Impact of the Global Economic Crisis in Arab Countries: A First Assessment

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INTRODUCTION

As in other parts of the planet, the Arab world is being affected by the global economic crisis. However, the effects and the degree of its impact are being diverse depending on each country and sector.

The Arab world is not a homogenous reality; on the contrary, the economic, political, geographic, social, demographic and cultural features of each country make it a highly diverse, heterogeneous and complex region. The multi-faceted nature of the way in which the crisis is affecting the region puts into evidence this complexity.

The initial impact of the international crash of the stock markets, which began in September 2008, was partly felt in certain Arab countries, and to different degrees depending on their openness and involvement in international financial markets. However, the fall in global demand which consolidated in 2009 is having important repercussions in certain countries and sectors. Not only has this downturn been transmitted through the collapse of international finance, with its constraints in investments and credit, but also through the drop in the price of hydrocarbons and the reduction of exchanges at a global level, especially concerning exports, tourism and remittances. The International Monetary Fund (IMF), in its latest report of October 2009, indicated that three main channels by which the crisis was transmitted to the region were “the reduction of remittances, foreign investment and exports”.¹

The region is being affected by the crisis on different fronts, to different extents and in different ways, revealing important structural and developmental problems yet to be resolved. The main problem is still the extreme dependence on hydrocarbon exports and fluctuations in international markets, as a result of the still scarce industrialization and economic diversification in the majority of these countries. The fundamental challenges posed in this sense are, on the one hand, the creation of a competitive productive system and, on the other, the reform and improvement of the education system that would allow these societies to join the new global knowledge and would create employment for their large youth population.

¹ Final Document presented to the Club of Madrid Annual Conference, November 12-13, 2009
² Regional Economic Outlook: Middle East and Central Asia. IMF. October 2009. Page 1
The region in a relatively positive position

Following six years of unprecedented economic growth, coined ‘the third oil boom’, the region has collectively tackled the current downturn from a relatively advantageous position in terms of accumulated assets and resources. Despite consecutive reductions in the area's growth forecasts, the growth indicators continue to be higher than most regions on the planet. According to estimations from the Economist Intelligence Unit, in 2010 economies in Arab countries will be growing at 4%, almost double the world average. These coincide with those presented by the IMF in their latest report on the region at the beginning of October 2009.

Diverse effects in different countries

The starting points of Arab countries are very diverse. For some the fall of hydrocarbon and food prices has meant a certain level of respite – to a certain extent moderating the so-called “Crisis of the three Fs”, Food, Fuel & Finance, which experienced its most critical period in the middle of 2008 - for others it means a drastic reduction in estimated revenue. Furthermore, the global economic downturn has surprised those in the middle of running ambitious economic investment and diversification plans conceived during the boom. Other countries, however, are facing the crisis following a prolonged period of reform and structural adjustment, as well as economic and commercial liberalization, during which significant reductions in social protection and limits to the State intervention in the economy had to be carried out.

The impact and consequences of the crisis in each of these countries will depend on both the social and economic structures and the specific strategies and development plans implemented during the previous period of economic growth.

Greater exposure to financial markets in the U.S. and United Kingdom as well as higher levels of speculative real estate investment have produced large budgetary cutbacks in Gulf countries. The drop in oil prices has seriously affected exporting countries such as Algeria, Saudi Arabia and Yemen, and the reduction of workers' remittances abroad, exports and tourism has put countries like Egypt, Morocco and Jordan in a difficult social and financial position, due to significantly increasing unemployment levels, particularly among young people, and reducing vital sources of revenue for households. In contrast, in countries like Qatar, the number one global exporter of liquefied natural gas, the effects of the crisis have gone undetected. In others, such as Emirates, which habitually has an annual GDP growth of close to 15%, the economy has come to a standstill, even registering negative growth. The scarce demographic pressure and liquidity accumulated over the boom years has meant that the downturn has not significantly lowered citizens' standard of living, although this is not the case in immigrant populations from neighbouring countries, particularly Asian.

Nevertheless, other oil-exporting countries with higher populations, scarce levels of economic industrialization and diversification and less foreign investment face a series of challenges worsened by the crisis. These include growth in unemployment and poverty.

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3 Economist Intelligence Unit. Middle East and North Africa. Regional overview. September 2009
rates and discrimination of certain sections of the population, all of which can become sources of social instability.

The cut of revenues, either due to the fall in oil incomes or from lower exports, remittances or tourism revenues, will bring about important limits to current development processes as well as substantial social and political challenges and uncertainties. Therefore, the crisis is testing out the development policies and strategies, introduced by the States, and their stability and strength, both on a national and regional level.

The aim of this document is to provide a tool with objective data and information that helps to understand the multiple characteristics and perspectives by which the international crisis manifests itself in the Arab world. It is a starting point for carrying out a more in-depth analysis of its repercussions on the region. Likewise, it shows the main ideas and dimensions of the social and political challenges that this crisis poses to the Arab countries, as it was discussed by the experts and Club of Madrid’ Members, during the roundtable “The Political Dimensions of the World Economic Crisis: an Arab World Perspective” organized by Casa Árabe and the Club of Madrid on October 28th, 2009 in Madrid.

I. THE IMPACT OF THE FINANCIAL CRISIS AND THE CONVERGENCE OF DIVERSE CRISES IN ARAB COUNTRIES

The early years of the 21st century witnessed a third oil 'boom', between 2002 and 2008, and were specially positive for the income of the for Arab oil-exporting countries, particularly, for those in the Gulf. Oil and gas prices reached historic figures and their liquidity and reserves practically increased exponentially during those years. The economies of these countries grew at rates of consistently over 6%, in real terms, and were even close to 10% in some Gulf countries; as a result, the per capita income practically doubled.

As in other similar time periods, joint economic expansion spread to other countries in the region. The rise in liquidity allowed exporting countries to tackle diverse industrialization, diversification and infrastructure projects, generating a significant demand for employment and an increase in economic activity, which benefited neighboring countries. Consequently, non-oil exporting Arab countries also experienced strong growth in their GDP and per capita incomes, as recognized in the latest Arab Human Development Report 2009.5

I.1. The first impact of the financial crisis: sovereign wealth funds, stock markets and banking systems

The first symptoms of a financial crisis appeared in the United States during the last quarter of 2007 with the outbreak of the subprime mortgage crisis, which quickly spread across the European financial system, primarily in Britain. At first it did not appear to be a cause for alarm in the Arab world; both the World Bank and the IMF emphasized that Arab financial systems had “little exposure” to global finance and, consequently, to those toxic assets which triggered the credit and banking crisis in the United States.

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5 “Producer countries gained most in that narrative, amassing untold wealth, but non-oil Arab countries also benefited substantially from oil-related services, worker remittances, intraregional investment flows, regional tourism receipts, and aid.” UNDP, Arab Human Development Report 2009: Challenges to economic security. Page 109.
Nonetheless, a number of sovereign wealth funds from Gulf countries, which had stored a large part of the liquidity accumulated in these countries during the boom years, came to the rescue, along with other Asian funds, to recapitalize some of the U.S. banks and financial institutions affected by the subprime mortgage crisis. It is calculated that between 2007 and 2008 sovereign wealth funds invested over 100 billion dollars in the United States and Europe. The Kuwait Investment Authority (KIA) and the Abu Dhabi Investment Authority, with the Singapore GIC and the Saudi prince al-Waleed Bin Talal, put up 14.5 billion dollars to rescue Citigroup, while Kuwait also supplied funds to save Merrill Lynch. In February and June, Qatar also invested in Barclays and Credit Suisse, who then declared themselves bankrupt in September 2008, inflicting significant losses on the sovereign funds that had intended to secure them a few months earlier.

At first, the exposure to markets and risk assets were difficult to gauge due to the opacity of the funds. The British newspaper *The Observer* estimated that the sovereign wealth funds in the Gulf and Asia would register losses of least 4 billion dollars by the end of 2008. According to the latest data released by the *Economist Intelligence Unit* (EIU), some funds such as those from Abu Dabi ended up losing around 27% of the invested capital.

**Changes in the funds’ investment strategies**

The crash suffered by a large part of these funds during the financial crisis has caused investment strategies to be redefined. On the one hand, some funds are opting for more conservative strategies, such as SAMA, the Saudi Sovereign Wealth Fund Institute, whereas on the other, they are changing the nature and destination of their investments. Those traditionally focused on financial markets in Europe and the U.S. are turning their attentions towards other markets - in Arab countries and emerging ones, as well as towards direct investments. One example of this strategy change, announced on January 10th 2009 by the Abu Dhabi Investment Company, was to create four investment funds in the Middle East and North Africa. More precisely, the Emirate investment funds proposed the creation of stock funds in the Gulf Cooperation Council, an investment fund in the United Arab Emirates, a third for the whole of the area covering the Middle East and North Africa, and a fourth in developing North African countries. The President of the company's Board of Directors indicated that it is “the ideal moment” for the Middle East and North of Africa to become the destination for the investment of these funds. This consolidated a trend which started in the last years of economic expansion, when the sovereign wealth funds started to play a more important role in intraregional development funds.

**Repercussions for stock markets and the Arab financial system**

The huge losses recorded by both sovereign wealth funds and private Arab capital in financial markets in the United Kingdom and the United States meant that the stock market crash in September 2008 affected the majority of the Middle Eastern stock markets. After the insolvency of Lehman Brothers was announced, on September 15th 2008, the Saudi Arabian stock market fell by 6.5%, Doha 7%, Kuwait 3% and Abu Dabi 4.35%. Certain markets, such as Kuwait, had to close for a number of days to avoid outbreaks of panic.

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6 Olivia Orozco, Casa Árabe Economic and Business Bulletin “Crisis and sovereignty”, Nº9, Dec 08–Jan 09
8 Ibid., Page 11.
Over the last year, falls in these Gulf stock markets have followed a parallel path to those in Europe and North America and are strongly linked. From May 2008 to January 2009 practically all the Arab market values noted how indices slumped by 50%.

In contrast, some Arab stock markets were relatively unaffected by these fluctuations, as those in Morocco, Lebanon and Jordan, with accumulated falls from January 2008 to March 2009 of between 13 and 28%, respectively. The behaviour of Tunisia's stock market was particularly noteworthy, with an accumulated growth in this period of 18%.

The spread of the crisis to the banking system and credit availability

The impact of these losses, the fall in investments and the ensuing lack of liquidity all had important consequences for the Gulf banks. In the Emirates, as in other countries, the central banks had to intervene to guarantee credit and deposits. As a result, from September 2008 to February 2009 cases of payment defaults multiplied; in particular, they tripled in Bahrain and doubled in Adu Dabi, according to IMF data.

As in Europe and the U.S., various factors coincided at the same time in the banking crisis – on the one hand, large excesses in credit concessions over a period of economic expansion, particularly in the real estate industry, together with, on the other, the investments' strong preference for secondary markets. As the IMF remarked, when the value of these assets and company profits plummeted both the general financial risk and the payment defaults increased, weakening the banks' balance sheet.

I.2. The end of the third oil boom: the fall in oil prices

Oil prices started to fall in the summer of 2008. However, from September to December that year the price dropped from 100 to 40 dollars per barrel, recovering slightly after February 2009, but following a much more moderate trend from then on.

Arab countries make up 65% of the world's oil reserves and 45% of the gas reserves. The export of these products generates 50% of the GDP and 80% of its revenues. Therefore, the fall in oil prices has particularly affected exporting countries - Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, United Arab Emirates (UAE), Algeria, Iraq, Libya, Sudan and Yemen – and has halted the high growth taxes maintained in previous years.

As a result of the decline, both in exports and the price of oil, the Central Bank of Yemen announced its revenues from oil exports dropped around 75% last June. Likewise, the magazine 24-7 noted in July that the combination of low prices and the decline in production could mean a revenue drop of oil exports in the UAE of around 43% in 2009.

I.3. The fall of investments and the bursting of the real estate bubble

Another issue emanating from the international crisis and affecting Arab countries is the fall of direct foreign investment.

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10 Ibid. Page 6
11 Ibid. Page 5
The crisis faced by European and American companies has slowed down recent investments being carried out in Arab countries. According to the World Bank, in its report of October 2009, the global flow of direct foreign investment in MENA countries could “drop notably in 2009”. The report indicates a recovery in 2010, though still below those levels prior to the current crisis.13

This has particularly affected the real estate market in many Gulf and North African countries. On September 17th 2009, the Kuwaiti newspaper, Al-Qabas, published that the crisis had made 675 real estate projects to be cancelled in Gulf countries, with 75% in Emirates, mainly in Dubai.14 Real estate speculation had been among the highest in recent years in Dubai - with construction and the real estate industry representing 25% of the GDP– and, consequently, it has also suffered one of the worst falls in house prices.

On the other hand, the IMF estimates that foreign investment in non-oil exporting Arab countries will go down by around 11 billion dollars between 2008 and 2009, attributing the fall to credit and financing constraints, and the lack of domestic liquidity.15

In North Africa the real estate and construction industry have also suffered the consequences of the recession. One example is Morocco, where the industry has grown significantly in recent years thanks to large investments from both European companies and Gulf investment funds.16 According to the newspaper Al-Yarida al-Ula, foreign investment in Morocco went down by 6% in 2009.17

The sharp downturn of growth in Gulf countries has had a negative effect on intraregional investment which many investment funds and companies were developing in North Africa. Besides Morocco, Algeria is also another country affected by the fall in Arab investments. The Emirate company Emaar, one of the largest construction companies in the Gulf, announced in June that it was ceasing its activity and closing its office in Algeria, where it was involved with projects worth 20 billion dollars.18 According to the newspaper Al-Hayat, the same company had lost 351 billion dollars in just three months at the start of 2009.19

I.4. The drop in remittances and tourism

Together with the drop in foreign investment, certain Arab countries have also suffered severe economic setbacks due to the decrease of immigrant remittances, among non-oil exporting countries, and a decrease in the number of tourists. The last issue has had repercussions in all Arab countries, but also particularly in the non-exporting ones who rely heavily on this source of revenue.

Significant drop in remittances

The drop in remittances is mainly due to those thousands of immigrants that had to leave those employments in emerging sectors either in Europe or the Gulf. According to the

14 Al-Qabas. September 17th 2009
16 In particular, the Reuters agency estimates that in recent years Gulf investors have invested close to 30 billion dollars in the Moroccan real estate and construction industries. “Industry trends and developments. Construction 2009”. Business Monitor 2009. March 11th 2009
17 Al-Yarida Al-Ula. August 11th 2009
18 Reuters, July 4th 2009
19 Al-Hayat, July 31, 2009
World Bank, it is precisely Arab countries which will suffer this drop the most, ahead of other countries in Latin America, Asia or Sub-Saharan Africa.

Egypt is the fifth highest country in the world to receive remittances from foreign workers, although the economic dependence on these revenues is greater in countries such as Senegal, Morocco, Jordan, Lebanon and Yemen, where they represent a higher percentage of their GDP.

In the case of Morocco, as with Tunisia, almost 80% of remittances come from workers in European countries; whereas in Egypt, like Jordan and Lebanon, the majority of them (over 50%, and 60% in Jordan) work in Gulf countries. Therefore, Egypt, Jordan and Lebanon are suffering indirectly, though in equal measure, the consequences of the economic standstill in oil-exporting countries.20

In June, the newspaper Al-Bayan reported that, according to a report by the Egyptian Economic Observatory, Egyptian workers' remittances abroad fell by 15%, while the number of these workers returning to the Gulf increased by 7,000 in March 2009.21

In Jordan, the Central Bank announced in June that remittances of Jordanians working abroad fell by 3% for the second month in a row. As in Egypt, the remittances are one of the fundamental sources of revenue and exceed the total of foreign aid the country receives. According to the newspaper Al-Dustur, this fall is due to many Jordanians losing their employments abroad, particularly in Arab countries.22

Tourism drops by 18% in the Middle East while maintains its growth in North Africa

In terms of tourism, using the figures from the first quarter of the year, the report carried out by the World Tourism Organisation in June 2009 emphasizes that tourism in the Middle East globally dropped the most at the beginning of 2009 - in total, Middle Eastern countries received 18% less tourists. The report published by the Central Bank of Egypt on June 17th affirmed that revenues from tourism decreased by 17.3% in the first quarter of 2008. In contrast, in North African countries tourism did not decrease, in fact it increased by 6%.23

I.5. The decline of exports

Finally, the collapse of the international markets following the economic crisis has given rise to a serious decline in exports to countries from the region. The economic standstill and the drop in demand from markets in Europe, the United States and Asia - the leading markets for exporting manufactured products and oil in Arab countries - has brought about an additional economic reversal for economies in the Middle East and North Africa. In some cases, exports to countries in the European Union constitutes almost 80% of the total exports (80% for Tunisia and 78 and 76% for Libya and Morocco respectively).24

20 For instance, on September 25th, the newspaper Al-Quds al-Arabi reported that 17,000 foreign workers abandoned Kuwait in the first half of 2009 as a direct result of the economic crisis. Al-Quds al-Arabi, September 25th 2009. Page 14.
21 Al-Bayan, 22 June, 2009
22 Al-Dustur, 6 June 2009
latest data provided by *The Economist* in September 2009 demonstrated a general deterioration in current account balance sheets, which were slightly steeper in the Gulf, though they generally maintain positive balances. In particular, oil exporting countries in the Arab world have gone from having a positive balance sheet of 348 billion dollars in 2008 to 62.1 billion in 2009. This is primarily explained in terms of the exports exceeding a trillion dollars in 2008 and coming to a standstill at 685 billion in 2009.

Although Morocco’s official sources maintain a stance of economic optimism, there is still concern about the combined drop in exports, tourism and remittance revenue. A report from the Royal Institute for Strategic Studies details how, during the first quarter in 2009, Moroccan exports fell by 5%, direct foreign investment by 36%, remittances by 11% and revenue from tourism by around 14%.25

II. UNEMPLOYMENT AMONG YOUNG PEOPLE: THE MAIN SOCIAL CHALLENGE OF THE CRISIS

The economic crisis in the Arab world has not affected everyone in the same way. In fact, the macro-economic figures do not reflect the real impact the recession has had on the citizens of Arab countries. A 10% drop in the growth of the United Arab Emirate's GDP has not been translated into a lower standard of living or less social peace for Emirate citizens; however, a reduction of 0.1% in the growth of the Algerian economy could pose significant social challenges. The World Bank has warned about this situation and the risk various Arab countries run of the economic crisis becoming a social crisis.

Per capita incomes: disparate starting points and demographic pressure

As outlined in the introduction, not all Arab countries started off from the same position when coming up against the crisis. The per capita incomes allow an estimation of citizen's general living standards, though they do not guarantee a fair distribution or balance of wealth. In some GCC countries we can see how the per capita incomes are found at the same level, or even higher, than member countries from the OECD. Therefore, although the financial crisis has significantly reduced the level of reserves, liquidity accumulated during the years of economic expansion, levels of infrastructures and capital, as well as little demographic pressure has allowed them to face the recession with a position of relative confidence. However, from Qatar to Yemen, countries that have respectively the highest and lowest income per capita in the region, the position of each country is very diverse. In this sense, the countries with high level incomes (Bahrain, Kuwait, Qatar, Saudi Arabia and United Arab Emirates) are the least likely to suffer political or social tensions, while those with low incomes are potentially more at risk to show social uprisings or political instability, in particular in Sudan, Yemen, and Mauritania. In between these two extremes are those countries with medium-high incomes like Libya, Lebanon and Oman, and those with medium-low incomes like Algeria, Djibouti, Egypt, Jordan, Morocco, Syria and Tunisia.

The challenge of unemployment

Unemployment rates, especially among young people, represent one of the main short and long term challenges for many Arab economies. According to the Arab Human

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25 Royal Institute for Strategic Studies. *Le Maroc face a la crise financiere et economique mondiale.*
Development Report, youth unemployment “disproportionately” affects Arab countries, with the unemployment average rate among young people reaching around 30%. It is particularly alarming in countries such as Algeria, which reveals a youth unemployment rate of 45%. Although slightly less alarming, the figures are also worrying in other places such as Saudi Arabia or Egypt, which reveal a youth unemployment rate of 25%, but that as Algeria, have higher percentages of population under 15, which could mean an increase in future youth unemployment rates.26

In this way, in June 2009, the newspaper *Al-Bayan* revealed that unemployment rates in Egypt could soar in 2010, an analysis shared by the Union Of Egyptian Workers Abroad, which believes the impact of the crisis on Egyptian labour will be fully felt next year.27

Hence, one of the greatest challenges a large number of Arab countries face is unemployment and the need to create jobs for an increasing youth population. This socioeconomic situation becomes even more complex in those countries without revenues from hydrocarbon exports and with strong demographic pressure. Before long they will have to create jobs for a predominantly young population. Morocco and Egypt are possibly the clearest example of this situation, with unemployment and illiteracy particularly posing serious problems for the poorest sections of the population, which are, along with immigrants in the Gulf, those that will be most affected by the adjustment of the crisis and the fall in employment and remittances.

Other oil-exporting countries, such as Algeria and Sudan, with medium and low revenues and high levels of young population, will also have to face similar challenges.

Another challenge linked to the rise in unemployment is the possible increase of poverty. According to the *Arab Human Development Report 2009*, Arab countries, compared with other developing countries with similar levels of income and human development, should obtain higher results in poverty indicators.28

The economic crisis and the resulting public deficit has put development and public investment plans, industrialization processes, social policies and public employment at risk. The rise in unemployment is probably the most likely way the economic crisis will become a social one, particularly in those countries with a lower income per capita and lower human development conditions.

### III. PUBLIC DEVELOPMENT PLANS AND PERSPECTIVES REGARDING THE CRISIS

After the impact of these consecutive crises, the economic and fiscal situation of the Arab countries has been significantly debilitated. Nevertheless, it can be generally said that, as in other countries, public investments in infrastructures, services and energy have taken over for the drop in private investment, especially foreign investment, and not just in the petroleum exporting countries. The projects for highway expansion, ports, railways, power networks, etc. are being maintained and increased in Morocco, Algeria, Saudi Arabia and other Gulf countries. Even though these investments will produce pressure on the public deficits, especially in the exporting countries that had anticipated having higher revenues, given the price situation in the oil market, it is expected that the accumulated reserves avoid

having to turn to exterior debt. Algeria, which had managed to eliminate its exterior debt, enters once again into a position of budgetary deficit (4 percent of the GDP according to *The Economist*, although the Business Monitor International (BMI) predicted the largest budgetary deficit of the last 15 years, 10 percent of the GDP). In turn, according to the Economist Intelligence Unit (EIU), the only ones to avoid a deficit will be Kuwait, Qatar and Oman, while the BMI estimated in February that Qatar and the UAE would be the only countries in the Gulf that would not return to deficit situations.

**Signs of recovery, reviewing development models and some lessons from the crisis**

Certain institutions, such as the IMF in its last report of October 2009, dared to confirm certain recovery of the economy. In the case of the Middle East, this recuperation will take place thanks to “the recovery of financial conditions in the region and a rise in asset prices (especially oil)” 29. The International Monetary Fund has indicated that the outlook for the Middle East in the past few weeks has improved “thanks to the stabilization of the global economy along with the resurgence in oil prices”. They do, however, warn that the situation is still “complicated” and add that the main danger of these faint signs of recovery could be that they are neither real nor sustained and continue to depend on possible future slumps in oil prices.

The World Bank is equally cautious. In a report made also public on October, it indicated that if MENA countries wish to uphold this economic recovery for the long term, they must take advantage of the current crisis to face imminent challenges in institutions and infrastructures that have hampered growth over decades.

A simply quick glance at the evolution of the GDP in Arab countries over the past 20 years allows to verify the high-level of dependency their economies have on the evolution of oil prices - a succession of peak and troughs in a sharp curve that reflect the volatility of a non-diverse, highly dependent economy controlled by factors out of its control.

The World Bank also added that in the years prior to the crisis the growth of Middle Eastern countries was “respectable, not staggering” compared with other developing regions. This growth is identical to the 90s, and even less than the 80s. It is estimated that the MENA region requires 300 billion in investments over the coming years to cover the current need for infrastructures, which is especially high in the countries of the Gulf Cooperation Council (GCC), despite the current efforts already implemented. It is calculated that between 1998 and 2007 GCC countries invested close to 20% of the GDP in infrastructures, significantly lower than the 39% invested in China or the 30% in South Korea.

Certain countries in the Gulf have already recognised this obstacle and have set up measures to resolve it. In 2009, Saudi Arabia has increased public spending in infrastructures by 36%, reaching 60 billion dollars in the process, and its medium term development plan includes 400 billion dollars worth of investment in infrastructures over the next five years. Qatar and Bahrain have also announced ambitious investment plans and Dubai, despite the high impact of the crisis, looks well set for recovery.

Without these necessary infrastructures, bureaucratic improvements and industrialization and diversification processes, the current signs of economic recovery, which have been observed in Arab countries during the last few months, could pass in history as another

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29 *Regional Economic Outlook: Middle East and Central Asia*, IMF. October 2009.
new shoot or pick up on the graph's curve instead of constituting a positive and sustainable growth trend over time, characteristic of an emerging economy.

In the current context, strengthening the reforms and development plans set up in the years of boom is more urgent than ever in order to curtail the dependency Arab countries suffer on the fluctuation of oil prices and international markets. Greater diversification and industrialization would be the key for creating more sustainable economies capable of generating more employment in the medium term.

IV. THE POLITICAL DIMENSIONS OF THE CRISIS: POLICIES AND MEASURES FOR REGIONAL DEVELOPMENT

Even though the region’s socio-political aspects are extremely diverse, the experts and the members of the Club of Madrid, meeting at the Casa Árabe in the round table discussions organized in October, listed a series of priorities that should be worked out from the political sphere, at a national, regional and also international level, in order to promote more sustainable development models and to recover a stable line of short-term economic growth in the region. These priorities and measures are focused on three areas in particular: development and governance strategies, regional integration and international cooperation.

4.1. Development and Governance Strategies at a national level

Although the economic prosperity of this last expansive period was positive, the total growth of the region was not sufficiently important in relation to its potential and to the growth experienced in other emerging countries. Moreover, the way in which the drop in oil prices and of international trade was transmitted to the Arab countries proved the strong dependence that Arab economies have on the fluctuations of oil prices, as well as on the evolution of foreign markets.

It is necessary to implement new economic policies and new development strategies in order to recover from the crisis and to guarantee a sustainable and prosperous future in the region in the medium and long terms. To do this, it is necessary to confront an entire series of reforms and improvements in economic policies and governance in the following aspects:

1. Education and employment

Unemployment (especially among young people) is probably one of the greatest challenges in the political and economic agenda of the present Arab leaders. The deterioration of the real economy and the consistent increase in unemployment, as well as the decrease in the quality of life for the citizens can generate situations of social reaction and protests in some States, especially in those weaker governments such as Palestine, Iraq, Yemen or Sudan. The creation of better and greater work opportunities is also an important challenge in more stable countries such as Algeria, Morocco or Saudi Arabia, where demographic growth puts heavy pressure on the working population, with a growing and prepared youth. In view of this situation, it is necessary to carry out economic and educational reforms designed to promote diversification and develop the industrial, services and knowledge sectors, which are needed in order to generate a productive and competitive economy, capable of creating at least 100 million new jobs during the next decade.

2. State intervention in the economy and liberalization programs
During the last decade, the majority of the Arab countries have promoted processes of economic liberalization and structural programs designed to open their economies and adapt them to the global and free market model. However, the present financial and economic crisis has shown some failures in the self-regulated market system and has given some protagonism back to the State. In this way, the present economic crisis has deteriorated these liberalization processes, as well as the open economic policies undertaken by the Arab countries. The crisis must not be used as an excuse to return to interventionist processes, or to paralyze economic policies aimed at diversifying the economy and opening markets. However, the States must implement measures that guarantee greater social coverage for the least favoured sectors of the population, especially after the crisis. Its role must be especially active in the creation of a clear and transparent legal and regulating framework that guarantees the correct functioning of the markets.

3. Economic diversification, industrialization and knowledge society

The present economic crisis has revealed the existence of various structural problems in the Arab economies. The extreme dependence on oil revenue, as well as the lack of economic diversification is presented as one of the greatest challenges for the oil-exporting countries. Other structural problems are those related with the insufficient work performed in promoting a knowledge society.

A key point, in this sense, is for the revenue generated by the oil exports to be invested in generating a growth process for the real economy, so that this growth is reflected in the creation of job opportunities, especially among young people.

It is “essential” to improve the education of future generations in Arab countries, encourage research, as well as increase innovation and the use of new technologies. Promoting knowledge society is the best way to develop the great human capital that exists in the region. In this regard, the Arab countries must improve the quality of their education systems, as well as develop and strengthen knowledge and research in emerging sectors such as renewable energies.

4. Democracy and development through small governance projects

Even though the present economic crisis signifies a time of transformation in the Arab countries, most of the experts pointed out that the economic situation will produce few changes in the present government systems. In relation to the democratization processes in the region, the experts stated that the situation of an economic crisis may cause an increase in demand for transparency and control, especially regarding the management of Sovereign Funds. However, this increase in demand for transparency does not seem to be turning into an increase in tension and social contestation against the present governments, or altering the status quo in the region.

Nevertheless, small changes in governance at a national level can influence greater development of the region’s democratization processes. These small projects could entail initiatives that promote transparency and good governing practices, and fight corruption. As Professor Tarik Yousef, Dean of the Dubai School of Government, stated the best way to encourage change in governance and favour future democratization processes in the Arab region is to promote these small projects of government reform (Small Governance Projects). On a small scale, these projects can be focussed on aspects such as promoting transparency, governance, rule of law, or small changes in institutional management. In the medium term, these small projects can generate a great impact on the improvement of the governing systems. Europe could be an interesting partner in this sense when it comes to
offering support, assistance and cooperation in the development of these small governance projects.

5. Predictability, transparency and planning in the economic policies

In order to transmit security and stability to investors and commercial partners and thus attract long-term international investment projects, it is necessary for both plans and economic policies to be developed through a predictable and transparent process. Each country in the region should design its own economic plans to be implemented and announced in an open and transparent manner. This point was especially stressed by the former Prime Minister of Spain and member of the Club de Madrid, Felipe González, who emphasized that the more foreseeable, transparent, and planned the processes for design and implementation of economic policies are, the more investment and economic growth opportunities create.

4.2. Integration and economic cooperation at a regional level

It is necessary to improve and reconsider the current political and economic relations of the Arab countries at a regional level and encourage greater political-economic cooperation among these countries. Abdeslam Baraka, former Moroccan ambassador in Spain and ex-Minister of Relations with the Parliament, stressed in his intervention that the Arab countries “need to develop a true neighbourhood policy, whether it be among the Arab States themselves or between the latter and their natural geographic environment, accompanied by a sincere desire for dialogue and cooperation and for resolving conflicts due to anachronistic frontiers inherited from the colonial period”. Felipe González also pointed out the strategic importance of regional cooperation. According to the former Spanish Prime Minister, the Sovereign Funds of the States of the Gulf Cooperation Council (GCC) should look towards the countries of northern Africa and focus their investments in that area. In this regard, Tarik Yousef did not seem excessively optimistic and stated that even though the countries in the CCG are promoting various pan-Arab business projects, the countries of the Maghreb are basically being left out of this dynamic mainly because economic interests are turning towards the East, towards China and India. On the other hand, he noted that, unlike the region of the Gulf, the countries of the Maghreb are becoming with time less homogeneous and less cohesive.

Greater political and economic cooperation among Arab countries is necessary in order to manage more efficiently the region’s natural resources and coordinate their economic policies. In this respect, with the exception of the integration process being started among States of the Gulf Cooperation Council, in the rest of Arab countries these policies are still a chimera. Inter-Arab trade represents just 5 percent of the total of commercial exchanges carried out in the Arab world. Besides, the inter-Arab tourism hardly represented a 10 percent in the whole region. In this respect, various experts showed their pessimism due to various factors:

1. Economic interest is turning towards the East

As Tarik Yousef stated, the economic weight of countries such as India or China interferes with the integration and inter-Arab economic cooperation processes. The global economy is turning towards the East, which causes the States of the GCC also to look toward these markets with more interest than to northern Africa. The countries in the Gulf want to take advantage of, in this sense, their economic potential as platforms between Europe and Asia, incrementing their regional economic power, in contrast with other Arab countries that until now had a greater economic weight.
2. Sovereign Funds: new actors in regional development

During the last decade, Arab Sovereign Funds have accumulated a large part of the liquidity coming from oil exports. As previously stated, a large part of this liquidity, instead of being reinvested in regional and local development projects, has been traditionally deposited in foreign funds that have suffered great losses in the present financial crisis. As a result, Arab Sovereign Funds should reconsider their investment strategies and focus on creating an increase of the real economy in the Arab region. This change in policy could turn them into prominent actors of regional economic development.

3. A pragmatic and open regionalism designed around energy

Taking into account the difficulties of a regional integration process in the Arab world, the European integration process can be taken as an example in order to develop regional cooperation with a pragmatic nature. A common and specific interest in the region, that could define this type of cooperation or regionalism, can be the management, consumption and distribution of energy. Also, given the present context and the points previously stated regarding the existence of different close or peripheral actors, any integration process in the region must maintain an open attitude in order to take into account other actors such as Turkey, Europe or southern Asia.

4.3. The role of the Arab region in the international sphere.

Currently, the Arab world lacks a single voice on the international scene. The lack of a common voice to speak with legitimacy on behalf of Arab countries entails an important handicap when defending the needs and interests of the Arab region in international institutions. Arab countries should urgently name a representative to represent them in organizations such as the G20 or other forums where important economic decisions are made for the region at an international level. Two aspects may contribute to advancing in this direction:

1. Greater cooperation and integration with Europe and emerging countries

Greater political and economic cooperation among them, as well as a deeper relationship with other regions, such as Europe and emerging countries, would help the Arab countries to gain greater influence in the international decision-making centres.

The almost perfect complementarities between Europe and Arab countries were an aspect especially emphasized by Felipe González. The Arab world and Europe are two complementary regions, destined to understand each other and to cooperate. In this sense, Europe needs to commit more to the Arab region and encourage a sustainable and lasting development in the long term. The former Moroccan Ambassador to Spain, Abdeslam Baraka, stressed the importance of “implementing the needed dynamics so that the peoples of the Mediterranean build up a new relationship based on mutual respect and on its projection towards the future”. The Arab countries, on their side, must improve their policies and their relationship with other international markets, in addition to Europe, with developing and emerging regions, such as China, India, Brazil or Turkey.

2. Oil: an international policy tool

Even though the decrease in oil prices was one of the main causes that generated the crisis in the Arab countries, in recent months the price of oil has gone back up until reaching once again $70 a barrel. Most of the forecasts consider that during 2010 the price of oil will continue to rise, which will contribute to allowing the exporting Arab countries to return to
a central position in the international sphere. This position should be used to develop an
active role in the definition of a more sustainable model and stable global development.
On the contrary, the recovery of prices should not be an excuse for disregarding and not
facing the main economic challenges in the region, and not working to reduce their
dependency on these products, as well as trying to mitigate the effects of climate change
and guarantee food security.
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