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Summary of the Survey of Economic and Social Developments in the Economic and Social Commission for Western Asia Region, 2011-2012

Summary

Following an initial recovery after the global recession in 2009, the world economy is now entering a difficult stage with concerns about a double-dip recession. World gross product is estimated to have increased by 2.8 per cent in 2011, compared with 4 per cent in 2010. The impact of the global downturn on member countries of the Economic and Social Commission for Western Asia (ESCWA) varies from country to country depending on their integration with Europe, the United States of America and the rest of the world. Oil prices are expected to remain high, but if financial woes and fiscal austerity measures were to trigger another global recession, oil prices may drop below break-even prices for fiscal sustainability.

Since the start of 2011, uncertainty has returned to the ESCWA region as the Arab Spring social movement spread across the Arab world. However, due to high oil prices, growth in the ESCWA region in 2011 was expected to be 4.8 per cent. Growth in 2011 in the member countries of the Cooperation Council for the Arab States of the Gulf (Gulf Cooperation Council) was estimated to be 5.7 per cent, up from 4.4 per cent in 2010, while growth in the more diversified economies in the region fell to 2.3 per cent in 2011, from 5.7 per cent in 2010. The outlook for 2012 is extremely uncertain as the situation in the Syrian Arab Republic is expected to remain highly volatile and political uncertainty is still present in Egypt and Yemen. Growth in Gulf Cooperation Council member countries is projected to be 4.6 per cent in 2012, while more diversified economies are expected to grow by 2.6 per cent. Growth in these economies is mainly driven by Iraq, which is expected to boast double-digit growth rates. Excluding Iraq, more diversified economies will grow by 0.8 per cent.

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Expansionary fiscal policies were implemented in 2011 in both the Gulf Cooperation Council member countries and more diversified economies, as they introduced discretionary social spending in order to stem the fear of contagion of political unrest. Reactions came in the form of increased public-sector employment and wages, subsidy hikes and increased social benefits. Large fiscal deficits in some countries are creating concerns about debt sustainability and plans for fiscal reform are being discussed in several countries.

Unemployment rates in the region are still high and even increasing, especially for youth unemployment. The Arab Spring social movement moved job creation to the top of the regional and national development agendas. It opened a window of opportunity to analyse previous macroeconomic policies that had led to the economic exclusion of many compared with the prosperity of the privileged. It is therefore crucial to better understand the effects of macroeconomic policies, such as Government spending, taxation and exchange rates and their relationships to job creation.

I. Global context

1. Following an initial recovery after the global recession in 2009, the world economy is now entering a difficult stage and concerns about a double-dip recession are growing. World gross product is estimated to have increased by 2.8 per cent in 2011, compared with 4 per cent in 2010. The slowdown was most critical in developed countries, where growth was nearly non-existent at 1.3 per cent in 2011. Developing countries are still the main engine of growth, but their growth also decelerated by 1.5 percentage points to reach 6 per cent in 2011.[1] Sovereign debt distress in Europe continues to plague the world economy. After months of political stalemate, eurozone Governments took bold steps to reach an orderly system to relieve the sovereign debt of Greece, and European Union leaders agreed to back a new fiscal compact treaty. Despite those efforts, the eurozone crisis is still far from being settled and concerns about contagion to other larger economies in the eurozone remain. The public debt of the United States of America was downgraded in August 2011, an event that affected financial markets worldwide and weakened market confidence. In November, the failure of the United States to reach an agreement on deficit reduction triggered automatic spending cuts of $1.2 trillion to be spread over a 10-year period starting in 2013. On a positive note, the most recent data shows that the United States economy has regained some momentum and that, in January 2012, its manufacturing index had increased to its highest level in seven months. However, growth in several major developing countries, including Brazil, India, the Russian Federation, South Africa and Turkey, is slowing due to the tightening of domestic fiscal policy, and below-consensus growth is expected in China.[2]

2. On the social front, global unemployment rates in 2011 remained high at around 6 per cent, and particularly high in some of the countries facing sovereign debt distress.[3] Youth unemployment soared globally and particularly in developed countries. In Spain, it is estimated to be around 40 per cent. Youth unemployment is detrimental both in economic and social terms. At the individual level, a lack of economic opportunities creates psychological stress for the affected young people, while at the collective level it can represent a potential source for social unrest. Youth unemployment is extremely high in the different countries where protests and violence took place, such as in the North Africa and West Asia regions and some European countries, in particular the United Kingdom of Great Britain and Northern Ireland and Greece. At its meeting in Cannes, France, in November 2011, the Group of 20 recognized the importance of employment generation and adopted an action plan for growth and jobs.

3. Another global challenge is the issue of record-high food prices, which remain high despite falling from their peak in the first quarter of 2011. The 2011 annual food price index exceeded the 2010 annual index by 24 per cent.[4] This has had global implications and has contributed to famines in Somalia and other parts of East Africa. High food prices also have social implications in other countries by putting pressure on the domestic price of food, which can have devastating effects

[1] *World Economic Situation and Prospects 2012* (United Nations publication, Sales No. E.12.II.C.2).
[2] World Bank, “Global Economic Prospects”, vol. 4, January 2012 (Washington, D.C., 2012).
[3] International Labour Organization, *Global Employment Trends 2012* (Geneva, 2012).
[4] World Bank, “Food Price Watch”, January 2012 (Washington D.C., 2012).

on the poorer segments of society. Countries have responded to the issue of elevated food prices in different ways, with many countries shielding their populations by using domestic subsidies or price controls, which are often fiscally unsustainable.

4. The global outlook for 2012 is particularly gloomy and characterized by a significant risk of a downturn. Slow growth, unresolved debt and deficit challenges in Europe, the United States and Japan are eroding market confidence. Optimistic forecasts are for a global growth of 2.6 per cent in 2012. However, if the European debt crisis escalates and combines with the weakness of the United States economy to create a downward spiral, the world economy could fall into a double-dip recession and global growth could fall to around 0.5 per cent.[1]

5. The impact of these developments on the member countries of the Economic and Social Commission for Western Asia (ESCWA) varies from country to country depending on the degree of integration with Europe, the United States and the rest of the world. Several countries in the region are heavily integrated with Europe, meaning a recession in Europe would have implications through weak demand for exports and a reduction in remittances. The region is also heavily affected by any financial turmoil in the United States, as demonstrated by the downturn of most regional stock markets following the downgrade of the United States debt by Standard & Poor's in August 2011. Furthermore, if the financial woes and fiscal austerity in developed countries were to trigger a global recession, oil prices could drop below break-even prices for fiscal sustainability in oil-exporting countries of ESCWA.

II. Oil sector development

6. The oil sector is and will continue to be essential for any analysis of the ESCWA region due to the large revenues it generates directly and indirectly. The sector represents a large share of exports for the majority of ESCWA member countries, including the six countries of the Cooperation Council for the Arab States of the Gulf (Gulf Cooperation Council) as well as Iraq, the Syrian Arab Republic, Yemen and, to a lesser extent, Egypt. The remaining countries are also indirectly affected by oil sector developments through remittances, tourism and export revenue.

7. According to figures from the Organization of the Petroleum Exporting Countries (OPEC), the total world demand for crude oil in 2011 averaged around 87.8 million barrels per day, while the total supply of crude oil averaged 87.6 million barrels per day. Between 2010 and 2011, total world demand for crude oil increased by 0.8 million barrels per day. Demand from countries of the Organization for Economic Cooperation and Development (OECD) contracted by almost 1 per cent, while demand from developing countries increased by around 2.4 per cent and demand from China increased by over 5 per cent.[5]

8. The OPEC reference basket price continues to increase and settled at a 10-month high in February 2012 at $117.5 per barrel. The increase in prices comes despite the weak economic data from major developed countries. The upward price trend is due to speculative activities in the crude oil futures market and to a

[5] Organization of the Petroleum Exporting Countries, "Monthly Oil Market Report", March 2012 (Vienna, 2012).

geopolitical risk premium amid fears of supply disruptions. These geopolitical risks include the security situation in Libya, tension between South Sudan and the Sudan and threats by the Islamic Republic of Iran to block exports. The security situation in Libya, which almost halted crude production in one of the largest crude oil-producing States, in particular raised fears of supply disruption. Production in Libya was almost zero in the third quarter of 2011, but by February 2012 it was back at 1.2 million barrels per day, close to its pre-crisis level of 1.5 million barrels per day. South Sudan has temporarily shut down its export flow due to its disagreement with the Sudan over pipeline tariffs. In addition, following the European Union ban on oil imports, the Islamic Republic of Iran threatened to block all oil exports through the Strait of Hormuz, which increased oil prices temporarily.

9. In 2011, the average total crude oil production of ESCWA countries was estimated at 19.5 million barrels per day, up from 18 million barrels per day in 2009. Production in ESCWA countries that are OPEC members was estimated to be around 17.8 million barrels per day, while production in non-OPEC members was around 1.7 million barrels per day. Crude oil production in the Syrian Arab Republic is expected to almost halve in 2012 compared with 2011, from 0.37 million barrels per day to 0.22 million barrels per day. This is due to the ongoing political situation as more operators leave the country due to security concerns. Attacks on oil installations have also been reported. In Yemen, oil production is falling due to strikes and pipeline bombing. OPEC expects production in Yemen to drop from 0.21 million barrels per day in 2011 to 0.19 barrels per day in 2012.[5]

10. The balance of supply and demand for 2011 remained unchanged from 2010 since non-OPEC production and demand saw a similar downturn that left the demand for OPEC crude at 30 million barrels per day. The demand for OPEC crude is expected to be almost unchanged in 2012, as an increase in non-OPEC supply will match the increase in global demand. Prices in 2012 are forecast to decline somewhat owing to the expected economic slowdown in developed countries and below-consensus growth in China. Nonetheless, due to geopolitical tension, persistent tightness in the market and some early signs of recovery in the United States, oil prices will remain resilient. Most projections are for prices to be around $100 per barrel, provided that there is no dramatic shock to the world economy (see table 1). If market fundamentals weaken sharply, it is possible that OPEC could agree to production cuts at its June meeting, in order to stabilize prices.

Table 1
Crude oil price estimation and forecast, 2009-2012
(United States dollars)

				Forecast annual average for 2012		
	Minimum	*Maximum*	*Annual average*	*Lower*	*Median*	*Higher*
2009	38.1	78	61.1			
2010	68.2	90.7	77.5			
2011	100	118.1	107.5			
2012				80	100	120

III. Economic trends and developments

11. After the pessimism that prevailed in 2008 and 2009, the economic outlook of the ESCWA region improved in 2010. However, since the start of 2011, uncertainty has returned as the Arab Spring social movement spread across the Arab world. Political unrest has had a direct adverse effect on economic activity in Bahrain, Egypt, the Syrian Arab Republic and Yemen, and negative spillover effects on neighbouring countries, particularly Jordan and Lebanon. The political unrest helped to push up oil prices, which boosted growth rates in oil-exporting countries. The prevailing uncertainty in Egypt and Yemen after changes in leadership, the escalating crisis in the Syrian Arab Republic and the tension between South Sudan and the Sudan following the secession of the former affected economic developments in 2011 and were expected to continue to influence the outlook for 2012.

12. Economic growth figures in the ESCWA region are expected to show an increase from 4.7 per cent in 2010 to 4.8 per cent in 2011. The figures were particularly driven by high growth rates in several oil-exporting countries as oil prices reached an average of $107 per barrel. Political unrest reduced growth rates in the more diversified economies. There was a sharp downturn in the Syrian Arab Republic and Yemen, whose economies are estimated to have contracted by around 2 per cent in 2011.

13. The Gulf Cooperation Council countries benefited from average oil prices of above $100 per barrel throughout 2011, and grew by an estimated 5.7 per cent that year, up from 4.4 per cent in 2010. Kuwait, Saudi Arabia and the United Arab Emirates also benefited from higher oil production to compensate for the disruption in Libyan oil production. The Arab Spring did not strongly affect the economic performance of these countries, since high oil prices made it possible to maintain the fiscal expansion and support household incomes and private consumption amid the nascent social movement. The exception to this was Bahrain, whose reputation as a stable financial hub was dented by social unrest in 2011 and whose essential financial and tourism sectors suffered, causing growth to drop from 4.5 in 2010 to around 2.5 per cent in 2011. Growth in the Gulf Cooperation Council countries is mainly driven by the oil sector, but an emerging non-oil sector is increasingly contributing to growth in a few countries. In Saudi Arabia, the non-oil sector is estimated to have grown by around 5 per cent in 2011, which is one of the highest growth rates in decades. This growth rate is expected to remain at 5 per cent in 2012, as public spending and investment remain high and private consumption is expected to increase.[6] Exports from the non-oil sector in Saudi Arabia should remain resilient since they are mainly destined for East Asia, where growth should remain firm.

14. Conversely, the economic performance of the more diversified economies was adversely affected by the social unrest and growth fell from 5.7 per cent in 2010 to an expected 2.3 per cent in 2011. Iraq benefited from high oil prices to record a growth rate of 9.6 per cent in 2011. Excluding Iraq, the average growth rate for the more diversified economies was 0.7 per cent (see table 1). This was mainly driven by the situation in the Syrian Arab Republic and Yemen, but the political unrest also affected neighbouring countries, particularly Lebanon, where growth decelerated

[6] National Bank of Kuwait, "GCC Economic Outlook", January 2012 (Kuwait City, 2012).

from 7 per cent in 2010 to an expected 2 per cent in 2011. Egypt was riddled with political uncertainty in 2011 and growth there fell to around 1 per cent. Overall in the more diversified economies, the financial and external environment worsened with substantial declines in capital inflows. This has had an adverse impact on growth and has contributed to greater current account deficits in Egypt, Jordan, Lebanon and the Syrian Arab Republic. In those four countries, the political turmoil has severely affected the vital tourism industries.

Table 2
Real gross domestic product growth rates and consumer price inflation, 2009-2012
(Percentage)

	Real GDP growth rate				*Consumer price inflation*			
Country/area	*2009*	*2010*	*2011*[a]	*2012*[b]	*2009*	*2010*	*2011*[a]	*2012*[b]
Bahrain	3.1	4.5	2.5	3.5	2.8	2.0	-0.5	3.0
Kuwait	-4.6	2.0	5.0	5.5	4.0	4.0	4.7	4.0
Oman	1.1	3.8	4.5	4.0	3.5	3.4	4.2	3.5
Qatar	12	16.6	16.0	7.0	-4.9	-2.4	1.9	2.0
Saudi Arabia	0.1	4.1	5.1	4.5	5.1	5.3	5.8	4.0
United Arab Emirates	-1.6	1.4	3.2	3.5	1.6	0.8	2.0	2.0
Gulf Cooperation Council countries[c]	**0.3**	**4.4**	**5.7**	**4.6**	**3.0**	**3.0**	**4.1**	**3.2**
Egypt[d]	4.7	5.1	1.8	1.6	11.8	11.3	11.5	11.0
Iraq	4.2	7.3	9.6	10.5	-2.8	3.1	6.0	5.0
Jordan	2.1	3.4	3.2	3.2	-0.7	5.0	4.4	5.5
Lebanon	8.5	7.0	2.0	2.5	1.2	4.0	6.0	6.0
Palestine	7.4	9.3	4.0	5.0	2.8	3.7	2.9	4.0
Sudan	4.5	5.5	-1.0	0.0	11.3	13.2	18.9	19.3
Syrian Arab Republic	5.9	3.4	-2.0	-5.5	2.8	4.4	6.0	10.0
Yemen	4.3	7.8	-2.5	1.0	5.4	11.1	17	12.0
More diversified economies[c]	**5.0**	**5.7**	**2.3**	**2.6**	**6.2**	**8.3**	**10.2**	**9.9**
More diversified economies excluding Iraq[c]	5.1	5.3	0.7	0.8	8.0	9.3	11.1	11.0
Total ESCWA region[c]	**1.6**	**4.7**	**4.8**	**4.0**	**3.9**	**4.6**	**5.8**	**5.0**

[a] Preliminary numbers as at March 2012.
[b] Forecasts as at March 2012.
[c] Figures for country groups are weighted averages, based on GDP at 2005 exchange rates.
[d] Figures for Egypt are for the fiscal year (July to June).

15. The outlook for the ESCWA region in 2012 is extremely uncertain as the situation in the Syrian Arab Republic is expected to remain highly volatile and political uncertainty is still present in Egypt and Yemen. The region is also vulnerable to a global downturn, which could affect oil prices and reduce demand for non-oil exports from the region. However, as oil prices are expected to remain

elevated at around $100 per barrel, the oil-exporting countries will drive growth. The Gulf Cooperation Council countries are projected to grow by 4.6 per cent in 2012, while the more diversified economies will grow by 2.6 per cent. Excluding Iraq, which is expected to boast double-digit growth rates, the more diversified economies will grow by only 0.8 per cent. This estimate is subject to a significant risk of downturn, depending on the developments in the political and security situation. The economy of the Syrian Arab Republic is expected to experience a contraction of 5.5 per cent. Lebanon, especially its tourism sector, will continue to be affected by the ongoing crisis in the Syrian Arab Republic. However, increasing capital inflows and remittances from the Gulf Cooperation Council countries will allow growth to increase from 2 per cent in 2011 to 2.5 per cent in 2012. In Qatar, the era of double-digit real gross domestic product (GDP) growth rate is probably over, but it will continue to boast the highest rates of the Gulf Cooperation Council countries owing to the ongoing expansion of liquefied natural gas production and continued Government expansionary policies. Overall in the Gulf Cooperation Council countries, as the public wage hikes from 2011 filter through, private consumption is likely to increase.

16. Regarding consumer price inflation, the ESCWA region experienced a slight increase to 5.8 per cent in 2011 compared with 4.6 per cent in 2010 as global commodity prices increased. Many countries in the region used subsidies to lessen the effects of global prices on domestic consumer prices. Despite this, inflation in the Gulf Cooperation Council countries is expected to have increased from 3 per cent in 2010 to 4.1 per cent in 2011, while inflation in the more diversified economies increased from 8.3 per cent to 10.2 per cent over the same period, mainly driven by high inflation in Egypt, the Sudan and Yemen. Egypt, the Sudan and the Syrian Arab Republic have experienced a significant depreciation of their currency, which contributed to the increase in inflation. The outlook for inflation is uncertain as a global slowdown could lower inflationary pressure, while recent salary increases could pull demand and create pressure in several countries, especially the Gulf Cooperation Council countries. Low interest rates could also spur rapid credit growth and generate some inflationary pressure. The strength of the United States dollar is deflationary for most countries in the region and the dollar is expected to strengthen further as the European economy struggles to contain the sovereign debt crisis. Oil and food prices are expected to remain high, but might fall slightly in 2012, which would reduce some of the inflationary pressure. Somewhat reduced inflation rates are therefore expected in the Gulf Cooperation Council countries (3.2 per cent) and more diversified economies (9.9 per cent) in 2012. Inflation in the more diversified economies will remain high in Egypt, the Sudan and Yemen, but double-digit inflation is also expected in the Syrian Arab Republic.

17. The social unrest will greatly affect the capital flows in the region, especially the inflow of foreign direct investment (FDI). Even though it is very difficult to determine the total impact, ESCWA estimates that these investments dropped by around $10 billion in 2011 to their lowest level in six years. The expectations for 2012 are relatively gloomy given that several countries in the region are still in a transitional state. Uncertainty is a major constraint to attracting external finance. Lebanon and Jordan will experience lower FDI inflows given their proximity to the Syrian Arab Republic and the potential implications of the protracted conflict there on their stability. According to the Central Bank of Egypt, total FDI in Egypt for the first three quarters of 2011 was only $376 million, compared with the annual inflow

for 2010 of $6.4 billion. According to provisional figures released by the Saudi Arabia Monetary Agency, FDI in the Saudi Arabian economy reached $6.3 billion in the first three quarters of 2011, but it is unlikely that the total annual inflow for 2011 will equal the $9.9 billion inflow for 2010. The Inter-Arab Investment Guarantee Corporation estimates that Yemen will experience a negative FDI balance of $200 million owing to ongoing instability, whereas such investment in Lebanon will fall to $3 billion in 2011 from $4.5 billion in 2010. According to an ESCWA forecast, the region as a whole is expected to experience a decrease in FDI of at least 16 per cent in 2011. Even though several countries in the region still have an attractive investment environment, short-term uncertainty remains owing to political instability, causing the overall region to suffer from lower capital inflows. However, with oil prices expected to remain elevated, the Gulf Cooperation Council countries will maintain their high capital spending, which can offset the declining inflows from outside the region.

18. Egypt, which continues to experience political uncertainty, is facing dangerously low and dwindling levels of foreign exchange reserves. According to the Central Bank of Egypt, reserves fell by, on average, around $2 billion a month in October, November and December 2011 and January 2012. In February and March 2012, reserves fell by around $600 million a month, to a total of $15.2 billion by the end of March. This has given Egypt some time to secure additional foreign funding. However, the situation remains critical as the reserves now cover just above three months of imports, the lower threshold level for foreign reserves. Egypt is currently negotiating with the International Monetary Fund (IMF), but an agreement is not expected before June 2012. Large amounts of capital have flowed out of Egypt over the past 12 months, forcing the Central Bank of Egypt to sell foreign exchange reserves to prevent a collapse of the Egyptian pound. Egypt's perilously low foreign exchange reserves raises concerns that the Egyptian Central Bank will not be able to keep the Egyptian pound stable. The pressure on the Egyptian pound stems not only from general strains on Egypt's balance of payments, but also from a decade of high inflation against a backdrop of a fixed currency peg that has eroded economic competitiveness. The two options facing the Egyptian authorities might be an orderly devaluation under a credible stabilization programme, or a disorderly devaluation under populist pressure and confusing macroeconomic policy. If not properly managed, this could trigger a balance of payments crisis in 2012. In the long term, if growth returns, Egypt could be able to rebuild its foreign reserves. A devalued currency could be beneficial and could help to kick start the growth process. Of course, a weaker currency could also lead to higher inflation rates and a destabilized political situation that would reduce growth by hampering the recovery of the important tourism sector.

19. In March 2012, as the uprisings in the Syrian Arab Republic marked their first anniversary, the economy was facing a harsh reality and pressure on the exchange rate was increasing. Since the beginning of the uprising, the Syrian pound has gradually depreciated on the black market. Between February and December 2011, the black market rate fell by around 50 per cent, while the official rate of the Syrian pound depreciated by around 20 per cent. This raised fears about increased inflation. According to the Central Bureau of Statistics, inflation started to accelerate in December 2011 and increased by 4 percentage points from December 2011 to January 2012. In January 2012, the Syrian Central Bank decided to change its exchange rate regime to a managed float in order to reduce the discrepancy between

the official and the black market exchange rate. In March 2012, the exchange rate plunged further and the Central Bank was reported to have intervened by selling dollars to stabilize the exchange rate.

20. The Sudan experienced a massive economic shock on 9 July 2011, when South Sudan became an independent State after officially seceding from the Sudan after decades of civil war. The Sudan lost around 75 per cent of its oil reserves to South Sudan. Since oil accounted for half of Government revenue and 90 per cent of exports before the break-up, this translated into a significant drop in GDP. The loss of oil has resulted in a decline in foreign reserves and a depreciation of the currency. This has contributed to inflationary pressure, especially for food products. Regarding debt, the Sudan agreed to the so-called zero-option, by which it would take the entire debt burden after the secession. This has made the Sudan one of the most indebted least developed countries in the world, with debt levels way above most commonly used thresholds for debt sustainability. It also creates an important constraint on fiscal policy and the ability of the country to pursue the much needed diversification agenda.

IV. Economic policy developments

21. Recent developments and trends have created a number of macroeconomic challenges for policymakers in the ESCWA region, who have limited policy instruments at their disposal. Since most countries in the region have a fixed or managed exchange rate, the effectiveness and role of monetary policy are restricted as such policy is tied to the policy of the United States Federal Reserve. Fiscal policy, which is therefore the main tool to address macroeconomic challenges, is facing increasing constraints in the non-oil-exporting countries as fiscal space is running out. In response to the global financial crisis in 2008 and 2009, most ESCWA countries successfully introduced a countercyclical fiscal policy to mitigate the impact of the global downturn. If a global recession returns in 2012, the capacity to conduct such strategies will be more limited due to already strained fiscal resources.

22. The Gulf Cooperation Council countries continued their fiscal expansion in 2011, as they introduced discretionary social spending in order to stem the fear of contagion of political unrest. Public-sector jobs were created to improve youth employment, and handouts and salary increases were given. Bahrain, the only Gulf Cooperation Council country strongly affected by social unrest, introduced a number of social spending measures, such as a BD 1,000 ($2,600) handout per household and the introduction of a cost-of-living subsidy.[6] Overall in the Gulf Cooperation Council countries, social spending was the largest component of the already expansionary fiscal policy, including large infrastructure projects and spending on education and health. It is estimated that Government spending increased by 17 per cent in 2011.[6] Despite this large increase, the Gulf Cooperation Council countries expect to post healthy surpluses, thanks to high crude oil prices. However, fiscal break-even oil prices have increased to record levels in recent years, which are a source of vulnerability in the case of a fall in oil prices. Break-even oil

prices are highest in Bahrain, at $112 per barrel, while they are around $80 per barrel for the other Gulf Cooperation Council countries.[7]

23. In 2012, public spending in the Gulf Cooperation Council countries is expected to slow to around 6 per cent, the lowest rate in several years. However, fiscal policy will remain expansionary in most countries. In January 2012, Oman announced a budget that confirms this view, including Government plans for spending on education, health care and the creation of 36,000 new Government jobs. Bahrain is also expected to continue its loose fiscal policy, as the policies introduced in 2011 are difficult to roll back in the short term. There are some indications of a slight shift in priorities for Government spending in Bahrain, with a larger share directed towards infrastructure rather than simple cash handouts. In the United Arab Emirates, since the global financial crisis, there has been a reappraisal of large infrastructure projects and a prudent prioritization of activities. In January 2012, Abu Dhabi's executive council approved the development programme, including several large-scale projects such as the Khalifa port and industrial zone, the Abu Dhabi international airport and housing and health-care projects. Also, in Kuwait and Saudi Arabia, the combination of a tense political situation and fiscal space will ensure a loose fiscal policy in 2012.

24. While the Gulf Cooperation Council countries have the fiscal space for continued expansion, the more diversified economies are more constrained in terms of fiscal policy. However, most of these countries also responded to the political tension stirred up by the Arab Spring social movement by increasing spending on subsidies, public sector wages and social benefits. This is problematic not only because most countries are running out of fiscal resources, but also because such measures might have a detrimental long-term effect if the increased discretionary social spending comes at the expense of productive investments. Lower investment might have an adverse impact on the long-term growth trajectory. Most countries have been running consecutive and large fiscal deficits, which have led to an increase in debt levels, in particular in Jordan and Lebanon.

25. The fiscal outlook for the more diversified economies will continue to be marked by high social spending, as most of the policies adopted in 2011 are politically difficult to reverse in the short term. There are increasing concerns about the sustainability of debt and fiscal reform plans are being discussed in several countries. Jordan revealed a three-year fiscal reform agenda that plans to reduce the deficit to 3.5 per cent of GDP by 2014 by removing tax exemptions, reducing spending and reforming the subsidy system. However, the fear of social unrest forced the Government to temporarily abandon its plans. In Yemen, disruptions in oil production and increased public sector wages widened the fiscal deficit in 2011. Given the priority of achieving political stability, efforts to reign in public spending will probably be deferred until 2013. In Egypt, there is still uncertainty about the future direction of economic policy and the Government has issued conflicting statements about fiscal policy, first saying that the deficit will widen and then saying it will stick to the budget plan. Deficits are also increasing in Lebanon and the Syrian Arab Republic. In the latter, the deficit is expected to increase further due to European Union sanctions on oil revenue and the economic standstill. The Sudan is in a particular situation, since it lost about 50 per cent of Government revenue

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[7] National Bank of Abu Dhabi, "GCC Economic Development and Outlook 2012" (Abu Dhabi, 2012).

following the secession of South Sudan. The country has embarked on a major adjustment of fiscal policy, including large spending cuts, the bulk of which have been to development spending and federal transfers to states. It is feared that this will have an adverse affect on poverty reduction and achieving the Millennium Development Goals. Despite the introduction of fiscal austerity measures, the fiscal deficit as a share of GDP is expected to double in 2012. Iraq is the exception in the more diversified economies as higher oil prices and production increase Government revenue. Iraq's 2012 budget includes a 20 per cent increase in total expenditure.

26. Monetary policy in the Gulf Cooperation Council countries remained relatively unchanged in 2011. The Central Bank of Kuwait made no changes to its official policy rate at 2.5 per cent, but appeared to be less aggressive in its demands that banks take additional provisions. Money supply in Kuwait increased throughout 2011 to keep the system liquid and put a downward pressure on interest rates. In Oman, the Central Bank made no change in the official lending rate, which has remained at 2 per cent since 2009. In Qatar, the authorities have in recent years implemented measures to tighten bank supervision and strengthen financial stability. In 2011, the Qatar Central Bank cut its deposit rate from 1.5 per cent to 0.75 per cent in a bid to stimulate credit to the private sector. In Saudi Arabia, monetary conditions have improved since the beginning of 2011 as liquidity, bank lending and deposit growth are all increasing. The spread between the Saudi Arabia Interbank Offered Rate and the London Interbank Offered Rate, narrowed in the second half of 2011, reflecting the more liquid relative position of the Saudi banking system. The United Arab Emirates experienced a surge in liquidity in the beginning of 2011 as it was regarded as a safe haven during the unrest in the Arab world. According to ESCWA, the Central Bank of the United Arab Emirates has maintained its repo rate at 1 per cent.

27. Monetary policy in the more diversified economies has also witnessed small changes in 2011 as most of the countries are heavily dollarized and tied to the monetary policy in the United States. However, in November 2011, the Central Bank of Egypt increased its interest rates for the first time since 2008. This was to support the Egyptian pound and boost local currency deposits. With the downward pressure on the Egyptian pound, it is expected that the Central Bank of Egypt will raise interest rates further in 2012, which might have a detrimental effect on economic growth. In Jordan, the Central Bank increased policy interest rates in May 2011 due to inflationary pressure, but further rises are not expected in 2012. In the Syrian Arab Republic, fears about a run on the Syrian pound forced authorities to take action; the Syrian Central Bank imposed restrictions on foreign currency transactions and abandoned its peg to the IMF special drawing rights. Currently there is a three-tier exchange-rate system in place, with an official exchange rate, a private bank rate and a black-market rate. In Iraq, as a response to decreases in inflation, the Central Bank has adopted an active monetary policy by reducing its policy rate.

28. Despite excess liquidity in the banking system, the financial sector in the region remains relatively underdeveloped. Loans-to-deposit ratios are below unity in most countries, which demonstrates that there is excess liquidity. A financial sector without depth and width is a challenging environment for the private sector and especially small and medium-sized enterprises. Since financial intermediation is based heavily on resolving information problems, banks find it more convenient to

fund large businesses. Therefore, in the absence of an inclusive financial infrastructure, small firms find it more difficult to access finance compared with large firms. Research shows that small and medium-sized enterprises lie at the core of private sector development and are essential for job creation. Given the unemployment problem in the region, there is a strong need for more vibrant and robust small and medium-sized enterprises that can drive private sector growth and job creation. A lack of access to finance places serious constraints on a country's ability to deal with its unemployment problem. There is therefore a pressing need for an overarching national strategy for financial inclusion in the region, which should particularly aim to ensure that small and medium-sized enterprises are given access to finance.

V. Social dynamics

29. Decades of accumulated social problems and political exclusion, together with the increased burden resulting from increasing global food prices and economic stagnation, led people to the streets to protest. The calls for dignity, freedom and social equity have demonstrated that the political economy of exclusion is no longer tenable. Even if the movements are of a complex nature and the underlying causes and demands of the people differ from country to country, there are similarities and issues related to unemployment, poverty and inequality have been highlighted in most countries. The social movement in the ESCWA region mainly carried an internal political agenda. The first change that was targeted as part of the social movement was political, which could then act as a catalyst for improving the socio-economic situation.

30. In 2011, the Arab Spring social movement demonstrated a promising trend in terms of social and political engagement of the Arab people. The increased participation of young people in social and political dialogue is particularly promising for the future of the region. The young people of the ESCWA region have inspired others worldwide; the "Occupy Wall Street" and "99 per cent" movements in the United States and Europe often refer to the influence of Arab youth. It is also worth noting the remarkable participation of women in the social movement in Egypt, Jordan, the Syrian Arab Republic and in particular Yemen. The awarding of the Nobel Peace Prize to the Yemeni activist Tawakkul Karman was one of the ways that women's crucial role in the social movement was recognized. It is important for the central role of women in the protests to be reflected in discussions in the aftermath of the revolutions. The region must take this opportunity to transfer the voice of women from the streets to political positions and affect concrete actions.

31. Among the most critical challenges for social development in the ESCWA region is high unemployment, in particular among young people. According to the International Labour Organization (ILO),[8] unemployment in the Middle East is among the highest in the world and is expected to have increased from 9.9 per cent in 2010 to a preliminary estimate of 10.2 per cent in 2011, with a further slight increase to 10.3 per cent expected for 2012. Behind these figures lies a significant gender disparity, with male unemployment estimated at 8.3 per cent for 2011 and

[8] International Labour Organization, *Global Employment Trends 2012: Preventing a deeper job crisis* (Geneva, 2012).

female unemployment estimated to reach 18.7 per cent in the same year. The extent of the disparity varies in the different ESCWA countries (see table 3).

Table 3
Unemployment in ESCWA countries, total and by gender
(Per cent)

Country/area	*Total unemployment*	*Male unemployment*	*Female unemployment*
Egypt (2009)	9.4	5.2	22.9
Jordan (2009)	12.9	10.3	24.1
Saudi Arabia (2009)	5.4	3.5	15.9
Syrian Arab Republic (2010)	8.4	5.7	22.5
Yemen (2009)	14.6	—	—

Source: International Labour Organization, *Key Indicators of the Labour Market 7th Edition* (Geneva, 2011).

32. Youth unemployment is a particular challenge in the region and ILO estimates that it has increased from 25.4 per cent in 2010 to 26.2 per cent in 2011. Vulnerable employment has fallen gradually in the region from 32.4 per cent in 2005 to 29.5 per cent in 2011. This is another area where women are more exposed, with more than 40 per cent of women in vulnerable employment compared with 27 per cent of men. An additional challenge in the labour market is the informal job sector. Although this sector is difficult to measure, anecdotal evidence suggests that it is significant in the ESCWA region, accounting for around one third of GDP in Egypt, Jordan, Lebanon, the Syrian Arab Republic and Yemen. This implies that a large share of the population is excluded from most forms of social protection.

33. Labour markets in the Gulf Cooperation Council countries differ from the rest of the region due to their reliance on expatriate labour. According to ECSWA, unemployment rates are often not comparable as the large foreign labour force skews the statistics and unemployment among nationals is probably much higher than aggregate statistics show. Despite relatively strong job creation in the region, youth unemployment has been increasing. Given the young and rapidly growing population in the Gulf Cooperation Council countries, job creation for nationals is a key issue that must be addressed. Governments in these countries have responded to this challenge by creating additional jobs in the public sector, but although this is currently an affordable solution, it is not a viable long-term strategy. These countries have also adopted so-called “nationalization” policies aiming to replace expatriate labour with nationals. However, in the long term, economic diversification must be the core strategy to provide more jobs for national youth.

34. Poverty and inequality are also widespread in the ESCWA region, but are often not reflected in most indicators. Measuring poverty as the number of people earning $1 or $2 per day is not relevant in most countries of the region and alternative measurements should be developed. According to national statistics, poverty in Yemen and the Sudan is high, at around 50 per cent. In the other more diversified economies, poverty is also sizeable and varies from 20 to 40 per cent. According to ESCWA, poverty is significant in the Gulf Cooperation Council countries and should be addressed. Inequality indicators such as the Gini coefficient suggest that there are moderate levels of income inequality in most ESCWA countries. However,

these results are controversial due to their measurement method and the fact that they do not reflect the glaring manifestations of rising inequality in many countries in the region.[9] Regional disparities are also present, particularly the different levels of access to public services, electricity and water in rural and urban areas. Such disparities fuel inequalities and the potential for increased rural-to-urban migration and the challenge of social dislocation.

35. Unemployment, poverty and inequality are not newly emerging issues but have become more serious in recent years owing to pressure from globalization coupled with ineffective domestic social and economic policies. The Arab Spring social movement and political protests succeeded in bringing such issues to the top of Governments' agendas. In response to the protests, several countries have adopted policies to increase unemployment benefits, wages, housing allowances and public sector jobs. However, these discretionary social policies are not sufficient to tackle the root cause of the social discontent and there is a need for a comprehensive social policy. Socio-economic development has not received sufficient attention at this transformative stage, where the focus has been solely on political reform. In the light of the experience of several countries in the region, particularly Egypt, the strong focus on political reform could be said to have negatively affected the overall reform agenda. Without substantive socio-economic dialogue within transitional bodies, the discussion digressed into a traditional election competition and ideological debate. The region needs to establish a social dialogue to discuss a new approach to development based on inclusion, equality and participation. There is a need to move away from the jobless growth that has dominated the region in the past by promoting diversification and competitiveness. This must be developed in parallel to an integrated social policy in order to synchronize policymaking with a long-term development vision.

VI. Conclusion

36. The global economy and the ESCWA region recovered in 2011 but the outlook for both for 2012 is particularly gloomy and characterized by a significant risk of downturn, which would have a significant impact on the ESCWA region through lower demand for exports and reduced remittances. If market fundamentals weaken sharply, oil prices might also drop below break-even prices for fiscal sustainability in oil-exporting countries. This could reduce fiscal space in oil-exporting countries, in addition to the already-strained fiscal situation in the more diversified economies. The social situation in the region is already fragile given the high unemployment rates. A global downturn would magnify the existing problems in the region, aggravate uncertainty and make political transition more difficult.

[9] United Nations Development Programme, "Arab Development Challenges Report 2011: Towards the developmental state in the Arab region" (Cairo, 2012).