVID-19 had dampened demand and would lead to further improvements in the trade deficit. The current account is estimated to have declined to 5.3 per cent of GDP.

The fiscal outlook for 2020 in Arab MICs clearly indicates a deterioration caused by the economic implications of COVID-19 and its repercussions in terms of declining government revenues and increased spending through stimulus packages. The pandemic slowed economic activity as all countries imposed total or partial lockdowns, which led to a contraction in economic growth and a decline in government revenues. Moreover, Governments of MICs implemented fiscal stimulus packages to mitigate the impact of the virus on their economies. However, with a limited fiscal space at their disposal to generously support their economies, these packages will pose an additional pressure on public finances by increasing government spending and leading to a tighter fiscal position. Policy measures adopted by MICs are different from those pursued in GCC countries.

## Lebanon

current account deficit improved from **25 per cent** in 2019 to **18 per cent** in 2020

## Algeria

deterioration in current account deficit from **$17 billion** in 2018 to **$24 billion** in 2019, and **$32 billion** in 2020

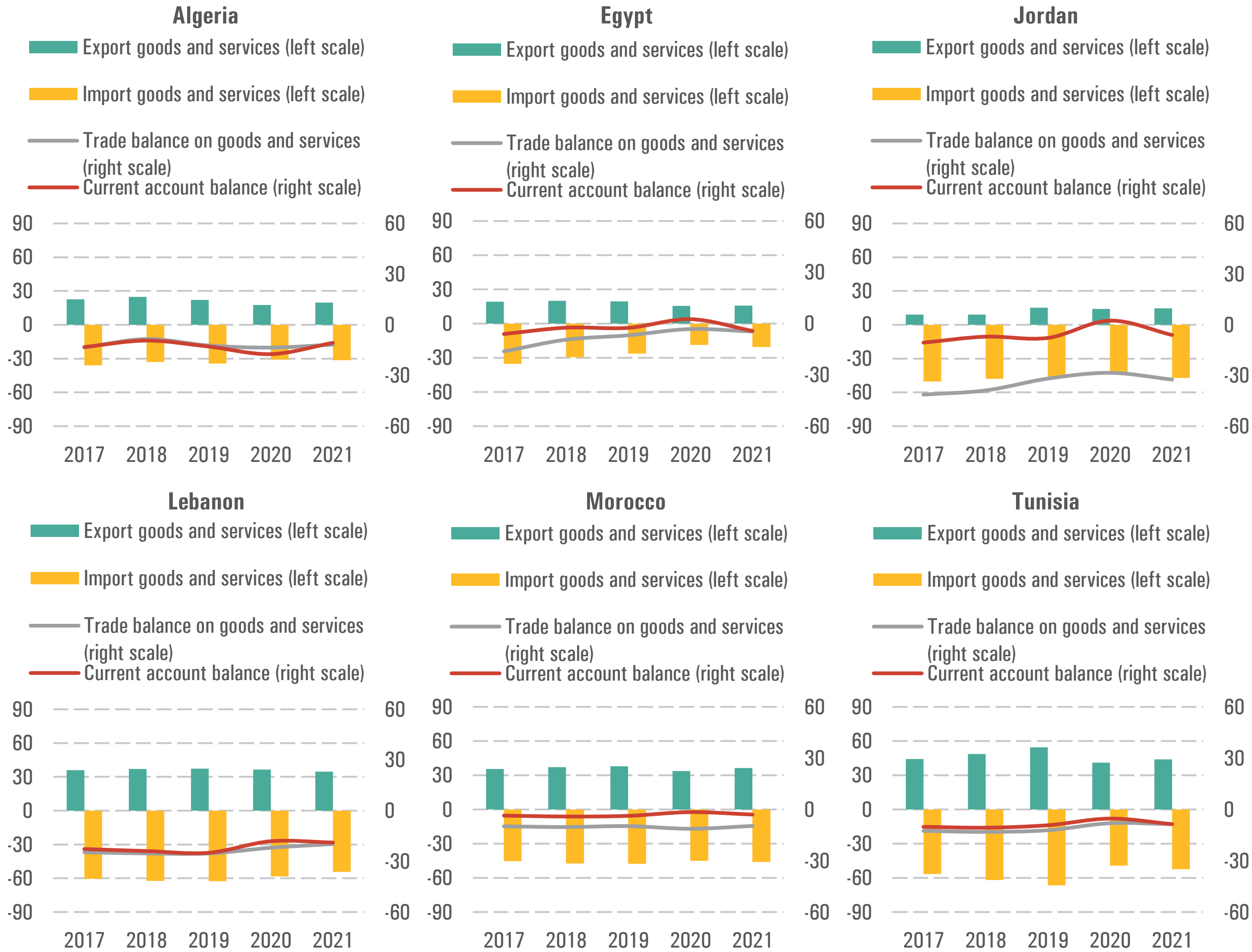
## Morocco

current account deficit decreased from **4.1 per cent** in 2018 to **3.7 per cent** in 2019, and **1.7 per cent** in 2020

## Tunisia

improvement in current account deficit from **10.7 per cent** in 2018 to **9.2 per cent** in 2019, and **5.3 per cent** in 2020

Figure 2.5 **Trade and current account balances of Arab MICs, 2017-2020 (percentage of GDP)**




**Sources:** ESCWA staff estimations/forecasts based on national statistical sources; *DESA, World Economic Situation and Prospects as of mid-2020, World Economic Situation and Prospects 2020;* and ESCWA, Statistics Information Portal.

Most MICs partly allowed businesses to defer tax payments, with varying degrees depending on the country, while others provided cash transfers or food distribution to the poor and unprivileged. Monetary policy in Arab MICs to a large extent followed the rest of the world, decreasing cash reserve requirements and cutting interest rates. The Egyptian Central Bank launched a share-purchase programme to buy stock market shares worth 20 billion Egyptian pounds to support the stock exchange, while banks in Jordan, Lebanon and Tunisia provided additional interest-free loans to affected businesses. The fiscal position is expected to improve in 2021, conditioned on the success of these measures and on resuming normal economic activity.[2]

In Algeria, the fiscal deficit increased from 5.5 per cent of GDP in 2018 to 9.3 per cent in 2019, driven partly by an increase in expenditure and a decrease in revenues, particularly oil revenues. This situation has worsened in 2020, with the fiscal deficit reaching 18 per cent of GDP in 2020 as a result of the unprecedented decline in international oil prices in the first half of the year. Revenues were estimated to have dropped from $6.5 billion in 2019 to $4.4 billion in 2020 (figure 2.6). The Algerian Government announced a plan to cut expenditures by 30 per cent in response to the fall in revenues caused by the oil price slump and to increase spending on its health sector, including spending on purchasing medical equipment. The situation is expected to improve in 2021 and the deficit will decrease to 8 per cent of GDP as signs of recovery in the global economy are expected to materialize and demand for oil is expected to resume.[3]

In Lebanon, the fiscal deficit decreased slightly between 2018 and 2019 from 9.6 per cent of GDP to 9.2 per cent. This deficit has widened in 2020, reaching 12 per cent of GDP as the country has been struggling with numerous challenges. Debt sustainability continued to be a significant challenge, especially after the Government defaulted on repayment of its issued Eurobonds over the period April-June 2020, with debt levels reaching around 159 per cent of GDP in 2019. Measures adopted by the Lebanese Government to mitigate the impact of COVID-19 included financial and in-kind support for those hit by the pandemic, in coordination with local authorities. This situation will improve slightly in 2021, with the fiscal deficit expected to decrease to 10 per cent conditioned on successful negotiations with IMF.

Similarly, Jordan is facing several socioeconomic challenges aggravated by the large number of refugees from neighbouring Iraq and the Syrian Arab Republic. The fiscal deficit, which decreased slightly between 2018 and 2019, is estimated to have increased from 2.1 per cent of GDP in 2019 to 7 per cent in 2020, and is expected to drop to 6 per cent in 2021.

In Egypt, the Government managed to increase its revenues from $989 billion in 2018 to $1,134 billion in 2019. As a result, the fiscal deficit declined from 8.3 per cent in 2018 to 7.1 per cent in 2019. The Government also managed to decrease debt levels from 95 per cent of GDP to 89 per cent in 2019. With the outbreak of COVID-19, the Government

## Algeria

fiscal deficit estimated at
**18 per cent** in 2020

## Lebanon

fiscal deficit estimated at
**12 per cent** in 2020

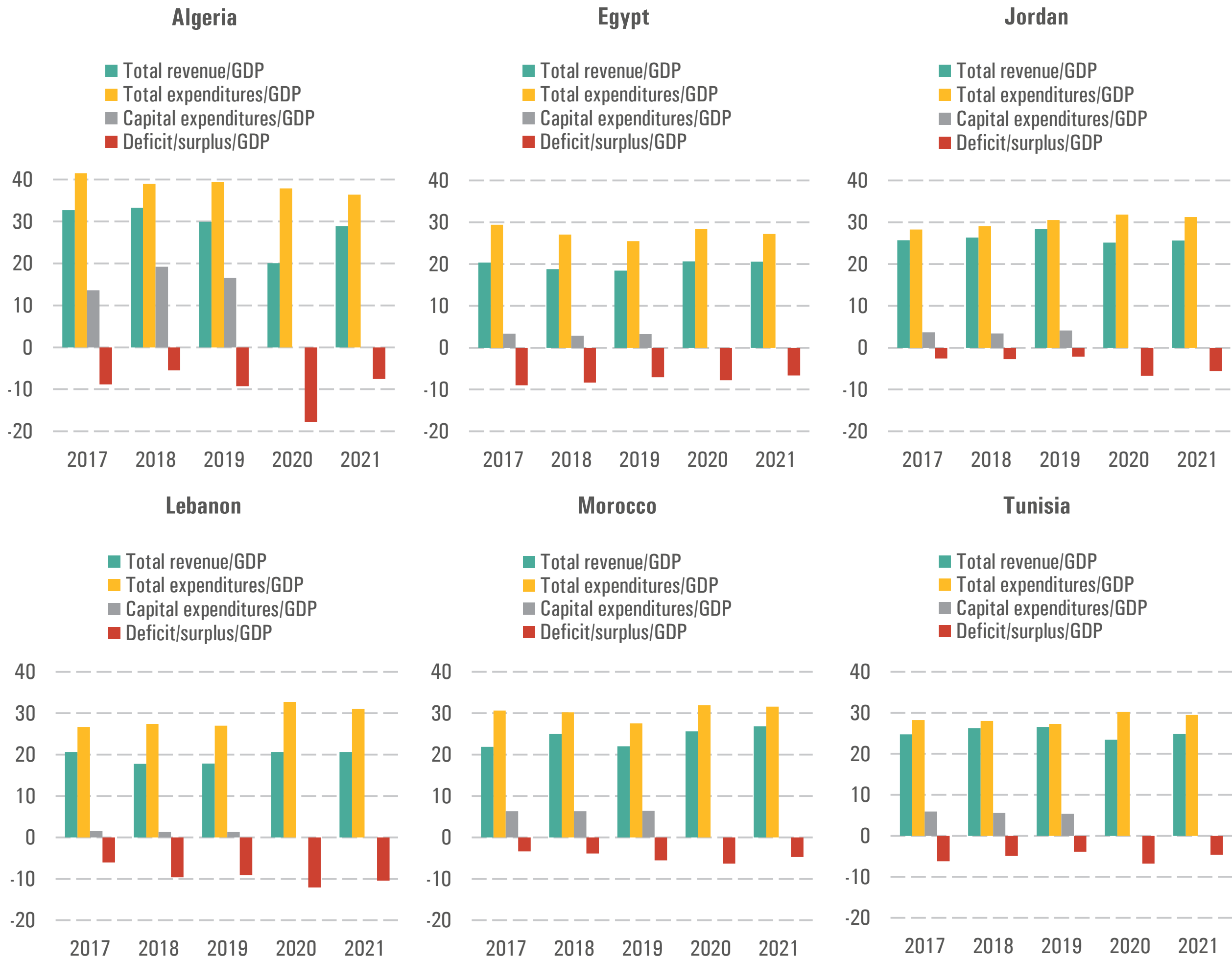
## Jordan

fiscal deficit estimated at
**7 per cent** in 2020

## Egypt

fiscal deficit estimated at
**7.8 per cent** in 2020

Figure 2.6 **Fiscal positions of Arab MICs, 2017-2021 (percentage of GDP)**




**Sources:** ESCWA staff estimations/forecasts based on national statistical sources; *DESA, World Economic Situation and Prospects as of mid-2020, World Economic Situation and Prospects 2020;* and ESCWA, Statistics Information Portal.

increased its expenditures substantially to finance measures to mitigate the impact of the pandemic. Consequently, the fiscal deficit is estimated to have increased to 7.8 per cent of GDP in 2020. The Government also created a special fund to support the tourism sector, responsible for 12 per cent of GDP and 10 per cent of employment. In May 2020, IMF approved a request by Egypt for assistance worth $2.77 billion in response to COVID-19 and in support of vulnerable groups and the most impacted economic sectors, notably the health sector.

In Morocco, government revenues decreased by 5 per cent in 2019 along with a 2 per cent decrease in expenditures, which led to a wider fiscal deficit from 3.9 per cent of GDP in 2018 to 5.5 per cent in 2019. This deficit increased further in 2020 to reach 6.3 per cent of GDP as a result of an 8 per cent increase in expenditures in 2020 (figure 2.6). The Government created a special fund financed by itself and tax-deductible voluntary contributions to support health infrastructure and help employees hit by the crisis.

In Tunisia, revenues increased by 10 per cent in 2019 along with a 6 per cent increase in expenditures, leading to a decrease in the fiscal deficit from 4.9 per cent of GDP in 2018 to 3.9 per cent in 2019. The debt-to-GDP ratio decreased from 76 per cent in 2018 to 73 per cent in 2019. However, with the outbreak of COVID-19, revenues are expected to drop by 9 per cent, while expenditures are expected to increase by 14 per cent to curtail the socioeconomic impact of the virus. The fiscal deficit is estimated to have increased to 6.8 per cent of GDP in 2020. The Government created a fund to cover expenditures related to mitigating the impact of COVID-19, and allocated 2 per cent of GDP to this fund.[4] In April 2020, IMF approved an emergency assistance loan of $745 million to support the Tunisian response to COVID-19 and to ease pressure on the country's public finances.

## Morocco

fiscal deficit estimated at **6.3 per cent** in 2020

## Tunisia

fiscal deficit estimated at **6.8 per cent** in 2020

# D. Arab conflict-affected countries

Suffering from persistent unrest, the economies of conflict-affected countries are estimated to have contracted by 4.2 per cent in 2020 and are expected to recover by 3.1 per cent in 2021 (a contraction of 7.9 per cent in 2020 followed by 3.9 per cent growth in 2021 in the pessimistic scenario), following modest economic growth in 2019 of 1.4 per cent. Prior to the pandemic, the economies of conflict-affected countries were estimated to have grown by 4.5 per cent in 2020 and are expected to grow by 5.2 per cent in 2021.

The 2020 fall in oil prices and social unrest had a dire impact on the Iraqi economy, which is estimated to have contracted by 4.7 per cent in 2020 before recovering by a projected 4.2 per cent in 2021 (a contraction of 8.8 per cent in 2020 followed by 5.2 per cent growth in 2021 in the pessimistic scenario). In 2019, Iraq benefited from an increase in crude oil production (up by 6.3 per cent) and a rebound in non-oil economic activity, leading to an economic growth of 3.2 per cent in 2019. Before the outbreak of COVID-19, this trend was expected to continue in 2020 and 2021, with a projected growth rate of 4.8 and 5.8, respectively.

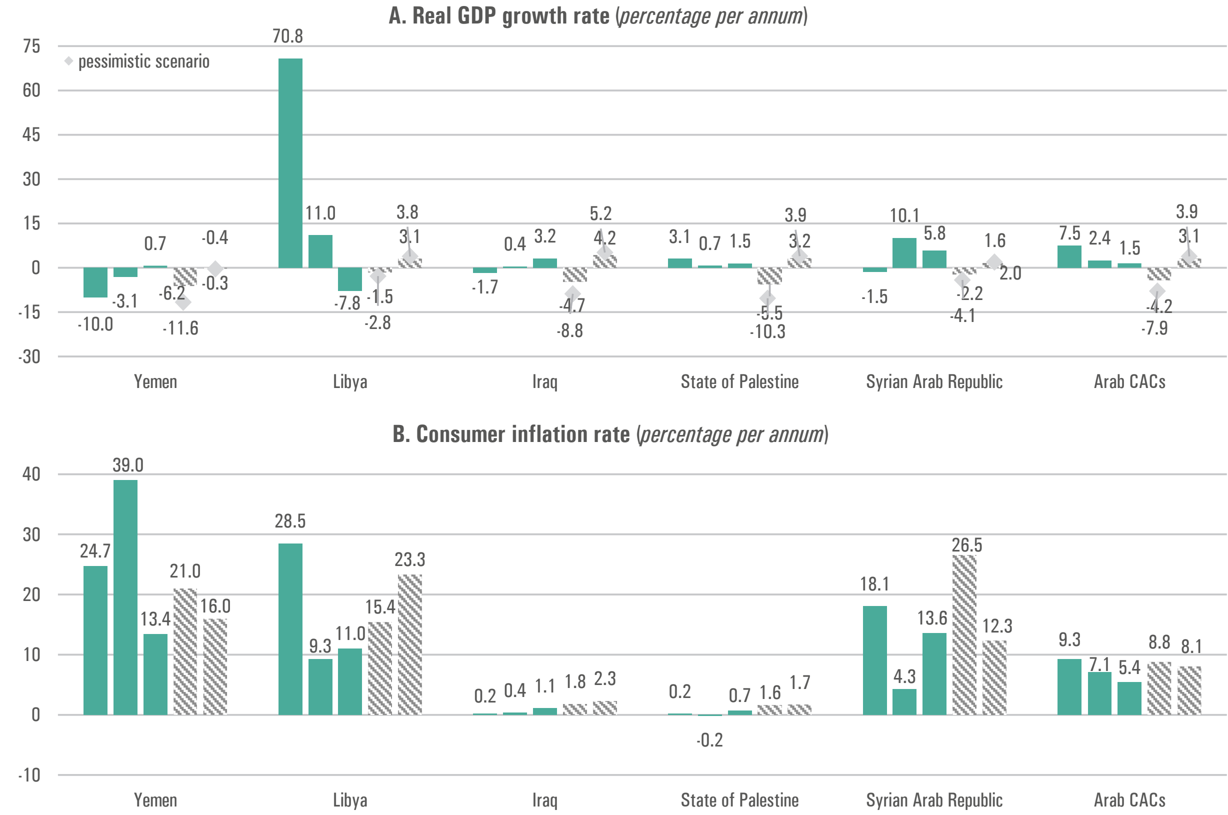
Prior to the pandemic, the Syrian Arab Republic was expected to grow at a rate of 3.7 per cent in 2020 and 3.3 per cent in 2021. However, these projections were affected by the outbreak of the virus and the revisions forecasted that the economy would contract by 2.2 per cent in 2020 before recovering modestly by 1.6 per cent in 2021 (a contraction of 4.1 per cent in 2020 followed by 1.6 per cent growth in 2021 in the pessimistic scenario). In 2019, many parts of the country were witnessing a relatively stable security situation, an increase in reconstruction activities and a gradual return of activity in certain sectors, such as agriculture and services. The economy grew at a rate of 5.8 per cent in 2019.

With the conflict unlikely to end in Libya in 2020, GDP was expected to shrink by 1.5 per cent in 2020 (2.8 per cent in the pessimistic scenario) compared with an estimated 4.5 per cent growth rate projected before the pandemic and the fall in oil prices. A recovery is expected in 2021, with a 3.1 per cent growth rate in 2021 (a contraction of 3.8 per cent in the pessimistic scenario). In 2019, the economy suffered from a severe contraction of 7.8 per cent in 2019 caused by increased conflict and the failure to reach an agreement between warring parties.

In Yemen, the economy is still suffering from fragmented national institutions and protracted armed conflict. In 2020, the economy is estimated to have contracted by 6.2 per cent (a contraction of 11.6 per cent in the pessimistic scenario), compared with a 3.6 per cent projection before COVID-19, and by 0.3 per cent in 2021 (a contraction of 0.4 per cent in the pessimistic scenario). In 2019, economic growth increased slightly by 0.7 per cent as a direct consequence of balance of payments assistance from Saudi Arabia and a gradual recovery of oil and gas production.

In the State of Palestine, GDP is estimated to have decreased by 5.5 per cent in 2020 (a contraction of 10.3 per cent in the pessimistic scenario) as a result of COVID-19 effects on donors and uncertainties about a resolution to the standoff on revenue clearance between the Palestinian and Israeli authorities. Prior to the pandemic, economic growth was expected to reach 2.6 per cent in 2020 and 2021. In 2021, the economy is projected to show signs of improvement, as the economies of donor countries begin to recover and aid flows resume. The Palestinian economy is expected to grow by 3.1 per cent in 2021 (3.8 per cent in the pessimistic scenario). In 2019, the economy grew at a rate of 1.5 per cent, suffering mostly from business, capital-flow and mobility restrictions under the Israeli occupation and a decline in aid levels.

## Figure 2.7 GDP and inflation in Arab CACs, 2017-2021



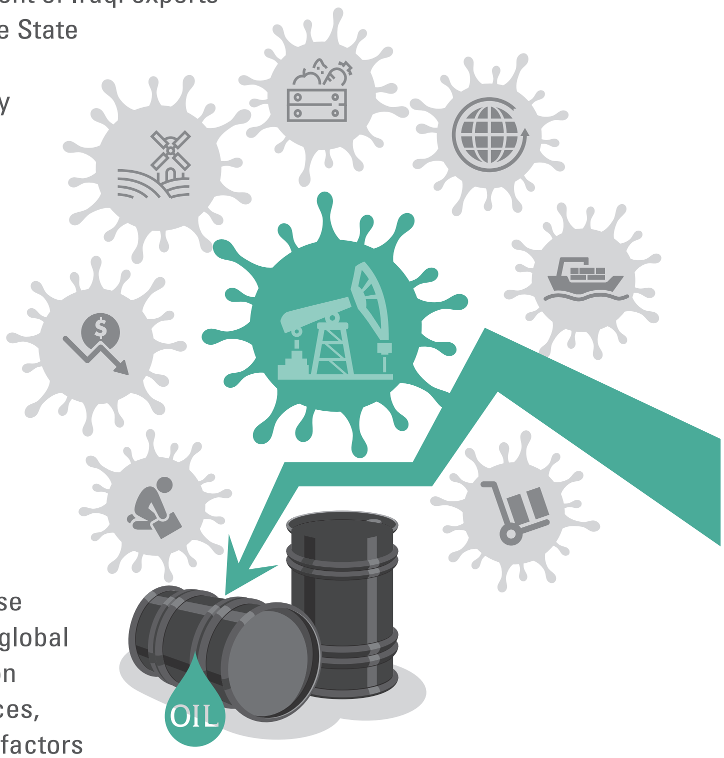

**Sources:** ESCWA staff estimations based on national statistical sources; *DESA, World Economic Situation and Prospects as of mid-2020, World Economic Situation and Prospects 2020;* and ESCWA, Statistics Information Portal.

The problems considered in the pessimistic scenario affect Arab conflict-affected countries similarly, doubling the expected GDP loss from 4.2 per cent to 7.9 per cent. The most significantly affected were the State of Palestine and Yemen. Even though projections for 2021 in the pessimistic scenario are slightly corrected upwards, this change does not compensate for the significant recession in 2020.Inflation rates in conflict-affected countries are estimated at 8.8 per cent on average in 2020 and are expected to decrease slightly to 8.1 per cent in 2021, with large disparities between countries. Libya, the Syrian Arab Republic and Yemen continued suffering from hyperinflation in 2020. Inflation is estimated to have increased from 11 to 15.4 per cent in Libya between 2019 and 2020, from 13.6 to 26.6 per cent in the Syrian

Arab Republic, and from 13.4 to 21 per cent in Yemen. In Iraq and the State of Palestine, inflation rates rose slightly but remained at low levels, increasing to 1.8 and 1.6 per cent, respectively.

With the return of oil production in Libya in 2017 and in Iraq in 2018, Arab conflict-affected countries have become net exporters since 2017. In 2019, their total exports amounted to $108 billion against $75 billion of imports. Exports from Iraq stood at around $86 billion and imports at around $39 billion in 2019, while exports from Libya reached $20 billion and imports hit $10 billion in the same year.

China was the main trading partner of Arab conflict-affected countries, particularly for oil products. Approximately 26 per cent of Iraqi exports and 19 per cent of Libyan exports went to China. The State of Palestine, the Syrian Arab Republic and Yemen exported mainly to other Arab countries, particularly neighbouring countries and Saudi Arabia. Their exports include agricultural and food products. All Arab conflict-affected countries import mainly from China and Turkey.




Ongoing conflict is affecting the external balance as a result of depressed business confidence and its negative impact on FDI inflow. Remittances and foreign aid play a key role in financing imports and in supplying foreign reserves. Lower oil prices recorded in 2020 are likely to improve trade balances for oil-importing conflict-affected countries, namely the Syrian Arab Republic and Yemen, as their import bill will decrease significantly. However, it is short-term relief, as the global economic recession will have severe implications on domestic unemployment and the inflow of remittances, and will contribute to increasing debt levels. These factors are likely to have adverse long-lasting implications.

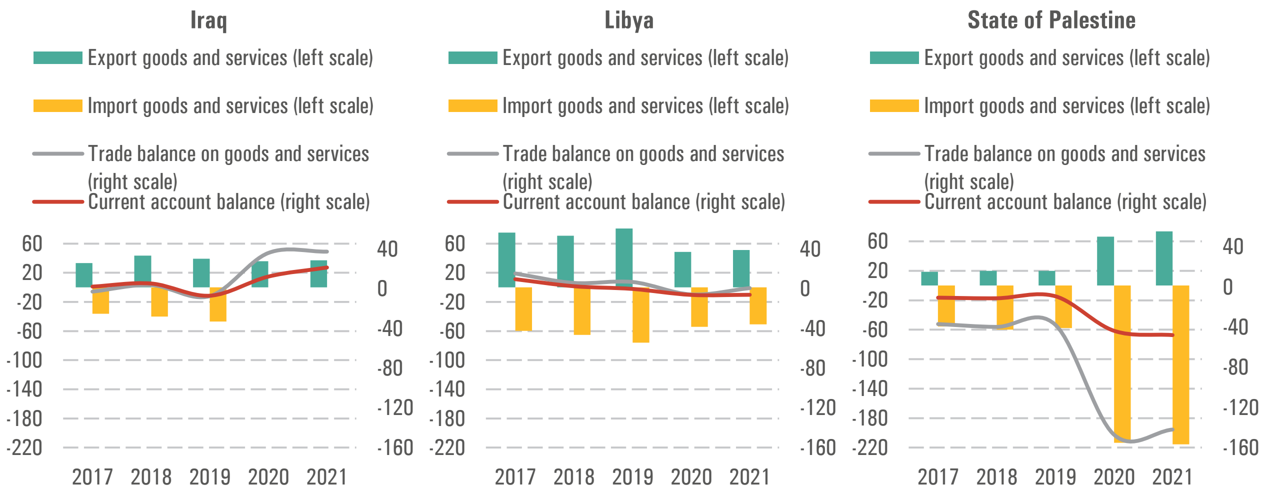
Social unrest in Iraq in 2019 affected trade, particularly merchandise exports. Trade surplus declined from $36 billion in 2018 to $17 billion in 2019. This decline was also reflected in the current account balance, which deteriorated from a surplus of 5.2 per cent to a deficit of 7.1 per cent of GDP between 2018 and 2019. The situation is likely to improve in the period 2020-2021, conditioned on a stable security situation, recovery of the global economy, and resumption of demand for oil exports.

In the State of Palestine, the current account deficit decreased from $1.7 billion in 2018 to $1.4 billion in 2019. The inflow of foreign aid and remittances play an important role in financing the external sector. In 2019, the current account deficit declined to 9.3 per cent, while the trade deficit reached 37.8 per cent of GDP.

In Libya, increased oil production since 2017 continued to have a positive impact on the trade balance, which recorded a surplus of 6.7 per cent of GDP in 2019. This situation changed in 2020, as the sharp decline in oil prices and the drop in global demand negatively affected export revenues, generating a trade deficit of 5.8 per cent. This deficit affected the current account, which is estimated to have recorded a deficit of 6.3 per cent of GDP in 2020.

Arab conflict-affected countries have limited fiscal capacity to deal with the pandemic and the fiscal repercussions of lockdowns. By mid-June 2020, the number of COVID-19 cases reported in these countries, except Iraq, was significantly lower than in other Arab countries. Their focus is therefore on preventing and containing the virus rather than dealing with its economic consequences.

Figure 2.8 **Trade and current account balances in Arab CACs, 2017-2021 (percentage of GDP)**




**Sources:** ESCWA staff estimations based on national statistical sources; *DESA, World Economic Situation and Prospects as of mid-2020, World Economic Situation and Prospects 2020;* and ESCWA, Statistics Information Portal.

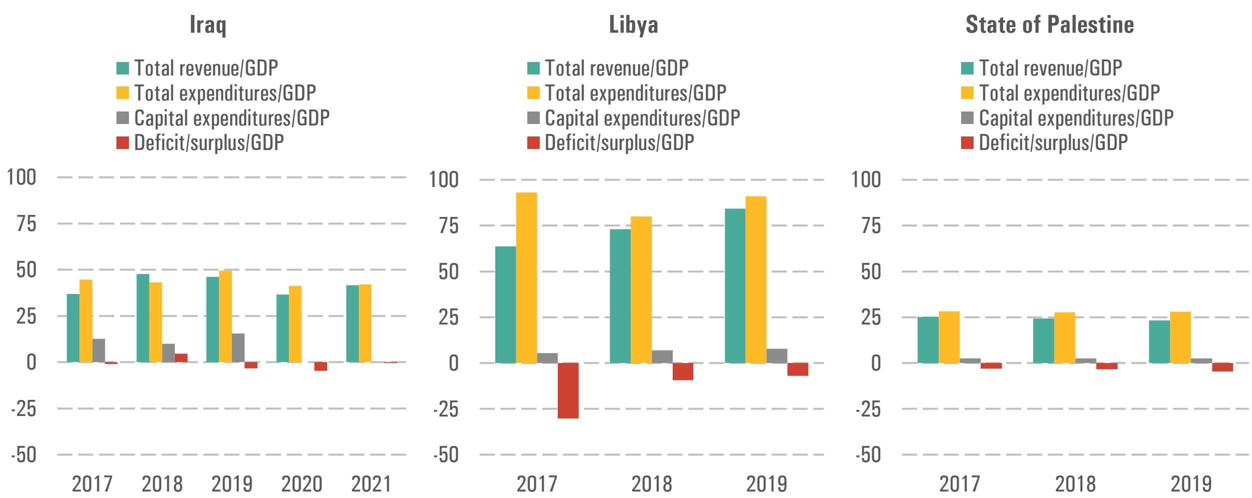
**Note:** Owing to a lack of official statistics, figures for the Syrian Arab Republic and Yemen are not presented.

Governments in conflict-affected countries have either allocated funds, or plan to increase spending on health. Iraq, for example, is in discussions with international organizations to obtain the necessary medical equipment to treat the virus.

The unprecedented decline in oil prices in 2020 has placed additional pressure on the public finances of Iraq and Libya, widening their fiscal deficit and increasing their indebtedness. In Iraq, the fiscal balance moved from a surplus in 2018 to a deficit in 2019. This deficit increased from 3.3 per cent to 4.7 per cent of GDP between 2019 and 2020, then it is expected to decrease to 0.4 per cent of GDP in 2021 as global demand for oil rises. In Libya, increased oil production contributed to closing part of the government deficit in 2019, which decreased from 9.4 per cent in 2018 to 6.9 per cent in 2019.

The Government of the Syrian Arab Republic is likely to increase expenditures on reconstruction activities. The fiscal deficit is estimated at 6.3 per cent of GDP in 2020 and is expected to reach 9.1 per cent in 2021.

Figure 2.9 **Fiscal positions of Arab conflict-affected countries (percentage of GDP)**




**Sources:** ESCWA staff estimations/forecasts based on national statistical sources; *DESA, World Economic Situation and Prospects as of mid-2020, World Economic Situation and Prospects 2020*; and ESCWA, Statistics Information Portal.

**Note:** Owing to a lack of official statistics, figures for the Syrian Arab Republic and Yemen are not presented.

## Box 2.3 **COVID-19, conflict and risks**

Suffering from prolonged conflicts and occupation, Arab conflict-affected countries were witnessing health and economic crises before the outbreak of COVID-19. Largely cut off from international travel, these countries avoided the brunt of the virus at first, when many countries worldwide were under total lockdown. However, in the spring and summer of 2020, cases rose precipitously, particularly in Iraq, Libya, the State of Palestine and the Syrian Arab Republic.

COVID-19 poses a great threat to conflict-affected countries that were already suffering from many of the world's worst humanitarian crises. Around 80 per cent of the Yemeni population (24.1 million persons) required humanitarian assistance as at January 2020, while 11.1 million Syrians, 4.1 million Iraqis, 2.4 million Palestinians, and 900,000 Libyans were in need of emergency aid. Health-care systems were on the verge of collapse before the outbreak. These countries were suffering from a low density of medical doctors (Iraq and the Syrian Arab Republic) as a large number of them had migrated, destruction of health infrastructure (Syrian Arab Republic and Yemen), and occupation and blockades (State of Palestine). The pandemic has only exacerbated the plight of those caught up in humanitarian crises, while the living conditions of refugees and internally displaced communities have deteriorated markedly in recent months. The health sector is facing mounting challenges, and ensuring water security is more imperative than ever.

The pandemic struck at a time when conflict-affected Arab countries were already suffering from a series of structural challenges, including eroded social and institutional capacities, corrupt and fragmented governance, large-scale disasters induced by the climate crisis, and inequality and socioeconomic deprivation. In addition to humanitarian and public service crises, the economic situation in these countries has worsened in recent months, as the pandemic unleashed a global economic crisis unmatched since the Great Depression.

In the absence of peace, there is little hope of minimizing the effects of the pandemic in the short term, let alone of "building back better". The international community has a political role in encouraging and using its leverage to convince conflicting actors to heed the call of the United Nations Secretary-General made in March 2020, and its subsequent endorsement by the Security Council in resolution 2532 (2020) of 1 July 2020, for a global humanitarian truce that would help alleviate humanitarian crises and potentially create an opportunity for sustainable political resolution of ongoing conflicts.

Resolving conflicts and combating the pandemic require swift and coordinated global, regional and local action. Without such concerted intervention at these three levels, violence will persist and the pandemic will continue to spread, thereby deteriorating the governance capacity and socioeconomic conditions of Arab conflict-affected countries. Furthermore, the compounded crisis will exacerbate the risks of violence and its transboundary impact on neighbouring countries, and will undermine ability to confront other risks, such as climate change, water scarcity, and food insecurity. In addition, building local and national governance structures capable of mitigating different types of shocks, such as pandemics, violence and socioeconomic hardship, is essential for a sustainable reconciliation process and establishing peace.

**Source:** ESCWA, "COVID-19, conflict, and risks in the Arab Region: The need to end hostilities and invest in peace" (forthcoming).

# E. Arab least developed countries

Arab LDCs face significant socioeconomic challenges that were exacerbated by the spread of COVID-19. Prior to the pandemic, the economies of Arab LDCs were expected to grow at a rate of 0.8 and 1.6 per cent in 2020 and 2021, respectively. However, the revised outlook is unfavourable. Economic growth is estimated to have contracted by 3 per cent on average in 2020 (a contraction of 5.5 per cent in the pessimistic scenario) and is expected to stabilize in 2021. In 2019, the economy witnessed a contraction of 0.6 per cent on average, marking the second consecutive year of negative growth, largely attributed to an economic deceleration in the Sudan, which is the largest economy in this group of countries. The Sudanese economy shrunk in 2019 by an estimated 2.5 per cent. Political uncertainty in the country has contracted growth in the services sector and investments in real estate and business sectors, while agriculture suffered from shortages of inputs, notably fuel. GDP is estimated to have contracted further by 3.3 per cent in 2020 (a contraction of 6.2 per cent in the pessimistic scenario), and will stagnate in 2021 owing to the political situation, a decrease in domestic demand, and weak private sector investments.

Djibouti was the only LDC to witness positive economic growth in 2020 (2 per cent growth rate in the baseline scenario), but at a slower rate than in 2019. In the pessimistic scenario, the Djiboutian economy is estimated to have slightly contracted by 0.1 per cent. Djibouti performed well in 2019 where GDP growth stabilized at 6.8 per cent, by taking advantage of the establishment of a free-trade zone, a desalination plant and road infrastructure. Before the pandemic, the 2019 rate was expected to persist for 2020 and beyond.

The Comoros has been mildly impacted by the COVID-19 crisis, with a 0.5 per cent loss in GDP in 2020 and 2 per cent projected growth in 2021 (a contraction of 0.9 per cent in 2020 followed by 2.5 per cent growth in 2021 in the pessimistic scenario). In 2019, economic growth in the Comoros increased at a slower pace because of a decrease in the agriculture and infrastructure sectors, which converted into an economic growth rate of 2.5 per cent in 2019 compared with 2.8 per cent in 2018.

Mauritania and Somalia also had relatively stable economic environments. In Mauritania, GDP growth in 2019 is estimated at 5.1 per cent, up from 3 per cent in 2018, as a result of mining sector development and a rise in fishing sector exports. The pandemic has affected projections and the economy is estimated to have contracted by 1.2 per cent in 2020 and is expected to grow by

## Djibouti

**2 per cent** growth rate estimated in 2020

## Comoros

**0.5 per cent** contraction in 2020
**2 per cent** recovery in 2021

3.1 per cent in 2021 (a contraction of 2.2 per cent per cent in 2020 followed by 3.8 per cent growth in 2021 in the pessimistic scenario). Somalia registered an increased growth rate from 3.1 per cent in 2018 to almost 3.5 per cent in 2019. The economy is estimated to have contracted by 1 per cent in 2020 before recovering by a projected 2 per cent in 2021 (a contraction of 1.9 per cent in 2020 followed by 2.5 per cent growth in 2021 in the pessimistic scenario). Differences between baseline and pessimistic forecasts are most significant for the Sudan, with more than a 6 per cent slump in GDP as a result of a recession year in 2019. This projection will be revised downwards in view of the devastating flood in September 2020 (box 2.4).

Inflation is still under control in all Arab LDCs, except the Sudan. Rates varied between 1.3 per cent in Somalia and 5.4 per cent in Mauritania in 2019, and are expected to stabilize or increase slightly over the period 2020-2021.

## Mauritania

**1.2 per cent** contraction in 2020
**3.1 per cent** recovery in 2021

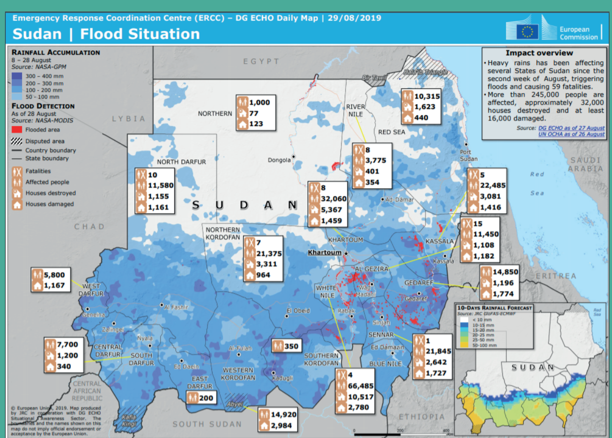
## Somalia

**1 per cent** contraction in **2020**
**2 per cent** recovery in **2021**

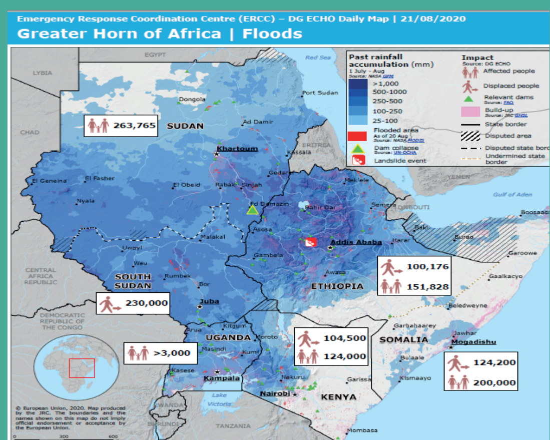
## Box 2.4 **A devastating flood hit the Sudan**

Before the flood, the Sudan was already suffering rom a 50 per cent drop in its GDP, declining from $66.4 billion in 2011 to $33.68 billion in 2019. As a consequence of the COVID-19 lockdown, the economy is likely to further shrink by 3.3 per cent in 2020 on top of a 2.5 per cent loss to GDP in 2019. This growth loss is depriving the country from badly needed income, forcing it to resort to borrowing, although an unsustainable debt-to-GDP ratio of 212 per cent makes it one of the highest indebted countries worldwide. Moreover, owing to a structural trade imbalance, exports have been declining at a rate of 10 per cent a year since 2013, and imports were losing 8 per cent a year on average.

**Map 1: 29 August 2019**




**Map 2: 21 August 2020**




**Source:** Map 1: “Sudan, flood situation”, Emergency Response Coordination Centre (ERCC) – DG ECHO Daily Map, 29 August 2019; Map 2: “Greater Horn of Africa, floods”, Emergency Response Coordination Centre (ERCC) – DG ECHO Daily Map, 21 August 2020.

The floods have affected over 650,000 people to date, destroying or damaging more than 125,000 homes, with 39 people dead in 17 of the country's 18 States, leading the Government to declare a three-month state of emergency. The floods are impacting subsistence agriculture, cash crops and the food security of 8.1 million people, 2.7 of whom are internally displaced persons (IDPs) and refugees from South Sudan. The damage has not been limited to the agriculture and water sectors. A total of 2,671 health facilities have been damaged, significantly limiting capacity to respond to emerging needs on top of the strain already imposed by the pandemic. Schools serving as temporary shelters for displaced families have also reached maximum capacity.

Poverty rates were estimated at 53.4 per cent in 2020 and are expected to reach 55.6 per cent in 2021 owing to a fall in purchasing power, caused by high inflation rates that reached 136 per cent in 2020, thus undermining the purchasing power of those who still have incomes and impacting the livelihoods of tens of millions of Sudanese. If the economic slowdown continues unabated, it will negatively impact employment, real wages and the flow of remittances, which had already declined by $500 million in 2020. It is estimated that $10.2 billion will be needed to close the poverty gap. At this scale and depth of poverty, no domestic solidarity redistribution can achieve poverty eradication. Instead, international donor support is needed, both in the immediate and longer term, to facilitate recovery.

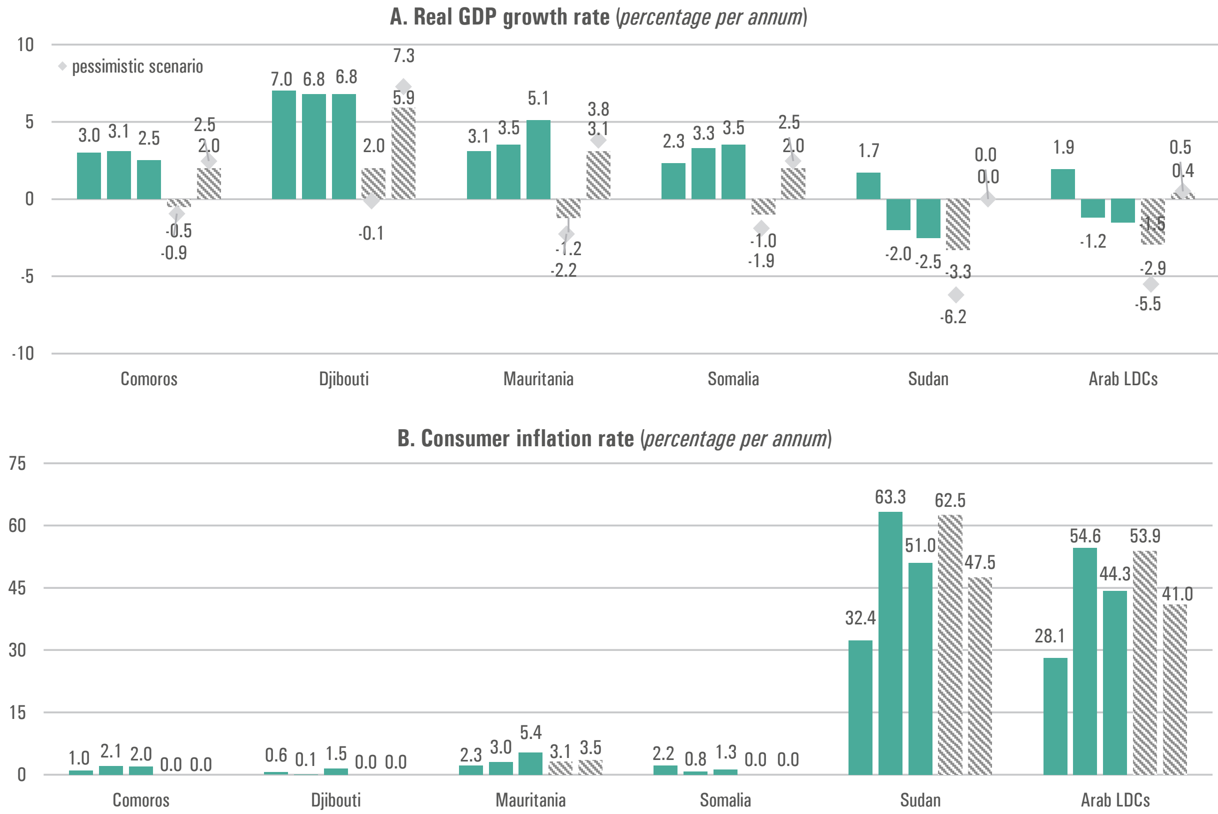
The inequality gap will increase and poor people will be disproportionately affected, not only because they are more exposed and more vulnerable to flooding, but also because they are highly dependent on unstable agricultural, fishing and other ecosystem-related income. Consequently, they have fewer resources and receive less support from the community, the financial system, and social safety nets.

**Source:** Food and Agriculture Organization of the United Nations, "Sudan revised humanitarian response Coronavirus disease 2019 (COVID-19)" May – December 2020; and E/ESCWA/CL2.GPID/2020/TP.10.

However, in the Sudan, hyperinflation is likely to persist, and rates, estimated at 62.5 per cent in 2020, are expected to reach 47.5 per cent in 2021. The devaluation of the currency in 2018 and the balance of payment constraints in the Sudan further exacerbated socioeconomic conditions. This was followed by hyperinflation that reached 63.3 per cent in 2018. Hyperinflation persisted in 2019, and fuelled demonstrations and political unrest that led to the departure of President Al Bashir.

Arab LDCs continue to be net importers, with merchandise exports amounting to $13 billion and imports to $18 billion in 2019. Intraregional exports represent around 52 per cent of total exports, driven mainly by exports from the Sudan, which exported around $4.8 billion to other Arab countries in 2019. Imports from Asia and the Pacific amounted to 43 per cent of total imports in 2019, driven mainly by Mauritania, Somalia and the Sudan. Together these countries imported around $6.7 billion in 2019. Other Arab and European countries together captured around 48 per cent of total imports in the same year.

## Figure 2.10 GDP and inflation in Arab LDCs, 2017-2021



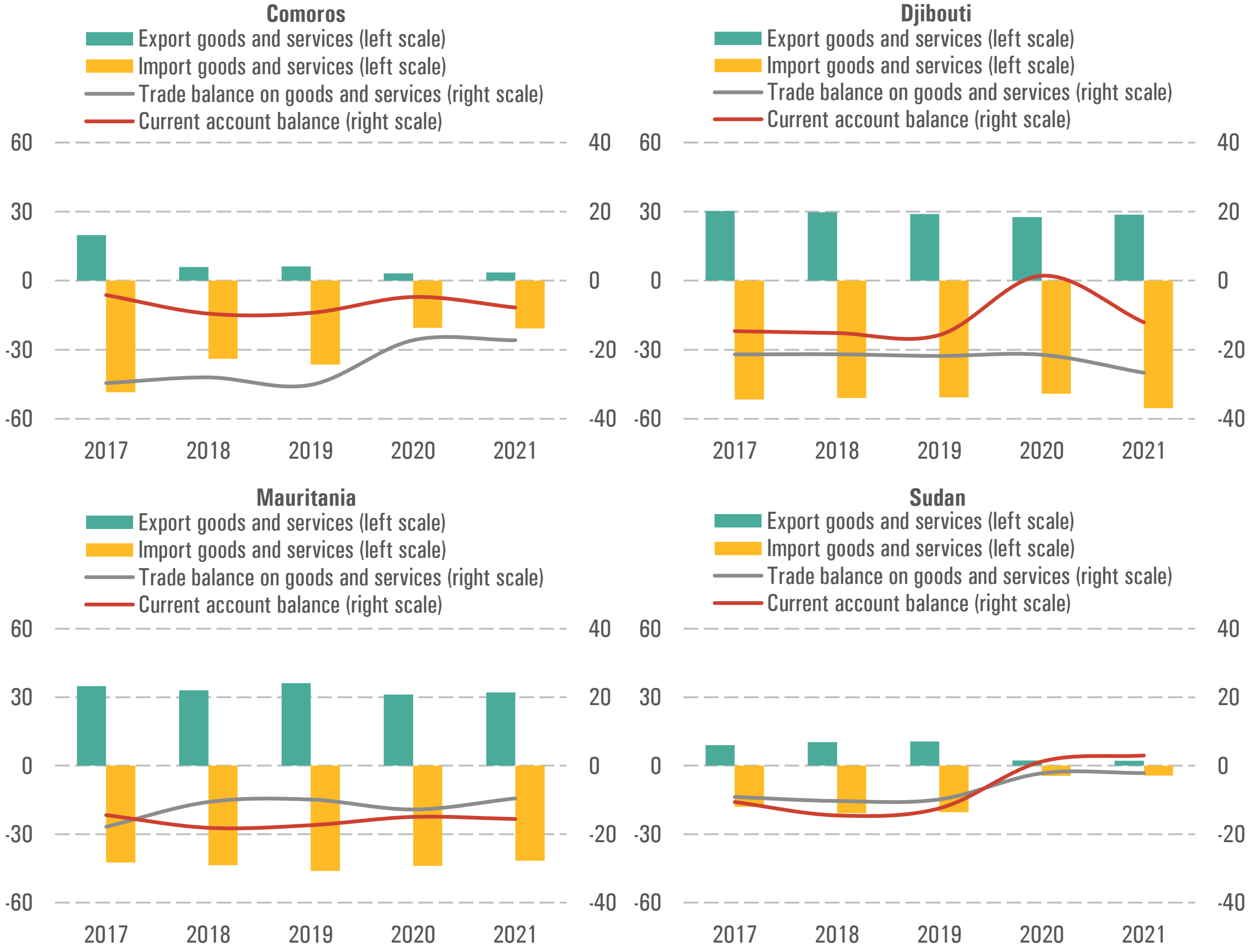

**Sources:** ESCWA staff estimations based on national statistical sources; *DESA, World Economic Situation and Prospects as of mid-2020, World Economic Situation and Prospects 2020;* and ESCWA, Statistics Information Portal.

Arab LDCs rely significantly on external support to address their socioeconomic challenges, particularly balance of payment constraints and debt sustainability. The consolidated current account recorded a deficit of 13.3 per cent in 2019. Trade is estimated to have deteriorated further, with exports losing 11.1 per cent on average in 2020, and imports falling by 6.6 per cent only. The rebound in 2021 will be slow, with a 7.2 per cent increase in exports and a 5.6 per cent rise in imports.

At the country level, all Arab LDCs were suffering from current account and trade deficits in 2019. The Comoros and Djibouti witnessed a large trade deficit in 2019, of around 30.2 and 21.8 per cent of GDP, respectively. In Mauritania and the Sudan, the deficit was around 9.9

per cent. In the Comoros and the Sudan, this deficit is estimated to have increased to 17.2 and 2.2 per cent, respectively, in 2020 because of a decline in imports. This would have a positive impact on the current account deficit, which is estimated to have decreased to 4.7 per cent in the Comoros in 2020. In Djibouti and the Sudan, the current account recorded a surplus of 1.4 and 1.2 per cent of GDP, respectively. Both the

## Figure 2.11 **Trade and current account balances of Arab LDCs, 2017-2021 (percentage of GDP)**

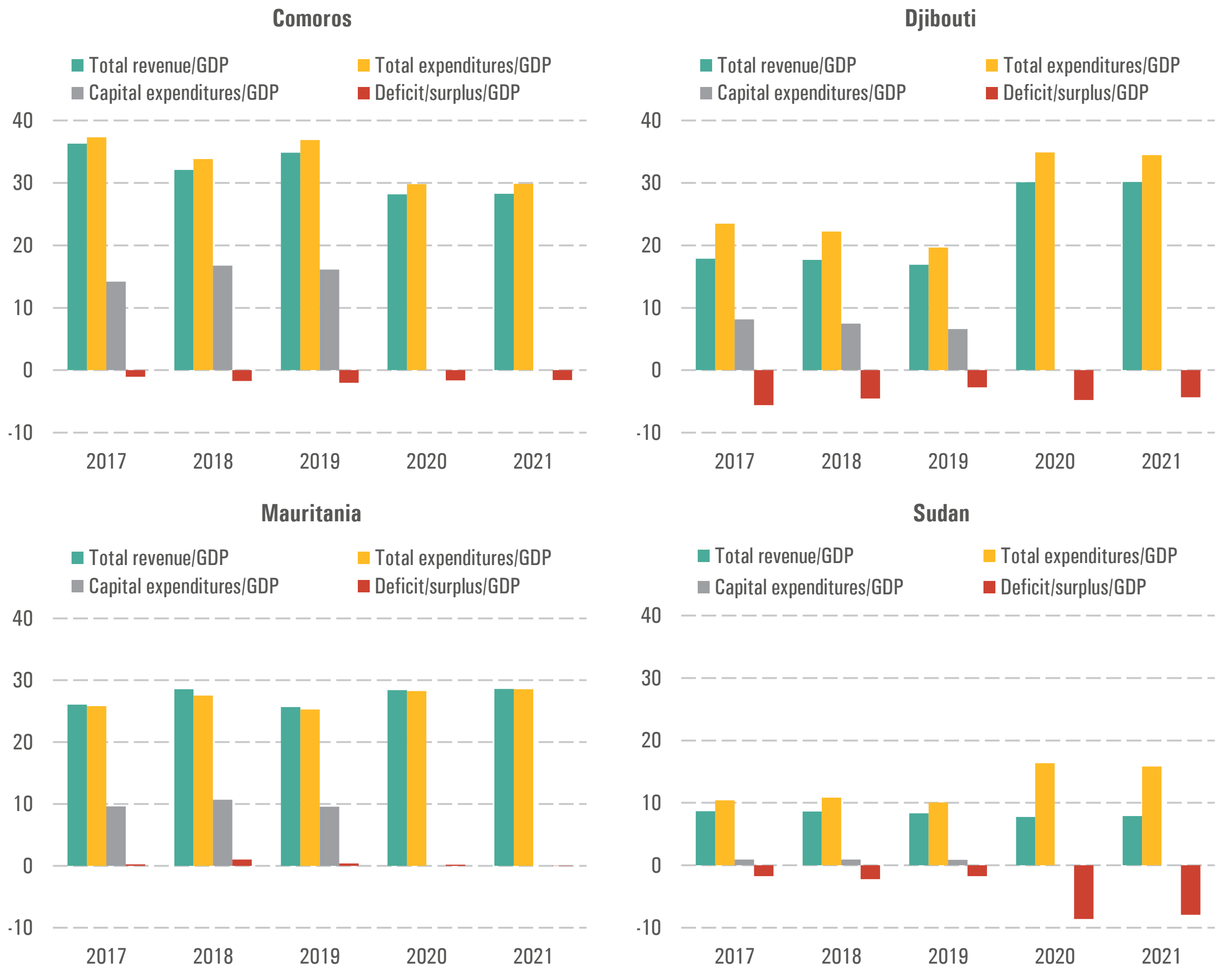



**Sources:** ESCWA staff estimations based on national statistical sources; *DESA, World Economic Situation and Prospects as of mid-2020, World Economic Situation and Prospects 2020;* and ESCWA, Statistics Information Portal.

**Note:** Owing to a lack of official statistics, figures for Somalia are not presented.

Comoros and Djibouti will benefit from IMF debt service relief under the Catastrophe Containment and Relief Trust, and from emergency assistance from IMF for balance of payment support and health spending ($12 million for the Comoros and $43 million for Djibouti). Mauritania received approval for a $130 million IMF credit facility.

Figure 2.12 **Fiscal positions of Arab LDCs, 2017-2021 (percentage of GDP)**




**Sources:** ESCWA staff estimations based on national statistical sources; *DESA, World Economic Situation and Prospects as of mid-2020, World Economic Situation and Prospects 2020;* and ESCWA, Statistics Information Portal.

**Note:** Owing to a lack of official statistics, figures for Somalia are not presented.

Arab LDCs are all suffering from severe budgetary constraints. With the spread of COVID-19, these countries have limited fiscal space to deal with the pandemic and the fiscal repercussions of lockdowns. Their policies are focused mainly on prevention and containment, rather than on dealing with economic consequences. In that regard, their Governments issued only broad declarations to increase spending on health. Part of the assistance received by the Comoros and Djibouti was earmarked to increase spending on the health sector to fight the virus. The Comoros also received $12 million in financial assistance from IMF to address the repercussions of the cyclone in 2019.

In 2020, fiscal deficits widened in Djibouti and the Sudan, with the deficit increasing from 2.8 to 4.8 per cent of GDP in Djibouti, and from 1.7 to 8.6 per cent of GDP in the Sudan. The significant deficit increase in the Sudan is also attributed to the depreciation of the local currency, and expenditures increasing by 125 per cent in 2020 along with only a 29 per cent increase in revenues. The Comoros witnessed a slight improvement in its fiscal deficit from 2 to 1.6 per cent of GDP thanks to the financial assistance it received. Mauritania seems to be less affected by COVID-19, and its fiscal balance showed a slight surplus of 0.2 per cent of GDP in 2020. The country has showed relatively high levels of resilience to external shocks, with a mastery of public expenditure and an increase in mining revenues.

# F. Concluding remarks

The outbreak of COVID-19 has plunged the Arab region into a recession in 2020. In oil-exporter countries, an unprecedented drop in oil prices and accompanying supply shock will deepen the recession, while lockdowns worldwide and interruptions to supply chains and production generated a demand shock in the oil market.

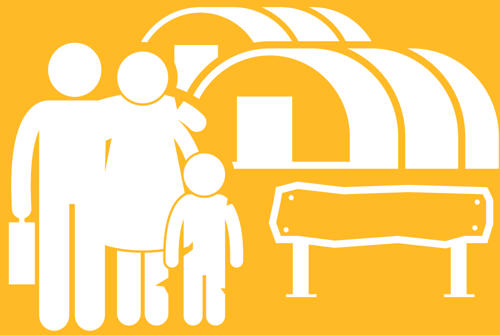
MICs suffered from recessions affecting their trading partners, which negatively affected their export demand, tourism sectors and remittance inflows. The recession in developed countries also affected Arab conflict-affected countries and LDCs through a reduction in ODA.

The 2021 recovery largely depends on the success of the stimulus packages enacted in the region, which exceed $180 billion. It also depends on the recovery of trading partners, and the success of the announced incentive packages.

## Significant increase in Gender Gap

caused by COVID-19

## Burdens of the pandemic



borne by women, refugees and IDPs, and migrant workers

## Gender gap

**40%**

**1.2%** unemployment

**3.2%** Poverty rates

## Women economic participation

**20.53%** at further risk

# 3 Social Developments and Gender Dynamics

## A. Status of gender equality

In terms of gender equality, indicators for the region have not recorded progress since 2018. According to the 2020 Global Gender Gap Report,[1] the Arab region still has a 40.05 per cent gender gap, the highest globally compared with other regions. There are concerns that the current health crisis will exacerbate the gender gap, and reverse progress. The 2020 Global Gender Gap Report divides the gap into four objective dimensions: health and survival; educational attainment; economic participation and opportunity; and political empowerment. The Arab region falls below the global average of 32 per cent. The United Arab Emirates is the top performer in the region, ranking 120 of 153 countries, followed by Kuwait (rank 122) and Tunisia (rank 124). Arab countries' ranks have the lowest dispersion, as they are stacked at the end. The Syrian Arab Republic (rank 150), Iraq (rank 152) and Yemen (rank 153) recorded the lowest ranks among the 153 countries in the index.

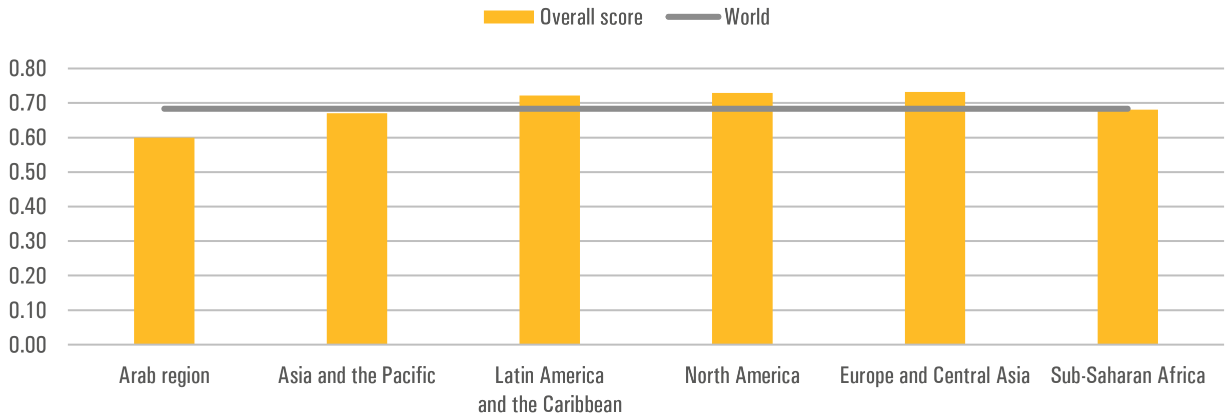
There is divergence in the subindexes among Arab countries. Most Arab countries are close to achieving gender equality in education and health. Women live longer than men on average in all Arab countries, except Bahrain and Kuwait. The education gender gap is narrow and close to 1, with significant disparities between countries. For example, compared with 78 per cent of men, only 35 per cent of women in Yemen are literate. This difference in literacy between genders is around 20 per cent in Mauritania and Morocco. Statistically, the educational attainment and the health and survival subindexes reflect good performance in the region. The wide gender gap is caused by the other two subindexes.

The political empowerment subindex score is below 10 per cent in the region, and is the worst among all regions. Oman (rank 150) and Yemen (rank 151) have the lowest scores in this subindex, with women almost absent from the political arena. Nonetheless, the percentage of seats held by women in Arab parliaments increased, while remaining below the world average. The

### Key messages

- The Arab region is facing a significant crisis caused by COVID-19 at a time when it was already suffering from an increasing gender gap and struggling with internal obstacles to redressing social inequalities.
- The burdens of the pandemic are disproportionately borne by women, refugees and IDPs, and migrant workers.
- The region has a 40 per cent gender gap, which is the highest globally. Poverty rates are estimated to have risen by 3.2 percentage points in 2020 along with an increase in unemployment by 1.2 percentage points.
- Around 31.4 per cent of the Arab workforce is at economic risk because of the crisis, which represents 39.8 million workers. The female labour participation rate remains the lowest worldwide at 20.53 per cent.

Figure 3.1 **Global gender gap index by region, 2019**




**Source:** ESCWA staff calculations based on World Economic Forum, 2019.

**Note:** Regional average scores are weighted by population using population data from the World Bank's World Development Indicators online database.

economic participation and opportunities subindex is also low in the region, as the labour market is characterized by systemic discrimination against women. On average, women's income is 28 per cent lower than men's in the region. Less than half of working-age women participate in the labour force in 16 Arab countries. In six of them, female labour force participation is less than 20 per cent.

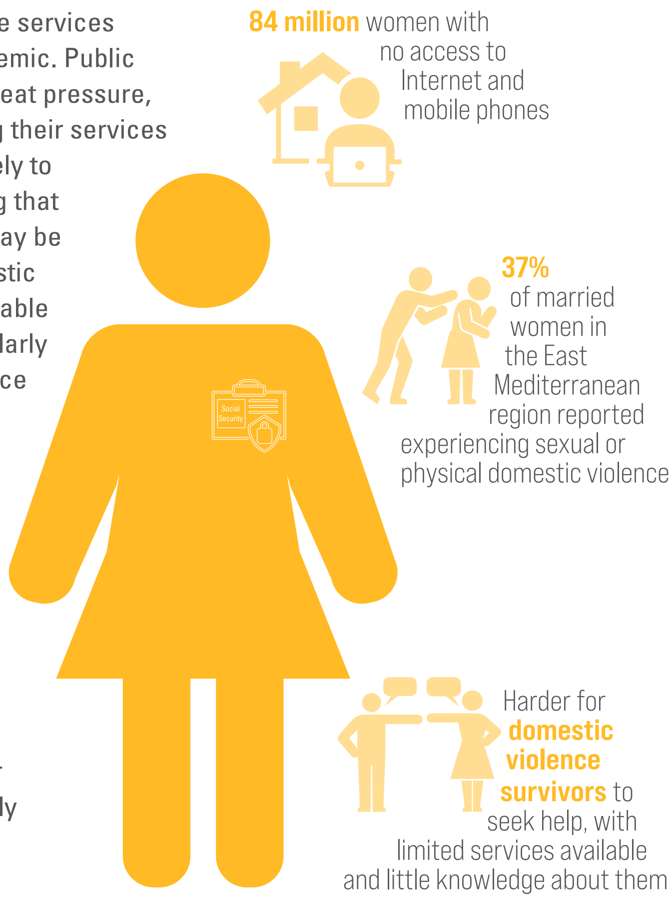
Most Arab countries have introduced social security programmes in the last decade, but the scope of legal social security remains low, especially among women. Moreover, female labour force participation was low and unemployment was high at 19.96 per cent in 2019. The unemployment gender gap has widened  widen in 2020.[2]

Given the multi-dimensional forms of discrimination women face, and the added challenges caused by the pandemic, women in the Arab region will bear numerous burdens at various levels. Like any other humanitarian situation, the pandemic is forecasted to impact men, women, boys, and girls differently. For example, the region has high illiteracy rates among women, estimated at 26 per cent in 2018,[3] which can affect their ability to access information on the pandemic during lockdowns. This makes seeking help more difficult for Arab women. Around 84 million women in the region are not connected to the Internet and do not have access to mobile phones. The pandemic will disproportionately impact these women, especially since certain jobs are expected to be pursued remotely during lockdowns.

Prior to the pandemic, 37 per cent of married women in the East Mediterranean region[4] reported experiencing sexual or physical domestic violence. The pandemic, fear of infection, food insecurity, economic stress, and community lockdowns have increased violence, particular gender-based violence as women remain isolated with their abusers during lockdowns. *Abaad*, a Lebanese non-governmental organization, indicated a 50 per cent increase in calls to their helpline regarding domestic abuse in 2020 compared with 2019, with one third of those calls during the month of March. A similar surge in reported domestic violence rates was recorded in China, France, Italy and Spain. With many women in the region being cut off from families and friends, and lacking Internet and mobile access, victims of domestic violence are becoming increasingly vulnerable. Significant economic challenges and enforced confinement are putting individuals and households under extreme stress, and acting as a catalyst for violent behaviour.

Many Arab countries do not criminalize marital rape and domestic violence, and few countries effectively document rates of gender-based violence. Even before the crisis, seeking help for domestic violence was difficult. Life-saving violence prevention and response services are expected to be heavily disrupted because of the pandemic. Public institutions, the justice system and the police are under great pressure, are often understaffed and face difficulties in coordinating their services to offer effective support to women and girls. They are likely to deprioritize acts of violence during the pandemic, meaning that perpetrators may not be arrested, and legal procedures may be delayed or halted. This situation makes it harder for domestic violence survivors to seek help, with limited services available and little knowledge about them. Furthermore, it is particularly difficult for social services to access gender-based violence victims in conflict zones, such as in Libya, the State of Palestine, the Syrian Arab Republic and Yemen.

The pandemic and the resulting containment policies have caused a shock to health-care systems worldwide. Accessing standard health services has become more difficult, with financial resources and health facilities being directed towards containing the crisis. This is illustrated by the number of shelters for women and girls that have either been shut to avoid the spread of the virus, or transformed into health facilities for COVID-19 patients. These factors are making it increasingly hard for Arab women and girls to access sexual and reproductive health services.



# B. Poverty and inequality

Initial estimates for the 14 countries in which poverty data is available show that the pandemic increased poverty rates from 29.2 per cent in 2019 to 32.4 per cent in 2020, and could increase them to 32.1 per cent in 2021, raising the total number of poor in these 14 countries from 101 million in 2019 to 116 million in 2021.[5] The bulk of the region's poor population (over 80 per cent) reside in four countries, namely Egypt, the Sudan, the Syrian Arab Republic and Yemen. The economic slowdown has negatively affected employment, real wages and the flow of remittances. The consequences of this crisis could be particularly severe on vulnerable groups, especially women and young adults, and those working in the informal sector who have no access to social protection schemes and unemployment insurance.

Estimates in tables 3.1 and 3.2 are based on growth projections from April 2020, and on national poverty lines that are not comparable and which may not accurately represent current living costs. A case in point is Lebanon, which has endured multiple growth shocks over the past year, including a severe devaluation of its currency and a resulting triple-digit inflation rate. Using an updated national-income growth rate (as at May 2020 of -1.2 per cent in 2019, -12.8 per cent in 2020, and 2.3 per cent in 2021), and a more appropriate national poverty line representing the cost of basic needs (of $8.5/day in 2011 $PPP), more realistic poverty estimates emerge: 8.2 per cent (less than 0.5 million poor) in 2019, 23.4 per cent (1.1 million) in 2020, and 21.4 per cent (1 million) in 2021.[6]

In light of these projections, measures to address poverty in the Arab region are more pertinent than ever. However, it is important to highlight that the pandemic has simply accentuated existing poverty trends. The Arab region is the only developing region where income poverty rose over the period 2010-2018, regardless of how it is measured.[7] Owing mainly to conflict and economic recession, poverty represented a major development challenge that was accentuated, but not caused, by the pandemic.

To tackle growing poverty, middle- and high-income countries could tap the substantial wealth concentrated in the hands of a small number of their nationals. Table 3.3 compares the estimated assets of countries' wealthiest 10 per cent with the depth of countries' poverty in 2019. Among Arab MICs, including

Lebanon, the cost of closing the poverty gap is 1-5 per cent of the wealth of the top decile. However, among Arab LDCs, the cost constitutes a greater share or even exceeds the available assets of the wealthiest decile.[8]

For Arab LDCs, the ESCWA-proposed 'emergency national policy response' is a more realistic short-term solution. Arab Governments are called upon to establish a regional social solidarity fund that supports vulnerable countries, including Arab LDCs, especially in times of crisis. The fund should target the poor and vulnerable, ensure rapid response, and provide relief during food shortages, health emergencies and other disasters. For the fund to succeed, it is vital that the richer GCC countries fully support the initiative.

Table 3.1 **Projected headcount poverty rates using national poverty lines, 2018-2021 (percentage)**

| **Country** | **2018** | **2019** | **2020** | **2021** |
|---|---|---|---|---|
| Algeria | 3.1 | 3.1 | 4.0 | 4.2 |
| Comoros | 41.4 | 41.4 | 43.0 | 43.4 |
| Djibouti | 20.7 | 19.6 | 20.1 | 19.1 |
| Egypt | 32.7 | 29.2 | 31.9 | 29.3 |
| Iraq | 18.0 | 17.9 | 23.2 | 22.4 |
| Jordan | 17.7 | 19.6 | 23.2 | 22.2 |
| Lebanon (projection April 2020) | 7.8 | 7.8 | 12.7 | 12.1 |
| Lebanon (updated projection May 2020) | 7.8 | 8.2 | 23.4 | 21.4 |
| Mauritania | 30.9 | 28.9 | 31.6 | 31.8 |
| Morocco | 3.1 | 2.3 | 3.3 | 3.6 |
| State of Palestine | 38.4 | 38.4 | 44.3 | 44.2 |
| Sudan | 46.0 | 48.2 | 53.4 | 55.6 |
| Syrian Arab Republic | 78.8 | 76.8 | 78.8 | 79.9 |
| Tunisia | 12.7 | 12.7 | 15.4 | 15.1 |
| Yemen | 73.6 | 73.7 | 79.0 | 80.3 |
| **Arab region** | **30.0** | **29.2** | **32.4** | **32.1** |

**Sources:** E/ESCWA/CL2.GPID/2020/TP.10; E/ESCWA/CL3.SEP/2020/TP.8.

**Note:** In Lebanon, rapidly deteriorating growth conditions and inflation have given rise to higher poverty projections.

## Table 3.2 Number of poor based on headcount poverty ratio using national poverty lines, millions, 2018-2021

| Country | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|
| Algeria | 1.3 | 1.3 | 1.7 | 1.9 |
| Comoros | 0.3 | 0.4 | 0.4 | 0.4 |
| Djibouti | 0.2 | 0.2 | 0.2 | 0.2 |
| Egypt | 32.1 | 29.3 | 32.6 | 30.6 |
| Iraq | 6.9 | 7.0 | 9.3 | 9.2 |
| Jordan | 1.8 | 2.0 | 2.4 | 2.3 |
| Lebanon (projection April 2020) | 0.5 | 0.5 | 0.9 | 0.8 |
| Lebanon (updated projection May 2020) | 0.5 | 0.5 | 1.1 | 1.0 |
| Mauritania | 1.4 | 1.3 | 1.5 | 1.5 |
| Morocco | 1.1 | 0.8 | 1.2 | 1.3 |
| State of Palestine | 1.8 | 1.8 | 2.1 | 2.2 |
| Sudan | 19.2 | 20.6 | 23.4 | 25.0 |
| Syrian Arab Republic | 13.3 | 13.1 | 13.8 | 14.6 |
| Tunisia | 1.5 | 1.5 | 1.8 | 1.8 |
| Yemen | 21.0 | 21.5 | 23.5 | 24.5 |
| **Arab Region** | **102.4** | **101.4** | **114.9** | **116.3** |

**Sources:** E/ESCWA/CL2.GPID/2020/TP.10; E/ESCWA/CL3.SEP/2020/TP.8.

**Note:** In Lebanon, rapidly deteriorating growth conditions and inflation have given rise to higher poverty projections.

## Table 3.3 Countries' cost of closing the poverty gap and wealth of the richest decile

| Country | Mean wealth of top national decile, 2019 (2019$) | Adults in the top national decile, 2019 ('000) | Top decile wealth, 2019 ($million) | Cost of closing poverty gap, 2019 (current $million) | Cost of closing poverty gap as a share of top-decile wealth, 2019 (percentage) |
|---|---|---|---|---|---|
| Algeria | 60 342 | 2 698 | 162 821 | 362 | 0.2 |
| Egypt | 99 771 | 5 831 | 581 755 | 8 952 | 1.5 |
| Iraq | 93 705 | 1 979 | 185 423 | 1 735 | 0.9 |
| Jordan | 163 214 | 551 | 89 964 | 816 | 0.9 |
| Lebanon | 360 069 | 421 | 151 409 | 381 | 0.3 |
| Morocco | 84 181 | 2 361 | 198 777 | 120 | 0.1 |
| Tunisia | 86 227 | 811 | 69 939 | 584 | 0.8 |
| **MICs** | **98 285** | **14 652** | **1 440 087** | **12 950** | **0.9** |
| Comoros | 33 734 | 42 | 1 427 | 211 | 14.8 |
| Djibouti | 18 685 | 58 | 1 089 | 49 | 4.5 |
| Mauritania | 14 521 | 231 | 3 354 | 529 | 15.8 |
| Sudan | 3 258 | 2 047 | 6 670 | 8 559 | 128.3 |
| Syrian Arab Republic | 13 477 | 966 | 13 024 | 7 365 | 56.5 |
| Yemen | 32 270 | 1 458 | 47 050 | 8 951 | 19.0 |
| **LDCs** | **15 117** | **4 803** | **72 615** | **25 665** | **35.3** |
| **Total** | **77 752** | **19 456** | **1 512 702** | **38 615** | 2.6 |

**Source:** E/ESCWA/CL2.GPID/2020/TP.9.

# C. Labour market dynamics

Labour force participation Unemployment

The impact of the pandemic on work modalities and the lockdown in most sectors are unfavourably affecting the Arab region's workforce. The situation is causing harmful losses to business across a range of economic sectors, owing to a sharp fall in economic output. Certain sectors are facing high risks because of the current and expected collapse in regional economic activities. According to the International Labour Organization (ILO), millions of workers are now vulnerable to layoffs and income loss, especially unprotected workers. The bulk of declining working hours and job losses in the Arab region will be in the highest impacted sectors that employ 39.8 million,[9] representing 31.4 per cent of the Arab workforce. These workers are now facing a sharp decline in economic output and serious risk of termination. Nonetheless, the share of employment in at-risk sectors in Arab countries (31.4 per cent) is below the global average of 37.5 per cent, and is the second to last compared with other regions.

ILO has classified the pandemic's impact on economic output at the sectoral level globally. Wholesale and retail trade, manufacturing, real estate and business activities, accommodation and food services are the most affected sectors, as they have the highest economic risks for workers. These sectors represent most of the enterprises at risk in the region, especially the wholesale and retail trade sector. Around 31.4 per cent of the region's employment is concentrated in these sectors, which employ millions of low-skilled and low-paid workers. Women comprise an average of 12.58 per cent of those employed in these sectors.[10] However, women make up 47.7 per cent of those employed in health and social work activities in the Arab region,[11] meaning that they are on the frontline of the fight against COVID-19.

## Labour force participation

The Arab region has one of lowest labour force participation rates worldwide. This is mainly due to the low participation of women in the labour market. Female labour participation in the Arab region is the lowest worldwide estimated at 20.53 per cent, far below the global average of 47.66 per cent. The average male labour force participation rate is 73.67 per cent, indicating a large gap between the participation of the two genders in the region.

Restricted access to financial services, lower salaries, limited mobility and harassment in public places are some of the challenges that prevent women from participating in the labour force and obtaining better jobs.[12] In some Arab LDCs, male labour force participation is five times the female rate, where most women outside the labour force are housemakers and most men are students. The significant reduction in the education gender gap has not enhanced women's participation in the labour market. In some countries, higher education levels among women have resulted in an increase in unemployment owing to a lack of opportunities for educated women. This education paradox is a result of cultural factors, family responsibilities, discrimination and lack of opportunities for women in the labour market. It demonstrates the importance of applying not only a top-down approach to fighting gender inequality, but also a bottom-up approach that challenges societal and cultural attitudes. Cultural barriers play a key role in maintaining women as an unutilized and unrecognized human reserve in the region. Moreover, women who disregard those barriers are more likely to participate in the labour force.

## Unemployment

Before the pandemic, high unemployment was already a major development challenge for the region, which has one of the highest unemployment rates worldwide, especially among women and young people. The Arab region has the highest unemployment gender gap in the world. The female unemployment rate is estimated at 19.96 per cent compared with a male unemployment rate of 7.83 per cent, but both rates are above the global average. Youth unemployment is the highest worldwide at 26.44 per cent, while the global average is 13.62 per cent. Female youth unemployment is the highest across all regions at 38.47 per cent, while the global average is 13.07 per cent.[13] Young people (aged 15-24) form almost 17 per cent (74 million) of Arab countries' population.[14]

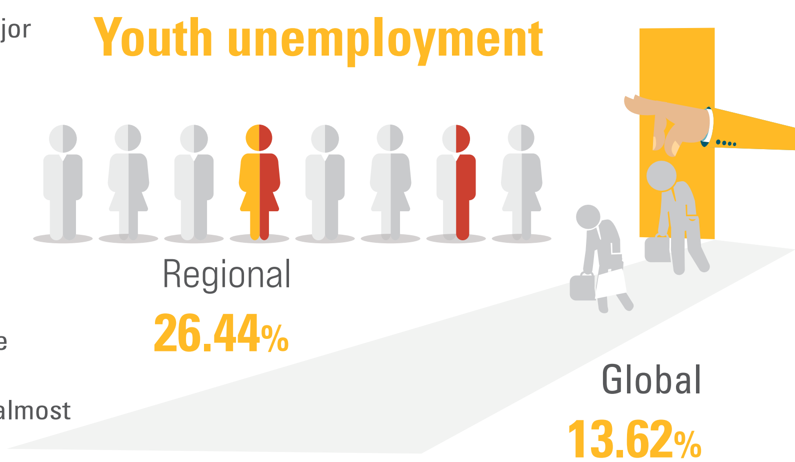
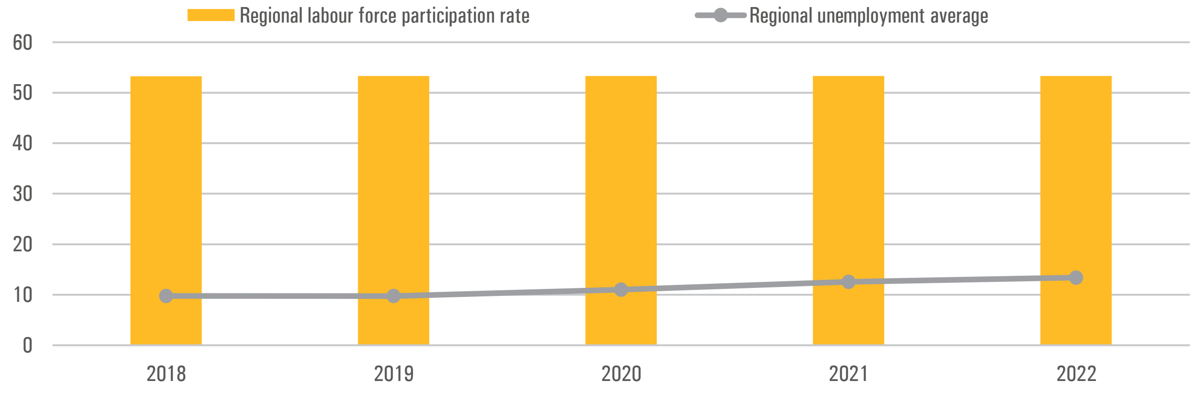


Figure 3.2 **Regional unemployment and labour force participation rates projections, 2018-2022**




**Source:** Compiled by ESCWA.

Young people are already three times more likely to be unemployed than adults,[15] especially those in the informal sector.

The pandemic will worsen the situation (figure 3.3). According to the ILO nowcasting model,[16] compared with 2019, the Arab region witnessed a 2.2 per cent decline in working hours in the first quarter or 2020, 19.65 per cent in the second quarter, and 12.8 per cent in the third. These estimated declines are equivalent to approximately 3 million, 23 million, and 15 million full-time jobs consecutively in each quarter. The unemployment rate is estimated to have increased by 1.2 percentage points.[17]

Increased unemployment will affect all Arab countries. In Saudi Arabia, the unemployment rate is estimated to have increased 1.39 percentage points in 2020, and is projected to increase by 1.83 percentage points in 2021. Qatar, which has one of the lowest unemployment rates globally, witnessed an estimated increase of 2.03 percentage points in 2020, with unemployment rates jumping for the first time in years above 1 per cent, reaching 2.12 per cent in 2020 and 4.77 per cent in 2021. Qatar announced a stimulus package of $23 billion to support and provide financial and economic incentives to the private sector, which may reduce unemployment. The United Arab Emirates has adopted a similar stimulus package; however, the unemployment rate is estimated to have increased by 2.85 percentage points to reach 5.2 per cent in 2020 and is projected to reach 6.92 per cent in 2021.

In Jordan, small and medium enterprises (SMEs) represent 95 per cent of the private sector, with 52 per cent of the country's total workforce operating informally. Both SMEs and the informal sector are the most economically affected by the pandemic. This raises concerns about unemployment rates in Jordan. Jordanians working outside the country are expected to lose their jobs and return home, adding to the national unemployment rate which increased by an estimated 2.7 percentage points in 2020 to reach 17.41 per cent, and is projected to increase 3.86 per cent in 2021 to reach 21.27 per cent.

The Lebanese economy has been semi-paralyzed since protests began on 17 October 2019. After the COVID-19 outbreak, Lebanon went into lockdown and struggled with a financial crisis and inflated prices because of the depreciating Lebanese pound. The country is expected to lose many SMEs as a result, where hundreds of thousands of employees losing their jobs in the education, services and banking sectors, in addition to thousands of Lebanese workers in GCC and African countries returning home following layoffs. The unemployment rate in Lebanon is estimated to have increased by 1.81 percentage points in 2020 and is forecasted to increase by 2.91 percentage points in 2021. Moreover, because of persistent protests, political instability, temporary and permanent closures, and the Beirut Port explosion, the labour market in Lebanon will face significant challenges in the coming years, as the economy is expected to contract by at least 10.2 per cent.

In Morocco, the Ministry of Employment and Professional Integration stated that 113,000 companies had halted operations since 15 March 2020, and over 700,000 employees have been unable to work or laid off. The unemployment rate in Morocco estimated to have increased by 2.76 percentage points in 2020 to 11.78 per cent, and is projected to increase by 3.46 percentage points in 2021 to 15.24 per cent.

In Tunisia, the Government has rolled out a series of socioeconomic measures to support individual entrepreneurs and businesses in maintaining jobs and incomes across all sectors. Nonetheless, the unemployment rate increased by 2.18 percentage points in 2020 to 18.02 per cent, and is expected to increase by 2.93 percentage points in 2021 to 21.1 per cent.

Somalia in the country least affected by unemployment in the Arab region. Around 83 per cent of the workforce in Somalia operates in agriculture sector, which has a low economic risk for employees and employers. The remaining 17 per cent of the workforce is distributed across different sectors, including those most affected by the pandemic. The unemployment rate in Somalia slightly increased by 0.57 percentage points in 2020, reaching 11.92 per cent.

## Jordan

national unemployment rate increasing by **2.7 percentage** points in 2020 and **3.86 per cent** in 2021

## Lebanon

national unemployment rate increasing by **1.81 percentage** points in 2020 and **2.91 percentage** points in 2021

## Morocco

national unemployment rate increasing by **2.76 percentage** points in 2020 and **3.46 percentage** points in 2021

## Tunisia

national unemployment rate increasing by **2.18 percentage** points in 2020 and **2.93 percentage** points in 2021

## Somalia

national unemployment rate increasing by **0.57 percentage** points in 2020

Figure 3.3 **Projections of unemployment and labour force participation rates in selected Arab countries, 2018-2022**


**Source:** Compiled by ESCWA.

# D. Migrant workers' conditions

The pandemic has exposed migrant workers in the region and the world to significant risks. The region hosts 35 million international migrants, of which 31 per cent are women.[18] They are mainly concentrated in GCC countries, Jordan and Lebanon. Non-nationals represent the majority of the population in Bahrain, Kuwait, Qatar and the United Arab Emirates (80 per cent of the population in Qatar and the United Arab Emirates). The six GCC countries host over 10 per cent of migrant workers globally. Saudi Arabia and the United Arab Emirates host the third and fifth largest migrant populations, respectively. Most of these workers are from South and Southeast Asia, and East Africa (Ethiopia, Kenya and Uganda).[19]

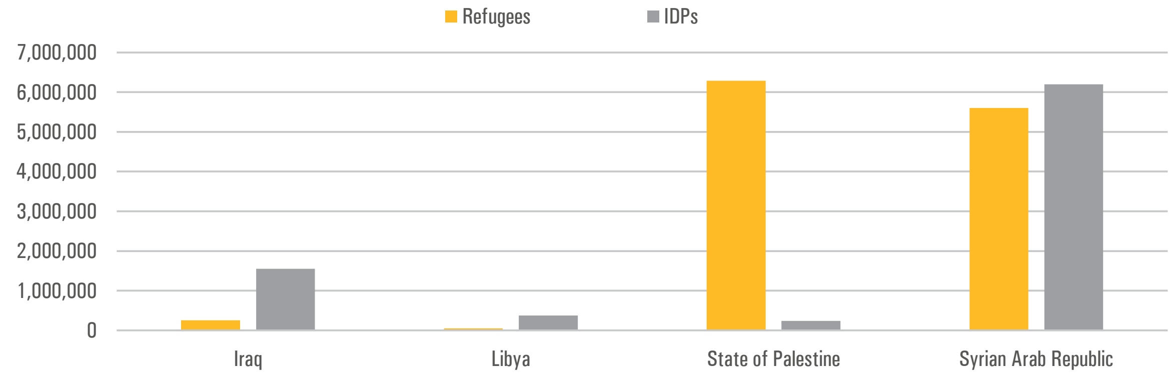
The pandemic, the travel ban and lockdown restrictions have harmed migrant workers' livelihoods, and hindered their ability to support family members in their country of origin. Most migrant workers in the region are either self-employed or work in sectors where there are minimal employee protections, making them vulnerable during economic downturns. They are explicitly excluded from labour laws in nearly all Arab countries. Most migrant workers in the region are regulated by the *Kafala* system.[20] Under this system, migrant workers cannot leave the country, transfer employment, or resign from a job without their sponsor's consent or until a contract expires.[21] This raises serious concerns regarding their situation during the pandemic, which will also affect women disproportionately owing to the nature of their jobs. Migrant women form a high portion of domestic workers in the region. Globally 6 out of every 10 working women are migrant domestic workers.[22]

# E. Refugees and internally displaced persons

Armed conflict, poverty, famine, corruption and political rivalries have ravaged many Arab countries, and represent a perpetual obstacle to the region's development and shared prosperity. According to United Nations High Commissioner for Refugees (UNHCR), there are 16 million people of concern in the Middle East and North Africa (MENA).[23] The number of both refugees and IDPs is increasing in the region. There are 70.8 million forcibly displaced persons worldwide,[24] and 41.4 million internally displaced. As at the end of 2019, there were 79.5 million forcibly displaced people and 26 million refugees worldwide, with 80 per cent of the world's displaced living in countries affected by insecurity and malnutrition.[25] Refugees and IDPs create significant pressure on the infrastructure and public institutions of host countries. They compete with citizens over scarce resources, services, food, water, housing and land. With persistent unrest in the Arab region, many host countries are facing overwhelming demand for natural resources, social services, health and education services, energy and transport, and employment. This leads to price inflation and depressed wages for both locals and refugees.

As at August 2019, there were 6.2 million internally displaced Syrians, and 5.6 million registered as refugees in Egypt, Iraq, Jordan, Lebanon, Turkey and North Africa.[26] The Syrian crisis is in its ninth year, and continues to be the largest refugee crisis in the world. In Iraq, as at September 2019, at least 1.55 million people were internally displaced, and 257,000 Iraqi refugees were registered with UNHCR in neighbouring countries. Around 32 thousand people live in camps in Al-Hasakah, the Syrian Arab Republic, without formal registration. The ongoing conflict in Libya has undermined all the country's systems and sectors. Libya has 373,709 IDPs and 48,626 refugees registered with UNHCR. There are also people of concern outside conflict situations. According to the Displacement Tracking Matrix, there are 1.2 million IDPs in Somalia and 2 million in the Sudan. According to the United Nations Relief and Works Agency for Palestine Refugees in the Near East (UNRWA),[27] there are 6,293,390 registered refugees distributed across Jordan, Lebanon, the Syrian Arab Republic, the West Bank and the Gaza strip, in addition to 238,000 IDPs according to the Internal Displacement Monitoring Centre. The ongoing conflict in Yemen has resulted in 24.1 million people in need of humanitarian assistance. This represents more than 80 per cent of the Yemeni

## Figure 3.4 **Refugees and IDPs in the Arab region, 2019**



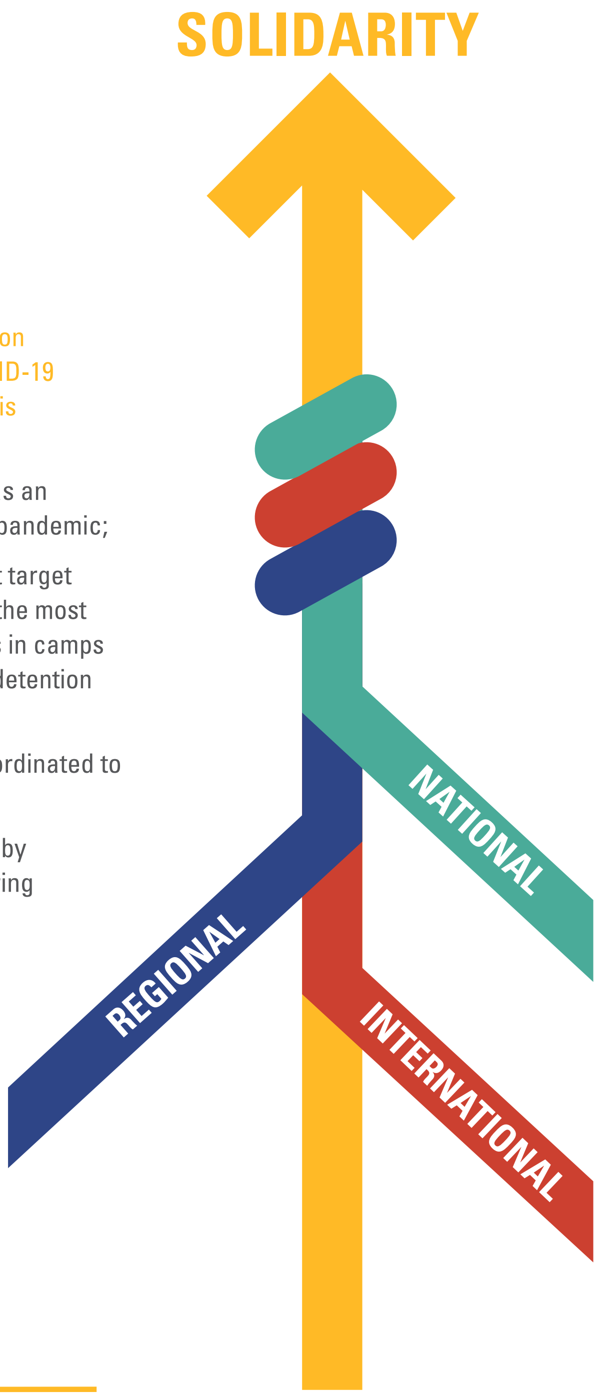

**Source:** United Nations High Commissioner for Refugees (UNHCR), 2020c, 2020d; UNRWA, 2019; Internal Displacement Monitoring Centre, 2019.

population. Yemen recorded nearly 4 million IDPs and 276,000 refugees in 2019. The first case of COVID-19 was reported on the 10 April 2020, causing immense concern about the virus spreading in a country already grappling with one of the worst humanitarian crises in contemporary history, where half of the population at risk of famine.[28]

The pandemic is disproportionately impacting those living in the economic margins of society, asylum seekers, refugees, IDPs,[29] and host communities. The virus is threatening 55 million people in need of humanitarian aid in the region, where around 26 million are refugees and IDPs. Humanitarian aid, including medical supplies, health services, food, water and sanitation, is at risk. Refugee camps and IDP settlements contend with high population density, making social distancing difficult to apply. There are limited health services, which may further increase exposure of people of concern to severe health risks. Many already struggle with underlying health issues.

Many host countries suffer from serious socioeconomic obstacles that impact both refugees and locals. There are 910,256 Syrian refugees in Lebanon and 656,213 in Jordan, where 52.1 per cent of those in Lebanon and 50.1 per cent of those in Jordan are females.[30] Compounded factors will expose forcibly displaced women and girls not only to the virus but also to an increasing risk of violence, including sexual exploitation and abuse. The economic devastation and burdens that the pandemic has created may be translated into child marriage and survival sex. Many forcibly displaced women are facing increasing burdens as caregivers. The lockdown and mobility restrictions make it harder for women to access services, including shelters that have been shuttered. Over 75 per cent of Syrian refugee families in Lebanon live in overcrowded shelters in dangerous conditions below humanitarian standards.[31] Around 63 per cent of Syrian refugee households are food secure, but households headed by women are more food insecure (35 per cent) than households headed by men (28 per cent).[32] About 55 per cent of these refugees have less than $2.9

to spend per day. The pandemic will lead to additional economic pressures and burdens on refugees, which in turn will exacerbate already dire humanitarian conditions. They will also suffer from restrictions to health-care services.[33] Discrimination against refugees and IDP is likely to increase, and funding needs for humanitarian aid will grow substantially.

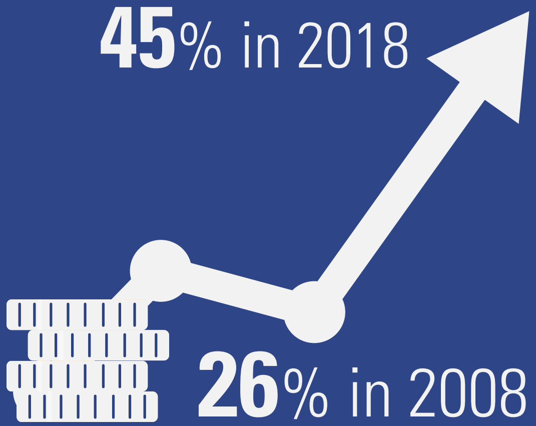



## F. Concluding remarks and policy recommendations

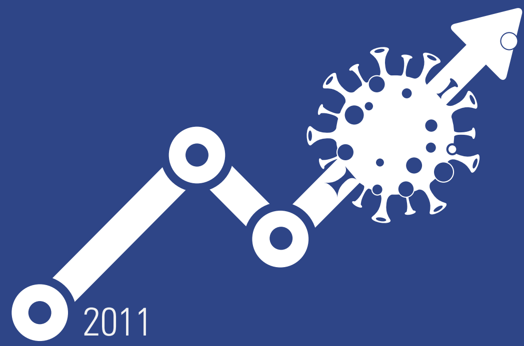
Prior to the pandemic, socioeconomic development in the Arab region was already marked by high levels of inefficiency and inequity. COVID-19 has exacerbated all these issues. To mitigate the social impact of this unprecedented crisis, the following actions should be considered:

- National and international collaboration and solidarity can act as an important line of defence against the detrimental effects of the pandemic;
- Policies and measures implemented to tackle the pandemic must target all social groups and ensure that no one is left behind, including the most marginalized and vulnerable women and girls, refugees and IDPs in camps or informal settlements, prisoners, migrant workers, migrants in detention centres, and persons with disabilities;
- National policies should be comprehensive, timely and well-coordinated to stimulate economic growth and labour demand;
- Governments should help protect companies, especially SMEs, by reducing employers' charges in the most affected sectors, offering extended tax credits, and reducing interest rates;
- Compensation packages should be provided to workers in the informal sector, where women represent over half the workforce;
- Gender dimensions must be integrated in countries' economic responses, given that social distancing and school closures will oblige many women to take leave from paid jobs to undertake disproportionate amounts of household responsibilities and unpaid work, which can increase stress levels and mental health issues.

## Debt levels increased in the Arab region




## Public debt in the Arab region




grown more rapidly than the economy

## Increase in debt

- Fiscal reaction function
- High interest rate and growth differential
- Low impact of government

## For debt levels to be < 75%

- Reduce interest rate
- Primary balance around zero
- Fiscal policy
- Enhancing the growth impact of expenditure

# 4 Fiscal Policy Response to Public Debt and Debt Sustainability in Arab Countries

## A. Public debt in the Arab region: size, composition and changing patterns

Structure and decomposition of public debt

Changing patterns of external public debt

Burden of debt service and interest payments

### Key messages

- Debt levels have increased significantly in the Arab region since 2008. Overall, average debt to GDP increased from 26 per cent in 2008 to 45 per cent in 2018.
- Since 2011, public debt in the Arab region has grown more rapidly than the economy. A situation that will be exacerbated by the adverse impact of the COVID-19 pandemic.
- This increase in debt is caused by the following: an inadequate fiscal reaction function, high interest rate and growth differential; and the low impact of government expenditure on productivity and growth.
- To maintain debt levels below 75 per cent, the region should maintain its primary balance at around zero, or reduce its interest rate and growth differential. Arab Governments also need to reform their fiscal policy and enhance the growth impact of their expenditure.

Since the 2008 global economic downturn, public debt in several major economies globally has increased significantly.[1] Similarly, the Arab region's average debt to GDP stood at 45 per cent in 2018, increasing steadily from 26 per cent in 2008. This trend is particularly notable in Arab LDCs and MICs.[2]

In MICs, the public debt-to-GDP ratio increased to an average of 78 per cent in 2018, from 47 per cent in 2008. Excluding Algeria, the average debt share of GDP in MICs was 92 per cent in 2018. Among these MICs, debt share to GDP was 157 per cent in Lebanon, 93 per cent in Egypt and 94 per cent in Jordan in 2018.[3]

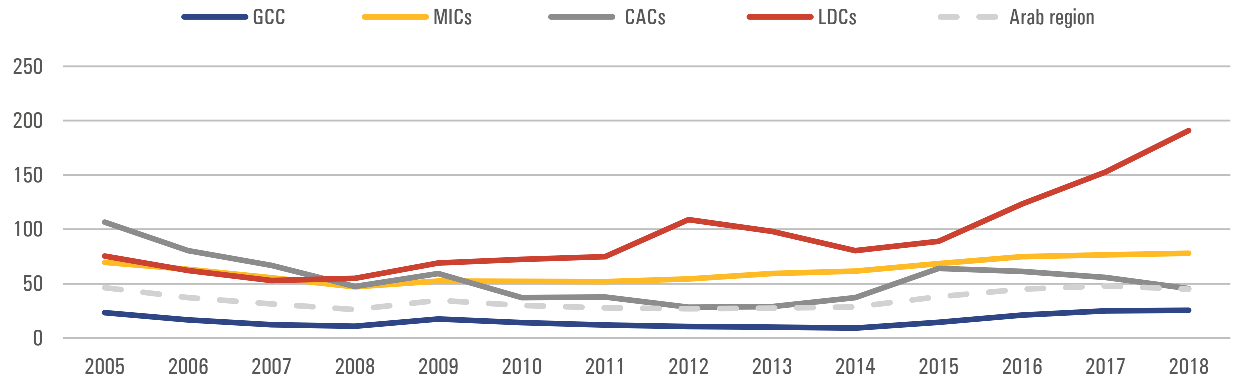
The average debt-to-GDP ratio for Arab LDCs is mainly influenced by a rapid increase in the share of debt to GDP in the Sudan, which climbed from 55 per cent in 2008 to 212 per cent in 2018. LDCs have a greater dependence on external borrowing. In 2018, the share of external debt to GDP was 68 per cent in the Comoros, 146 per cent in Djibouti, and 91 per cent in Mauritania.[4] Debt dynamics in LDCs are different than in MICs, since LDCs are eligible for concessional borrowings and debt relief under the heavily indebted poor countries (HIPC) initiative, as discussed later in the present chapter.

GCC countries used to have low debt to GDP on average. However, in recent years, these countries have reported a significant jump in debt to GDP, particularly since 2014 owing to a drop in oil revenues. Their average debt-to-GDP ratio was 25 per cent in 2018, compared with 9 per cent in 2014. There are sharp contrasts among GCC countries, as Bahrain and Oman showed an exponential rise in debt compared with other countries. In Bahrain, public debt to GDP reached 94 per cent in 2018, which led to the announcement of the Fiscal Balance Programme in 2018.[5]

The average debt to GDP in conflict-affected countries was 55 per cent in 2018. Lack of adequate data for several such countries, including the State of Palestine, Somalia and the Syrian Arab Republic, potentially underestimate the average.

The speed of debt accumulation is even more alarming than its level. Figure 4.2 shows that in all subregions, the rate of the increase in debt stock exceeds the rate of economic growth in the region. This trend was expected to stop in 2020, but the pandemic and collapsed oil prices mean that it will continue in 2021. The adverse impact of COVID-19 has pushed Arab countries to borrow more. Large fiscal shortfalls are expected to be financed by increased external borrowing. Consequently, the response measures to mitigate the pandemic's impact have increased debt burdens further in 2020 for most Arab countries, especially MICs and LDCs that are already highly indebted (figure 4.3).

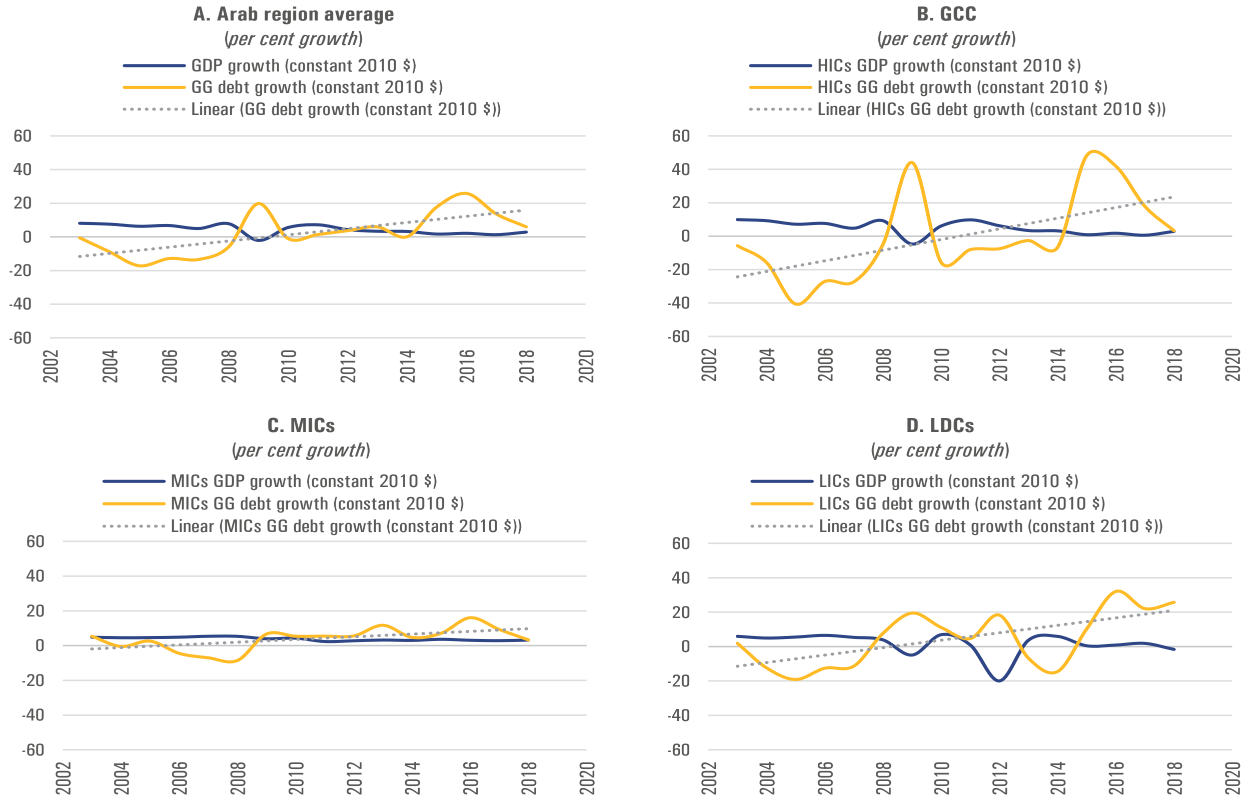
Figure 4.1 **Gross public debt, 2005-2018 (percentage of GDP)**




**Source:** Sarangi, 2020a, based on IMF, 2020d.

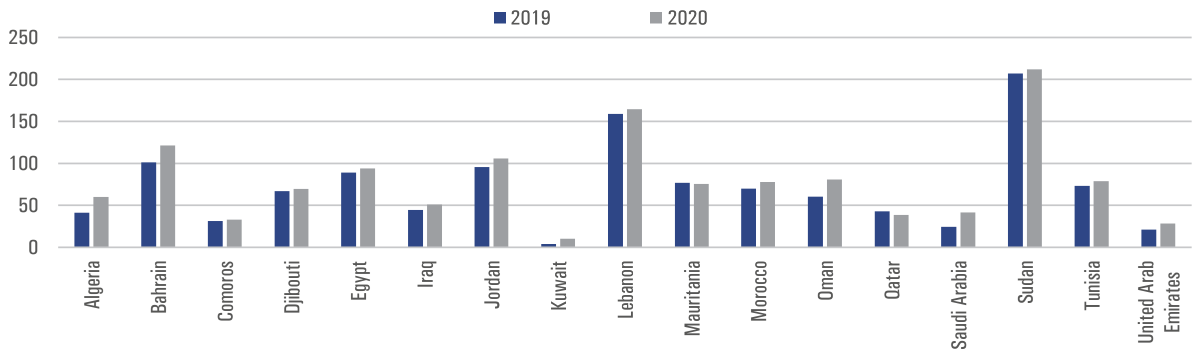
**Note:** The aggregates for conflict-affected countries exclude the State of Palestine and the Syrian Arab Republic. The aggregates for LDCs exclude Somalia owing to lack of data.

## Figure 4.2 GDP growth and public debt growth, 2003-2018 (constant 2010 $)




**Source:** Sarangi, 2020a, based on IMF, 2020d.

## Figure 4.3 Estimated gross public debt to GDP owing to the impact of COVID-19, 2019-2020 (percentage)

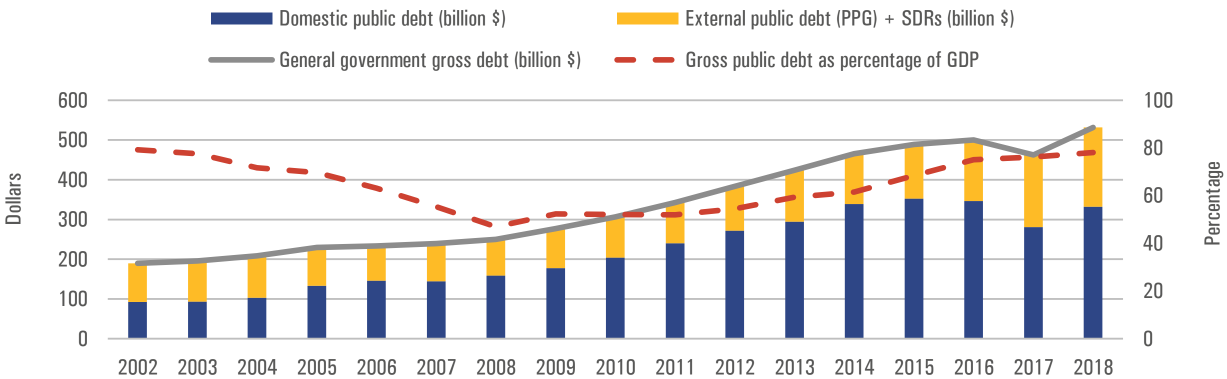



**Source:** Based on World Economic Forecasting Model (ESCWA, 2020e).

# Structure and decomposition of public debt

The aggregate gross public debt of MICs has more than doubled over the period 2008-2018, increasing from \$250 billion in 2008 to \$531 billion in 2018 (figure 4.4). The majority of public debt, nearly 63 per cent, is financed by domestic borrowing. The share of external public debt, including special drawing rights (SDRs), was 37 per cent of total gross public debt in 2008, which steadily declined to 27 per cent in 2014 but then increased to 37 per cent in 2018. In Egypt, the recent increase in the share of external debt since 2017 (or the reduction in share of domestic debt) is attributed to the impact of exchange rate depreciation since November 2016, which reduced the dollar value of most of its domestic debt.[6]

Figure 4.4 **Gross public debt disaggregated by domestic and external debt, MICs, 2002-2018**




**Source:** Sarangi, 2020a, based on data from IMF, 2020d.

# Changing patterns of external public debt

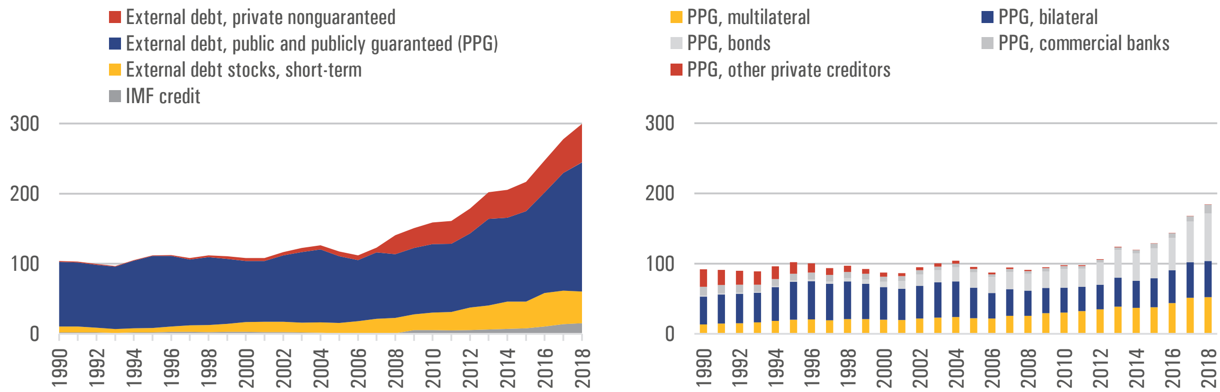
Public debt as a share of total external debt has declined steadily over the past three decades.[7] However, in the past 10 years, the share has declined marginally from 65 per cent in 2008 to 61 per cent in 2018. During the same period, private non-guaranteed debt increased from $27 billion to $55 billion. In addition, short-term external debt increased from $22 billion to $45 billion between 2008 and 2018. This recent pattern suggests higher risks associated with external debt servicing, either owing to exchange rate shocks or any negative shock to the trade balance.

The decomposition of Arab MIC external public debt shows that there is a steady decline in the share of official creditors in total external public debt. In the last decade, the share of official debt in MIC total external public debt has declined from 68 per cent in 2008 to 56 per cent in 2018.[8] Bond issuance and commercial banks have increasingly become the source of external borrowing for MICs. Most notably, the debts raised through bonds increased from about $24 billion in 2008 to $68 billion in 2018 (figure 4.5B).

Figure 4.5 **Size and composition of external public debt in MICs, 1990-2018**

**A. Composition of total external debt** (*$ billion*)

**B. Size of external public debt by creditors type** (*$ billion*)



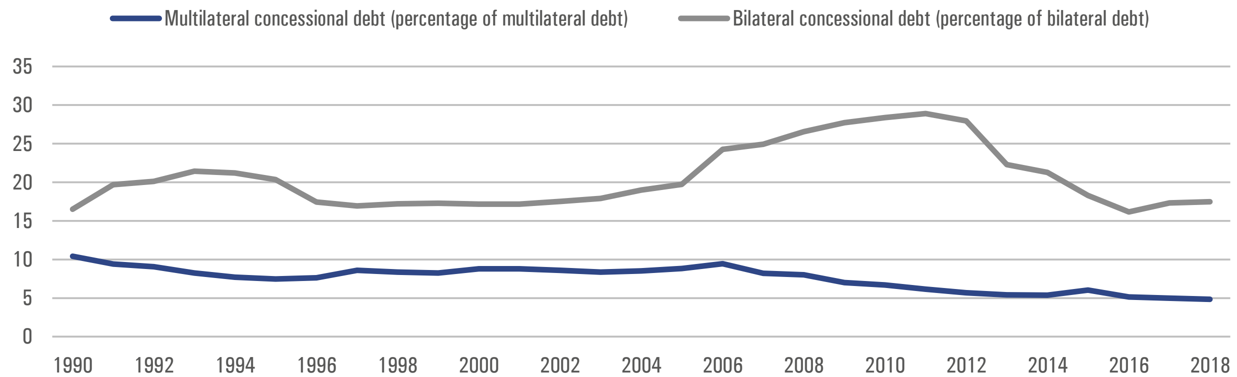

**Source:** Sarangi, 2020a, based on data from World Bank, 2020b.

Furthermore, the share of concessional debt from official creditors has declined substantially,[9] particularly during the past decade. It reached 11 per cent in 2018 compared with its peak of 19 per cent in 2008. Concessional credit as a share of total multilateral credit has been steadily declining from 9.4 per cent in 2006 to 4.8 per cent in 2018. Similarly, concessional credit as a share of total bilateral credit dropped from 29 per cent in 2011 to 17.5 per cent in 2018 (figure 4.6).

Except for Tunisia, MICs who used to rely on official creditors have reported a sharp decline in access to concessional external debts from official creditors. Given that concessional debts are no longer easily available, Governments rely on external debt from private creditors to finance deficits. These changing patterns suggest that external public debt is becoming increasingly costlier to MICs compared with the 1990s, which poses a higher debt servicing burden and risks of solvency in the case of shocks to the exchange rate or trade balances.

While MICs are struggling with high debt and persistent current account deficits since 2008 (figure 4.7), the pandemic's adverse economic consequences have exacerbated higher debt risks, mainly from external sources. To meet emergency needs caused by COVID-19, Egypt, Jordan and Tunisia together have borrowed over $10 billion under the IMF short- and medium-term lending mechanisms (table 4.1).[10] Since these loans are non-concessional, the debt service burden of MICs will grow further in the upcoming period.

Figure 4.6 **Concessional debt share from official creditors to MICs, 1990-2018 (percentage)**



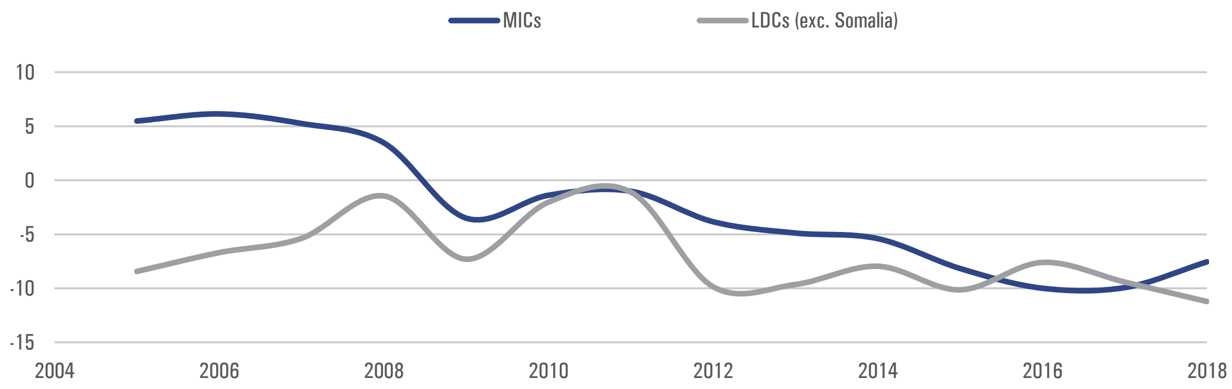

**Source:** Sarangi, 2020a, based on data from World Bank, 2020b.

## Table 4.1 Emergency financing from IMF to Arab MICs during the pandemic

| Country | Type of Emergency Financing | Amount approved (SDR) | Amount approved | Date of approval |
|---|---|---|---|---|
| Egypt | Rapid Financing Instrument | 2 037.1 million | $2 772 million | 11 May 2020 |
| | Stand-by Arrangement | 3 763.64 million | $5 200 million | 26 June 2020 |
| Jordan | Rapid Financing Instrument | 291.55 million | $396 million | 20 May 2020 |
| | Extended Fund Facility | 926.37 million | $1 300 million | 26 March 2020 |
| Tunisia | Rapid Financing Instrument | 545.2 million | $745 million | 10 April 2020 |

**Source:** IMF, COVID-19 Financial Assistance and Debt Service Relief. Available at https://www.imf.org/en/Topics/imf-and-covid19/COVID-Lending-Tracker#ftn (accessed on 15 September 2020).

## Figure 4.7 Current account balances, 2004-2018 (percentage of GDP)

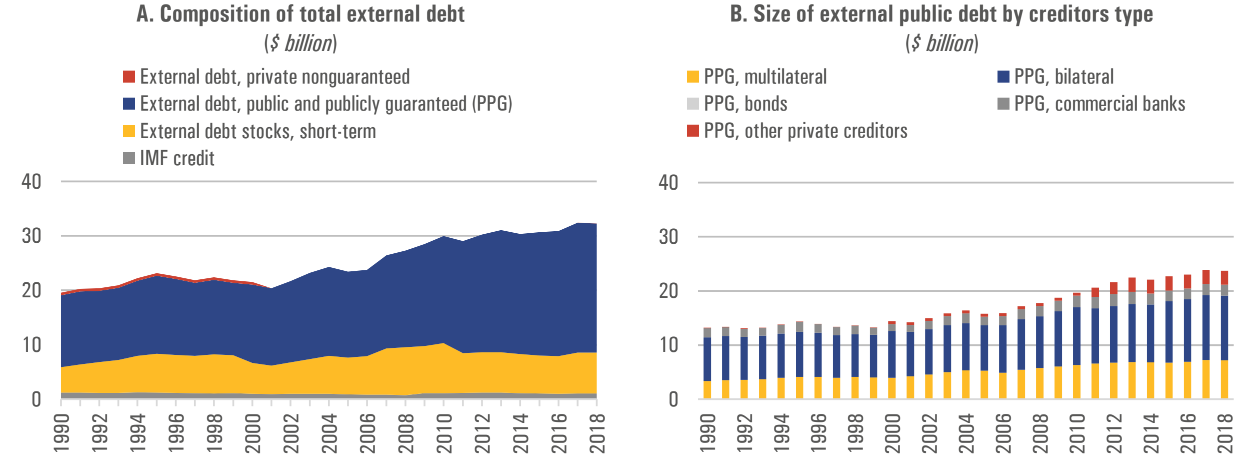



**Source:** Sarangi, 2020a, based on IMF, 2020d.

For Arab LDCs, the aggregate external public debt was $23.7 billion in 2018 of a total external debt of $33 billion (figure 4.8A). Over 70 per cent of the total external debt is public debt, and official creditors accounted for 80 per cent of the external public debt in 2018 compared with 86 per cent in 2008. LDC external public debt reported a steady increase from commercial banks and other private creditors, from 2.5 billion in 2008 to 4.6 billion in 2018 (figure 4.8B).

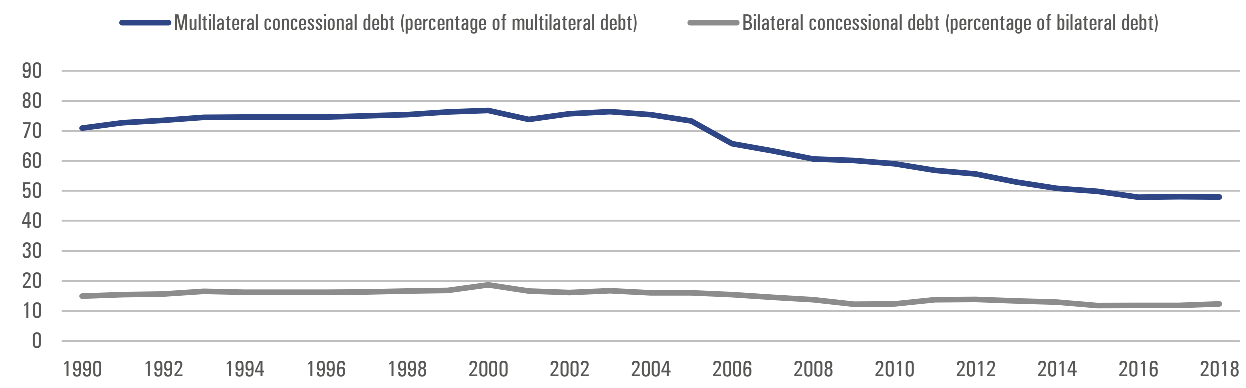
Another notable trend is that the share of concessional debt of official creditors to LDCs has declined since the mid-2000s. The share of concessional bilateral debt reduced sharply to 48 per cent in 2018 compared with 60 per cent in 2008 (figure 4.9). Over the same period, the share of concessional multilateral debt showed a relatively slow decline from 14 to 12 per cent of LDC credit. Overall, the share of total concessional debt from official creditors declined from the peak of 38 per cent in mid-2000 to 25 per cent in 2018.

Figure 4.8 **Size and composition of external public debt in LDCs, 1990-2018**




**Source:** Sarangi, 2020a, based on data from World Bank, 2020b.

Figure 4.9 **Concessional debt share from official creditors to LDCs, 1990-2018 (percentage)**



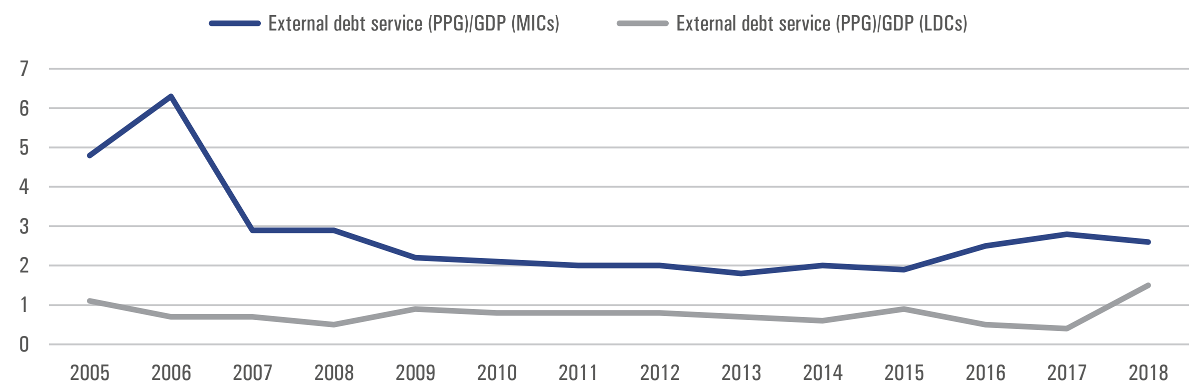

**Source:** Sarangi, 2020a, based on data from World Bank, 2020b.

# Burden of debt service and interest payments

The burden of external debt service as a share of GDP of LDCs and MICs has increased since 2015. During the period 2009-2015, the share of external debt service remained stable at around 2 per cent of GDP in MICs, and 0.9 per cent in LDCs. In 2018, the shares increased to 3 per cent of GDP for MICs and 1.5 per cent for LDCs (figure 4.10).

For MICs, the average share of external debt service to exports earnings increased from around 7 per cent in 2015 to 10 per cent in 2018 (figure 4.11). The share of external debt service to revenues shows the same pattern. The increasing share of debt service to exports earnings or revenues is largely due to rising costs of borrowing, especially short-term borrowing from private creditors. The cost of short-term debt, measured by average effective rate of interest, steadily increased from 1.7 per cent in 2015 to 3 per cent in 2018 (figure 4.12). Following the 2008 global recession, the average short-term interest rate was lower than the average long-term interest rate of public debt; however, in 2018, the short-term rate rose to converge with the long-term rate.

Figure 4.10 **External debt service of MICs and LDCs, 2005-2018 (percentage of GDP)**

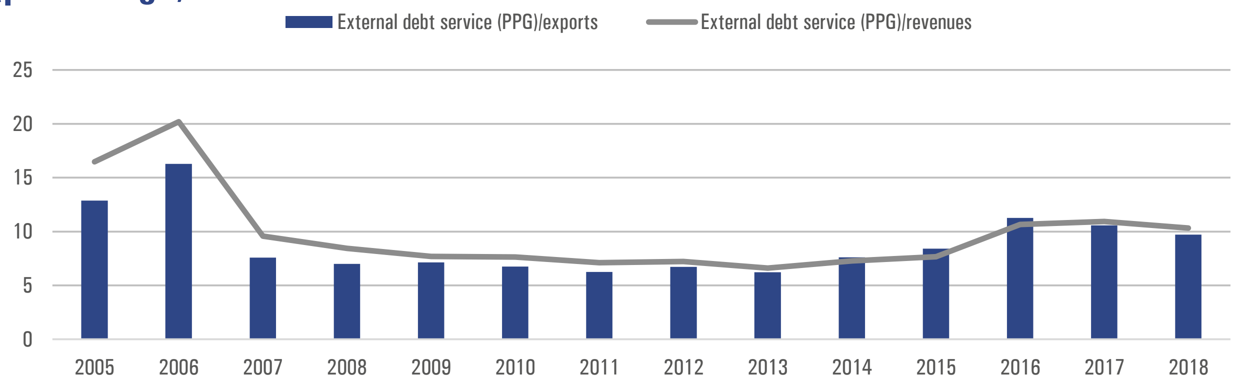



**Source:** Sarangi, 2020a, based on data from IMF, 2020d; and World Bank, 2020b.

For LDCs, average debt service as a share of exports and of revenues rose between 2017 and 2018 (figure 4.13). Over the period 2008-2018, shares were hovering between 4 and 6 per cent. Average debt service as a share of exports and of revenues reached 14 per cent and 15 per cent, respectively, in 2018, compared with 4 per cent and 5 per cent, respectively, in 2017.

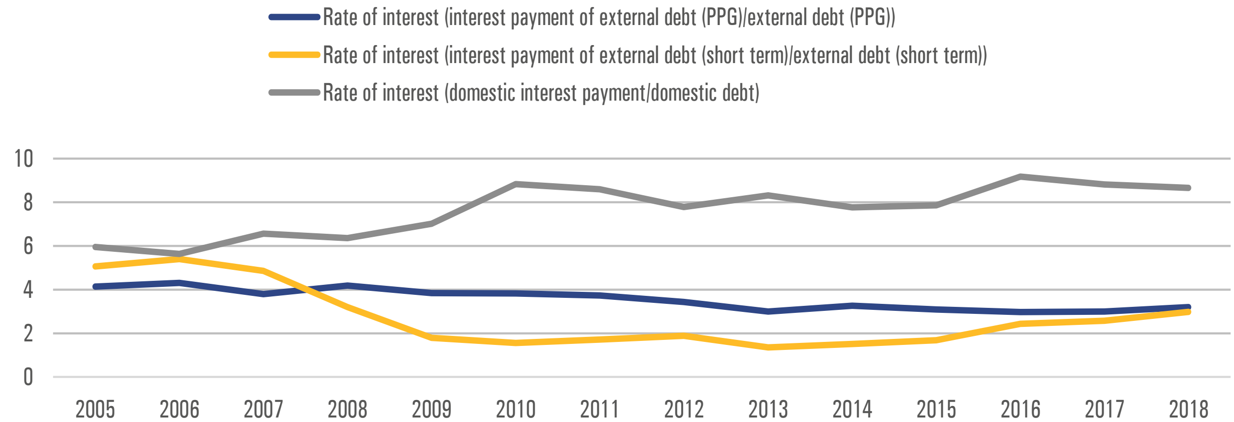
The effective rate of interest for external debt service of public debt rose between 2017 and 2018, after being fairly stable at below

Figure 4.11 **Debt service burden in MICs: share of exports and revenues, 2005-2018 (percentage)**




**Source:** Sarangi, 2020a, based on data from IMF, 2020d; and World Bank, 2020b.

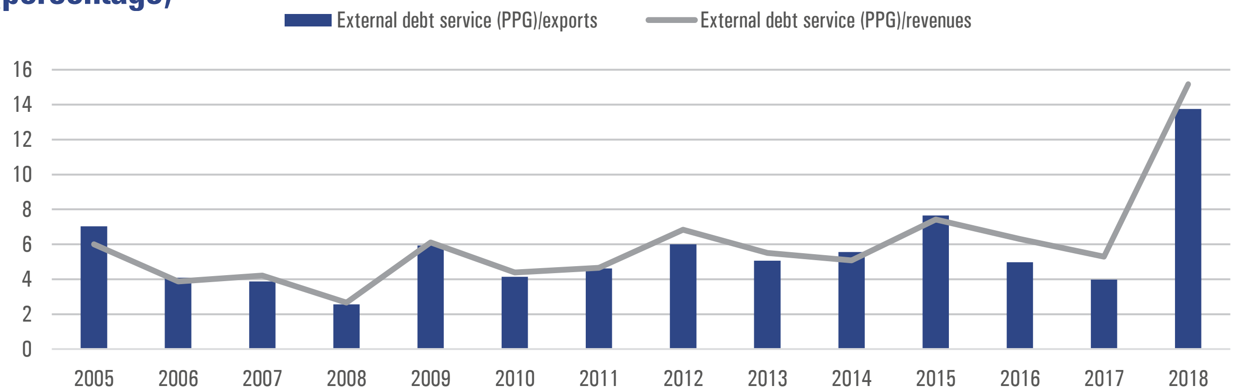
Figure 4.12 **Cost of borrowing in MICs: effective rate of interest, 2005-2018 (percentage)**




**Source:** Sarangi, 2020a, based on IMF, 2020d; and World Bank 2020b.

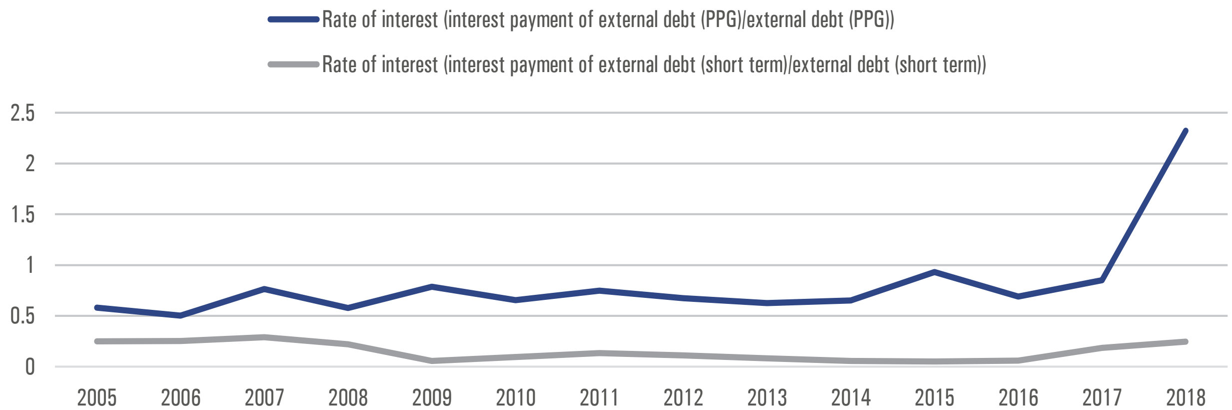
1 per cent until 2017. The effective rate of interest of short-term external debt has remained consistently lower than that of public debt over time: it was 0.24 per cent in 2018. The higher share of concessional debt in total external debt, eligibility for HIPC debt relief initiatives, and access to short-term concessional debt from IMF all influence the debt dynamics of LDCs. However, most of them remain at high risk of debt stress (table 4.2).

Figure 4.13 **Debt service burden in LDCs: share of exports and of revenues, 2005-2018 (percentage)**




**Source:** Sarangi, 2020a, based on IMF, 2020d; and World Bank 2020b.

Figure 4.14 **Cost of borrowing in LDCs: effective rate of interest, 2005-2018 (percentage)**




**Source:** Sarangi, 2020a, based on IMF, 2020d; and World Bank, 2020b.

# B. Understanding the key drivers of debt accumulation in the Arab region

High fiscal and primary deficits

Weak fiscal reaction

Influence of interest rate and growth differential on public debt build up

Low impact of government expenditure on productivity and growth

## High fiscal and primary deficits

For GCC countries, fiscal and primary balances converge, on average, because they are primarily net receivers of interest payments, and therefore the difference between fiscal and primary balances is marginal. On average, these countries incurred surpluses in their fiscal, primary and current accounts in most years since 2005, except for years when oil prices dropped significantly. The average fiscal and primary balances (as a percentage of GDP) slipped into deficits for a short period in 2009 owing to a drop in oil prices, but picked up again from 2010 with the rise in oil prices. Following the 2014 plunge in oil prices, fiscal surpluses turned into deficits from 2015 onwards (figures 4.15A and 4.15B). The average fiscal deficit and primary deficit of GCC countries were at -1.8 per cent and -2.8 per cent of GDP, respectively, in 2018. These countries are increasingly considering borrowing by issuing sovereign bonds in international capital markets to meet expenditure needs, in addition to introducing new policy measures such as VAT and subsidy reductions.

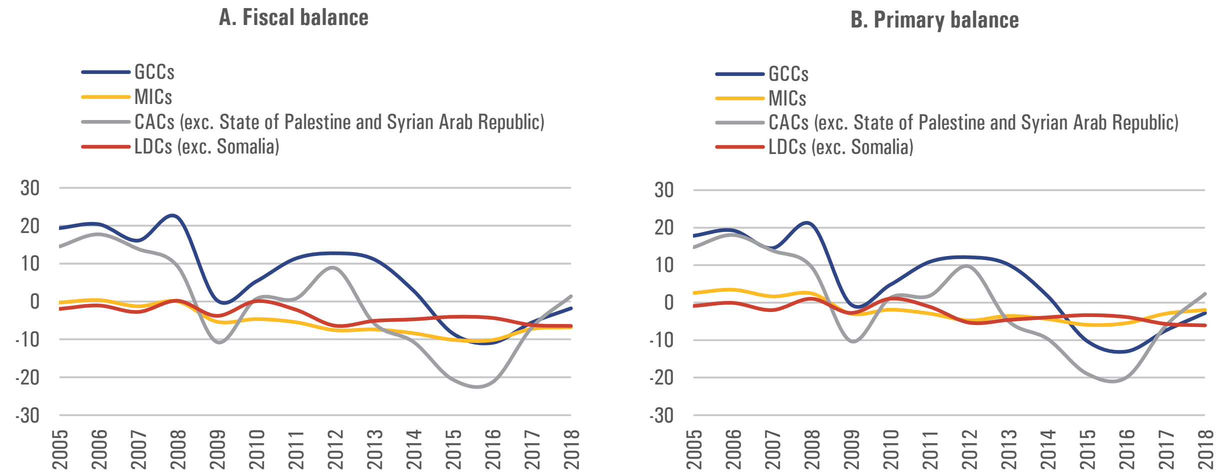
In contrast to GCC countries, fiscal balances in MICs and LDCs were mostly in deficit, and their average fiscal and primary balances worsened between 2008 and 2018. MICs in particular have witnessed a continuous decline in fiscal and primary balances (as a percentage of GDP) since 2008, reaching -10 per cent and -6 per cent, respectively, in 2015, and -7 per cent and -2 per cent, respectively, in 2018. Average fiscal and primary balances in LDCs swung up and down over the same period, but remained negative throughout. In 2018, the average fiscal and primary balance of LDCs was about -6.4 per cent and -6.1 per cent, respectively.

Low oil prices after 2014 helped improve the fiscal balances of oil-importing low- and middle-income countries; however, their fiscal accounts remained negative largely owing to low growth and revenue mobilization. A high current account deficit is a major constraint for most Arab MICs and LDCs, because they are heavily reliant on imports for local consumption while their exports are largely limited to primary products. For instance, between 2010 and 2018, peak imports in Jordan and Lebanon were at 74 per cent and 75 per cent of GDP, respectively, compared with their peak exports to GDP at 48 and 55 per cent of GDP, respectively. Morocco and Tunisia also have huge gaps between imports and exports. The persistence of a current account gap is closely linked to recurrent budget deficits and a debt surge. Neaime (2015) observed that the persistence of a budget deficit exacerbated the trade deficit in Lebanon through upward pressure on domestic interest rates and exchange rate appreciation since the mid-1990s, which resulted in a high debt surge. These twin deficits are related to debt sustainability challenges in most developing countries.[11]

The pandemic has exacerbated deficits and debt in Arab MICs and LDCs, which are highly indebted and are at high risk of debt stress. Projections for 2020 show that the fiscal balance in GCC countries will be -10.4 per cent, compared with -10.2 per cent and -7.7 per cent in MICs and LDCs, respectively.

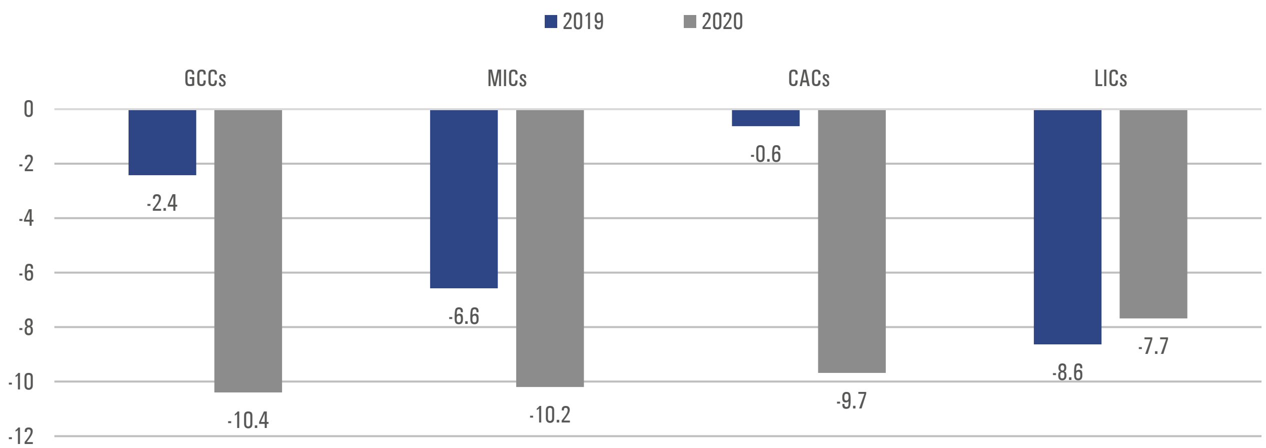
Figure 4.17 shows that the fiscal balance and primary balance, measured as share of GDP, were positive for several countries over the period 2008-2010, compared with negative balances over the period 2016-2018. The deterioration in fiscal and primary balances is associated with an increasing share of gross debt to GDP.

Figure 4.15 **Fiscal and primary balances, 2005-2018 (percentage of GDP)**



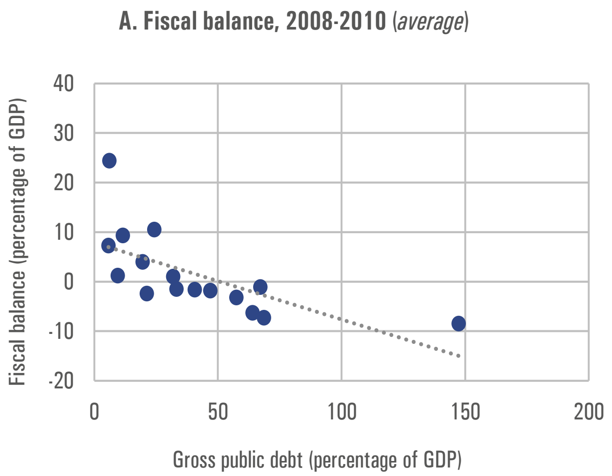

**Source:** Sarangi, 2020a, based on data from IMF, 2020d.

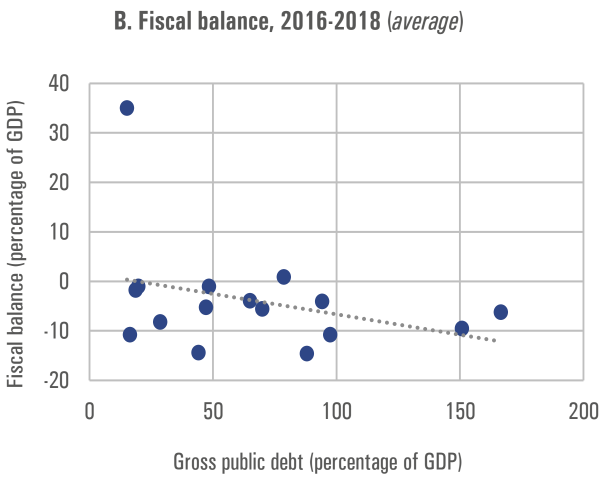
Figure 4.16 **Estimated fiscal deficit to GDP due to adverse impact of COVID-19, 2019-2020 (percentage)**




**Source:** Sarangi, 2020a, based on ESCWA, 2020e.

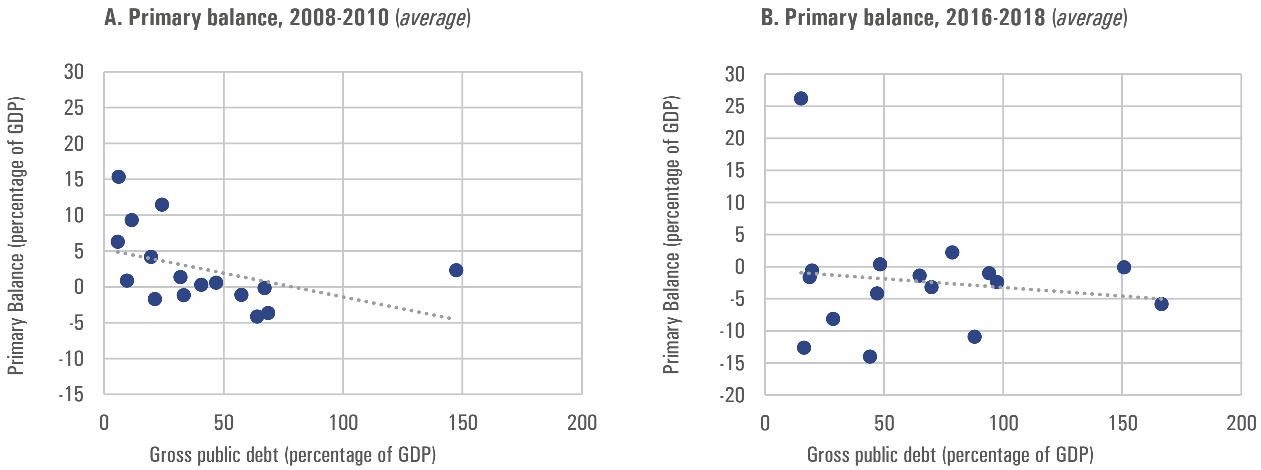
Figure 4.17 **Gross public debt and fiscal balances in Arab countries (percentage of GDP)**




**Source:** Sarangi, 2020a, based on IMF, 2020d.

Figure 4.18 **Gross public debt and primary balances in Arab countries (percentage of GDP)**




**Source:** Sarangi, 2020a, based on IMF, 2020d.

## Weak fiscal reaction

Using the basic framework put forward by Bohn (1998) to assess the fiscal prudence of Arab countries, particularly LDCs and MICs, Sarangi (2020a) conducted an economic assessment of the relationships between debt level and fiscal balance through a fiscal reaction function analysis (table 4.4).

This study shows that in the Arab region, the lagged debt ratio is significantly negatively correlated with the primary balance, meaning that the primary balance ratio deteriorates with an increase in the lagged debt ratio by one period.[12] The fiscal reaction is positive (and significant) by a third period lag only. This behaviour needs to be interpreted carefully, as there may be other factors that influence or force the primary balance to respond positively other than fiscal policy mechanisms.

Temporary increases in government expenditures, captured by the government expenditure gap, have a significant negative effect on the primary balance. This is expected and the results are broadly in line with other studies, where results are associated with quality of economic governance. In Sarangi (2020a), an increase of real expenditure above its trend can lower contemporaneous primary balance by an average factor of -0.13. The strength of budget institutions is a key determinant of fiscal outcomes.[13] An IMF study of 20 countries indicated that those with stronger budget institutions plan and deliver better on fiscal adjustments, including responding to adverse shocks, while countries with weaker institutions did not attempt to counteract adverse shocks through additional fiscal efforts[14]. Furthermore, a positive shock to the cyclical component of output has no significant impact on increasing the primary balance (the coefficient of output gap is insignificant in the sample of MICs). This is the result of low tax to GDP and low tax revenue buoyancy in Lebanon.[15]

The coefficients of lagged debt ratio in the quadratic and cubic functional specifications (positive and negative, respectively) are interesting findings. They indicate that the marginal response of the primary balance to lagged debt increases after a certain threshold (around 90 per cent), but then plateaus and eventually declines (the coefficient turns negative) at a very high level of lagged debt ratio (around 150 per cent) (figure 4.18). The plateau and decline can determine a debt limit, which is referred to as ‘fiscal fatigue’ by Ghosh and others (2013). The results in Sarangi (2000a) appear to be closer to Ghosh and others (2013) than Adams, Ferrari and Park (2010) or Bohn (1998), which indicates that fiscal adjustment efforts strengthen after a certain critical level of debt ratio (a ‘u-shaped’ fiscal reaction function).

A careful look at the results also indicates that, except for Lebanon, most countries have a debt ratio below 100 per cent. It is therefore intuitive that ‘fatigue’ is driven by the higher debt ratio in Lebanon compared with the other countries, as shown in figure 4.19. Furthermore, the coefficient in the cubic function for all countries is not statistically significant. Therefore, Arab LDCs and MICs follow a ‘u-shaped’ fiscal reaction function, if Lebanon is taken out of the sample. However, unlike the standard ‘flattened u-shaped’ response of fiscal policy to debt ratio in other studies, these results show a ‘steep u-shaped’ curve and the primary balance ratio appears perpetually negative. That raises concerns about the existence and effectiveness of fiscal rules in handling debt sustainability in the long run. A decomposition of the change in public debt suggests that persistent primary deficits is the main contributor to increasing debt build-up across Arab MICs, which corroborates well with the panel regression analysis. In addition, exchange rate pressures and high interest rates relative to economic growth also contribute to increasing debt build-up in some years (see annex). The issue of interest rate and growth differential is examined in the next section.

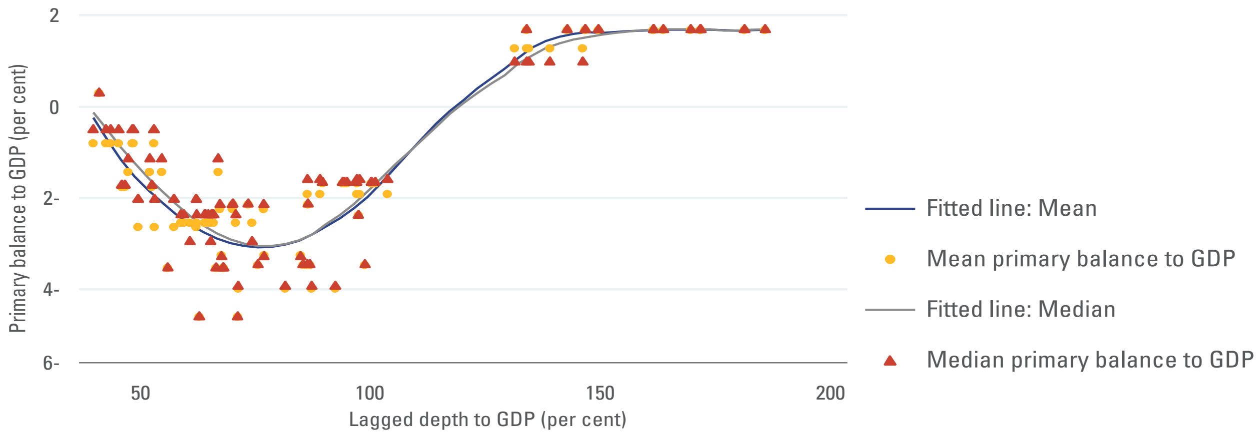
## Table 4.2 **Fiscal reaction function: panel regression results**

| | Dependent variable: primary balance (percentage of GDP) | | |
|---|---|---|---|
| | (1) | (2) | (3) |
| **Variables** | **MICs linear fixed effect** | **MICs, FGLS quadratic** | **MICs, FGLS cubic** |
| | | **MIC sample** | |
| Debt/GDP, lag 1 | -0.007 | -0.061 | -0.313* |
| | (0.18) | (1.21) | (2.31) |
| Debt/GDP, lag 2 | 0.007 | -0.021 | -0.024 |
| | (0.13) | (0.59) | (0.64) |
| Debt/GDP, lag 3 | 0.089* | 0.039 | 0.046 |
| | (2.62) | (1.34) | (1.57) |
| Lagged debt square | | 0.0004* | 0.003* |
| | | (2.00) | (2.10) |
| Lagged debt cubic | | | -0.000 |
| | | | (1.78) |
| Expenditure gap | -0.080 | | |
| | (0.92) | | |
| Output gap | 0.028 | 0.113 | 0.061 |
| | (0.36) | (1.41) | (0.77) |
| Expenditure gap | -0.120** | -0.133** | -0.128** |
| | (3.48) | (5.05) | (4.70) |
| Constant | -6.701* | -1.251 | 6.384 |
| | (2.23) | (0.62) | (1.46) |
| Observations | 80 | 80 | 80 |

**Source:** Sarangi, 2020a.

**Notes:** FGLS: Feasible Generalized Least Squares estimation, allowing for country-specific autocorrelation (AR1) and heteroskedasticity. Standard errors in parentheses; ** p<0.01, * p<0.05. Output gap: GDP gap from the trend, percentage; Expenditure gap: Expenditure gap from the trend, percentage.

## Figure 4.19 **Fiscal response to gross public debt in MICs**




**Source:** Sarangi, 2020a.

**Note:** The fitted line is derived from the cubic function of the MIC sample.

# Influence of interest rate and growth differential on public debt build-up

The interest rate and growth differential (IRGD) plays a key role in examining the debt sustainability gap, by assessing the difference between the actual primary balance and the required debt-stabilizing primary balance. In a situation where the Government is financing deficits by issuing bonds, the interest payment on the last period's bonds minus the Government's current primary surplus must be covered by issuing new bonds. If the primary surplus is zero, then debt will grow by the nominal rate of interest.[16] In terms of the debt-to-GDP ratio, a sustainability condition, or 'no-Ponzi game condition', means that the terminal nominal rate of interest should be no larger than the growth rate of nominal GDP. If the interest paid on this debt is lower than the growth rate of the economy (IRGD < 0) then, all else being equal, the debt will stabilize below the current level. Therefore, a negative IRGD is favourable for countries where economic growth can erode the debt ratio more quickly than it can build it by accumulating interest, all else being equal. The opposite conclusion holds when interest paid on a debt is greater than the growth rate of the economy (IRGD > 0). Using IRGD, the primary balance required for different shares of debt-to-GDP targets over time can be estimated.[17] Therefore, the gap between actual primary balance and required primary balance can also be derived, as discussed in section D below.

Egypt and Tunisia show an improved situation, with widening negative IRGD in recent years compared with their historical average. IRGD for Morocco is near zero. The situation in Jordan and Lebanon deteriorated in 2017 and 2018, with IRGD turning positive compared with their historical average. IRGD in Lebanon is positive from 2013 onwards, which contributes to a significant build-up of debt stock (figure 4.20). In Jordan and Lebanon, higher interest rates relative to economic growth are strong contributing factors to increasing debt build-up in some years, along with other factors such as the exchange rate and primary deficit (see figures in the annex). Interest rates thus have a critical role in improving solvency and correcting debt rollover, all things equal. In most Arab countries, monetary policy is passive, given their pegged exchange rate regimes. The role of interest rates is therefore rather limited in correcting inflation, except for some countries that have recently adopted a more flexible exchange rate regime. High interest rates are mainly set by the oligopolistic banking

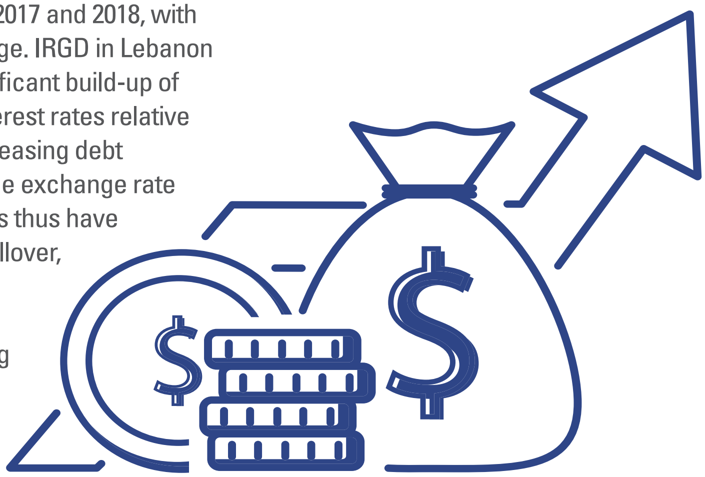
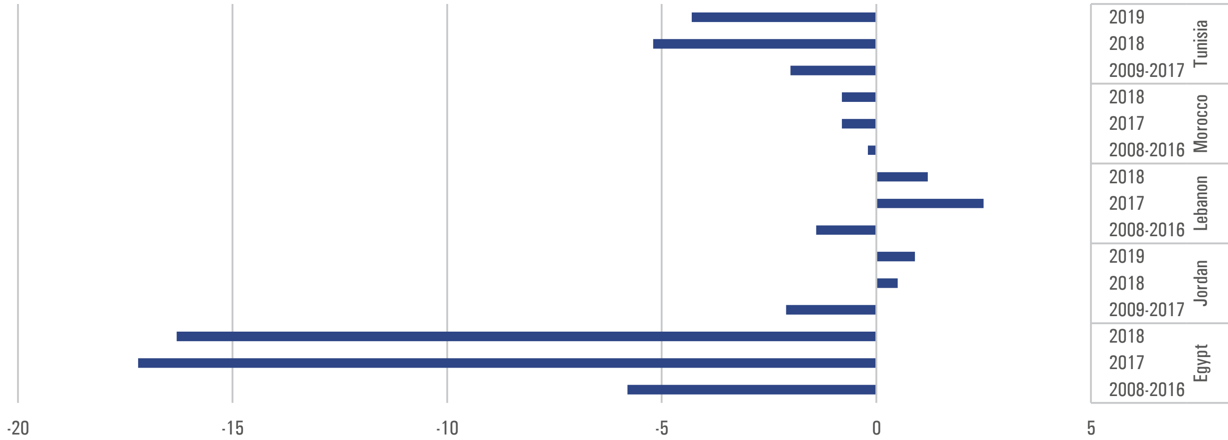


Figure 4.20 **Interest rates: growth differential (percentage points, nominal)**



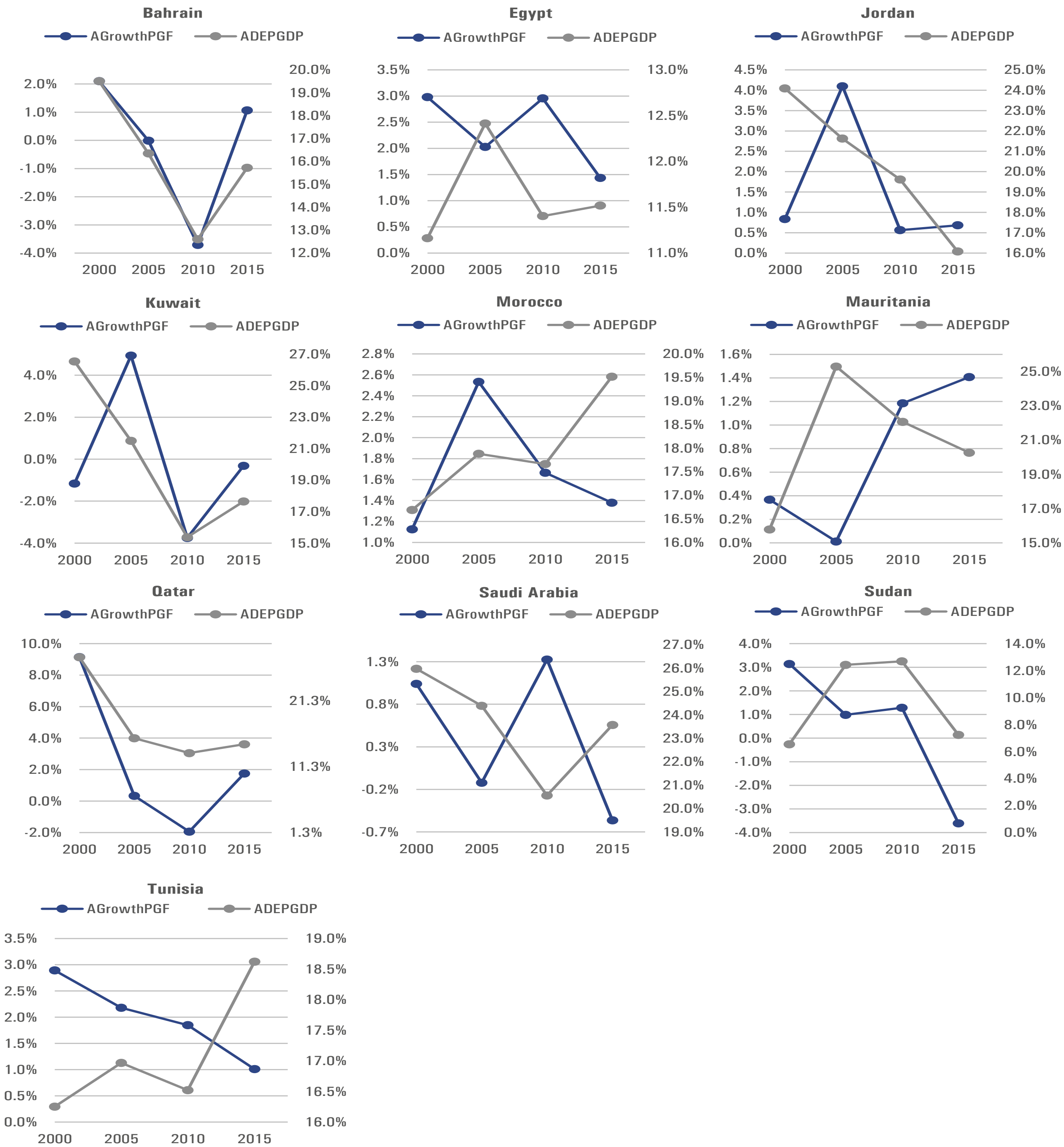

**Source:** IMF Article IV for respective countries.

industry, which is the main government creditor, as is the case in Lebanon. In the absence of high growth, high interest rates pose high risks of insolvency and lead to snowballing debt, as witnessed in the past years. While the average IRGD provides interesting insights into stabilizing debt conditions over the medium term, it must not be taken as a sufficient condition. Cost of capital may be low in some emerging markets temporarily or monetary policy may change significantly, which affects interest rates and growth, thereby influencing IRGD.[18]

## Low impact of government expenditure on productivity and growth

The debate on debt sustainability in the Arab region has mainly focused on ways to increase government revenue and/or decrease government expenditure. However, there is a third approach that has been long neglected: the way in which government expenditure affects the rest of the economy. Grier and Tullock (1989) and Barro (1991) have clearly established that government

Figure 4.21 **Evolution of government current spending as a share of GDP versus total factor productivity growth, 2000-2015**




**Source:** Compiled by ESCWA.

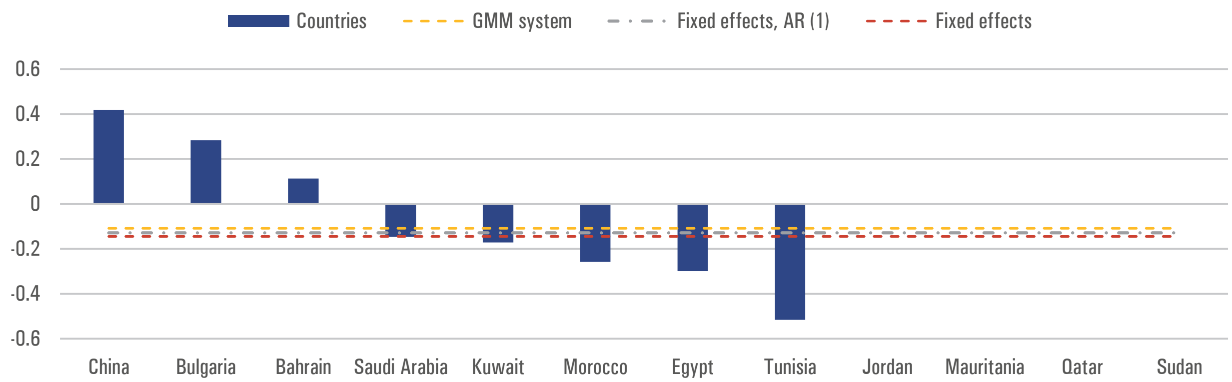
spending affects economic growth, and by consequence the denominator of the debt-to-GDP ratio. In other words, rather than reducing the level of public deficit, the Government could focus on how public expenditure has the potential to increase GDP, and by consequence decrease the debt-to-GDP ratio.

In the Arab region, there is some indication that government spending has a negative impact on productivity. This phenomenon has been particularly worrying since 2010. In most countries, the share to GDP allocated to public current spending has increased, while productivity has decreased. This is particularly visible in Tunisia and Egypt, where the average five-year total factor productivity growth rate decreased from 3 per cent in 2000 to around 1 per cent in 2015, while the average five-year share of government current expenditure to GDP increased over the period 2010-2015 from 16.5 per cent to 18.6 per cent in Tunisia, and from 11.4 per cent to 11.5 per cent in Egypt.

To analyse the effects of public expenditure on productivity, Bchir and Ben Abdallah (2020) developed an econometric model with a dynamic panel data procedure.[19] The economic estimations show that at the global level, the effect of public consumption on total factor productivity is negative and statistically significant, while that of public investment is not significant. These results are in line with most empirical studies on the impact of government spending on growth.[20]

For Arab countries, the estimation confirms the stylized facts observed in figure 4.22. The effect of government current expenditure on total factor productivity is significantly negative, while the effects of public investment are insignificant.

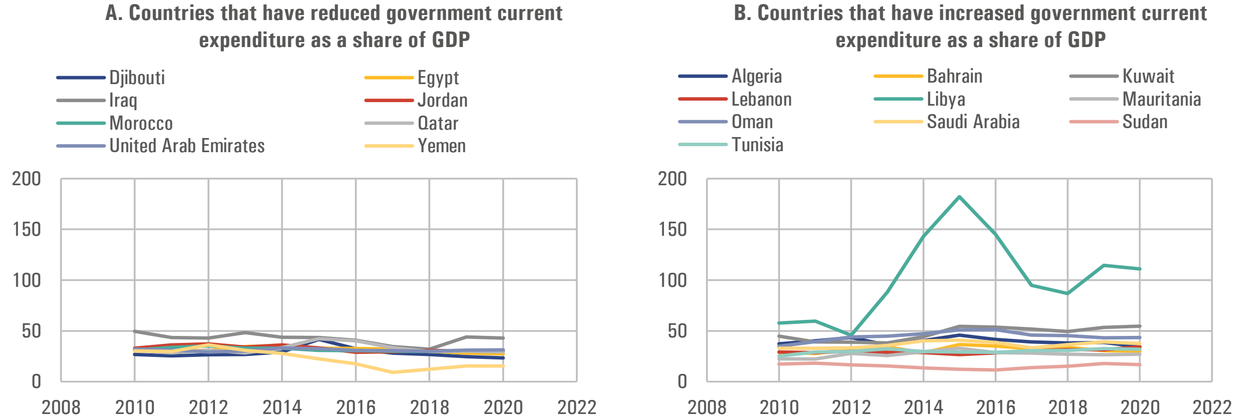
Figure 4.22 **Impact of public consumption on productivity growth in Arab countries, 1995-2017**




**Source:** Compiled by ESCWA.

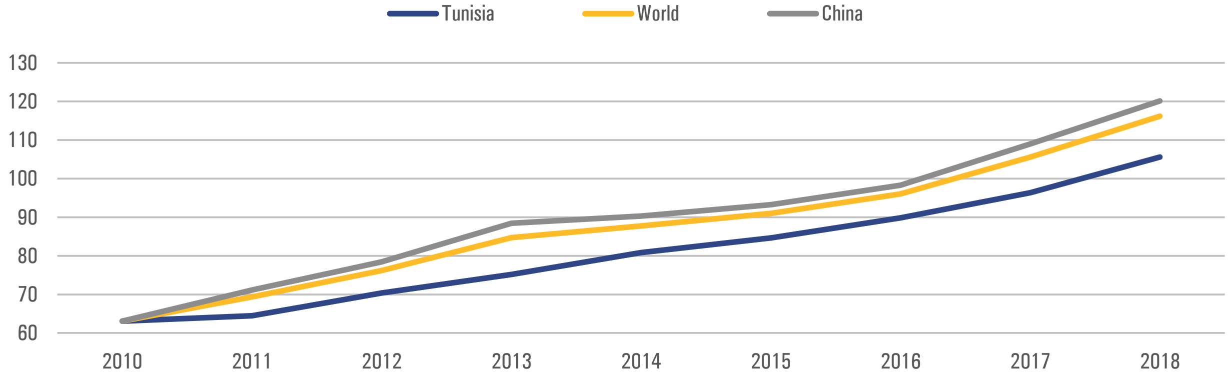
However, when comparing Arab countries' performance to the world average, the magnitude of the problem becomes apparent. Except for Bahrain, the effect of public expenditure on total factor productivity is lower than the world average, regardless of the method of calculation (system GMM, fixed effect, fixed effect with first order autoregression). The situation is even more alarming when compared with the performance of Bulgaria or China.

## Figure 4.23 **Government current expenditure as a share of GDP, 2008-2022**




**Source:** World Bank, World Development Indicators. Available at https://databank.worldbank.org/source/world-development-indicators (accessed on 20 April 2020).

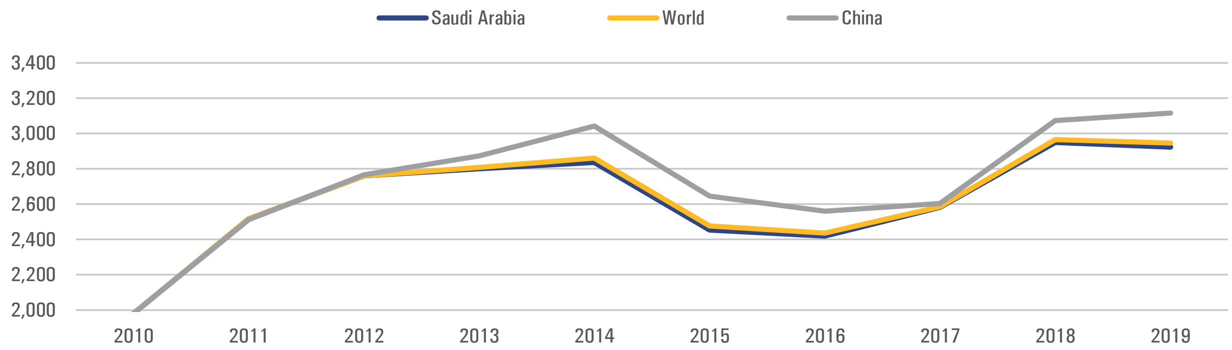
## Figure 4.24 **Evolution and projection of Tunisian nominal GDP with different levels of government efficiency, 2010-2018**




**Source:** Compiled by ESCWA.

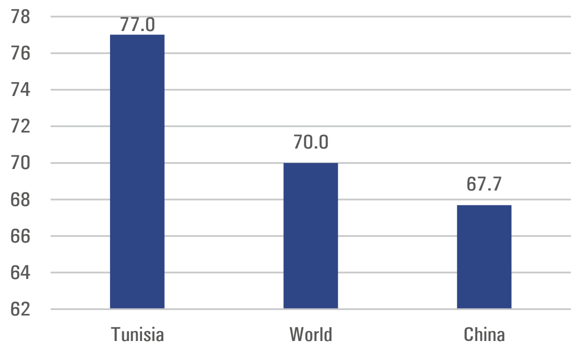
This result implies that a large part of the debt problem is driven by low efficiency of government expenditure in the Arab region. To tackle this problem, Arab Governments have adopted two types of policies. One group has opted for a drastic reduction in government expenditure as a share of GDP (figure 4.23A). Egypt, for example, reduced the share of public current expenditure to GDP from 11.2 per cent in 2010 to 8.4 per cent in 2018. These countries have internalized the inefficiency of their public interventions, and in return are risking the degradation of their public facilities and social conditions.

Figure 4.25 **Evolution and projection of Saudi nominal GDP with different levels of government efficiency, 2010-2019**



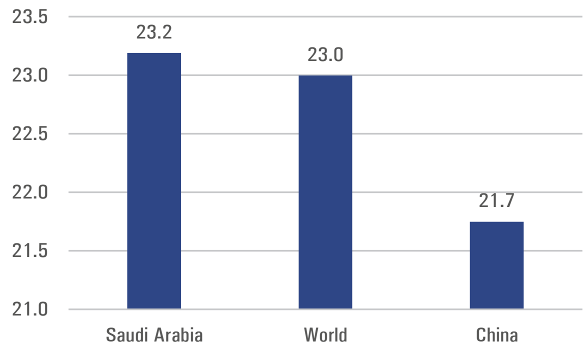

**Source:** Compiled by ESCWA.

Figure 4.26 **Tunisian debt-to-GDP ratio in 2018 under different levels of government efficiency**




**Source:** Compiled by ESCWA.

Figure 4.27 **Saudi debt-to-GDP ratio in 2019 under different levels of government efficiency**




**Source:** Compiled by ESCWA.

The other group opted for an increase in the share of government current expenditure as a share of GDP (figure 4.23B). For this group, the economic cost of public inefficiency is quite high. If the model is rerun using the performance level of public current expenditure in China, the relative cost of public expenditure's relative inefficiency can be estimated. The cumulative cost of Tunisian government inefficiency is estimated at 51.8 billion Tunisian dinars, if the efficiency level of the Tunisian Government was at the world average. When compared with Chinese Government efficiency, the cost is estimated at 71.9 billion Tunisian dinars.

With better efficiency, the level of indebtment would drop with the same level of government expenditure. The debt-to-GDP ratio in Tunisia of 77 per cent in 2018 would be 69.7 per cent if the efficiency the Tunisian Government was the same as the world average, and it would be 67.2 per cent if the Tunisian Government was as efficient as the Chinese Government. Another example is Saudi Arabia, where the cost of inefficiency is estimated at 199.6 billion riyals when compared with the world average, and at 1,608.8 billion riyals when compared with China.

The quality of governance is strongly associated with government efficiency in economic growth and fiscal outcomes. The Arab region has suffered from decades of bad governance (table 4.3), which could explain part of the economic crisis that the region is currently undergoing. The economic literature has proved the positive relationship between governance indicators and growth performance. The econometric estimation conducted by AlAdlani (2019) demonstrates that governance contributes to better economic growth, especially in the long term. Chong and Calderon (2000) found that the effects of institutional reform on economic growth in poorer countries take longer to materialize than the influence of economic growth on institutional quality. A study by Mehanna, Yazbeck and Sarieddine (2010) concluded that voice and accountability, government effectiveness, and control of corruption are among the six governance indicators that influence growth performance in oil-rich MENA countries. Mira and Hammadache (2017) find that political stability is significant for non-oil producing MENA countries. This finding also resonates with studies focused on other developing regions, such as sub-Saharan Africa (Williams, 2017) and cross-sectional studies (Aisen and Veiga, 2013; Han, Khan, and Zhuang, 2014).

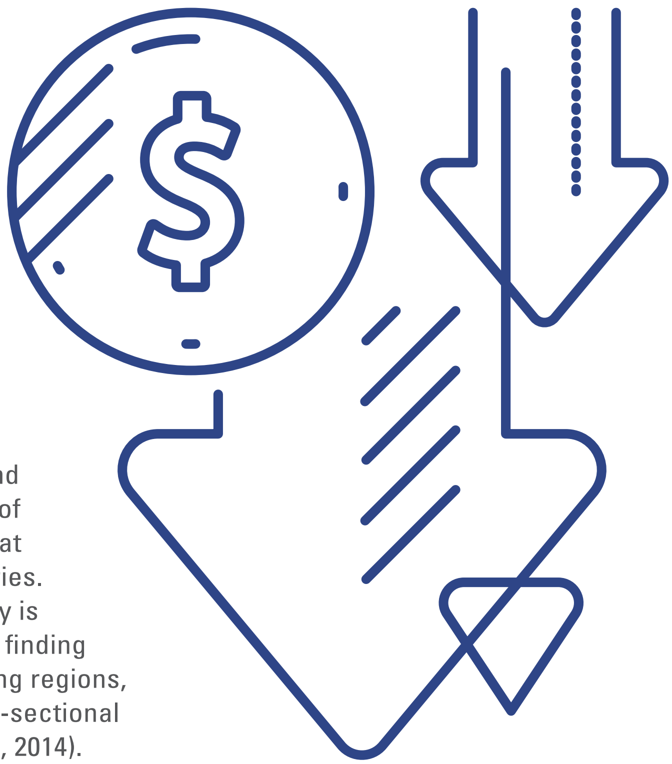


Table 4.3 **Arab countries' percentile rank among all countries (from 0 (lowest) to 100 (highest) ranking)**

| | Voice and accountability | Political stability and absence of violence/terrorism | Government effectiveness | Regulatory quality | Rule of law | Control of corruption |
|---|---|---|---|---|---|---|
| Algeria | 20.2 | 13.8 | 33.7 | 7.7 | 20.7 | 29.3 |
| Bahrain | 9.9 | 22.4 | 63.9 | 67.8 | 68.8 | 56.7 |
| Comoros | 28.1 | 41.9 | 3.8 | 10.6 | 12.5 | 15.4 |
| Djibouti | 10.8 | 34.8 | 24.0 | 20.7 | 18.3 | 20.7 |
| Egypt | 8.4 | 12.9 | 36.5 | 18.8 | 38.0 | 27.9 |
| Iraq | 22.7 | 1.9 | 9.6 | 9.6 | 3.8 | 8.7 |
| Jordan | 28.6 | 33.3 | 56.7 | 57.2 | 58.2 | 60.6 |
| Kuwait | 29.1 | 54.3 | 52.9 | 57.7 | 61.1 | 51.0 |
| Lebanon | 32.5 | 7.6 | 17.8 | 36.5 | 19.7 | 12.0 |
| Libya | 7.9 | 1.4 | 1.9 | 1.0 | 1.9 | 2.4 |
| Mauritania | 25.1 | 26.2 | 34.6 | 22.1 | 28.8 | 20.2 |
| Morocco | 29.6 | 32.4 | 47.6 | 46.2 | 48.6 | 45.7 |
| Oman | 17.2 | 67.1 | 62.5 | 64.4 | 70.7 | 67.3 |
| Qatar | 13.8 | 70.0 | 75.0 | 74.0 | 75.5 | 79.3 |
| Saudi Arabia | 5.9 | 29.5 | 64.4 | 51.9 | 58.7 | 63.0 |
| Somalia | 3.0 | 2.9 | 1.0 | 1.9 | 0.0 | 1.0 |
| Sudan | 5.4 | 6.7 | 5.3 | 3.8 | 10.6 | 7.7 |
| Syrian Arab Republic | 1.5 | 0.5 | 3.4 | 3.4 | 1.0 | 1.4 |
| Tunisia | 56.7 | 17.1 | 48.6 | 35.6 | 55.8 | 52.9 |
| United Arab Emirates | 17.7 | 69.5 | 88.9 | 78.4 | 77.9 | 83.7 |
| West Bank and Gaza | 21.2 | 4.8 | 23.1 | 56.7 | 33.7 | 46.6 |
| Yemen | 4.4 | 0.0 | 0.5 | 4.3 | 2.9 | 1.9 |

**Source:** World Bank, Worldwide Governance Indicators (WGI). Available at https://info.worldbank.org/governance/wgi (accessed on 15 April 2020).

# C. Debt sustainability gap and debt stabilization scenarios

Several Arab LDCs remain at risk of debt distress, according to the Joint Bank-Fund Debt Sustainability Framework for Low Income Countries (LIC-DSF). According to the assessment, Somalia and the Sudan are in debt distress, whereas the Comoros, Djibouti and Mauritania are at moderate to high risk of debt distress (table 4.4). These countries are experiencing steep output contractions, while COVID-19 relief and recovery efforts are demanding a massive increase in expenditures. Large external arrears in the Sudan continue to hinder access to external financing.[21] The country has yet to meet all the requirements to qualify for HIPC debt relief. The Sudanese authorities have requested a 12-month staff-monitored programme to support their efforts to restore macroeconomic stability, lay the foundation for strong and inclusive growth, mobilize external financing, make progress toward debt relief under the HIPC initiative, and cope with the impact of COVID-19.[22] Somalia has taken the necessary steps to begin receiving debt relief under the enhanced HIPC initiative, which will reduce its debt from $5.2 billion at end-2018 to $557 million in net present value terms once it reaches the HIPC completion point in about three years.[23]

COVID-19 and its economic fallout are exacerbating already high debt risks. The international community has taken action to provide relief through the G20 debt service suspension initiative (DSSI), and debt relief by the IMF for 25 countries from the Catastrophe Containment and Relief Trust (CCRT). An estimate of potential DSSI savings suggests that participating countries

Table 4.4 **DSSI participants and their potential savings based on amounts owed to creditors**

| Country | DSSI participation? | Risk of external debt distress | Risk of overall debt distress | Publication date of data sustainability analysis | Potential DSSI savings ($ million) | Potential DSSI savings (percentage of 2019 GDP) |
|---|---|---|---|---|---|---|
| Comoros | Yes | Moderate | Moderate | Apr-20 | 2.3 | 0.2 |
| Djibouti | Yes | High | High | May-20 | 59.2 | 1.6 |
| Mauritania | Yes | High | High | Apr-20 | 90.0 | 1.2 |
| Somalia | No | In distress | In distress | Mar-20 | … | |
| Yemen | Yes | … | … | … | 142.7 | 0.5 |

**Source:** World Bank, 2020c.

**Note:** Potential DSSI savings are estimated debt service payments owed, based on monthly projections for May-December 2020, based on end-2018 public and publicly guaranteed debt outstanding and disbursed.

would have a potential saving of $294 million, based on estimated debt service payments owed during the period May-December 2020 (table 4.4). This is not enough, however, since the total public debt service of Arab LDCs is about $1 billion, and interest payment of public external debt is about $550 million. DSSI needs to include multilateral debt; it is currently limited to bilateral debt only. Table 4.5 shows the IMF debt service relief assistance from CCRT to the Comoros, Djibouti and Yemen, amounting to nearly $23.4 million. In parallel, the Comoros, Djibouti, Mauritania and Somalia have borrowed from IMF a total of $423 million under the concessional lending mechanisms: Rapid Credit Facility (RCF) and Extended Credit Facility (ECF). The Comoros has also borrowed $5.93 million for non-concessional loans under the Rapid Financing Instrument (RFI).

IMF also provides concessional financial support (currently at zero interest rates until June 2021) through the Poverty Reduction and Growth Trust (PRGT), which is tailored to the diversity and needs of low-income countries. Standby Credit Facility (SCF), Extended Credit Facility (ECF) and Rapid Credit Facility (RCF) are three main concessional finance tools to assist low-income countries in case of balance of payment problems in the short term, medium term, and for urgent needs, respectively.

## Table 4.5 **Emergency financing and debt service relief from IMF to Arab LDCs**

| Country | Type of emergency financing | Amount approved (SDR) | Amount approved ($ million) | Date of approval |
|---|---|---|---|---|
| Comoros | Debt service relief: CCRT | 0.97 million | $1.33 million | 13 April 2020 |
| | Rapid Credit Facility | 2.97 million | $4.05 million | 22 April 2020 |
| | Rapid Financing Instrument | 5.93 million | $8.08 million | 22 April 2020 |
| Djibouti | Rapid Credit Facility | 31.8 million | $43.4 million | 8 May 2020 |
| | Debt service relief: CCRT | 1.69 million | $2.3 million | 8 May 2020 |
| Mauritania | Rapid Credit Facility | 95.68 million | $130 million | 23 April 2020 |
| Somalia | Extended Credit Facility, and the Extended Fund Facility | 292.4 million | $395.5 million | 25 March 2020 |
| Yemen | Debt service relief: CCRT | 14.44 million | $19.76 million | 13 April 2020 |

**Source:** IMF, COVID-19 Financial Assistance and Debt Service Relief. Available at https://www.imf.org/en/Topics/imf-and-covid19/COVID-Lending-Tracker#ftn (accessed on 15 September 2020).

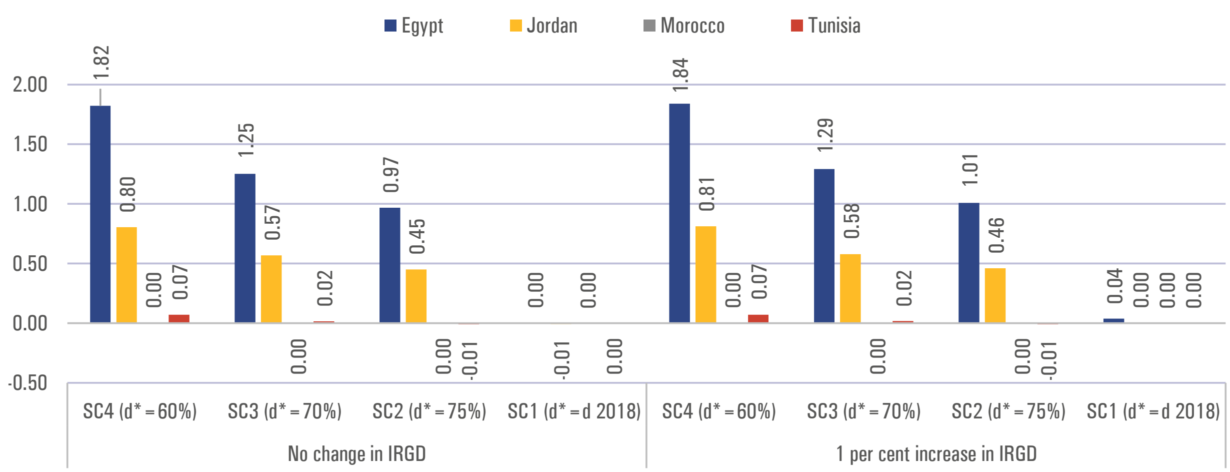
**Note:** According to IMF, the debt service relief from CCRT benefitted countries that have their debt service due between 13 April and 13 October 2020.

Using IRGD, the required primary balance can be worked out through a simulation exercise to arrive at certain debt-to-GDP ratio targets over the medium term. To do so, 10-year average and 5-year average IRGD were used, by taking into consideration weighted real effective interest rate, weighted by share of foreign debt and domestic debt, and the real growth rate. Figure 4.28 presents the simulation exercise for four scenarios, while allowing for variations or shocks to IRGD. The exercise was undertaken for Arab MICs with IRGD less than zero or near zero, as a precondition stated in the methodology. Lebanon is not part of the exercise since IRGD at current and at historical averages turns out strongly positive.

- Scenario 1: Debt target (d*) to be maintained at the 2018 level as a percentage of GDP by 2030;
- Scenario 2: Debt target (d*) to be maintained at 75 per cent of GDP by 2030;
- Scenario 3: Debt target (d*) to be maintained at 70 per cent of GDP by 2030;
- Scenario 4: Debt target (d*) to be maintained at 60 per cent of GDP by 2030.

For all four scenarios, IRGD was applied based on the historical average of the past 10 years (since 2009 through 2018). Furthermore,

Figure 4.28 **Required debt stabilizing primary balance ratios under various debt targets, 2019-2030**




**Source:** Sarangi, 2020a.

a 1 per cent increase in IRGD was used to take into consideration the impact of a possible rise in interest rates or a deterioration in growth. It should be noted that foreign interest rates picked up during 2018 and 2019 (pre-COVID-19). This is not currently a concern owing to low interest rates pursued by most countries to ease liquidity conditions during the pandemic. Interest rates may go up again when economies start recovering, or interest rates may come under pressure to contain inflation in the near future. Therefore, it is useful to see the impact of shocks to IRGD to arrive at debt targets by using such simulations.[24] The required primary balance versus the actual primary balance, as a share of GDP, shows the adjustment in primary balance required to maintain the debt-to-GDP share at the baseline, or to arrive at the share of debt-to-GDP target for certain years.

Figure 4.28 presents the estimated required primary balance, as a share of GDP, to achieve different debt targets, as share of GDP, by 2030. If countries decide to maintain the same debt-to-GDP ratio as in 2018, they need to ensure that primary balance to GDP must be maintained at zero over the years, while assuming no change in IRGD. If the decision is to maintain debt to GDP at 75 per cent by 2030, Egypt would need to maintain a primary balance-to-GDP ratio of 0.97 per cent, Jordan needs to maintain it at 0.45 per cent, Morocco needs to maintain it at 0 per cent, and Tunisia needs to maintain it at -0.01 per cent. A lower target of debt to GDP would necessitate a higher primary surplus as shown by different targets of debt to GDP. The critical assumption is that IRGD remains the same. A favourable change in IRGD, mainly by an improvement in the growth rate, would reduce the required primary balance. In contrast, an increase in IRGD either owing to a contraction in growth or an increase in interest rates, would necessitate a higher required primary balance to stabilize debt at the target level, as shown in the right-side panel of the bar graph (figure 4.28).

Table 4.6 **Required adjustments in the primary balance assuming no change in IRGD and assuming that debt to GDP will stabilize at 75 per cent by 2030**

| | Actual primary balance 2018 (percentage of GDP) | Required primary balance on average (percentage of GDP) | Adjustment required for 2019 (primary balance as percentage of GDP) | Billion $ |
|---|---|---|---|---|
| Egypt | -0.40 | 0.97 | 1.36 | 3.41 |
| Jordan | -1.45 | 0.45 | 1.90 | 0.80 |
| Morocco | -1.28 | 0.00 | 1.27 | 1.51 |
| Tunisia | -1.91 | -0.01 | 1.90 | 0.76 |

**Source:** Sarangi, 2020a.

Assuming no change in IRGD, Egypt would need to adjust its primary balance to 1.36 per cent of GDP (a primary balance of $3.41 billion in 2019). Jordan would need to maintain a primary balance of $0.80 billion, Morocco $1.51 billion and Tunisia $0.76 billion. The adjustments are reasonable compared with those required for reducing debt stock as per IMF frameworks. During the period 2005-2008, the average primary balance of Arab MICs was 2.5 per cent of their aggregate GDP. Achieving 0 to 1 per cent of the primary balance is therefore a necessity to improve debt sustainability and release relatively more fiscal space for social development expenditure. How to raise the primary balance is a fiscal policy question, which is beyond the scope of the present chapter.[25]

Using IRGD, similar primary balance requirements can be computed for Arab LDCs. The interest rate would be the external rate of interest. A critical issue is that calculating the effective rate of interest will not always present an accurate picture, since many of these countries have access to concessional loans and debt relief. An ideal situation would be to know the rate of interest of borrowing to compute the IRGD, for which adequate data are not available. Furthermore, these countries are in debt distress. Their primary balance, on average, is negative historically. They also face a persistent current account deficit. All these issues create complications in making sense of debt stabilizing primary balance for LDCs, especially because they would need more financing to realize their potential capacities.

# D. Conclusion and policy implications

Since 2008, the Arab region has been experiencing increasing debt as a share of GDP. The share rose from 26 per cent in 2008 to 45 per cent in 2018. There are many reasons for debt accumulation, including the negative impact of the global economic downturn, persistent trade deficits in MICs, conflict in several countries, and commodity price fluctuations that widened fiscal deficits in countries dependent on oil and commodity exports. The adverse impact of COVID-19 has pushed Arab countries to borrow ever more.

The evolution of public debt across Arab LDCs and MICs is rooted in high and persistent primary deficits, often led by discretionary expenditures, and persistent current account deficits owing to greater reliance on imports than exports. The analysis of the fiscal reaction function and the fiscal sustainability gap resulted in the following recommendations:

- Improve the quality of economic governance and strengthen budget institutions to enhance fiscal policy responses to economic crises;

- Adjust the primary balance in line with a debt-to-GDP target;
- Strengthen growth by improving fiscal and monetary coordination.

The following recommendations should also be considered by all Arab Governments:

- Work out debt stabilizing scenarios over the medium to long term, taking into account any need for augmenting existing borrowing or new borrowing to help improve fiscal space to finance the SDGs and boost economic growth;
- Use fiscal policy strategically to enhance fiscal space, and reduce debt by cutting wasteful discretionary expenditures;
- Prioritize growth enhancing fiscal measures; establish monitoring and targeting mechanisms; improve overall public finance management through debt stabilizing fiscal rules, medium-term expenditure frameworks, and medium-term revenues frameworks; improve transparency; and minimize leakages;
- Develop a conducive monetary policy that ensures the necessary conditions to maximize the value of fiscal measures. However, it is not enough to generate fiscal space to the scale that is required to mitigate the adverse impact of COVID-19. To recover better and faster, these countries would require additional fiscal support;
- Diversify the economy to promote exports, jobs and growth;
- Link government spending to development outcomes and enhance its productivity by monitoring and evaluating the outputs and outcomes of each public expenditure item in terms of its contribution to development outcomes, including the SDGs;
- Extend and expand the scope of debt relief to Arab LDCs and MICs so as to generate immediate fiscal space to allocate resources to targeted sectors and people to recover better from the adverse impacts of COVID-19.

With regard to LDCs:

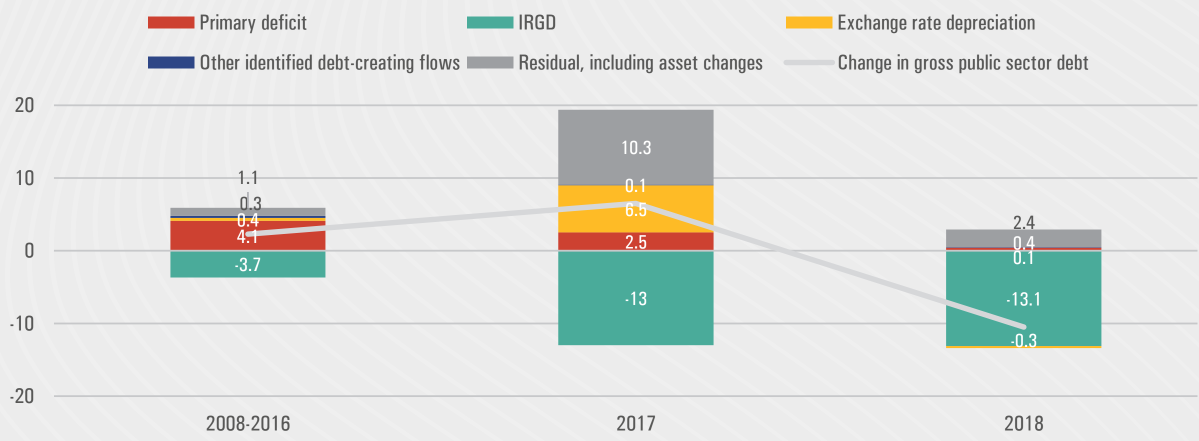
- Extend the period of G20 DSSI until the end of 2021;
- Include multilateral debt in DSSI, which is currently limited to bilateral debt;
- Provide access to debt relief under the HIPC initiative to benefit countries such as the Sudan.

With regard to MICs:

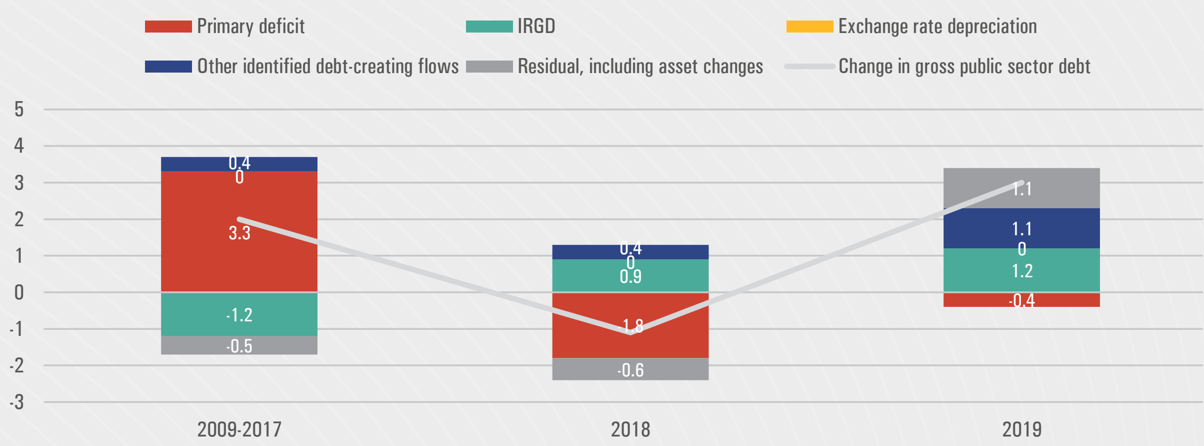
- Broaden the scope of DSSI to include MICs and vulnerable countries;
- Enhance private sector participation in DSSI;
- Improve access to concessional loans for MICs;
- Promote debt restructuring and debt swap as important instruments for debt reduction in the immediate and short term.

# Annex

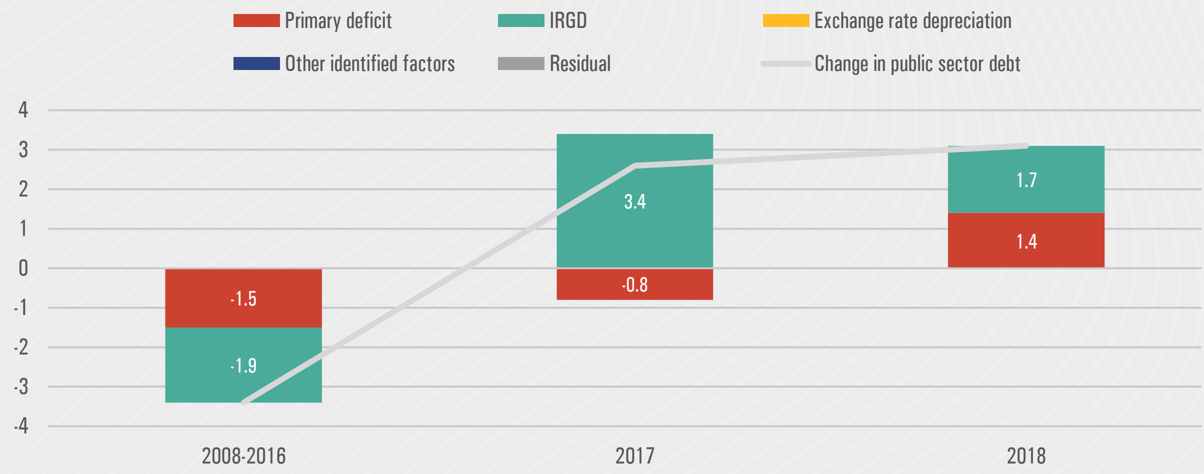
## Contribution to change in public debt in Egypt (percentage of GDP)



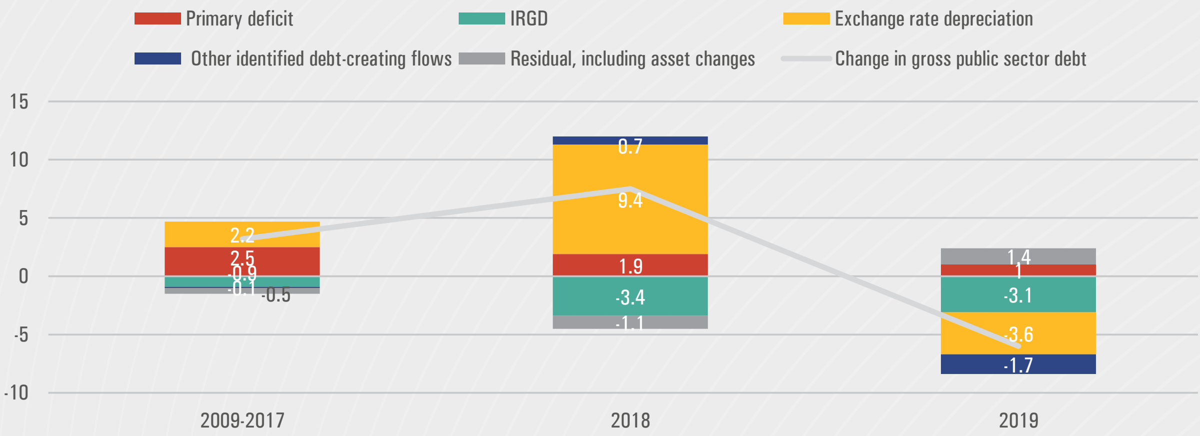

## Contribution to change in public debt in Jordan (percentage of GDP)



## Contribution to change in public debt in Lebanon (percentage of GDP)




## Contribution to change in public debt in Tunisia (percentage of GDP)



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# Endnotes

## Chapter 1

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3. ESCWA staff estimations based on DESA, 2020.
4. According to the World Bank data, international tourism receipts constituted 22 per cent of total exports in Morocco and 12 per cent in Tunisia in 2018.

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3. Algeria, Portail du Premier Ministère, 2020.
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## Chapter 3

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2. ILO, 2019c.
3. المنظمة العربية للتربية والثقافة والعلوم، 2018.
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8. E/ESCWA/CL2.GPID/2020/TP.9.
9. ILO, 2019b; ILO, 2020c; Abu-Ismail, n.d.
10. Ibid.
11. Based on ILO, 2019b.
12. Council on Foreign Relations, Women around the World and Women and Foreign Policy Program, 2017.
13. ILO, 2019b.
14. E/ESCWA/CL2.GPID/2020/TP.4.
15. ILO, 2020a. p. 13.
16. ILO, Estimates from ILO, 2020b.
17. E/ESCWA/CL3.SEP/2020/Policy Brief.1.
18. ILO, 2019d; ST/ESA/SER.A/438.
19. ILO, 2019a.
20. A sponsorship system that ties the worker residential status and immigration to a single individual that is the sponsor.
21. Kagan, 2017.
22. Global Action Programme on Migrant Domestic Workers and their Families, 2016.
23. UNHCR, 2020e.
24. UNHCR, 2020a.
25. UNHCR, 2020f.
26. UNHCR, 2020d.
27. UNRWA, 2019; IDMC, 2019.
28. United Nations Office for the Coordination of Humanitarian Affairs, 2020.
29. E/ESCWA/2020/INF.3.
30. UNHCR, 2020c.
31. UNHCR, UNICEF and WFP, 2019.
32. Ibid.
33. Chehayeb and Sewell, 2020.

## Chapter 4

1. IMF defines general government gross debt as all liabilities that require payment or payments of interest and/or principal by the debtor to the creditor at a date or dates in the future. It includes debt liabilities in the form of special drawing rights (SDRs), currency and deposits, debt securities, loans, insurance, pensions and standardized guarantee schemes, and other accounts payable.

2. Sarangi and El-Ahmadieh, 2017.
3. Sarangi, 2020a.
4. Ibid.
5. IMF, 2019a.
6. Sarangi, 2020b.
7. Total external debt refers to debt owed to non-residents, repayable in currency, goods or services. It is the sum of public, publicly guaranteed, and private non-guaranteed long-term debt, IMF credit, and short-term debt.
8. There are disparities among MICs. The external public debt of Lebanon was about $33 billion in 2018, of which official creditors accounted for only $2 billion. Therefore, the majority of the external debt stock belong to private creditors, mainly bond holders (a little less than $31 billion), commercial banks ($135 million), and other private creditors ($29 million).
9. Concessional debt is defined as loans with an original grant element of 25 per cent or more. Concessional external debt conveys information about a borrower's receipt of aid from official lenders at concessional terms, as defined by the Development Assistance Committee of OECD.
10. IMF financial assistance for emerging and advanced market economies are: Stand-by Arrangements to address short-term or potential balance of payments problems; the Extended Fund Facility as medium-term support to countries facing protracted balance of payments problems because of structural weaknesses that require time to address; and the Rapid Financing Instrument to provide rapid assistance to countries with urgent balance of payments need to cope with shocks.
11. Khalid and Guan, 1999.
12. Ghosh and others (2013) found similar results for a sample of 23 advanced countries during the period 1970-2007. However, in other MICs, such as in Asia, the coefficient is found to be positive and significant (Adams, Ferrari and Park, 2010; Ferrarini and Ramayandi, 2012).
13. E/ESCWA/EDID/2017/4.
14. IMF, 2014.
15. E/ESCWA/EDID/2019/WP.20.
16. Blanchard and Fischer, 1989; Adams, Ferrari and Park, 2010; Escolano, 2010.
17. Sarangi, 2020a.
18. Escolano, Shabunina and Woo, 2011; Obstfeld and Rogoff, 1996.
19. Loko and Diouf, 2009.
20. Grier and Tullock, 1989; Barro, 1991; Ghali, 1999; and Loko and Diouf, 2009.
21. As at 31 December 2018, arrears to IMF amounted to 968.4 million Sudanese pounds (about $1,346.9 million). Arrears to the World Bank Group amounted to $962.8 million, and 254.4 million Sudanese pounds (or $353.8 million) to the African Development Bank (Gamarra and others, 2019).
22. IMF, 2020e.
23. World Bank, 2020a.
24. A negative IRGD is an essential but insufficient condition for stabilizing debt, since fluctuations in IRGD can make it unfavourable. Robust debt-stabilizing fiscal policy conditions refer to a situation where the debt ratio can be stabilized in circumstances where the interest rate is even higher than the growth rate (See the modified golden rule efficiency condition of Blanchard and Fischer (1989)).
25. See E/ESCWA/EDID/2017/4; E/ESCWA/EDID/2019/WP.20.

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