Next Generation Democracy

Middle East and North Africa

(Not including Turkey, Palestine and Israel)

Track 2 - Business and the Economy

Regional Trends 2000-2015 & Projections 2015-2030

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NOTE TO THE READER

The NGD regional reports for Track II, 'Business and the Economy', analyze trends and projections in de¬mocratic governance from a predominantly economic perspective, on the basis of a multidimensional template specifically formulated by the Club de Madrid and the Bertelsmann Stiftung. These reports have been prepared by the Bertelsmann Transformation Index (BTI) team and complemented and fine-tuned as a result of exten¬sive exchanges between International IDEA relevant staff, the CdM Secretariat and, more significantly, NGD regional partners and relevant stakeholders from each region, from sources such as the Round Table discussions that took place in the respective regions.

The template for NGD Track II reports is based on BTI and Bertelsmann Sustainable Governance Indicators (SGI) which provide an overview of the quality of the market economy (including both economic performance and social developments) as it relates to democratic governance. The BTI team has contextualized and interpreted other economic indicators, particularly those provided by the World Bank's Doing Business project. The assessment covers the past ten to fifteen years, and the projections sections, which have been drafted by NGD regional partners, represent an attempt to foresee key challenges and opportunities in the respective field for the next fifteen years.

The relevant BTI and SGI indicators for each section are as follows (see full range of indicators at https://www.bti-project.org/en/index/methodology/):

- ***Economic competition***: 7.1 Market-based competition; 7.4 Banking system.
- ***Legal certainty***: 9.2 Private enterprise – market principles; 9.1 Property rights; 3.3 Prosecution of office abuse.
- ***Market Access***: 9.2 Private enterprise – protection of private companies and privatization processes; 7.2 Anti-monopoly policy; 7.3 Liberalization of foreign trade.
- ***Inclusiveness & Non-discrimination***: 10.1 Social safety nets; 12.2 Education policy; Labor market policy – information from BTI indicators 6, 7.1 and 10.2.
- ***Strategic capacity and Efficiency***: 8.1 Price stability/monetary policy, Macrostability, fiscal / debt policies; 12.1 Sustainability / environmental policy; 17.1 Effective use of support of international partners.
- ***Consensus-building***: 16.1 Actor consensus; 16.4 Civil society participation in shaping economic policies.

These reports constitute the second major step of the NGD process following the discussions on Track I reports, which will progressively orga¬nize transformative practices and ideas, and will draft NGD regional agendas in reaction to signals of democratic decline, advancing democracy worldwide

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Introduction

The region's title of **"Middle East and North Africa"** reflects not only a geographic but also an economic divide between the rapid economic growth observed in the oil-rich monarchies of the Middle East (**Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, United Arab Emirates**) over the last 15 years and the sluggish development seen in North Africa over the same period. In the former, an unparalleled and unprecedented boost in income generation and economic activity deriving primarily from massive oil and gas revenues has been accompanied by strategic sector development, particularly in banking and trade, but also attempts to diversify trade. The **United Arab Emirates, Qatar** and to some extent the remaining **Gulf monarchies**, have become *eldorados* for international investors, political advisers and development experts seeking benefits from the increasing wealth. Bar the current oil price slump, economic indicators for these countries are consistently positive, companies like *Emirates* or *Qatar Airways* are illustrative of these countries' economic success, and the *Qatar Foundation* has become a global brand promoting culture, sports, education, and business around the world.

By contrast, the countries of North Africa and of the Levant plus a few Middle Eastern 'outliers' (i.e., **Algeria, Egypt, Iran, Iraq, Jordan, Lebanon, Libya, Morocco, Sudan, Syria, Tunisia,** and **Yemen**) continue to battle with underdevelopment, despite some erratic progress in certain areas. This is particularly true for the former socialist republics, such as **Algeria** and **Egypt**, and the resource-poor monarchies **Jordan** and **Morocco**. Most dramatically, **Syria, Libya, Yemen** and partly **Iraq** have, in the aftermath of the Arab Spring of 2011, all succumbed to full-fledged civil wars that have utterly destroyed their economies. The countries of this group are marked by bloated public administrations resulting from governments that have sought public support by providing jobs for massive numbers of people in unproductive sectors. In consequence, neither productivity nor salary developments could keep pace with the needs of growing and ever younger populations. Massive calls from the *World Bank* and *International Monetary Fund* in the mid-1990s for governments to privatize industrial conglomerates and public enterprises and to liberalize trade and capital movement while deregulating the economy led to measures that failed to increase individual wealth or create functional market-based frameworks. Instead, the measures taken fostered an increase in the wealth of elites in the economic, security and political sectors. This resulted in a shrinking middle class as both absolute and relative poverty rates increased, and the gap between the few rich and the many poor widened dramatically. Even if inequality in the distribution of wealth and assets rather than the distribution of income lies at the core of these countries' problems, it is the inability to create jobs for an increasingly educated population that perpetuates poverty.

These economically unjust developments became a major driver of the revolutionary movements that arose in late 2010 and continued throughout 2011 and 2012. The self-immolation of a young Tunisian fruit vendor on 17 December 2010 brought millions of people to the streets in Tunis, Cairo, Benghazi, Damascus, Sanaa, Manama and other cities, in protest of autocratic despotism and elite-driven kleptocratic corruption. Sadly, all countries subject to the turmoil of the **Arab Spring** that is, **Egypt, Libya, Syria, Tunisia**, and **Yemen**, and to lesser extent also **Bahrain**, faced massive economic decline associated in part with civil war, but also with a dramatic drop in tourism and a sharp drop in international currency reserves. Each of these countries struggles with a negative trade balance, capital flight and increasing poverty and unemployment. MENA countries' key challenges are to build resilient economies able to face uncertainties and guarantee inclusiveness, and to accompany economic growth

with effective anti-corruption measures.
The MENA region can be subdivided into three clusters of countries facing similar economic and political challenges:

- **Resource-rich monarchies of the Gulf Cooperation Council (GCC)**: Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, United Arab Emirates
- **Middle-income countries:** Algeria, Egypt, Lebanon, Iran, Jordan, Morocco, Tunisia
- **War-torn countries:** Iraq, Libya, Sudan, Syria, Yemen

Gulf Cooperation Council countries

The Arab Spring of 2011 did not lead to a destabilization of autocratic rule in most GCC countries, with the exception of **Bahrain**. Generous state budgets and welfare provisions have for the most part allowed the ruling monarchies to maintain a firm grip on their societies. However, sectarian tensions in several countries, an increasingly acute geopolitical struggle with **Iran**, uncertainty regarding royal succession (in **Oman** and, even in spite of a recent smooth designation of the crown prince, **Saudi Arabia**), along with a growing sense of entitlement to political freedoms among domestic populations, a bloated public sector, and falling oil prices suggest that the situation is nowhere near as stable as many observers have assumed.

That said, there are positive trends for most indicators in GCC countries. Aggregate GDP in current prices rose exponentially from 2002 to 2008 and recovered quickly following the 2008 recession, though it appears to have slowed again. GCC economies are expected to grow at an annual nominal rate of around 5% for the next four years.

There has been an upward trend in the GCC countries' share of world income since 2002. This share has yet to reach its highest-recorded level from 1980, though this is almost certainly due to the rise of emerging economies and consequent expansion of the global economy. Since 2000, population growth rates across the region have been relatively high, but they seem to have stabilized at just above 2% annually, which is in line with the global trend. This can be attributed to the fact that people in the region are marrying later in life and a decline in fertility rates since the 1980s.

Trade volumes for GCC countries suggest a strong upward trend in openness underway since 2000 that has slowed (in some cases drastically) since 2008. Overall, exports (mainly of natural resources) grew faster than imports of produced goods (as a percentage of GDP). Currently low oil and gas prices, combined with increased spending on military operations in **Yemen**, represent a serious burden to the GCC countries' generous welfare expenditures and could lead to fundamental revision of fiscal policies in these countries affecting both income generation and public spending. Current oil prices are below the breakeven point for most GCC countries and many are already running fairly large budget deficits. Some have even opted for slashing energy subsidies and imposing taxes like **Saudi Arabia** and **Qatar**. This may shake internal stability at least in the medium-to long-term in case international energy prices keep plummeting.

Credit to the private sector as a percentage of GDP, again, is a crude indicator of the extent to which financial services are expanding in an economy. Despite a recent decline, the long-run trend appears to be upward. Data are, however, incomplete. Aggregate reserves (including gold) have increased considerably from 2004 to 2008, falling drastically in the wake of the global financial crisis, only to recover quickly thereafter. Despite a massive spike in 2005, growth rates across the region do not appear to be accelerating, though they remain high at 10% or higher.

Middle-income countries

The countries belonging to the region's middle-income group are more dissimilar structurally than the GCC countries. The group includes resource-rich countries like **Algeria** and **Iran** as well as resource-poor countries like **Egypt, Jordan, Morocco** and **Tunisia**, which makes identifying clear trends within the group more challenging.

Some trends observed within this group are similar to those observed among the GCC countries. This includes an exponential increase in aggregate GDP levels in the early-2000s. The events of 2011 have had a more negative impact on GDP than did the global financial crisis of 2008-onwards. Given the current security challenges faced by many countries in the region, a quick recovery of growth rates seems unlikely. Growth in reserves has bottomed out over the past few years after a steep rise in levels in the early part of this century.

Aggregate GDP based on purchasing power parity (PPP) as a share of global income is relatively stable (3%-4%), but is expected to fall to its lowest level since 1980 by 2019. Again, overall population growth is not accelerating and has remained stable at under 2% annually while marked improvements have been recorded in educational attainment. Nonetheless, the quality of public education remains underdeveloped.

Non-oil exporting middle-income countries like **Morocco, Tunisia, Jordan** and, to a lesser extent, **Egypt** have experienced a strong deterioration in trade openness since 2008, including a sharp drop both in imports and, even more sharply, in exports as a percentage of GDP. This comes on the heels of a general upward trend observed from 1998 to 2008. And though there are signs of recovery underway, it will likely be some time before the highs reached in the mid-2000s are attained once again. Conversely, other oil-exporting middle-income countries like **Algeria** and **Iran** managed to amass very large reserves, thanks to soaring oil prices from 2008 to 2014. However, it should be borne in mind that even non-oil rich countries managed to secure large capital inflows in the form of workers' remittances from oil-exporting countries. This has been the case with **Egypt, Jordan** and, to a lesser extent, **Tunisia** and **Morocco**, each of which benefited from large remittance inflows generated by high oil prices from 2008 to 2014. These inflows were essential to keeping Egypt's imbalance of payments afloat in the aftermath of the 2011 revolution which dealt a heavy blow to the country's dollar-generating economic activities like tourism, FDI (foreign direct investment) and exports, which were hit by the recession in the Euro-zone i.e. Egypt's biggest trade partner.

There is no clear trend in financial deepening i.e. a wider choice of financial services geared to all levels of society despite sustained improvement between 1995 and 2002. Recent data suggest a downward trend is underway, but relevant data are incomplete. There has been a promising long-term decline in terms of government consumption as a percentage of GDP – despite the relatively strong increase observed between 2010 and 2012 in response to rising protests. It is too early to say, however, whether this represents a new trend for the foreseeable future.

External debt stocks are trending upwards, yet their growth is unstable and has been zigzagging since the mid-2000s. Sustained increases in FDI as a percentage of GDP have been all but turned back since 2008. Again, there are signs of a mild recovery underway, but it is difficult to confirm this with certainty.

War-torn countries

Data availability problems are most evident for the five countries mired in military conflict. In **Iraq**'s case, there is a dearth of statistics for the pre-2003 period, while for **Syria**, few indicators are available for the years since 2010. In addition, officially released statistics are often unreliable and subject to partisan bias. Given these problems, aggregate data is only really complete for a period of seven or so years.

The data is reasonably complete for reserves and educational attainment, and shows a steep increase in reserves in the mid-2000s that leveled out around 2008. There are also strong improvements observed in educational attainment, following a short-lived dip in the 1990s. For the other series of economic indicators, variations can be assessed without implying long-term trends. Despite an otherwise chaotic state of affairs in this group's countries, there is the expected upward trend in aggregate GDP along with strong growth.

Trade openness has an inverted U shape and there does not seem to be any major shift toward increasing access to financial services. General government consumption as a percentage of GDP appears to be falling, while FDI as a percentage of GDP grew steadily before falling drastically in the wake of the global financial crisis.

Values and Institutions

1. Economic competition (2000-2015)

The regional economic disparity described above, is already manifest in the region's institutional frameworks for economic and capital markets. The member states of the Gulf Cooperation Council provide sound institutional frameworks for economic activity. Barriers to establish and run business are low, and the free-trade zone within the GCC, combined with multiple bilateral free-trade agreements with external countries, foster economic trade. Generally facilitative conditions and the strength of public enterprises in dominant sectors (i.e., natural resource extraction and processing) mean that informal activities are rare. However, certain restrictions regarding property ownership for non-nationals persist, particularly in strategic sectors and infrastructure, and subsidies sometimes interfere with pricing mechanisms otherwise determined by supply and demand. Reforms are needed, in particular with regard to the sponsorship system ("*kafala*") that severely restricts the personal freedoms of foreign workers in some GCC countries. Reforms are also needed to redress the close kinship bonds, which, at times, allow royal families to bypass official competition rules and amass both wealth and power.

As international financial hubs, the GCC countries also have well-established **banking systems.** Central banks act as supervisory bodies for each country's banking system and though officially independent, often reflect governmental interests in their policies. Thanks to their sound institutional frameworks, most if not all GCC member states (clearly excepting **Dubai**, which suffered blows in its real estate market) weathered the global financial crisis relatively well, undergoing a quick recovery in most indicators.

The region's less wealthy countries also weathered the 2008 global financial crisis relatively well, though for a different reason: none of these middle-income countries are strongly involved in international trade and exchange. In these countries, free economic activity is often hindered by opaque regulatory policies and weak judicial frameworks. Privatization measurements initiated in the 1990s and 2000s yielded benefits for the ruling elites alone and not society as a whole. ***Basel II*** standards are not fulfilled in many of these countries, with the notable exception of **Egypt, Jordan, Morocco, Tunisia** and (to some extent) **Lebanon.**

The Arab Spring countries have been subject to considerable economic turbulence since 2011. This is true in particular of **Tunisia**, which, previous to the Arab Spring was well integrated into the European economy, but now suffers from a lack of FDI and a faltering tourism sector. Tunisia's pre-revolution success in increasing manufactured exports is now seen to have represented an enclave economy unable to generate the needed number of decent jobs to prevent social tensions from increasing. **Egypt**, meanwhile, has failed to keep its national army from interfering with the country's key economic activities, and the country continues to grapple with major distortions of free market competition. In the conflict-ridden countries of I**raq, Libya, Sudan, Syria** and **Yemen** in particular, regulatory frameworks as well as banking systems are weak and abused by members of the ruling elites or local tribesmen.

2. Legal certainty (2000-2015)

The crony capitalistic conditions in many of the region's countries, particularly in those featuring strong government interference such as **Algeria, Egypt, Morocco, Sudan** and **Tunisia**, have only strengthened since the 1990s, when Western donor organizations such as the *World Bank* and the *International Monetary Fund* in particular demanded major structural changes be made. The resulting privatization measures were mainly taken to appease donors. More importantly, the manner in which these measures were undertaken increased primarily the wealth of those already in power (politically as well as economically).

Despite these problems, which also involve cumbersome bureaucracies, private economic activity has taken root in the formerly state-controlled economies, most visibly in the Internet and telecommunications sectors. Indeed, the World Bank's **"Doing Business" reports** point to smooth processes with regard to establishing and operating businesses in most of the region's countries. However, private business is still mainly restricted to small- and medium-sized enterprises that lack access to state resources, technical knowledge, finance and property. In addition, in certain states, particularly **Egypt**, but also **Algeria, Iran, Sudan** and **Syria**, the armed forces interfere with economic activity and are themselves important economic actors. In these countries, competition is often distorted in favor of companies and investors with close military ties, which undermines fair economic competition and private business investment. Similarly, royal families, tribes and elites in these countries often serve as closed economic entities that are protected from open competition. Corruption is widespread, and the prosecution of office abuse is weak or effectively absent. There are some exceptions of widely publicized cases sometimes used to discredit members of the opposition or members of the regime having fallen into disgrace. In addition, lack of transparency with regard to property rights is a considerable barrier to private ownership in these countries. Legal disputes are often not subject to clear and transparent rules but are instead pursued through erratic, costly and lengthy court procedures.

In the Gulf monarchies, legal provisions regarding private enterprise and property rights are well developed, yet kinship bonds continue to undermine competition. Royal family members (and those close to them) carry almost all central positions and control nearly all economic activities. In addition, these countries' economies remain – despite attempts to diversify – based primarily on the exploitation of natural resources. Crucial sectors such as petrochemicals remain under the government's control. In addition, for citizens in each of these countries, jobs in public administration are more lucrative, which means that private economic activity is often not pursued. International investment in non-crucial sectors such as banking or food production is, however, well developed and does not face major obstacles.

Iran represents a specific case here as it has been excluded from international economic activity over the last few decades in part as a result of international sanctions but also the government's unwillingness to successfully implement economic reforms. Privatization in Iran has failed, and a closed network of semi-governmental owners and pseudo-private investors continue to dominate the economic order.

Projections (2015-2030)

Economic competition

GCC countries will undoubtedly face challenges in maintaining the exceptional social services for its citizens. In particular, and against the backdrop of falling oil prices, it will be difficult to reconcile labor market nationalization ("*Gulfization*") policies with diversification programs aimed at ensuring the stability and sustainability of income levels. This may place under pressure the traditional authoritarian social pact in which royal families provide the requisite financial resources in return for political loyalty. If oil prices continue to decline in the long-term, some form of popular representation or participation may eventually emerge.

Gulf rulers would most likely prefer the status quo rather than the development of a free market in its truest sense. For most of the regimes, income sustainability means little if it leads to political destabilization. The ability of OPEC member states and, in particular, **Saudi Arabia**, which currently provides around 30 percent of the global oil supply, to raise future oil prices are, at best, dubious since sanctions against **Iran** have been lifted and **Libya** may soon resume oil production, thereby increasing the global oil supply in the short- to medium-term. Moreover, advances in oil and gas extraction technologies (e.g., fracking) have shifted attention away from OPEC to several smaller producers.

Policymakers in middle-income countries are likely to face a "time inconsistency" problem in implementing economic reforms. In other words, policymakers are less likely to consider the implementation of reforms necessary in the absence of an urgent need for reforms and end up introducing reforms when they are most costly. **Tunisia**'s delayed banking sector reform, for example, requires resolving the problem of bad debts and faces the risk of many businesses going bankrupt. This is also relevant for resource-poor middle-income countries such as **Egypt** (which has since 2013 received some $30 billion in aid and credit from **Qatar, Saudi Arabia** and the **United Arab Emirates**), **Jordan** and **Lebanon**. Given the reliance of these middle-income countries on the financial support of wealthy Gulf states to balance their budgets and avoid economic collapse and the likelihood that this state of affairs will continue through the near future as governments are keen on maintaining regional stability, liberalizing reforms or those aimed at mediating the effects of the chaotic privatization policies of the past are unlikely to be introduce. In other words, the status quo will likely endure.

Fiscal reform, especially in the areas of taxation and subsidy restructuring, is urgently needed in **Egypt, Jordan, Morocco** and **Tunisia**. Subsidy reforms will not only reduce the budget deficit and public debt but will open up more resources in the banking sector for private-sector investment.

Egypt and **Tunisia** are already facing problems with currency convertibility given the large balance of payment deficits these states run. The economic slowdown in the EU, which happens to be both countries' largest trading partner, together with a weak recovery of the tourism sector, has put considerable pressure on **Egypt** and **Tunisia**'s foreign currency earnings. This has led to the emergence of a variety of formal and informal barriers to capital mobility and currency convertibility that are likely to persist until those sectors generating foreign currency have entered into recovery.

The popularity of reforms has become something of a secondary issue to many in middle-income countries. Having witnessed the political instability, militant backlash and economic recession affecting many Arab Spring countries, public demand for democratic economic governance in most MENA countries is likely to take a backseat to stability. In **Egypt**, however, the military-backed regime headed by **Field Marshal al-Sisi** has been keen on extending additional guarantees, incentives and tax holidays to private investors with the hope of attracting badly needed foreign capital. In this context, investment legislation was passed in March 2015 on the eve of the **International Investment Conference** that took place in Sharm al-Sheikh. However, these incentives and guarantees are unlikely to boost investment unless the deeper political, social and macroeconomic roots of uncertainty are addressed.

Post-revolutionary middle-income countries have witnessed a virtual explosion of economic informality since 2011. Various developments such as increasing unemployment resulting from the revolution-driven recession or weakened state capacities to regulate the economy account for the growth of informal economic activity here. In countries such as **Tunisia** and **Egypt**, where the informal sector prior to their revolutions was estimated at 40 and 60 percent of GDP respectively, the informal sector has since expanded even further and is likely to persist in the medium-term.

The situation in war-torn countries can only steadily deteriorate for the foreseeable future. The prospects for an effective conflict resolution leading to democratic transition within the next five years are not encouraging.

Legal Certainty

For the foreseeable future, military interests particularly in **Egypt, Iran** and **Sudan**, but probably also **Syria** and **Yemen** once their wars are hopefully over are likely to continue influencing the private sector. In areas such as public utilities and infrastructure like rail and road connections, military interference could increase. Across the region more generally, rulers are likely to continue to avoid policies that might result in a confrontation with the security establishment.

There are, however, cases of partnerships between the military and private business, such as the new ***Suez Canal project*** in **Egypt**. Here, the Egyptian military has engaged more than 80 private businesses of different sizes as sub-contractors. Six out of the eight tunnels planned under the Suez Canal have been assigned to Orascom, Egypt's largest private construction company. This suggests that the military does not always crowd-out the private sector and that there is room for cooperation or even partnership, yet not always in the pursuit of economic competitiveness alone. There seems to be an increase in military-private sector partnerships in Egypt. Even though this may provide opportunities for foreign and national private sector, it bears a lot of medium-term risks. The legal framework governing such partnerships will unlikely become well defined or predictable. There will always be the risk for the creation of new crony networks with those with close ties with military leadership.

With the democratization pressures of the Arab Spring subsiding, the judiciary in many of the region's countries will be instrumentalized even further for political purposes, as is the case currently in **Egypt.** The lack of legal security will negatively impact on international investors' engagement in these countries, despite economic liberalization measures

Faltering or falling regimes in the wake of the Arab Spring have not ushered in the removal of corruption; instead, it has been reorganized and, in most cases, has spread to low level bureaucrats. As a result, regime change does not necessarily mean the end of corruption but rather the modification of its patterns and modalities, as new rulers are often less able to constrain it. In **Egypt**, the new leadership has on many occasions emphasized the need to fight corruption as a cornerstone of economic reforms and efforts targeting social justice. In September 2015, the minister of agriculture and a few top-level officials were detained on corruption charges and are currently being tried. This was the very first time in Egyptian history that an acting minister was removed from office and held in custody. However, these efforts remain top-down and are thus susceptible to political exploitation by the security and intelligence community to remove those not perceived as not loyal.

II. Access and Inclusiveness

1. Market Access (2000-2015)

Throughout the region, access to lucrative markets depends to a large extent on kinship and familial/personal relations. This is particularly true for the monarchies, where the royal families and their entourage (e.g., the "*Makhzen*" in **Morocco**) control all relevant sectors. However, in the region's republics, influential networks also determine among themselves who should have access to lucrative investments and who should be excluded (e.g., the "*Le Pouvoir*" in **Algeria**). In **Egypt**, the military is favored over private investors when it comes to running a certain share of strategic businesses and holding shares in lucrative companies. As a result, private-sector business engagement is often distorted or severely subjected to military oversight and control, as is the case with respect to **Suez Canal** investments. In **Iran**, up to 80% of the country's economy is estimated to be controlled by the Revolutionary Guards. In **Qatar**, state-run corporations are not subject to the country's competition law.

As a consequence of the favoritism afforded to government or military actors, private economic activities take place primarily within micro, small- and medium-sized businesses often run by families. Given the overall low level of access to education, vocational training and property (land) investment in many of these countries, most of these businesses lack the capacity to become internationally competitive or engage in research and development. This massively limits each of these countries' competitiveness on global markets. In end effect, this results in the government's de facto support for monopolies. In this regard, not only are monopolies not prevented by the government, but also they are even frequently supported. Rulers use the distribution of economic benefits to please their supporters (or in some cases, opponents, as a means of incorporating them into their power base). In the region's monarchies and republics alike, there is a widespread assumption that "the government cares for us," which runs counter to economic innovation and entrepreneurship.

Across the region – apart from the resource-rich Gulf monarchies – international trade is highly underdeveloped. Positive exceptions include **Morocco** and **Tunisia**, which (in addition to **Jordan**) have "advanced status" in the **European Union's Neighborhood Policy** and therefore enjoy preferential treatment in many areas of trade. **Bahrain, Egypt, Jordan, Kuwait, Morocco, Oman, Qatar, Saudi Arabia, the United Arab Emirates** and **Yemen** have joined the *World Trade Organization*, some of them (**Egypt**) as early as it was created in 1994. The remaining countries in the region have observer status and are unlikely to become members any time soon. This is particularly the case for **Iran, Sudan** and **Syria**, where international sanctions have made it considerably difficult to engage in international trade.

Still underdeveloped is the potential of regional free-trade agreements. Only the **Gulf Cooperation Council**, established in 1981, has triggered a remarkable level of trade exchange and interconnectedness among its members **Bahrain, Kuwait, Oman, Qatar, Saudi Arabia** and **United Arab Emirates**. While the establishment of a common currency has been given up due to internal disputes, the GCC countries had won some political power through its leadership as a peace broker in **Yemen**. This has to some extent been tempered by the fact that the GCC's road map for peace in Yemen remained largely unsuccessful, and S**audi Arabia**'s recent military involvement has undermined the GCC's reputation as an impartial third party. At the same time, different perspectives within the GCC on how to deal with the ***Muslim Brotherhood*** in **Egypt** led to major differences between **Qatar** and the remaining GCC member states. Nonetheless, the GCC governments officially declared an end to their internal disputes in September 2014.

Apart from the GCC, regional trade arrangements such as the **Greater Arab Free-Trade Agreement** (GAFTA) or the **Agadir Agreement** are still far from living up to their true potential.

2. Inclusiveness & Non-discrimination (2000-2015)

The region's economic dichotomy is also present with regards to the level of social support and inclusion of disadvantaged members of society in education, health, and labor market. Overall, the resource-rich monarchies along the Persian Gulf perform on a high level. They provide free education and health care to their citizens, though tertiary education often meets labor market needs only partially. The landscape of poverty in countries such as **Qatar** and the **United Arab Emirates** (UAE) differs from those in countries such as **Bahrain** and **Saudi Arabia** where poverty is widespread among the widely discriminated Shi'ites (though a majority in Bahrain) and slum dwellers in the outskirts of the bigger cities like Jeddah, Riyadh, and others. Governments in Bahrain and Saudi Arabia have not invested enough money and creativity in order to provide social safety nets to those neglected. Excluded from the otherwise generous state provisions are usually the blue-collar workers from various (mainly South Asian) countries.

In all other countries of the region, social services are usually linked to employment, which means that only those in regular jobs enjoy social support, though their levels are often very decent. However, with double-digit unemployment rates, social support programs often reach only parts of society, and rarely those in real need. Education as provided in public schools and universities is mostly insufficient; private institutes of education (often in the form of international schools or universities) favor privileged families over poor families and hence deepen the social rift in the societies. In remote areas of particularly the poorer Arab countries, Islamic madrasas are often the only source of education. Here, religious education is usually favored over training of job-relevant skills. Subsidies for food and fuel continue, though the latter in particular is subject to controversy, as it benefits primarily the middle and upper classes rather than the poor.

Egypt is a specific point in case (similar observations are valid for **Algeria, Tunisia** and **Syria**). Continuing to ride on the legacy of its Nasserist past, the Egyptian government aims to provide social services by providing jobs in public administration or in quasi-public sectors but without having the appropriate financial means to adequately pay for these jobs. In consequence, the state budget is under constant strain, and salaries are insufficient. This misconstruction has come under further stress by the rapidly increasing population, with a continually growing demand for schooling, health care, vocational training, tertiary education, jobs, and the like.

In the war-torn countries of **Libya, Sudan, South Sudan, Syria, Iraq** and **Yemen**, social support policies are either absent or rudimentary. Here, social support is managed and organized primarily through international development organizations such as **UNHCR, WFP** or **UNICEF**.

Given their dire and strained labor markets, all poorer Arab countries depend on the out-migration of their workforce (which helps reduce domestic unemployment) preferably to oil-rich Arab states. Thousands of teachers, doctors, pilots, engineers and other professions have been moving toward the Gulf and, at least until 2011, also to **Libya** (most of whom were expelled once violence broke out). This mass migration within the region has positive implications for sending countries' economies as pressures on local labor markets are reduced and remittances usually number among poorer countries' top three income sources. However, it also poses serious problems for economic competitiveness and skills-building and competence development in poorer states as a result of brain drain. Yet much of this intra-regional migration is circular in character, which means that returning migrants often bring positive (i.e., improved skill sets, international experience) and negative effects (reintegration problems). Reintroduced visa obligations between certain Arab states such as **Egypt** and **Tunisia** are in essence counterproductive. Egypt even imposed exit visas in December 2014 for Egyptians aged 18–40 when traveling to **Albania, Iraq, Jordan, Lebanon, Libya, Malaysia, Qatar, Syria, Turkey** and **Yemen** out of fear that Egyptians might join extremist Islamist groups in these countries. Unfortunately, the current climate of distrust among many of the region's countries undermines cooperation in labor migration.

Cooperation on labor migration across the region is stymied as well by a fundamental split in attitude toward labor migration. Given the benefits enjoyed by the Gulf countries in the current system involving precarious labor migrants, these states have no profound interest in elaborating a regional framework for labor migration. They therefore reject any external interference with their disputed "*Kafala*" system. The Department of Arab Expatriates within the **League of Arab States** (LAS), for instance, has been trying for years but without success to convince LAS member governments to elaborate a common migration strategy.

Regular labor migration toward Europe and North America on the individual country level is also still rudimentary. **Egypt,** the region's biggest country in terms of population size and workforce, has only one labor agreement with **Italy** (signed in 2005), and even this remains widely underused. **Morocco** and **Tunisia** have similar agreements with **France**. In addition, both countries signed Mobility Partnerships with the European Union in 2013 and 2014 respectively. **Jordan** did likewise in 2014, while Egypt refused any negotiations whatsoever. Yet, whether Mobility Partnerships exist or not, they are primarily about mutual border protection and less about enhancing labor migration, so remarkable improvement in Arab countries' strained labor markets cannot be expected from them.

Projections (2015-2030)

Market Access

Regimes will likely continue to utilize public sector employment as a tool to cement support from politically influential groups in society and to mitigate, albeit marginally, the social impact of youth unemployment. In **Oman**, for example, positive developments in the mid-2000s with regard to the inclusion of native Omanis into private employment have been turned back, to some extent, as the government responded to the Arab Spring with more generous provisions. This trend also shows few signs of abating in other countries like **Egypt, Jordan, Morocco** and **Tunisia**, though here public salaries are usually still far below revenues that can be earned in (formal) private business. These jobs are often also more accessible for women or persons with special needs.

In **Egypt**, micro, small and medium-sized enterprises have faced considerable discrimination. Even though they constitute approximately 98% of the total number of private enterprises and account for the largest share of job creation, they are generally denied access to finance, land and therefore opportunities to grow and expand. State policies through three decades of liberalization, deregulation and privatization have consistently favored big business, be it private or public and domestic or foreign. The marginalization of micro, small and medium-sized enterprises (MSMEs) helps explain the rise under Mubarak of the "missing middle" syndrome in which the economy is dominated by a handful of extremely large enterprises while the broad base of private enterprises are born small and remain so indefinitely. This situation has not changed much since 2011 as military-related enterprises started to claim their own share of economic activity, thereby further squeezing the already squeezed MSMEs.

Regimes in war-torn countries are losing their economic capacity to act. Since the struggle over oil-producing regions involving the "Islamic State group" (IS) has begun in **Syria**, electricity grids have been placed under massive strain. The regime has been buying oil and gas from IS to keep the lights on, which is not a sustainable situation. The government has taken to importing crude oil from abroad in order to keep its refineries running (the only operational refinery is located in the coastal city of Baniyas). At the same time, the devaluation of the Syrian pound caused a scramble for dollars in the face of rampant inflation to the extent that the government criminalized the use of any currency other than the Syrian pound in commercial and retail transactions.

The economic structure of the war-torn countries, and hence their future competitiveness, will be determined by how the respective civil wars end. In **Libya**, oil production has fallen from a post-Qaddafi high of 1.4 million barrels a day to less than 250,000 a day. Oil pipelines are under regular attack by armed groups and there is constant fighting over the control of terminals. The chairman of Libya's National Oil Corporation has recently stated that they have lost 80% of their production. Given low oil prices internationally, the government will find it difficult to rebuild infrastructure and embark on development programs (oil accounts for 90%-95% of Libyan government revenues). The ongoing violence and uncertainty caused by the de-facto split of the country makes any positive changes unlikely in the next few years.

In **Iraq**, IS controls critical trade routes and has taken to charging toll-like taxes on trucks looking to pass through their territory. The increase in shipping costs will harm trading activities and exert downward pressure on reserves. IS has established a government-like system with approved seals, documentation, and so forth. This has led to the paradoxical situation of the Iraqi government's treatment of the IS seal as if it were the official stamp of another state. Even relatively stable southern provinces are facing challenges in attracting investment in sectors besides oil and gas. The absence of a developed financial sector, the restrictions placed on foreign ownership of companies, and nebulous laws governing economic activity are making matters worse. Shi'ite provinces' reputation for stability took a hit in 2013 when mobs attacked a British contractor at Rumeilah oilfield over a perceived affront to Shi'ite religious beliefs.

Inclusiveness & Non-discrimination

Non-inclusive welfare programs and tribal/sectarian/regional favoritism in wealth distribution have been major drivers of social unrest in many countries (especially **Algeria, Bahrain, Egypt, Iraq, Saudi Arabia, Syria, Tunisia**). Unless a radical reconciliation program is introduced, this situation is likely to persist and deteriorate. There is also the risk that poverty will continue to be exacerbated by government mismanagement and sluggishness. Basra, for example, has massive oil reserves yet its residents suffer from some of the worst conditions in Iraq despite belonging to the same sect as the ruling elite. The gap between the interior regions and the coast in **Tunisia** attests to the importance of regional inequality in terms of access to public infrastructures (electricity, water, roads), health services and employment. This gap is likely to be a major driver of unrest over the next few years in Tunisia and many other countries.

Most middle-income countries have inherited massive food and fuel subsidy schemes. These programs are neither economically efficient nor socially just. They are, however, politically sensitive as they support the middle classes and effectively cushion the deterioration in their real incomes after two decades of neoliberal reforms. **Egypt, Morocco** and **Jordan** undertook recent measures to tackle the ever-growing subsidy bill. The aim is to run more targeted and thus efficient schemes. In **Egypt**, however, the fuel subsidy slashing undertaken in July 2014 went without any alternative measures that would have been necessary to mitigate the inflationary impact. So far, these subsidies have been slashed rather than restructured. Egypt needs to restructure its subsidy schemes if it is to target the rural and urban poor, women and other underprivileged individuals, families and groups. The experiences of Latin America, like **bolsa familia in Brazil**, can be very helpful for policymakers and stakeholders.

The youth bulge in most MENA countries spells for additional stress on government resources in the future, as policymakers will struggle to provide for the youth while fulfilling social security and health obligations for the elderly. There are already signs of this across the region and especially in **Jordan**, as the government implements (seemingly ad hoc) tax increases and hasty social security program adjustments. Youth unemployment in **Egypt** and **Tunisia** as well as the disastrous situation in **Libya, Syria** and **Iraq**, are likely to increase the number of asylum seekers and labor migrants to Europe underway since 2015.

Female unemployment is another major problem in the region. MENA features the world's lowest female participation rate in the labor market. This does not match the region's income level or the educational attainments achieved by women in the last three decades. One of the reasons behind the exclusion of women from the labor market is that private enterprises prefer to hire men. This leaves public employment as the main serious opportunity for (in particular educated) females seeking jobs. This situation is likely to worsen in the short-term as slashing public sector employment will likely have a negative effect on female employment.

The Gulf states are also experiencing an increasingly limited ability to absorb new young cohorts of native workers. Their historic reliance on migrant labor to fill private-sector positions will become untenable if oil prices remain low in the medium run. The likely strain resulting from a revision of this strategy will by no means be limited to the domestic sphere as middle-income countries will be deprived a main source of income, namely remittances, and thereby face additional downward pressure on foreign reserves.

The "*kafala*" sponsorship system is unlikely to be reformed because, especially when considered in tandem with labor nationalization policies, natives benefit considerably on several fronts. For one, the diminished occupational mobility of foreigners leads to artificial rents captured by the mobile local populace (who earn a higher wage for a comparable job). Second, there is the issue of "phantom employees." In order to comply with "*Gulfization*" requirements regarding the proportion of native-born employees, companies often keep unproductive employees on the payroll. This is particularly lucrative for these employees, who in effect receive unemployment benefits. Reforming this system will likely be vehemently opposed, especially given the current political and social circumstances.

III. Management and Policies

1. Strategic capacity & Efficiency (2000-2015)

Clearly, none of the region's governments – with the cautious exception of **Tunisia** – currently pursue economic policies that are in line with promoting democratic principles and values. Instead, the **Russian or Chinese model** of development – economic progress without relevant political reforms – serves as an ideal worth copying. That said, some governments in the region, in particular the **Qatar, UAE** and **Kuwait** governments, maintain successful monetary and fiscal policies. Inflation in most of the region's countries is low, excepting **Egyp**t (9.5%), **Sudan** (37.4%), **Syria** (36.7%), **Yemen** (17.2%) and – most disconcerting – **Iran** (39.3%; IMF data for 2013 or, where not available, 2012). Prices have risen for food imports in particular, which all countries depend on to a very high degree.

In the resource-rich countries, including **Algeria** and **Libya**, state budgets are balanced (and in some cases doing very well), though Libya's assets and resources have been hard hit by the violent destruction of critical infrastructure. In the resource-poor countries, public debts and deficits have soared, as inefficient tax systems, massive state subsidies for several commodities (e.g., fuel and basic foodstuffs such as bread) and bloated public sector employment (accounting in **Egypt** for 25% of total state spending and 40% in **Tunisia**). In such cases, reform is urgently needed but elusive given the profoundly negative impact such reforms would have on most people in these societies. In **Egypt**, the al-Sisi administration has recently introduced subsidy reforms, but is hesitant to push cuts too fast and too far. **Sudan** took similar steps in 2013 with the backing of the IMF only to face the most severe anti-government protests in the country's history.

The concept of environmental and economical sustainability is still in an infant state in most of the countries. For example, despite the potential for solar and wind energy throughout the region, neither energy source has to date been satisfyingly exploited. This is particularly true of those countries with high oil and/or gas reserves, but applies as well to the resource-poor countries. The government of **Egypt** decided in 2014 to build new coal power plants and in spring 2015 decided to erect a nuclear power plant with Russian technology in order to overcome the country's chronic electricity shortage. These plans require massive investments in the country's infrastructure (e.g., ports, roads) as coal and uranium have to be imported and paid for in international currencies that the country does not have as a consequence of its weakened tourism sector and exports. Meanwhile, an agreement was signed in March 2015 to build a 4,4 GW combined-cycle power plant and a 2 GW wind park by 2017.

International support in terms of technical cooperation is welcomed in **Jordan, Morocco** and **Tunisia**, while global financial investment and knowledge transfer takes place primarily in **Qatar** and the **United Arab Emirates**. Support in the form of OECD expertise is least popular in **Iran** and **Sudan**, particularly if human rights demands are attached to the potential support. In addition, imposed U.S. and UN sanctions make cooperation extremely difficult. Currently, given the precarious state of security in **Libya, Syria** and **Yemen**, international technical cooperation is more or less absent and occurs on the ground almost exclusively through local partners. **Algeria** and **Egypt** also demonstrate weak international cooperation with Western experts. Clearly, the state of international cooperation in these countries has not cultivated a strong trend toward democratization.

2. Consensus-building (2000-2015)

Most generally, consensus on a market economy as the best framework for economic activities exists in most MENA countries, but with three major restrictions. First, the question of Islamic banking and economic rules (enriched by the broader question of the legality of **Sharia-based legislation**) and its level of complementarity with global economic rules poses serious questions particularly in the traditional Gulf countries, **Iran, Sudan** and **Yemen** as particularly religious countries, but also in the remaining more secular countries. Second, in most countries there is a significant gap between what governments claim to be targeting in terms of social inclusion and their actions in support of the needy. Third, military-backed governments (e.g., **Algeria, Egypt, Sudan, Syria** and (partly) **Yemen** and those run by a closed elite network (e.g., the **Arab monarchies** and **Iran**) refuse to open up what they consider to be "sensitive" sectors to competitive market rules. Motivated less by operational concerns and more by their own specific interests, the corrupt elites in charge of these governments are reticent to risk their privileged positions by potentially eroding their country's economic wealth.

Across the region, key political actors differ with regard to the extent to which religious influence should be allowed, social protections should be provided and transparency and economic openness should be fostered. In addition, the extent to which civil society should be included in formulating and targeting economic policies also differs considerably. Civil society in most of these (non-democratic) countries is subject to severe restrictions, even with respect to relevant economic issues. With the notable exception of **Tunisia** and to a lesser extent **Morocco**, this is true in particular for trade unions, including those that have emerged as a consequence of labor protests that have taken place since 2004 and are perceived as one of the biggest potential threats to existing regimes. These trade unions have the potential to mobilize masses, call strikes and organize protests and demonstrations. This has been particularly visible in **Egypt** where, in 2011, the recently won independence of certain trade unions has since been rolled back by the government in power since 2014.

Similarly, civil society actors dealing with social support are often perceived as a potential threat to the ruling elites. The Muslim Brotherhood in **Egypt** and Hamas in **Palestine**, for instance, have gained much popular support through their social engagement in fields neglected by official state agencies. Therefore, in almost all states of the region (with the cautious exception of **Lebanon** and **Tunisia**), non-state actors engaged in social work are closely monitored by governments and not perceived as valuable contributors to positive economic transformation. In certain cases, such as **Egypt, Iran, Oman, Sudan** and **Syria**, civil society organizations are therefore subject to government harassment and suppression.

The lack of well-consolidated political parties in almost all countries of the region (excepting again **Tunisia**) is problematic. The lack of influence, or even utter absence (in **Saudi Arabia, Oman, Qatar, United Arab Emirates**) of independent political organizations means public debates over future economic options simply do not take place. As a result, governments make almost all fundamental decisions regarding economic pursuits alone and without any democratic consent.

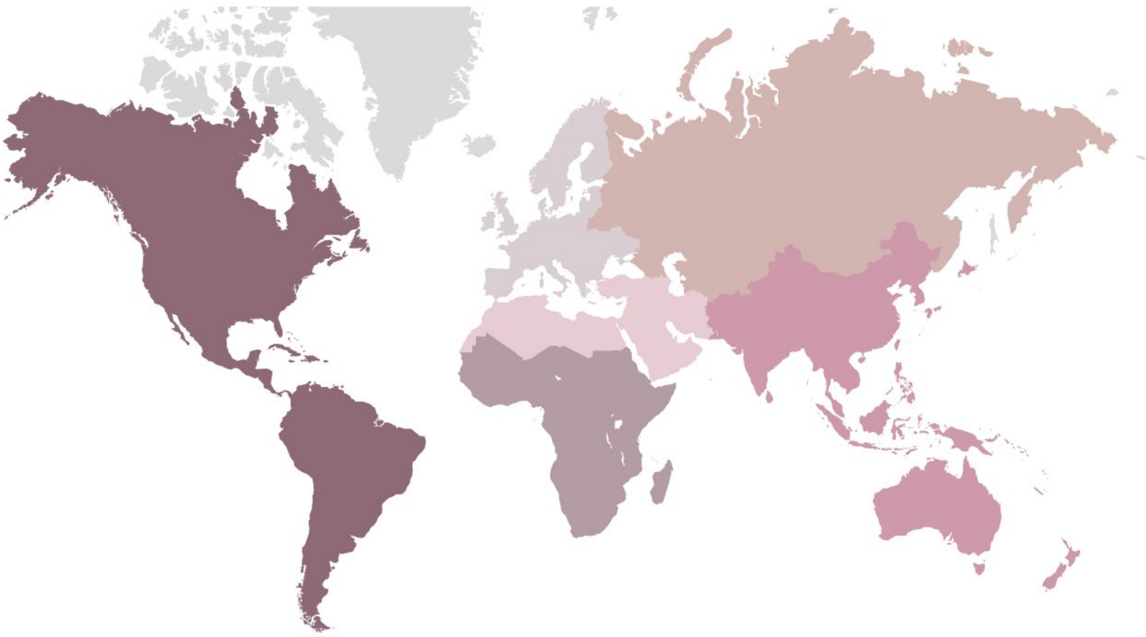
Projections (2015-2030)

Persistently low oil prices and rapidly expanding military needs weigh heavy on the continued reliance of many of the region's states on generous foreign aid from the wealthy Gulf states. If the costs of regional stability lead to social welfare cuts in Gulf countries, this could lead (at best) toward a more isolationist foreign policy or (at worst) a collapse of the existing social contract in the region's poorer countries, such as **Egypt**, which is heavily dependent on fiscal support from Gulf states.

International investment will likely decrease in countries facing uncertain ruler succession. The most pressing case has been **Saudi Arabia**, whose King Salman is 81 years old and said to be in precarious health. It is unclear what will happen when the next generation comes to power. **Oman** faces even more uncertainty as Sultan Qaboos has no clear heir. Neighboring **Yemen** has been brought to the brink of collapse by al-Qaeda in the Arab peninsula, with IS, the Houthi militias and various army factions supporting either Ali Abdallah Saleh or Abd Rabbuh Mansour Hadi. At the time of this writing, the country faces the threat of being split either along the old North-South divide or dissolving into various territories. There is also uncertainty regarding the successor of long-ailing president Bouteflika in **Algeria,** and Omar al-Bashir in **Sudan**. Given these circumstances, it is difficult to imagine major foreign direct investment taking place in these countries.

OPEC has shown something of a philosophical shift in its approach to falling oil prices. In the past, supply would be cut to stabilize prices (in 2008, for example, production was cut by 2.2 million barrels a day). Supply quotas have been maintained for now, arguably resulting in a supply glut and a further fall in prices. The move appears to be aimed at maintaining market share and avoiding a situation such as that seen in the 1970s (which incentivized other countries to begin developing their oil and gas industries). Considering that the countries with the most sway in OPEC have considerable foreign reserves to finance their profligate budgets, the world is likely to enjoy low oil prices for the near future. This could, of course, lead to tensions within OPEC in the medium term, particularly with countries like **Algeria**.

In **Egypt**, erratic macroeconomic management is likely to continue as the government tries desperately to contain the balance of payment deficit. There is no clear economic strategy pursued by the Egyptian government and this will probably be the case in the months to come as the government subjects long-term plans to short-term concerns of generating foreign currency and balancing the current account. Despite lower oil prices, the budget deficit will remain a problem in the short to medium term in Egypt. This translates into an ever-growing public debt, which moreover increases banks' liquidity pressures, crowds out the private sectors and raises the cost of investment. Moreover, the structure of public expenditure does little to foster development, as more than 80% of it is comprised of recurrent expenses, which means that the government is increasing the cost of investment for the private sector and uses bank credit to finance public consumption, wages, debt service and subsidies rather than investment. This results in lower investment rates that further disable the economy from generating growth and creating jobs.



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