

Survey of Economic and Social Developments in the Arab Region

2018-2019



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Economic and Social Commission for Western Asia

Survey of Economic and Social Developments in the Arab Region

2018-2019



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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 General Assembly resolution 35/56, para. 173; ESCWA resolution 270 (XXIV) paras. 2, 3 and 4; and ESCWA resolution 303 (XXVII), paras. 1 and 2. This publication is linked to subprogramme 3 of ESCWA, on economic development and integration, which seeks to contribute to efforts by member States to reform economic institutions and develop and implement policies based on principles of

good governance in order to enable economic planning and policymaking in support of inclusive and sustainable development. This 2018-2019 edition focuses on analysis of the most recent socioeconomic developments under a set format, with a reporting period primarily from January 2018 to March 2019. There are two main objectives: to analyse routinely monitored economic and social variables in the Arab region in a global context (chapters one and two) and to focus on studies of reforms of the energy subsidy system and the macroeconomic implications (chapter three).

Acknowledgements

The report was prepared under the overall direction and guidance of Moctar Mohamed El Hacene, Director of the Economic Development and Integration Division (EDID) at the Economic and Social Commission for Western Asia (ESCWA). Mohamed Hedi Bchir, Chief of the Modelling and Forecasting Section at EDID, led a core team, which included Ahmed Moummi, Seung-Jin Baek and Nathalie Khaled. Research assistance and administrative support were provided by Arpy Atamian, Maroun Laoun, Abdullah Al Hamdi, Hyunjin An and Sunkoo Lee.

The team would like to greatly acknowledge the internal peer review by Elias Ghadban, David Krivanek, Gisela Nauk, Sara Salman, Mehmet Eris and Youness Abouyoub, and the substantive contributions made by ESCWA's divisions: Sustainable Development Policies

Division (SDPD), Social Development Division (SDD), Technology for Development Division (TDD), Statistics Division (SD), Emerging and Conflict-Related Issues Division (ECRI) and ESCWA Centre for Women (ECW). The team is also indebted to Yarob Badr and Nirranjan Sarangi for their contributions to the boxes.

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 on 11 June 2019 in Beirut. The experts were: Taoufik Rajhi, Minister of Major Reforms in Tunisia, Professor Hun Joo Park from the Center for Strategic Development in Saudi Arabia, Professor Abeer Elshennawy from the American University in Cairo and Professor Walid Marrouch from the Lebanese American University.

Executive Summary

The trajectory of world economic growth in 2018 was largely shaped by the effect of the intensifying trade dispute between the United States and China. The growth of global gross domestic product (GDP) slowed slightly by 0.1 percentage points to 3.0 per cent in 2018. International trade activity weakened, and financial conditions tightened under the United States Federal Reserve's decision to raise interest rates. As a result, business confidence and investment deteriorated over the course of the year. These circumstances, combined with persistent geopolitical tension across the regions and the uncertainty of international policy, are expected to restrain global economic growth at 2.7 per cent in 2019.

Meanwhile, the global demand for oil surged in 2018, driven particularly by strong economic activity in China, India and the United States. The oil supply dynamics were, however, complicated by the uncertain political situations in some oil-exporting countries. The oil production in Venezuela and Iran significantly dropped under sanctions, while the Organization of Petroleum Exporting Countries (OPEC) agreed upon an oil production cut in December 2018.

Despite these cuts, the overall global supply during year 2018 increased, driven mainly by the rise in shale oil production in the United States. That said, such geopolitical volatility caused severe fluctuations in global oil prices in 2018. The price of crude oil increased substantially during the first three quarters of 2018, mainly an effect of supply reduction in Venezuela, Canada and Libya; but it reduced during the fourth quarter, which was further associated with the policy change by the United States in dropping the Iran

sanction waivers on the impacted countries during early 2019.

Along with the rise in the oil prices throughout the year in 2018 and up to the first quarter of 2019, the economy in the Arab region recovered with a growth rate of 2.3 per cent in 2018, compared to 1.7 per cent the previous year. This growth was driven by the hydrocarbon sector in the region's oil-exporting countries, particularly Gulf Cooperation Council (GCC) countries. In contrast, oil-importing countries such as Jordan, Lebanon and the Sudan relied heavily on oil imports which widened their current account deficits and public debt.

Exposed to such vulnerability to fuel prices, many parts of the Arab region were encouraged to implement a series of subsidy reforms and fiscal adjustment initiatives. Nevertheless, political instability, high levels of public debt, geopolitical tension and uncertainty about international policy continued to weigh down economic growth. The economic outlook in the years to come reflects this unpredictable backdrop in the Arab region, with 2.6 per cent growth anticipated in 2019 and 3.4 per cent in 2020.

At the subregional level, the growth trajectory was heterogenous. The GCC countries significantly recovered the pace of economic growth in 2018 reaching 2 per cent, following a 0.2 per cent contraction the year before. In the meantime, the introduction of GCC-wide value added tax contributed to mild inflationary pressures.

The pickup in the economies of Mashreq countries was driven by the strong economic

expansion in Egypt and reconstruction in the Syrian Arab Republic. In contrast, growth in Jordan and Lebanon remained subdued in 2018, with a real GDP growth of 1.9 per cent and 0.3 per cent, respectively. These two economies are constrained by political instability and long-standing conflicts in their neighbouring countries.

The pace of economic growth in Maghreb countries slowed to 3.3 per cent in 2018, owing to Libya's growth rate which decreased massively due to the current military escalation. However, real GDP growth rate, excluding Libya, was estimated at 2 per cent in 2018, which is down slightly from 2.1 per cent in 2017, implying that growth outcomes in the subregion appeared somewhat well sustained in recent years.

The economies of Arab least developed countries (LDCs) contracted by 1.7 per cent in 2018 before rebounding with an expansion of 0.3 per cent in 2019. This negative growth in 2018 was largely the result of underperformance in the economies of the Sudan and Yemen, which were largely impacted by political upheavals.

As for the monetary policy stance, central banks in almost all Arab countries increased their policy rates in tandem with the ongoing cycle of interest rate hikes in the United States, with interest rate increases on four occasions to reach the target rate of 2.5 per cent in 2018. They did so cautiously in order not to discourage domestic credit growth. Such tightening monetary policy stance, however, worsened the region's fiscal position, increasing the fiscal deficit and public debt levels.

Under these regional economic conditions, the social development dynamics in the Arab region were stagnant. While the labour force participation rates in the region remain the lowest in the world, due in large part to women's lack of participation in the Arab

region work force, the gender gap in the employment has widened. In 2018, the female unemployment rates in the region were recorded at 15.6 per cent as compared to 5.8 per cent for males. The gender equality indicator showed no significant progress from the previous year.

Notably, employment in many countries of the region is largely comprised of informal work and underemployment, with workers in these sectors suffering from a lack of access to social protection and its benefits to well-being. In addition to the region's gender gap in the labour market, the gender equality indicators showed no significant progress from last year. Women's political participation in the region was also low, potentially limiting policy initiatives for gender equality.

The main challenge facing the Arab region is its delicate fiscal situation. In particular, the energy subsidy system has placed considerable burdens on government revenues over the past decades. In fact, several Arab countries have already established new energy subsidy systems which are aimed at maintaining affordable energy prices against oil price fluctuation. The Survey, therefore, examines the macroeconomic implications of energy subsidy reforms system in this regard, considering the case studies of two countries in particular: Tunisia (an oil importer) and Saudi Arabia (an oil exporter).

Tunisia has carried a severe financial burden as a result of the low economic growth and higher social spending since 2011, with the consequent substantial increase in debt level. In response to this situation, Tunisia implemented a tax reform in 2016. Even so, the decrease in fiscal deficit in 2018 was still well below the targeted levels of 3 per cent of GDP. In particular, the energy subsidy still accounts for 48 per cent of public deficit in the country, which needs Government intervention to reform. In the assessment of the economic and sectoral implications of an

increase in energy prices on the effect of the energy reform conducted by the Economic and Social Commission of Western Asia (ESCWA), every 10 per cent increase in energy prices resulted in a slight 0.2 percentage point decrease in growth. On the other hand, the inflationary pressure from higher energy prices could be offset by external variables such as the appreciation of the Tunisian dinar from improvement in the trade balance.

Faced with fiscal deficit problems that are also strongly linked to oil prices, Tunisia and Saudi Arabia implemented value added taxes (VAT) in 2015 and a substantive subsidy cut in fossil fuel in early 2016. The same method of assessment showed that when the energy subsidy reform is undertaken with a fiscal consolidation objective, it has a negative impact on growth and employment creation. For example, a 10 per cent increase in energy prices led to proportionate decreases in real GDP by 0.11 percentage points. Such lack of growth in GDP is attributed to the negative impact of the rise in energy prices on households' final consumption and on firm's intermediate consumption. In Saudi Arabia's case, the higher energy prices from subsidy reforms has had no impact on its pegged

exchange rate, but has translated into a surge in price indexes, negatively pressuring purchasing power and resulting in economic consequences.

Although higher energy prices from the subsidy reform would negatively impact economic growth due to lower economic activity arising from lower demand and production, the impact would be expected to eventually improve the fiscal balance in both countries. To address such heterogeneous effects of reform on the economy, the long-term implementation strategy needs to be taken into consideration.

Indeed, if the improved fiscal balance were to be channelled towards increasing public spending in growth-enhancing sectors, it would provide inclusive growth for the economy, even if it were at the expense of higher inflation. In effect, the gradual removal of the energy price subsidy would lead to higher government revenue, lower financing needs and improvement of the country's foreign reserves, enhancing the public investment potential. Such expansionary fiscal policy enhances economic activity, outweighing the slowdown effects that arise from higher energy prices.

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Abbreviations and Explanatory Notes

AfCFTA	African Continental Free Trade Area	IPU	Inter-Parliamentary Union
BAU	business as usual	IRENA	International Renewable Energy Agency
BIS	Bank for International Settlements	LDC	least developed country
CAGR	compound annual growth rate	LIBOR	London Interbank Offered Rate
CFTC	Commodity Futures Trading Commission (United States)	LNG	liquefied natural gas
CGE	computable general equilibrium	LPG	liquefied petroleum gas
CNRPS	Caisse Nationale de Retraite et de Prévoyance Sociale	MENA	Middle East and North Africa
CNSS	Caisse Nationale de Sécurité Sociale	MMBtu	million metric British thermal units
CO₂	carbon dioxide	NEOPD	non-exported oil primary deficit
CPI	consumer price index	OECD	Organisation for Economic Co-operation and Development
DAP	diammonium phosphate	OLG	overlapping generations
DESA	Department of Economic and Social Affairs (of the United Nations)	OPEC	Organization of Petroleum Exporting Countries
ECB	European Central Bank	PAYG	pay-as-you-go
ECRA	Electricity and Co-generation Regulatory Authority	PIT	personal income tax
EIA	Energy Information Administration (United States Department of Energy)	PPP	purchasing power parity
ESCWA	Economic and Social Commission for Western Asia	QQME	quantitative and qualitative monetary easing
EU	European Union	SDGs	Sustainable Development Goals
FTSE	Financial Times Stock Exchange	TED	Treasury-Eurodollar
GCC	Gulf Cooperation Council	TFP	total factor productivity
GDP	gross domestic product	UNDP	United Nations Development Programme
GECF	Gas Exporting Countries Forum	UNFCCC	United Nations Framework Convention on Climate Change
GGI	Gender Gap Index	VAT	value added tax
GVC	global value chain	WEF	World Economic Forum
ICT	information and communication technologies	WGI	Worldwide Governance Indicators
IEA	International Energy Agency	WTO	World Trade Organization
IFA	International Fertilizer Association		
IFRS 9	International Financial Reporting Standard 9		References to dollars (\$) are to United States dollars, unless otherwise stated. For other currencies, the following abbreviations are used:
IGU	International Gas Union	CNY	Chinese yuan renminbi
ILO	International Labour Organization	€	euro
IMF	International Monetary Fund	¥	Japanese yen
INDCs	Intended Nationally Determined Contributions		

The following subregional groupings are used in this report, taking into account a combination of per capita income levels, geographical proximity and similarities in economic and social characteristics and conditions: Gulf Cooperation Council (GCC) countries: Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the

United Arab Emirates; Mashreq countries: Egypt, Iraq, Jordan, Lebanon, the State of Palestine and the Syrian Arab Republic; Maghreb countries: Algeria, Libya, Morocco and Tunisia; Arab least developed countries (LDCs): the Comoros, Djibouti, Mauritania, Somalia, the Sudan and Yemen.



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

A. Global context

Global economic growth continued at a moderate, albeit slightly decelerated, pace of 3.0 per cent in 2018 (figure 1.1A). This growth trajectory was largely attributed to the effect of the accelerated trade disputes between the United States and China. In addition, the market sentiment for investment deteriorated amid weakened international trade activities and declining business confidence, which started to worsen during the second half of 2018. Domestic macroeconomic policy challenges, closely linked to high volatility of oil prices and escalated financial stress, further complicated the global economy landscape.

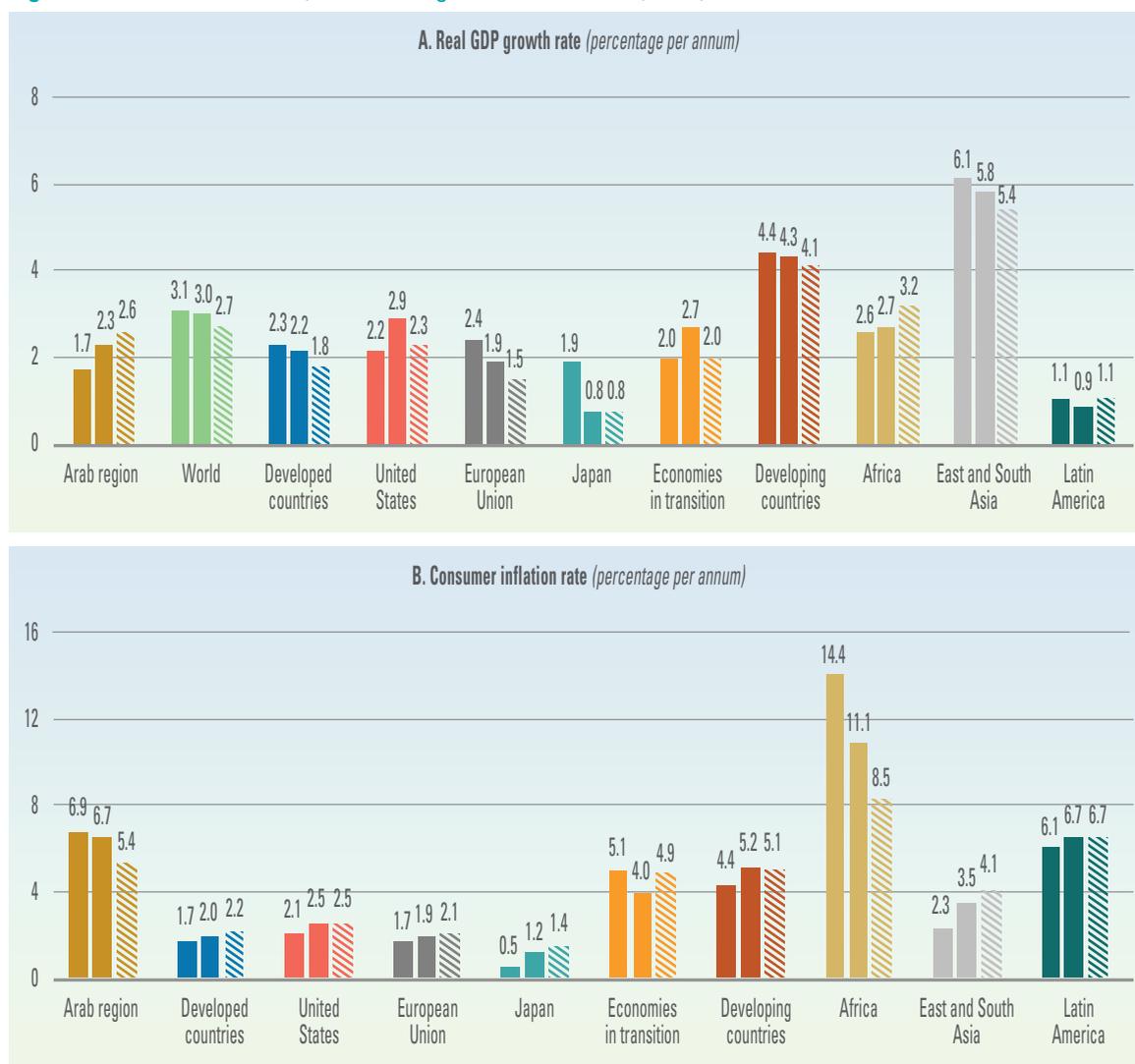
Together with such headwinds, particularly in the context of conflict-affected countries, persistent geopolitical tensions amplified and caused heterogeneous dynamics in terms of growth outcomes, which varied between regions and countries. This posed challenges in securing a multilateral, cooperative and integrated global policymaking process aimed at achieving inclusive, equitable and sustainable development. These challenges cast a cloud over the prospects for sustainable global economic activity, translating into an aggregate growth rate of 2.7 per cent in 2019.

As far as the dynamics of developed countries are concerned, the average growth rate in 2018 was registered at 2.2 per cent, a slight decline of 0.1 percentage point from the previous year. A sizeable economic expansion was observed in the United States, whose economy experienced a 2.9 per cent growth rate. This was driven by stimulus measures aimed at minimizing the negative impact of the trade dispute on its domestic economy. As the

economic boost from the stimulus measures wanes (and taking note that the United States Federal Government was temporarily shut down in late 2018), real gross domestic product (GDP) growth is, however, forecast to be 2.3 per cent in 2019 with a further 0.2 percentage point decrease anticipated in 2020.

Meanwhile, the growth rate in the European Union declined by a 0.5 percentage point over the period 2017-2018 as increased trade tensions, fears over the risks posed by a no-deal Brexit and geopolitical uncertainty posed weaker financial market sentiments across the region. Germany, in particular, was subject to substantial economic uncertainty, largely owing to weaker dynamics in private consumption and industrial production following the introduction of revised auto emission standards as well as subdued demand from foreign markets such as China. Japan also recorded sluggish growth of 0.8 per cent in 2018 relative to its growth figure in 2017, dragged down by the sharp decline in export growth and decelerated private consumption. Partly as a consequence to these conditions, growth prospects surrounding developed countries are expected to be inhibited in the years to come.

The inflation rate of developed economies showed an upward trend of around 2 per cent in 2018 (figure 1.1B). In the United States, the inflation rate rose to 2.5 per cent amid increases in the fuel prices and economic expansion. The inflationary pressure further prompted the pace of the United States Federal Reserve's tightening policy, which raised the interest rate on four separate occasions to finally reach the target rate of 2.5 per cent. The interest rate hikes triggered a sharp tightening

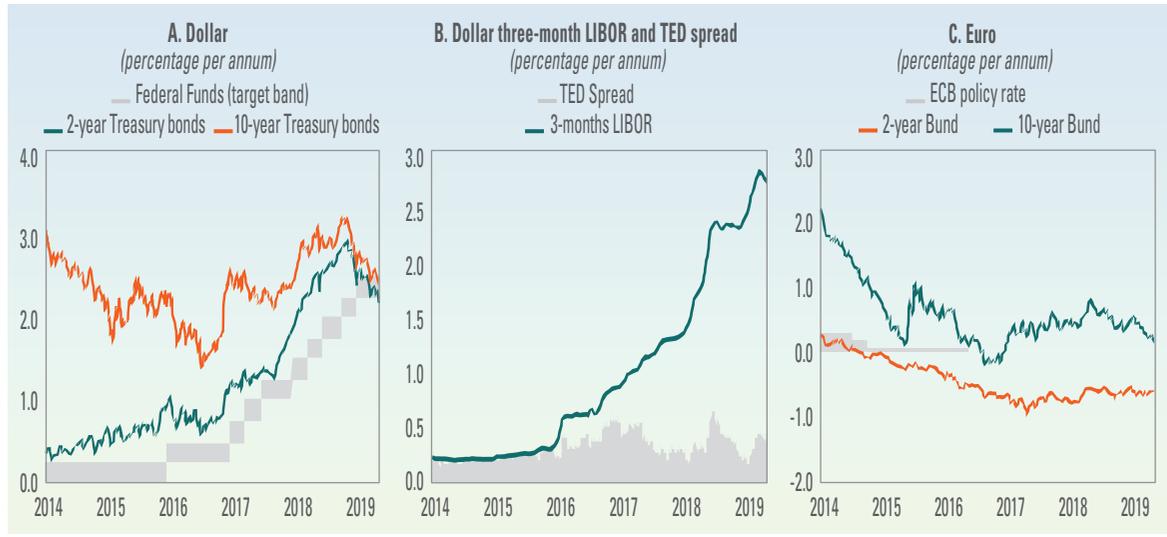
Figure 1.1 GDP and inflation, selected regions and countries, 2017, 2018 and 2019

Source: Figures for the Arab region are ESCWA staff estimations/forecasts based on national statistical sources. Others are based on the United Nations Department for Economic and Social Affairs, 2019b, 2019c.

of global liquidity conditions. In this context, market interest rates, benchmarked by a 2-year Treasury bond yield, consistently increased until early November 2018, eventually reaching 2.9 per cent (figure 1.2A). A similar trend was applied to 10-year Treasury bonds, which edged up to 3.2 per cent in the same month. Since then, both rates have dropped as the recent shift in United States monetary policy (with no further hikes expected in the coming months) likely eased the tightened financial conditions and pushed up equity valuation in early 2019.

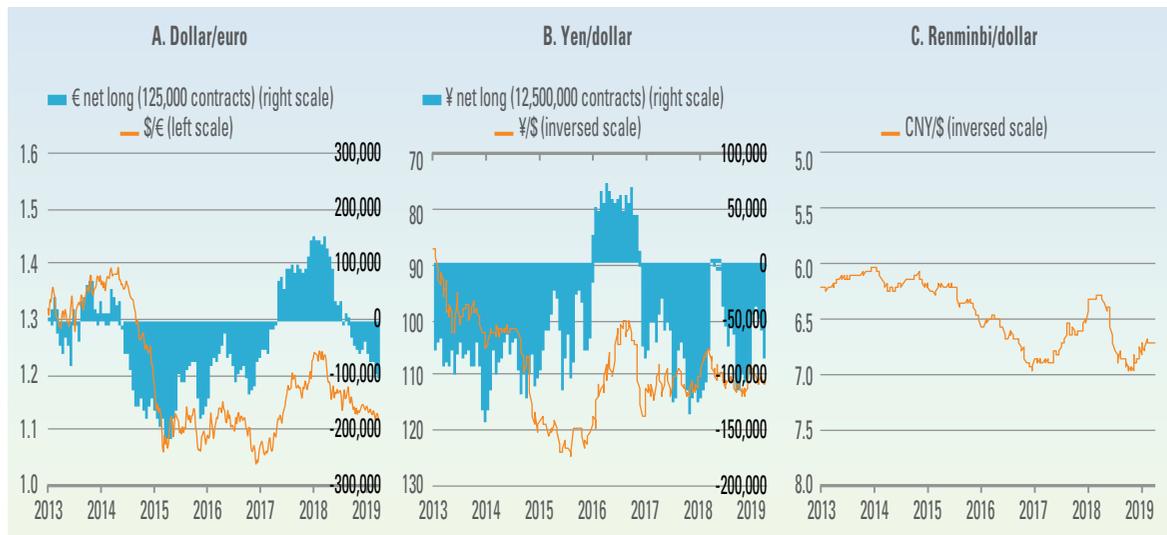
Under the tightened financial conditions in 2018, the 3-month LIBOR (London Interbank Offered Rate, a benchmark for bank-to-bank transactions) has also leapt by nearly 0.9 of a percentage point to 2.6 per cent over the period January 2018 – April 2019 (figure 1.2B). Meanwhile, highly volatile dynamics have also been observed in the Treasury-Eurodollar spread (TED) between the 3-month LIBOR and the 3-month United States Treasury Bill yield rate. This rose until May 2018, dropped until December 2018 and then rose again in early 2019.

Figure 1.2 Interest rates: dollar and euro



Source: ESCWA staff calculations based on the Board of Governors of the Federal Reserve System, 2019b, 2019c; Federal Reserve Bank of St. Louis, 2019; and Deutsche Bundesbank, 2019.

Figure 1.3 Foreign exchange rates of major currencies



Source: ESCWA staff calculations based on Board of Governors of the Federal Reserve System, 2019a; and United States Commodity Futures Trading Commission (CFTC), 2019b.

These rate movements may have also been connected with the monetary policy stance in some European countries. In late 2018, the European Central Bank ended its historic bond-buying operation that was aimed at stimulating the Eurozone’s economy. The Bank of England also raised the interest rate to 0.75 per cent in August 2018, which is expected to remain unchanged until the Brexit issue is resolved. In

tandem with these accommodative monetary policies, the German Government’s 2-year bond yield was persistently moderated from October 2018, while the German 10-year bond yield continuously dropped from 0.57 per cent in October 2018 to 0.06 per cent in April 2019 (figure 1.2C).

Affected by somewhat different monetary policy stances of the United States Federal

Reserve and the European Central Bank, the euro has constantly depreciated in relation to the dollar since April 2018 (figure 1.3A). Similarly, the Japanese yen also depreciated against the dollar during 2018, partly accompanied by a quantitative and qualitative monetary easing (QQME) policy to maintain its low short-term interest rate (figure 1.3B). The Chinese renminbi depreciated significantly against the dollar in 2018, despite a slight reverse trend observed starting in November 2018 (figure 1.3C). Such depreciation may have largely been attributed to the effect of the trade dispute with the United States, which clearly triggered capital outflows from China.

One of the most impactful factors that largely shaped the global economic landscape in 2018 (as well in 2019) was escalating trade tensions between the two largest economies in the world: the United States and China. The tariffs imposed in the second half of 2018 significantly reduced the bilateral merchandise trade by more than 15 per cent. The increased trade barrier and tariff hikes also weakened business confidence and reduced merchandise import demand in both developed and developing countries, which led to slower global trade growth in 2018. Likewise, the trade tensions partially disrupted the global financial market sentiment and further reduced investor confidence, which was reflected in a reduction of the gross fixed capital formation in the second half of 2018 in several vulnerable developing countries.

Furthermore, higher tariffs on several sectors in both economies added adverse spillovers in some developing countries. For instance, industries using steel and aluminium as capital goods, such as machinery and electronic sectors, and automobile producers in the United States looked for cheaper substitutes from other exporting countries such as Mexico (for motor vehicles) and Malaysia (for electronic integrated circuits, copper waste and scrap). The retaliated tariffs imposed on soybeans and corn exported from the United States to China reversely offered greater

opportunity to agricultural product exporters in Brazil. Nevertheless, if the trade dispute remains unresolved in the years to come, increased trade barriers will deteriorate the trickle-down gains from the global value chains (GVCs), especially in developing countries.

Recognizing such potential headwinds from the trade tensions, growth performance in developing countries was somewhat contained at 4.3 per cent in 2018. China, the principle driver of global growth, registered a growth performance of 6.6 per cent in 2018, representing a 0.2 percentage point decrease from the 2017 level. Coupled with the ongoing trade dispute, softened domestic investment primarily resulted in a downturn in the expansion of the Chinese economy, despite the regulatory stimuli. Consequently, India has now taken on the role of the world's economic powerhouse given the fact that they managed to achieve continued expansion at a growth rate of 7.2 per cent in 2018. Growth in private consumption and investment played a key role in India. The growth outcome in the Russian Federation also appeared competitive, with real GDP growth rate of 2.3 per cent in 2018, relative to 2017 figure, in part as higher fuel prices offset economic sanctions.

In the meantime, tightening financial conditions and high volatility of global commodity prices weighed on growth levels in many commodity-exporting countries. The tightened monetary policy by some major central banks caused severe currency depreciation and widened the sovereign spread,¹ for instance, in Argentina and Turkey. It triggered such countries to tighten their monetary policy to contain inflationary pressure. In Brazil, the economy experienced the same rate of growth in 2018 as in the previous year (1.1 per cent), with robust private investment offsetting the impact of fiscal reform challenges. Concerns over structural reform in Mexico deteriorated private investment and employment growth, amid widened sovereign spread in 2018. Moreover, oil-exporting countries showed a gradual

recovery, profiting from higher oil prices, except for Iran and Venezuela which were subject to severe sanctions by the United States. Iran registered an economic contraction of 1 per cent in 2018, while Venezuela experienced its worst economic crisis ever, resulting in a contraction of 15 per cent.

In terms of labour market dynamics, the unemployment rate in developed countries dropped from 5.8 per cent to 5.4 per cent over the period 2017-2018, resulting in historical lows. In the United States, the unemployment rate dropped to 3.9 per cent in 2018 as fiscal stimuli boosted the economy. Taking great benefit from structural reforms encouraging women and elderly people to work, Japan also reached its lowest level of unemployment at 2.7 per cent in 2018. The German economy, as well, experienced a favourable employment situation (declining mini jobs² and increasing minimum wages) and thus registered its unemployment rate at 3.4 per cent in 2018.

Despite the downward trend in the unemployment rate in developed countries, however, the global employment situation appears unequal across countries and various segments of the populations. The unemployment rate in some developing countries, such as Argentina, Brazil and South Africa, is expected to increase to the highest level in a decade, amid 26 per cent of the working-age population in these countries living in extreme and moderate poverty. Furthermore, improvement in global working conditions has not progressed. In 2018, about 61 per cent of 3.3 billion globally employed workers fell into the category of informal workers, who either received low wages or lacked social protection.

This type of employment, characterized by the poor quality of jobs, is one of the major socioeconomic challenges in low- and middle-income countries as more than one quarter of such paid workers are living in extreme or moderate poverty. In particular, one third of workers for the Arab region, excluding GCC

countries, are estimated to belong to extreme or moderate poverty groups.³ This may be because the legal social security coverage still remains low in the region, especially for women. The refugee crisis creates further vulnerability in an already weak social protection network and keeps workers in conditions of poverty.

B. Natural resource commodities

1. Oil

In line with the modest performance of the global economy in 2018, global oil demand reached 99.2 million barrels per day (b/d), an increase of \$1.3 million b/d from 2017. The stronger oil demand was accompanied by increased economic activities in developed countries, particularly the United States. Oil demand in the United States, the world's largest oil consumer, rose by 2.2 per cent to 20.7 million b/d in 2018. Furthermore, oil demand in developing economies (countries not in the Organisation for Economic Co-operation and Development (OECD)) surged by 2 per cent to 51.4 million b/d over the same period. Seventy per cent of this increase came from China and India whose demand grew by 0.5 million b/d and 0.2 million b/d, respectively. The recent upward trend in oil demand is anticipated to continue for 2019, reaching 100.5 million b/d.

As for the supply side, global oil supply in 2018 was recorded at 97.5 million b/d, a 2.1 per cent increase from the previous year. The world's largest consumer, the United States, has also emerged as the world's largest oil producer since 2017 and has continued to dominate growth in global supply with a total oil production of 15.5 million b/d in 2018, a 16.6 per cent increase from 2017. According to the United States' Energy Information Administration (EIA), the country's production of shale oil accounted for 59 per cent of total oil output. The shale industry has been building

Table 1.1 OPEC oil market rebalancing efforts since 2016

28 September 2016	Saudi Arabia held an informal meeting with 12 OPEC members in Algeria to discuss oil production cuts to between 32.5 million b/d and 33.0 million b/d for the first time since 2008, although oil production increased to 33.4 million b/d in September 2016.
30 November 2016	At the meeting in Austria, OPEC decided to cut the oil production to 32.5 million b/d.
10 December 2016	The Declaration of Cooperation was established by OPEC and 11 non-OPEC producers, including Russia. They decided to implement a production adjustment of 1.2 million b/d, effective 1 January 2017.
25 May 2017	Equatorial Guinea became a full member of OPEC. The second joint OPEC and non-OPEC Producing Countries' Ministerial Meeting agreed to extend the production adjustment for another nine months commencing on 1 July 2017.
30 November 2017	The third joint OPEC and non-OPEC Producing Countries' Ministerial Meeting decided to amend the Declaration of Cooperation to extend for the year of 2018 with agreed production adjustment.
22 June 2018	The Republic of the Congo became the seventh African country with full membership of OPEC.
6 December 2018	Participants at the 175th Meeting of the OPEC Conference took note of an announcement by Qatar to withdraw from OPEC in January 2019. OPEC and non-OPEC countries agreed on a production adjustment to cut oil output by 1.2 million b/d for an initial period of six months, effective January 2019.
12 February 2019	OPEC reported a sharp reduction in its oil production, mainly owing to cuts in oil production in Saudi Arabia and a decline in oil exports from Venezuela.
1 July 2019	176th Meeting of the OPEC Conference and the sixth joint OPEC and non-OPEC Producing Countries' Ministerial Meeting agreed to extend the previous voluntary production adjustments (implement a production adjustment of 1.2 million b/d) for an additional period of nine months from 1 July 2019 to 31 March 2020.

its competitiveness by continuing to improve its technical innovation and productivity, which helped the country become the swing producer in the oil market. In the coming years, the United States will continue to lead the way in global oil output growth, accounting for 70 per cent of the increase in global production capacity.⁴

Another critical factor affecting global oil supply dynamics was the Organization of Petroleum Exporting Countries (OPEC) agreement to cut oil production, which contributed to rebalancing the 2018 global oil market. A significant output reduction was observed in countries under sanctions, namely Iran and Venezuela, which registered a consolidated oil output cut in 2018 of nearly 0.3 million b/d and 0.6 million b/d, respectively. In contrast, Libya and Nigeria, countries exempted from the OPEC cut deal,

were able to raise their oil supply to around 1 million b/d and 1.7 million b/d, respectively. Likewise, Saudi Arabia increased its oil output by 0.35 million b/d to 10.3 million b/d in 2018 to partially compensate for lower Iranian supplies, despite significantly influencing the OPEC agreement to cut oil production. Overall, the outcomes of the OPEC rebalancing were somewhat restrained in 2018, with a consolidated output of 31.9 million b/d, a slight decrease of nearly 0.1 million b/d from the 2017 volume.

Reflecting the observed trade-offs in oil production between OPEC countries, a reduction of 0.3 million b/d from non-OPEC countries partly contributed to the oil market's ongoing rebalancing efforts. Mexico, for instance, reduced oil output to 2.08 million b/d from 2.23 million over the period 2017-2018,

largely owing to a natural depletion in oil fields and the delayed development of new ones.

A series of OPEC rebalancing initiatives have been discussed and this effort will continue (table 1.1). In December 2018, OPEC and non-OPEC countries agreed to cut oil production by 1.2 million b/d during the first half of 2019. However, their impact on the global oil market could be limited since the United States announced in April 2019 that sanctions waivers will no longer be granted to any importers of Iranian oil.⁵ Ending sanctions waivers to eight countries (also coupled with recent sanctions on Venezuela)⁶ will have a considerable impact on the recent decision for an oil production cut by OPEC and non-OPEC countries (table 1.1), thereby complicating the oil demand-supply equation which renders the global oil market highly uncertain at the end of 2019. Persistent political instability will further complicate the recent oil market dynamics, including the ongoing crisis in Libya, the political crisis crushing Venezuela's oil sector and the balancing of interests among major oil-exporting countries.

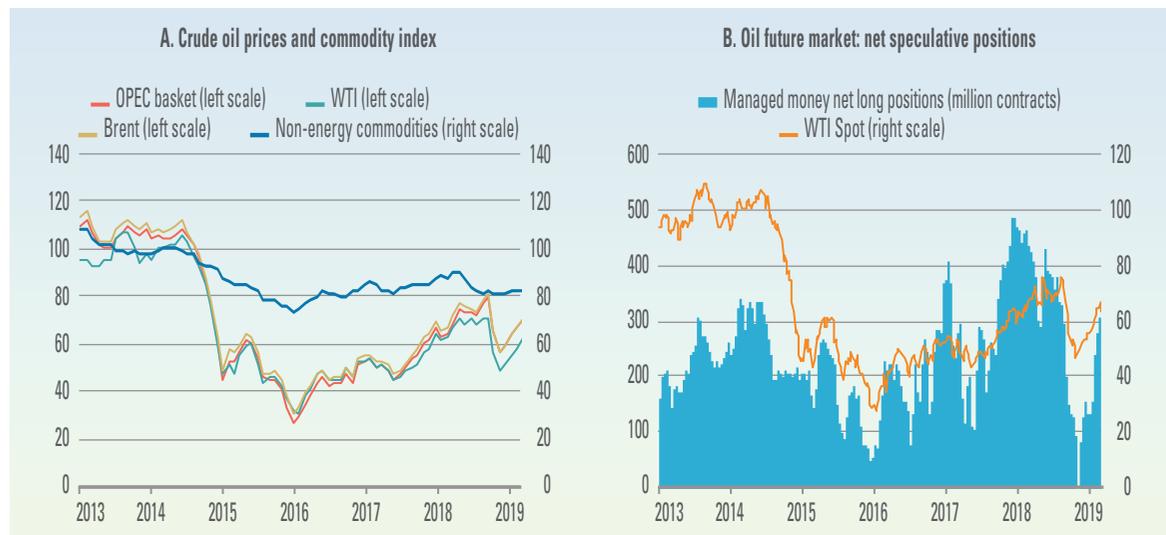
The price of oil fluctuated significantly in 2018 (figure 1.4A). For the first three quarters of

the year, the oil price increased by \$12.5 per barrel to \$79.4, largely owing to a collapse in Venezuelan oil production and unexpected outages in Canada and Libya. During the fourth quarter, it plummeted to \$56.9 per barrel, dragged down by oil supply uncertainty that was intensified by sanctions on Iran. This sizeable drop was further accompanied by a cooling down of speculative activities (figure 1.4B).

Up until May 2019, the price of oil constantly rebounded, trading at around \$74 per barrel on average. Such a price upturn can be traced to the complications of both oil supply control resulting from the 2018 December production cut deal by OPEC and non-OPEC countries and the end of Iran oil waivers. Nonetheless, the price level is anticipated to stabilize by the end of 2019, with a forecast price of \$66.2 per barrel and a further drop to \$64 per barrel is anticipated in 2020 (table 1.2). These forecast figures are firmly based on the following assumptions: the continuation of the oil market adjusting efforts by OPEC and non-OPEC countries and no radical change in American sanctions on Iran and Venezuela.

In terms of crude oil output, the Arab region produced nearly 25.1 million b/d of crude oil in

Figure 1.4 Oil prices, 2013-2019



Source: ESCWA staff calculations based on World Bank, 2019c; CFTC, 2019a; and EIA, 2019b.

Table 1.2 Crude oil price estimation and forecast (OPEC reference basket: dollars per barrel)

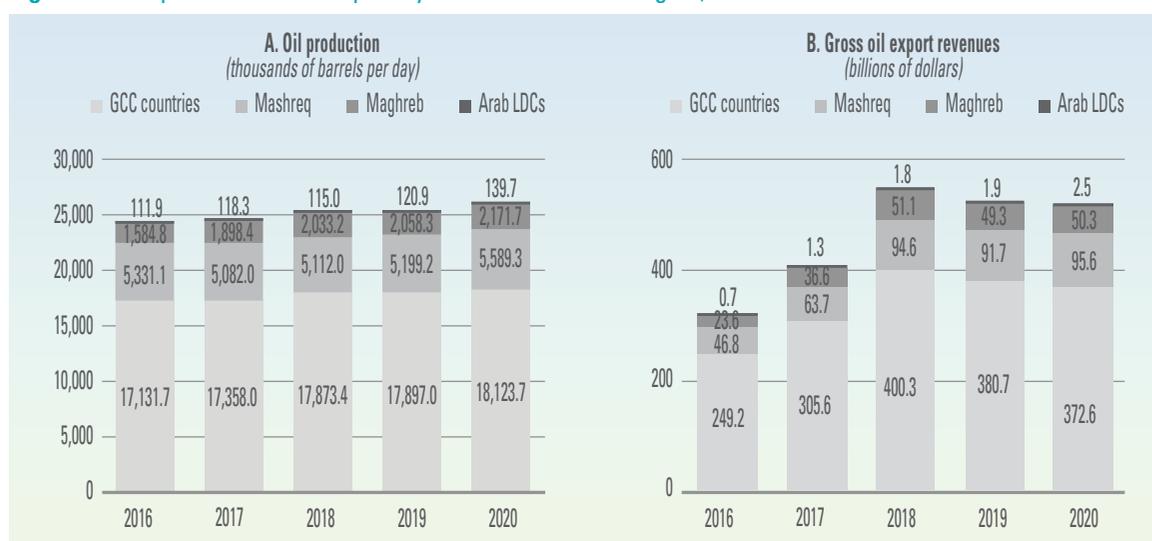
Year	Minimum	Maximum	Annual average	Forecast annual average		
				Lower	Baseline	Higher
2016	26.50	51.67	40.68			
2017	45.21	62.06	52.51			
2018	56.94	79.39	69.52			
2019				55.35	66.18	77.41
2020				49.08	64.04	79.34

Source: Figures for 2016-2018 are based on the Organization of the Petroleum Exporting Countries (2018). Figures for 2019 and 2020 are ESCWA staff forecasts (as of May 2019) where VAR model is employed with a method of least squares (Gauss-Newton/Marquardt steps), incorporating lagged year-on-year quarterly variables of OPEC reference basket, OECD consumption, non-OPEC production, non-OECD consumption and money managers net position, most of which are based on national statistical sources.

2018, a sizeable increase from the 24.5 million b/d recorded in 2017 (figure 1.5A). At the subregional level, GCC, Mashreq and Maghreb countries produced 17.9 million b/d, 5.1 million b/d and 2 million b/d, respectively, each of which can be translated into a 3 per cent, 0.6 per cent and 7.1 per cent increase, respectively, over the period 2017-2018. All four oil giants in the region, namely Saudi Arabia, the United Arab Emirates, Kuwait and Iraq raised their oil output by 3.5 per cent, 2.4 per cent, 1.4 per cent and 0.1 per cent, respectively. Libya, who was exempt from the OPEC cut deal, faced

unexpected outages in mid-June 2018, followed by skyrocketing oil production in the latter half of the year, eventually reaching nearly 1 million b/d on average in 2018. In contrast, Arab LDCs experienced a production drop of 2.7 per cent to 115,000 b/d in 2018, mainly owing to disruptions in the Sudan.

Overall, adjusting between the regional oil producing performance and the global oil price evolution throughout 2018 allowed the Arab region to achieve a substantial increase in gross oil export revenues from \$407.3 billion to \$547.8

Figure 1.5 Oil production and export dynamics in the Arab region, 2016-2020

Source: ESCWA staff estimations/forecasts based on national statistical sources; OPEC, 2019; and the Organization of Arab Petroleum Exporting Countries, n.d.

billion over the period 2017-2018 (figure 1.5B). At the subregional level, all four subregions registered increased oil export revenues in 2018: \$94.7 billion for GCC countries; \$30.9 billion for Mashreq countries; \$14.5 billion for Maghreb countries; and \$503 million for Arab LDCs. In the coming years, however, total receipts from oil export by the Arab region are forecast to slightly reduce by 4.4 per cent in 2019, followed by a further decrease of 0.5 per cent in 2020. These forecast figures are generated based on the impact of lower oil prices substantially offsetting a modest increase in oil output.

2. Natural gas and phosphate

Natural gas is another important hydrocarbon sector 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 grew: it is forecast to increase by 1.6 per cent in 2019.⁷ Such constant growth in demand for natural gas is further supported by the collective need of all countries to improve environmental sustainability in both residential and industrial sectors. Under these global market dynamics, global trade in liquefied natural gas (LNG) increased in 2018 by 3.2 billion cubic feet per day (cf/d) to 41.3 billion cf/d.

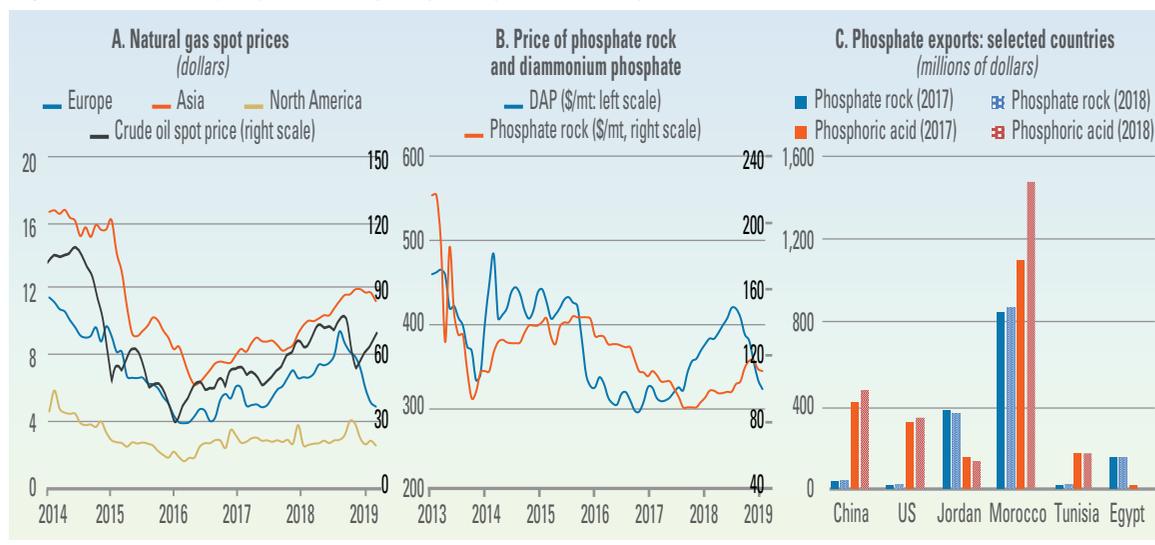
China is driving such demand and became the world's largest natural gas importer by the fourth quarter of 2018, surpassing Japan.⁸ The United States, the world's top natural gas producer, has substantially profited from improvements in shale gas technology, which accounts for more than 40 per cent of global production growth, but remains a net importer due to higher levels of domestic consumption. The benchmark price in 2018 constantly increased and peaked in November at \$8.3 per million metric British thermal units (MMBtu)

in Europe and \$4.1 MMBtu in the United States; however, since then, both started to fall as supplies from the United States to Australia flooded the market (figure 1.6A). Arab natural gas exporters should therefore focus on earning a profit from growing demand, especially in Asia, while effectively responding to short-term import diversification efforts by European consumers. This may explain the decision by Qatar to leave OPEC in line with its future energy strategy of pivoting towards natural gas.

Qatar maintained its position as the world's largest LNG exporter in 2018. According to the International Gas Union, however, it was overtaken by Australia in early 2019. The surge in Australian exports of LNG followed the start-up of a number of export projects in the country over the past three years, the most recent being the Ichthys project offshore its northern coast. In effect, Qatar made significant efforts to diversify its portfolio and seek new markets. The country especially focused on a project called North Field Expansion by investing in four LNG mega-trains in its North Field, while investing in another facility in Texas, among others. Furthermore, Qatar Petroleum, a state-run LNG company, embarked on another major LNG shipbuilding plan, with the potential to exceed 100 new LNG carriers over the next decade.

Meanwhile, Egypt, the United Arab Emirates and Jordan managed to reduce their LNG imports in 2018, thanks to their improved domestic production capacity of natural gas. Egypt has recently completed and operated natural gas development projects and is expected to become a net natural gas exporter by the end of 2019; the country made an agreement with Jordan to supply 165 million cf/d, which amount to nearly half of Jordan's daily needs.

Regarding food security challenges in the Arab region in term of food availability, the indispensability of phosphate as a macronutrient for agriculture production and productivity should be recognized. The

Figure 1.6 Natural gas prices and phosphate prices and exports

Source: ESCWA staff calculations based on World Bank, 2019c; and International Trade Centre, 2019.

region has the largest phosphate reserves in the world (Morocco accounts for nearly 70 per cent of the total reserves). According to the International Fertilizer Association (IFA), the global consumption of phosphorus nutrients for fertilizers was 45.1 million tons in 2018, up from 44.2 million tons the year before. This is expected to constantly increase by 0.8 per cent and 1.8 per cent over the next two years.⁹ In responding to the growing demand, prices for fertilizers, including phosphate-based fertilizers, increased through the first three quarters of 2018 but began to slightly decline thereafter.

To be more specific, the price of diammonium phosphate (DAP) increased by \$32 per metric tons (mt), from \$357 mt to \$389 mt over the period December 2017 – December 2018, while the price of phosphate rock also increased by \$19.1 mt during the same period (figure 1.6B). The price rise in DAP and phosphate rock was mainly as a response to the increase in global fertilizer demand throughout 2018. During the first quarter of 2019, however, the price of DAP decreased by 12 per cent, relative to the fourth quarter of 2018. This recent price decline can be traced to dynamics in China whose imports shrank due to the Government's intention to lower the use of chemical fertilizers.¹⁰

In reflecting this demand and price movement, the fertilizer industry in the Arab region has significantly invested in improved phosphate capacity, including expanding a fertilizer plant in Jorf Lasfar in Morocco, a leading exporter globally; and strengthening the production of phosphate-based products in Egypt. This improved capacity allowed more phosphoric products to be exported over the 2017-2018 period (figure 1.6C). In contrast, Tunisian phosphate production declined over the same period as a result of social tension such as a labour strike in the Ghafsam, which is a phosphate producing area.

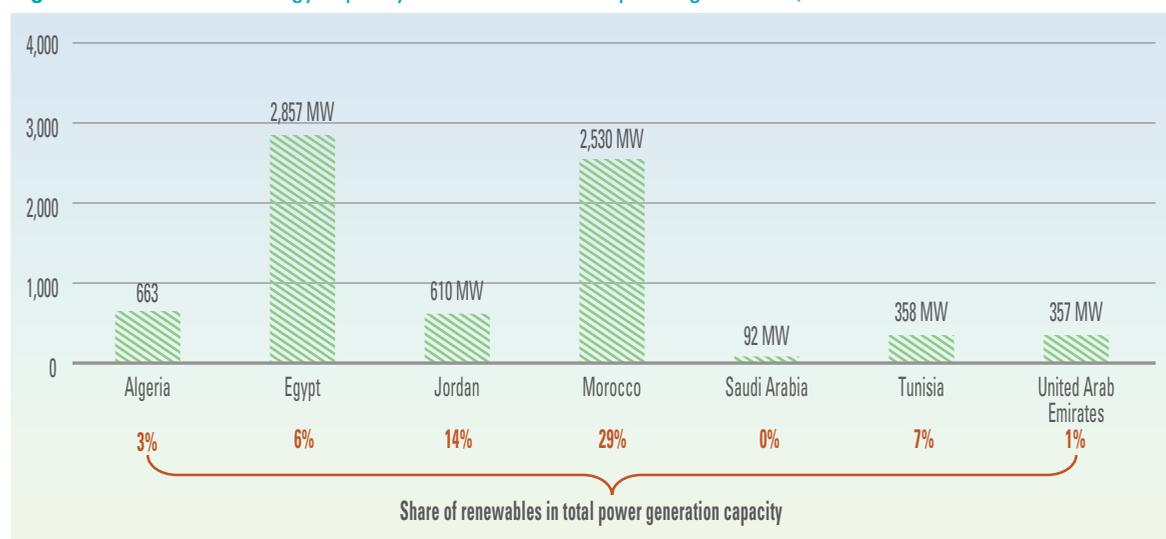
Despite the importance of natural gas and phosphate production (and arguably oil production), Arab countries should intensify efforts to diversify their economies away from commodity dependence. A high level of dependence on such commodities, both as a source of domestic energy supply and as a source of revenue for oil- and gas-producing countries leaves many parts of the Arab world vulnerable to a narrow range of energy mix. More than 95 per cent of the regional energy supply is derived from oil and natural gas, making the Arab region the most fossil fuel-dependent region in the world. The absence

of alternative energy sources, especially renewable ones, will pose one of the greatest risk factors to the process of sustainable development in the foreseeable future.

In response, many Arab countries have already initiated renewable energy-led development plans, some of which are already among the global front runners in this field. The renewable energy strategies are also consistent with regional efforts of Intended Nationally Determined Contributions (INDCs) on the Paris Agreement under the United Nations Framework Convention on Climate Change (UNFCCC). Egypt's Sustainable Energy Strategy to 2035 confirms the target stated in 2009 of 20 per cent of the country's electricity generation from renewable sources by 2022, with more recent plans for renewable energy to contribute 42 per cent of electricity generation by 2025. Jordan is also seeing rapid growth in renewable energy deployment. Endowed with some of the Arab region's best solar as well as excellent wind resources, the Jordanian government launched its new National Green Growth Plan in early 2018, earmarking renewable energy as a key sector in driving sustainable growth and reigniting the country's stagnated economy.

Notwithstanding recent efforts to increase the deployment of renewable energy, the region's global share of renewable energy generation capacity is exceptionally low (1 per cent), according to the International Renewable Energy Agency (IRENA), in comparison to 2 per cent in Africa, 10 per cent in Latin America and the Caribbean, 16 per cent in North America, 26 per cent in Europe and 45 per cent in Asia and the Pacific region. In an individual country context, Arab countries' renewable energy (including hydropower, wind, solar photovoltaic, concentrating solar power and others) accounts for a very low share in their total power generation (figure 1.7). Relative to other countries in the region, Saudi Arabia and the United Arab Emirates produce the least renewable energy, each estimated at producing less than 1 per cent of their total power generation. On the other hand, Morocco's recent effort to invest in utility-size solar and wind projects has been remarkable and now the country hosts Africa's single largest windfarm as well as one of the world's largest concentrating solar power plants. Ultimately, Morocco's share of renewable energy in its total power generation reached nearly 30 per cent in 2017 and will be over 40 per cent by the end of 2020 based on its strategic plan on energy mix.

Figure 1.7 Renewable energy capacity and its share in total power generation, 2017



Source: E/ESCWA/SDPD/2019/1.

C. Financial and trade linkages to the Arab region

Benefitting from the increase in average oil prices, the regional financial sector improved in 2018, especially in GCC countries. In parallel to the rise in oil export revenues, the GCC countries' broad money stock gained growth momentum (figure 1.8A; see chapter 2 for more details). The improved domestic demand conditions further contributed to boosting non-oil activity, coupled to some extent with strengthened private sector development. Consequently, the value of financial wealth in GCC countries, measured by market capitalization, rose substantially by \$87.6 billion in 2018, the highest recorded increase over the past several years. The two biggest contributors to capital accumulation was the Saudi Stock Market and the Doha Securities Market whose value of capitalization surged in 2018 by nearly \$55.9 billion and \$48.4 billion, respectively. It is particularly worthwhile to recognize that the Doha Securities Market substantially recovered from the capital flight of \$24 billion registered in 2017, which was seriously affected by the boycott imposed on Qatar by other Gulf States.

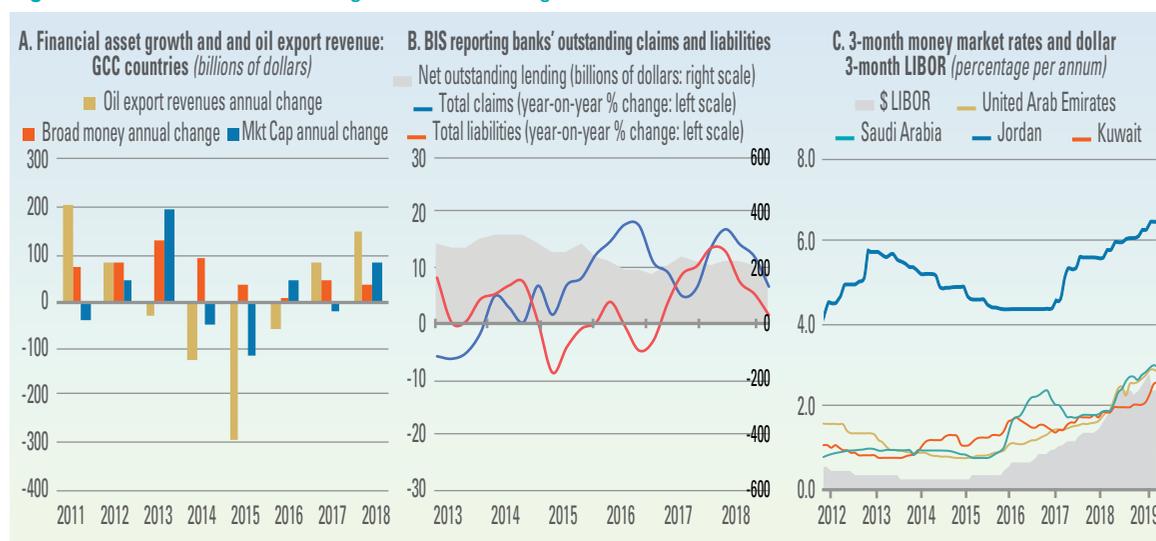
Meanwhile, the external financial wealth of Arab countries can be explained by an evolution of both the total cross-border claims and the total cross-border liabilities based on data from the Bank for International Settlements (BIS) (figure 1.8B). Over the period 2017-2018, total liabilities (Arab clients' deposits with main international banks) increased by only 2 per cent, while total claims (borrowings by Arab clients from main international banks) increased by 6.6 per cent. The Arab region as a whole remained a net lender, with \$190 billion in loans to the main international banks as of December 2018. In 2018, Saudi Arabia (\$126.1 billion) and Kuwait (\$81.6 billion) were the largest net lenders, whereas Qatar (\$55.5 billion) and Egypt (\$11 billion) were the biggest net borrowers.

With their close association with the international capital market, the region has faced constantly

increasing financing costs since 2016. Measured by three-month money market rates, overall rates in the region rose in parallel with the rise of the United States dollar three-month LIBOR (figure 1.8C). Largely affected by American monetary policy tightening, most banks (particularly those in GCC countries) repriced loans and thus their net interest income increased. In addition, lending activity generally picked up on the back of higher government expenditure. Such lending performance may have resulted in higher profitability for these banks, despite sudden stress on the implementation of International Financial Reporting Standard 9 (IFRS 9) that came into force in January 2018.

Notwithstanding the improved financial performance (and the banking sector's liquidity), some downside risks remain critical. Many Qatari banks still struggle with the negative repercussions from the previous years' diplomatic embargo. Some other banks in the region continue to manage potential risks posed by their global operations exposed to Turkey.¹¹ Higher loan loss provision charges may restrain banking profitability in Bahrain, despite financial aid of nearly \$10 billion from Gulf neighbours. In particular, bank consolidation and mergers among banks in the region would help consolidate the overcrowded banking systems to improve their profitability and funding capacity, but this would not be an easy task, mainly because substantial ownership of major banks belongs to the governments, making merger talks even more complicated than usual.

International trade is another essential channel to be analysed. The Arab region has generally been a net exporter over the past years, except in 2015 and 2016, when the region suffered from a sharp drop in oil prices (figure 1.9A). In 2018, trade in the Arab region recorded total exports of more than \$1 trillion and imports of \$794 billion, with exports exceeding imports by \$223 billion. This radical increase of exports in 2018 was largely equated with sensible demand (an increase of 32.7 per cent) from Asia and the Pacific region. These recent trade dynamics allowed the region to escape

Figure 1.8 Global financial linkages in the Arab region

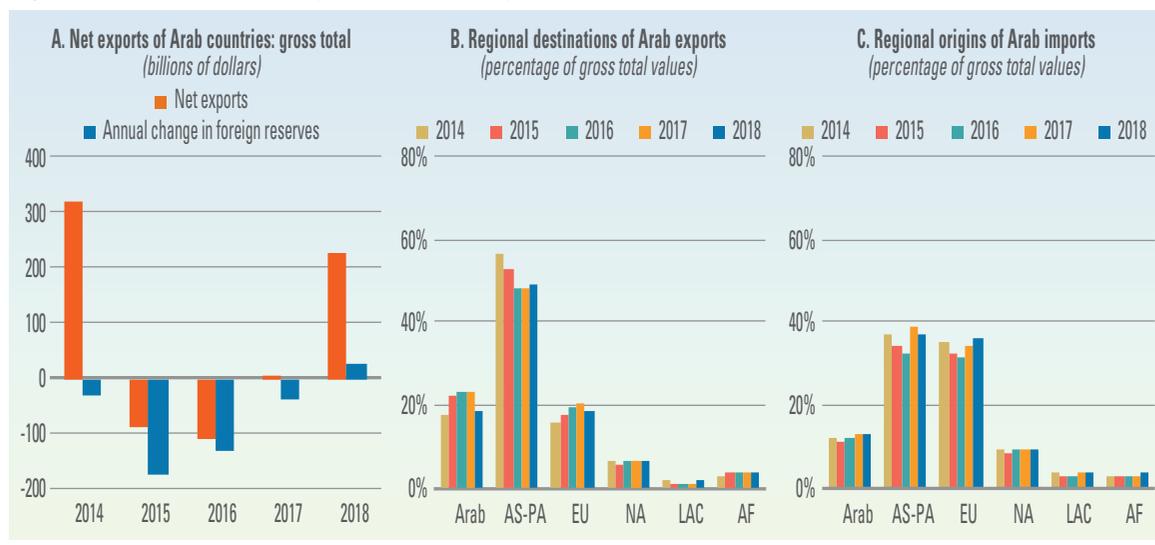
Source: ESCWA staff calculations based on national statistical sources; Arab Monetary Fund, n.d.; and the Bank for International Settlements, n.d.

from persistent outflows in foreign reserves, which resulted in an additional accumulation of \$26.5 billion to reach more than \$1 trillion by the end of 2018. Nonetheless, there is still a long way to go for the Arab region to recover to the level in 2015-2016, prior to the drop in oil prices.

Against this backdrop, the Arab region continued to strengthen its export ties with Asia and the Pacific region (figure 1.9B). In terms of gross total, nearly 50 per cent of goods exported by the region were destined for Asia and the Pacific region in 2018. This indicates that Asia and the Pacific region is the major importer for energy-related products from the Arab region. In contrast, the share of exports to Europe decreased from 22.6 per cent to 18.3 per cent over the period 2017-2018, in part owing to somewhat sluggish economic activities and associated lower demand from some European countries. In terms of the geographical patterns of Arab country imports, the general trend remains consistent with the exporting dynamics but relatively minimal with no substantial changes in 2018 (figure 1.9C). Asia and the Pacific region and Europe have continued to play a significant role by dominating the export products to the Arab region, with a share of 37 per cent and 35.5 per cent, respectively.

Intraregional trade in 2018 made up an 18.3 per cent share of total gross exports, a decrease from 22.6 per cent the previous year, while the share of imports within the region remained unchanged, with 13.1 per cent throughout 2017 and 2018. However, this lower share in intraregional exports does not necessarily mean poor performance in intraregional exports given the fact that the value of intraregional exports indeed increased by \$10.1 billion in 2018. Rather, it was mainly because of the substantially increased base total (denominator) from \$780 billion in 2017 to more than \$1 trillion in 2018. A continuously broadening share in intraregional trade over the past three years (\$157 billion in 2016, \$176 billion in 2017 and \$186 billion in 2018) has been accompanied by efforts to introduce a series of trade integration mechanisms, including the Grain and Feed Trade Association, the Arab-Mediterranean Free Trade Area, and the GCC Customs Union, among others.

Notably, the potential impact of the recent trade tensions between the United States and China should not be underestimated in the Arab context. In effect, the direct exposure of Arab economies to the United States is not as high as some people may think, although many are somewhat tightly interconnected to Europe and

Figure 1.9 Global trade linkages in the Arab region

Abbreviations: Arab, Arab countries; AS-PA, Asia and the Pacific; EU, Europe; NA, North America; LAC, Latin America and the Caribbean; AF, Africa excluding Arab countries.

Source: ESCWA staff calculations based on IMF, 2018b, 2019b.

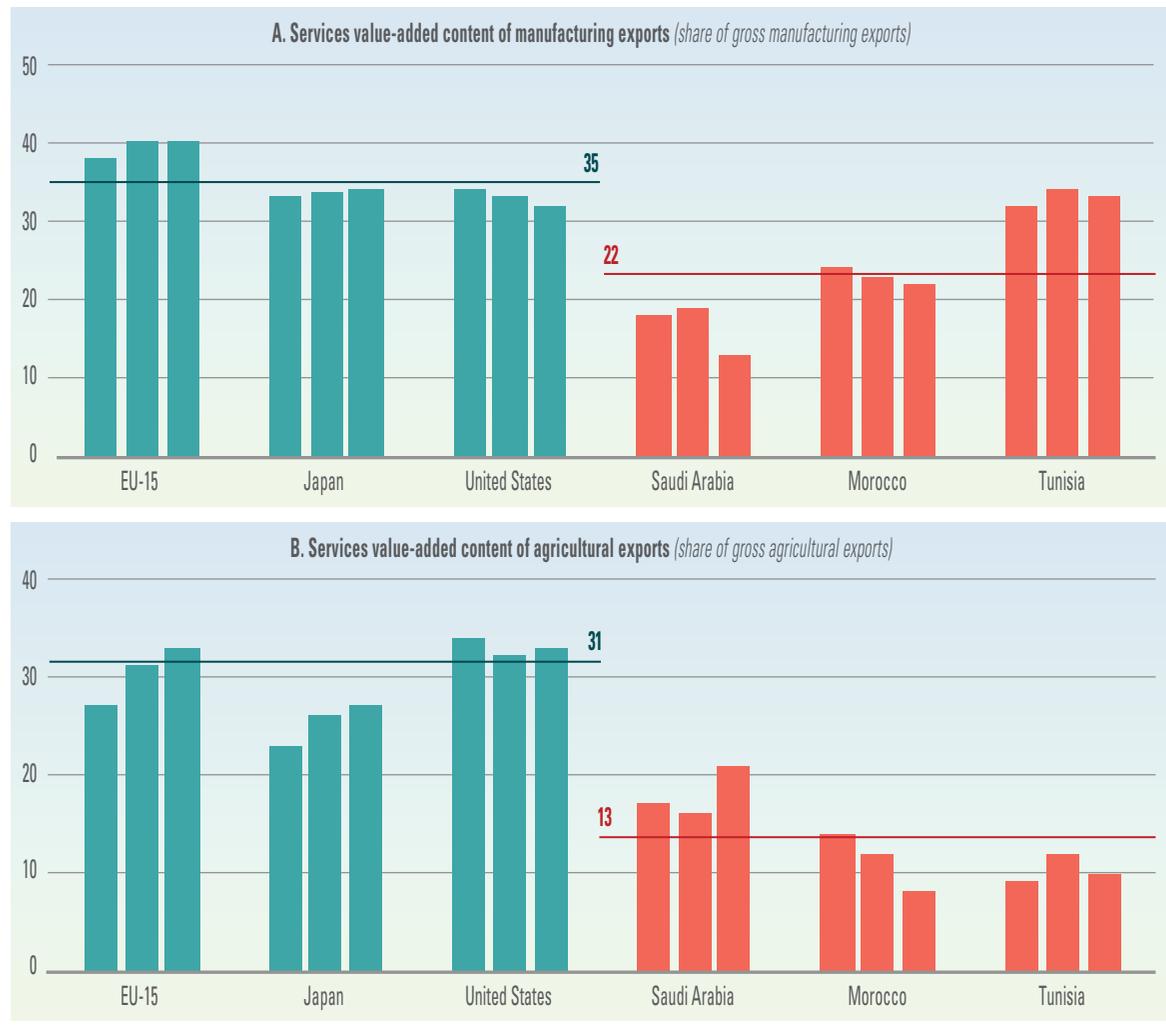
China. For instance, in Bahrain, the export of aluminium to the United States constitutes only about 5 per cent of the country's total export of aluminium and Bahrain's aluminium could possibly be exempted from tariffs. The export of cars and associated parts accounts for nearly 15 per cent of Morocco's total export volume, most of which are destined for European countries.

The impact by trade tensions and a slowdown in demand from China and some European countries would be of concern for several countries in the region, including Mauritania (lower demand in minerals and fish) and Tunisia (electronics, food and textiles). Meanwhile, the region's oil exporters, particularly GCC countries, would also be exposed to falling industrial activities and lowering demand for oil from China as a result of the trade war. Not just oil itself but global commodity prices are expected to highly fluctuate as China's share of the world's commodity consumption stays very high. Such commodity market-led volatility could dampen investor confidence and tighten the financing conditions for many Arab countries. An escalation of trade tensions could therefore negatively impact the Arab region, especially in the longer term.

Under this potential risk of escalating trade disputes, the crucial role of the services trade among Arab economies needs to be taken into account. Services could not only satisfy domestic consumption and investment demands but could also be exported and used as intermediate inputs. Therefore, services generally account for increasing shares of value-added exports and are a key determinant of the extent and nature of engagement in the global value chain.

Despite the importance of the services trade, Arab countries underperformed in terms of the utilization of services value added for their exporting performance relative to other developed economies (figure 1.10). In general, developed economies have more utilized services value-added activities to boost their manufacturing exports than Arab economies: on average, about a 35 per cent share for selected developed economies, compared to 22 per cent for selected Arab economies, with available data. The estimated figures on the services value-added content of gross agricultural output implies even more serious challenges for Arab countries. On average, this accounts for about a 31 per cent share for selected developed

Figure 1.10 Services value-added content of gross exports, selected developed countries and Arab countries, 2000, 2005 and 2011



Source: E/ESCWA/EDID/2017/6.

economies, compared to 13 per cent for selected Arab economies with available data. In this regard, Arab countries have great room for improvement, while noting that a diversified and competitive services sector is not only important in itself but also for the productive efficiency of other sectors that can create more jobs and help reduce extreme poverty in the region.

The fact that many parts of the Arab region could benefit from promoting financial services trade for their economic transformation process should not be underestimated. For instance, Jordan has recently reduced their financial

services restrictiveness during the years 2013-2016, while in recent years GCC countries have been competing to be the financial services centre of the region, for example, in financial technology (fintech).¹²

D. Concluding remarks

Under the moderate pace of global economic growth, there have been a number of critical factors that have noticeably influenced Arab economies. Higher oil prices (mostly in 2018)

Box 1.1 Potential contributions of digital technologies and ICTs for achieving SDGs



	No poverty	By making communications more affordable, digital technologies help multiply development opportunities for the poor. The deployment of broadband can have a positive effect on GDP growth, thereby creating new markets and contributing to job creation and poverty eradication.	
	Zero hunger	Green ICT and biotechnology can improve agricultural efficiency by providing farmers with the latest information on water consumption, irrigation efficiency, safe fertilizers, weather forecasts, planting and harvesting technics, as well as market situation and prospects.	
	Good health and well-being for people	Digital technologies enable health workers to be connected to information and diagnostic services, while analytics can help make projections about disease outbreaks, health service usage, patient knowledge, attitudes, personal continuous management of diseases and health practices.	
	Quality education	ICT opens the way to e-learning, the dissemination of Arabic content and the provision of high-quality digital content thus making education more accessible to all people, including people with disabilities and children in vulnerable situations, and leading to better educational performance.	
	Gender equality	Access to ICT can enhance gender equality and women's empowerment, allowing women and girls access to education as well as information and technologies of importance to their economic productivity, reproductive health and rights, social well-being and decision-making.	
	Clean water and sanitation	Digital technologies will be crucial in ensuring the availability and smart sustainable management of water and sanitation for all. This is particularly important for infrastructure location, better and lower-cost maintenance, optimized operations and improved quality of service to customers.	
	Affordable and clean energy	Digital solutions such as smart grids, smart buildings and homes and smart logistics allow other sectors of the economy to improve their energy efficiency and lower its consumption. Harnessing renewable energy sources also depends on the use of new technologies and innovation.	
	Decent work and economic growth	Digital technologies can aid educated young people in identifying economic opportunities; Technology and ICT offers great opportunities for entrepreneurship and the creation of start-ups, and helps to attract investment, thus offering new ways of work, enhancing employment opportunities for all people.	
	Industry, innovation, and infrastructure	ICT benefits this goal in the emerging information and knowledge societies, which depend on open access to academic research, transparency to make informed decisions and the power of online collaboration to support cross sector and in-house co-creation, learning and work.	
	Reducing inequalities	Digital technologies can help reduce inequality within and between countries, especially when used to help deliver information and knowledge, and therefore, social and economic progress to disadvantaged segments of society, including those living with disabilities, women and girls.	
	Sustainable cities and communities	Smart cities will make it possible to harness various digital technologies for the collection and analysis of data and assessment of priorities, the identification of potential challenges and adoption of the necessary measures to overcome them.	



	Consumption and production	Digital technologies can foster sustainable consumption and production through product-specific improvements and the implementation of smart technologies in sectors such as agriculture, transport, energy, supply chain management, and smart buildings.	
	Climate action	Smart applications in urbanization in general, can help tackle climate change and mitigate its impacts. ICT can optimize value chains and reduce resource usage and waste. It plays a crucial role in sharing climate information, forecasting and early warning systems.	
	Life below water	Digital technologies can assist in oceanic conservation and sustainability. Satellite monitoring delivers timely and accurate global data, while big data can be used to analyze biodiversity, pollution, weather patterns and ecosystem evolution, and to help plan mitigation strategies.	
	Life on land	Digital technologies can help in the conservation and sustainable use of terrestrial ecosystems and preventing biodiversity loss through improved monitoring and reporting, as well as through the use of big data to analyze short- and long-term trends and plan mitigation activities.	
	Peace, justice and strong institutions	Within crisis management, humanitarian aid and peacebuilding, digital technologies have proved a powerful tool in areas such as electoral monitoring, using crowdsourcing. Government use of open data increases transparency, empowers citizens and helps to drive economic growth.	
	Partnerships for the goals	The private sector, working with and under the guidance of the public sector, can enlarge ICT markets, especially in broadband and mobile communications, thereby making the most of this technology for development. Technology can play an enabling role in support of the implementation of all the SDGs.	

were beneficial for oil exporters, especially GCC countries, while at the same time crucially burdening some oil-importing economies in the region. The oil market dynamics thus continue to be a driving factor that characterizes the regional outlook, albeit to varying degrees between subregions and countries. The prospects for the Arab region are further clouded by elevated levels of uncertainty, arising from escalating global trade disputes and geopolitical tensions. Such uncertain factors will likely impact regional economic activities via supply chain disruptions and sluggish investment dynamics. All of this means that Arab policymakers face daunting challenges to resume economic diversification and fiscal consolidation in a sustainable way (see chapter 2).

Nonetheless, greater development potential for the region should be recognized, especially

with the use of digital technologies and innovation. In fact, many Arab countries have already started to heavily invest in digitalization sectors. Leveraging the region's energy potential and taking advantage of technological innovation will be critical to promoting added value, industrial growth and employment. Moreover, the inclusiveness of such growth can be enhanced through measures to promote digital technology-based financial inclusion by facilitating access to financial services for unbanked and underserved social groups. The Arab region, with its 400 million inhabitants, including many educated young people, natural resources and a privileged geographical position, has a strong chance of becoming a digital economic powerhouse with technologies aimed at accelerating the process of sustainable development (box 1.1).



2. Socioeconomic Trends and Developments in the Arab Region

A. Economic situation and prospects

1. Overview

Against a backdrop of the global development landscape, the Arab region experienced an economic recovery with a growth rate of 2.3 per cent in 2018, up from 1.7 per cent the year before (figure 2.1A). This recovery was largely attributed to hydrocarbon sector-led growth in the region's oil-exporting countries, as oil prices continued to consistently increase through the first three quarters of 2018. Oil exporters, particularly GCC countries, witnessed a sizeable increase in oil export revenues.

In contrast, the countries characterized by a significant dependence on oil imports remained highly vulnerable to rises in global fuel prices. In the end, their current account deficits further worsened, and their public debt increased thus limiting their space for policy. In response to these market volatilities, a series of policy reforms and fiscal adjustment initiatives have been made, including raising value added tax (VAT) rates, eliminating tax exemptions, improving tax administration and rationalizing customs duties. The economies of oil-importing countries expanded partially in this regard.

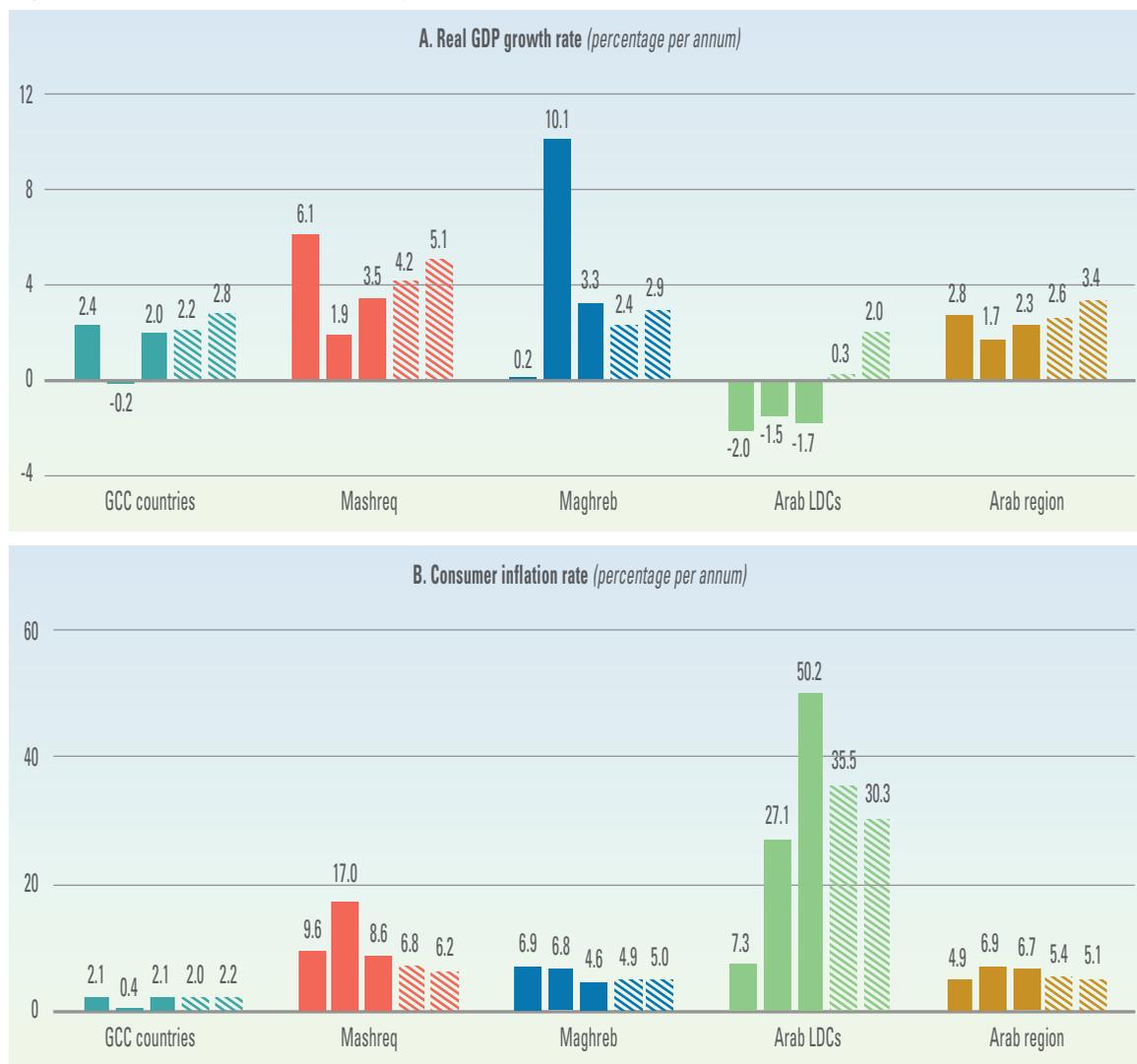
Nonetheless, geopolitical tensions and high levels of public debt weigh heavy on their mid-term perspectives in the region as a whole. These negative factors further amplify politically driven economic challenges, especially in fragile economies which suffer from ongoing refugee crises, shaky investor confidence, weak private sector development and external trade headwinds (associated with recent global trade tensions).

Reflecting all these issues, real GDP growth in the Arab region is expected to continue at a modest pace of 2.6 per cent in 2019 and to increase further to 3.4 per cent for 2020. It should, however, be noted that these forecast figures are subject to future revision, as official national accounts have been unavailable for some conflict-affected countries for several years. With this in mind, estimating the economic cost of social conflict in those countries is difficult (box 2.1).

Under these diversified trajectories of regional growth, the average annual consumer price inflation for 2018 was 6.7 per cent, slightly down from 6.9 per cent in the previous year (figure 2.1B). These estimations may not, however, accurately reflect the comprehensive regional price dynamics, as inflation trends vary significantly by subregion and country.

For instance, inflationary pressures in GCC countries appeared strong in 2018, especially in Saudi Arabia, whose inflation rate was 2.5 per cent in 2018, following a deflation of 0.9 per cent in 2017. This upward trend was partly associated with the recent implementation of a GCC-wide VAT, which might have had knock-on effects on household spending power. Meanwhile, inflation in conflict-affected countries continued to suffer from hyperinflation, even though the Syrian Arab Republic experienced a substantial drop of 13.8 percentage points over the same period.

More heterogeneity in Mashreq countries was observed than in the other subregions. Tax reforms and rising energy prices resulted in higher prices in Jordan and Lebanon, making it hard for them to reduce public debt and putting increasing pressure on the banking

Figure 2.1 GDP and inflation, Arab region, 2016, 2017, 2018, 2019 and 2020

Source: ESCWA staff estimations/forecasts based on national statistical sources; DESA, 2019a, 2019b, 2019c; and ESCWA, n.d., 2019e.

system. Egypt, on the other hand, faced strong inflationary pressures, although they were somewhat contained. The Egyptian situation reflected the effects of the pass-through of the exchange rate and import prices to domestic inflation that was accompanied by fuel subsidy cuts (see chapter 3).

Dragged down by the effect of somewhat lower global commodity prices in 2019, inflationary pressures for the Arab region are expected to ease towards the end of the year, with a forecast of 5.4 per cent.

In particular, the recently adopted 2030 Agenda for Sustainable Development reinforced all responsible and accountable governments and other actors to integrate economic, social and environmental aspects and to recognize their interlinkages, so as to achieve full sustainable development. In so doing, several Arab countries are in the process of aligning their national development plans and strategies with the SDGs. At the 2019 Arab Forum for Sustainable Development (AFSD), the three main areas of development were broadly discussed as follows:

Box 2.1 Six distinctive trends of Arab social statistics to consider for policymaking

The social development landscape can never be isolated from consideration in macroeconomic policymaking. The graphic below draws on some distinctive trends through a statistical interpretation of Arab social statistics. The volume of statistical data used in this narrative is extensive and has been collected primarily from the national statistical offices. Exploring the social statistics allows a full picture understanding of social transformation nexus and the mainstreaming of the distinctive trends facts into regional and national macroeconomic policy frameworks, making them more inclusive and equitable. Below, six areas of social dynamics are selected and explained based on the importance of macroeconomic policy relevance.

Six areas Distinctive trends of Arab social dynamics

Arab social statistics	1	The population continues to grow rapidly, with a growth rate of 2.1 per cent over the recent years. Meanwhile, the population is young overall, partly in line with higher fertility rates relative to other regions. Improvements in the health and longevity of the population are also important to note. Life expectancy at birth ranges from 62/64 years (for men and women, respectively) in Yemen to 77/81 years in Qatar. In particular, the number of international migrants has more than doubled since 1998. The region also has the largest number of refugees and displaced populations worldwide, with three countries (Jordan, Lebanon and the State of Palestine) hosting over 1 million refugees each.
	Population dynamics	
	2	Most countries have moved away from the tradition of extended family households and increasingly show a nuclear household structure. The average household size ranges from a high of around seven persons in Oman and Yemen to around four persons in Lebanon and Tunisia. Female household headship is generally low. Meanwhile, the number of registered marriages and divorces has surged in recent years. The mean age at first marriage has increased for both men and women, although in some countries it is still common that girls are married as children.
	Household composition and family formation	
	3	Overall, more than 60 per cent of all households own the homes they live in, except in GCC countries. The low home ownership in GCC countries is attributable to the high number of non-nationals living there. Moreover, apartments are the more prevalent form of housing in urban areas, while freestanding houses and villas are more prevalent in rural areas. More than 90 per cent of households have improved sanitation facilities and electricity. The exceptions are Mauritania, the Sudan and Yemen, where improved sanitation facilities and electricity are particularly rare in rural areas.
	Housing conditions	
4	Reproductive and maternal health have improved significantly, but disparities persist. Most pregnant women receive at least one antenatal visit, and most births are attended by a skilled health professional and delivered in health facilities. However, maternal mortality ratios are still very high in some Arab LDCs. Childhood immunization coverage is high in most countries as a substantially large share of children received the five main vaccinations. However, adult obesity is common, particularly among women. The most prevalent causes of death in all countries are diseases of the circulatory system, followed by neoplasms and diseases of the respiratory system.	
Health		
5	The region has experienced a dramatic expansion of education in recent decades. In most GCC countries, 99 per cent of young people are literate, while the lowest youth literacy rate is reported in Mauritania (70 per cent). Enrolment in primary schools is generally high and in some countries the gender gap in the net enrolment ratio has significantly narrowed in recent years (for example in Iraq and the Sudan). Enrolment in secondary education is lower than in primary education. Meanwhile, wide variations are observed between countries in the pupil-teacher ratios at all levels.	
Education		
6	The overwhelming majority of adults practice a religion. Lebanon reported the lowest proportion: roughly 80 per cent. Women tend to be more religious than men; in Tunisia, the difference between the sexes is 20 percentage points. Trust in other people is low in the region. Yemen reported the highest levels of trust, at about 40 per cent. Membership in civic organizations is low for almost all countries. Less than 20 per cent of the population are active members of sports or recreational organizations, and in most countries that number is less than 10 per cent for women. Internet usage has increased over the past decade, in particular in GCC countries.	
Culture and social participation		

Note: This box draws on E/ESCWA/SD/2017/5.

- First, take stock of global and regional progress on the 2030 Agenda and include reviews of specific SDGs, namely, SDG 4, SDG 8, SDG 10, SDG 13, SDG 16 and SDG 17;
- Second, focus on unpacking each of empowering people, ensuring inclusiveness and equality for accelerating the process of sustainable development through exploring policy interlinkages, policy coherence, mechanisms, and lessons learned;
- Third, highlight the importance of national, regional and global follow-up and review processes, especially voluntary national reviews and messages to the High-level Political Forum (HLPF) 2019 at United Nations Economic and Social Council (ECOSOC) and General Assembly levels.

2. Gulf Cooperation Council countries

Mainly supported by higher oil prices,¹³ coupled with a 3 per cent increase in oil production, GCC countries significantly recovered their pace of economic growth in 2018, reaching 2 per cent, following a 0.2 per cent contraction the year before (figure 2.2A).

In Saudi Arabia, the largest economy of the GCC group, economic expansion was primarily driven by booming oil sector activity. Furthermore, non-oil sector activity was also solid and contributed to the momentum of the recovery. Although a decline (-0.7 per cent) in Saudi Arabia's crude oil output is anticipated in 2019, its recently renewed commitment to improve its natural gas processing capacity will likely support positive growth in the years to come. The regional economic upturn took advantage of boosts in non-oil activity, in line with planned public investment projects such as the football World Cup in Qatar in 2022 and the World Expo in 2020 in the United Arab Emirates.

Meanwhile, a substantial increase in oil export revenues improved external balances and

resumed the accumulation of foreign exchange reserves in the subregion. Such favourable circumstances were further aided by the recent issuance by GCC countries of around \$30 billion in sovereign debt and their more active involvement in global financial markets, such as the inclusion of Saudi Arabia in the Morgan Stanley Capital International (MSCI) Emerging Markets Index.¹⁴

Consequently, the current growth trajectory is anticipated to continue in 2019, with real GDP growth expected to be 2.2 per cent. The economies of Bahrain, Kuwait, Qatar and the United Arab Emirates are forecast to expand in 2019 at 2.3 per cent, 2 per cent, 2.9 per cent and 2.7 per cent, respectively. On the other hand, growth performance in Oman and Saudi Arabia will remain subdued relative to 2018, at 1.2 per cent and 1.8 per cent, respectively, before rebounding substantially to 4.2 per cent and 2.3 per cent in 2020.

These forecast figures are indeed largely based on several assumptions including: the current public investment projects will continue; the expected moderate impact of oil prices on investment confidence will manifest itself towards the end of 2019; and some visible payoff from recent fiscal reforms will be integrated into economic activities and translated to provide fiscal space.

In the longer term, however, a potential downside risk cannot be ruled out as efforts towards the above-mentioned structural reforms may be delayed. This is in part because such a series of fiscal adjustments may not be regarded as urgent, especially should future oil market movements provide fiscal buffers. That said, in Saudi Arabia, the National Transformation Programme 2020 and Vision 2030 emphasized the essence of economic diversification initiatives so as to move away from the high dependence on oil activities. Furthermore, the country has also been looking to diversify revenue sources within the energy sectors (such as into refineries producing

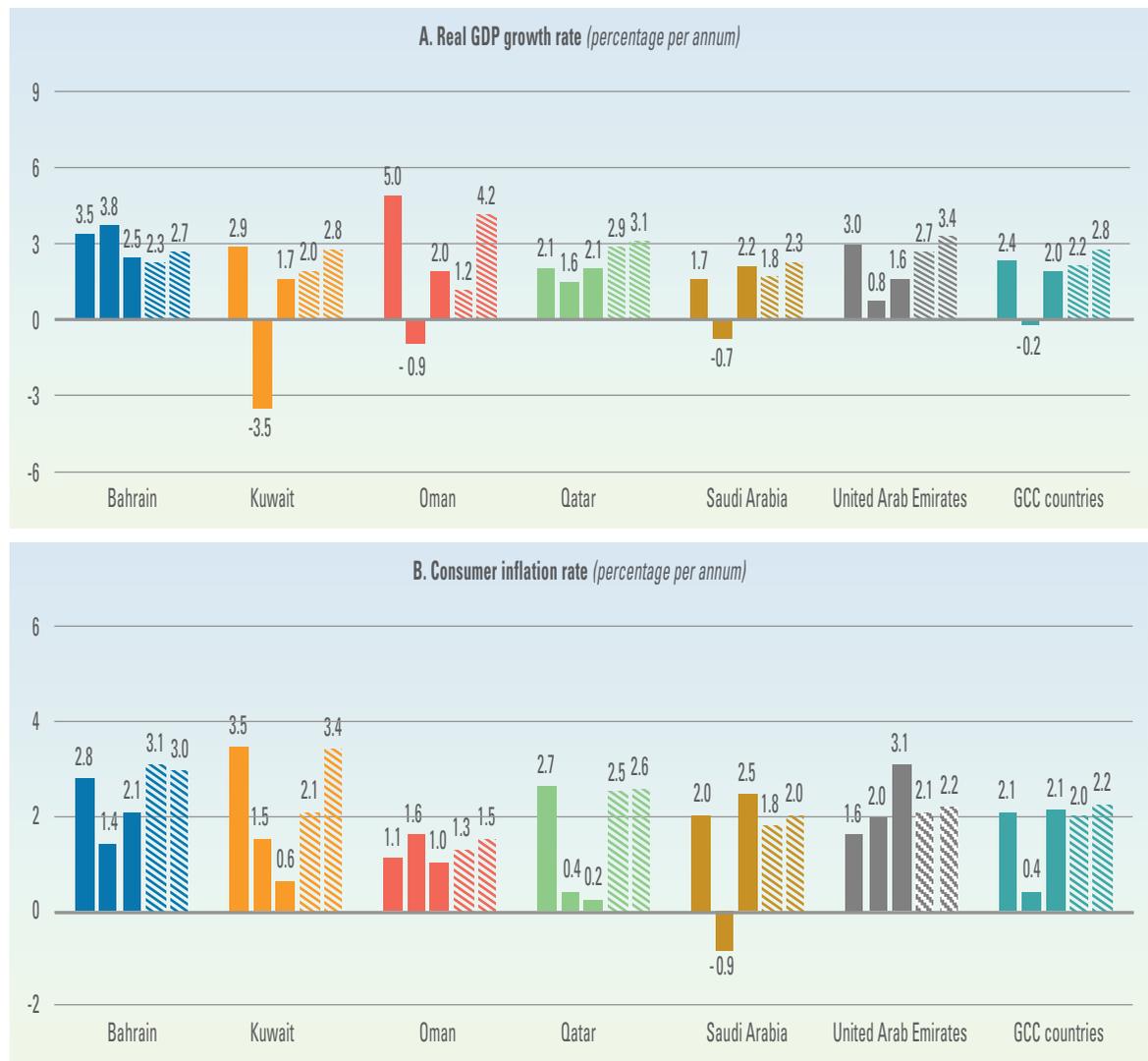
material for the energy industry). However, if the pace of structural reforms is slow, such an ambitious development plan is likely to be thwarted. In this context, a timely delay (or failure) of effective economic diversification would cloud the positive prospects.

As far as inflation dynamics are concerned, the overall economic recovery in GCC countries appeared to be accompanied by mild inflationary pressures, reinforced by the introduction of a unified VAT that fuelled consumer inflation in 2018 at 2.5 per cent in

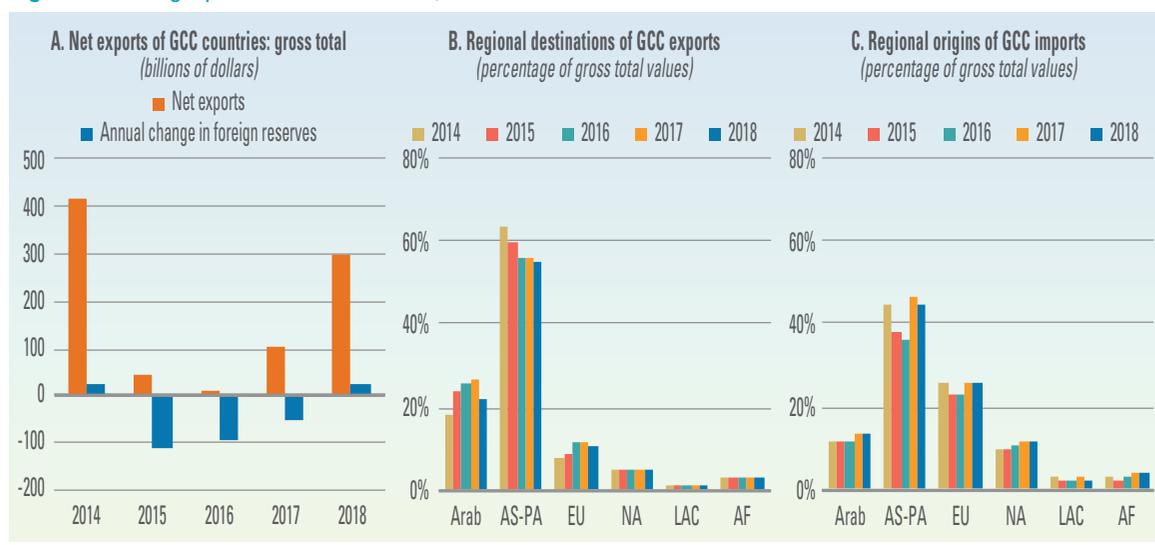
Saudi Arabia and 3.1 per cent in the United Arab Emirates (figure 2.2B). The VAT-led inflationary pressures will have only temporary knock-on effects on household spending power so that the inflation rates of these two countries will slightly lower in 2019 to 1.8 per cent and 2.1 per cent, respectively. An additional easing is expected in 2020, as the impact of the VAT rollout dissipates.

The inflation rate in Bahrain registered at 2.1 per cent in 2018, up from 1.4 per cent the prior year. The domestic price rise was largely due

Figure 2.2 GDP and inflation, GCC countries, 2016, 2017, 2018, 2019 and 2020



Source: ESCWA staff estimations/forecasts based on national statistical sources; DESA, 2019a, 2019b, 2019c; and ESCWA, 2019e.

Figure 2.3 Geographical trade structure, GCC countries

Abbreviations: Arab, Arab countries; AS-PA, Asia and the Pacific; EU, Europe; NA, North America; LAC, Latin America and the Caribbean; AF, Africa excluding Arab countries.

Source: ESCWA staff calculations based on IMF, 2018b, 2019b.

to higher food prices and transport costs, and this upward trend is expected to continue in 2019 given the scheduled imposition of VAT and additional energy tariff hikes.

In contrast, inflationary pressures stabilized in Oman, Kuwait and Qatar to 1 per cent, 0.6 per cent and 0.2 per cent, respectively. Weaker food price growth contributed considerably to the decline. But these countries' inflation rates are expected to pick up in 2019. Especially in Oman, where higher consumer spending is anticipated in 2019 and the possible introduction of indirect taxes in the following year will force the domestic price level to go up.

With global oil prices having generally increased in 2018, the value of total exports from GCC countries rose substantially by \$181.3 billion over the previous year, while the total import value to the subregion decreased by \$13.9 billion (figure 2.3A). Net exports thus amounted to \$293.3 billion in 2018. Benefitting from the increased trade bill, GCC countries succeeded in accumulating \$23.8 billion in foreign reserves in 2018, reaching \$681 billion as a whole.

In terms of the geographical concentration of trade in 2018, Asia and the Pacific region received the largest share of GCC exports by more than half in total (55.1 per cent), despite having decreased its global share over the past years (figure 2.3B). In the meantime, the share of imports shipped from Asia and the Pacific region also stayed the largest globally in 2018 (figure 2.3C). As trade dynamics with Asia and the Pacific region can be broadly associated with the recent trade tensions between the United States and China, the largest regional shares in both exports and imports will be somewhat damaged in near future. As far as intraregional trade is concerned, the shares in 2018 were 21.6 per cent in terms of exports and 13.5 per cent in terms of imports, which explains why there is still greater room for GCC countries to take into consideration intraregional trade promotion especially in merchandise goods, thus moving towards greater economic diversification efforts.

The external sector performance in GCC countries generally improved (figure 2.4), associated with the recovery of oil prices and boosts in oil export activities. Consolidating all GCC countries, net trade balance on goods

and services in percentage of GDP was posted at 12 per cent in 2018, which was up from 10.2 per cent recorded in the previous year. As such, the current account surplus widened from 3.8 per cent GDP to 6.1 per cent GDP. However, the surplus is forecast to narrow in the coming years, reflecting somewhat stabilized oil prices, adding to complicated oil production dynamics, including pressures from OPEC discussions on the oil production cut and American sanctions against Iran. It should particularly be noted that fuel exports account for nearly 65 per cent of the total merchandise exports in GCC countries on average, compared to around 11 per cent for the world average. In contrast, manufacturing exports for GCC countries on average account for 12 per cent in their total exports but 68.5 per cent for the world average.

At the country level, Saudi Arabia has seen radical improvements in its trade balance. Net trade balance in goods and services reached \$53.3 billion. The Saudization programme, the Government plan to replace expatriate workers with Saudi nationals known as Nitaqat, also restricted outward remittances. As a result, the current account balance substantially improved in 2018 to a surplus of \$37 billion, which is translated into 9.2 per cent GDP. However, partly as a consequence of the recent OPEC agreement on production cut in 2019, oil exporting performance will be slightly restrained, thereby reducing current account surplus to less than 2 per cent GDP in the upcoming years.

Likewise, the United Arab Emirates also sustained a surplus in its current account in 2018. Higher oil prices and net income of investment inflows of nearly 7.3 billion dirhams greatly underpinned such trade fundamentals. In 2019 and 2020, the country will continue to enjoy a current account surplus, despite some weakness in the dollar and anticipated lower oil export volumes. This outlook for the external sector, the part of the economy that interacts

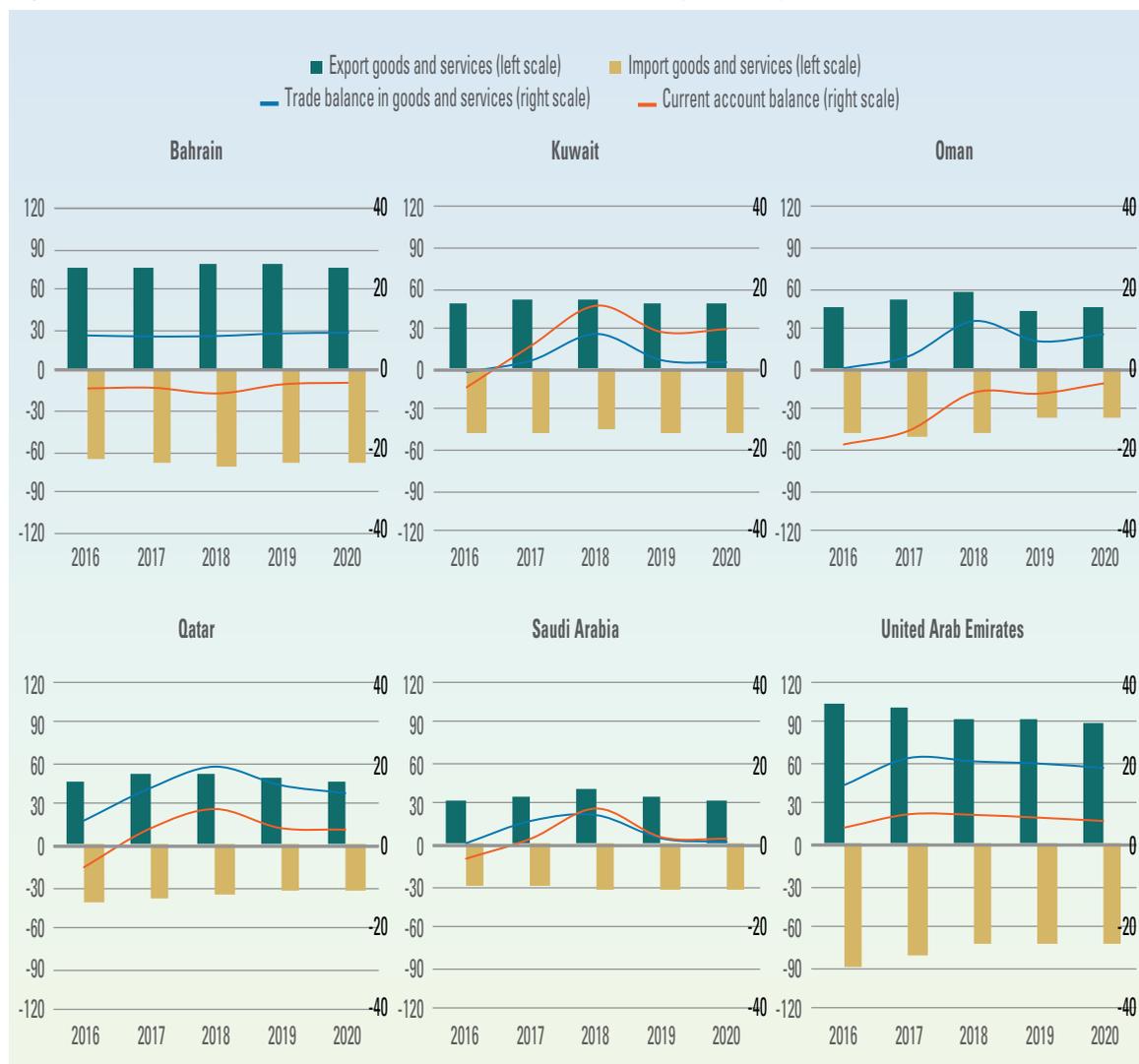
with other economies, is to some degree based on the assumption that services income will increase as the World Expo attracts international visitors.

The oil export-led improvement in trade dynamics applies to Kuwait and Qatar as well. Even though a declining surplus on merchandise trade is anticipated in the years to come, both economies will likely sustain a surplus outcome in their current account balance. This will be especially so in Qatar where the beginning of the Barzan Gas Project operations will accelerate gas production and associated exports.

On the other hand, the external positions of Oman and Bahrain remained relatively weak in 2018, despite some tangible improvements in merchandise trade and buoyancy exhibited by non-oil exporting activities. Oman thus witnessed a substantial reduction in its current account deficit in 2018, recording close to 6 per cent GDP. Meanwhile, Bahrain experienced a marginal increase in deficit, with nearly 6 per cent GDP, as the country suffered from profit repatriation by foreign companies and approximately 1.2 billion dinars worth of outward workers' remittances. Both economies will remain constrained by a persistent deficit in their current account, partially due to underperformance of primary/secondary income account reflecting ongoing reliance on foreign labour for their private sector development. Such accumulated deficits with less than supportive global financial conditions will put a further burden on external debt sustainability in these two countries, resulting in high external debt to GDP at nearly 100 per cent in Oman and 190 per cent in Bahrain over the period 2019-2020.

Monetary and liquidity dynamics were broadly in line with developments in the real economy and the external environment (figure 2.5). Saudi Arabia's foreign exchange reserves, a measure of the ability to defend its currency, ended its downward trend in 2018,

Figure 2.4 Trade and current account balances, GCC countries (percentage of GDP)



Source: ESCWA staff estimations/forecasts based on national statistical sources.

accumulating to \$496.2 billion in December 2018. The rebounded trajectory mainly came into effect with current account surplus and the country's inclusion in the Financial Times Stock Exchange Russell and MSCI Emerging Markets indices.

In the meantime, the Central Bank of the United Arab Emirates, ranked second in foreign reserves among GCC nations, with \$99.2 billion in December 2018, recorded an addition of \$4.1 billion from its 2017 level. Credit account balances and deposits with

foreign banks substantially contributed to such accumulation. In line with these dynamics, broad money supply in domestic currency showed resilience, indicating some sensible growth in domestic demand.

Kuwait, Qatar and Oman followed a similar trend in foreign reserves, amounting to \$37 billion, \$29.1 billion and \$17.4 billion, respectively, by the end of 2018. In particular, the Qatar Central Bank reserves soared by \$15.3 billion, driven by its hike in investments in bonds and foreign treasuries. The overall

Figure 2.5 Monetary indicators, GCC countries



Source: ESCWA staff elaboration based on national statistical sources and IMF, 2018b.

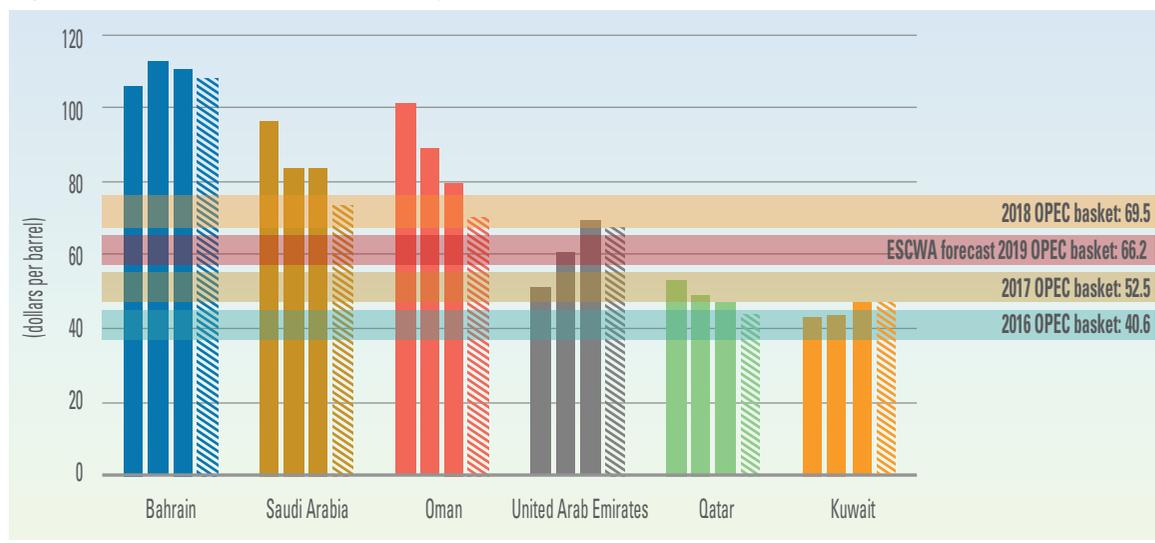
domestic liquidity as measured by the supply of broad money declined in Qatar by 6 per cent over the period from January to December 2018. This marginal decrease in broad money was accompanied in particular by a drop in quasi money, meaning assets that can easily liquidify.

Unlike other GCC countries, Bahrain's foreign reserves diminished by \$490 million in 2018, despite slightly picking up in November 2018 (thanks to generous oil prices and some financial support from GCC neighbours).

Reflecting weaker domestic demand and a slowing real estate market in several GCC countries, private sector credit growth did not greatly influence the GCC's overall monetary and liquidity conditions. For example, lower credit for construction activities has more than offset increased mortgage lending in Saudi Arabia,¹⁵ while Bahrain's corporations were not necessarily demanding credit because of the existence of GCC funds.

Especially throughout 2018 and up to the first quarter of 2019, a tighter monetary stance

Figure 2.6 Fiscal balance break-even oil price, GCC countries, 2016, 2017, 2018 and 2019



Source: ESCWA staff elaboration based on IMF, 2018d.

prevailed with rising financial costs for central banks of GCC countries that increased their policy rates in tandem with the ongoing cycle of the United States' interest rate hikes. Such policy rates led to some capital outflows during the second half of 2018 and further affected the demand for credit.

There is wide consensus that the fiscal balance performance of GCC countries is greatly characterized by a high dependence on oil revenue, which significantly hinges upon oil prices dynamics. Reflecting recent oil prices movements, most GCC countries (Bahrain, Saudi Arabia, Oman and the United Arab Emirates) appeared to experience an unfavourable situation whereby their fiscal break-even oil prices are estimated above recent price levels (figure 2.6). On the other hand, two other GCC countries have fiscal buffers, which may have influenced their decision on a delay in implementing VAT. So far (as of May 2019), Saudi Arabia, the United Arab Emirates and Bahrain have introduced a VAT and Oman plans to implement one by September 2019 to scale up their revenue mobilization.

At the country level, Saudi Arabia's fiscal deficit substantially declined to 4.6 per cent

GDP, thanks to higher oil prices together with various revenue-raising measures, including VAT, excise tax, expat levy and energy price reform (see chapter 3). The improved outcome was further accompanied by a widening of non-oil revenue coverage (embodied in Saudi Arabia's Vision 2030). In the years to come, their fiscal position will be maintained, reflecting that revenues are expected to grow by 9 per cent while a 7.3 per cent increase is forecast for total expenditure in line with strong public investment under a four-year stimulus plan.

Like that of Saudi Arabia, the fiscal position in Bahrain and Oman improved in 2018, despite both experiencing a deficit. Bahrain's efforts to narrow its fiscal deficit took place, driving it to 9.3 per cent GDP in 2018, while the deficit situation will be stabilized partly by a fiscal aid package of \$10 billion from other GCC countries. Nonetheless, a potential risk remains as the country's debt burden is the greatest among GCC nations, at nearly 100 per cent GDP (figure 2.25). In the meanwhile, Oman's sensible reduction in fiscal deficit, equating to 9.5 per cent GDP in 2018 and the deficit reduction trend, albeit marginally, will continue over the next few

Figure 2.7 Fiscal positions, GCC countries (percentage of GDP)

Source: ESCWA staff estimations/forecasts based on national statistical sources.

years. This forecast is mirrored somewhat by the slower pace of implementing new revenue-raising measures.

Elsewhere, Kuwait, Qatar and the United Arab Emirates recorded fiscal surpluses in 2018, equivalent to 3 per cent GDP, 2.2 per cent GDP and 2.8 per cent GDP, respectively. A rise in crude oil prices that boosted government revenues along with consistent reforms positively affected their fiscal balance. The fiscal position in the case of the United Arab Emirates will be somewhat constrained,

reflecting the cabinet approval in September 2018 of a substantial increase in 2019 spending (allocated for community development, education and the health care sector).

Moreover, the Government of Qatar will sustain a favourable fiscal position, firmly supported by abundant natural gas reserves. Despite rebounding to a fiscal surplus in 2018, Kuwait's financing needs (after compulsory transfers to the Future Generations Fund and excluding investment income) and the burden of wages and subsidies that constitute nearly 70 per cent of the country's total budget will constrain its

overall fiscal position, ultimately turning to deficit over the next few years.

3. Mashreq countries

Growth in Mashreq countries averaged 3.5 per cent in 2018, an increase from 1.9 per cent the year before (figure 2.8A). This increase in aggregate demand was mostly driven by strong growth in Egypt, the largest country in this subregion, with a real GDP growth rate of 5.2 per cent. Egypt's economic expansion was realized as tourism, natural gas activity, remittances and international reserves all appeared strong. Continual policy reforms also supported such growth momentum, influencing positively an upgrade of the country's sovereign rating in late 2018.

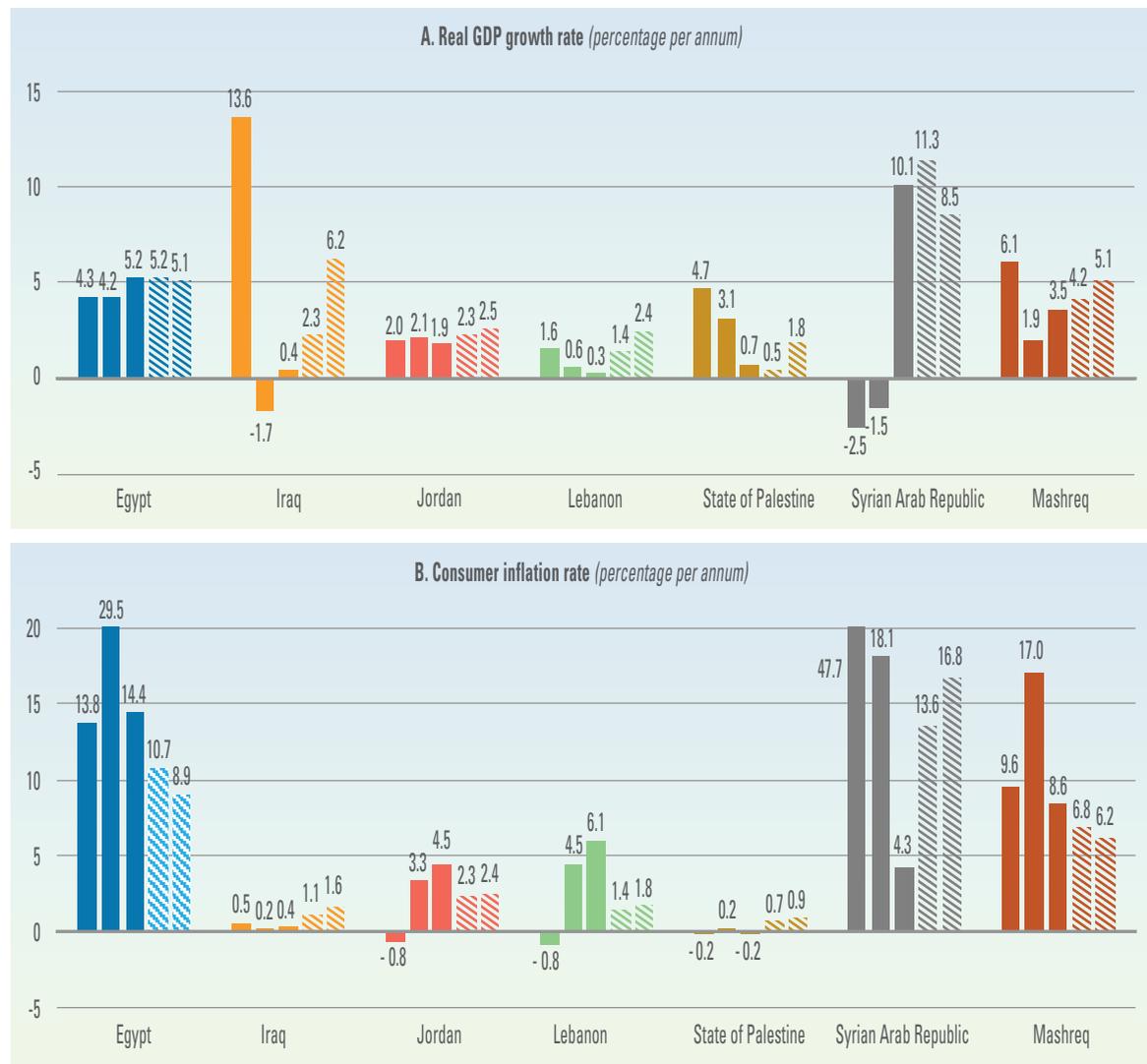
The Syrian Arab Republic was also fairly strong in 2018 in terms of economic growth, with a rate of growth at 10.1 per cent. Reconstruction efforts have already begun, and Syrian expatriates have also started to return home, boosting private consumption levels. Similarly, economic activities in Iraq were also strong enough to rebound into positive growth in 2018 (from an economic contraction of 1.7 per cent in 2017). Iraqi economic conditions will gradually improve in the coming years, supported by greater gross oil-export revenue.

In contrast, growth in Jordan and Lebanon remained subdued in 2018, with a real GDP growth of 1.9 per cent and 0.3 per cent, respectively. These two economies are constrained by political instability and long-standing conflicts in neighbouring countries. Additionally, intraregional trade was somewhat stagnant partly due to geopolitical characteristics, including lower workers' remittances and foreign investments, especially in Lebanon. Meanwhile, the State of Palestine suffered seriously from the Israeli occupation and associated policies and practices, including restrictions on donor fund transfers, resulting in its economy expanding by 0.7 per cent in 2018.

The outlook in this subregion will stay clouded due to a combination of external uncertainties (such as mounting global trade tensions and financial market uncertainty), socioeconomic situations in neighbouring countries and persistent structural rigidities of the individual country as well as the internal political situation (for example, some delay in policy reforms due to the formation of a new government in Iraq and Lebanon). Overall, although the subregion's growth will pick up slightly, mainly pumped up by lower oil prices, increased risk of rising social tensions will continue in the longer term, possibly intensifying security concerns and capacity constraints, associated with demographic changes such as the ageing population (box 2.2).

The inflation trends in Mashreq countries are heterogeneous (figure 2.8B). Despite a substantial cut in policy rates by 300 basis points in February 2018 following a series of sharp hikes in the aftermath of the Egyptian pound's flotation, double-digit hyperinflation in Egypt remains a real concern. This stabilizing trend will be, however, challenged since energy subsidies will continue to be phased out. In the Syrian Arab Republic, strong inflationary pressure over the past few years (double-digit hyperinflation) has significantly eroded real income growth and made households highly vulnerable to any economic shock. In 2018, the country was able to greatly mitigate through its managed single-digit inflation.

Apart from those countries substantially easing their inflationary pressures, inflation rates in Jordan and Lebanon edged up to 4.5 per cent and 6.1 per cent in 2018, respectively, traceable to a strong rebound in commodity prices, especially fuel products. Inflationary pressure will, however, continue to the end of 2019, reflecting some declining energy prices. Meanwhile, the State of Palestine experienced a deflation of 0.2 per cent in 2018, followed by marginal inflation hovering around 0.7 per cent

Figure 2.8 GDP and inflation, Mashreq countries, 2016, 2017, 2018, 2019 and 2020

Source: ESCWA staff estimations/forecasts based on: national statistical sources; DESA, 2019a, 2019b, 2019c; and ESCWA, n.d., 2019e.

in 2019. Likewise, the Iraqi inflation rate was 0.4 per cent in 2018 and will gradually increase as higher domestic demand together with rising food and transportation costs is expected.

Influencing the improvement in economic activities in general, a steady growth of export goods was recorded in Mashreq countries, which increased by \$32.3 billion to \$132.1 billion in 2018. Notwithstanding the steady growth, the subregion as a whole was still positioned to be a net importer in 2018, with a net value of \$34.5 billion (figure 2.9A). As

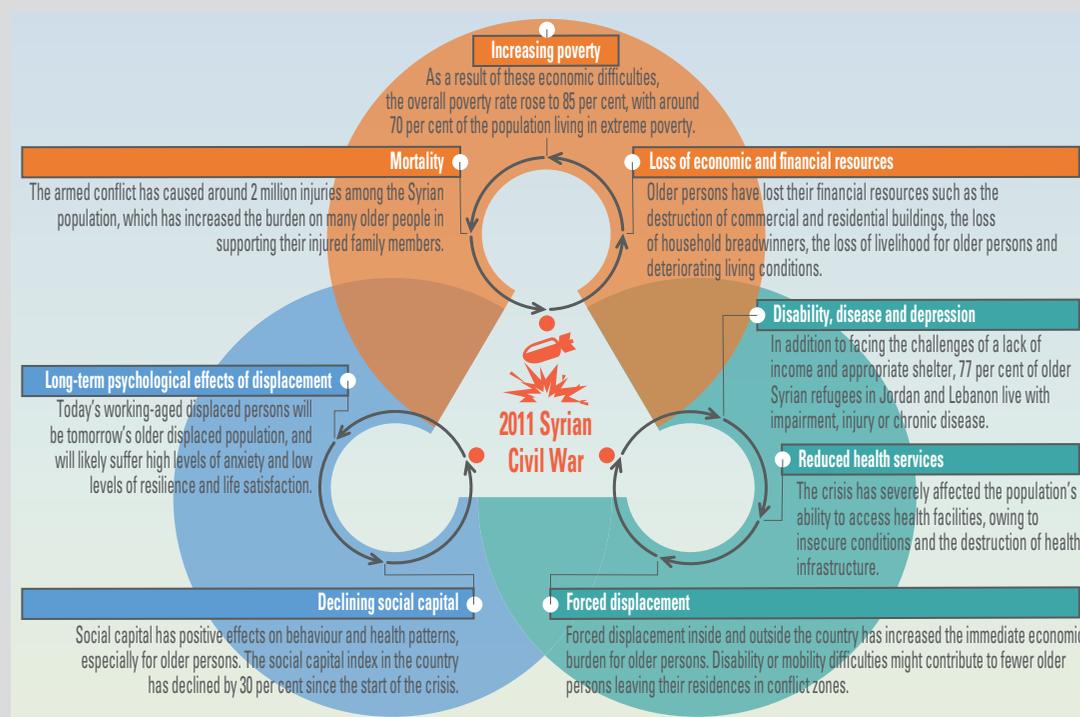
such, the foreign reserves of most Mashreq countries dwindled due to the trade deficit. But in Iraq, reserves were accumulated sizably, mainly driven by its improved external balance. The foreign reserves in this subregion thus rose in 2018 by \$16.6 billion, of which \$15 billion belongs to Iraq.

It is worth revisiting the export-import nexus that significantly affects the subregion's geographical trade pattern. The value of total exports to Asia and the Pacific region soared by \$21.9 billion to reach \$62.1 billion in 2018,

Box 2.2 Conflict-associated vicious circle on older persons in the Syrian Arab Republic

The population of the Arab region had until recently been characterized by the demographic phenomenon of the “youth bulge”; however, a demographic shift towards a larger ageing population is projected for the near future. Having faced the challenges associated with larger proportions of young people, Arab countries must now prepare for and adapt to growing numbers of older persons. Population ageing is occurring in the Arab region as a result of decreased fertility rates and increased longevity, largely due to development and health gains. Older persons (individuals aged 60 and above) have unique needs and abilities: the growing number and proportion of older persons means that countries and societies must be prepared to support their dependency and health, and recognize and promote their active, meaningful involvement in society.

While various challenges associated with older persons in the region are broadly explored in box 2.6, this box focuses on conflict-associated vicious circle on older persons. Of all the conflict-affected countries, the Syrian Arab Republic suffers most from the negative impact from the combination of ageing population and a deep sociopolitical crisis. Understanding the impact and dynamics of the Syrian crisis is thus important to identify strategies, policies and programmes that promote inclusion and better understanding of the consequences for older persons (vulnerable populations), including those who stayed in their homes, the internally displaced, refugees who fled the country, and those who emigrated for other reasons. Older persons are encountering a chain of daunting challenges as a result of the conflict.



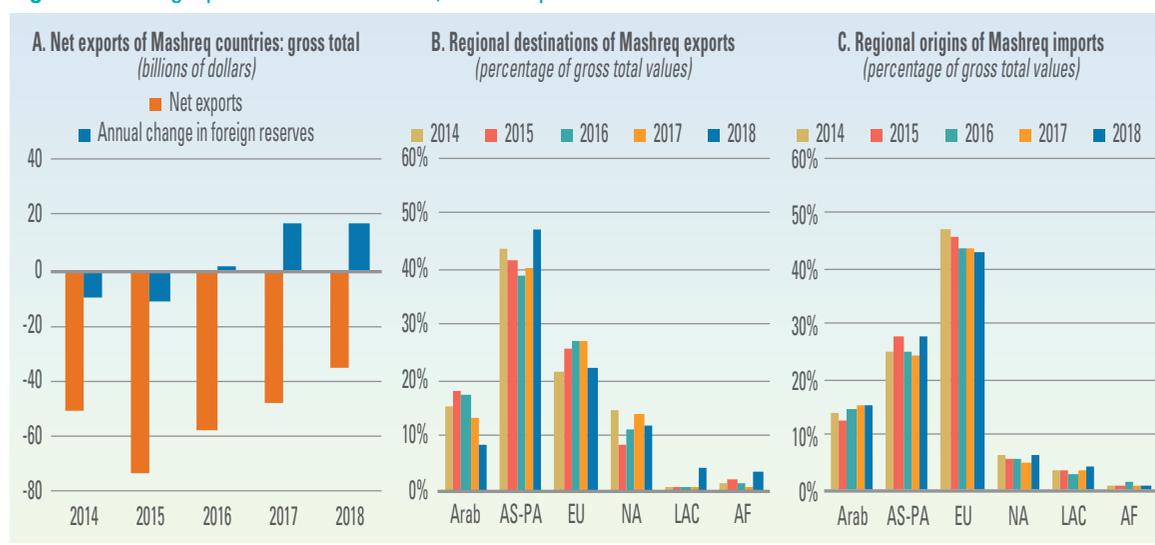
The negative impact of the crisis in the Syrian Arab Republic on older persons has been significant, affecting their health and psychological, social and economic well-being. The conflict has had an immediate impact on the current older population and, according to research on other post-conflict situations, is likely to impact the next generation of older persons. There is therefore a need for short- and long-term policies under a strategic vision that protects and respects the



rights and dignity of all population groups, including older persons. Moreover, it is important to recognize that Syrian older persons could play a major role in rebuilding social cohesion after the conflict ends, contributing their experience to support an inclusive reconstruction process.

Note: This box draws on E/ESCWA/SDD/2017/3.

Figure 2.9 Geographical trade structure, Mashreq countries



Abbreviations: Arab, Arab countries; AS-PA, Asia and the Pacific; EU, Europe; NA, North America; LAC, Latin America and the Caribbean; AF, Africa excluding Arab countries.

Source: ESCWA staff calculations based on IMF, 2018b, 2019b.

accounting for nearly a 50 per cent share in total (figure 2.9B). Meanwhile, exports to Europe, North America, Latin America and the Caribbean and Africa stood at 22.1 per cent, 11.7 per cent, 4.7 per cent and 4 per cent, respectively. The greatest share of imports, at 42.7 per cent, came from Europe, followed by Asia and the Pacific region (27.7 per cent), North America (6.8 per cent), Latin America and the Caribbean (4.4 per cent) and Africa (1 per cent) (figure 2.9C). A large share of trade with China, Europe and the United States would be a downside risk to Mashreq countries, especially if the ongoing trade tensions were to persist.

Out of many analytical viewpoints considering geographical trade dynamics, the subregion's underperformance in the promotion of the intraregional export initiative is particularly significant. The low engagement in the regional

value chain is perhaps due to currently high transport costs combined with poor infrastructure. Therefore, the macroeconomic policy framework in Mashreq countries should focus on improving trade cooperation with neighbouring countries.

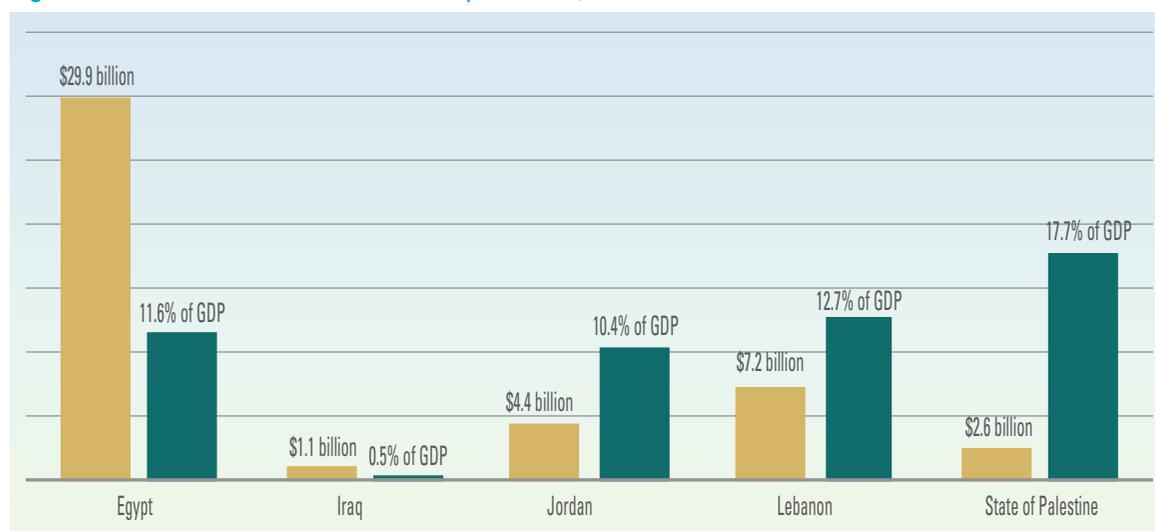
In terms of external sector balance, Mashreq countries in general suffered from current account deficit, owing to the negative impact of higher oil prices. Mashreq's consolidated trade deficit (on goods and services) decreased from \$70.7 billion in 2017 to \$49.9 billion in 2018, while the consolidated current account deficit also followed a similar trend, posting at 2.3 per cent GDP. The deficit in the current account balance is forecast to widen, to close to 7 per cent GDP. At the country level, however, the external trade outcomes and prospects varied significantly (figure 2.10).

Figure 2.10 Trade and current account balances, Mashreq countries (percentage of GDP)

Sources: Total reserves excluding gold are from IMF, International Financial Statistics database. Broad money estimations are ESCWA staff calculations based on national statistical sources.

The current account deficit in Egypt, for instance, narrowed to \$6 billion in 2018 (2.4 per cent GDP). This reduced deficit level was largely attributed to the country substantially narrowing its trade deficit by \$8.2 billion. In addition, the country's manufacturing exporting capacity continues to improve and its share accounts for more than half of total exports. A surge in services surplus was also remarkable, greatly contributing to these improved trade dynamics and was associated with increased tourism revenues by almost 100 per cent. The average

expenditure per night was \$95.6 in 2018 an increase from \$86.1 in the previous fiscal year. Furthermore, the capital and financial account also improved, traceable to a net inflow of both foreign direct investment of \$7.7 billion and portfolio investment of \$12.1 billion. The recent trend in the external sector performance will likely continue over 2019 and through 2020 when a modest expansion of hydrocarbons export (new production of natural gas) and improvement in export competitiveness (under a weaker currency) are expected.

Figure 2.11 Remittance inflows to Mashreq countries, 2018

Source: ESCWA staff elaboration based on the World Bank, 2019f; and IMF, 2018b.

Note: Due to the lack of statistics, figures for the Syrian Arab Republic are not presented.

Jordan's current account challenges eased gradually in 2018 on the back of a narrower trade deficit (increases in exports and decreases in energy-related imports). In terms of the recovery in merchandise exports (of which manufacturing exports account for more than 70 per cent), the country took great advantage of active transactions with major trade partners such as the United States and India while also profiting from the re-opening of trade routes to Iraq. Tourist receipts also showed positive growth momentum. However, foreign direct investment declined and remittances remained somewhat stagnant. For 2019 and 2020, the economy of Jordan will see the growth of export earnings, partly due to some recovery of prices of phosphates and improved regional market access as well as trade agreements with Europe. Meanwhile, Jordan will likely struggle with higher global energy prices and a heavy reliance on tourism. These factors expose the country to external risks as weaker global growth is anticipated in the coming years.

Lebanon's balance of payments situation in 2018 was similar to Jordan but somewhat more complicated with a larger current account deficit (equivalent to nearly 24

per cent GDP). A slowdown in remittances and deposit inflows, which have been critical parts for the country's financing requirements, represented a serious burden to the balance of payments constraints. Although the reopening of trade routes through the Syrian Arab Republic and the gradual improvement of transport of goods by land to neighbouring countries are considered positive factors, high transit costs will remain a serious impediment to exporting activities. If a weaker external environment is prolonged, Lebanese external debt level (gross term) is expected to reach over 190 per cent GDP.

A current account deficit was also the case for the State of Palestine, reaching 11.4 per cent GDP in 2018. A dual deficit in merchandise trade and services were the main drivers for such unfavourable external sector outcomes, despite the surplus of income account (driven by increased levels of compensation for employees working in Israel) and the fund transfers (of which donors' transfers constituted more than one third in total transfers from abroad). It should be noted that remittance inflows are essential, accounting for a substantial portion of the economy (17.7 per cent GDP) (figure 2.11).

Figure 2.12 Monetary indicators, Mashreq countries

Source: ESCWA staff elaboration based on national statistical sources and IMF, 2018c.

Note: Due to the lack of official statistics, figures for the Syrian Arab Republic are not presented.

Unlike the other four Mashreq countries, the Iraqi economy registered a surplus in its current account balance in 2018. The recovery in oil prices was quite conducive to generating domestic economic activities as some additional refinery facilities which were seriously damaged by armed conflict in 2014 resumed operations. It should especially be noted that almost all exports are fuel-related. Eventually, the current account surplus widened to 5.2 per cent GDP. Nonetheless, the country's external sector prospects in the forthcoming years may be subdued since its import value is expected to

surge as security improves on the border roads connecting it to Jordan.

With some improvement in the balance of payments situation, the subregion's foreign reserves showed some positive resilience (figure 2.12). Egypt's foreign reserves increased, closing the year at \$38.6 billion in December 2018. This trend of accumulation was mainly attributable to inflows of foreign direct investment, Eurobonds and central bank deposits from donors. A similar improved external balance on the dynamics of foreign

Figure 2.13 Fiscal positions, Mashreq countries (percentage of GDP)

Source: ESCWA staff estimations/forecasts based on national statistical sources.

Note: Due to the lack of official statistics, figures for the Syrian Arab Republic are not presented.

reserves also impacted Iraq as it managed to accumulate \$60.6 billion towards the end of 2018, which covered the imports of goods and services for seven to eight months. In contrast, the Central Bank of Lebanon and Jordan experienced a decumulation in foreign currency reserves in 2018. This largely stemmed from the redemption of three sovereign bonds denominated in foreign currencies, leaving \$40.6 billion (a reduction of \$2.9 billion) and \$11.5 billion (a reduction of \$729 million) at the end 2018 for Lebanon and Jordan, respectively.

Reflecting the subregion's growth trajectory in both real and external sectors, domestic demand generally showed positive signs throughout 2018. This subregional trend, however, cannot explain the whole story, which entails a diverse dynamism in each Mashreq country. For example, Egyptian money supply was tightly managed in 2018 as the Central Bank of Egypt had to exert control to cool down inflationary pressure in line with an arrangement for a \$12 billion International Monetary Fund (IMF) deal signed in 2016. Year-on-year growth of

broad money stock in Egypt is still very high (averaging 18.4 per cent), but the favourable impact of domestic demand dynamics was, however, mostly offset by double-digit inflation in 2018.

Meanwhile in Iraq, the pace of broad money growth was stabilized, together with private sector cash credit extended by commercial banks in 2018. For Jordan, Lebanon and the State of Palestine, broad money growth presented high volatility and showed a downward trajectory, close to zero towards the end of 2018. The downward trend of these three countries indicates long-standing challenges in sustaining their domestic demand expansion. On the other hand, the Syrian Arab Republic has not published official figures of these indicators, but it is likely that the country will start to issue new foreign currency certificates of deposits to improve its trade operations in the near future.

The fiscal situation in Mashreq countries was unfavourable in 2018 except in Egypt and Iraq. Egypt's fiscal situation improved in 2018. Petroleum spending decreased and is expected to further reduce, following the recent completion of a fuel subsidy reform. Furthermore, the continued reduction in electricity subsidies will support the creation of some fiscal space that can be beneficial to income transfers and social welfare spending. Egypt's fiscal deficit therefore narrowed to 8.3 per cent GDP and an additional decrease in deficit is anticipated in the coming years as the country's continuous fiscal reforms will pay off in the form of fiscal space. Thanks to the recovery in oil prices, Iraq's fiscal balance substantially rebounded from a deficit of 1 per cent GDP to a surplus of 4.5 per cent GDP over the period 2017-2018. This favourable situation allowed the country to substantially lower its public debt level to below 50 per cent GDP. Iraq has been, relative to other Mashreq countries, able to manage and keep Government debt under control.

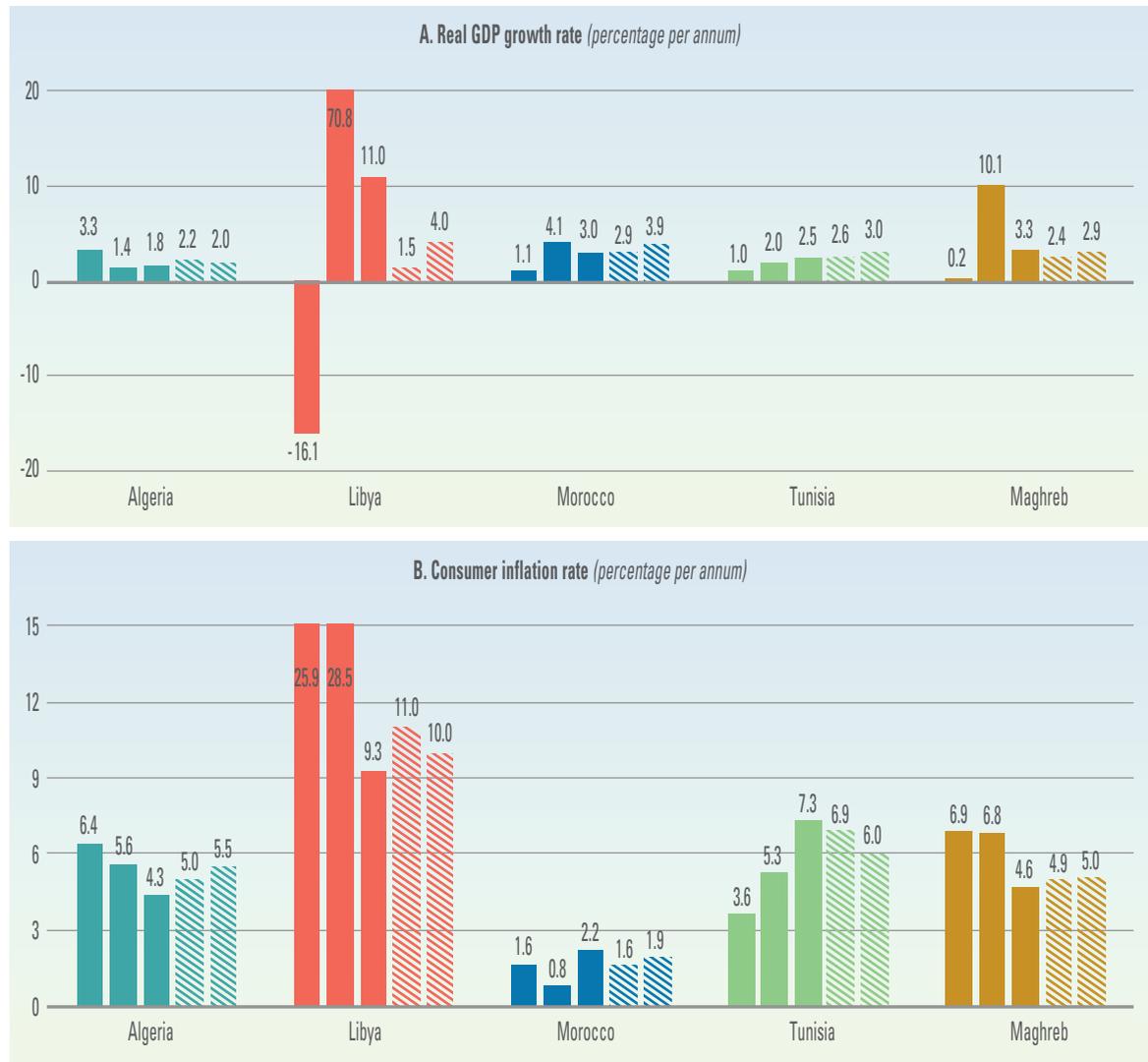
In Jordan, on the other hand, public finances are constrained by the continuous fiscal deficit situation. Tax receipts were constrained, dragged down by the slow pace of economic expansion, while expenditure rose as support for refugees remained an economic burden. This persistent deficit meant that the Government struggled to curb public debt, equivalent to 94 per cent GDP (figure 2.25). In fact, the debate about debt sustainability has been more devastating in Lebanon whose public debt level amounted to roughly 150 per cent GDP. In light of rising service debt, amounting to nearly one third of total spending, Lebanon's fiscal deficit further widened to reach close to 10 per cent GDP in 2018. Meanwhile, the fiscal situation in the State of Palestine deteriorated marginally to a deficit of 3.4 per cent GDP in 2018 which is expected to further widen in 2019, to nearly 5 per cent GDP. Such reduced fiscal space can be largely traceable to a continued decline in foreign aid.

4. Maghreb countries

In 2018, the Maghreb countries underwent an economic slowdown with an average growth rate of 3.3 per cent, a substantial drop from the 10.1 per cent the year before (figure 2.14A). However, this weighted averaged figure might have distorted the real growth performance, given that the subregion's growth is heavily influenced by Libya whose growth rate, under the current military escalation massively decreased. Real GDP growth rate, excluding Libya, is estimated at 2 per cent in 2018, a slight decline from 2.1 per cent in 2017, implying that growth outcomes in the subregion appeared somewhat well sustained in recent years.

As expected, economic performance masked considerable variation across the countries in the subregion. The Algerian economy was partially hurt by a decline in hydrocarbon production in 2018 although it is managing to increase public spending through monetary financing. As a result, economic activities stayed moderate, with a real GDP growth of 1.8

Figure 2.14 GDP and inflation, Maghreb countries, 2016, 2017, 2018, 2019 and 2020



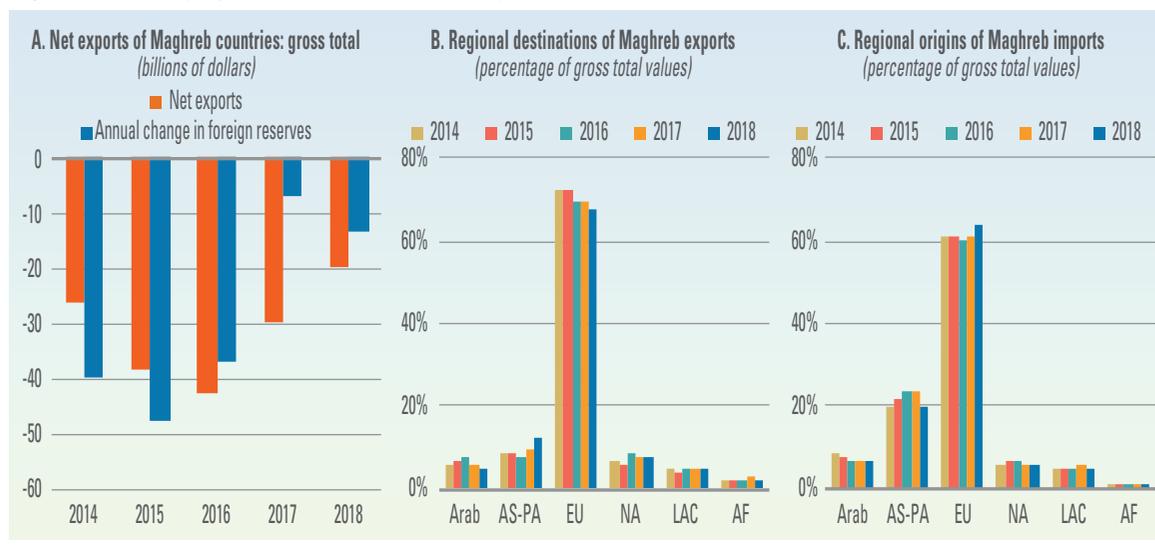
Source: ESCWA staff estimations/forecasts based on national statistical sources; DESA, 2019a, 2019b, 2019c; and ESCWA, 2019e.

per cent in 2018. The growth momentum will continue in the years to come and will profit from higher gas production as new fields come on stream. Meanwhile, Morocco and Tunisia experienced modest agricultural production in 2018 that boosted domestic demand expansion, which helped expand their economies by 3 per cent and 2.5 per cent, respectively.

Overall, growth prospects in Maghreb countries will most likely continue to be subject to more uncertain external environments (such as slower demand from European market) and be

constrained by persistent structural rigidities that may impede private sector development. Such challenges will result in growth to edge down in the subregion to 2.4 per cent before rebounding back to 2.9 per cent in 2020.

In terms of inflation trajectory, as a whole the Maghreb subregion roughly experienced a downward trend and will continue on such a trajectory in the years to come (figure 2.14B). The biggest contributor to this is Libya whose inflation strongly decelerated in 2018 thanks to the appreciation of the Libyan dinar on

Figure 2.15 Geographical trade structure, Maghreb countries

Abbreviations: Arab, Arab countries; AS-PA, Asia and the Pacific; EU, Europe; NA, North America; LAC, Latin America and the Caribbean; AF, Africa excluding Arab countries.

Source: ESCWA staff calculations based on IMF, 2018b, 2019b.

the parallel exchange market. However, the Libyan domestic price evolution will be highly uncertain owing to disruptions to supply chains relating to a lack of goods and services. Persistent hyperinflation dynamics over the last four years have in fact badly affected real incomes and has certainly pushed more Libyans into financial hardship.

Meanwhile, inflation in Algeria remained relatively under control in 2018 at about 4.3 per cent. This was partly because prices of consumer goods and housing were largely subsidized. Inflation in Morocco also posted at 2.2 per cent, with an exchange rate pegged to a euro and dollar basket. Tunisian inflationary pressures, on the other hand, rose sharply to 7.3 per cent in 2018, perhaps traceable to an increase in VAT coupled with the effect of exchange rate passthrough.

Maghreb countries continue to hold the status of net importers (figure 2.15A). This reflects total merchandise exports of \$108.2 billion and total imports of \$127.7 billion, consolidating at a total of \$19.5 billion in net imports. Despite the moderate inflow of funds from increased fuel export revenues, particularly in Libya,

another three Maghreb countries had difficulty with regards to an outflow of foreign reserves in 2018, forcing the sale of foreign currency reserves over the past few years (\$203.3 billion in 2017 and \$189.7 billion in 2018).

Notwithstanding this backdrop, the geographical pattern of trade in Maghreb countries remained largely unchanged in 2018. Trade links with Europe were substantial, probably because of the subregion's geographical orientation to the continent. Maghreb countries' gross total exports in 2018 were \$73.4 billion, accounting for nearly 67.8 per cent in total exports, followed by Asia and the Pacific region (11.8 per cent), North America (7.7 per cent), Latin America and the Caribbean (4.3 per cent) and Africa (1.8 per cent) (figure 2.15B). Europe also remained the largest source of imports to the subregion, accounting for 64.1 per cent of gross total imports, followed by the Asia and the Pacific region (19.6 per cent), North America (5.7 per cent), Latin America and the Caribbean (4.9 per cent) and Africa (0.4 per cent) (figure 2.15C).

The share of intraregional trade exports slipped to 4.6 per cent in 2018, largely driven

Figure 2.16 Trade and current account balances, Maghreb countries (percentage of GDP)



Source: ESCWA staff estimations/forecasts based on national statistical sources.

by changing terms of trade, while the share of intraregional imports marginally increased to 6.5 per cent. In fact, since 2016, all Maghreb countries' export shares to the Arab region have continuously declined. As of 2018 export shares to the Arab region amounted to 1.6 per cent in Libya, 3.7 per cent in Morocco, 4.6 per cent in Algeria, and 9.5 per cent in Tunisia. The challenges in intraregional trade should be addressed by redoubling efforts to improve transport and logistics services, a point which has been raised as a key strategy to integrate this subregion into global value chains. It

should also be noted that intraregional trade would offer great potential for Maghreb countries to boost their economic activities, increasing employment and taking advantage of capacity-building for value added industries.

More specifically, the deficit challenges sustained in 2018 both in terms of trade balance (8.2 per cent GDP) and current account balance (6.8 per cent GDP), and will go on over the coming years (figure 2.16). For example, Tunisia's situation in balance of payments was connected to a current account

Figure 2.17 Monetary indicators, Maghreb countries



Source: ESCWA staff elaboration based on national statistical sources and IMF, 2018c.

deficit, reaching more than 10 per cent GDP in 2018. This modest deterioration was the result of a rise in import bills, coupled with the depreciation of the country's local currency, thereby widening the trade deficit. In 2019, soaring prices of raw materials and energy-related items that were a root cause of the negative balance of payments situation will be partially mitigated. Morocco's economy faced similar circumstances, but its deficit challenge was, however, not as serious as that in Tunisia given the fact that the current deficit level slightly widened to 4.5 per cent

GDP, thanks to export of phosphate products. Notwithstanding such balance of payments constraints, Morocco and Tunisia are the top among countries in the Arab region to register a significant portion of exports associated with manufacturing: around 70 per cent and 81 per cent, respectively.

In contrast, the subregion's energy exporters, namely Algeria and Libya, profited from increased fuel export earnings in 2018 given the fact that fuel exports account for over 90 per cent of their total merchandise exports.

Figure 2.18 Fiscal positions, Maghreb countries (percentage of GDP)

Source: ESCWA staff estimations/forecasts based on national statistical sources.

With exceptionally low external debt (in fact, the lowest among Arab countries), Algeria managed to reduce its current account deficit to nearly 9 per cent GDP in 2018 as oil and gas exports roughly accounted for more than 90 per cent of Algeria's total exports. This upward momentum will likely reverse in 2019, owing to a rebound in oil and gas production. Similarly, but notably, Libya recorded a current account surplus close to 2.5 per cent GDP in 2018, reflecting a 56 per cent increase in oil export receipts (despite of unexpected outages that faced the country in mid-June

2018). This balance of payments situation will, however, turn into a tiny deficit in current account position, with 0.3 per cent GDP in 2019, based on the assumption that the ongoing political conflict will be accompanied by large import of products.

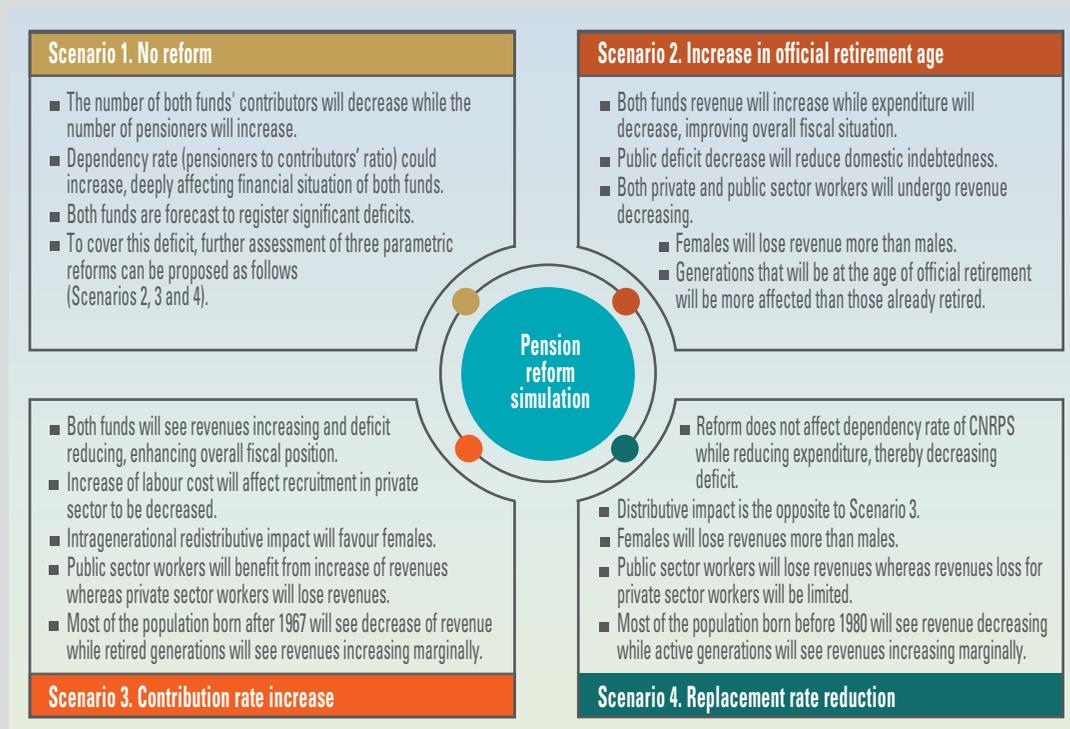
The exacerbation of the imbalance of external payments led to a further erosion of foreign reserves in most Maghreb countries, except in Libya. Tunisia's official reserves decreased by nearly \$480 million over the period December 2017 to December 2018, during which tensions

Box 2.3 Rethinking pension reforms in Tunisia

The financial viability of the Tunisian pension system has been questionable since the 1990s. The transition to a large ageing population phenomenon now underway in Tunisia, coupled with high population replacement rates and the low linkages between contributions and pension benefits, has put the financial situation under intense pressure. The current Tunisian pension system is a pay-as-you-go (PAYG), based on the concept of solidarity within and across generations. It is administered by two funds: The National Fund for Social Security (Caisse Nationale de Sécurité Sociale; CNSS), and the National Fund for Retirement and Social Welfare (Caisse Nationale de Retraite et de Prévoyance Sociale; CNRPS).

- CNSS is a public body with civil character and financial autonomy under the supervision of the Ministry of Social Affairs and administered by a board of directors, in which the State, employers' organizations and labour unions are represented;
- CNRPS manages the pensions of public sector employees in ministries and public institutions, local collectivities and public companies, reports to the Ministry of Social Affairs and has legal entity and financial autonomy.

Various prospective quantitative tools have been used to assess the viability of the Tunisian pension system and to propose reforms in Tunisia over the past years. Taking advantage from some models that can be applied well to the Tunisian context, the analysis here opts for the hybrid approach, taking the best elements of overlapping generations (OLG) and the partial equilibrium model, in order to assess the viability of the pension system and to simulate a number of prototypical reforms.



Pension reforms are not neutral in terms of growth, fiscal sustainability and redistributive impacts. The illustrative simulations show that each type of reform produces different results in



terms of growth, job creation and fiscal deficit among and between generational redistribution. Since the pension system also interacts with the rest of the economy, any change in its parameters could affect the cost of labour, the Government's fiscal position, social disparities and economic growth. For this reason, pension reforms should not be an accounting exercise in which the sole objective is to find the parameters that ensure the financial equilibrium. Policymakers should conduct an ex ante assessment of the possible implications of any change in legislation and find the optimal reform that has the best economic and social implications.

Note: This box draws on E/ESCWA/EDID/2018/TP.7.

over foreign exchange dynamics then reinforced a further depreciation of the Tunisian dinar. Morocco's foreign currency reserves also reduced by \$1.7 billion in 2018, mainly owing to an unfavourable external trade environment. The largest reduction was reported in Algeria whose official reserves shrank by \$17.4 billion, in part due to ongoing current account deficits and limiting capital inflows. Meanwhile, the Central Bank of Libya succeeded in accumulating foreign reserves, largely supported by an increase in oil export bills.

On the back of somewhat sustaining domestic demand in 2018, broad money stock supply continued to grow helping to bolster private sector activities across most countries in the subregion. Year-on-year growth of broad money stock throughout 2018 averaged at 11 per cent in Algeria, 11.3 per cent in Libya, 4.6 per cent in Morocco and 10.3 per cent in Tunisia. However, accelerating broad money growth coincided with creeping inflation towards the end of 2018, which did not necessarily contribute to growth in domestic demand, especially in Libya and Tunisia.

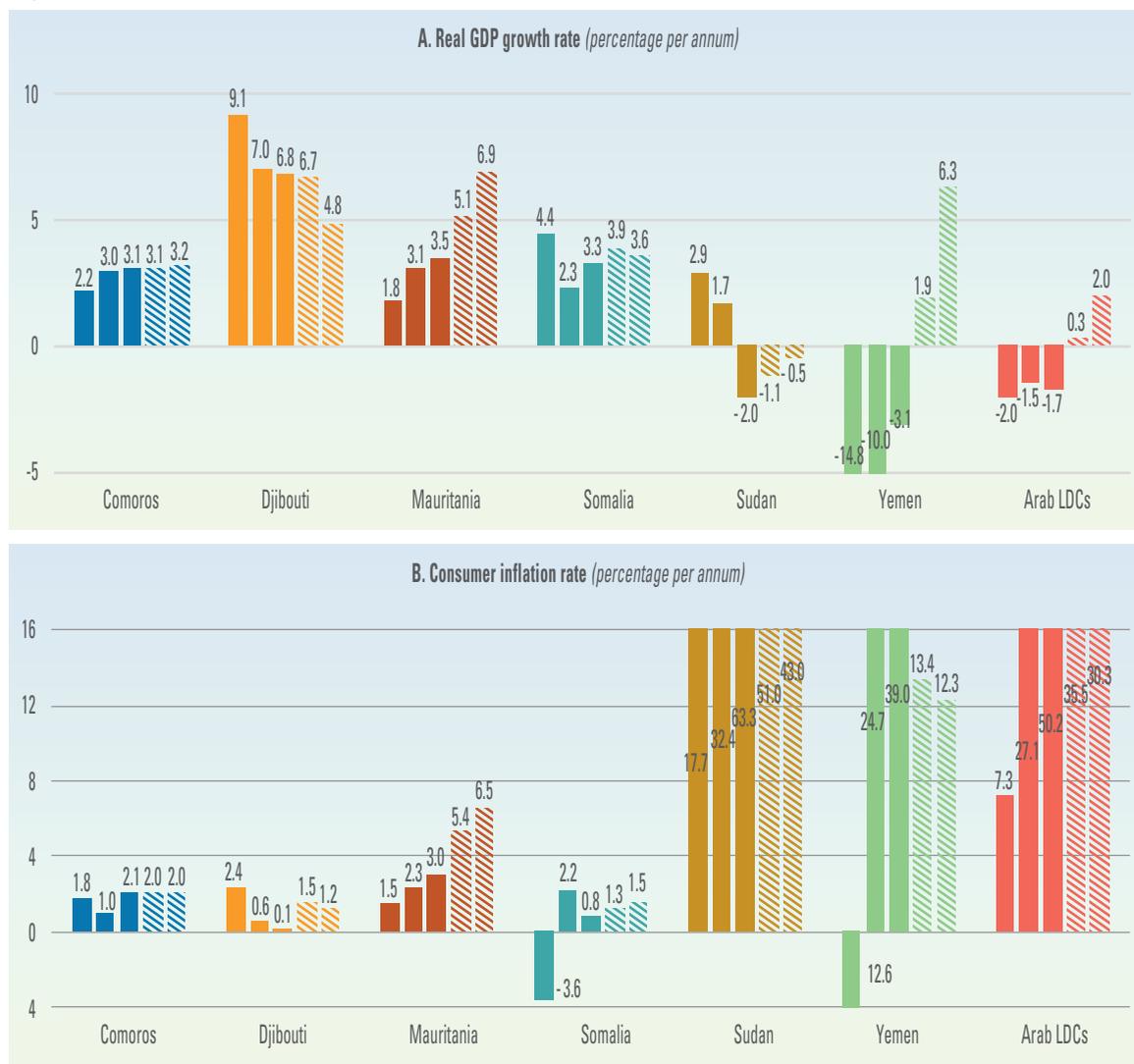
In terms of fiscal dynamics, Maghreb countries managed to improve their fiscal situation through significant efforts made to address fiscal deficit challenges such as introducing subsidy reforms and revenue mobilization. The economy of Algeria cut spending substantially by 2.6 per cent GDP, leading to an improvement of fiscal balance. The higher level of revenues driven by fuel price increases also contributed to narrowing

the deficit level to 5.5 per cent GDP in 2018. Continued fiscal adjustment was also done in Tunisia and Morocco. Their improved tax collection through efforts fighting tax evasion compensated for their higher subsidy outlays associated with rising energy prices in 2018. Reflecting these efforts, the fiscal deficit slightly narrowed in 2018 to 4.9 per cent GDP in Tunisia, while Morocco maintained the previous year's deficit level of 3.9 per cent GDP. These two countries recently started pension reform programmes to respond to the considerable deficit that has accumulated in their pension system. The Government of Tunisia in particular has studied various pension reform options (box 2.3).

Quite the opposite, Libya's fiscal situation improved as Government revenues substantially rose in 2018 (61 per cent), while the country's spending remained restrained (20 per cent). Consequently, the fiscal deficit narrowed massively to 9.4 per cent GDP in 2018 from 30 per cent GDP the previous year. The improved dynamics further allowed the Libyan Government to control its public debt level having radically reduced it from 140 per cent GDP to almost 100 per cent GDP over the period 2017-2018 (figure 2.25). Nevertheless, the limited scope for public spending on social safety nets will remain a risk for sustaining the Libyan economy.

5. Arab least developed countries

The economies of Arab least developed countries (LDCs) contracted by 1.7 per cent

Figure 2.19 GDP and inflation, Arab LDCs, 2016, 2017, 2018, 2019 and 2020

Source: ESCWA staff estimations/forecasts based on national statistical sources; DESA, 2019a, 2019b, 2019c; and ESCWA, 2019e.

in 2018 before rebounding to an expansion of 0.3 per cent in 2019 (figure 2.19A). This negative growth was largely the result of underperformance in Yemen and the Sudan whose economies were impacted by political events. The steep depreciation of the Yemeni currency in mid-2018, coupled with double-digit hyperinflation, weighed down expansion of domestic demand, despite a rise in oil production. In the same manner, the Sudanese economy struggled against devaluations of the Sudanese pound. The country's economic situation was aggravated by hyperinflationary

pressures and serious balance of payments constraints. These downside risks were translated into dampened private consumption and deterred investment. In this context, the Sudan is facing serious unrest and political crises triggered by such growing economic hardships.

The other four LDCs, namely the Comoros, Djibouti, Mauritania and Somalia, had relatively stable economic environments. In the Comoros, agriculture and infrastructure sectors drove economic expansion, maintaining a growth

rate above 3 per cent. The growth outcomes in Djibouti and Mauritania were more favourable in 2018. Ongoing construction of a free-trade zone, a desalination plant and road infrastructure were conducive to positive economic activities in Djibouti, while the Mauritanian economy benefited from mining sector development and other commodity exporting activities. Despite long-standing conflict and poverty, the economy of Somalia also expanded at 3.3 per cent, thanks to telecommunications, construction and service sectors.

Overall, economic challenges in these low-income countries will be partly mitigated by a number of global-level trade facilitation initiatives, including the Bali Package and the duty-free and quota-free market access initiative under the guidance of the World Trade Organization (WTO). However, the subregion's heavy reliance on external assistance may still encumber the medium-term economic outlook. This is especially so for the economy of Somalia where remittance receipts account for a substantial portion of GDP: uncertainties leading to an economic slowdown in GCC countries or Europe in the forthcoming years may possibly exacerbate socioeconomic concerns.

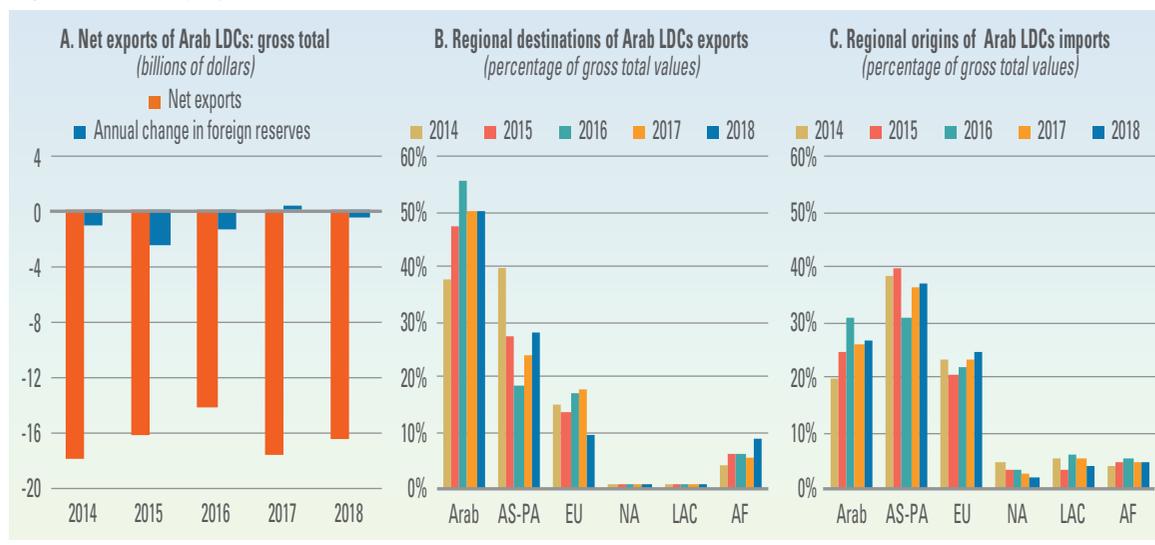
Reflecting on the macroeconomic challenges and political instability surrounding Arab LDCs, inflationary pressure was very strong in 2018, with about 50 per cent on average, a substantial increase from 27.1 per cent the year before (figure 2.19B). A surge in consumer prices was, however, attributed largely to the Sudan whose inflation soared to 63.3 per cent, driven by a sharp devaluation of the Sudanese pound and fiscal deficit monetization. Yemen is another conflict-affected country in this subregion whose double-digit hyperinflation has seriously reduced the purchasing power of households over the past year. That said, it should be noted that if double-digit hyperinflation from these two conflict-affected countries were excluded from the subregional average, Arab LDCs have faced quite low inflation. Subregional inflationary pressure

excluding these two appears to be around 0.2 per cent over the period 2017-2020.

The Comoros' inflation rate rose by 1.1 percentage point to 2.1 per cent in 2018, reflecting increased import prices that partially offset the effect of the decrease in communication prices resulting from competition among private telephone providers. Somalia's inflation also remained low at less than 1 per cent and this downward pressure will continue. Inflation in Mauritania stayed within price stability targets, at 3 per cent in 2018, but is expected to increase to 5.4 per cent in 2019. Meanwhile, the economy of Djibouti recorded the lowest inflation among Arab LDCs at 0.1 per cent, partly as a consequence of anchoring the Djibouti franc to the dollar at a fixed rate.

Arab LDCs are net importers, with merchandise exports and imports averaged for the past six years at \$8.8 billion and \$24.9 billion, respectively (figure 2.20A). This ongoing status of net importers implies that the subregion's trade structure is heavily dependent on imports, making fuel importing countries highly vulnerable to global price fluctuation. As a consequence of this, Arab LDCs as a whole were not able to accumulate foreign currency reserves in 2018. Moreover, the persistent trade account challenge led to no substantial change in their geographical trade structure in the end.

The subregion continued to export a large amount of energy and natural resources to Asia and the Pacific region, Europe and Africa, the three regions that received nearly half the subregion's total export value in 2018 (figure 2.20B). The remaining half were intraregional exports, which compromised a very high share relative to other subregions. For instance, the Comoros and Djibouti imported \$81.4 million (35.8 per cent share) and \$863.4 million (46 per cent share) in goods, respectively, from GCC countries while Somalia and the Sudan exported \$358.9 million (68 per cent share) and \$2.6 billion (47.4 per cent share) in goods,

Figure 2.20 Geographical trade structure, Arab LDCs

Abbreviations: Arab, Arab countries; AS-PA, Asia and the Pacific; EU, Europe; NA, North America; LAC, Latin America and the Caribbean; AF, Africa excluding Arab countries.

Source: ESCWA staff calculations based on IMF, 2018b, 2019b.

respectively, to GCC countries. Meanwhile, the share of Arab LDCs' imports from the three major trading partners also remained relatively stable and somewhat evenly distributed: 37.1 per cent from Asia and the Pacific region, 26.6 per cent from intraregional imports and 24.4 per cent from Europe (figure 2.20C).

This interregional trade performance is expected to continue to be supported by the WTO's preferential trade arrangements in favour of LDCs and the recent African Continental Free Trade Area (AfCFTA) agreement, which removes tariffs on nearly 90 per cent of goods among agreed members. In particular, not only could AfCFTA promote value added trade activities related to manufacturing goods and commercial services, it could also mitigate the negative effect of the trade dispute between the United States and China, for example.

In terms of the subregion's balance of payments performance, all Arab LDCs were faced with large external imbalances in 2018 (figure 2.21). The consolidated current account deficit was 14.9 per cent GDP in 2018 and this trend is expected to continue in 2019 and 2020, depending in part on the

development potential of AfCFTA for some countries. In the Comoros, the current account deficit widened from \$26 million in 2017 to \$68 million in 2018. The worsening of the current account position was mainly due to the structural deficit in the balance of trade and their vulnerability to diaspora remittances, which is expected to persist in the coming years.

Djibouti and Mauritania went through similar challenges in which imports for food and petroleum products are habitually large and thus their trade dynamics are highly affected by rising fuel prices. Ultimately, the deficit level in the current account balance posted as 15.2 per cent GDP in Djibouti and 18.2 per cent GDP in Mauritania. However, the deficit challenges could partly be mitigated in the coming years, hinging upon the performance of iron ore and gold exports (especially in Mauritania). The Sudan also faced serious weaknesses in the balance of payments particularly with large current account deficits close to 14.5 per cent GDP in 2018.

In brief, such persistent external sector challenges raised serious questions on

Figure 2.21 Trade and current account balances, Arab LDCs (percentage of GDP)

Source: ESCWA staff estimations/forecasts based on national statistical sources.

Note: Due to the lack of statistics, figures for Somalia and Yemen are not presented.

external debt sustainability especially in Djibouti (103 per cent GDP), Mauritania (82 per cent GDP) and the Sudan (160 per cent GDP). This forces the countries to become extremely vulnerable to a high level of risk of insolvency, despite their efforts to speed up negotiations of debt relief under the Heavily Indebted Poor Country debt initiative.

Most Arab LDCs use foreign reserves to finance long-standing current account deficits. Because of this, the subregion's foreign reserves dwindled in 2018: reserves

in the Comoros, Djibouti and the Sudan were reduced by \$8 million, \$102 million and \$4.8 million, respectively (figure 2.22). Broadly observing foreign reserves dynamics in Arab LDCs, the growth dynamics of broad money stock in the Sudan pointed to money-led inflation as consumer inflation posted at 63 per cent in 2018. Nonetheless, compounded by conflict-led high-risk premiums, the financial sector in the Sudan was challenged to extend credit to the private sector. Domestic demand growth in Mauritania and the Comoros generally appeared strong, owing to improved

Figure 2.22 Monetary indicators, Arab LDCs



Source: ESCWA staff elaboration based on national statistical sources and IMF, 2018c.

Note: Due to the lack of statistics, figures for Somalia and Yemen are not presented.

activities in the mining sector (in Mauritania) and the agriculture and infrastructure sectors (in the Comoros). Meanwhile, Djibouti initially benefitted from strong domestic demand during the first three quarters of 2018 but since suffered from a negative rate of year-on-year growth of broad money stock. This was due to weak consumer spending and reduced confidence, despite several large infrastructure projects under way.

The fiscal situations in most Arab LDCs remained relatively stable, compared to

other subregions (figure 2.23). In Djibouti, the fiscal deficit narrowed to 4.5 per cent GDP in 2018, in part owing to the completion of some infrastructure projects together with steadily rising customs duties from the re-export of goods from Ethiopia. The Government's intention to tighten spending in goods and services and transfers further contributed to declining the fiscal deficit. Meanwhile, the fiscal position in Mauritania was close to 1 per cent GDP in surplus in 2018. This well-managed fiscal outcome reflected a modest growth in mining receipts and accounted for a

Figure 2.23 Fiscal positions, Arab LDCs (percentage of GDP)

Source: ESCWA staff estimations/forecasts based on national statistical sources.

Note: Due to the lack of statistics, figures for Somalia and Yemen are not presented.

third of fiscal revenue. Following the rebasing exercise by the Central Bank of the Comoros, their fiscal deficit slightly widened to 1.7 per cent GDP in 2018. On the other hand, the Sudan's fiscal deficit continued in 2018, with 2.2 per cent GDP as the series of currency devaluations coupled with ongoing protests negatively affected economic activities, which in turn resulted in low tax collection and challenged the Government's spending capacity. Such gloomy circumstances in the fiscal position challenged the sustainable management of government debt, resulting in

a surge to 163 per cent GDP in 2018 from 120 per cent GDP the year before (figure 2.25).

B. Policy challenges

Throughout 2018 and up to the first quarter of 2019, a tighter monetary stance with rising financial costs for the Arab region was observed. Overall, central banks in almost all Arab countries increased their policy rates in tandem with the ongoing cycle of interest rate

hikes by the United States, with an increase in the interest rate on four occasions to reach the target rate of 2.5 per cent in 2018 (although no further hikes are expected in the coming months) (figure 2.24). They did so cautiously in order not to discourage domestic credit growth.

The Saudi Arabian Monetary Authority raised the policy lending rate to 3 per cent. It was indeed the first time the rate had been revised since January 2009. It also increased its policy deposit rate several times to reach 2.5 per cent in response to the Federal Reserve rate rises. Likewise, Jordan's Central Bank revised its policy interest rates up by 25 basis points in three steps in March, September and December 2018. In fact, the exchange-rate regimes of currencies pegged to the dollar continued to dominate in the Arab region. This exchange rate arrangement has meant many Arab countries have little role to play in their own monetary policy.

Meanwhile, Egypt and Morocco adopted a floating exchange-rate regime, which means they could afford a somewhat neutral or opposite monetary stance as more flexible exchange rates can be better positioned to absorb external shocks.¹⁶ After a series of sharp hikes in the aftermath of the Egyptian pound's flotation, the Central Bank of Egypt cut policy rates by 100 basis points in February 2018, an additional 100 basis points in March 2018 and again a further 100 basis points in February 2019. In a less aggressive fashion, Morocco has kept the policy interest rate unchanged at 2.25 per cent since March 2016.

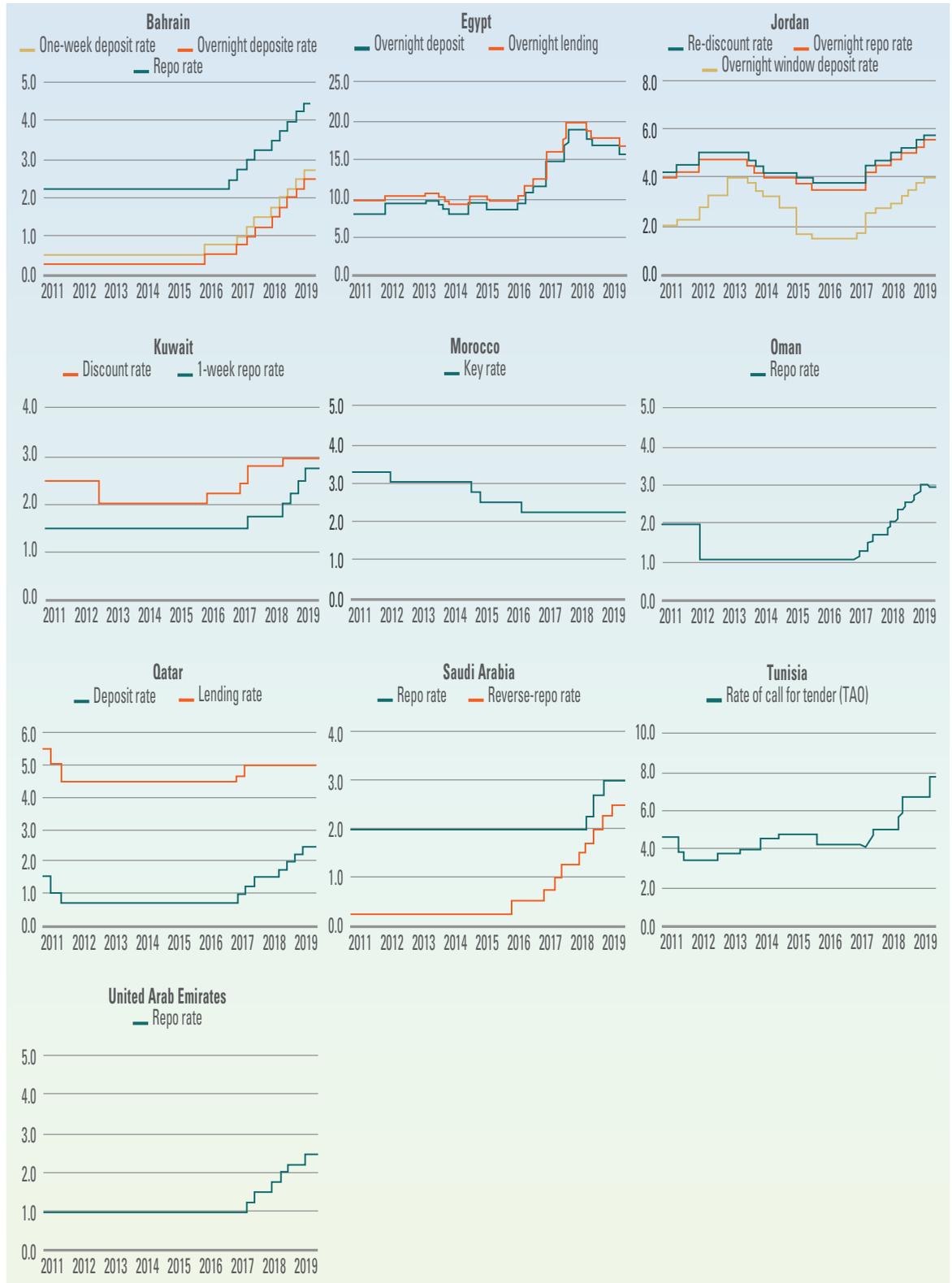
This normalization effort associated with the fast appreciation of the United States dollar has raised the cost of international financing, with many Arab countries using debt issuance for deficit financing purposes, thereby leaving many parts of the Arab region exposed to fiscal vulnerabilities. After all, many Arab countries run sensible fiscal deficits, despite extensive austerity measures implemented over the past few years. Their efforts include the recent

implementation of a unified GCC-wide VAT, the introduction of a series of subsidy reforms and revenue mobilization, and the removal of various tax exemptions (box 2.4). Under these fiscally challenging circumstances, several countries in the region have had no choice but to watch as public debt increased. The debt-to-GDP ratio for nearly half of the Arab countries exceeded 70 per cent GDP which is the benchmark of high risk of debt distress in the context of developing country groups (figure 2.25).

Elevated debt levels may have been aggravated, together with more volatile global financial market dynamics, thereby challenging the countries' macroeconomic policymaking capacity. Special attention should be paid to countries like Egypt whose public debt is considerably exposed to foreign exchange rate risk and is also likely to mature in the years to come. In particular, many parts of the Arab region benefited substantially from Chinese loans and investments (in line with China's Belt and Road Initiative), which has in turn resulted in them being significantly indebted to China in recent years. As a result, debt sustainability concerns are becoming more serious and will become more critical unless a significant effort is made to improve domestic revenues (or resources) mobilization.

In responding to such fiscal challenges, many Arab countries have already initiated energy subsidy reforms (figure 2.26) with efforts planned to continue in the coming years as well. These reforms are designed within the scope of fiscal consolidation, but the impacts will spread over sectors and industries. Energy subsidy reforms will undoubtedly support the fiscal balance, possibly generating some adjustment costs in terms of growth, employment and comparative advantage. However, differentiated impacts of the reforms can be expected in terms of gender when exploring sectoral employment implications. Such matters need to be addressed by policymakers and taken into consideration when designing appropriate actions to mitigate them (see chapter 3).

Figure 2.24 Policy interest rates, selected Arab countries, 2010-2018

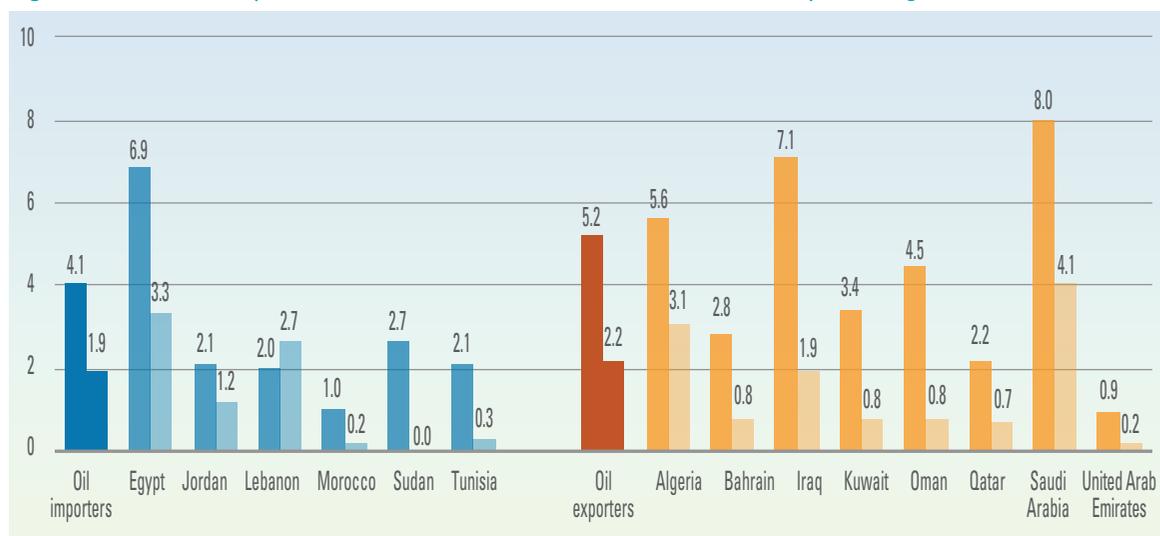


Source: ESCWA staff elaboration based on national statistical sources.

Figure 2.25 Public debt to GDP ratio, Arab countries, 2018 (percentage)

Source: ESCWA staff elaboration based on IMF, 2019b.

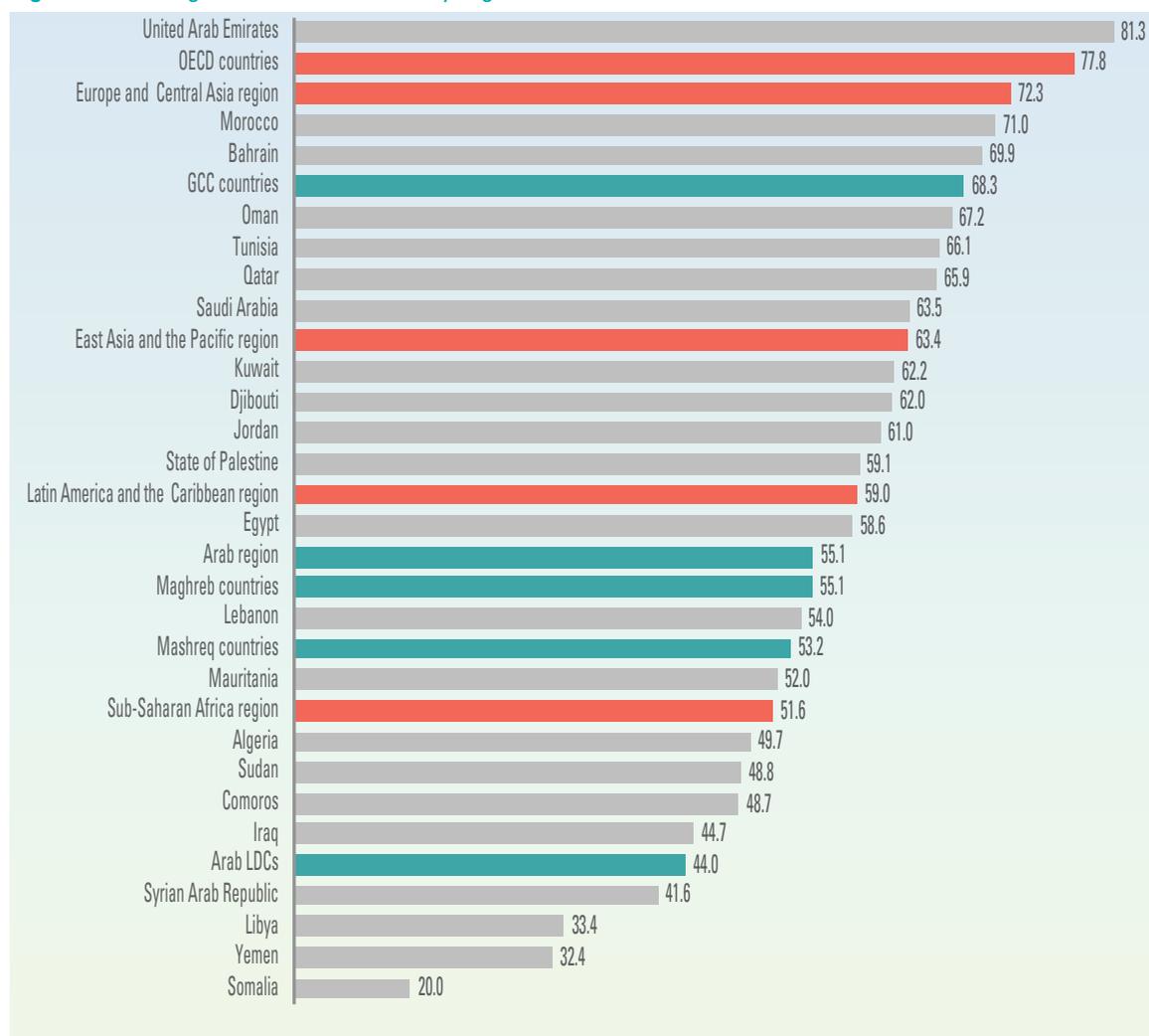
Note: Figures for Lebanon, Jordan, Bahrain, Morocco, Oman, Iraq, Algeria, Saudi Arabia and Kuwait are central Government debt, while Mauritanian Government debt includes oil revenue transferred to the oil fund, as well as public enterprises and central bank debts.

Figure 2.26 Petroleum price subsidies cuts, Arab countries, 2013 and 2016 (percentage of GDP)

Source: E/ESCWA/SDPD/2019/1.

In addition to persistent fiscal policy challenges, Arab countries are likely to rely on growth models that favour large public enterprises. However, this State-led development strategy may not be clearly linked to the creation of more decent jobs nor will it render their economies more inclusive. In this context, improving the business environment should be placed at the heart of policymaking

and legislation consideration. Some countries (Egypt, Jordan, Morocco and Tunisia) have already made steps towards strengthening their business environment in terms the ease of doing business. Meanwhile, other countries have focused particularly on legislative reforms to spur domestic investment and attract more non-hydrocarbon foreign investment.

Figure 2.27 Doing Business 2019 score by regions and countries

Source: ESCWA staff elaboration based on the World Bank, 2019j.

Note: This overall index is a composite indicator of 10 critical measures: (1) starting a business, (2) dealing with construction permits, (3) getting electricity, (4) registering property, (5) getting credit, (6) protecting minority investors, (7) paying taxes, (8) trading across borders, (9) enforcing contracts and (10) resolving insolvency, where 0 represents the lowest and 100 represents the best performance. For instance, a score of 75 means that an economy was 25 percentage points away from the best regulatory performance constructed across all economies while a score of 80 would indicate that the economy is improving.

Notwithstanding various attempts to promote private sector development, the Arab region as a whole is still not considered a business-friendly environment (figure 2.27). This underperformance can be measured by the World Bank's "Doing Business" index, which provides a snapshot of several business-related issues. The coverage of this index ranges across economic enterprises, determining on how easy it is to start a

business, get electricity, register property, get credit, pay taxes, protect investors and trade across borders. Looking at index scores on the business environment, the Arab region ranked fifth out of six groups, above only sub-Saharan Africa. Meanwhile, OECD countries, despite being overlapped with other regional groups, held the top position on the doing business score, followed by Europe and Central Asia, East Asia and the

Pacific, and Latin America and the Caribbean. Although individual GCC countries ranked relatively high, thanks to Dubai which is one of the world's most popular business hubs, other countries in other subregions remain far behind.

The doing business indicator has in general a strong correlation with the level of total factor productivity (TFP), which is a crucial measure of efficiency and effectiveness of an economy and thus an important indicator for policymakers. Acknowledging such close relationship means the better a country's

doing business score, the higher on average its level of total factor productivity.

It can also be suggested that a better business environment likely translates into the improvement of total effectiveness among economic agents. Having said that, Arab policymakers should be able to design and implement productivity-enhancing reforms through strengthening a national-context-dependent business environment (such as legal regulatory frameworks, fair competition and innovative public procurement with a particular form of public-private partnership).

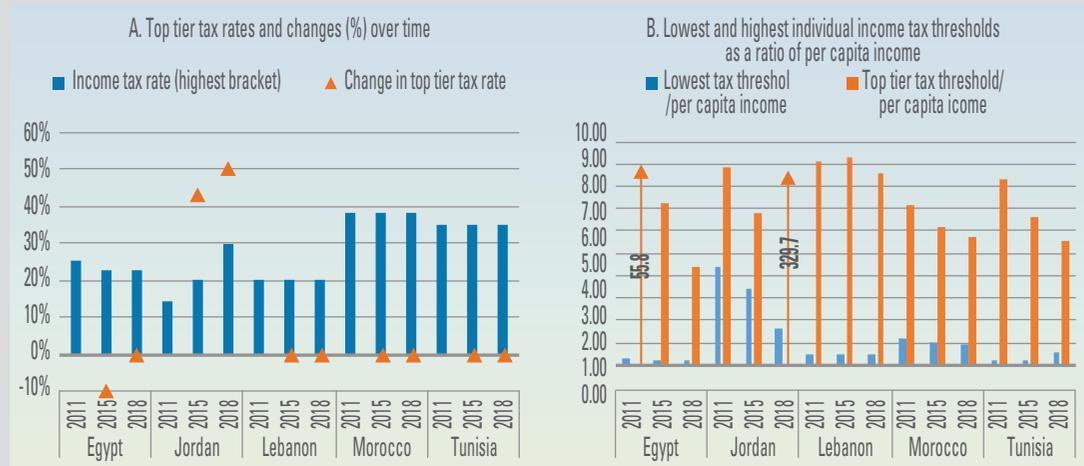
Box 2.4 How equitable and efficient are recent tax reforms in the oil-poor middle-income Arab countries?

Arab countries have systematically low tax collection rates relative to the size of their economies, and little attention has been paid to ways of improving taxation systems to raise more revenue or to ways of improving fairness in tax systems.^a Historically, oil-rich countries rely largely on oil revenues and oil-poor countries rely on tax revenues as major sources of their revenue. On average, the share of taxes in GDP in oil-rich countries of the region were 7.3 per cent in 2017 while in oil-poor countries of the region the figure was 13.7 per cent. The median tax revenue as a share of GDP was 15.8 per cent in 2017, which is lower than the median for the middle-income countries and much below the median of the developed countries in the world. In the Arab region, the exceptions are Morocco and Tunisia, where the share of taxes in GDP was about 22 per cent in 2017.^b

Amid low oil prices, high debt and rising expenditure needs for meeting aspirations of people during the recent years, public budgets across the Arab region have come under heavy pressure. Hence, several Arab governments have undertaken tax reforms during the past five years, mostly focusing on income tax and taxes on goods and services such as VAT, with the aim to raise revenues. These reforms are analysed below in the perspective of their impact on equity and revenue raising potential.

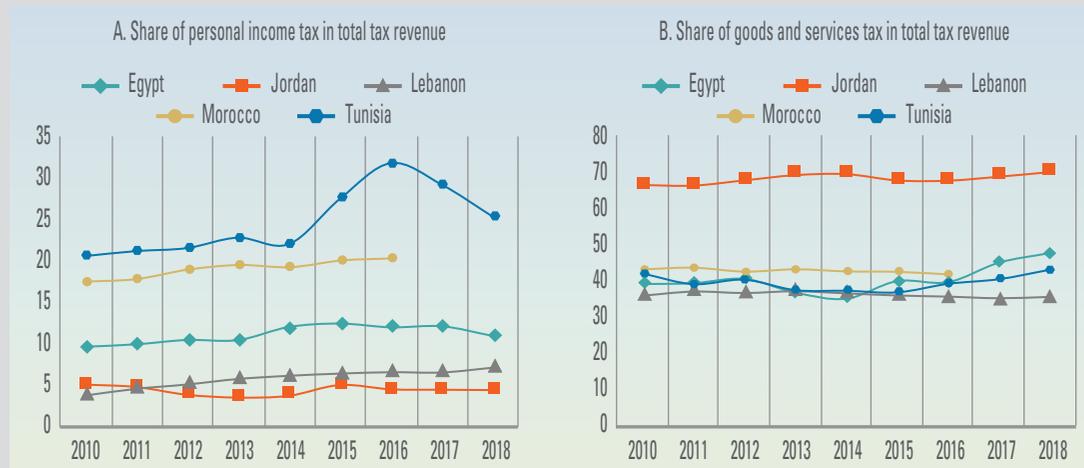
In the years since 2010, the top tier tax rates have not changed for most middle-income countries of the region that most rely on tax resources, except for Jordan and Egypt. In Jordan, the top tier tax rate increased from 20 to 30 per cent from 2015 to 2018. In Egypt, there was a decline in top tier tax rate from 2011 (25 per cent) until 2015 (22.5 per cent) and the rate remained unchanged after that (figure 1A). However, there have been efforts to expand the tax base to harness more revenues from individual income tax, which can be deduced from the declining ratio of top tier tax thresholds to per capita income between 2011 and 2018 (figure 1B). The ratio declined for most countries, except for Jordan where a new upper threshold was introduced during 2018. The new threshold went up to 1,000,000 Jordanian dinars (JD) replacing the previous threshold of 20,000 JD and the tax rate for the top tier went up to 30 per cent. Interestingly, the bottom threshold also reduced during the same period, from 12,000 JD in 2011 to 5,000 JD in 2018. Elsewhere, in terms of the ratio of bottom threshold to per capita



Figure 1. Reforms in individual income tax

Source: Based on national statistical sources.

Note: The arrow for Egypt shows the top tier tax threshold to GDP per capita ratio in 2011; the arrow for Jordan shows the top tier tax threshold to GDP per capita ratio in 2018.

Figure 2. Changes in tax collections – Tax on income and goods and services

Source: Based on national statistical sources; and IMF, 2018a.

income, most countries show a declining trend, except for Tunisia.^c The declining ratio is indicative that more people at the lower end of income, who were exempted previously, would have entered the tax bracket. The impact of these changes on expenditure and poverty is yet to be assessed. In general, the significant reductions in the ratio of top tier tax threshold to per capita income tend to show improvement in tax fairness. However, there are significant differences across countries. For instance, this ratio is 1.65 times the per capita income in Jordan, while it is 0.17 times the per capita income in Egypt.

Furthermore, the question remains as to how effective these changes have been in improving tax collections. The share of income tax to total tax revenues increased in the cases of Lebanon and Tunisia (figure 2A). Jordan and Egypt, which introduced several changes in top



tier tax rate and bracket during 2015 to 2018, didn't notice any significant change in the share of tax collections from individual income. For Morocco, updated data on individual income tax is not yet available, but there seems to be an upward trend share of personal income tax to total tax revenues.

Several of these middle-income countries have also introduced reforms in goods and services tax, including introduction of value added tax (VAT) or the upward revision of VAT. Until 2015, Egypt had a goods and services tax rate (GST) of 10 per cent. In 2016, Egypt implemented a VAT system instead of a GST. The general VAT rate was 13 per cent in 2016 and it increased to 14 per cent in 2017. Tunisia increased VAT rate by 1 percentage point for all VAT slabs^d in 2018.^e Lebanon increased its VAT from 10 to 11 per cent in 2017 and it implemented the increase in 2018.

The introduction of VAT in Egypt has led to a significant increase in share of goods and services tax in total revenues since 2016. In Tunisia too, the continuous increase in the share is reflected upon the rising VAT (figure 2B). In Lebanon, the effectiveness of increased VAT is yet to be assessed, as there is missing data for the month of December in 2018.^f In Jordan, the share of goods and services tax constitute about 70 per cent of total tax revenue. High reliance of tax revenue on goods and services is indicative of a regressive tax system, as the burden lies more on the poor and middle class. The middle-income countries of the region, who rely highly on tax resources, unfortunately, depend on indirect taxes more than individual income tax collection. Therefore, there is much more scope to improve fairness and equity in tax systems.^g

^a E/ESCWA/EDID/2017/4.

^b Based on data from IMF, 2019b.

^c In Tunisia, the ratio was lowest among all countries and the ratio of bottom threshold to per capita income went up between 2015 and 2018. This is due to upward revision of the bottom threshold, giving tax exemptions to individual incomes at the lower end of income distribution.

^d VAT slabs refer to a system of taxation where rates depend on the categories of goods and services.

^e The VAT rates increased from 6 to 7 per cent, 13 to 14 per cent, and 17 to 18 per cent for the classification of goods and services.

^f For Lebanon, latest VAT collection records are available up to November 2018.

^g E/ESCWA/EDID/2017/4.

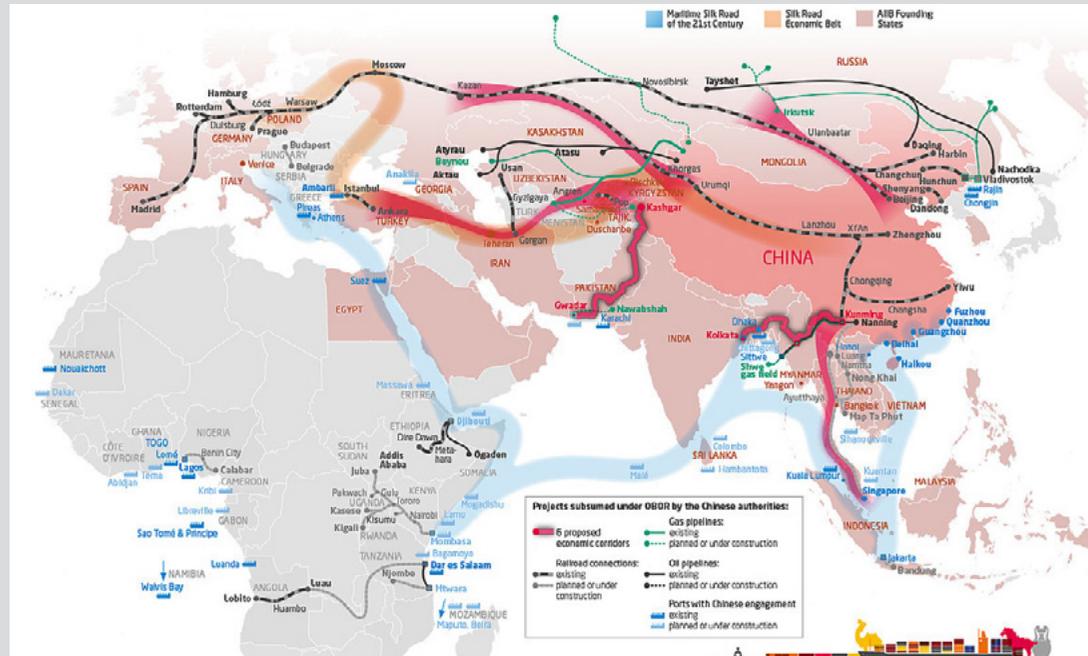
Box 2.5 The Belt and Road Initiative

Background: In September 2013, the Chinese President Xi Jinping announced a strategic initiative to develop a network of land and sea routes to diversify Chinese export channels across the world. At the start, it was known as the One Belt One Road Initiative, then as the Belt and Road Initiative, and sometimes as the New Silk Road. The initiative aims to finance various infrastructure projects in the field of transport and logistics to strengthen Chinese trade relations with emerging countries in Africa and Central Asia, on the one hand, and to develop northern and western Chinese provinces that are relatively distant from major Chinese ports by directly linking them via rail to European markets, on the other.

The "Belt" refers to the six-proposed land economic corridors connecting Asia with Europe and Middle East, while the term "Road" refers to the Maritime Silk Road of the twenty-first century linking between China, Asia, Africa and Europe.



Main components of the Chinese Belt and Road Initiative (BRI)



Source: China and Her History, "Infographic/China Mapping Silk Road Initiative", 16 February 2017, available at <https://chinahistory101.wordpress.com/2017/02/16/infographicchina-mapping-silk-road-initiative-infographicchina-mapping-publications-mercator-institute-for-china-studies/>.

Main financiers: The total value of the proposed projects under the initiative is estimated at around \$1 trillion in roads, railways and sea port investments. The financing framework of the BRI is presented as following:

- Financiers of the Chinese companies:
 - ⊙ Chinese policy banks: Chinese Development Bank and the Export Import Bank of China;
 - ⊙ Silk Road Fund (Established in 2014 with \$40 billion of initial total capital).
- Financiers of projects in BRI countries:
 - ⊙ Asian Infrastructure Investment Bank (AIIB): established in 2015 with \$100 billion of initial total capital;
 - ⊙ New Development Bank (NDB): established in 2014 by the BRIC countries.

International involvement with the BRI: The involvement of countries in the BRI projects is expressed mainly through bilateral memoranda of understanding (MoU) and agreements with the Chinese Government and its relevant agencies. More than 60 bilateral agreements were signed since 2014 with more than 70 countries accounting for around half of world population and the third of world GDP.

The second Belt and Road Forum on the BRI, held from 25 to 27 April in Beijing, attracted 5,000 participants from 150 countries and 100 organizations. In his remarks at the opening session, the Secretary-General underscored sustainable development/sustainability link and pointed out three important opportunities that can be seized: the world will benefit from a Belt and Road Initiative that accelerates efforts to achieve the Sustainable Development Goals; the world needs to leverage the Belt and Road Initiative to help close significant financing gaps for achieving the



Sustainable Development Goals; and the Belt and Road Initiative can serve as an important space where green principles can be reflected in green actions.

As for the Arab region, the BRI was addressed in a recent ESCWA concept note on “[Megatrends in the transport sector and their potential impact on the Arab region](#)”, presented at the [Thirtieth Ministerial Session of ESCWA](#) held in Beirut from 25 to 28 June 2018. The Belt and Road Initiative was considered as one of the main global drivers of change in world transport during the twenty-first century. The paper revealed that advances in the development and implementation of the initiative’s projects have raised questions about their potential impact on sea transport via the Suez Canal and the Mediterranean Sea to Northern Europe. The paper also noticed that BRI projects could shift focus from major regional sea ports in the Arabian Gulf to new ports in the Indian Ocean, the Arabian Sea and the eastern coasts of Africa.

More recently, ESCWA participated to an international forum on the “Silk road initiative and the investment opportunities between the Arab countries and China”, held in Alexandria on 17 and 18 September 2018, in cooperation with the League of Arab States and the Arab Academy for Science, Technology and Maritime Transport. ESCWA advocated the necessity for the Arab countries to deal with the BRI projects through a [strategic common vision for the development of multimodal transport](#) that enhance the connectivity between the countries and the integration of the Arab region with the rest of the world.

C. Social developments and gender dynamics

1. Overview

In this section of the Survey, we highlight the main socioeconomic developments that took place in the region during the reporting period. We explore the region’s progress and drawbacks using a gender-focused lens and draw the attention to the main achievements and challenges that may be impeding progress towards equality and prosperity. The Arab region has some of the most diverse socioeconomic features in the world: it includes high income and oil-exporting countries, least developed countries and countries with ongoing conflict or affected by conflict. However, and despite these heterogeneous conditions, the labour market dynamics in the region have many similarities in terms of opportunities and challenge.

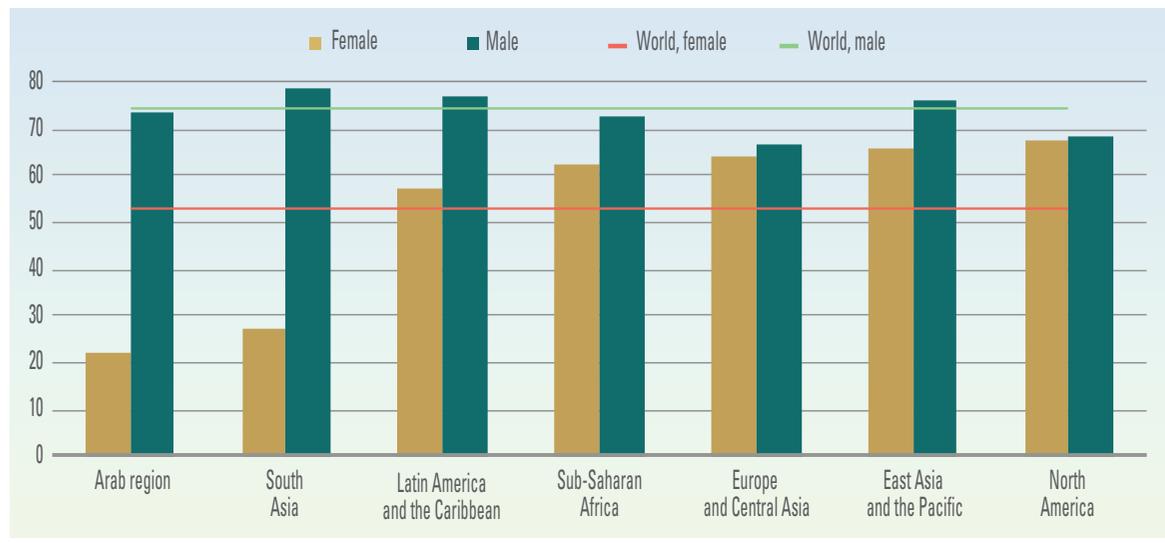
While progress towards gender equality and participation of women in the region has been positive, it has also been slow. Despite

the many challenges faced in the regional labour market, countries are more than ever cognizant of the issues to be addressed, including the segmentation and segregation of the labour market. Many are developing labour policies that address these challenges and target the underrepresented and most vulnerable groups. However, the road is long and targets are far from being achieved. The region has a great opportunity to exploit the full potential of women’s employment as well as to take advantage of the contributions of women who have attained high levels of education. However, more effort is required to ensure equal opportunities and protective spaces and practices for women if countries want to pursue further economic growth and catch up with global progress.

2. Labour market

In 2018, the employment situation in the Arab region recorded its worst performance since 2010.¹⁷ Labour force participation rates are the lowest worldwide because women’s participation is significantly below the global

Figure 2.28 Labour force participation rates, regional averages, 2018 (percentage)



Source: World Bank, 2019g.

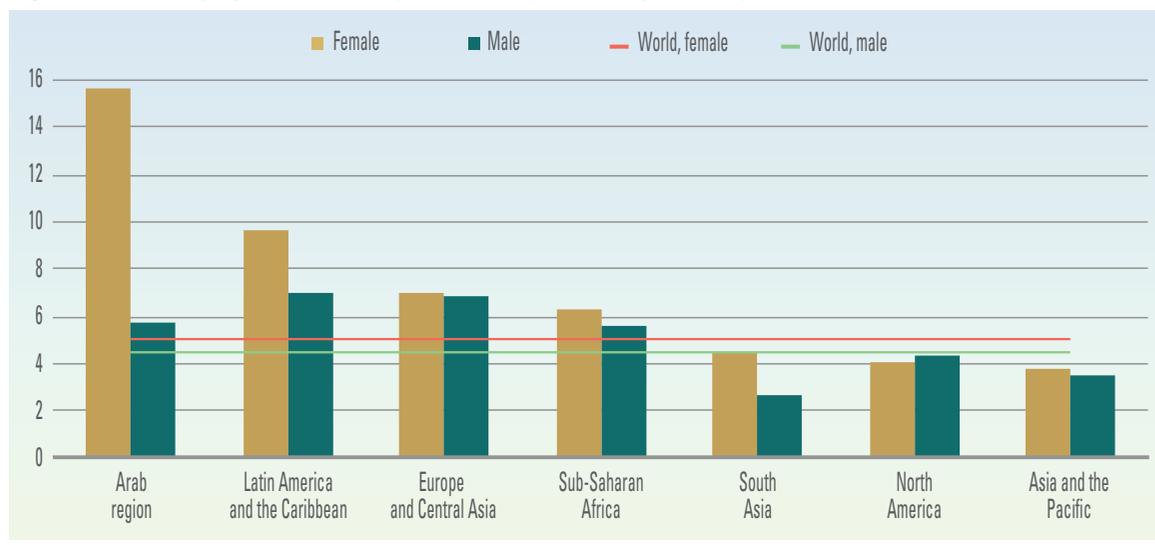
average. Men's participation rate, however, is close to the global average. In 2018, the female labour force participation rate was 21 per cent, compared to 74 per cent for men and well below the world average of 53 per cent (figure 2.28).¹⁸ The political crises and persistent conflicts in countries including Iraq, Libya, the State of Palestine, Somalia, the Syrian Arab Republic and Yemen continue to impede labour market development in the region.

Concerning unemployment, the region recorded alarming rates in 2018 for both women and men. Additionally, Arab women face uneven challenges and opportunities in the region's labour market. According to International Labour Organization (ILO) estimates, female unemployment rates in the region reached 15.6 per cent compared to 5.8 per cent for men in 2018 (figure 2.29). The region has the highest unemployment rates in the world for females and is above the world average for both females and males.

Unemployment rates are particularly alarming among youth, whose unemployment reached 26.1 per cent¹⁹ after a peak of 27.3 per cent in 2012.²⁰ Population in the region is growing²¹ and youth account for a significant percentage

of the population which signals the imminent need for policies targeting job creation. The region must also foster more entrepreneurial initiatives, targeting youth in particular, as well as offer fiscal incentives to start-ups and small-to medium-sized enterprises.

In 2018, the United Arab Emirates ranked first in the Arab region and twenty-fifth in the world in terms of Ease of Doing Business²² followed by Morocco (rank 34 globally) and Oman (rank 37 globally). In recent years, these countries have taken serious steps in reforms to improve the business climate ranging from streamlining approval processes, to introducing electronic governance to offering fiscal incentives such as abolishing or reducing the minimum capital requirements and other costs for business start-up. In Bahrain, the number of start-ups has grown at a compound annual growth rate of 46.2 per cent over the past three years, according to the Economic Development Board of Bahrain,²³ supporting mostly technology and ecosystem start-ups such as software development and financial technology (FinTech) firms. The country is supporting more venture capital and angel investment initiatives that provide funding and assistance to start-ups and early stage firms.

Figure 2.29 Unemployment rates, regional averages, 2018 (percentage)

Source: ILO, 2019a.

There is wide agreement on the problems facing youth employment in the region which include: skills mismatching, rigid employment regulations and a deterrent business environment. A major complication that women face is the cultural disapproval of their equal participation in the labour market, the deprivation of the basic human right of education (in some Arab countries) and, consequently, potential unemployment. Finally, the supply-side failure of gainful employment opportunities, especially in attractive public sector posts, is also resulting in excessively high youth and women unemployment rates in the region.²⁴ However, the main issue is that there are simply not enough jobs created to absorb all the new entrants to the labour market.

These are some of the most common issues that need to be addressed by policymakers when devising strategies for not only creating jobs but also decent working conditions.

When looking at specific country performances, we notice huge disparities in labour participation rates between men and women which are evident in all countries in the region. For example, and based on ILO estimates, the female participation

rate fluctuates from 6 per cent in Yemen, which has the lowest female employment rates, to around 59 per cent in Kuwait. Labour force participation rates are much better for males and range from around 64 per cent in Jordan and Morocco to around 94 per cent in the United Arab Emirates and Qatar (Appendix). The disparity is also noticeable across subregions whereby most of the high-income countries in the region, including the GCC countries, are performing better in terms of labour force participation for both sexes, with particular progress for females during the past five years. Most of the GCC countries have introduced labour nationalization policies accompanied with improved compensation and benefit plans in both the public and the private sector that are attracting more females into the labour force market. On the opposite end of the spectrum, countries undergoing, recovering from or affected by conflict suffer the most in terms of employment conditions, coupled with marginalization and poverty. Although labour force participation and unemployment are difficult to measure in countries of conflict due to the lack of or insufficient data, evidence shows a direct relationship between conflict and employment in which

formal sector jobs decline during crisis, while opportunities mostly in the informal sector (and frequently illegal jobs) rise.²⁵

Despite the heterogeneous situations and different socioeconomic structures in countries in the region, there are some common labour market characteristics. The region is highly segmented which means that conditions of access and terms of employment are fundamentally different from country to country. This hampers the labour market and the ability to match demand with supply. There is also segmentation in the share of employment in the public versus private sector in many countries of the region: nationals are primarily employed in the public sector while migrant workers mostly in the private sector. Work in the informal economy or underemployment represents a great proportion of employment in many countries of the region and a significant portion of the private sector employment. At least 67 per cent of the region's workforce is employed in the informal sector²⁶ which is mostly concentrated in agriculture and the lower end of the services sectors and thus employs low-skilled workers. The lack of opportunities with good compensation for high-skilled workers and weak job security and social protection nets in the informal sector drives away educated workers and is a significant cause of brain drain in the region. Countries undergoing conflict in the region are main recipients of the informal sector jobs, as a coping mechanism to the scarce opportunities in the formal sector. This problem usually persists into the post-conflict phase, due to the lack of skill matching with job seekers and the dearth available jobs. The informal sector is recognized for the serious deficits in work conditions, access to social protection and insecure wages and income.

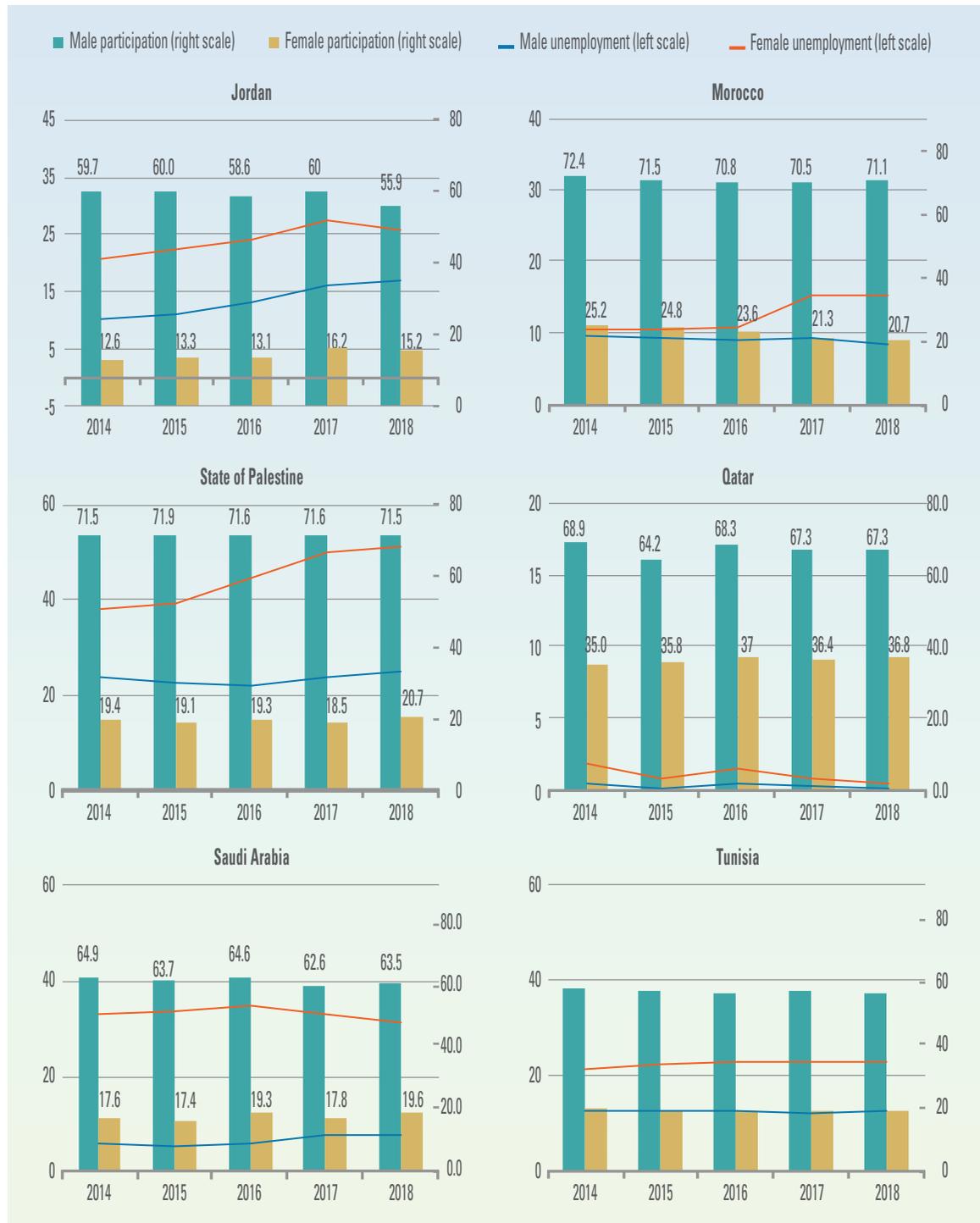
Gender segregation in the region's labour market persists and can be plainly observed through multiple factors that are challenging for women. Government or public-sector jobs

are seen as the employment of first choice for women in the region due to better incentives and pay. A "crowding" of women is seen in certain occupations, such as services, that are characterized as being family friendly, augmenting the competition for these specific jobs and increasing unemployment differentials for women. In the region and throughout the past years, there has been a significant increase in the levels of education, especially tertiary education for both sexes but most significantly for women, however the new jobs being created mostly require low skills. This mismatch between demand and supply is attracting migrant labour and driving a "brain drain" from the region. Other common concerns for women that may be impeding them from entering and remaining in the workforce include limited mobility and transportation, concerns on personal safety and fears of harassment, political instability and cultural norms that subordinate woman in certain Arab countries. However, the uneven distribution of unpaid care is likely to remain a dominant factor.²⁷ It is promulgated by the overriding social norms, which define the role of women and lead the factors mentioned above. The region also suffers from significant gender wage gaps and other gender-related differentials. For instance, in Morocco, women working in both the private and the public sectors, earn around 17 per cent²⁸ less than men. Women in the region are much more likely to be engaged in unpaid care work²⁹ than men and are mostly employed in low-productivity sectors and part-time work, all facts that heighten the inequalities in pay. While several measures can be taken by governments in the region to mitigate these challenges, the first and most important step is to examine the labour laws and policies and how they affect men and women differently. Such policies include gender-blind policies that do not take into account the specific challenges faced by women compared to men, such as different family care expectations, and then act to reinforce the structures needed to encourage

women to enter and stay in the labour market (including family friendly policies, flexible

working hours, maternity protection, nursing facilities, paternal leave and other social

Figure 2.30 Unemployment and labour force participation rates, selected Arab countries, 2014-2018 (selected countries)



Sources: ESCWA staff calculation based on data from national statistical offices (appendix).

protection mechanisms), with the ultimate goal of achieving gender equality.

For the past four years, Jordan maintained a notably increasing rate of unemployment for both men and women reaching peaks in 2017, especially for women. In 2018, a slight decrease in unemployment rate for women to 25.7 per cent was observed compared to 27.5 per cent in 2017. This shift was matched with a decrease in female participation rate to 15.2 per cent in 2018. Men on the other hand, recorded a slight decrease of labour force participation rate compared to 2017 at 55.9 per cent in 2018, which was accompanied with an upward trend in the unemployment rate since 2010, reaching its highest rates of 16.9 per cent in 2018 (figure 2.30).

The Syrian crisis has had a toll on Jordan's economy's trajectory in general and the work force specifically as the massive influx of Syrian refugees reported has caused a deterioration of wages and led to increased unemployment. The inflow of refugees has had an especially negative effect on the rate of employed nationals to the informal market.

The most notable factor in Morocco's labour market is the wide gap between male and female unemployment rates. Female unemployment rate continued to increase, recording 15.2 per cent in 2018 compared to 8.3 per cent for males (figure 2.30). This expanding gap corresponds with a significant decrease in female participation rate to 20.7 per cent in 2018 from 25.2 per cent in 2014, while men's rates remained stable at 71 per cent over the past five years.

In the State of Palestine, the already extremely wide gap in unemployment rates between men and women continued to grow wider. Women's unemployment rate was recorded at an alarming level of 51.2 per cent while men's increased slightly to 25 per cent in 2018 from the previous year. This gap was accompanied with an increase

in female labour force participation rates reaching 20.7 per cent in 2018. Men on the other hand maintained a stable participation rate hovering around 71.5 per cent since 2015. The escalation of the Palestinian struggle and internal conflict in 2018 in addition to the isolation of Gaza strip resulted in a damaging trend in both unemployment and labour force participation for both men and women. Restrictions on mobility and the hostile environment remain the main challenging issues for Palestinians, especially women when seeking employment.

Qatar continues to have low unemployment rates for both men and women in the region, accompanied with high rates of labour force participation, for women in particular. A stable participation rate of 67.3 per cent for men and 36.8 for women in the Qatari labour market was recorded in 2018. The unemployment rate gap between men and women continued to shrink recoding 0.1 per cent for males and 0.4 per cent for females in 2018.

In addition to the "Qatarization" policy, Qatar has been working on educational reforms targeted towards equipping nationals with the skills required to satisfy the demands of the current labour market. This approach can be observed in the launching of branch campuses of multiple major western universities to increase tertiary education in Qatar. Gross tertiary education enrolment increased from 9.85 per cent in 2010 to 16.2 per cent in 2017, according to UNESCO statistics.³⁰ At the primary and secondary education level, Qatar excels at providing premium schooling systems, that are productive, practical and free of charge, preparing young generations with the skills needed to match the labour market demand.

The wide gap in unemployment rate between men and women persisted in Saudi Arabia. That said, the female unemployment rate recorded a notable decrease to 31 per cent in 2018 compared to 34.5 per cent in 2016.

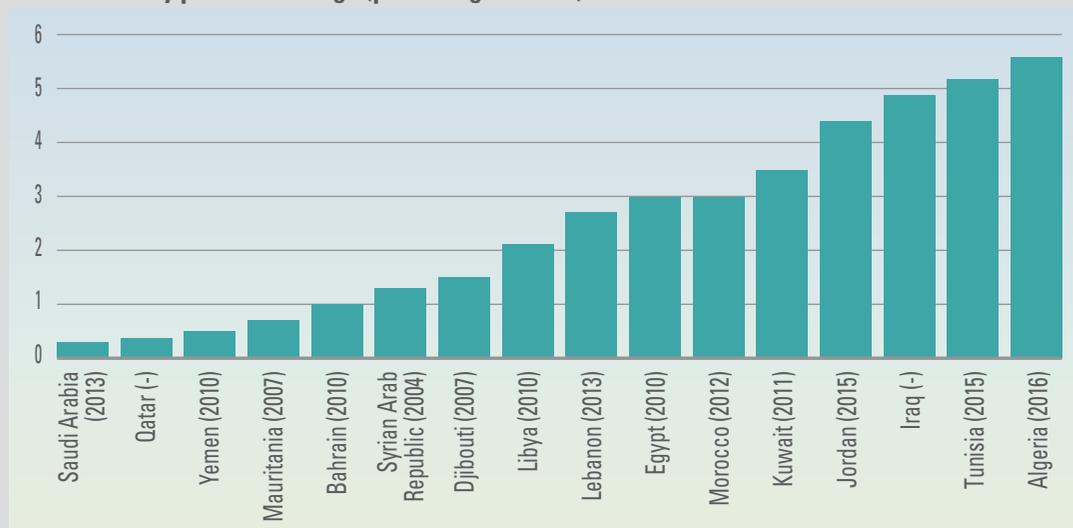
Box 2.6 Social protection for older persons in the Arab region

The Arab region will experience considerable demographic and socioeconomic changes over the coming decades, including population ageing. The number of older persons (aged 60 years and above) which is currently close to 27 million, is projected to reach around 49.6 million by 2030 and to exceed 100 million by 2050, thus constituting over 15 per cent of the population in 2050.^a

It is critical to acknowledge the economic and social value of older persons, while ensuring their social protection and income security. Adequate social protection, including pension coverage, is a prerequisite for the well-being of older persons, protecting them from poverty, ill health, exclusion and isolation.

All Arab countries have some type of mandatory contribution of earnings linked to social insurance systems. However, pension spending in the region is relatively high, provides only low coverage and suffers from structural problems. Low coverage rates are attributed to the large informal employment sector and to unemployment, which disproportionately affect women. When compared with other regions, the Arab region has relatively low levels of public expenditure on social protection for pensions and other benefits, excluding health, for persons above the statutory pensionable age (2.6 per cent of GDP in Arab countries compared to 5.1 per cent in Asia and the Pacific region countries).^b Furthermore, many pension schemes are unsustainable because of the likelihood of a higher number of beneficiaries than contributors in the future as a result of population ageing, low retirement age and generous survivorship pensions in some countries.

Public social protection expenditure on pensions and other benefits, excluding health, for persons above statutory pensionable age (percentage of GDP)



Source: ILO, 2017.

In the light of these circumstances, it is essential for governments to develop appropriate social protection systems. The core goals for recommended social protection and long-term care policies are to ensure income security and to meet the long-term care needs of current older persons and those of younger individuals who will reach old age in the coming decades. Policies must therefore adopt a life-course approach and include proactive and preventative policies to enhance the wellbeing and quality of life of current and future cohorts of older persons in the



region. Governments also need to make use of current population dividends and acknowledge the role played by families and informal caregivers in supporting older persons.

Policies should address the following key dimensions:

- Human rights and equality in old age;
- Be centred on providing care and support to persons;
- Ageing-in-place and enabling environments;
- The role of social capital and healthy ageing;
- Tackling health inequalities in old age;
- Ensuring that central and local governments are taking the lead in shaping aged care and support policies, programmes and providers;
- Developing an appropriately trained long-term care workforce;
- Utilizing developments in innovative technologies to support older populations;
- Ensuring strong data and evidence to inform practices and policies.

Implementing social protection policies and schemes for all age groups enhances the opportunities of future generations for a more fulfilling and dignified experience in old age. Now more than ever, governments are prompted to take action to “leave no one behind” as they work to achieve the 2030 Agenda for Sustainable Development.

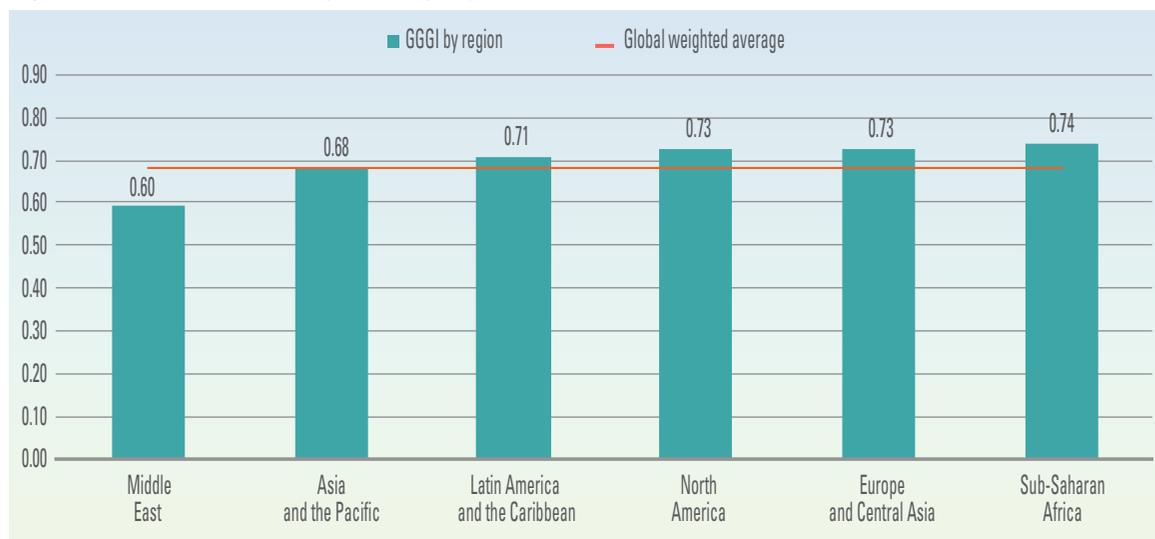
^a DESA, 2017.

^b ILO, 2017.

Furthermore, this was complemented with a record high female participation rate of 19.6 per cent in 2018, the highest rate since 2010. Males, on the other hand, have maintained a stable rate of unemployment which has hovered around 5.8 per cent since 2017. However, men’s participation rate experienced a slight increase to 63.5 per cent in 2018. Despite the persistence of a wide gender gap which conveys a broader narrative of gender inequality in Saudi Arabia, there are promising indications that women are on the verge of tangible change based on last year’s result. This reflects the proactive measures taken to achieve the gender equality goals of Saudi Government’s Vision 2030. These included recent Government actions in giving women the right to drive and apply for jobs previously off limits, introducing new labour laws and the “Women in the Workplace” initiative. These actions by the Ministry of Labour and Social Development have helped expanding an accessible and comfortable working environment for women.³¹

Tunisia’s labour market maintains a steady participation rate for both men and women hovering since 2016 at around 60 per cent for men and 20.5 per cent for women. However, the unemployment gap continues to grow, with female unemployment rate reaching a record high of 22.9 per cent in 2018 compared to 12.5 per cent for men. In Tunisia’s labour market, 40 per cent of youth graduates are unemployed, a percentage rising from 30.5 per cent in 2016, according to OECD.³² In addition, the deterioration of Tunisia’s economy has not helped improve the situation of the labour force market. Even though improvements are expected in the export sector due to the recovery of the European market, young graduates are expected to continue to struggle with unemployment in the absence of appropriate measures.

In 2017, 40.8 per cent³³ of all workers in the Arab region were migrant workers – the highest proportion in the world.³⁴ A share of that

Figure 2.31 Global Gender Gap Index by region, 2018

Source: ESCWA staff calculations based on WEF, 2018.

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

percentage in the region (around 1.6 million)³⁵ is composed of domestic workers who carry out household duties and are typically female migrants³⁶ coming from developing countries in Asia and Africa. Their numbers are increasing with the increase in demand for these services. Notwithstanding the many recent movements and some achievements driven by civil societies and international organizations to improve policies in the region, it is imperative that Arab countries, who are apparently becoming reliant on this sector, put in place effective regulatory systems that serve both the employers and workers and uphold basic human rights.

3. Indicators for gender equality

In terms of gender equality indicators, the region recorded no significant progress from 2017. The region continues to rank last globally with a 40 per cent gender gap according to the 2018 Global Gender Gap Report. The report uses four objective dimensions to measure the Gender Gap Index: Economic Participation and Opportunity, Educational Attainment, Health and Survival and Political Empowerment. The Arab region is still also the only region that falls below the global average of 32.0 per cent

compared to other regions of the world (figure 2.31).³⁷ Two countries, Oman and Iraq, joined the index in 2018. Tunisia is the top performer in the region with a rank of 119 out of 149 countries followed by the United Arab Emirates (rank 122) and Kuwait (rank 126). On the other end, the Syrian Arab Republic (rank 146), Iraq (rank 147) and Yemen (rank 149) recorded the lowest ranks amongst countries featured in the index in 2018.

The report also reveals the disparities in subindexes between and within Arab countries in the overall index. While significant progress was achieved by some countries in areas of education and health, the Global Gender Gap Index results for 2018 indicate that the major gender disparity in the region is in the Political Empowerment subindex. Egypt, Saudi Arabia and Yemen have been the world's lowest ranked countries on this subindex reflecting the weak representation of women in the political field, especially in leadership positions.

4. Women's political participation

According to the Inter-Parliamentary Union data as of January 2019, the Arab region

Table 2.1 Women in national parliaments: comparison 2018-2019

Country		As of June 2018				As of 1 February 2019			
		Lower or single house				Lower or single house			
		Elections	Seats ^b	Women	% of women	Elections	Seats ^b	Women	% of women
1	Tunisia ^a	10 2014	217	68	31.34%	26.10.2014	217	78	35.90%
2	Sudan ^a	4 2015	426	130	30.52%	13.04.2015	481	133	27.70%
3	Djibouti ^a	2 2018	65	17	26.15%	23.02.2018	65	17	26.20%
4	Algeria ^a	6 2017	462	119	25.76%	04.05.2017	462	119	25.80%
5	Iraq ^a	5 2018	329	84	25.53%	12.05.2018	329	83	25.20%
6	Somalia	10 2016	275	67	24.4%	23.10.2016	275	67	24.4%
7	United Arab Emirates	10 2015	40	9	22.50%	03.10.2015	40	9	22.50%
8	Morocco ^a	10 2016	395	81	20.51%	07.10.2016	395	81	20.50%
9	Mauritania	11 2013	147	37	25.17%	01.09.2018	153	31	20.30%
10	Saudi Arabia	12 2016	151	30	19.87%	02.12.2016	151	30	19.90%
11	Libya	6 2014	188	30	15.96%	25.06.2014	188	30	16.00%
12	Jordan ^a	9 2016	130	20	15.38%	20.09.2016	130	20	15.40%
13	Bahrain	11 2014	40	3	7.50%	01.12.2018	40	6	15.00%
14	Egypt	10 2015	596	89	14.93%	17.10.2015	596	89	14.90%
15	Syrian Arab Republic	4 2016	250	33	13.20%	13.04.2016	250	33	13.20%
16	Qatar	6 2016	41	4	9.76%	01.07.2013	41	4	9.80%
17	Comoros	1 2015	33	2	6.06%	25.01.2015	33	2	6.10%
18	Lebanon	5 2018	128	6	4.69%	06.05.2018	128	6	4.70%
19	Kuwait	11 2016	65	2	3.08%	26.11.2016	65	3	4.60%
20	Oman	10 2015	85	1	1.18%	25.10.2015	85	1	1.20%
21	Yemen	4 2003	275	0	0.00%	27.04.2003	301	1	0.30%
22	State of Palestine ^c	-	-	-	-	-	-	-	-

Source: Inter-Parliamentary Union, 2019a.

^a Figures correspond to the number of seats currently filled in the parliament.

^b Quota system in place to reserve a number of seats for women in the parliament.

^c Data are unavailable or not separately reported.

had an average of 19 per cent of women represented in the lower or single house compared to the world average of 24.3 per cent. This constitutes a slight increase from the regional average of last year (18.3 per cent) but the region remains in the second to last rank compared to other regions of the world in terms of women representation in national parliaments. As for the upper house or senate representation, the Arab region recorded a regional average of 12.5 per cent compared to the world average of 24.1 as of January 2019. Tunisia preserves its position at the top of the chart in the region with the share of women parliamentarians constituting 35.9 per cent owing to its well-established quota system.³⁸

However, according to ESCWA's *Women in Numbers* publication—women remain underrepresented in government and in local government, holding only about 12 per cent of ministerial posts. Most of these posts are considered “soft” posts such as education and social development. Based on the report, Mauritania recorded the highest percentage of ministerial posts held by women in the region at a modest rate of 31.8 per cent. Mauritania is an outlier in comparison to the average of the Arab region, especially compared to Iraq and Saudi Arabia where women hold no ministerial posts at all.³⁹

In the region, the presence of women in other leadership roles is still limited, and this impedes equal gender representation and development. Appointment of women judges and female public prosecutors in the region is still among the lowest in the world despite some efforts by certain countries. Even though Lebanon has the highest percentage of female judges in the region at about 50 per cent, still women represent only 30 per cent of public prosecution. Other than Tunisia and Algeria, female representation in the judiciary sector is low for most of the countries in the region, and less than 1 per cent in Egypt, Saudi Arabia, and the United Arab Emirates.⁴⁰

D. Concluding remarks

Overall, the growth perspective in the Arab region remains inextricably linked to geopolitical uncertainties, which are further exacerbated by a number of ongoing intraregional diplomatic rifts and armed conflict. The high volatility of oil prices, coupled with the impact of American sanctions against Iran's oil exports, has complicated the capacity to balance between output and fiscal consolidation, especially for oil exporters in the region. Meanwhile, the prospects for oil importers will be clouded by somewhat weaker external demand from key trading partners (China and Europe) which negatively affects trade dynamics as well as remittances. Nonetheless, some positive effects (such as improved terms of trade) from lower oil prices in 2019 will be encouraging to some oil importers.

Coupled with these challenges, higher global interest rates, driven by the United States and other advanced economies, further tightens credit conditions and increases fiscal vulnerabilities in the Arab region. In response to these risks, many parts of the Arab region continue to implement series of policy reforms and fiscal adjustment initiatives, which will pay off in the form of fiscal space and external balances. Reflecting this, the Arab region is expected to sustain a pace of growth between 2.6 per cent and 3.4 per cent in the coming years.

On the social development front, policymakers in the region are more aware of the socioeconomic challenges they face and, are working, more than ever, towards implementing reforms and actions to mitigate these challenges. However, the region needs to ensure that these policies are geared towards equitable and sustainable growth that supports the achievement of the 2030 Agenda. Policymakers, civil society and the international community need to work together in the region to support marginalized

groups including the poorest, migrants, women and persons with disabilities.⁴¹ They also need to target not only job creation but the revision of labour and social protection laws in line with implementing practices and the provision of public services and facilities to support the excluded. Awareness needs to be raised in Arab societies on the continuing inequalities such as poor representation of women in decision-making in public life and the burden of women's unpaid work.⁴² Realizing the economic benefits from "leaving no one behind"⁴³ and the inclusion of all people in the means to secure their economic livelihood will help achieve long-term prosperity in the region.

In order to take a balanced approach simultaneously promoting economic and social development while maximizing the potential growth effect of turning to sources of renewable energy, Arab countries need

to redouble their efforts to implement the 2030 Agenda for Sustainable Development to integrate economic, social and environmental aspects and recognize their interlinkages. It should be noted, however, that implementing such a development initiative hinges upon the institutional capacity for planning and coordinating interventions, adequate monitoring and reporting. In this context, weaknesses in governance, intensified by the lack of institutional capacity (coordination across and within implementing entities such as ministries and agencies) remains a hindrance for many Arab countries (box 2.6). Therefore, Arab policymaking frameworks should focus on urgently identifying the most appropriate institutional architecture, eventually improving governance that could help many Arab countries to explore policy options that envisage greater inclusiveness, equality and sustainability.

Box 2.7 Post-conflict governance situation in the Arab region

Since 2011, the Arab region has suffered from a bewildering array of intense, complex and interlocked armed conflicts. Today, almost 40 per cent of Arab countries are immersed in or have lived through armed conflict over the past eight years. The multiple causes and impact of these conflicts involve geopolitical as well as interconnected national governance deficits and socioeconomic issues. Deaths, injuries, food insecurity, regression of human rights, the loss of jobs and access to education, weak governance structures and inefficient institutions are just some of the most immediate and severe effects. It is important to note that the immediate effects of conflict at the regional level are catastrophic in terms of scale and impact, further exacerbating conflict dynamics at a national level, and straining socioeconomic and political affairs in neighbouring countries.

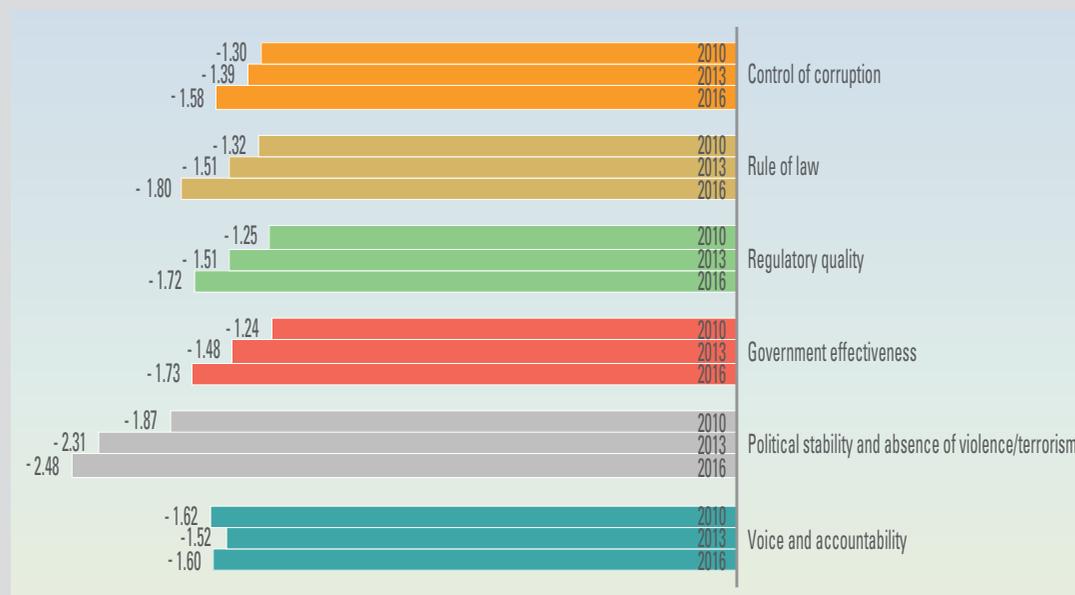
A marked rise in displacement is among the most prevalent outcomes of conflict. The total number of people in the region forcibly displaced from their homes increased from 12.7 million in 2010 to 29 million in 2016. And while the region has only 5.4 per cent of the world's population, it hosts 37.5 per cent of its refugees. The number of people in need of humanitarian assistance in the seven crisis countries (Iraq, Libya, the State of Palestine, Somalia, the Sudan, the Syrian Arab Republic and Yemen) is increasing with some 58.4 million people requiring humanitarian assistance in 2019. Countries affected by conflict in the region lost \$613.8 billion cumulatively in GDP between 2010 and 2015, or 6 per cent of the regional GDP. Even while such losses will be hard to recuperate due falling oil prices and the structural weaknesses of Arab economies, defense budgets are rising leading to even more decreases in public expenditure. The drivers and impacts of conflict are inherently linked through a self-fulfilling cycle, with the impacts of conflict contributing to its persistence and leading to the spread of insecurity and rise of other new conflicts.



While fragile State institutions are often drivers of resentment, unrest and eventually conflict, conflict weakens them further. As can be seen in the figure below, all but one of the six dimensions of governance monitored by the World Bank through the Worldwide Governance Indicators (WGI) have gradually worsened since the onset of the Arab uprisings in the countries affected.

Institutions shape all areas of human behaviour. As constraints, institutions can, by definition, generate frustration and resentment as much as guarantee peace and protection from violence. To a large extent, the popular uprisings that took place throughout the Arab region in 2011 were the result of weak and exclusive State institutions, and a call for them to be transformed into more effective and inclusive ones. Post-conflict institution-building is a difficult undertaking, however, and learning from the experiences of other countries that have gone through comparable transitions from conflict or crisis can help national authorities decide which approaches to institution-building best fit their needs.

Worldwide Governance Indicators in Arab countries in crisis, 2010, 2013 and 2016



Note: Indicators are simple averages with the range in performance from approximately -2.50 (weak) to 2.50 (strong). The presence of weak States in the Arab region, and the vacuum created and subsequently filled by other States and non-State actors, can be traced to a history of governance failure brought about by the inadequacies of the authoritarian model that was prevalent prior to 2011. The Arab uprisings of 2011 brought these weaknesses to light, exposing weak State institutions, high levels of corruption, increased and increasing fiscal and external deficits and constrained private sector growth.

While the global proliferation of conflict and crisis in 2018 affects all regions and reflects a growing climate of uncertainty, conflict and occupation in the Arab region is particularly persistent. The multiple causes and impact of these conflicts involve geopolitical as well as interconnected national governance deficits and socioeconomic issues and have been the subject of analysis and debate since 2011. Some have deep historical roots, while others are based on recent events. Death, injury, food insecurity, regression of human rights, the loss of jobs and access to education, weak governance structures and inefficient institutions,



particularly the inability of State institutions to provide essential services for all, are just some of the most immediate and severe effects. It is important to note that the immediate effects of conflict at regional level are catastrophic in terms of scale and impact, further exacerbating conflict dynamics at the national level, confining countries in crisis to a conflict trap and straining socioeconomic and political affairs in neighbouring countries.

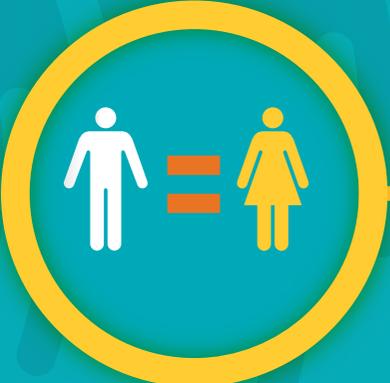
Source: This box draws on E/ESCWA/ECRI/2017/4.



**SOCIO-ECONOMIC
POLICIES**



**GENDER
EQUALITY
IN EMPLOYMENT**



**ENERGY SUBSIDY
REFORM**

3. Studying the Effects of Energy Subsidy in the Arab Region: A Macroeconomic and Sectoral Assessment

A. Context

Many developing countries have based their development model on the cheap energy paradigm. One of the most important tools for governing was the establishment of an energy subsidy system that maintained energy prices at an affordable price for households and firms even in the face of international oil price fluctuations. This system has been internalized by production businesses and many firms have developed their business plans on the basis of affordable energy. In many countries, this system succeeded in maintaining access to energy for the poor, created jobs, protected nascent industries and secured energy. At the same time, these energy subsidy systems put substantial pressure on the fiscal balance and balance of payments. The International Energy Agency estimated that global fossil fuel subsidies amounted to \$260 billion compared to \$140 billion for renewable energy subsidies.⁴⁴

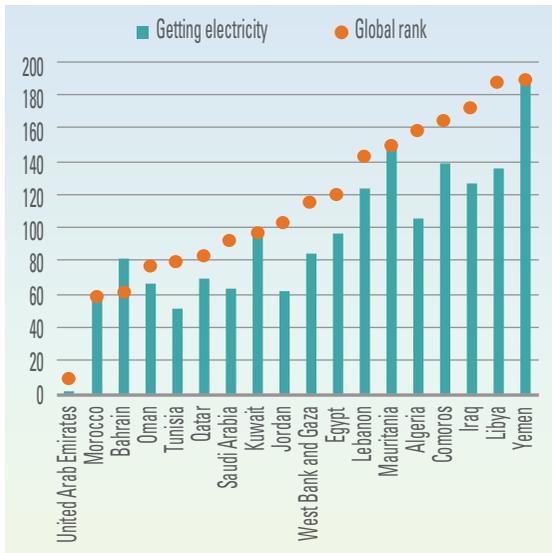
The Arab region has largely adopted this system. In fact, according to the IMF, Arab countries provide more than one fourth of global energy subsidies, amounting to \$117 billion out of a total of \$436 billion worldwide.⁴⁵ Out of this, \$94 billion is in Arab oil-exporting countries and corresponds to 5.5 per cent of their GDP. These countries also possess the largest subsidies per capita. This policy led the region to triple its primary energy consumption over the past 26 years. Meanwhile, affordable subsidized energy prices have contributed to the inefficient use of energy resources and wasteful consumption patterns, exacerbating the fiscal burden. This is why most of Arab governments now acknowledge the need to rationalize some of their energy subsidies as a way to insure their fiscal sustainability. For

now, a change in energy prices will not only have a social and fiscal impact, it will affect the overall competitiveness of the economy. Many energy-intensive sectors could be affected, which will affect formal employment creation, jobs that are mainly filled by the middle-class workers. These effects are not well studied in the region. This chapter will try to fill this gap and go beyond the assessment of the social and fiscal effects to assess the macroeconomic, labour and sectoral implications of changes in the price of energy.

1. The complex effects of energy subsidy in the Arab region

The access to electricity is one of the pillars of the economic attractiveness in most of the Arab economies. The Doing Business Report 2019 reveals that in most of the countries in the region the ranking for getting electricity pillar outperforms their overall rank (figure 3.1). Tunisia, an oil-importing country, ranks 51 in terms of getting electricity compared to its global rank of 80. Saudi Arabia, a major oil exporter, has a rank of 64 in getting electricity compared to its overall rank of 92. Bahrain is the only country with a global rank (62) outweighing its rank in getting electricity (82). In addition, the affordability of electricity is one of the most attractive traits attracting investors to many Arab economies. Figure 3.2 shows that Lebanon, Qatar, Morocco and Algeria rank much better in terms of cost of electricity compared to getting electricity. Lebanon ranks 20 in terms of the cost of getting electricity compared to the rank of 124 for the ease of getting electricity. Although high costs of electricity are typically a major point of criticism in Lebanon, multiple and long electricity outages forcing the reliance on

Figure 3.1 Getting electricity rank compared to the overall rank in Doing Business



Source: World Bank, 2019j.

Figure 3.2 Cost of getting electricity rank compared to getting electricity rank

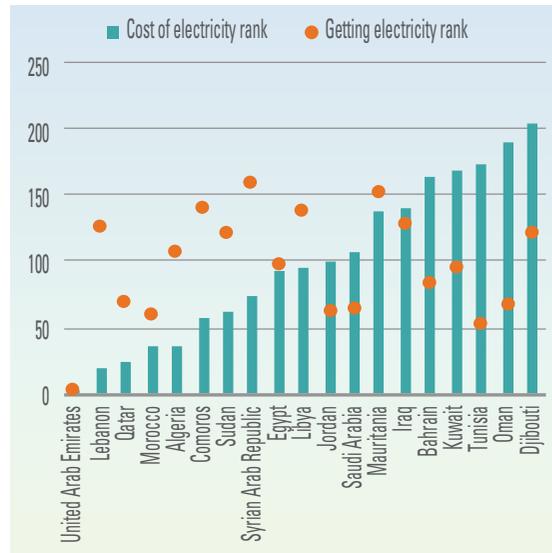
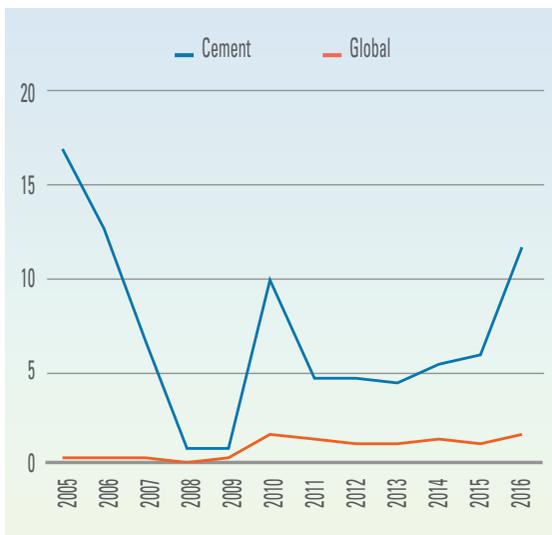
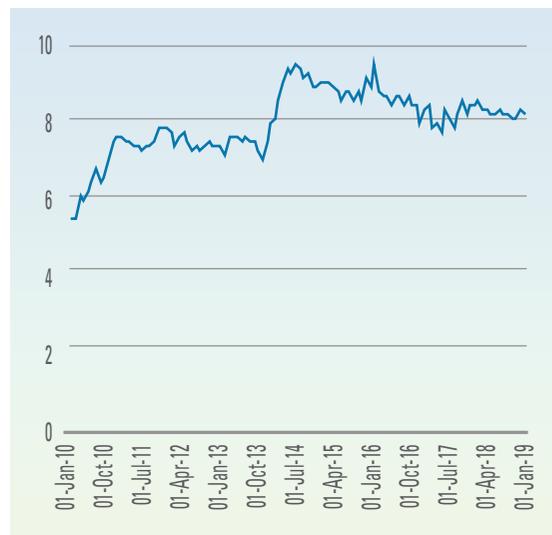


Figure 3.3 Share of the Arab production of cement in the global production



Source: United Nations Industrial Development Organization, 2019.

Figure 3.4 Share of GCC production of aluminium in the global production



Source: World Aluminium, 2019.

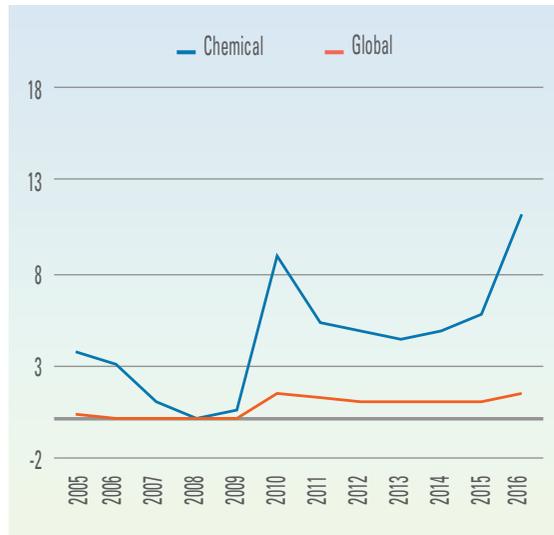
diesel generators could explain why getting electricity in the country is relatively worse compared to its cost.

The IMF illustrates that the region also maintained low prices for petroleum products. Gasoline prices are the lowest in the world.⁴⁶ For regular gasoline, diesel and kerosene,

subsidies in Arab countries represent on average about 65 per cent of total energy subsidies (which includes petroleum products, electricity and natural gas).

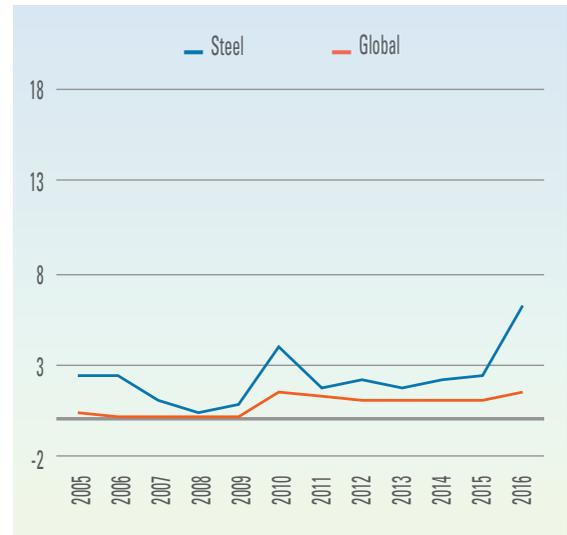
Such low energy prices policy allowed Arab countries to boost a range of energy-consuming industries such as aluminium,

Figure 3.5 Share of the Arab production of chemical products in the global production



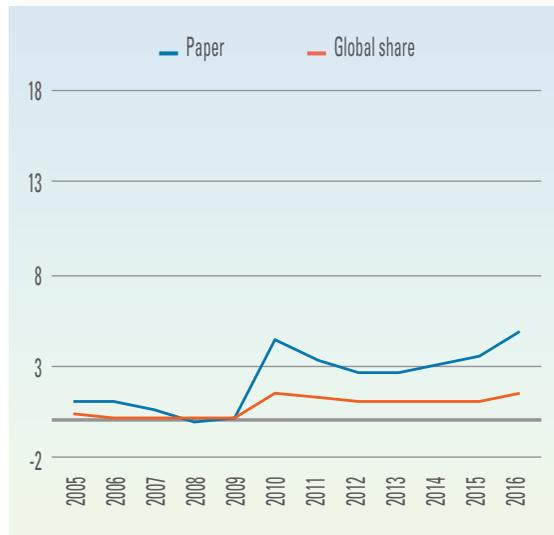
Source: UNIDO, 2019.

Figure 3.6 Share of the Arab production of steel in the global production



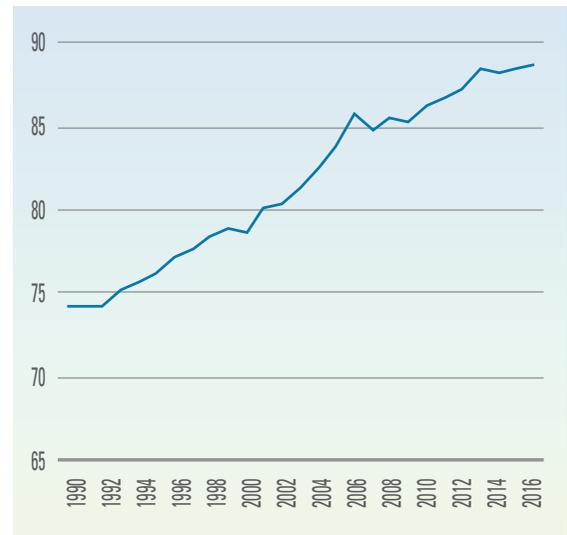
Source: UNIDO, 2019.

Figure 3.7 Share of the Arab production of paper products in the global production



Source: UNIDO, 2019.

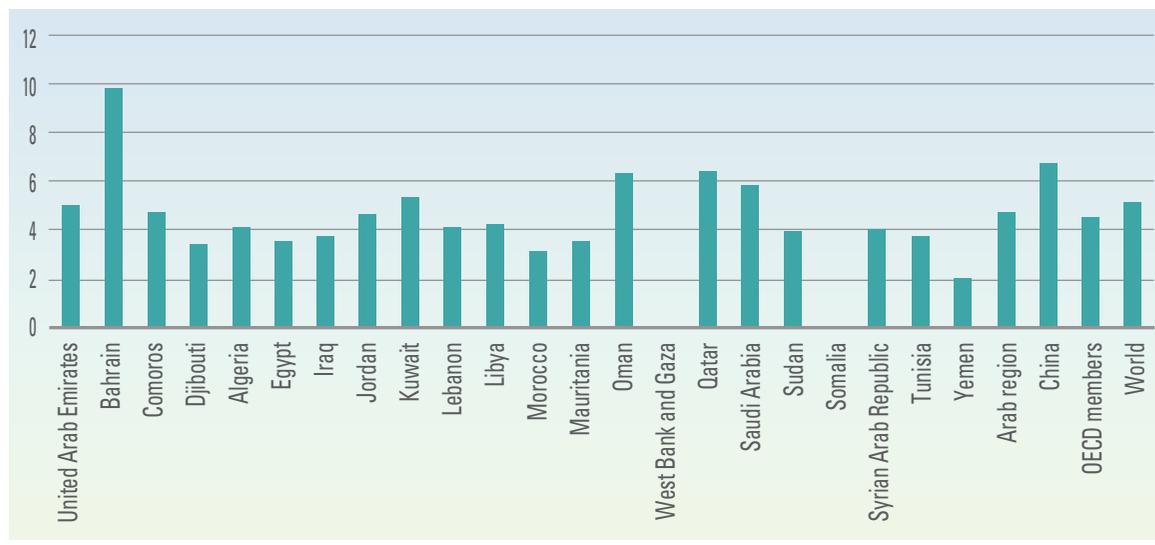
Figure 3.8 Access to electricity in the Arab region (percentage of population)



Source: World Bank, 2019a.

steel, cement, fertilizer and petrochemicals. Although the share of the Arab industrial production represents only between 1 and 1.5 per cent of the world’s global production, the share of the Arab production in the above-mentioned industries is noticeable and exceeds 10 per cent of the world production in many sectors. The region’s share in the

global production of cement has reached almost 12 per cent of the global production (figure 3.3). GCC countries became one of the major players of the aluminium global industry (figure 3.4) reaching over 8 per cent of the world aluminium production. The aluminium industry is one of the most energy-intensive sectors. Similarly, the share of

Figure 3.9 Energy intensity level of primary energy, 2015 (MJ/\$2011 PPP GDP)

Source: World Bank, 2019e.

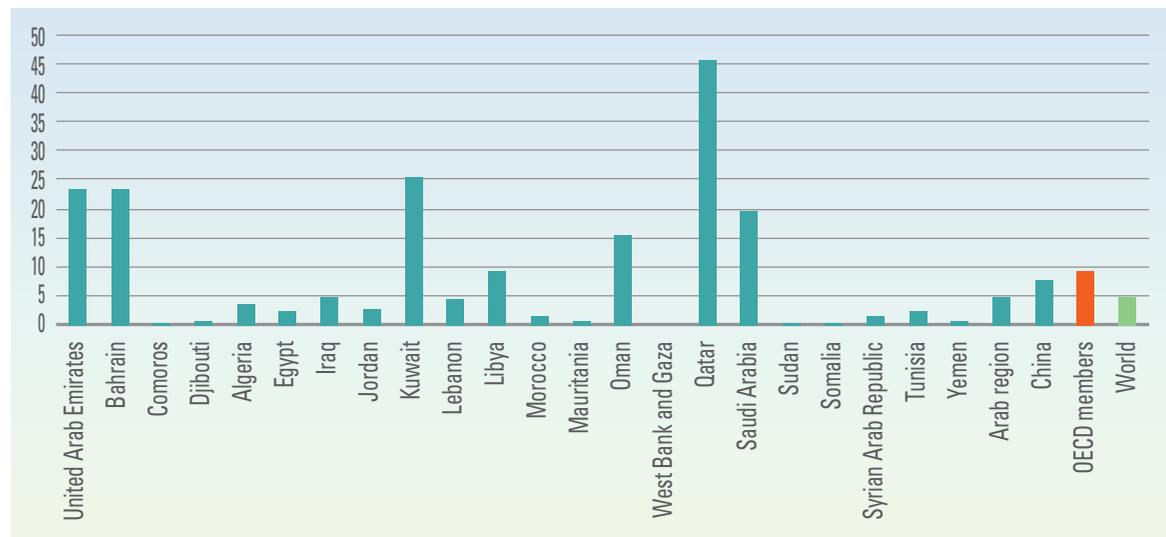
the Arab production of chemical products represents 11 per cent of the global chemical production (figure 3.5); the Arab share in the steel production exceeds 6 per cent of the world steel production (figure 3.6); while the paper industry production in the region amounts for almost 5 per cent of the world production (figure 3.7). In addition, the region succeeded in ensuring access to electricity to the population (figure 3.8), as the above favourable getting electricity indicator clearly depicts. In fact, in 2016, almost 90 per cent of the population in the Arab region had access to electricity compared to nearly 75 per cent 25 years ago.

Overall, such cost benefits grant the Arab countries large comparative advantages and striking shares in world production in many of the related industries. Energy subsidies in kerosene, for example, explain the competitiveness of the airline companies in the Gulf region, placing them among the leaders in the industry globally.

Nevertheless, and despite these successes, this policy leads to critical economic inefficiencies and distortions that could affect the development sustainability in many countries.

First, there is a low level of energy efficiency in the region. Low energy prices have led to an overconsumption in energy products. Figure 3.9 shows that the share of primary energy intensity level in megajoules (MJ) per \$2011 purchasing power parity (PPP) of GDP in several Arab countries outweigh both the world and the developed countries of the OECD. In many GCC countries, the intensity level of energy is exceptional. For example, the usage ratio in MJ in Bahrain is 10 times larger than the PPP of GDP, making it the greatest energy consumer in the region. Many Arab countries such as Oman, Qatar and Saudi Arabia have a consumption intensity close to that of China's energy intensity level, which in turn exceeds the world and the OECD members.

Second, there is a negative effect on the environment. Fossil energy is a primary source of air pollution and a rising carbon footprint. The GCC countries are among the highest carbon dioxide (CO₂) emitters, surpassing by far more highly industrialized nations.⁴⁷ This is clearly represented in figure 3.10 in which the United Arab Emirates, Bahrain, Kuwait, Saudi Arabia and Oman had levels of CO₂ emissions in 2014 ranging between 15 and 25 metric tons per capita, greatly exceeding the Arab region

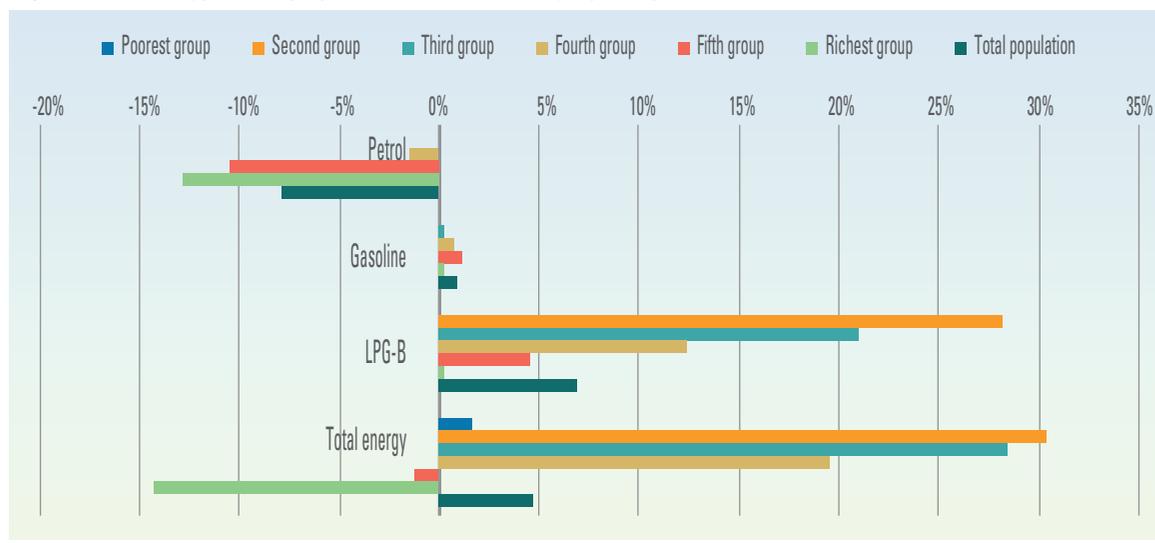
Figure 3.10 CO₂ emissions, 2014 (metric tons per capita)

Source: World Bank, 2019b.

average of 4.86 metric tons per capita and the world average of 5 metric tons per capita. The high CO₂ emissions in the GCC also surpass the levels in China (7.5) and the developed countries (9.5). It is worthwhile noting that Qatar, with CO₂ emissions of 45 metric tons per capita, is by far the largest polluter and contributor of greenhouse gas emissions.

Third is the low redistributive impact of this policy. Energy subsidies have regressive effects. The richest fraction of the population rather than the poorest benefits the most. High-income groups consume more energy, possess more cars and are better connected to electricity grids, while the most vulnerable groups might not have any access to electricity. A closer look at the subsidy distribution by income group, based on IMF calculations of the average distribution computed for Egypt, Jordan, Lebanon, Mauritania and Morocco, reveals, on one hand, that the top 20 per cent of the population benefit from more than 50 per cent of energy subsidy for diesel and gasoline and more than 40 per cent for electricity. Conversely, the poorest 20 per cent only benefit the most from kerosene subsidies at a rate up to 20 per cent of the subsidy compared to nearly 18 per cent for the

top 20 per cent of the population. While low income groups are the biggest consumers of kerosene, it only accounts for 3.5 per cent of total petroleum subsidies in the Arab countries so the benefit from the product subsidy is very limited.⁴⁸ Likewise, Tunisia's sizeable subsidies on food and energy (together amounting to 3.1 per cent of GDP in 2017), which mainly reach the better-off, exemplify this flawed targeting. In fact, energy subsidies benefit rich households up to 30 times more than the poor ones; while government support in cash and health transfer programmes for low-income families covers only about 12 per cent of the poor.⁴⁹ ESCWA research confirms that access to cheap energy is not the most efficient way to help low-income groups.⁵⁰ In fact, the poor not only consume much less energy but most of the time do not have access to "networked" utilities such as electricity. As Sdrulevich and others show in their study of energy subsidies, 38-86 per cent of petrol subsidies, 42-71 per cent of diesel subsidies, and 26-53 per cent of electricity subsidies in a number of Arab countries go to the richest fifth of the population.⁵¹ For Tunisia, the richest categories of the population (decile 8-10) receive more than 54 per cent of energy subsidies while the poorest categories (decile 1-3) receive only 13 per cent. These

Figure 3.11 Energy subsidy by socioeconomic category and product for Tunisia

Source: Author's simulation.

results show that redistribution of subsidies are not pro-poor.⁵²

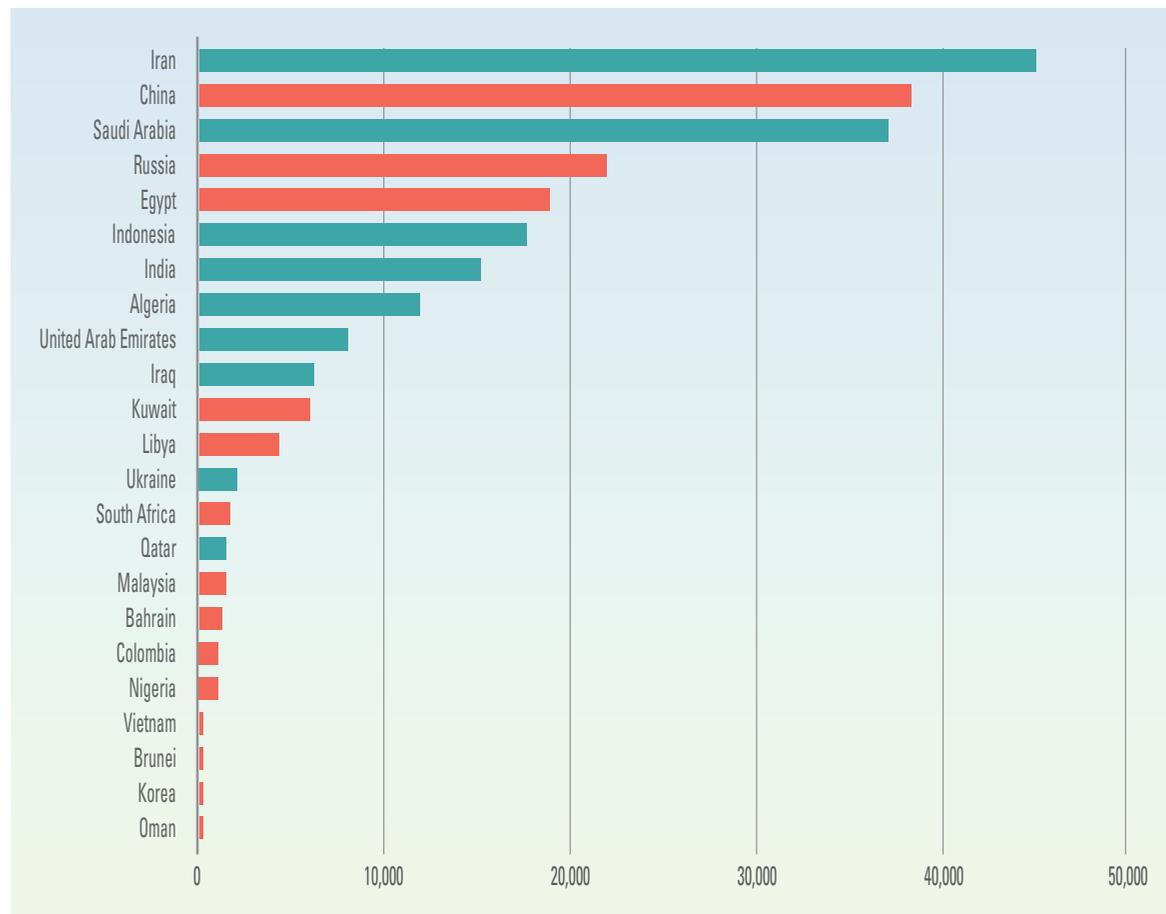
In fact, price subsidies for fuel and electricity that are universally applied not only end up benefiting the higher income groups, businesses and industries, but also generate important costs for governments. This leads to a draining of fiscal resources that could have been used as spending targeted towards helping the poor, such as investment in education, health and infrastructure, for example, by expanding the power sector and the grid.⁵³

For Tunisia, the redistributive impact is very pronounced (figure 3.11). For the poorest category, about 90 per cent of their total energy use comes from liquefied petroleum gas (LPG) in bottles. In sum, the incidence of subsidy for total energy represents almost 30.4 per cent and 28.5 per cent, respectively for the second and the third groups⁵⁴ which represent the poorest population while the richest category uses more gasoline and petrol.⁵⁵

Fourth is the fact that energy subsidies have a major negative impact on a country's external position. In fact, subsidies and their accompanying overconsumption lead to a

deterioration in the balance of payments due to higher energy imports (for oil-importing countries) or to lower exports (for oil-exporting countries). Such subsidies might also promote smuggling, leading to further export revenue losses. Smuggling can, in turn, also lead to shortages, rationing and the emergence of a black market with prices exceeding the official one.⁵⁶

The last and most significant issue for policymakers is the large fiscal burden created by these measures. The total fiscal value of energy subsidies⁵⁷ in the region has been estimated at around \$70 billion in 2016 (down from \$133 billion in 2014 and \$100 billion in 2015), representing around one quarter of the value of the world's energy subsidies. In 2017, Saudi Arabia remained the world's third largest subsidizer of energy, according to IEA data, with total subsidies amounting to around \$37 billion in 2017 (up from \$30 billion in 2016, but down from \$57 billion in 2014 and \$44 billion in 2015) (figure 3.12). Egypt has been spending between 10 to 14 per cent of its total government expenditure between 2014 and 2016 on energy subsidies alone, nearly as much as the country's total expenditure on education and health care combined.

Figure 3.12 Energy subsidies by country, 2017 (millions of dollars)

Source: IEA, 2017b.

2. The ongoing and planned reform of energy subsidy policy in the Arab region

Arab countries have initiated the reform of their energy subsidy systems (table 3.1). They are planning to continue this effort in the upcoming years, especially if fiscal deficits remain high. These reforms are conducted in the scope of a fiscal consolidation, but their effects will spread throughout the structure of the economy. They will generate some adjustment costs in terms of growth, employment and comparative advantage. There are also differentiated implications on gender when discussing sectoral employment. Such matters need to be addressed by policymakers and taken into consideration when designing appropriate actions to mitigate them.

More specifically, since 2015, all Arab exporters have undertaken reform steps by increasing the prices of energy products domestically. For some GCC countries such as the United Arab Emirates, higher prices were the result of a total elimination of fuel price gaps,⁵⁸ while for others (such as Bahrain, Kuwait, Oman, Qatar and Saudi Arabia) the price gaps were reduced but remain significant. Higher electricity tariffs were also implemented in most GCC countries (led by the United Arab Emirates, mainly Dubai, following the global financial crisis) to levels leading to a potential decrease in consumption by 20 per cent. To boost growth and competitiveness, the Emirati authorities announced a series of structural reforms in 2018 with a reduction in electricity tariffs

Table 3.1 Status of energy reform in the Arab region

	Petroleum	Natural gas	Electricity	Measures to protect the poor? (Yes/No)	Medium-term plan? (Yes/No)
Oil Importers					
Djibouti	■	■	■	No	Yes
Egypt	■	■	■	Yes	Yes
Jordan	□	□	□	Yes	Yes
Lebanon	□	□	■	No	No
Mauritania	□	■	□	Yes	Yes
Morocco	□	■	□	Yes	Yes
Sudan	■	■	■	Yes	Yes
Tunisia	■	■	■	Yes	Yes
Oil exporters					
Algeria	■	■	■	Yes	No
Bahrain	■	■	■	No	Yes
Iraq	■	■	■	Yes	Yes
Kuwait	■	■	■	No	Yes
Oman	■	■	■	No	No
Qatar	■	□	■	No	No
Saudi Arabia	■	■	■	Yes	Yes
United Arab Emirates	□	■	■	No	No

□: Subsidies eliminated
 ■: Reform initiated, subsidies remain
 ■: No specific measure

(September 2018) for the industrial sector, a rise in non-oil tax revenue through VAT (January 2018) and implementation of excise taxes (October 2017).⁵⁹

Iraq's increased electricity tariffs led to a 40 per cent boost in cost recovery. In Algeria, reforms were undertaken in 2016-2017 through higher taxes with increased tax rates on gasoline and diesel and a 2 percentage points higher VAT rate for both electricity and gas.⁶⁰

Oil importers have also made substantial adjustments to their energy prices. Some, such as Jordan and Morocco, resorted to the use of local price adjustments, thus eliminating all fuel subsidies, while others,

such as Egypt, the Sudan and Tunisia adopted some ad hoc discretionary reforms in local prices without full indexation to international prices. Jordan is the only country which eliminated electricity and natural gas subsidies totally – although it kept subsidies for the most vulnerable groups by a small amount, equivalent to the value of 0.1 per cent of GDP, while other oil importers undertook more gradual medium-term reforms. In fact, Egypt undertook gradual adjustments between 2013 and 2015 and plans to increase tariffs over the next five years, while Tunisia implemented tariff increases in 2012 and 2013.⁶¹ The Tunisian authorities, aiming to reduce energy subsidies in an effort to shield the budget from oil price increases,

implemented an ad hoc price increase of 3 per cent on average for the three main fuel categories in December 2017 and applied four more price adjustments in 2018 and one in March 2019.⁶²

Overall, as part of their reform process, oil importers have taken measures to address the most vulnerable groups, protecting the poorest segments of the population. However, these social protection measures for the poorest groups were not undertaken among oil exporters (with the exception of Algeria, Iraq and Saudi Arabia).

The experience of Yemen serves as a cautionary tale for both the argument against subsidizing energy and the argument against reforms that may be detrimental to the most vulnerable and must be coupled with social measures. By 2014, Yemen’s Government could no longer afford to sell fuel at a loss – which forced people to buy diesel from the black market, at prices higher than international ones – and decided to drastically cut fuel subsidies. This worsened the country’s situation by further driving up inflation and creating a fertile ground

for violent protests, in part calling for a reverse of the subsidy cuts.⁶³

B. Assessment of the economic, social and sectoral implications of the reforms of energy subsidy systems in the Arab region: case study of Tunisia and Saudi Arabia

To illustrate the complex effects of energy reforms in the region, we use the computable general equilibrium (CGE) models applied to two representative cases in the Arab region: an oil-importing country (Tunisia) and a net oil-exporting country (Saudi Arabia). The choice of the CGE models is underpinned by the fact that they are considered one of the best tools in designing an overall reform package. They are flexible and detailed to deal with the wide variety of energy subsidies that exist. They offer a comprehensive evaluation of the effects of reform, including (a) an assessment of the government revenues; (b) an identification of the industries and households that would be

Figure 3.13 Growth performance of the Tunisian economy

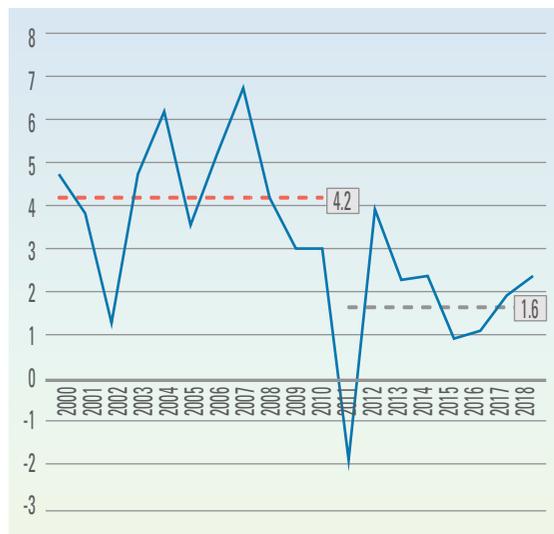
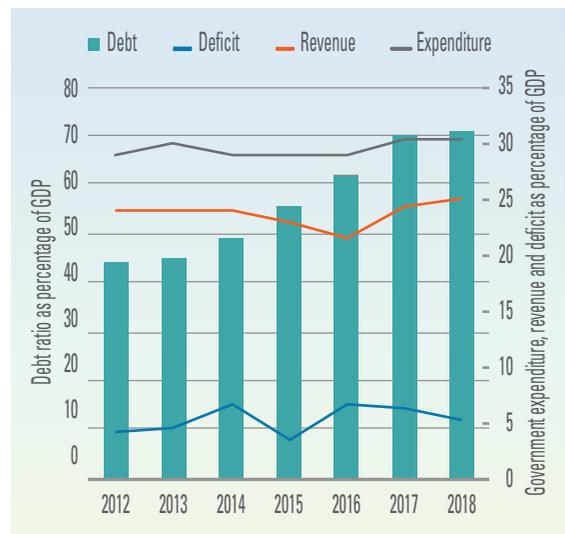
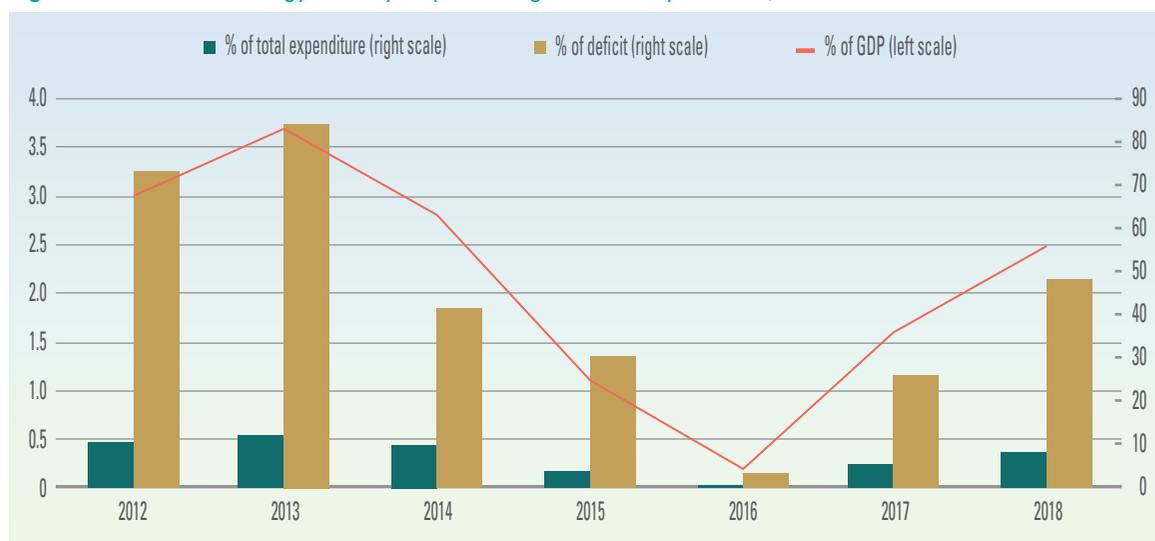


Figure 3.14 Fiscal performance of the Tunisian economy



Source: ESCWA staff calculations based on national statistical sources, see appendix.

Figure 3.15 Share of energy subsidy as percentage of total expenditure, deficit and GDP

Source: ESCWA staff calculations based on national statistical sources, see appendix.

affected by reform; (c) an estimation of the short-term adjustment costs of implementation of policies as distinct from long-term effects.

1. The case of Tunisia

In the period since 2011, the Tunisian economy has almost reverted to its pre-revolution growth performance. Growing at an average rate of 4.2 per cent between 2000 and 2010, since 2011 Tunisia has had growth performance of just 1.6 per cent (figure 3.13). This slowdown in the country's economic activity – which also includes a recessionary period during 2011-2012 – was the result of adverse effects caused by both international and regional disruptions as well as by local social conditions. Slow growth coupled with rising Government expenditures (through higher transfer payments) to respond to increasing social needs and support, put a serious burden on public finance. In fact, the Government's wage bill increased from the equivalent of 12.2 per cent of GDP in 2012 to the equivalent of 14 per cent of GDP in 2018, reaching a peak of 14.8 per cent in 2016. This situation translated into a high fiscal deficit and a significant increase in the country's level of indebtedness which rose from an equivalent of 44.5 per cent of GDP in

2012 to an equivalent of 70.5 per cent of GDP in 2018 (figure 3.14).

In order to tackle the issue and stabilize this situation, the Government of Tunisia is currently implementing a series of fiscal reforms. Starting in 2016, the Government revised its Personal Income Tax (PIT) and the VAT. These reforms boosted Government's revenue from 21.3 per cent of GDP in 2016 to nearly 25 per cent in 2018 but, given the slight increase in public expenditures by around 1 per cent over the same period, they were insufficient in reducing the fiscal deficit below the targeted levels of 3 per cent of GDP. In fact, the fiscal deficit declined from 6.5 per cent of GDP in 2016 to 5.2 per cent in 2018; and this 1.3 per cent decrease was not enough to return the Government's deficit to its 2015 pre-fiscal reforms level of 3.6 per cent of GDP.

In a second wave of reform, the Government is tackling the expenditure-side of its budget with a special focus on subsidy reform. Indeed, in 2018 energy subsidies represented over 8 per cent of total Government expenditure and 48 per cent of the public deficit amounting for 2.5 per cent of GDP (figure 3.15). The significant share of subsidies in public finance explains

Table 3.2 The “business as usual” scenario’s, macroeconomic framework, Tunisia

	2019	2020	2021	2022	2023
Real GDP	2.90	3.40	3.60	4.00	4.20
Deflator	0.93	0.95	0.96	0.95	0.96
Labour force	1.52	1.52	1.52	1.52	1.52
Unemployment rate (percentage)	15.00	15.00	15.00	15.00	15.00
Exchange rate: dinar/\$ (average)	1.05	1.07	1.03	1.03	1.02
Total revenue and grants (percentage of GDP)	23.31	23.52	24.25	24.66	24.88
Revenue	25.93	26.14	26.20	26.25	26.40
Tax revenue	23.11	23.56	23.68	23.80	23.99
Direct taxes	8.91	8.83	9.00	9.04	9.16
IRPP	6.30	6.25	6.37	6.40	6.48
IS	2.61	2.58	2.63	2.65	2.68
Trade taxes	1.19	1.19	1.17	1.17	1.17
VAT	6.46	7.00	7.01	7.08	7.16
Domestic					
Imported					
Other indirect taxes	6.55	6.54	6.50	6.50	6.50
Non-tax revenue	2.82	2.58	2.52	2.45	2.41
Grants	0.21	0.20	0.19	0.18	0.17
Subsidies	2.83	2.82	2.14	1.77	1.69
Food	1.65	1.53	1.47	1.38	1.30
Energy subsidies	0.75	0.91	0.29	0.00	0.00
Other	0.42	0.38	0.38	0.38	0.38
Total expenditure and net lending and amortization	31.88	31.11	31.44	31.71	31.81
Total expenditure	31.88	31.11	31.44	31.71	31.81
Current expenditure	25.77	24.41	24.16	24.05	23.92
Wages and salaries	14.03	12.43	12.23	12.23	12.23
Goods and services	1.45	1.47	1.46	1.46	1.46
Interest payments	2.58	2.83	2.90	2.94	2.94
Domestic	0.99	0.93	0.84	0.79	0.70
External	1.58	1.90	2.06	2.15	2.24
Transfers	2.33	2.27	2.27	2.27	2.27
Capital expenditure	6.11	6.71	7.28	7.67	7.89
Overall balance	-8.57	-7.59	-7.19	-7.05	-6.93
Financing (net)	8.57	7.59	7.19	7.05	6.93
Net Foreign financing	3.22	3.37	1.74	2.87	2.54
Drawings	7.55	7.91	6.22	7.33	6.98
Amortization	4.33	4.54	4.48	4.46	4.43
Domestic financing	-0.03	-1.20	0.14	-0.97	-0.64

Drawings	1.02	-0.32	0.97	-0.28	-0.04
Amortization	1.04	0.88	0.82	0.69	0.60
Gross public debt	69.28	69.38	67.85	65.59	63.82
Domestic	15.70	13.23	12.41	10.41	8.98
External	53.58	56.14	55.44	55.18	54.83

Source: ESCWA staff compilation based on national statistical sources (appendix).

the need for the Government to implement subsidy reforms.

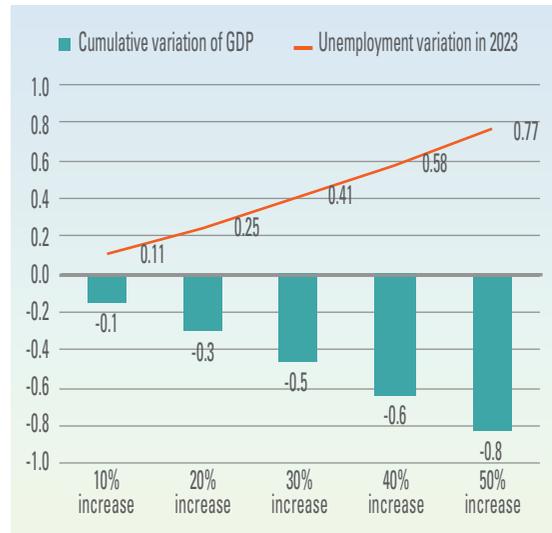
To study of the effects of the magnitude of the increases in the price of energy products, we undertake a simulation considering five different price increase scenarios. In fact, we simulate the effect of a rise in the price of energy products for five quintiles representing each respectively 10, 20, 30, 40 and 50 per cent increases in the price of the middle and high voltage electricity in Tunisia as well as the prices of hydrocarbons (LPG, gasoil, gasoil50 and others). We assume that all adjustments in response to the Government's financing needs are done through variation in internal indebtedness, so that the external debt remains unchanged. We study the impact of such simulation on key macroeconomic variables, mainly on growth, inflation, fiscal deficit but also on different sectors. The results of the simulation are compared to the macroeconomic framework presented by the IMF at its last review (table 3.2). Such "business as usual" (BAU) scenarios show, for the next five years, stability in the price level, unemployment rate and exchange rate. The overall deficit is reduced over the years from 8.57 to 6.93 as a result of (a) a slight increase in total revenue and grants from 23.31 per cent of GDP in 2019 to 24.88 in 2023, mainly due to higher VAT revenues and to slightly lower non-tax revenues arising from grants and subsidies (including a removal in energy subsidies); and (b) a constant total expenditure, net lending and amortization. Consequently, the country will face a decrease in financing needs and a lower gross public debt.

(a) Effects on growth

Simulations show that higher prices for energy products (high and low voltage electricity) and hydrocarbon prices (LPG, gasoil and gasoil50) negatively affect the country's economic growth. Every 10 per cent increase in energy price generates a loss of about 0.2 percentage point on growth reaching a 0.8 per cent decrease in the growth rate for a 50 per cent rise in energy prices (figure 3.16). As a result of this slower growth, the unemployment rate rises by almost the same proportion as the decline in the growth rate, however, in an exponential mode, increasing by 0.11 percentage point for the initial increase in energy prices by 10 per cent and reaching 0.77 percentage point when the overall energy prices are higher by 50 per cent. More specifically, for every increase in the energy price range by 10 per cent, the unemployment rate rises respectively by 0.11, 0.14; 0.16; 0.17; and by 0.19 for a rise in energy prices from 40 to 50 per cent. It is important to note that economic adjustments dampen the effects of this shock as we go.

The growth differentials between the simulations and the reference scenario are reduced (figure 3.17) as factor allocation adjustments are implemented. In 2023, the growth rate of the simulations is higher than that of the reference scenario. In fact, in the reference year 2018 when the simulations are undertaken, the direct effect on growth rate of any percentage increase in energy prices varies from a rate of 2.32 per cent for 10 per cent energy prices increases to 2.8

Figure 3.16 The implications of the increase of energy products prices on growth and unemployment, Tunisia



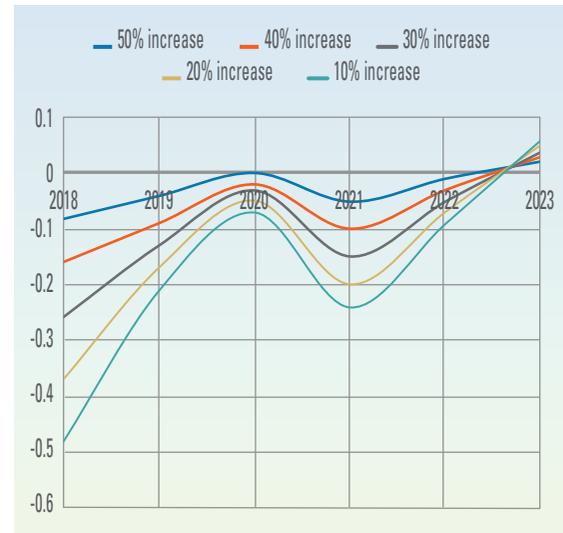
Source: Author's simulation using Tunisia CGE model.

per cent for a 50 per cent increase in energy prices, similar to that of the reference year 2018. However, five years later, in 2023, the multiplying effect of the fiscal stimulus would have worked, leading to an overall effect on the growth rate that outweighs the initial reference point effect of 4.2 per cent, with a 4.26 per cent growth rate for a 10 per cent increase in energy prices and a growth rate for all other energy price increase quintiles also above the reference point of 4.2 per cent.

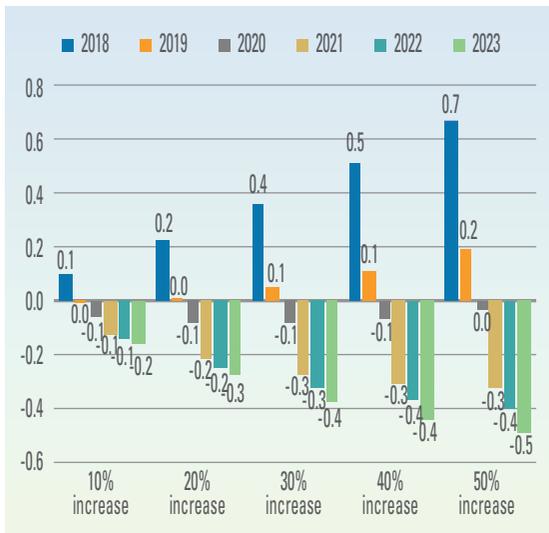
(b) The effect on inflation

Higher prices of energy products are initially accompanied by an inflationary surge (figure 3.18). In fact, for initial increases in energy prices by 10 and 20 per cent, the CPI increased by 0.1 and 0.2 percentage points respectively in 2018. The inflationary pressure becomes more important for higher increases in energy prices by 30, 40 or 50 per cent, with a multiplying effect on overall average price, increasing by 0.4, 0.5 and 0.7 percentage points in 2018. Nevertheless, this inflationary pressure is offset by external variables, which will contain such inflation and turn it into a deflation in the following years. More specifically, the fall in

Figure 3.17 Growth gap, Tunisia



the fiscal deficit resulting from lower public spending on subsidies and the improvement in the trade balance enhances the dinar's position vis-à-vis foreign currencies. The appreciation of the Tunisian dinar limits the share of imported inflation, an effect that takes over in the following years (figure 3.19). The greater the increase in energy prices, the larger is the appreciation in the exchange rate and the lower the inflationary pressures. The exchange rate appreciation is almost five times larger when stemming from a 50 per cent increase in energy prices compared to a 10 per cent increase. In fact, a 50 per cent increase in energy prices compared to 10 per cent increase will lead to a rise in the exchange rate by 3.4 points, as opposed to 0.7 points, thus leading to a 0.5-point decrease in inflation in 2023 instead of a 0.2-point decrease for the first quintile. Consequently, an initial increase in inflation by 0.7 point is offset and turned into a 0.5 decrease in inflation in five years, depicting an important gap on inflationary effects by 1.2 points, in magnitude. It is true that small increases in energy prices have a lower impact in magnitude on inflation, however, their long-term effect on the exchange rate appreciation and deflation, with their accompanying rise

Figure 3.18 Effects on inflation, Tunisia

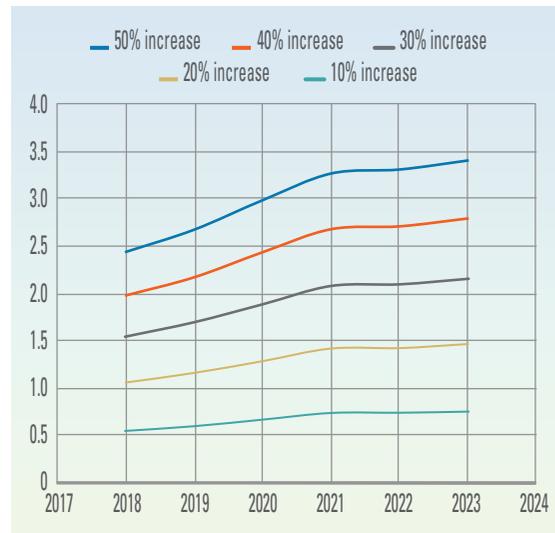
Source: Author's simulation using Tunisia CGE model.

in purchasing power, will also be dampened, ranging from a higher inflationary pressure by 0.1 point to a 0.2-point deflation, for the first quintile.

(c) Fiscal implications

The expenditure side (figure 3.20) shows that the increase in the price of energy products reduces the amount of energy subsidies by a range of 0.6 to nearly 3 equivalent GDP points for increases in energy price from the first to the fifth quintile. Such reduced spending arising from lower subsidies implies a decrease in the deficit and consequently in the burden of the debt both in terms of interest and amortization. These two effects imply a fall in total public expenditure ranging between quintiles from an equivalent of 1 to 4 GDP equivalent points.

On the other hand, the Government revenue (figure 3.21) reveals a rise in total public revenues across quintiles as a result of higher energy prices. The model shows that the decline in economic activity results in lower revenues arising from direct taxes. In fact, figure 3.21 depicts decreases in personal

Figure 3.19 Exchange rate, Tunisia

income taxes and corporate taxes by an equivalent of up to 0.15 GDP points for a 50 per cent increase in energy prices. In contrast, price increases imply a larger increase in the VAT from an equivalent of 0.1 to 0.3 points of GDP and other indirect taxes of up to 0.2 equivalent GDP points. The appreciation of the Tunisian dinar which leads to lower payments of imports denominated in foreign currencies also implies a decrease in tariff revenues and grants. Overall, the increase in indirect tax revenues, mainly through VAT collection, outweighs the decline in direct tax revenues, tariffs and grants, leading to a rise in total revenue by 0.1 to over 0.2 equivalent points of GDP.

The decline in public spending and the relative stability of revenues reduce public deficit. Since we made the assumption that foreign financing (in foreign currency) remains constant, most of the decline is observed in domestic financing (figure 3.22). In fact, the noticeable decline in domestic financing by a range of 0.77 point to 3.5 points for every additional increase in energy prices from 10 to 50 per cent, clearly outweighs the neglectable decline in foreign financing by only 0.05 and up to 0.23 point for a similar range of energy

Figure 3.20 Variation of public spending as equivalent GDP points, Tunisia

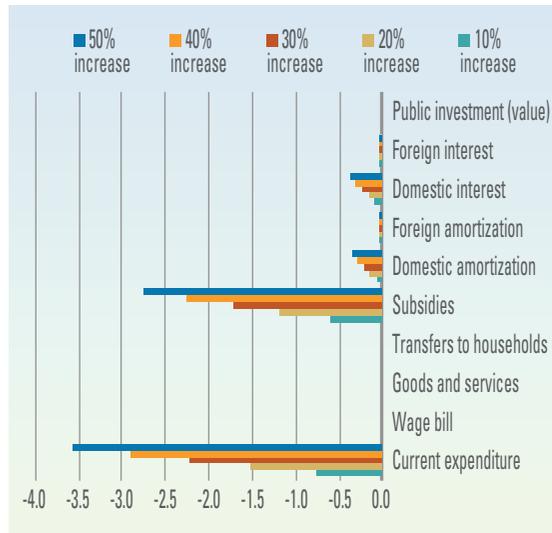
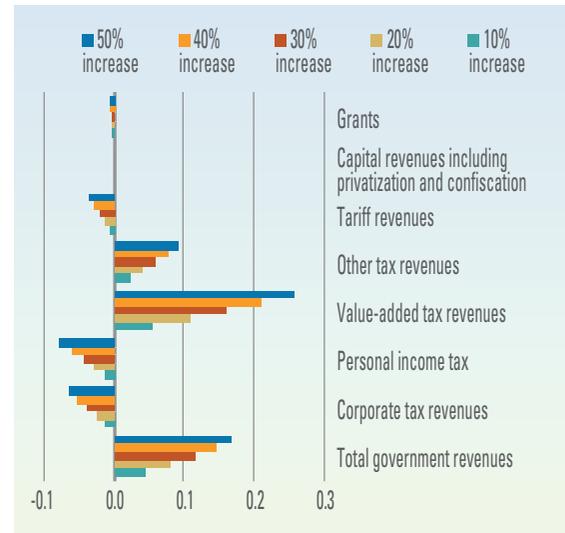


Figure 3.21 Variation of Government revenues as equivalent GDP points, Tunisia



Source: Author's simulation using Tunisia CGE model.

Figure 3.22 Variation of financing needs, Tunisia

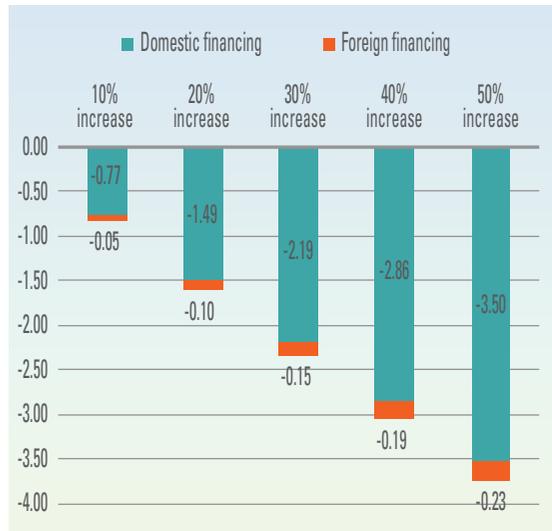
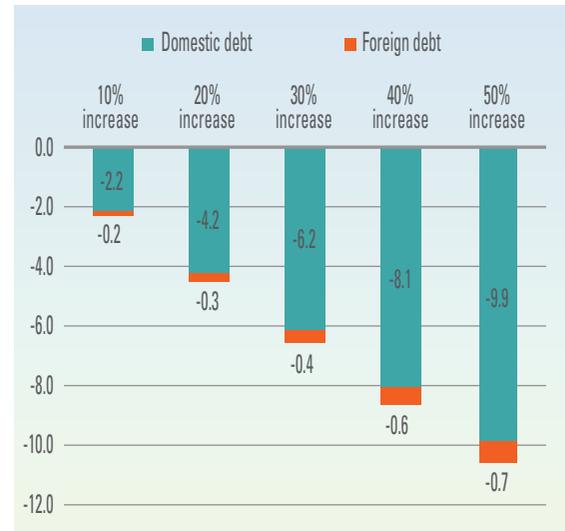


Figure 3.23 Variation of final stock of debt, Tunisia



Source: Author's simulation using Tunisia CGE model.

price increases. As a result of this decline in domestic financing, the Government's domestic borrowing is reduced, which allows for a decrease in the domestic debt by 2.2 points for 10 per cent increases in energy prices and up to almost 10 points lower for 50 per cent increases in energy prices. A slight decrease in foreign debt, by 0.2 points and up to 0.7 points from the first to the fifth quintile of energy price

increases, is also observable as a result of the Tunisian dinar appreciation (figure 3.23).

(d) Sectoral effects

The sectoral impacts of energy subsidy reduction are quite complex. As argued by Bacon and Kojima (2006), energy price increase has a significant effect on fuel and electricity

Figure 3.24 Variation of sectoral demand, Tunisia

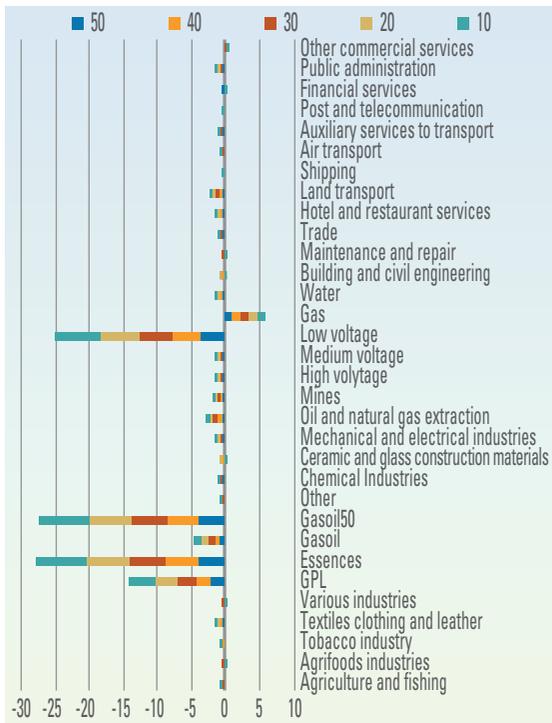
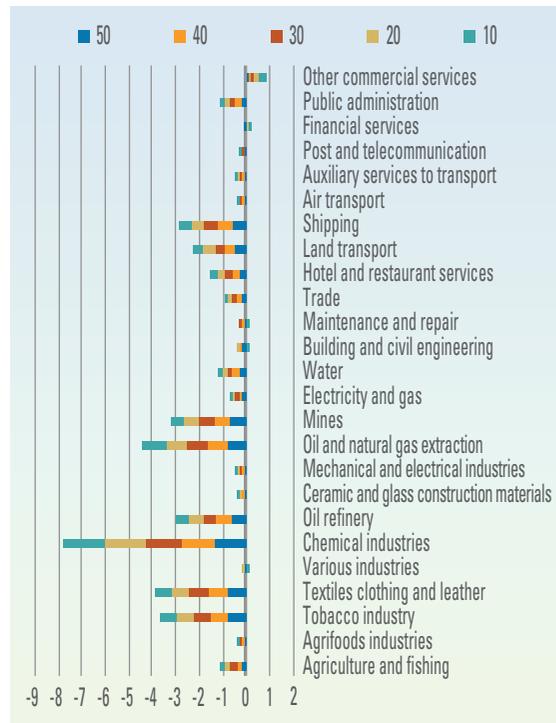


Figure 3.25 Variation of sectoral output, Tunisia



Source: Author's simulation using Tunisia CGE model.

Figure 3.26 Variation of sectoral margins, Tunisia

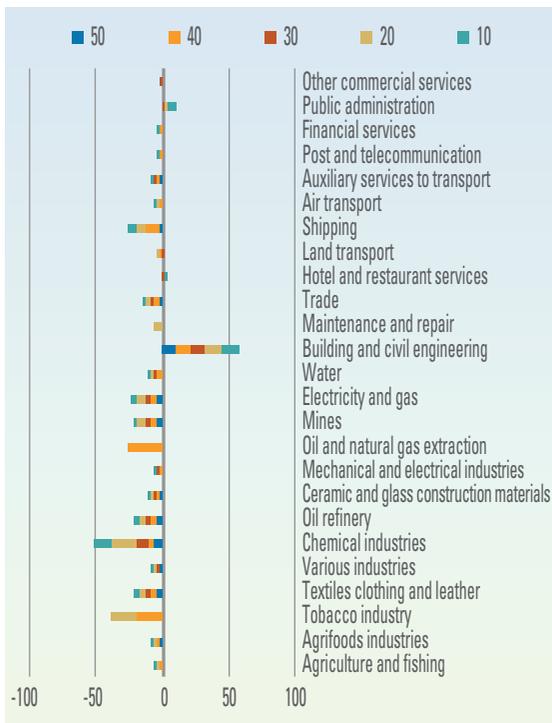
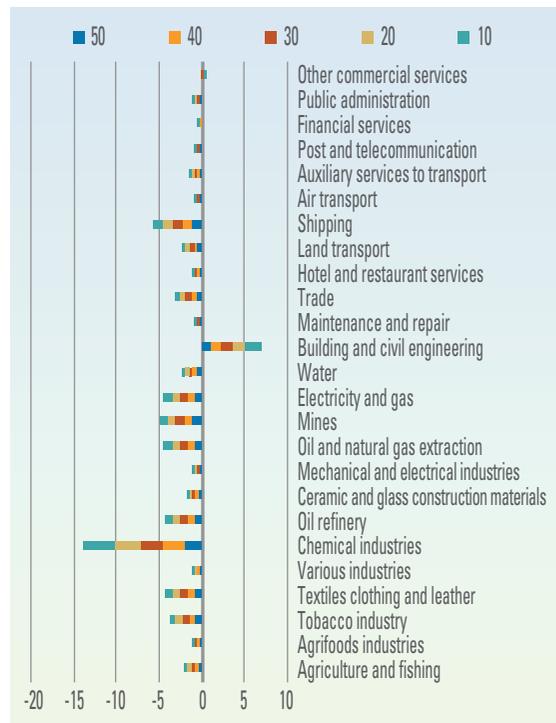


Figure 3.27 Variation of labour demand, Tunisia



Source: Author's simulation using Tunisia CGE model.

demand. The model shows that domestic demand relevant to the products affected by the reform declines significantly. In addition, because households and firms reallocate their spending to offset their higher spending on energy, the demand facing most products will decline. Only the demand for gas could increase. This product, not affected by subsidy decline, will benefit from the substitution effect (figure 3.24).

As a result, firms will adjust their outputs (figure 3.25) and reduce their margins (figure 3.26). Transportation sectors (mainly land transport and shipping) and industrial sectors (mainly chemical, tobacco and textile industries, but also directly-linked oil and gas extraction industries) will suffer the largest losses. Therefore, labour demand decreases in the majority of the sectors raising the unemployment rate, as described previously, with a significant exception in the building and civil engineering sectors (figure 3.27). Given the construction sector is a highly intensive, male labour force in the country, the gender impact of this reform could be quite unequal, leading to a gender bias increase in unemployment affecting females more.

(e) Implications of the fiscal closure

The model shows that reducing energy subsidies generates fiscal space for the Tunisian Government. In the first group of simulations we supposed that these “saved” amounts are totally directed towards the reduction of fiscal deficit. This policy enhances the fiscal sustainability and reduces indebtedness but has a negative impact on growth and job creation.

Fuel subsidy removal will certainly improve the Government budget. Expenditure-wise, the Government will have more room for various fiscal policies thanks to the subsidy removal. The Government should reallocate this extra budget to each sector accordingly. Meanwhile, alternative policies are possible:

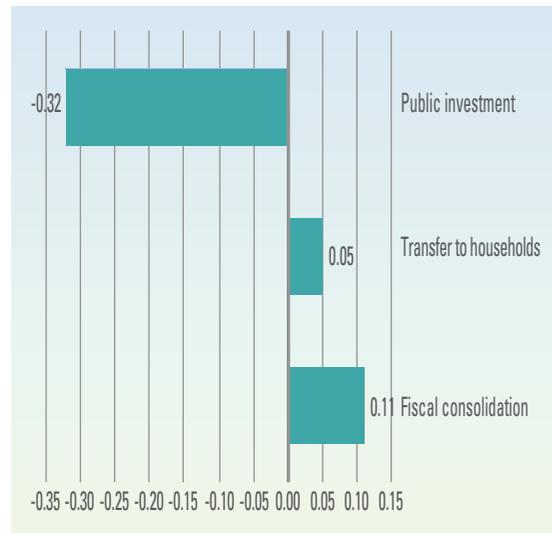
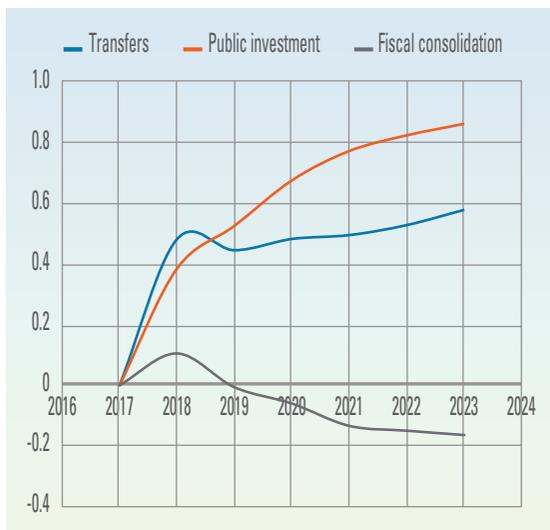
the saved amount could either be transferred to households as a lump sum transfer or used to fund additional public investment programmes. The implications of these alternative policies are illustrated by the simulation of a 10 per cent increase of energy prices. The results are quite informative.

The macroeconomic impacts of such alternative policies could be completely opposite. On one hand, increasing public investment enhances the global performance of the economy whereby economic growth could increase by 0.5 per cent over the simulated period (figure 3.28) while unemployment rate could decrease by 0.32 per cent (figure 3.29). On the other hand, reallocating the “saved” amount towards a lump sum transfer to households has a negative impact on growth and unemployment since it does not foster an incentive to work. However, these negative effects are still less important than those arising from the fiscal consolidation scenario. In fact, such transfer payments to households reduce growth by a mere 0.07 per cent compared to a decrease by 0.14 per cent under fiscal consolidation. Similarly, transfers to households raise the unemployment rate by 0.05 per cent compared to a 0.11 per cent unemployment rise under fiscal consolidation.

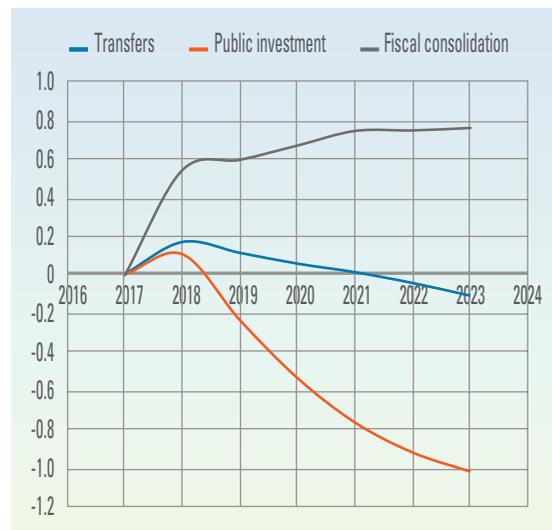
The price effects of such alternative policies compared to the fiscal consolidation scenario are also opposite (figure 3.30). If fiscal consolidation improves the balance of payments of the country and implies an appreciation of the Tunisian dinar and a decrease of the inflationary pressures on the long run by 0.2 points, the use of the new fiscal space to increase public investment deteriorates the trade balance and consequently devaluates the Tunisian dinar by 1 point compared to foreign currencies (figure 3.31). Thus, both the energy price increase and the money depreciation have an important and amplifying double effect on creating inflationary pressure. On the other hand,

Figure 3.28 Real GDP variation, Tunisia

Source: Author's simulation.

Figure 3.29 Unemployment rate, Tunisia (percentage)**Figure 3.30** Relative variation of price index, Tunisia

Source: Author's simulation.

Figure 3.31 Relative variation of exchange rate, Tunisia

the reallocation of this higher fiscal space towards a lump sum transfer to households places the effect of such policy on inflation in between the demand stimulus effect of higher public investment and the fiscal consolidation scenario. In fact, the effect of household transfers on inflation is higher than the fiscal consolidation impact with its 0.6 points increase in inflation effect compared to a 0.2 decrease in inflation under fiscal consolidation.

However, the inflationary impact of such transfer policy remains lower than that of the public investment increase scenario, which induces 0.85 points increase in inflation.

As a result, depending on the long-run key macroeconomic target variables of the Government, overall public investment seems to be a more profitable scenario that is both growth-enhancing and unemployment-

reducing, even if it is at the expense of a slightly higher inflationary pressure of 0.25 points. It provides a fiscal stimulus to the economy allowing it to counter the effect of the contractionary economic activity pressure induced by higher energy prices.

2. The case of Saudi Arabia

The Saudi economy has been deeply affected by the 2014 drop in oil prices. An economy that had grown at an average pace of 5.3 between 2010 and 2014 has since 2015 grown at an average pace of 1.7 per cent (figure 3.32). With the country's reforms in place, growth is expected to increase further as oil output increases. The employment of Saudi nationals has increased, especially for women, but the unemployment rate among Saudi nationals rose to 12.8 per cent in 2017. The introduction of VAT and higher gasoline and electricity prices led to an expected CPI inflation of 3 per cent in 2018, before stabilizing at around 2 per cent over the medium term.⁶⁴

The performance of the Saudi economy and its fiscal revenue are highly linked to oil price (figure 3.33). The share of oil revenue in the

Government revenue decreased from 92 per cent in 2011 to around 70 per cent in 2018. The fiscal deficit reached 17.2 per cent in 2016 and the non-exported oil primary deficit (NEOPD) amounted for 44.6 per cent of non-oil GDP in 2016.

To address this situation, Saudi Arabia started diversifying its Government resources with the implementation of the VAT in 2015. It announced in early 2016 a significant reduction in fossil fuel subsidies. Gasoline prices increased by about 50 per cent, and natural gas prices by 67 per cent. Ethane, a key input used by the petrochemical sector, has seen its price increase by 133 per cent. These measures narrowed the fiscal deficit to 9.3 per cent of GDP in 2017 and non-exported oil primary deficit to 38.6 per cent of non-oil GDP. In 2018, the NEOPD level was 25 per cent of non-oil GDP, below its peak in 2014. The fiscal deficit is projected to continue to narrow to 4.6 per cent of GDP in 2018 and then further to 1.7 per cent of GDP in 2019. With the decline in oil prices, the deficit is projected to widen and is expected to continue to be financed by a combination of asset drawdowns and domestic and international borrowing.⁶⁵

Figure 3.32 Evolution of the growth performance of the Saudi economy



Source: IMF, 2018e.

Figure 3.33 Evolution of the fiscal indicators of the Saudi economy

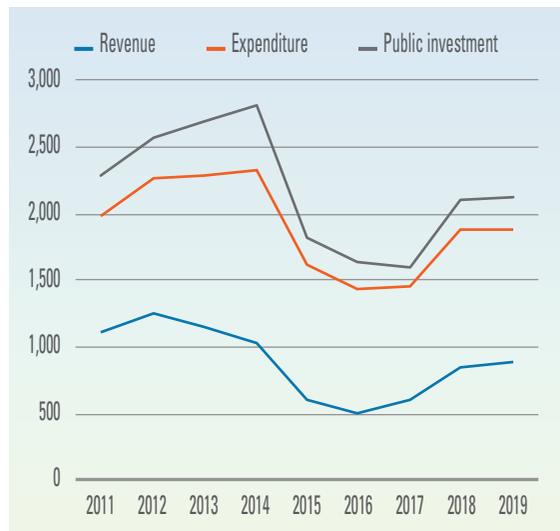


Table 3.3 The “business as usual” scenario’s macroeconomic framework, Saudi Arabia

	2018	2019	2020	2021	2022	2023
Real GDP	1.9	1.9	2	2.1	2.2	2.4
Unemployment rate (nationals)	12.8	12.8	12.8	12.8	12.8	12.8
Average oil export price level	70.7	69.5	65.4	62.5	60.5	59.2
Population (millions)	33.2	33.9	34.5	35.2	35.9	36.7
Revenue	28.9	29.3	28.9	27.9	26.8	25.9
Oil revenue	20.0	19.3	18.0	16.9	16.0	15.2
Non-oil revenue	4.2	5.1	5.9	5.9	5.7	5.5
Direct tax	1.2	1.2	1.2	1.2	1.2	1.3
Indirect tax	2.8	3.0	3.0	3.1	3.1	3.2
Tariff revenue	0.7	0.7	0.8	0.8	0.8	0.8
Expenditure	27.2	25.5	25.8	26.0	25.9	26.0
Wage	15.8	14.3	14.4	14.4	14.3	14.2
Goods and services	4.9	5.0	5.1	5.2	5.3	5.4
Transfer to households	6.2	5.8	5.8	5.8	5.7	5.8
Transfer to the rest of the world	0.3	0.5	0.5	0.6	0.6	0.6
Public investment	8.0	7.9	8.1	7.9	7.7	7.5
Deficit	-6.3	-4.2	-5.1	-6.1	-6.8	-7.5

Source: IMF, 2018e.

The Government has announced its intention to continue to gradually increase energy prices to benchmark levels by 2025. The price of natural gas is expected to start increasing in 2020; LPG and kerosene prices should reach their reference price levels in 2019; diesel prices should be incrementally increased starting 2019. Plans for water price reforms have been delayed as metering and billing issues remain to be resolved. The Electricity and Cogeneration Regulatory Authority (ECRA) is supervising an assessment of these issues and will be conducting a study on water supply costs that will help build future water tariff schedules.

To have a first order assessment of the economic and sectoral implications of an increase of energy prices on the Saudi economy we use a multisectoral dynamic CGE model and simulate the same shocks

implemented for the Tunisian case. As a reference scenario, we also used the macroeconomic framework presented by the IMF in its August 2018 review, but this time taking into consideration the revenues generated from energy price reforms. The “business as usual” scenario is presented in table 3.3. It depicts a decline in the average oil export price level in the next five years, leading to a total decline in revenues due to important declines in oil revenues. As a result, Government expenditures will be reduced with lower transfers to households and lower public expenditures. However, the downward pressure on revenue outweighs the cut in expenditures, thus widening the public deficit. Consequently, with an expected growing population from 33.2 million to 36.7 million, real GDP is expected to rise from 1.9 to 2.4, with the unemployment rate for nationals left unscathed.

(a) Effects on growth

Simulations show that when the energy subsidy reform is undertaken with a fiscal consolidation objective, it has a negative impact on growth and employment creation, especially for nationals.

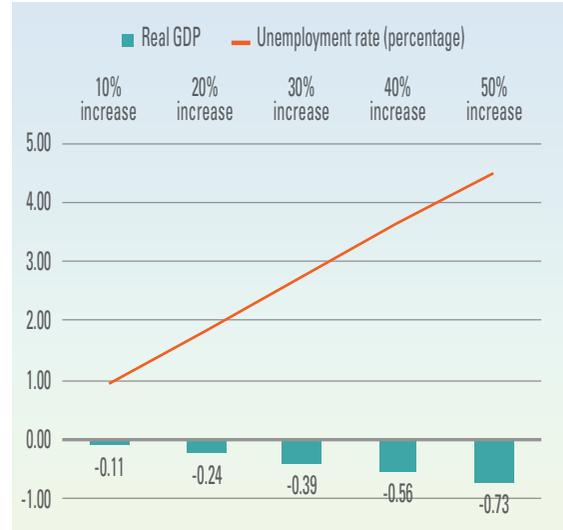
In fact, increases in energy prices by 10 and 20 per cent lead to proportionate decreases in real GDP respectively by 0.11 and 0.24 percentage points, with further rises in energy prices leading to larger negative effects on growth, pushing real GDP down by 0.73 percentage point for 50 per cent increases in energy prices (figure 3.34). This recessionary pressure brings along with it increasing unemployment. For every increase in energy prices by 10 per cent, unemployment rate rises by 1 per cent reaching nearly 5 per cent for a 50 per cent increase in energy prices.

The growth gap between the different price simulation scenarios is initially wide in the implementation year 2019, however, after all adjustments have taken place, the gap is once again narrowed down to only 0.1 percentage point in the following five years (figure 3.35).

(b) The impacts on demand

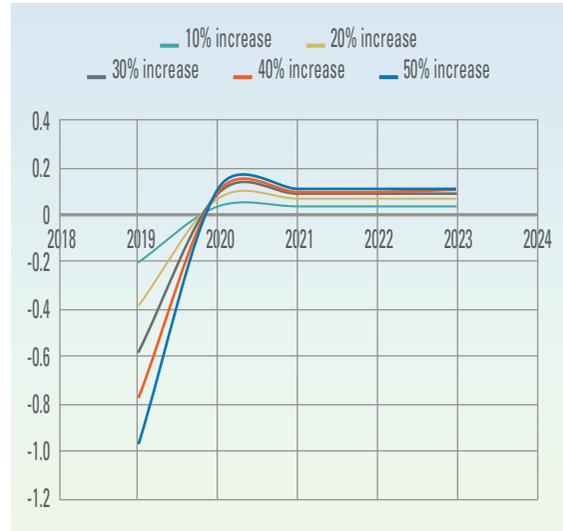
The increase in energy prices has a negative impact on households' final consumption and on firms' intermediate consumption. Meanwhile the reduction of the crowding out effect has a positive impact on private investment (figure 3.36). In fact, on one hand, for every 10 per cent increase in energy prices, total final consumption falls proportionately by 1 percentage point while the decrease in intermediate consumption is slightly larger for larger increases in energy prices, ranging from a decrease by 0.28 to 0.35 percentage points for 10 and 50 per cent increases in energy prices, respectively. On the other hand, as a result of a lower crowding out effect, the decline in public spending is offset by higher private

Figure 3.34 The implications of the increase of energy products prices on growth and unemployment, Saudi Arabia



Source: Author's simulation using Saudi Arabia's CGE model.

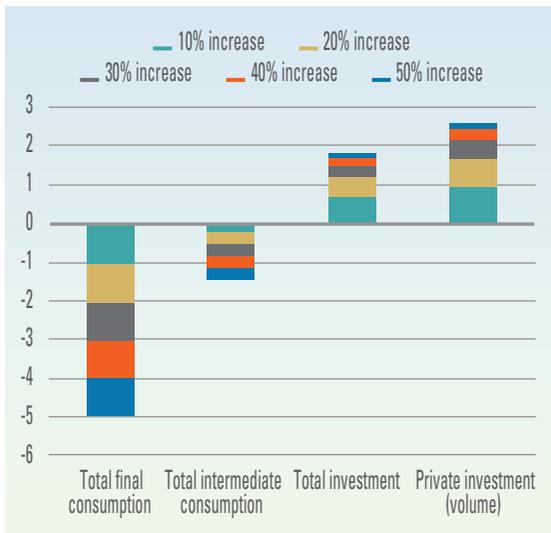
Figure 3.35 Growth gap, Saudi Arabia



Source: Author's simulation using Saudi Arabia's CGE model.

investment thus causing positive effects on total investment. Hence, a 10 per cent increase in energy prices leads to an increase in private investment by 1 percentage point and 0.71 percentage points in total investment. However, high increases in energy prices dampen the positive effect on investment due to their stronger contractionary impact leading to small

Figure 3.36 Local demand, Saudi Arabia



Source: Author's simulation using Saudi Arabia's CGE model.

Figure 3.37 Effects on external trade, Saudi Arabia

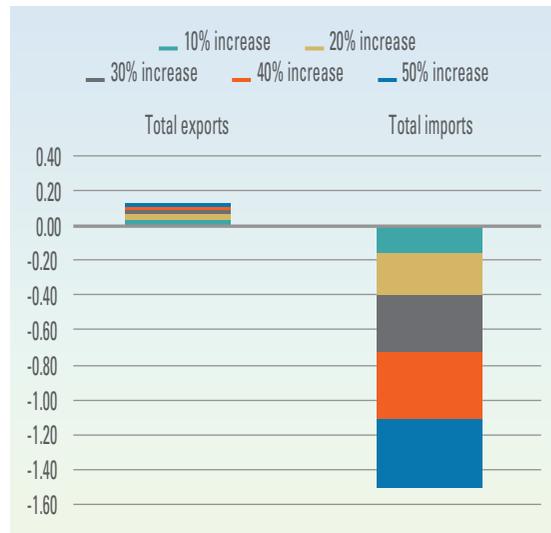
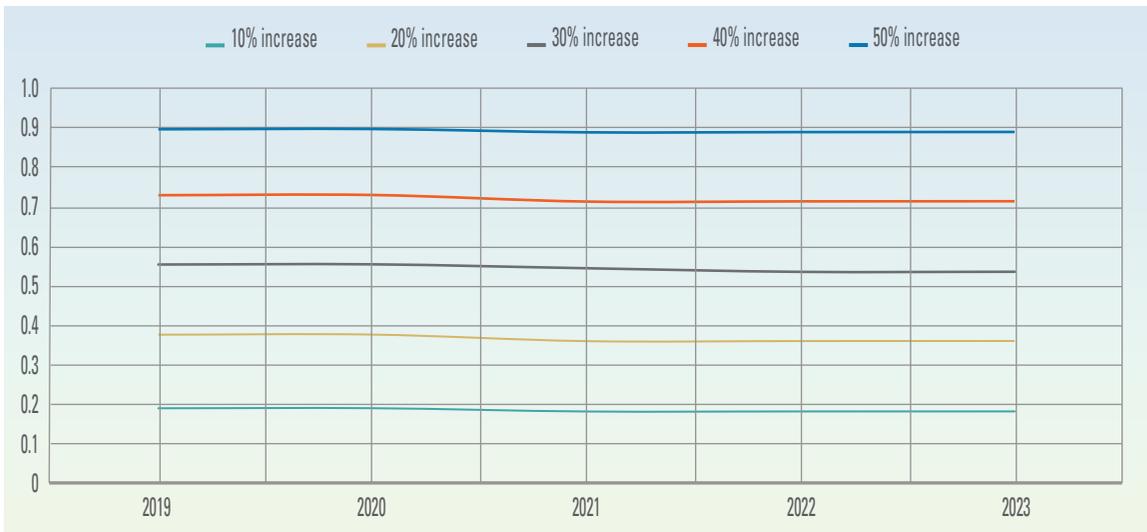


Figure 3.38 Effects on inflation, Saudi Arabia



Source: Author's simulation using Saudi Arabia's CGE model.

increases in private and total investments respectively by 0.15 and 0.11 percentage points for 50 per cent increases in energy prices.

Given the fixed exchange rate, the decrease in both final and intermediate consumption reduce the volume of imports in the country. Such a decrease in imports is occurring at an increasing marginal propensity whereby total imports decline by 0.15 percentage points as a

result of 10 per cent increases in energy prices, by 0.32 percentage points for 30 per cent increases in energy prices, and by 0.42 percentage points for 50 per cent increases in energy prices (figure 3.37). Consequently, firms marginally increase the volume of their exports to compensate for the decrease in the domestic demand. Total exports increase by a mere 0.02 percentage points for every 10 per cent increase in energy prices, compared

to noticeable decreases in imports, thus leading to a higher trade deficit.

(c) The effect on inflation

Since Saudi Arabia has a pegged exchange regime, the subsidy reform has no impact on its exchange rate. Thus, the increase in energy prices is completely translated into a surge in the price index. Such inflationary pressure is sustained throughout the five years following the reform (figure 3.38). Results of the simulation confirm the important weight that energy prices place on the overall price level. In fact, while a 10 per cent increase in energy prices leads to a 0.2 percentage point higher inflation, a 50 per cent increase in such energy prices raises the inflation rate by 0.9 percentage points denoting noticeable inflationary pressure which comes with the major problem of lower purchasing power and its economic consequences.

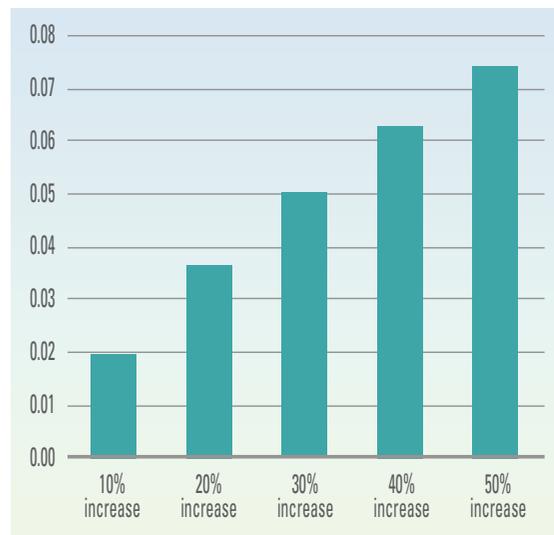
(d) Fiscal implications

One of the major benefits stemming from such energy subsidy reforms is the positive effect on the fiscal balance. Lower public

expenditure on subsidies will free up resources to allow the Government to increase its investment in key development sectors such as education, infrastructure, etc. In fact, a 10 per cent increase in energy prices would raise the value of public investment by 0.02 equivalent GDP points and up to nearly 0.08 points for 50 per cent increases in energy prices (figure 3.39).

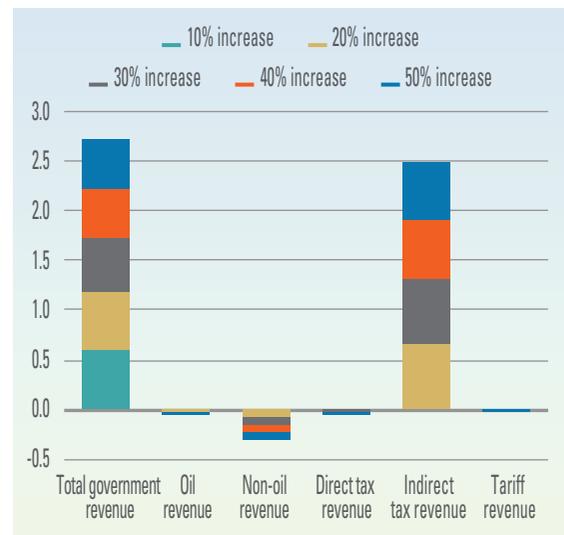
As a result of a reduction in subsidies paid, total Government revenue would rise by a range of 0.5 to 0.6 equivalent GDP points for every quintile increase in energy prices (figure 3.40). Given the higher VAT rates imposed in the reforms and the higher prices of energy products and goods, the sales tax or indirect tax revenue would rise. Higher indirect tax revenues are noticeable starting at 20 per cent increases in energy prices, to levels over 0.6 percentage equivalent GDP points for every quintile increase in energy prices. Such 0.6 percentage points in equivalent GDP increase in Government and indirect tax revenues largely outweigh the negligible 0.01 and 0.08 percentage points decline in oil and non-oil revenues, respectively, tilting the balance towards higher total public revenue.

Figure 3.39 Variation of public spending as equivalent GDP points, Saudi Arabia



Source: Author’s simulation using Saudi Arabia’s CGE model.

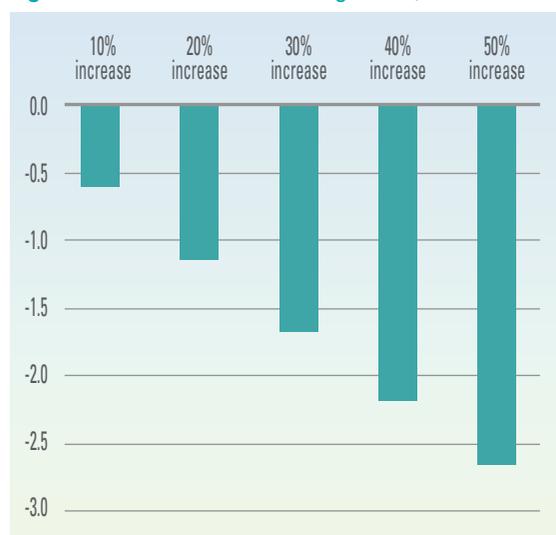
Figure 3.40 Variation of Government revenue as equivalent GDP points, Saudi Arabia



Consequently, higher Government revenue reduces its level of indebtedness and the debt burden faced since financing needs are lowered as a result of lower subsidies. In fact, a 10 per cent increase in energy prices lowers the financing needs of the Government by 0.6 percentage points with a sharper decline for higher price increases (figure 3.41). Ultimately, a 50 per cent increase in energy prices reduces the need for financing by over 2.5 points. The lower level of required financing will raise the level of public resources available and thus increase the country's foreign reserves. An increase in energy prices by 10 per cent enlarges the amount of foreign reserves by 0.55 percentage points (figure 3.42). Such an increase in foreign reserves reaches over 1 percentage point for a 20 per cent increase in energy prices and up to 2.2 percentage points for 50 per cent increases in energy prices.

Needless to say, the fiscal position is improved as a result of such gradual energy price subsidy removal, leading to higher Government revenue, lower financing needs and improvement in the country's foreign reserves with more growth enhancing public investment potential.

Figure 3.41 Variation of financing needs, Saudi Arabia



Source: Author's simulation using Saudi Arabia's CGE model.

(e) Sectoral effects

Higher energy prices arising from energy subsidy reforms decrease both production and demand in all sectors of the economy (table 3.4). In fact, energy products represent a major input cost going in the production process. Such higher costs lower the supply and thus the production in all sectors. The higher the increase in energy prices, the higher will be the decrease in production resulting from it. Electricity, gas and water supply are obviously the largest sectors affected directly in which production declines by 3.19 per cent for 10 per cent increase in energy prices and by 12.10 per cent for 50 per cent increase in such prices. Home construction is the second most affected sector given the large share of domestic energy product consumption: production of private households by regularly employed persons declines by nearly 1 to 5 per cent for increases in energy prices by 10 to 50 per cent. Other community and service activities and transport sectors also face lower production, with around 3 per cent decline as a result of 50 per cent higher energy prices.

This decline in production is coupled with a similar decrease in demand in all sectors as a

Figure 3.42 Variation of foreign reserve, Saudi Arabia

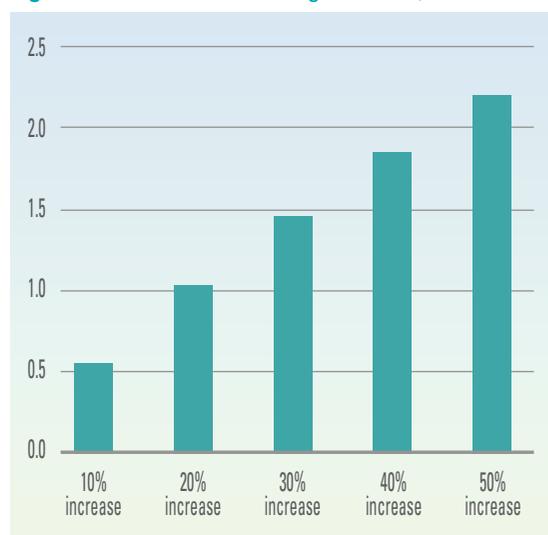


Table 3.4 Impact on production and demand by sector

	Production					Demand				
	10% increase	20% increase	30% increase	40% increase	50% increase	10% increase	20% increase	30% increase	40% increase	50% increase
Agriculture, hunting and forestry	-0.06	-0.15	-0.26	-0.40	-0.55	-0.29	-0.61	-0.95	-1.32	-1.69
Fishing	-0.38	-0.79	-1.23	-1.69	-2.17	-0.39	-0.80	-1.25	-1.71	-2.20
Crude petroleum and natural gas	0.10	0.17	0.22	0.26	0.29	-0.29	-0.60	-0.92	-1.24	-1.58
Other mining and quarrying	0.04	0.03	0.00	-0.05	-0.13	-0.11	-0.30	-0.54	-0.82	-1.13
Petroleum refining	0.03	0.04	0.02	-0.02	-0.07	-0.45	-0.91	-1.37	-1.85	-2.32
Other manufacturing	-0.23	-0.52	-0.84	-1.19	-1.57	-0.09	-0.27	-0.50	-0.78	-1.10
Electricity, gas and water supply	-3.19	-5.89	-8.23	-10.28	-12.10	-3.19	-5.91	-8.25	-10.30	-12.12
Construction	0.35	0.55	0.63	0.63	0.57	0.41	0.66	0.79	0.84	0.81
Wholesale and retail trade repair of motor vehicles and personal household goods	-0.31	-0.65	-1.01	-1.39	-1.77	-0.38	-0.79	-1.21	-1.64	-2.08
Hotels and restaurants	-0.15	-0.32	-0.52	-0.74	-0.97	-0.53	-1.08	-1.65	-2.23	-2.82
Transport storage and communications	-0.47	-0.97	-1.49	-2.03	-2.59	-0.45	-0.92	-1.40	-1.91	-2.42
Financial intermediation	-0.07	-0.17	-0.29	-0.42	-0.57	-0.35	-0.72	-1.11	-1.50	-1.91
Real estate renting and business activities	-0.13	-0.29	-0.47	-0.67	-0.89	-0.44	-0.90	-1.38	-1.87	-2.38
Public administration and defense compulsory social security	-0.47	-0.93	-1.38	-1.83	-2.28	-0.38	-0.76	-1.13	-1.50	-1.87
Education	-0.40	-0.80	-1.19	-1.59	-1.99	-0.37	-0.74	-1.11	-1.48	-1.85
Health and social work	-0.46	-0.92	-1.38	-1.83	-2.29	-0.37	-0.74	-1.11	-1.49	-1.86

Other community, social and personal service activities	-0.63	-1.27	-1.90	-2.54	-3.18	-0.62	-1.25	-1.87	-2.50	-3.13
Private households with employed persons	-0.97	-1.95	-2.94	-3.92	-4.91	-0.97	-1.95	-2.94	-3.92	-4.91

Source: Author's simulation using Saudi Arabia's CGE model.

result of higher prices for all products. In fact, demand for electricity, gas and water supply as well as households' demands are the largest impacted sectors. However, the negative effect on the demand side for all other sectors exceeds that of the supply, mostly noticeable for crude petroleum and natural gas, which are the only sectors whose production is not negatively affected by higher energy price increases but whose demand (in contrast to the case of Tunisia) largely declines by almost 1.5 per cent for 50 per cent increase in prices. This difference, as specified above, is due to the fact that subsidy reforms have been initiated in Saudi Arabia for all energy products including gas, which is not the case in Tunisia. Thus, the substitution effect towards gas consumption is not present in Saudi Arabia.

Such a decrease in both demand and supply has a negative impact on both employment and capital returns. A lower demand and correspondingly a lower supply imply a lower demand for inputs consequently leading to higher unemployment and lower capital rates of return. The factor remuneration by sector depicts both lower employment rates and capital rates of returns for all sectors except the construction sector as a result of higher energy prices (table 3.5). Once again, the rise in the unemployment rate is mostly noticeable in the electricity, gas and water supply sector whereby employment is reduced by 11 per cent for 10 per cent increases in energy prices and by almost 40 per cent for 50 per cent increases

in energy prices. Fishing, transport, storage, communications and manufacturing sectors also face declines in both capital remuneration and employment. Although the construction sector is the only one facing positive factor remuneration, the increase in employment due to high energy prices is by a mere 1 per cent and a similar increase is noted for the rate of return on capital. This positive effect is minimal compared to the magnitude of the negative impact on employment and capital returns in other sectors. Thus, the gender bias in the level of unemployment across sectors is not a concern as it was the case in Tunisia. In Saudi Arabia, the gender diversity component is not present in many goods and service sectors. In fact, although labour force participation among Saudi women increased significantly between 2000 and 2017 (from 10.1 per cent to 19.4 per cent), it is still well below the GCC average and other countries at a similar income level. The female unemployment rate is high at 31 per cent and educated women have a much higher unemployment rate than their male counterparts.⁶⁶

(f) Implications of the fiscal closure

Overall, the impact of the energy subsidy has a positive effect on the fiscal balance but weighs negatively on economic growth and unemployment due to lower economic activity arising from lower demand and production. Given the country's fixed exchange rate system, the increase in energy prices is

Table 3.5 Factor remuneration by sector

Saudi employment	Employment					Capital rate of return				
	10% increase	20% increase	30% increase	40% increase	50% increase	10% increase	20% increase	30% increase	40% increase	50% increase
Agriculture, hunting and forestry	-1.15	-2.33	-3.53	-4.76	-6.00	-1.12	-2.24	-3.36	-4.50	-5.63
Fishing	-3.74	-7.39	-10.98	-14.50	-17.95	-3.41	-6.73	-9.98	-13.17	-16.30
Crude petroleum and natural gas	-0.08	-0.16	-0.24	-0.32	-0.40	-0.16	-0.29	-0.41	-0.52	-0.62
Other mining and quarrying	-0.48	-1.05	-1.68	-2.37	-3.10	-0.53	-1.11	-1.73	-2.39	-3.06
Petroleum refining	-0.80	-1.62	-2.46	-3.30	-4.15	-0.82	-1.63	-2.43	-3.22	-4.01
Other manufacturing	-1.56	-3.22	-4.96	-6.75	-8.58	-1.48	-3.03	-4.63	-6.27	-7.92
Electricity, gas and water supply	-11.17	-19.96	-27.05	-32.89	-37.80	-10.03	-18.01	-24.51	-29.92	-34.49
Construction	0.87	1.32	1.43	1.29	0.96	0.66	0.97	1.01	0.84	0.50
Wholesale and retail trade repair of motor vehicles and personal household goods	-1.65	-3.29	-4.91	-6.52	-8.12	-1.56	-3.09	-4.59	-6.06	-7.52
Hotels and restaurants	-0.98	-1.98	-2.98	-4.00	-5.03	-0.97	-1.93	-2.88	-3.83	-4.77
Transport, storage and communications	-2.78	-5.53	-8.24	-10.92	-13.57	-2.56	-5.07	-7.54	-9.97	-12.37
Financial intermediation	-1.02	-2.05	-3.08	-4.12	-5.16	-1.01	-1.99	-2.97	-3.93	-4.89
Real estate renting and business activities	-1.35	-2.71	-4.08	-5.45	-6.82	-1.30	-2.58	-3.85	-5.11	-6.36
Public administration and defense compulsory social security	-0.52	-1.02	-1.52	-2.01	-2.49	-0.55	-1.08	-1.57	-2.05	-2.51
Education	-0.45	-0.90	-1.34	-1.79	-2.23	-0.50	-0.97	-1.42	-1.85	-2.28

Health and social work	-0.64	-1.28	-1.91	-2.53	-3.15	-0.67	-1.31	-1.92	-2.52	-3.09
Other community, social and personal service activities	-1.22	-2.41	-3.59	-4.75	-5.89	-1.18	-2.31	-3.41	-4.48	-5.52
Private households with employed persons	-0.98	-1.95	-2.94	-3.92	-4.91	0.00	0.00	0.00	0.00	0.00

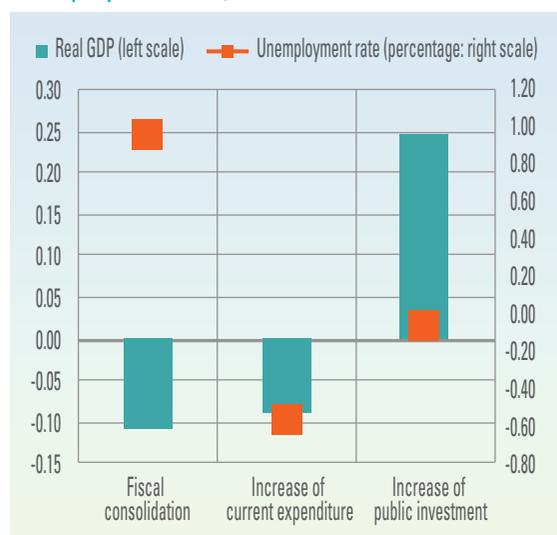
Source: Author's simulation using Saudi Arabia's CGE model.

automatically reflected by higher inflation. However, the magnitude of the variation of the price index arising from the different scenarios is what is considered in the analysis.

In fact, the fiscal consolidation scenario depicted in figure 3.43 shows a decline in real GDP by 0.11 points and an increase in the unemployment rate by nearly 1 per cent (0.94). Consequently, such a scenario with its slowdown in economic activity has the lowest inflationary pressure with a CPI rising by 0.18 points (figure 3.44).

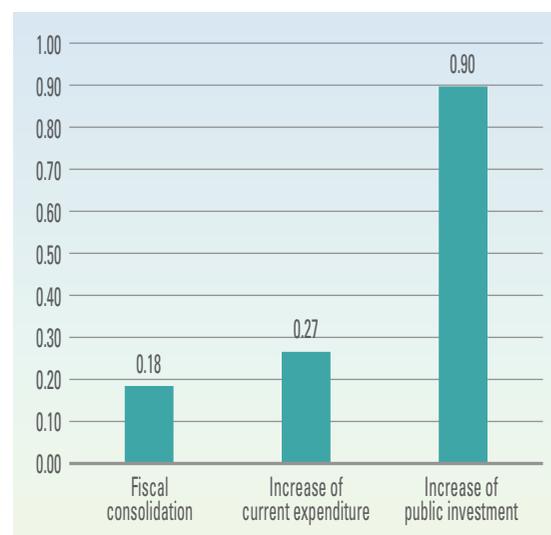
If such higher fiscal space with its accompanied higher revenues is allocated towards increased current expenditures mainly via lump sum transfer payments to households – which are currently not available – the noticeable positive effect will be observed on reducing the unemployment rate by 0.57 percentage points, while the negative effect on real GDP persists although slightly improved by 0.02 points compared to the fiscal consolidation scenario. As a result of this stimulus, higher inflation is encountered with an increase in the CPI by 0.27 points.

Figure 3.43 Nominal GDP variation and unemployment rate, Saudi Arabia



Source: Author's simulation using Saudi Arabia's CGE model.

Figure 3.44 Relative variation of price index, Saudi Arabi



Ultimately, if the improved fiscal balance is channelled towards increasing the public spending in growth-enhancing sectors, not only would it foster growth by increasing real GDP by 0.25 percentage points due to its strong and direct multiplier effect, but also by lowering the unemployment rate by 0.06 percentage points. Evidently, such stronger fiscal stimulus has the highest impact on inflation with an increased CPI by 0.9 points.

Although the strength of the impacts might differ depending on the country considered, our model shows once again that overall public investment seems to be a more profitable scenario that is both growth enhancing and unemployment reducing, even if it is at the expense of a higher inflation. Such expansionary fiscal policy enhances economic activity outweighing the slowdown effects that arise from higher energy prices.

C. Conclusion

According to the research conducted by ESCWA, subsidies reduce the incentive to invest in energy generation and provision, resulting in a lack of development and maintenance of energy infrastructure. Moreover, energy subsidies lead to energy inefficiency in the industries rather than stimulating productivity or competitiveness and tend to promote capital-intensive industrialization at the expense of the labour-intensive variety, placing a toll on job-creation.⁶⁷

Simulations demonstrate that reducing energy subsidies generates a fiscal space for governments. Meanwhile, if the “saved” amounts are totally directed to the reduction of fiscal deficit, fiscal sustainability could be enhanced. However, economic growth and job creation will be negatively affected.

Application of alternative policies is possible. The saved amount could either be transferred to households as a lump sum transfer or

used to fund additional public investment programmes. The implications of the application of these alternative policies are different in terms of growth, job creation and inflation. Increasing public investment could have a better impact in terms of growth and job creation but negative impact on inflation and balance of payments, as the country needs to increase its exports of capital good. The impacts of households’ lump sum option could have an in between effect. The impacts on growth and job creation could be higher than the fiscal deficit reduction but less than the public investment option.

The macroeconomic model used does not take into consideration inter-fuel substitution and competition and the effect of improvement in energy efficiency and energy saving in different economic sectors and households. These effects could be taken into consideration later. Econometric assessments could determine the effects of energy efficiency programmes on the level of energy consumption by sector. The estimated relationships will be then introduced in the model in order to fill this analysis gap.

As a follow-up to this report, research is envisaged that could investigate further the topic of energy subsidy policies and their impact at the sectorial level which will allow for an assessment of the impact of increasing the share of renewable energy in the energy mix, the effect of the use of clean technologies and the upscaling of energy efficiency measures on the different economic sectors. Provided the availability of data and modelling tools, this research could complete the macro modelling of the present Survey and eventually refine policy recommendations to be suggested.

In the 2019 report *Energy Vulnerability in the Arab Region*, ESCWA has provided a number of policy recommendations for mitigating the effect of the reform of energy subsidies.⁶⁸ Among the recommendations, the report proposes to (a) diversify the national energy mix and increase the share of renewable

energy; (b) establish sustainable demand-side management systems for domestic energy use; (c) reprioritize structural economic diversification; (d) implement large-scale energy efficiency retrofit programmes across all economic sectors; (e) ensure effective enforcement of energy efficiency performance standards and regulations; and (f) increase the uptake of off-grid systems and enhance regional energy trade.

These estimations could prove to policymakers in the Arab region that if the portion of the fiscal space generated by energy subsidy reforms can be used to fund some of the above set portfolio of policy recommendations through adequate choices of infrastructure, technology, governance and sustainable management practices, then this will be key in addressing the effect of any energy subsidy reform and will speed up the mainstreaming of sustainable energy management.

Endnotes

Chapter 1

1. The sovereign spread of a dollar denominated bond is defined as the difference in yield between the bond and a benchmark US Treasury bond of a similar maturity and is normally expressed in basis points.
2. The term “mini job” was coined in Germany to describe a form of marginal employment that is generally characterized as part-time with a low wage. According to the latest law, the monthly income of a mini job is less than €450, exempting them from income tax.
3. For more details see, ILO, 2019b.
4. For more details see, International Energy Agency, 2019.
5. In November 2018, the United States issued eight waivers lasting 180 days to importers of Iranian oil, namely China, Greece, India, Italy, Japan, South Korea, Taiwan and Turkey.
6. In January 2019, the United States Government announced sanctions to freeze the assets of the Venezuelan State-run oil company PDVSA (Petróleos de Venezuela), which used to ship around 0.5 million b/d to the United States, equivalent to 41 per cent of total Venezuelan oil exports.
7. For more details see, IEA, 2018.
8. For more details see, General Administrator of Customs of the People’s Republic of China, 2018; and Trade Statistics of Japan Ministry of Finance, 2018.
9. For more details see, International Fertilizer Association, 2019.
10. For more details see, National Development and Reform Commission, 2016.
11. In August 2016, the detention of American missionaries and the purchase of a Russian military equipment started a diplomatic conflict between the United States and Turkey leading to a fall in the value of Turkish lira and a drop in Turkey’s international credit rating.
12. For more details see, E/ESCWA/SDPD/2018/TP.8.

Chapter 2

13. A high and positive correlation coefficient between real GDP growth rate in GCC countries and change in Brent spot price over the last 30 years is estimated: 79.9 for Bahrain, 55.9 for Kuwait, 84.7 for Oman, 86.2 for Qatar, 87.9 for Saudi Arabia, 91.9 for the United Arab Emirates, and 92.2 for GCC countries as a whole.
14. The Index captures large and mid-cap representation across 24 emerging markets. See Morgan Stanley Capital International, 2019.
15. According to the Saudi Arabian Monetary Authority, some 12,949 mortgage contracts worth 5,653 billion Saudi riyals (\$1.507 billion) were signed in the month of May 2019, a surge of 212 per cent in terms of volume and 122 per cent increase in value, compared to May last year.
16. Arab countries have implemented different exchange rate arrangements. Countries with rigid exchange rates include Bahrain, Comoros, Djibouti, Iraq, Jordan, Kuwait, Libya, Morocco, Oman, Qatar, Saudi Arabia and the United Arab Emirates. Countries with flexible exchange rates are Egypt, Lebanon, Mauritania, Somalia, the Sudan, Tunisia and Yemen. In the cases of Algeria and the Syrian Arab Republic, the exchange-rate regimes that do not correspond to criteria for any of the other categories and include arrangements that are characterized by frequent shifts in policies. For more details see E/ESCWA/EDID/2018/1.
17. World Bank, 2019g.
18. World Bank, 2019h.
19. Youth unemployment rate for Arab-22, ages 15-24.
20. World Bank, 2019g.
21. The Arab region was home to 422.7 million inhabitants representing 5.5% of the world’s population and growing by 1.9% in 2018.
22. World Bank, 2019d.
23. Bahrain, Economic Development Board, n.d.

24. ILO, n.d.
25. Keen, 1998.
26. ILO, n.d.
27. E/ESCWA/EC.6/2019/11.
28. El Masaiti, 2017.
29. A methodical way to categorize policies to tackle unpaid care work as a barrier to women’s labour participation is the so-called “3R approach” (OECD, SIDA): Recognition of unpaid care work (such as through implementation of time-use surveys that give an idea of the scope and characteristics of the issue and how it affects women’s labour force participation); Reduction (such as investment in care-related infrastructure) and Redistribution (such as paternal leave). See, Swedish International Development Cooperation Agency, 2019.
30. UNESCO, n.d.
31. Saudi Arabia, Council of Economic and Development Affairs, 2019.
32. OECD, 2018.
33. Kagan, 2017.
34. Share of migrant workers as a proportion of all workers.
35. ILO, 2018.
36. ILO, 2011.
37. World Economic Forum, 2018.
38. IPU, 2019a.
39. IPU, 2019b.
40. E/ESCWA/ECW/2018/Brief.1.
41. E/ESCWA/SDD/2018/1.
42. E/ESCWA/ECW/2017/Technical Paper.2.
43. UNFPA, 2016.

Chapter 3

44. IEA, 2017a.
45. IMF, 2017.
46. IMF, 2018d.
47. E/ESCWA/SDPD/2019/1.
48. IMF, 2018b.
49. IMF, 2017.
50. E/ESCWA/SDD/2017/Technical Paper.5.
51. Sdravlevich and others, 2014, pp. 15-16.
52. E/ESCWA/EDID/2019/WP.9.
53. Ibid.
54. The sample of households is divided into five groups: the first group is

the poorest and the fifth group is the richest.

55. E/ESCWA/EDID/2019/WP.9.
56. E/ESCWA/SDD/2017/Technical Paper.5.
57. Measured as the difference between domestic and international prices for given fuels and electricity in Arab countries.
58. A fuel price gap is the difference between international and domestic prices.
59. IMF, 2019b.
60. IMF, 2018b.
61. Ibid.
62. IMF, 2018f.
63. ESCWA, 2017c.
64. IMF, 2018e.
65. Ibid.
66. IMF, 2018b.
67. E/ESCWA/SDD/2017/Technical Paper.5.
68. E/ESCWA/SDPD/2019/1.

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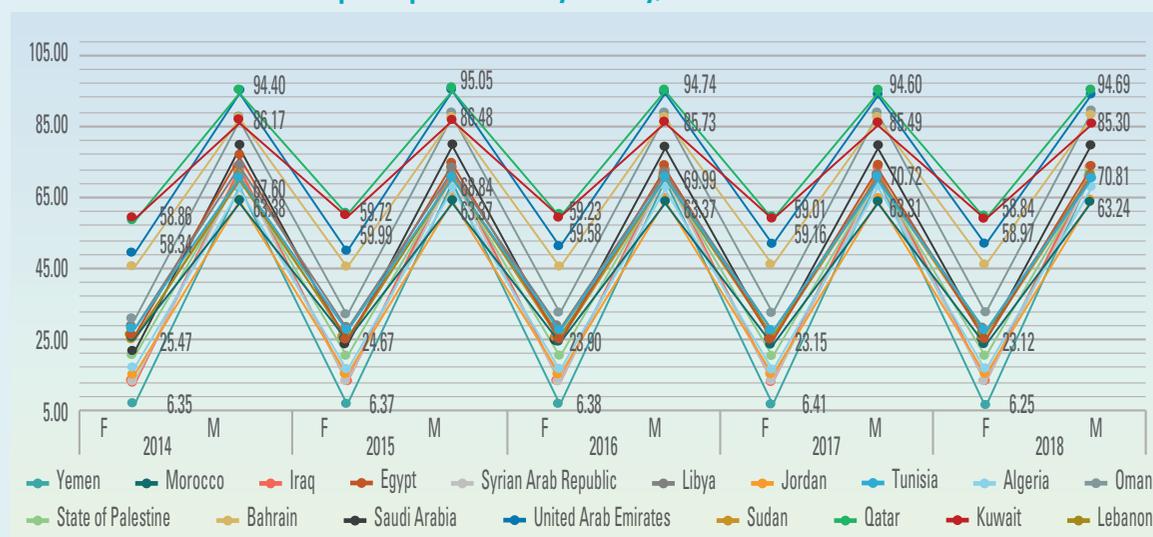
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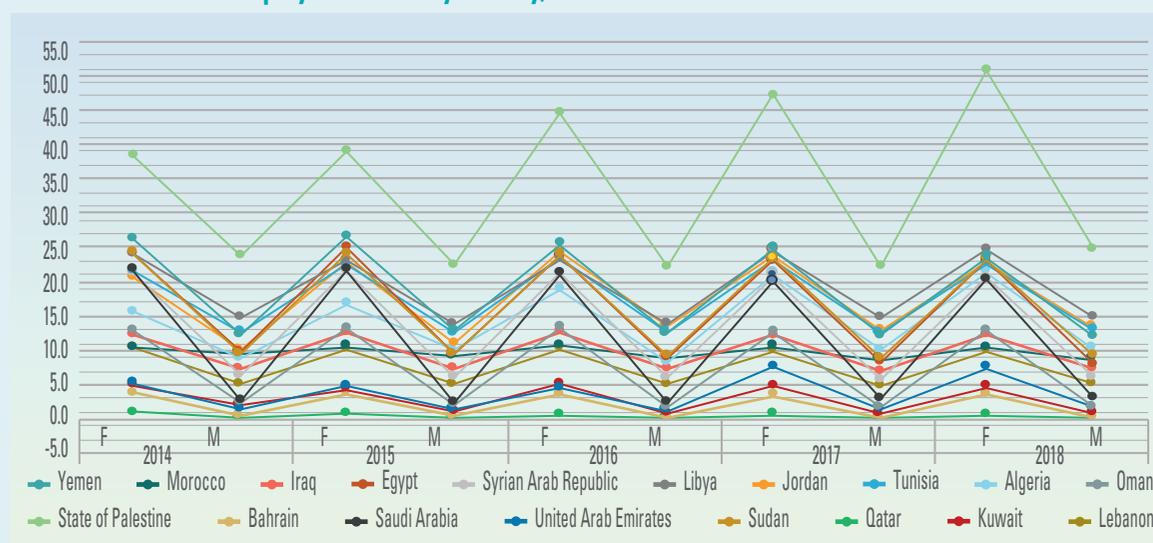
Appendix

Female and male labour force participation rates by country, 2014-2018



Source: World Bank, World Development Indicators database. Available at <https://datatopics.worldbank.org/world-development-indicators> (accessed on 18 May 2019).

Female and male Unemployment rates by country, 2014-2018



Source: International Labour Organization, ILOSTAT database. Available at <https://www.ilo.org/ilostat> (accessed on 18 May 2019).

Sources of National Statistical data

1. Algeria

Gross oil export revenues

Bank of Algeria
Quarterly Statistical Bulletin, No. 44 (September 2018)
https://www.bank-of-algeria.dz/pdf/bulletin_44e.pdf.

Real GDP growth

Office National des Statistiques
Quarterly National Accounts, No. 838
Third Quarter 2018
<http://www.ons.dz/Au-deuxieme-trimestre-2018-les.html>.

Consumer inflation rate

Office National des Statistiques
Indice des prix à la consommation, No. 277, Mois de Décembre 2018
<http://www.ons.dz/-Indice-des-prix-a-la-consommation,124-.html>.

Trade and current account balances

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Central Administration of Statistics

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Palestine Monetary Authority

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VISION

ESCWA, an innovative catalyst for a stable, just and flourishing Arab region

MISSION

Committed to the 2030 Agenda, ESCWA's passionate team produces innovative knowledge, fosters regional consensus and delivers transformational policy advice. Together, we work for a sustainable future for all.

