Iqtisadi
Middle East Economy

Editors: Paul Rivlin and Yitzhak Gal   Assistant Editors: Brandon Friedman and Gal Buyanover

Vol. 4, No. 1   January 23, 2014

$800 Billion and Rising: The Costs of the Arab Winter

Paul Rivlin

The Arab Spring, which turned into the Arab Winter, has had huge costs. One estimate puts the loss at $800 billion, but the real costs are likely to be higher and enduring.

The most dramatic example is the destruction of the Syrian economy. The conflict in Syria is now in its fourth year, 130,000 people have been killed, tens of thousands have been wounded and the humanitarian crisis in the region has deepened. Up to half of the Syrian population is internally displaced and two million refugees are straining capacities of neighboring countries. Some 16 million people in Syria, Egypt, Iraq, Jordan, Lebanon, and Turkey are expected to require humanitarian assistance in 2014. While this has become the largest humanitarian disaster that the Middle East has experienced in modern times, it is not the only one plaguing the region.

In Iraq, in the first nine months of 2013, 5,740 people were killed and 13,801 were injured, according to the U.N. humanitarian mission there. Fighting intensified at the end of last year and so the annual figure has exceeded 8,000. Furthermore, according to government statistics, an estimated 1.3 million people have been displaced in Iraq.

In Yemen, one of the poorest countries in the Middle East, the collapse of basic services in 2011-2012 and endemic food insecurity have destroyed the livelihoods of large numbers of people. These factors together with displacement have combined to create a major humanitarian emergency. Up to 10.5 million people suffer food insecurity, over a million children are experiencing malnutrition, about half the population has no access to adequate water sources or sanitation facilities while 8.6 million have insufficient access to healthcare. The conflict has led to a rise in civilian deaths and injuries, with the number of those wounded increasing by 60 percent in 2013. Deaths and injuries among women and children rose by almost 40 percent. In addition there are 240,000 refugees in the country, mostly from Somalia. Some 14.7

million people are therefore in need of assistance, which is more than half the population.

Libya, Lebanon, and Bahrain are also suffering from lower levels of conflict in which thousands have been killed, wounded, or made homeless. This is the background to a deteriorating economic situation that prevails in much of the region.

In November 2013, the International Monetary Fund (IMF) issued a grave warning about the economic and socio-economic future of the region. Widespread uncertainties resulting from political transitions and intensifying social tensions have prevented economic recovery; in this atmosphere, limited progress has been made so far in building consensus for much-needed fiscal and structural reforms. Growth is expected to remain significantly below the levels necessary to reduce high unemployment and improve living standards in the near and medium terms. In 2013, the regional growth rate fell to an estimated 2.2 percent. Fiscal and balance of payments deficits have widened in oil importing countries. Domestic, regional, and geopolitical tensions mean that the oil importers in the Middle East are increasingly susceptible to the risks of increasing food and fuel import prices. These conditions make it difficult to focus on policy reforms, although they are urgently needed to ensure macroeconomic stability, create jobs, and improve living standards. There is therefore a danger that oil-importing countries in the region will be drawn into a vicious cycle of economic stagnation and continued socioeconomic strife.

The Hong Kong and Shanghai Banking Corporation (HSBC) has counted the cost of what has happened and what is expected in 2014. It estimated that those countries most affected by the Arab Winter – Egypt, Tunisia, Libya, Syria, Jordan, Lebanon, and Bahrain – will have lost $800 billion of economic output between 2011 and the end of 2014, equal to 35 percent of their GDP. During that period their combined population will have risen by six million to 136 million. As a result, per capita income will be nearly 68 percent lower than they would have been without the effects of the Arab Spring/Winter. This is equal to at least $6,000 per person. If Yemen is added to this list, then a further $10 billion or more of GDP was lost and an additional 1.75 million people were added to the population between 2011 and 2014.

According to HSBC, the outlook continues to be bleak in Egypt, where unemployment has increased and public finances are in disarray. Financial aid from GCC countries has helped – the Gulf monarchies pledged $12 billion after former president Mohammed Morsi was ousted in July, but aid means that there is a risk that the breathing space provided might slow the pace of fiscal reforms.

Economic recovery has not taken hold in Tunisia, although the approval of a new constitution may indicate a more consensual politics than prevails elsewhere. Libya is experiencing the breakdown of law and order and is in bad shape both politically and economically as it struggles to revive oil production. The economic effects of Syria's civil war are spilling over into Lebanon and Jordan.

As a result of these pressures, the public finances of the oil importing countries region have deteriorated drastically since 2010. Slower economic growth and the disruption of tax collection mechanisms have reduced revenues, while increased debt-servicing costs and rising spending on subsidies and wages have driven expenditure upward. As a result, budget deficits in Egypt, Tunisia, Jordan, Lebanon, and Bahrain have swollen from just over $10 billion in 2005 to $22 billion in 2009 and an estimated $50 billion in 2013.

In the oil-rich Gulf Cooperation Council (GCC) countries (apart from Bahrain), the story is different. In the decade to 2012 oil export revenues rose more than six-fold from $120 billion to $780 billion. This huge increase has given those countries – Saudi Arabia, the UAE, Kuwait, and Qatar – a great deal of room for maneuver. Their response to the Arab Spring was to increase public spending, which boosted demand and output. HSBC estimates that public spending in the GCC reached $500 billion in 2013 and that there was overall budget surplus of 9 percent of GDP. Higher government spending has, however, prolonged dependence on the public sector and slowed down reforms designed to stimulate private-sector growth. As a result the increase in spending has exacerbating structural weaknesses: dependence on oil earnings has never been higher and the role of the state rarely more dominant. Rapid increases in current spending have created long-term fiscal obligations that promise only limited returns.

Alongside these economic developments are worrying demographic trends. In 2010, the population of the Arab World was 334 million. According to the U.N.'s medium variant forecast (made in 2012), in 2020 it will reach 403 million, an increase of 20 percent. (The U.N.'s "medium-variant" projection assumes a substantial reduction in the fertility levels of intermediate- and high-fertility countries in the coming years. For these countries, it is assumed that the pace of future fertility decline will be similar to that observed for other countries, mostly in Asia and Latin America, when they underwent similar declines during the second half of the twentieth century).

By 2050, the population of the Arab World is forecast to reach 563 million an increase of 68 percent over forty years, the result of the fastest demographic growth rate in the world. In absolute terms, the population will rise by 229 million in 40 years. Perhaps the most critical economic variable influencing political stability is the rate of unemployment. This is where demographics and economics interact.

In 2004, the World Bank issued a report entitled "Unlocking the Employment Potential in the Middle East and North Africa: Toward a New Social Contract." The challenge was summarized as follows:

> Over the next two decades, the Middle East and North Africa (MENA) region faces an unprecedented challenge. In 2000, the labor forces of the region totaled some 104 million workers, a figure expected to reach 146 million by 2010 and 185 million by 2020. Given this expansion, the economies of the region will need to create some 80 million new jobs in the next two decades. With unemployment in 2004 at about 15 percent, the more ambitious goal of absorbing unemployed workers in addition to new entrants suggests that 100 million jobs will need to be created by 2020, a doubling of the current level of employment in the first two decades of the 21st century.

What has happened since 2004? The International Labor Office has provided some of the answers. Economies in the region suffer from a specialization in sectors that generate low employment growth, such as petroleum refining. They lack structural transformation towards high-productive industries such as high-tech. Over the past decade, economic growth was two per cent per year. This was too low to generate sufficient employment opportunities for the fast growing population and many workers only found jobs in the informal sector where productivity and therefore incomes were very low. As a result, unemployment in the region was the highest in the world. In contrast to many other regions the worsening of labor market conditions in recent years was mainly a result of the political instability; the global economic crisis did not contribute significantly to labor market developments.

Furthermore, smaller, oil-exporting countries in the GCC redistribute the wealth generated from their main export goods (oil, gas, and petrochemicals) through the generous provision of public employment to nationals. This further pushes up wages for natives and limits the capacity of these countries to develop a sustainable business sector outside a few highly productive sectors such as oil, gas, and petrochemicals.

Besides a lack of structural transformation, many countries in the region also suffer from a challenging business climate characterized by poor and limited infrastructure, such as costly, unreliable, and inefficient supplies of electricity and water. This further dampens and limits investment opportunities and growth. As a result, the demographic change characterized by a growing young population has become a burden on the economy rather than an asset.

Table 1 shows that youth unemployment in North African and Middle Eastern countries remains the highest in the world. Even more worrying is the forecast that it will remain very high or even increase in the period to 2018.

Table 1
Youth Unemployment in the Arab World, 2010-2018

	North Africa, percent	Middle East, percent	World, percent
2010	23.7	26.0	12.9
2011	28.1	26.0	12.7
2012	29.2	26.0	12.9
2013	29.4	27.0	13.1
2014	29.5	27.9	13.2
2018	29.5	28.6	13.1

Source: Global Employment Trends 2014, International Labor Office

Youth unemployment in the Middle East and North Africa is more than twice as high as the global average. For example, unemployment among young people has reached approximately 19 percent in Morocco, more than 22 percent in Algeria and Lebanon, 25 percent in Egypt, closer to 30 percent in Jordan and Saudi Arabia, approximately 40 percent in the Occupied Palestinian Territories, and over 42 percent in Tunisia. The youth labor force is expected to decline over the coming years, but this will provide only a short-term relief: as of 2020, long-term demographic projections indicate a return of stronger growth of the youth population than the total population (known as the demographic dividend) making it essential that the region develops a labor market that can utilize the new entrants.

Arab countries lack the political consensus that is needed to implement economic reforms, although Tunisia might be moving in the right direction. Given the demographic trends the socio-economic pressures are likely to increase and that could further threaten political stability.