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Summary of the survey of economic and social developments in the Economic and Social Commission for Western Asia region, 2007-2008

Summary

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

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

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I. Recent economic and social development trends in the region

A. The global context

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

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

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

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

B. Oil sector development

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

5. The price of crude oil surged during 2007, with the OPEC reference basket at a yearly low of $47.92 per barrel on 17 January, climbing to its yearly high of $90.84 on 28 December. (The OPEC basket price marked historical highs of over $100 per barrel in March 2008.) In 2007, the average crude oil price of the OPEC reference basket was $69.08 per barrel, compared to $61.08 in 2006. Certain observers interpreted this surge to be the result of financial speculation whereby crude oil futures became relatively attractive financial assets. Others, however, saw the price escalation as being caused by the tight supply condition or geopolitical considerations. In 2008, the OPEC reference basket price is projected to average $75 per barrel, albeit with the usual caveat of a high margin of error that is standard with regard to oil price forecasts.

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

C. Output and demand

7. In 2007, real GDP growth across the ESCWA region averaged 5.4 per cent. It was 5.9 per cent in 2006 and is forecast to be 5.7 per cent in 2008 (see table below). Steady growth in import-based affluent consumption was observed in the region, and the incomes of the rich rose at a higher pace than those of the poor. In less-developed parts of the region, the incomes of the poor declined as a result of a fall in the purchasing power of wages. In particular, the latest figures show that poverty in the Gaza Strip has already sunk to unprecedented depths, with approximately 8 out of 10 households currently living below the poverty line of $594 per household per month, which constitutes a dramatic increase from the rate of 63.1 per cent in 2005. Of those, 66.7 per cent of households in Gaza are living in deep poverty, less than $474 per month. The population in that territory is more dependent on food aid and direct assistance than in previous years, with 80 per cent of households currently receiving humanitarian aid, compared to 63 per cent in 2006. While high oil prices and associated oil revenue forecasts boosted business and import-based affluent consumption, liberal pricing policies for basic

commodities, including food staples, left traders unregulated in terms of raising food prices far in excess of the costs incurred in production.

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

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

Real GDP growth rate and consumer inflation rate, 2004-2008

(Annual percentage change)

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

Country or territory	Real GDP growth 2004	2005	2006	2007[a]	2008[b]	Consumer inflation rate 2004	2005	2006	2007[a]	2008[b]
Palestine	2.0	6.0	-8.8	-2.2	1.0	3.0	3.5	3.8	2.5	5.2
More diversified economies[c]	**6.3**	**6.2**	**5.6**	**6.0**	**5.8**	**11.1**	**9.1**	**13.6**	**11.1**	**9.5**
Total ESCWA region[c]	**7.2**	**6.9**	**5.9**	**5.4**	**5.7**	**5.0**	**4.9**	**7.5**	**7.9**	**9.8**

Source: ESCWA, based on national sources.

[a] Estimates in March 2008.

[b] Forecasts in March 2008.

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

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

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

D. Costs and prices

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

12. Despite a rise in public sector wages in GCC countries, the rapid rise in the price of basic goods in 2007 caused a partial decrease in real wages. Equally, real wages declined in the more diversified economies, and Government intervention aimed at fending off the eroding impact of inflation was less than adequate. Consequently, given rising asset and property prices, inflation as a kind of indirect form of taxation redistributed income towards asset and property owners, thereby lowering labour's share. While it is possible for nominal wages to rise commensurately with inflation, the process did not take hold principally because regional labour representation and autonomous trade unionism remained weak.

E. External sector

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

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

F. Social dynamics

15. Despite evidence of the pitfalls that arise from relying exclusively on a "growth first" approach to solving social problems, ESCWA member countries continued to rely on social benefits derived from that model. In many countries of the ESCWA region, economic development is not living up to its promise of guaranteeing comprehensive social benefits. Poverty and unemployment continue to plague entire societies; such basic social services as health care and education are lacking in quality or are unevenly distributed and are largely inadequate in terms of meeting demand; and significant disparities in social indicators, including maternal health and poverty levels, continue to widen. Particularly relevant in this context is the ideological hold of uncritical thinking methods in teaching, namely, rote learning, which limits the development of human capital. There is an urgent need for an integrated social policy in which "social" issues are not viewed as residual or secondary to economic processes, but rather as a central focus and wherein public policy is informed at every stage by social equity and human rights concerns. Social policy enhances economic growth by addressing those social structures and

conditions that prevent people from access, participation and full inclusion as citizens and human beings. Moreover, social policy attends to the needs of the poor and vulnerable by ensuring that people have access to social services that promote their health and well being and, by extension, their ability to work and contribute to society, promoting equal access to opportunities and participation in society and the economy and establishing regulations and institutional mechanisms aimed at removing any barriers to inclusion and participation. More pertinently, while social investment does not exhibit immediate economic payoffs, the long-term development returns are evident.

16. Inequality as measured in terms of both income and non-income criteria has been increasing in the ESCWA region. Despite efforts by ESCWA member countries aimed at balancing economic and social development, social dynamics remain characterized by diverging trends in income levels and the acquisition of financial and social resources across social groups. The rapid rise in housing and food prices for the poor underscores the growing cleavage between owners and non-owners of assets. For this course of events to be reversed, there needs to be a change in policy. However, there is an uncritically held view of the market in the region, which decontextualizes income inequality and poverty and obscures their origins and mechanisms of reproduction over time and across countries. In minimally complex market economies, exclusion from local or international markets is normally not the cause but rather a consequence of poverty. In ESCWA economies, poverty tends to be sustained by the form of integration of specific social groups into the dominant rentier mode. It is this modality of economic and social integration that imposes upon the poor exploitative labour regimes, including poorly paid wage labour in the informal sector, precarious primary production, tenuous self-employment and, potentially, degrading forms of labour. In turn, such labour regimes are associated with low productivity, low incomes and unsteady living standards. Consequently, given the non-existent or negligible alternative support mechanisms, State-sponsored integrated social and welfare policies must be aimed at reintegrating the poor and vulnerable into the economic process.

17. Slow employment creation has been observed in the ESCWA region. The real economy and labour-intensive sectors are modest in terms of size and productivity relative to the oil rent sector. The issue of unemployment and underemployment remains the region's major socio-economic predicament. Despite successive achievements in education, particularly the rapid growth in the enrolment of women in higher education, a lack of employment opportunities persists, affecting most adversely the region's youth and women. Most experts agree that employment generation represents the most important link between growth and poverty alleviation, and its persistent weakness is symptomatic of a deep macroeconomic malaise. These employment problems are potentially destabilizing both socially and politically and, for those reasons alone, they must be addressed constructively by Governments within a regional framework aimed at promoting labour-intensive industrialization. Rent-driven economic growth on its own cannot bridge the developmental gap. Rather, a qualitatively different type of growth, which is rights based, is needed to bridge the gender gap, reduce income inequality and provide people with decent employment outside the rentier system. Given the specific oil mode of this region's integration with the global economy, the solution to these deeply ingrained problems of poverty and inequality is primarily political rather than economic. Within these limitations, a rights-based macroeconomic policy can

provide an essential contribution to the complex and inevitably contentious process of redressing structural inequalities and eliminating the symptoms of poverty in the region only insofar as ESCWA member countries make fighting unemployment and poverty their main objective. In the interim and until macroeconomic policies can be coordinated to create industrially generated employment, Governments are best advised to adopt a framework of integrated social policies and, ultimately, to act as employers of last resort.

G. Socio-economic policy developments

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

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

H. Prospects

20. The economy of the ESCWA region is projected to grow at 5.7 per cent in terms of real GDP in 2008. The inflation rate is expected to rise in 2008 to a regional average of 9.8 per cent. The projections are based on three precarious

conditions, namely: (a) high international commodity and oil prices; (b) the expansion of domestic demand led by consumption, principally affluent consumption of imported goods; and (c) poorly regulated asset markets in the region that allow unrestrained bubble formation backed by banking credit. While the economies in the ESCWA region could remain resilient in the face of accelerating inflation owing to persistently high oil prices, continuing inflation in terms of food and housing prices is anticipated to put more pressure on the poorer segments of the population. The Governments of ESCWA members are advised to exert more effort to keep basic goods at stable prices, integrate social policies into the very core of State functions, create a regional insurance programme for non-economic losses in order to boost intraregional investment and focus on qualitative rights-based growth rather than on growth-first scenarios.

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

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

II. Capital flows and development in the region

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

A. Resource leakages indicative of a poor investment climate

24. For oil exporters, capital flight of a different order of magnitude has taken place in recent years. Given that capital flight involves the unrecorded export of mostly short-term capital, it acts as a gauge of the outlook of those who control money capital with respect to productive long-term investment. Towards the end of the 1990s, there was already substantial capital flight from Kuwait and the United Arab Emirates. However, capital flight became particularly pronounced with the onset of this current oil boom, especially in Saudi Arabia. In short, a significant part of the rents from the recent oil boom have leaked abroad for investment in non-transparent financial instruments. While the development implications of these resource outflows cannot be accurately quantified, they clearly delineate the drain on resources from a region that is already characterized by low productive investment levels, high income inequality, high illiteracy rates in some member countries and vast potential to expand the physical and social infrastructure.

25. For oil exporters, the sum of capital outflows and capital flight are significant, as is to be expected from countries that have generated substantial current account surpluses in recent years. While there are only rough estimates, it is reasonable to assume that capital flight was as strong in 2005 and 2006 as it was in 2003 at the onset of the current oil boom. Nearly all member countries experienced capital flight; however, the main source since 2000 appears to be Saudi Arabia, with strong outflows also registered by Kuwait and the United Arab Emirates. While a choice could have been made to develop and hold assets regionally under rigorous protection/regulatory frameworks, this did not occur. Most of the region's dollar-held assets abroad are devalued along with the dollar, resulting in the write-off of a portion of the wealth that could be bequeathed to future generations.

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

insurance and real estate context, and economic growth is led by import-based affluent consumption.

27. A major change in the economic environment is needed in order to help steer the region from the existing consumption-led path of growth to a higher and sustainable investment-led path. However, given the uncertainties, guarantees on non-economic losses over the long term have to be reworked in a regional setting. Moreover, the current weak financial intermediation has to change, otherwise a greater proportion of the investment will be tied to short-term activity, given the outstanding regional security risks. This would need to include changes in fiscal, monetary and exchange rate policies that are coordinated at the regional level and that promote the inclusion of the poor in investment in activities generating higher returns, employment and industrial exports. Such a change, particularly in terms of directing some of the oil rents into investment in more diversified economies, could bring about a process that helps to break the dependence on volatile oil revenues in two ways, namely: (a) rapidly rising income would initially allow investment to be raised along with output, thereby raising society's total capabilities; and (b) sustained growth would attract both domestic and foreign capital, thereby reducing the dependence on official financing at a later stage. Oil dependence can ideally be attenuated through a massive regional industrialization programme and sustained rapid growth for a sufficiently long period to allow domestic savings and external private flows gradually to replace official involvement. This would be a reversal of development from a rent-based to an industrial-based system, whereby the whole circuit of capital would be revamped. However, in the current weak security and institutional set-up, it is short-sighted to speak of public investment retrenchment, fiscal discipline and a greater role for the private sector. Experience shows that the private sector has not been able to fill the gap and, moreover, that liberalization has increased the outflow of resources, thereby causing the degradation of nascent national industries and allowing merchants to raise their mark-ups on basic commodities, with a devastating impact on the poor.

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

B. Financial and trade policies

29. Rights-based financial policies in the ESCWA region need to be linked to a broader industrial strategy that fosters productivity growth and the development of domestic production capability in selected areas aimed at exhibiting increasing returns when possible. In that context, the first element is the promotion and diversification of exports, particularly in the more diversified economies. Export growth can contribute significantly to productivity growth given that it exposes producers to the stringent test of competition in foreign markets. Export growth in more diversified economies requires a competitive and stable real exchange rate, in addition to coordinated industrial policy initiatives aimed at developing the competitive advantages of those countries in strategically important sectors. Careful management of import restrictions is also necessary for long-term growth. Despite views to the contrary, the survey reiterates the finding that openness and trade integration, either separately or together, do not have a measurable impact on long-run growth. Imports must be liberalized cautiously and selectively given their potentially adverse impact on the poor and on strategically significant sectors.

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

C. Capital account controls

31. Rights-based strategies also require the regulation of the capital and financial account of the balance of payments. Unbridled liberalization of the capital account can be regionally destabilizing because: (a) liberalization promotes speculative inflows that can finance consumption rather than investment, that facilitate capital flight and increase the country's vulnerability to balance-of-payments crises, principally in the more diversified economies; (b) rights-based strategies require monetary policy autonomy, which is severely curtailed by international financial liberalization; (c) rights-based strategies require the State to direct investment and other resource flows to objectives that promote growth and reduce poverty, which

can conflict with the short-term interests of the financial sector; and (d) capital controls are needed in order to curb tax evasion given that the tax rates required to fund rights-based programmes will be higher than abroad. Even if capital account liberalization raises growth rates in the short term, this effect tends to vanish later. In the current boom, a high proportion of capital is held for a short term in speculative activity, and experience shows the need for transparency and stronger regulatory measures.

32. Capital controls can include restrictions on foreign currency bank accounts and currency transfers, taxes or administrative limits on outflows of direct and portfolio investments, restrictions on foreign payments for technical assistance between connected firms, non-interest-bearing "quarantines" on investment inflows, controls on foreign borrowing and multiple exchange rates determined by the priority of each type of investment. At a minimum, they need to include the requirement that all foreign resource flows be registered or, preferably, pass through the central bank in order to measure the country's financial relations with the rest of the world and allow the central bank to regulate the external exposure of domestic banks and firms. This helps to ensure that they do not build up unsustainable financial positions for speculative reasons, which is particularly tempting during a resource boom. There is sometimes an impression that there is no end in sight for the cycle and that financial investors keep pushing up prices. Capital controls help to reduce the scope for capital flight, including, for example through bank deposits, financial transactions, over-invoicing and other unauthorized means of capital transfers. While managing these controls burdens the monetary authorities, the task is not beyond the capabilities of most central banks. The most significant obstacle to capital controls is not technical, but rather political.

D. Exchange rate policy

33. Finally, it is important to release the exchange rate system of most ESCWA members from the fixed parity with a falling United States dollar because: (a) reiterating the position stated in the 2005-2006 survey, a shift towards managed floating against a basket of currencies will help to revalue the real exchange rate of oil-rich countries, which is especially necessary during a resource boom; (b) it will improve the match between the trading patterns and financial relations of those countries and their exchange rate systems, thereby helping to deliver macroeconomic stability; (c) it will restore the scope for monetary policy in the region; (d) it will facilitate the protection of national currencies and the control of capital flows; and (e) it will ease the transition towards the devaluation of the currencies of those countries that are adversely affected by the oil boom. In the medium and long term, monetary and exchange rate policy coordination among ESCWA members is essential for the success of a regional pro-poor and rights-based economic strategy. This can in future encompass a regional system of fixed exchange rates, thereby facilitating a move towards a single currency for the region that can float vis-à-vis other major currencies. This could help the region to stabilize trade and promote investment and increase the monetary policy space available to ESCWA members.

E. Regional integration

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

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

36. Any development strategy will be limited by security concerns and political instability in the region. The international environment in the aftermath of the terrorist attacks on the United States of 11 September 2001 illustrated the degree to which foreign investment from ESCWA members, particularly those in the GCC subregion, is insecure. This situation could represent a catalyst for regional policy changes and incentives to reinvest in the region. While political solutions to the conflicts in the region are ultimately necessary, financial incentives aimed at stabilizing the region and fostering investment could be explored, for instance by establishing a regional insurance scheme for non-economic losses, thereby encouraging long-term investment. While such schemes exist informally, including, for example, through significant investment by some GCC countries in conflict-affected countries of the region, it could be institutionalized through a multilateral body that would be responsible for the administration of regional insurance for investment in ESCWA members.

37. In order to support the development of this new regional policy compact, preferential treatment for ESCWA capital, including repatriated capital and migrant remittances, needs to be secured within the region. This can be achieved by, for example, reforming the tax, procurement and firm registration procedures, which

need to be exploited to the maximum extent in line with World Trade Organization rules, albeit giving priority to the interests of the region. The regulations need to be part of a regional industrial policy package aimed at raising regional investment and trade, internalizing supply chains and supporting employment generation and productivity growth. There is no doubt that this represents a long and costly process. However, if successful, it could build the conditions for stable and rights-based development in the ESCWA region.

F. Conclusion

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