Iqtisadi
Middle East Economy

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Winners and Losers in the Middle East Economy

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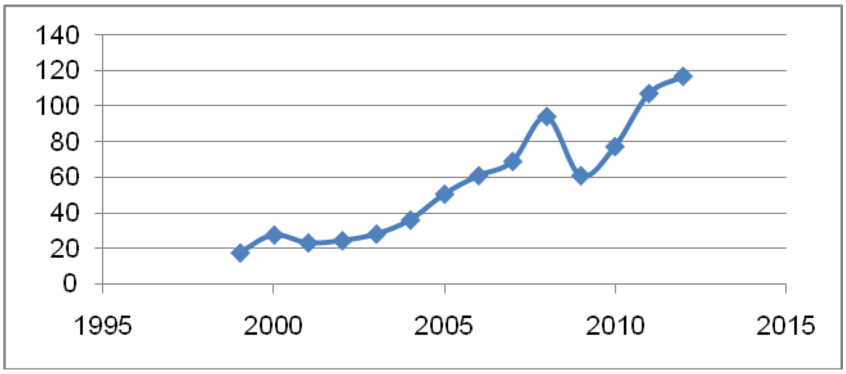
The Middle East economy has been dramatically affected by a number of recent developments within the region and in the international economy. The first development is the rise in oil prices, which has resulted in huge increases in the revenues of oil producers. (See Charts 1 and 2.)

Chart 1

The OPEC Basket Price, 1999-2012 ($/barrel)

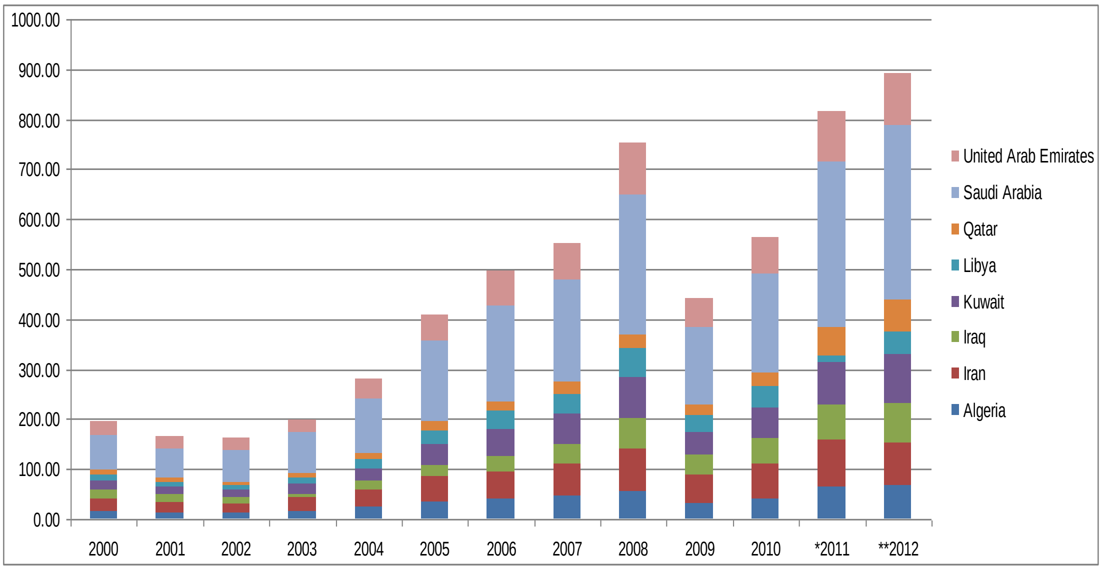


The main cause of currently higher oil prices has been disruptions in supply rather than demand factors. The oil market has lost more than one million barrels a day (mb/d) of supply in recent months. Up to 500,000 barrels a day (b/d) of Iranian oil is off the market due to the effects of European sanctions and payment disputes with China and India. Tensions in South Sudan and technical problems in the North Sea, among other factors, have reduced supply by another 700,000 b/d. Overall OPEC production has, however, held up. Between 2010 and the first quarter of 2012, OPEC output rose by 1.85 mb/d, or 6.3 percent. Saudi Arabia accounted for the bulk of this with a rise of 1.5 mb/d (18.4 percent); output in Iraq, Kuwait, and the UAE also rose significantly while that in Iran fell by 318,000 b/d (-8.5 percent). The increase in OPEC production, however, did not mean that exports rose by the same amount or proportion, because an increasing amount of oil is being used at home by OPEC producers, especially by those in the Middle East. Iran is the only OPEC member to have cut energy subsidies that stimulate consumption. Finally, tension resulting from Iran's nuclear activities is affecting the region, further pushing up oil prices and increasing risk premiums. Ironically, higher oil prices are helping Iran at a time when its economy is being increasingly affected by sanctions.

The World Bank expects that economic growth in the Middle East oil-exporting countries will be 5.4 percent in 2012 compared to 3.4 percent in 2011. This figure is influenced both by the sharp recovery in Libyan oil production and the decline in Iranian output. Growth in the Gulf Cooperation Council's member states reached eight percent in 2011. In contrast, the economies of oil importers in the region are expected to grow at only about 2.7 percent compared with 2.5 percent in 2011.

Chart 2

Middle East Oil Revenues ($ millions)



Oil exporters are now running balance of payments current accounts surpluses estimated by the International Monetary Fund (IMF) at $740 billion. Some 60 percent of this is accounted for by Middle East oil producers. These surpluses, which are rising, should be compared with China's—$250 billion—which is falling. The cumulative surplus of the oil producers is estimated at $4 trillion, twice that of China, while official reserves exceed $1 trillion. Many funds are invested overseas and cannot be identified in official reserve figures and, as a result, they have received much less attention than those of China.

The international recession has reduced the growth of demand and thus purchases from and investments in the Middle East and North Africa (MENA). The depth of the recession in Europe has intensified this effect because of the importance of this market to North African states. Exports to Europe account for approximately 20 percent of total exports of goods, or about seven percent of gross domestic product (GDP). This is a higher share than in Asia, Latin America, Sub-Saharan Africa, or the United States. Europe is also an important source of tourist revenues, foreign investment, and workers' remittances for the region. Middle East tourism saw a healthy increase between 2007 and 2010, but then fell by about 20 percent, largely as a result of the Arab Spring. This has badly affected not only the Tunisian economy, but has also affected the Egyptian, Moroccan and Algerian economies.

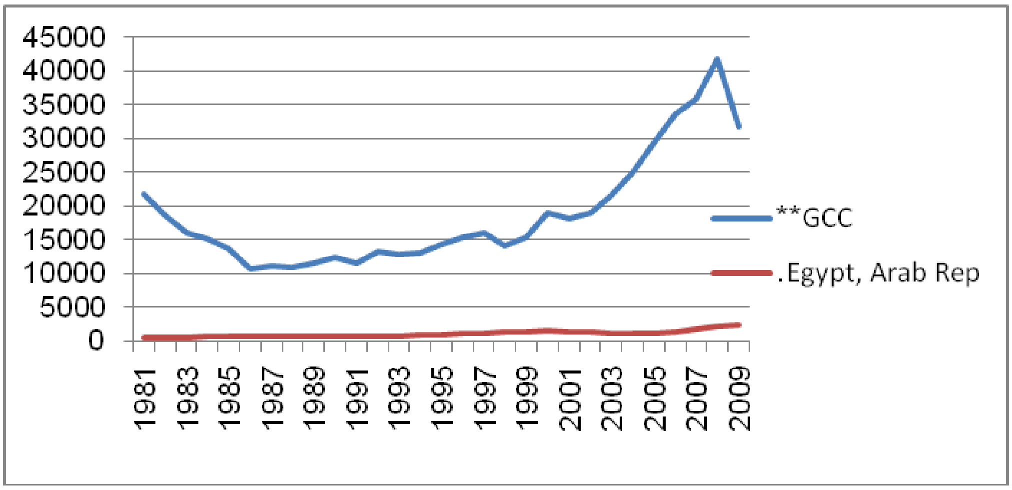
The decline in workers' remittances as a share of national income has been a long-term process, reflecting the growth of the Arab labor exporting economies and greater use of non-Arab labor in the Gulf. Foreign investment has become negative, with funds flowing out of the region in recent years. The Arab Spring has accelerated this process.

One of the effects of the rise of oil prices has been an increase in the cost of food. The links between crude oil and agricultural markets have considerably strengthened since 2005, and the pass-through effect of rising crude oil prices on agricultural prices has intensified. While the increase in oil prices was not the only reason for rising food prices, it was one of the causes and it was thus one of the key factors helping to divide the Middle East into two groups: winners and losers.

The gap between the winners and losers is illustrated in Chart 3. This shows the gap in GDP per capita between the GCC and Egypt. Between 2000 and 2005, the gap averaged about $17,000-20,000. Since then it has increased to about $35,000. It should be noted that GDP per capita is estimated to have increased as a result of the increase in oil prices and so the gap widened further. This trend is representative of what has happened in the region as a whole: the intensification of the division into rich and poor.

Chart 3

GDP/capita in the GCC and Egypt, 1981-2009 ($)



**GCC= Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, UAE
(Kuwait omitted 1992-1994)

The gap is not only the result of the rich getting richer, but also of the poor becoming poorer. One of the main reasons for this has been the rise in food prices.

According to the World Bank, global food prices increased by eight percent from December 2011 to March 2012 due to higher oil prices, adverse weather conditions, and Asia's strong demand for food imports. Rising food prices were a key trigger for the mass demonstrations of the Arab Spring. Arab governments have responded by increasing subsidies, which has worsened their fiscal position. This policy also runs contrary to those advocated by the IMF and the World Bank, which are significant potential sources of finance for the oil importers in the region.

The Arab Spring and its aftermath have affected the level of economic activity in all the countries that have experienced regime change or conflict as well as in some of those that have not. This has also intensified the division between rich and poor. The most dramatic examples are Egypt, for which there is data on the economic downturn, and Syria and Yemen, both which have been affected by internal conflict, but for which there are only guesstimates of the damage to the economy.

Egypt's economy has suffered a loss of foreign currency reserves; the withdrawal of foreign investment; capital flight resulting from Egyptians taking funds out of the country; loss of tourism revenues; and falls in industrial output because of strikes, demonstrations and disruptions. In Egypt and Tunisia, economic growth has ground to a halt; in Syria and probably in Yemen, it has declined as a result of conflict. Based on the recovery of its oil production, Libya is forecast to experience an upswing, but that assumes that conflict within the country does not escalate.

The consequences include larger budget deficits, weaker balance of payments and a slowdown of economic growth, probably including falls in GDP. This is very worrying because the region's population continues to increase. In Egypt, the population is growing by about 1.8 percent a year (about 1.4 million); if GDP does not go up by the same amount, then income per capita falls. In fact, the situation is even more serious than this because Egypt, like all Arab countries, has a high—and rising—rate of unemployment and is experiencing a rapid increase in the working age population. Huge numbers of young people are entering the labor market looking for work. In recent years, under Mubarak, the economy grew by an annual average rate of five percent; this resulted in gradual employment growth. Now that the economy has stopped growing, even this modest improvement in the labor market has ceased. The employment challenge for the new government in Egypt and in other Arab countries is huge. In Egypt an estimated 1.5 million young people reaching work age are trying to enter the labor force each year. Unemployment rate reached 12.4 percent in the last quarter of 2011 (the latest period for which figures have been issued) compared with 8.9 percent in the last quarter of 2010. Egypt's official statistics body, Central Agency for Public Mobilization and Statistics (CAPMAS), reported that in mid-2011, unemployment among youth aged 18-29 reached 20.4 percent. The rate of male unemployment reached 11.5 percent and that of females 46.4 percent, while unemployment among males who have university degrees reached 26.8 percent and among females 55.1 percent. Moreover, the definition of unemployment excludes many who work part-time; for this and other reasons, the true figure for overall youth unemployment is likely to be twice as high or more.

In Iran, the annual increase in the number of youth reaching working age and trying to join the labor force is 1.4 million. In each of Algeria, Iraq, Morocco, Saudi Arabia and Syria, the average is close to 600,000. As a result, the Arab states and Iran need to generate 6.6 million jobs a year *just to prevent unemployment from increasing*.

The gaps between income levels in richer and poorer Arab states have increased. At the same time, the opportunities for workers from poorer states to work in richer ones have been limited. Europe is in recession and has less need for immigrant workers (at least in the short run); Libya's internal conflict led tens of thousands of Egyptians and Tunisians to flee home; and the oil rich states in the Gulf have, for years, been recruiting workers from South and South East Asia who are considered less of a threat to internal security than Arab workers. Oil importing countries have external and internal financing needs estimated at $90 billion in 2012 and $100 billion in 2013. Incoming Islamic regimes have not formulated programs to cope with this level of financial and economic difficulty. The oil exporters in the region could help them with ease—but will they want to, in view of the political difficulties between, for example, Saudi Arabia and Egypt (not to mention those between Saudi Arabia and Syria)? The precedents are not encouraging: even when relations were closer, aid was not great. The other alternative is to ask for assistance from international organizations such as the IMF and World Bank. Egypt, for political reasons, has been balking for months at this. The policy options facing incoming governments in the coming months are unenviable.

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