

# The Financial Crisis's Impact on Employment in the Mediterranean Region: The Story of Two Coasts

## Zafiris Tzannatos

Adviser, World Bank (retired)  
Former Professor and Chair, Economics Department,  
American University of Beirut

The global financial and economic crisis triggered in high-income countries in September 2008 is having ripple effects across developing countries. However, one generalisation that can be made so far is that, on average, more advanced countries will feel the impact of the crisis more strongly than developing ones. The World Bank forecasts growth of 6% in developing countries in 2010 compared to only 2.2% in higher-income countries and 0.9% in the eurozone.

The differential impact of the crisis can also be seen in the simple comparison attempted below between the economies of the North and South Mediterranean. One reason for this is the *external* nature of the shock for developing countries and emerging markets: if a crisis is not created by internal problems such as unsustainable fiscal policies or poor governance (including of the financial sector), countries are in a better position to respond to it.

As the case of the EU is better known than that of the Arab members of the Euromed, this article focuses on the latter group, where, so far, no economy seems to have gone into recession (negative economic growth). Nevertheless, the indirect effects of the crisis may eventually hit the Arab economies if structural weaknesses remain.<sup>1</sup>

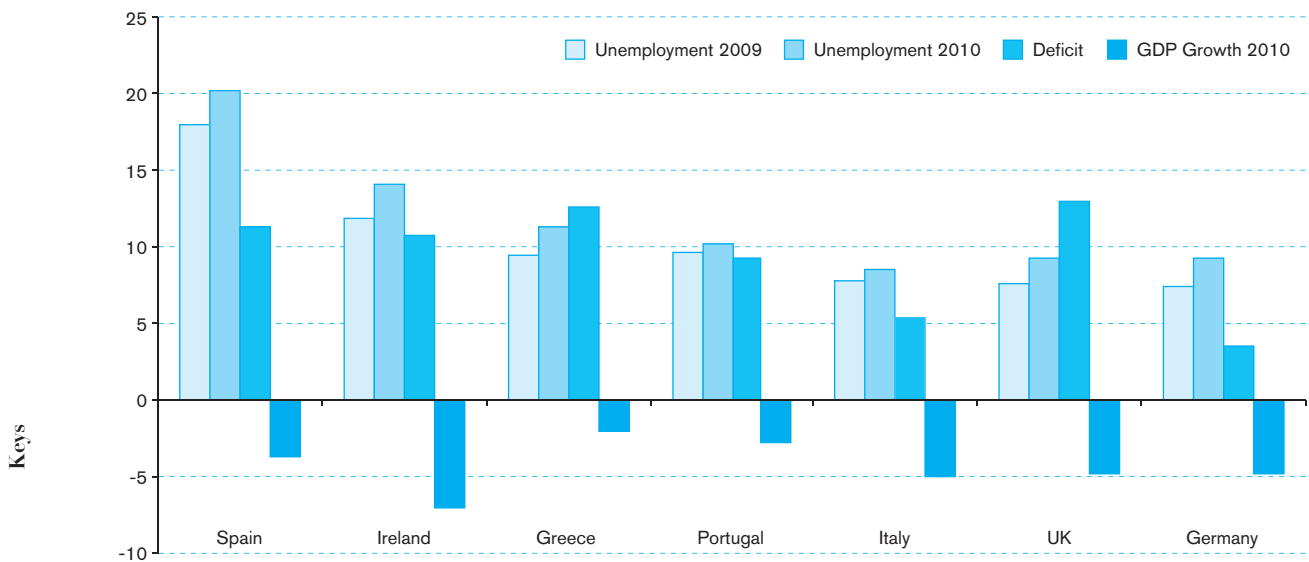
## The Story of the North Coast

Greece, Portugal, Spain and Italy are already showing signs of stress, with Greece at the centre of the turmoil. Though until October 2009 the Greek budget deficit was believed to be not much more than 6% of GDP, this figure was revised upward first to 12.6% and then to 13.6% as of April 2010, and it is speculated to be as high as 14.1%. Similar revisions have been made to the public debt estimate, initially believed to be 115% of GDP but now deemed to be as high as 122% and expected to keep rising until 2014. Greece managed to get a support package from the IMF and the EU in May 2010 consisting of €110 billion for the coming three years. In the meantime, Greek government bonds were downgraded to “junk” status (BBB) in April 2010, when the interest rate hit 11.3% for 10-year bonds and rose momentarily to almost 19% for 2-year bonds. These all-time record figures for a eurozone country were accompanied by a drop in the euro to \$1.2896, its lowest level in more than a year.

Greece's sudden fall seems to be being followed by what has been described as the “slow death” of Portugal. Portugal was downgraded by Standard & Poor's (S&P) in January 2010 and by Fitch in March, reaching A- status according to S&P in April 2010. Moody's is also indicating a negative outlook for Portugal. A Stability and Growth Program (SGP) was approved by the government in April 2010 but may not be sufficient to keep the debt from rising until at least 2012, when it is expected to reach 91% of GDP. Econom-

<sup>1</sup> As the style of the publication does not allow for footnotes and detailed referencing, readers are directed to Tzannatos (2009) for data sources and explanatory notes, especially with respect to country groupings (e.g., the Arab Euromed members versus the “Middle East and North Africa” (MENA) group).

CHART 1 Unemployment and GDP Growth, Selected EU Economies (%)



Source: Unemployment for 2009: OECD Harmonised Unemployment Rates and Levels (HURs); Unemployment projection for 2010: OECD Economic Outlook No. 86, November 2009; GDP Growth Rate and Labour Productivity: OECD statistics.

Keys  
Med.2010

34

ic growth is expected to turn positive at 0.5% in 2010 and gradually reach 1.7% in 2013 –not exactly a stellar rate. S&P also downgraded Spain's debt from AA+ to AA, expecting weak growth prospects after the collapse of a credit-fuelled housing and construction bubble. Chart 1 shows the impact of the crisis on unemployment in the Southern EU and comparator economies together with the current deficit rates and the expected (negative) economic growth rates for 2010.

In contrast, the Southern members of Euromed have technically avoided the recession, though growth rates have been reduced. Jordan's GDP growth remained positive at 2.8% in 2009, though this is a sharp decline from the average 7% attained between 2001 and 2007 and the 7.8% rate of 2008. Similarly, Tunisia's growth rate was 3.1% in 2009 compared to 4.5% in 2008, and on the latest count Syria's growth rate was 4% compared to 5.2% in 2008. In fact, practically no Arab Euromed economy is expected to grow at less than 3% in 2010.

### The Story of the South Coast

The impact of the crisis on the Arab economies was initially felt in the oil-producing Gulf Cooperation Council (GCC) countries. The United Arab Emirates (which include Dubai), Kuwait and Saudi Arabia were initially hit hardest through the effect on the financial and construction sectors. The impact on North African

and Middle Eastern countries was lower. Despite massive declines outside the GCC, for example in Jordan (-67% until August 2009) and Egypt (-45%), the financial sectors of the Arab Euromed economies do not seem to have been particularly adversely affected, as they are relatively isolated from the global financial system: Syria did not have a stock market until 2009, while the hit on Casablanca's Stock Exchange was only 25%.

While countries are trying to preserve the level of public spending and thus maintain aggregate demand, the reduced economic growth is bound to involve some budgetary cuts. There have been delays in the start or implementation of some projects and others have been abandoned. For example, Algeria is re-examining pending programs and will possibly delay some of them. Mauritania has already reduced capital expenditure on what is deemed to be non-essential spending. Jordan's ability to increase public spending is limited in view of high public debt and reduced foreign direct investment (FDI) and official aid. While oil-related investments are expected to be maintained in Libya, growth in public expenditure is expected to slow down sharply due to delayed project implementation.

However, the global crisis is expected to be slower in affecting the Arab Euromed economies compared to other regions, and its effects may be less severe. In fact, taken at face value, this is the case with respect to its impact on employment. Though the *number* of unemployed in North African and Middle Eastern

**TABLE 3 World Unemployment: Pre-Crisis and Latest Figures**

Unemployment Rate	2007	2010	Change	
			%	'000s
World	5.7	6.5	14	35,700
Developed Economies and the EU	5.7	8.9	56	16,600
Central & South Eastern Europe (non-EU) & CIS	8.3	10.1	22	3,500
Middle East	9.3	9.3	0	600
North Africa	10.1	10.6	5	900

Source: ILO (2010). (a) The figures for 2010 are forecasts. (b) All figures are subject to rounding. (c) The increase in the unemployment rate is lower at face value than that suggested by the increase in the number of unemployed persons (last column), as it also takes into account the increase in the labour force.

countries may increase by 1.5 million in 2010, this is very much in line with the increase in the labour force and will thus leave the unemployment *rate* practically unchanged. This compares to an increase in the global unemployment rate of 14% and an increase of more than 50% in developed economies (Table 3). An important transmission channel of the effects of the crisis on employment in the Arab Euromed countries is migration. In the early 2000s, foreign labour in OECD and GCC economies accounted for around 7% of the national labour forces of Morocco, Tunisia and Egypt. Among the Lebanese, up to half of each generation may migrate at some point in their lives. Some 10% of the world's remittance inflows are directed to Middle East and North Africa (MENA) countries, and nearly 20% of the world's remittance payments originate in GCC economies. Both figures exceed the predicted regional shares. Annual remittances to the Arab economies averaged \$13 billion between 1996 and 2000 but reached \$22 billion between 2001 and 2007.

Migration flows can slow as a result of declining economic activity in receiving countries, both in the EU (mainly for workers from North Africa) and the GCC (mainly for workers from the Middle East). Migrants in the EU and the GCC are facing the prospect of returning to their countries of origin, especially those working in sectors with higher unemployment (e.g., construction). According to some reports, unemployment among migrant workers has almost doubled in Spain and Ireland since the start of the crisis. Italy slashed an entry quota for non-seasonal migrant workers from 500,000 to zero and criminalised illegal immigration, which will affect an estimated 650,000 migrants who reside and work in the country without authorisation. There may also be changes in the makeup of migrant workers due to the crisis's different impacts on different sectors (e.g., construction versus services) or occupations (skilled versus unskilled). For example, Tunisians working abroad are more qualified and have been

less affected by the downturn than their Moroccan counterparts.

The wages of migrant workers may be reduced or paid with delays. Officially recorded remittance flows to developing countries stood at \$316 billion in 2009, down 6% from \$336 billion in 2008. Inflows to the MENA region fell by more (8%). According to the forecast for 2010, the region's remittances will still be lower in 2011 than they were in 2008. This is not good news, given that remittances are an important component of the region's income. For example, they amount to nearly 20% of GDP in Jordan and to more than 25% in Lebanon.

### Arab Policy Responses

In response to the crisis, North African and Middle Eastern governments took measures to mitigate its effects. Most of the emphasis has been on the financial sector, aiming to reduce the systemic effects of a lack of credit. Many countries introduced fiscal and monetary measures to maintain economic activity at the macro level. While some projects have been abandoned, there have been announcements of increases in public spending in Egypt, Jordan, Libya, Mauritania, Morocco and Tunisia.

There has also been some selective support for industrial sectors deemed to be critical during the crisis. Egypt is focusing on the building and construction sector, as well as government investment in water, sewage, infrastructure, railways and airports. Morocco is targeting tourism, as well as the textile, leather and automobile industries.

Revisions and replacements in the labour laws are being contemplated or have already been introduced in Jordan and Syria, which are also considering expanding and reforming their social security systems. Ministries in some countries are creating additional units to deal in a more focused way with various employment and social protection issues.

Some countries have taken defensive measures. In Algeria, some measures aim to restrict foreign investors to a minority share (49%) of joint ventures with local companies and to require companies that import goods for re-export to cede a 30% share of their capital to local entities.

Salary increases have been given to civil servants in most countries, including Algeria, Lebanon, Libya, Morocco and Tunisia. The minimum wage has been raised in a number of countries, including Jordan, Lebanon, Morocco and Tunisia.

Labour market programmes have also received more attention. These include:

- Early retirement (in Tunisia) in the hope that this will free up jobs for the unemployed.
- Employment services, which are already present in practically all regional economies and are expanding.
- Special measures for young people, including unemployed graduates, and more general attempts to expand training, which will be introduced or expanded in most countries.
- Job sharing (in Tunisia).
- Measures for combating child labour (Egypt, Jordan and Syria), including cash transfers for at-risk children to stay in school (Lebanon).

Support for income-generating activities, including for small- and medium-sized enterprises (SMEs), has taken various forms. In Egypt, enterprises are to benefit from various tax reductions and exemptions. In Jordan, Morocco and Tunisia, companies are given a tax “holiday” with respect to their social security contributions (meaning they can postpone or be excused from paying their contributions for a period of time). Various forms of subsidies have been added or expanded, as is the case in Mauritania, while Morocco has introduced certain housing subsidies.

### **Prospects (1): The Arab Countries Entered the Crisis on a High Note**

In the decade prior to the crisis, the Arab countries enjoyed an economic revival. This came on the heels of two decades of disappointing outcomes in the 1980s and 1990s. Per capita incomes in some Arab countries peaked sometime in the early 1980s and then stagnated or even declined. In fact, the oil economies did not fare any better than the non-oil

ones, a phenomenon that gave rise to the term “the oil curse.” Overall, between 1980 and 1993, and partly because of high fertility rates, the MENA region experienced an average decline in per capita GDP of 2.4% compared to a global increase that averaged 1.2%. However, the MENA region’s growth rate in 2006 was the highest since the 1970s: real GDP increased by an average of 6.3% in 2006, up from 4.6% during the first four years of the decade and from only 1.7% during the second half of the 1990s. On a per capita basis, the region grew at an average of 4.2% in 2006, the highest level recorded in the last two decades.

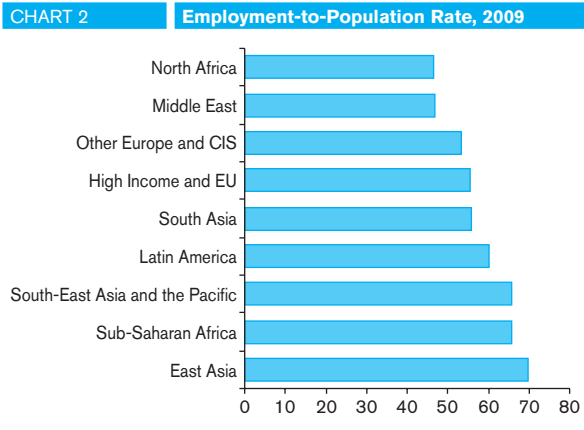
Output growth was associated with job creation: since 2000, employment in the region has been increasing by around 4.5% per annum. Unemployment increased in only one economy, Palestine. The good news on the unemployment front came despite rising female labour force participation rates, which grew significantly and have accelerated over time: the female labour force participation rate increased annually by 2.1% between 2000 and 2005 compared with only 1.4% between 1990 and 2000.

The positive effects on the labour market from changes in the policy environment in the last decade were reinforced by a decline in the explosive demographics of the Arab region. The rate of growth of the labour force in MENA has declined by almost 10% since 1990 and is projected to decline from 4% to 2.2% by 2020.

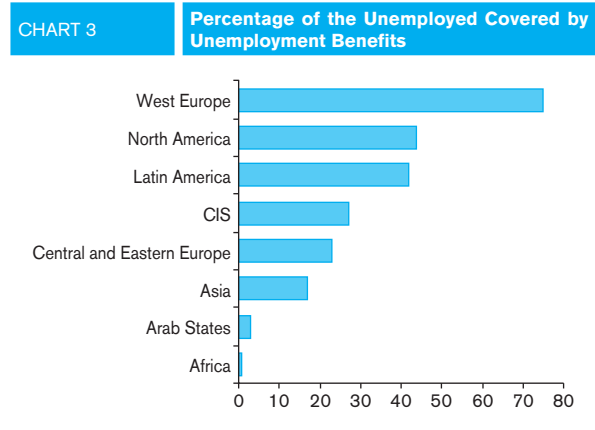
### **Prospects (2): Structural Weaknesses Remain**

Many structural problems in the Arab economies remain unsolved. What matters in today’s interdependent world is not how fast a country grows but how fast it grows *relative to other countries*. In the second half of the 1990s, real per capita income in the MENA economies was growing at 60% of the growth rate attained by developing countries. This rate has risen to nearly 75% since 2000. While that is certainly an improvement, the income gap between the Middle East and other regions is still increasing.

Labour productivity growth remains slow. The region’s economies are still biased towards low productivity investments (including in real estate) with the end result that the majority of the new jobs being created are low-skilled, low-wage jobs. Likewise, most jobs in agriculture consist of subsistence work. Meanwhile,



Source: ILO (2010).



Source: Tzannatos (2009), based on ILO data.

though no hard figures are available, informal employment increased in the major urban areas of most countries and, in some cases, such as Algeria, home-based work constituted the major share of new employment creation.

Though migration is a strength in many respects, regional migration has time and again been subject to political and economic shocks. For example, there was massive return migration to Egypt, Jordan and Palestine following the 1990 Gulf War. Out-migration from North African countries is now tempered by the tightening of the labour markets in Western European economies.

Also with respect to migration, the Arab economies appear to be more exposed to “brain drain” than other regions. The regional expatriation rate among the highly educated is over 9% compared to 8.3% in Latin America and 7.1% in East Asia. The largest streams of high-skilled workers have been migrating from the North African countries of Algeria, Morocco and Tunisia towards France and Belgium and, more recently, Spain and Italy. However, in relative terms the region’s highly skilled workers are mainly to be found in the USA and Canada. For example, 84% of Algerian migrants to the USA and 72% in Canada may be classified as highly skilled workers compared to 10% in Europe.

The Arab economies remain highly dependent on the dynamics of the international oil market, as well as on international aid –though the two apply to different countries. The volatility of oil and oil-related revenues is directly relevant to the economies of Algeria, Libya and Syria. Fluctuating aid from donors from within and outside the region makes it difficult to sustain a predictable development process, especially in countries such as Egypt, Lebanon, Jordan and Palestine. Past attempts by governments to reduce rising un-

employment by expanding employment in the public sector is now an additional constraint on job creation. The share of regional employment in the public sector is almost 30% –nearly double that of the world average. The short-term employment creation of an unjustified expansion of the government not only withers away quickly but can become a long-term liability that is difficult to reverse, especially in periods of lower economic growth, such as the current one due to the crisis. As the region has the world’s lowest employment rates (Chart 2), the private sector’s responsibility to create additional jobs is huge.

Only a small proportion of the region’s population enjoys adequate social security. Moreover, despite their low coverage, pension schemes in the region faced serious challenges of financial sustainability, equity, efficiency and governance even before the crisis started. Pension coverage in the region’s economies remains modest, with only about 10% of the elderly collecting pensions on average. Only 30% of the region’s labour force is currently enrolled in a pension scheme. Moreover, only a few countries (such as Tunisia, Algeria and Jordan) have unemployment insurance schemes, and coverage in the region remains the lowest in the world (Chart 3).

### Concluding Remarks

The relatively positive outlook for the Arab Euromed economies at the beginning of the crisis and until now needs to be qualified. First, the region’s countries suffer from data gaps and delays in the availability of statistics that prevent a confident assessment of the latest picture. Second, given the lower rate of the region’s integration with the global economy, the crisis may be slower in registering its effects through

TABLE 4 Peak-to-Trough Effects of Financial Crises: Global Averages Based on Major Episodes Since 1899

	Effect (percent)			Duration (in years)		
	AVG	MAX	(Country, Year)	AVG	MAX	(Country, Year)
House prices	-36	-53	(Hong Kong 1997)	6.0	17	(Japan 1992)
Real equity prices	-56	-90	(Iceland 2007)	3.4	5	(Spain 1977)
Unemployment*	7	23	(USA 1929)	4.8	11	(Japan 1992)
GDP	-9	-29	(USA 1929)	1.9	4	(Argentina 2001)
Public debt increase**	86	275	(Colombia 1998)	measured over 3 years		

Source: Reinhart and Rogoff (2009).

\* In percentage points.

\*\* The increase in public debt is measured over the 3 years following the crisis and is mainly due to the collapse of the tax base and ambitious countercyclical fiscal policies, not the costs of bail outs or recapitalisation of the banking system.

Keys

Med.2010

38

secondary, yet nevertheless significant, transmission channels. Third, crises take years to show their full effects (Table 4) and, even if not affected directly, the Arab economies are exposed to a combination of deteriorating terms of trade, global deleveraging and unprecedented weakness in global growth.

Another risk of the global crisis may be the creation of social tensions. The case of Greece is already well known, as it also exemplifies the more general case where governments pursue economic liberalisation or austerity programmes without introducing compensatory measures to cushion the costs of adjustment for the needy. The ILO forecasts that, should the global crisis take a turn for the worse, North Africa and the Middle East may be hit much harder than other regions compared to what has happened so far.

The challenge of employment creation in the Arab economies remains. Even before the adverse effects of the crisis, it was estimated that the region would need to add more than 50 million jobs to its current 100 million workers by 2020 in order to absorb the new job seekers. There are currently another 14 million unemployed who should also be absorbed in the labour market sometime in the future. Youth unemployment, which stood at more than 21% at the outset of the crisis compared to a rate of 6% among adults, likewise continues to be a challenge.

The real GDP growth rates needed to overcome the employment challenge are therefore comparable to those that predated the crisis, requiring countries in the region to maintain high average investment rates, generally above about 20% of GDP. This is no small challenge, even if one ignores the cumulative effects of anaemic domestic demand, declining foreign direct investment, reduced remittances and uncertain foreign aid. In fact, even under the more normal conditions before the crisis, remittance income had already been showing signs of decline in the region since 2000.

To counter this, the Arab economies can take advantage of the demographic window of opportunity: fer-

tility rates are declining and, in addition to the decline in the rate of growth of the labour force, the new entrants to the labour market will be better educated than existing workers and can therefore increase productivity. Increasing female labour force participation rates, as well as increased education for women, can further contribute to a more productive labour force, as well as to reducing the dependency ratio in the population. This will help increase individual savings and investments and enable governments to reform their currently unsustainable social insurance schemes.

## References

- HANDOUSSA, H. and TZANNATOS, Z. *Employment Creation and Social Protection in MENA*. Cairo: University of Cairo and World Bank Institute, 2002.
- INTERNATIONAL LABOUR ORGANIZATION (ILO). *Global Employment Trends*. Geneva: ILO, January 2010.
- ORGANISATION FOR ECONOMIC COOPERATION AND DEVELOPMENT (OECD). *OECD Economic Outlook No. 86*. Paris: OECD, November 2009.
- REINHART, C. M. and ROGOFF, K. S. "The Aftermath of Financial Crises." Paper presented at the American Economic Association Meetings, 3 January 2009.
- TZANNATOS, Z. *The Policy Environment for Job Creation in the Arab Economies*. Washington DC: The World Bank, Middle East and North Africa Region, Human Development Department, 2008.
- TZANNATOS, Z. *The Global Financial, Economic and Social Crisis and the Arab Countries: A Review of the Evidence and Policies for Employment Creation and Social Protection*. Beirut: ILO Regional Office, October 2009.
- WORLD BANK. *Outlook for Remittance Flows 2010-11. Migration and Development Brief No 12*. Washington DC: The World Bank, Migration and Remittances Team, Development Prospects Group, 2010.