

# Economic Crisis and Investments in the Arab Region

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The financial crisis started in the United States in the sub-prime market in the summer of 2007. It reached the real economy in the second half of 2008, resulting in a dramatic collapse of production, numerous bankruptcies and job losses in the millions. It then spread rapidly to Europe, Asia and the rest of the world. The crisis is the most devastating economic event since the Wall Street crash of 24 October 1929, the so-called "Black Thursday," and the ensuing Great Depression of 1929-1939. No region has been able to shield itself from the crisis, and the Euro-Mediterranean and Arab regions are no exception.

This paper will focus on the Arab region, including both its Mediterranean and non-Mediterranean parts. The Arab Mediterranean countries will receive most of the attention. The development of that part of the world is indeed essential to world peace, stability and prosperity throughout the Mediterranean, as well as to the security of Europe. This was amply recognised first in the Barcelona Process, or Euro-Mediterranean Partnership, then in the Union for the Mediterranean project. The inclusion of the remaining part of the Arab world in the analysis is motivated by what some have called "the beginning of an affair" between the Gulf and the Mediterranean. Gulf Cooperation Council (GCC) investors have become major players in the Mediterranean, sometimes surpassing their European counterparts. All Arab countries are in fact concerned with the Euro-Mediterranean project, not only because of their common historical, cultural and religious heritage, but also because of their close economic ties in terms of capital investment and worker remittances and because the EU is the Arab world's largest external trading partner.

The Arab world is a vast region spanning an area of about 13.9 million km<sup>2</sup> and home to a population of around 334 million in 2009. It comprises 22 countries, including Somalia and the Comoros. Arab countries spread over the shores of the Mediterranean, East and West Africa, and the Middle East. Total GDP was estimated at about \$1.7 trillion in 2008. It is unevenly distributed among the various countries of the region, some of which, such as Saudi Arabia, are large oil producers, while others, such as Egypt and Tunisia, are fairly diversified and industrialised countries, and still others, such as Mauritania and Somalia, are very poor and underdeveloped economies. The Arab world is traditionally subdivided into three main sub-regions: the Maghreb, which includes Algeria, Libya, Mauritania, Morocco and Tunisia; the Mashreq, which comprises Egypt, Iraq, Jordan, Lebanon, Palestine and Syria; and the Gulf, which consists of Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates (UAE). An additional non-homogeneous sub-region includes Djibouti, Somalia, Sudan, the Comoros and Yemen. The Gulf sub-region is the richest, with an average per capita GDP of \$27,000, compared to an overall Arab average of about \$5,700. It contributed close to \$850 billion to Arab GDP in 2008, or about 53% of the total. Gulf countries are also the most involved in world financial markets, mainly through their sovereign funds. It was, thus, the first region to feel the effects of the world financial and economic crisis, whose impact differed from one country to the other. At first, the Arab world was thought to be comparatively insulated from the adverse effects of the global financial and economic crisis. In fact, the crisis was rapidly transmitted to most Arab countries through transmission mechanisms that differed from one country to the next. A review of the effects of the crisis, the policy response of the various Arab countries and the lessons learnt will provide a realistic context for the evaluation of future Arab investment opportunities.

**TABLE 5** Integration of the Arab Region in the World Economy

Region	Oil (% of merchandise exports)	Manufactures (% of merchandise exports)	Tourism (% of total exports)	Workers' Remittances (% of GDP)	Openness
East Asia & Pacific	7.5	79.7	6.0	1.4	77.1
Latin America & Caribbean	17.5	55.4	6.4	1.7	44.6
Sub-Saharan Africa	37.0	31.9	8.3	1.7	65.8
Arab Region	56.3	24.5	14.1	7.0	87.9

Source: United Nations University – World Institute for Development Economics Research (UNU-WIDER), June 2009.

### Crisis in the Arab Region: Transient Hardship and Stern Warning

Prior to the crisis and following what have come to be known as the “lost decades” of the 1980s and 1990s, the Arab region was enjoying an economic revival characterised by an acceleration of growth, a reduction in unemployment and an attenuation of vulnerability and poverty. Since 2003, most countries in the region, particularly GCC countries, have witnessed fast growth. Between 2003 and 2008, annual GDP growth in real terms reached 4.9% for the region as a whole, 12% in Qatar, 8% in Saudi Arabia and the UAE, 7.5% in Kuwait, 6.2% in Jordan, 5.5% in Egypt, 5.4% in Tunisia and 5% in Morocco. In 2008, the economic fortunes of the region, particularly of oil producers, changed rapidly. The price of oil, natural gas, and other commodities rose rapidly during the first half of the year, leading to an exceptional accumulation of financial resources and an acceleration of investment and growth. But these prices collapsed in July 2008 as a consequence of the financial crisis and growing fear of a looming depression. As a result, Arab oil producers experienced a substantial fall in their export earnings and a serious deterioration of their balance of payments. Between July and December, the price of oil fell by 70%, from a peak of \$150 per barrel to under \$40 per barrel. In September 2008, following the collapse of Lehman Brothers and the turmoil on Wall Street, stock markets all over the world fell, including those in the Gulf countries and several other Arab countries. In the twelve-month period ending in February 2009, the Saudi stock market fell by 49%, Dubai’s by 72%, and Egypt’s by 61%. The loss of financial resources by GCC countries impacted the entire Arab world through reduced foreign direct investment (FDI) flows and falls in workers’ remittances. These reductions exacerbated the direct impact of the global financial crisis on the

Arab Mediterranean countries, in addition to leading to reduced exports and tourist inflows.

In fact, the Arab region’s high integration in the world economy, as illustrated in Table 5, makes it extremely vulnerable to external disturbances.

The degree of dependence on the above factors varies considerably among Arab countries, but all countries felt their effects, either directly in the form of depressed activity and job losses or indirectly through a decline of major investment resources.

GCC countries greatly suffered from the fall in oil prices and the reduction in their exports. Their oil revenues were cut by two-thirds between 2007 and 2008. Stock markets in the region experienced a major correction with indices losing an average of 50%. The Arab Monetary Fund index for 2008 GCC stock markets dropped to 166.2 points compared to 328.7 points in 2007, while the capitalisation value of the markets dropped by about one-third, from \$1,137 billion to \$769 billion. The worst performance was recorded in stock markets that had a high proportion of banks and real estate companies in their indices, such as Dubai’s and Abu Dhabi’s. This notwithstanding, most GCC banks performed comparatively well during the crisis, because they were well capitalised and had limited exposure to sophisticated financial products. Nonetheless, a small number of banks and investment firms suffered from the crisis and endured heavy losses. As to the real estate sector, the combined effect of the lower demand for oil, higher costs of financing and a real estate crisis reduced economic growth in 2009 to 3.5% in the United Arab Emirates, 1.2% in Kuwait and 1% in Saudi Arabia. Growth likewise slowed down in the remaining GCC countries, from 13.4% in 2008 to 9.5% in 2009. For the GCC region as a whole, growth was negative in 2009 with a rate of -0.47%. However, the prospects of all six countries are expected to improve in 2010 and the following years.<sup>1</sup> The fi-

<sup>1</sup> ECONOMIST INTELLIGENCE UNIT, *The GCC in 2020 – Outlook for the Gulf and the Global Economy*, March 2009.

**TABLE 6 Economic Growth in Arab Countries**

Country	Annual Rate of Growth				
	2006	2007	2008	2009	2010*
Algeria	1.8	3.1	2.8	2.6	4.6
Bahrain	6.7	8.4	6.3	2.9	3.7
Djibouti	4.8	5.2	4.0	6.4	5.8
Egypt	6.8	7.1	7.2	4.7	5.4
Iraq	6.2	1.5	7.8	5.0	6.2
Jordan	8.0	6.6	5.6	3.1	3.0
Kuwait	5.2	4.4	8.5	-1.7	3.7
Lebanon	0.6	7.5	8.0	5.1	5.8
Libya	5.9	5.6	6.0	4.0	4.6
Mauritania	11.7	1.9	3.5	1.5	3.0
Morocco	7.8	3.2	6.2	4.0	3.8
Oman	7.5	5.8	6.4	2.7	3.9
Qatar	12.2	17.3	13.4	9.5	23.5
Saudi Arabia	3.2	3.4	4.2	-1.0	3.2
Sudan	11.3	10.2	6.6	3.8	4.7
Syria	5.2	6.3	5.1	1.9	4.1
Tunisia	5.7	6.3	4.6	1.2	2.7
United Arab Emirates	14.9	6.0	7.4	-3.5	3.5
Yemen	3.2	3.5	3.2	3.8	5.0
Arab World	6.5	5.4	6.2	1.5	5.2

Source: Economist Intelligence Unit, *Country Reports*, December 2009.

\* The figures for 2010 are forecasts.

financial resources they accumulated during the oil price hike in 2007-2008 were large enough to ensure a fast recovery, and, with good oil prospects, they will sustain growth.

### The economic slowdown in developed countries negatively affected the exports of most Arab countries, leading to reduced numbers of tourists and diminished foreign direct investment

The financial sector in the other Arab countries was less exposed to the global financial turmoil than that of GCC countries. It is comparatively isolated and tightly controlled. The economic slowdown in developed countries negatively affected the exports of most Arab countries, leading to reduced numbers of tourists and diminished foreign direct investment. Hence, economic growth in the region in 2009 was impacted as shown in Table 6.

In some Arab countries, exports, tourism and capital inflows play a major role in the economy. Tourism provides 450,000 jobs in Tunisia, 1.5 million

in Morocco, 3 million in Egypt, 420,000 in Jordan and 900,000 in Syria. Total remittance inflows reach \$27 billion for Egypt, Lebanon, Jordan, Tunisia and Morocco taken together and account for about 15% of GDP in Jordan, which is the most dependent country on expatriate remittances. These countries endured a severe slowdown in economic growth as a consequence of the global crisis. Morocco was able to moderate the impact of the global economic crisis, thanks to an exceptionally good harvest in 2009. Growth in Arab oil exporters other than GCC countries, such as Algeria, Libya, Sudan and Yemen, was slowed down mainly because of lower oil and gas prices and tighter credit conditions.

However, all in all, the impact of the global crisis on the Arab world looks moderate compared to other regions, where growth was negative, jobs were lost by the millions and household savings lost most of their value. On the other hand, the Arab region is the region that suffers most from chronic unemployment. It will need to create no fewer than 70 million new jobs over the next two decades, many more than it created over the past two decades. Thus, the region cannot afford even the smallest slowdown in economic growth.

Arab governments adopted different approaches to mitigate the adverse effects of the global crisis.

GCC countries, which were the most adversely affected by the loss of value of overseas assets,<sup>2</sup> the shortage of financial capital in the banking sector and the cancellation of numerous investment projects, reacted swiftly and strongly. They relaxed monetary policies, opted for expansionary fiscal policies at the national level and agreed to coordinate these policies at the regional level. They also injected liquidity into their financial markets to boost investor confidence.

## Cooperation and consultation at the regional level are essential for genuine economic growth and durable financial stability. No country is rich or independent enough to act alone

The reaction of other Arab countries to the crisis was slower, much less coherent and uncoordinated, with each country reacting to its specific economic and financial conditions and constrained by institutional, political and social considerations. Egypt, for example, focused on helping the building and construction sector and on maintaining government investment in infrastructure. Morocco targeted the tourism, textile, leather and automobile industries to maintain their level of activity. Tunisia focused on supporting SMEs and increasing their competitiveness to mitigate the negative impact of the global crisis on its main export sectors. Jordan, Lebanon, Syria and Yemen, with their limited financial resources, large budget deficits, heavy dependence on foreign aid and significant exposure to GCC economies, had less leeway to define appropriate anti-crisis policies. Serious damage to national economies was undoubtedly avoided in most countries, but threats to financial stability, economic growth and job creation still loom. Policy reactions in most countries have been mainly short-term, but a sustainable solution for the region's vulnerability to external shocks will require a long-term vision and resolute strategies.

The countries of the region learned some important lessons from the global crisis. The first is that no

country can ever be shielded from other countries' problems. Even though the banking and financial systems of most Arab countries are comparatively insulated by their smallness and tight government controls, major economic disturbances can impact all countries. In a global world, there is no point in trying to increase isolation. On the contrary, Arab countries should seek greater openness and integration into the world economy and financial systems. However, it will remain a national responsibility to devise protective mechanisms to avoid the negative effects of external crises.

The second lesson is that weathering crises can never be a substitute to audacious reform programmes and resolute development strategies. The countries of the region have resisted the tide, kept economic growth positive and avoided major bankruptcies and breakdowns. However, further trouble may still be ahead. Rich Arab countries have utilised a large chunk of their financial reserves to ride out the global crisis. But they must still face the employment challenge and increased global competition with reduced resources. Increased efficiency is the only way out, but that requires greater transparency, accountability and good governance in both the public and private sectors.

Cooperation and consultation at the regional level are essential for genuine economic growth and durable financial stability. This is the third lesson of the global crisis. No country is rich or independent enough to act alone. Even the world's largest economies cannot handle today's problems on their own. It is in the Arab countries' interest to act in concert with their neighbours and partners to mitigate the effects of global crises.

### Investment Prospects: Challenges and Opportunities

The Arab region is often perceived as being locked into stagnation, conservatism and conflicts. That is simply not true. Even before demonstrating their resilience to violent external shocks and their readiness to implement the right corrective policies, Arab countries had proved over the past half century that they are open to change, willing to adopt new development strategies and capable

<sup>2</sup> The value of the government overseas assets of GCC countries has been estimated at about \$1.8 trillion. Analysts estimate that about 40% of that value, i.e. more than \$700 billion, may have been lost because of the crisis.

of accelerating economic growth and social progress. In spite of numerous external aggressions, harsh weather conditions and tense internal social relations, the economic performance of most Arab countries has been reasonable over the long run, as illustrated in Table 7.

Modern transportation, communication, electricity, water and sewage infrastructure has been built over the last three decades. Great progress has been made in education and health in most countries and poverty has markedly regressed. Numerous reforms have been implemented in the banking and financial sectors and tax reforms have been introduced. The most important result of these reforms is the improvement of the business environment. Table 8 reflects that in terms of world ranking with respect to various indicators of doing business.

Arab countries have changed considerably during the past few decades. They are now more capable of managing crises, setting the right priorities, implementing comprehensive reforms and providing better institutional environments for stimulating investment and accelerating growth. That is fortunate, because the region is currently facing huge social and environmental challenges and investment needs. It needs to mobilise all available energy and resources to respond to the urgent demands of a young population

Country	1960-1985	1986-2002	2003-2008	1960-2008
Algeria	5.3	1.7	4.4	3.9
Bahrain	-1.3	5.3	6.9	4.3
Djibouti	-	-1.1	4.3	0.6
Egypt	6.2	4.2	5.5	5.4
Iraq	-	5.1	4.3	4.8
Jordan	10.6	3.5	6.2	6.2
Kuwait	1.0	6.8	7.5	3.8
Lebanon	-	4.9	3.8	4.6
Libya	-	-0.3	4.4	5.8
Mauritania	4.3	2.7	5.7	3.9
Morocco	4.8	3.5	5.0	4.3
Oman	14.2	4.3	5.7	9.6
Qatar	-	0.9	12.1	5.4
Saudi Arabia	7.8	2.7	5.1	5.2
Sudan	2.4	5.4	8.4	4.2
Syria	7.1	4.1	4.8	5.7
Tunisia	6.0	4.1	5.4	5.2
United Arab Emirates	7.5	4.1	8.7	6.0
Palestine	-	1.5	4.5	2.7
Yemen	-	5.4	3.7	4.8
Arab World	4.6	2.7	5.3	4.0

Source: World Bank and Arab Fund databases, December 2009.

that is increasing at unprecedented rates. It also needs to stop further degrading an already harsh environment, as water resources are dwindling, arable

TABLE 8 World Ranking of Arab Countries

Country	Ease of Doing Business	Starting a Business	Dealing with Construction Permits	Employing Workers	Registering Property	Getting Credit	Protecting Investors	Paying Taxes	Trading Across Borders	Enforcing Contracts	Closing a Business
Saudi Arabia	13	13	33	73	1	61	16	7	23	140	60
Bahrain	20	63	14	13	22	87	57	13	32	117	26
United Arab Emirates	33	44	27	50	7	71	119	4	5	134	143
Qatar	39	68	28	68	55	135	93	2	41	95	33
Kuwait	61	137	81	24	89	87	27	11	109	113	69
Oman	65	62	130	21	20	127	93	8	123	106	66
Tunisia	69	47	107	108	59	87	73	118	40	77	34
Yemen	99	53	50	74	50	150	132	148	120	35	89
Jordan	100	125	92	51	106	127	119	26	71	124	96
Egypt	106	24	156	120	87	71	73	140	29	148	132
Lebanon	108	108	125	66	111	87	93	34	95	121	124
Morocco	128	76	99	176	123	87	165	125	72	108	67
Algeria	136	148	110	122	160	135	73	168	122	123	51
Palestine	139	176	157	135	73	167	41	28	92	111	183
Syria	143	133	132	91	82	181	119	105	118	176	87
Iraq	153	175	94	59	53	167	119	53	180	139	183
Sudan	154	118	139	153	37	135	154	94	142	146	183
Djibouti	163	177	102	151	140	177	178	65	34	161	135
Mauritania	166	149	154	125	74	150	147	175	163	83	150

Source: World Bank – International Finance Corporation, *Doing Business Database*.

land is receding, coastlines are being poisoned and marine resources are being depleted.

It should invest more in the modernisation process that started in the 1960s. First and foremost, the energy sector will offer exceptional investment opportunities over the next decade. Countries from the Arab peninsula alone will need \$20 billion a year to develop new oilfields, build refineries and generate electricity. The rest of the Arab world will probably need an equivalent amount of investment to develop its energy sector, and just Iraq may need as much as \$10 billion a year for its energy sector. This is a total of \$50 billion that Arab countries cannot finance out of their own resources.

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Amounts of a similar order of magnitude are needed for airports, ports, roads, railways and communication infrastructure. The GCC railway system alone will require about \$30 billion. It is planned to be operational in 2017. It is estimated that the region should invest about \$50 billion a year over the next decade

to improve and extend its road system. All these needs will offer investment opportunities for the private sector, both regionally and internationally.

However, oil producers, particularly GCC countries, are expected to continue to accumulate financial resources beyond what they can invest locally. A large share of these resources will probably go to advanced and emerging markets, but important amounts will also be attracted to the Arab Mediterranean region to finance infrastructure and other development projects there. That will be in the best interest of the Arab world, as it will enlarge domestic markets and attract greater FDI flows.

It will also be in the interest of Europe, as it suffers from waves of migrants in search of a better life. As more employment opportunities are created on the southern rim of the Mediterranean, opening markets, technology transfer, and the provision of training and education will create even more job opportunities and lead to greater stability and prosperity in the region as a whole.

Vital resources such as water, arable land and healthy marine resources are limited and are being rapidly depleted. This may be a prelude to coming catastrophes, unless economic development is accelerated and sound management promoted. The countries of the region may have made some notable progress on some of these fronts, but they should consolidate these gains and further improve public and corporate governance. They need enlightened government and social transformation. The Arab countries are capable of accelerating change if Mediterranean countries can renew their cooperation schemes. Arabs and Europeans can do much together to stabilise the region and make it a driving force for understanding, cooperation and progress.