The Arab Economy -
A Private Sector’s Perspective
For a Better Business Climate

The General Union of Chambers of Commerce, Industry & Agriculture for Arab Countries (GUCCIAAC)
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I. Introduction

The Arab world is experiencing a period of unprecedented change that will shape the future economic, social and governance systems of the region, at a time when the balance of economic power in the world economy between developed and emerging economies is being redefined.

The Arab world possesses the key raw materials of success, including a youthful population, a private sector that is used to work in risky environments, energy resources and some of the fastest globally growing economies. The region is home to 60% of the world’s oil and around 40% of its gas reserves. Nevertheless, many Arab Countries continue to struggle with their prolonged political transitions that started in 2011, continued regional tensions and difficulties in the global economy, slow growth, high fiscal and current account deficits, astounding unemployment rates and modest domestic and foreign private investment.

The economic impacts of the conflicts negatively influence the respective economies through multiple channels. It leads to a contraction in aggregate supply through the disorganization of production, destruction of physical capital, and dislocation of labor. Thus leading to a general decline in total factor productivity, as economic efficiency is compromised and technology absorption is interrupted, besides the decline in physical as well as human capital. The major manifestations of the implications are reflected in the contraction of output, acceleration of inflation, large fiscal and current account deficits, loss of reserves, as well as weaker financial systems.
The Arab private sector has a key role in partnership with Governments to enhance the Arab world’s competitiveness and the region’s vast potentials. Nevertheless, this role needs stability and depends on implementing systematic reform programs and legislations to eliminate the obstacles that face the private sector and its growth aspirations in individual countries, and as importantly, in the region as a whole.

Special emphasis need to be placed to move forward with the Arab economic integration path towards achieving an Arab Common Market that is able to compete in the world economy and be up to the fast and changing developments in the global investment and trade rules and maps.

II. Global Economic Prospects

a. Slow Recovery and debt constraints

The global economic recovery continues, but it remains a weak recovery. Recently, the International Monetary Fund (IMF) revised its growth forecast for 2014 from 3.7% in April 2014 to 3.4% by the end of July\(^1\). This is due to the United States negative growth rate in the first quarter of the year, besides other downward revisions, both in advanced and in emerging economies.

Advanced economies are still confronted with high levels of public and private debt, which act as constraints on the recovery. These constraints are gradually decreasing, but at different rates across countries. Emerging and
developing economies are slowing down from pre-crisis growth rates, as their economies show significant exposure to the normalization of monetary policy in the United States, besides the new emerging geopolitical uncertainties which mainly affected Russia, and the effects of conflicts in the Middle East that are clearly keeping oil prices relatively high. Yet their growth forecasts at 4.6% in 2014 and 5.2% in 2015 are fairly strong².

b. Regionalism & Technology – a major feature of the world new economic order

Today, regional trade and investment groupings shape global foreign direct investment (FDI) and global trade exchanges. Regional trade agreements (RTAs) have become increasingly prevalent since the early 1990s. According to the World Trade Organization (WTO), as of 15 June 2014, some 585 notifications of RTAs had been announced, of which 379 were fully in force³. International trade is now more regionalized, particularly in Asia, where growing supply and value chains within the trade regions reshape the distribution of production of good and services between many countries, especially in the manufacturing industries, leading to more efficient and less costly business transactions, while promoting trade, investments and rates of growth.

The regional groupings worked exceptionally well for attracting international investment for developing countries. FDI flows to developing countries reached a new high of $ 778 billion in 2013, constituting 54% of total global FDI⁴. Inward flows to developed countries increased by 9% to $566 billion, leaving them at 39% of global flows⁵. The balance of $ 108
billion went to transition economies. As for outflows, developing and transition economies together invested $553 billion, equivalent to 39% of global FDI outflows, compared with only 12% at the beginning of the 2000s.

Yet the most important change in the world investment map is the formation of Mega regional groupings and their rising influence in shaping the global FDI. The main ones currently under negotiation are the Trans-Pacific Partnership (TPP), the Trans-Atlantic Trade & Investment Partnership (TTIP), and the Regional Comprehensive Economic Partnership (RCEP) that includes 17 countries accounting for almost half of the world population, from east Asia, Japan, Australia and New Zealand. Each of these three account for a quarter or more of global FDI flows, with TTIP in decline and the others in ascendance. However, the group of Asia-Pacific Cooperation (APEC) remains the largest regional economic cooperation grouping, with 54% of global inflows in 2013, against 37% for the average of the period 2005 – 2007, as shown in the following Chart.

One major feature of these giant groupings is that they are broad economic agreements among a group of countries that have a significant combined economic weight in which investment is only one of the key subject areas covered. They are likely to have important multi-layered implications on the international investment and trade regimes and global economic patterns.

Regionalism and technology are key factors in the transformation process. Wireless exchange of trade and investment are growing by 30%
FDI Inflows to Major Regional and Inter-Regional Groups

<table>
<thead>
<tr>
<th>Average FDI Inflows 2005 – 2007 $ billion</th>
<th>% Share in World</th>
<th>FDI Inflows 2013 $ billion</th>
<th>% Share in World</th>
<th>% Change in Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>G20</td>
<td>878</td>
<td>59%</td>
<td>791</td>
<td>54%</td>
</tr>
<tr>
<td>APEC</td>
<td>560</td>
<td>37%</td>
<td>789</td>
<td>54%</td>
</tr>
<tr>
<td>TPP</td>
<td>363</td>
<td>24%</td>
<td>458</td>
<td>32%</td>
</tr>
<tr>
<td>TTIP</td>
<td>838</td>
<td>56%</td>
<td>434</td>
<td>30%</td>
</tr>
<tr>
<td>RCEP</td>
<td>195</td>
<td>13%</td>
<td>343</td>
<td>24%</td>
</tr>
<tr>
<td>BRICS</td>
<td>157</td>
<td>11%</td>
<td>304</td>
<td>21%</td>
</tr>
<tr>
<td>NAFTA</td>
<td>279</td>
<td>19%</td>
<td>288</td>
<td>20%</td>
</tr>
<tr>
<td>ASEAN</td>
<td>65</td>
<td>4%</td>
<td>125</td>
<td>9%</td>
</tr>
<tr>
<td>MERCOSUR</td>
<td>31</td>
<td>2%</td>
<td>85</td>
<td>6%</td>
</tr>
</tbody>
</table>

Source: Compiled from UNCTAD, World Investment Report 2014.

every year among supply chain businesses worldwide. 90% of trade flows through 39 trade bloc regions.
III. Arab Economy - Mixed Growth Performance

a. Evident variations

Growth performance in recent years across the Arab world was mixed, with considerable risks to the outlook, due to continued regional strains and global economic slowdown. The following table shows that the region witnessed considerable fluctuations in real GDP growth, especially in countries of turbulence transitions, like Libya and Syria. In 2013 overall real GDP growth in the Arab world achieved a slower economic growth of 3\%, as compared with 4\% in 2012\(^{10}\) (excluding Libya that witnessed high fluctuations as shown in the following table).

High oil prices have positively impacted the performance of the Arab oil exporters, although these countries need to adjust to lower global demand. The Gulf Cooperation Council (GCC) member States registered an average growth of 4.3\% in 2013, down from 5.7\% in 2012\(^{11}\). Overall growth is projected to remain firm at 4.4\% in 2014, driven by the non-hydrocarbon sector which is forecast to expand by 5.4\%\(^{12}\). The external current account and fiscal balances are projected to remain in large surpluses in 2014\(^{13}\). Net foreign assets are expected to rise to $2.3 trillion, equivalent to 138\% of aggregated GDP in the same year\(^{14}\). The main downside risk to the GCC outlook stems from and unexpected sharp drop in oil prices for a sustained period of time. The rise in asset prices in the real estate sector needs to be monitored, but is not a concern at this time.
While GCC Countries are on a stable recovery, the other Arab Countries are ranging between moderate to deteriorating economic growth, as illustrated in the following Table. Most of them suffer from stagnating economic activities, as a result of continued political instability and social unrest. The most troubled economies include Syria, Libya, and recently Palestine and Iraq that are currently also under devastating external and internal troubles. The crisis in Syria continues to have negative spillover effects on neighboring countries, particularly with regard to subdued cross-border economic activities, including trade, investment and tourism. Additionally the insufficient speed of economic recovery in Europe is affecting the non-oil exports of all Arab Countries, especially the Maghreb sub-region that is highly dependent on the European markets.
## Real GDP Growth Rates, 2010 – 2014
(Annual Percentage Change)

<table>
<thead>
<tr>
<th>Country</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Algeria</td>
<td>3.6</td>
<td>2.8</td>
<td>3.3</td>
<td>3</td>
<td>3.6</td>
</tr>
<tr>
<td>Bahrain</td>
<td>4.3</td>
<td>1.9</td>
<td>3.4</td>
<td>5.3</td>
<td>4</td>
</tr>
<tr>
<td>Comoros</td>
<td>2.2</td>
<td>2.6</td>
<td>3</td>
<td>3.4</td>
<td>3.8</td>
</tr>
<tr>
<td>Djibouti</td>
<td>3.5</td>
<td>4.8</td>
<td>4.7</td>
<td>5.3</td>
<td>5.8</td>
</tr>
<tr>
<td>Egypt</td>
<td>5.2</td>
<td>1.8</td>
<td>2.2</td>
<td>2.1</td>
<td>2.4</td>
</tr>
<tr>
<td>Iraq</td>
<td>6.9</td>
<td>9.5</td>
<td>9</td>
<td>6.1</td>
<td>6.8</td>
</tr>
<tr>
<td>Jordan</td>
<td>2.3</td>
<td>2.6</td>
<td>2.7</td>
<td>2.8</td>
<td>3</td>
</tr>
<tr>
<td>Kuwait</td>
<td>-2.4</td>
<td>10.2</td>
<td>8.3</td>
<td>4</td>
<td>3.8</td>
</tr>
<tr>
<td>Lebanon</td>
<td>8</td>
<td>2</td>
<td>1.2</td>
<td>1.7</td>
<td>2.5</td>
</tr>
<tr>
<td>Libya</td>
<td>4.3</td>
<td>-61.3</td>
<td>98.2</td>
<td>-3</td>
<td>-5</td>
</tr>
<tr>
<td>Mauritania</td>
<td>5.1</td>
<td>4</td>
<td>4.6</td>
<td>6.1</td>
<td>5.9</td>
</tr>
<tr>
<td>Morocco</td>
<td>3.6</td>
<td>5</td>
<td>2.7</td>
<td>4.6</td>
<td>3.6</td>
</tr>
<tr>
<td>Oman</td>
<td>4.8</td>
<td>0.9</td>
<td>5.8</td>
<td>3</td>
<td>3.8</td>
</tr>
<tr>
<td>Palestine</td>
<td>9.3</td>
<td>12.2</td>
<td>5.9</td>
<td>1.8</td>
<td>2.6</td>
</tr>
<tr>
<td>Qatar</td>
<td>16.7</td>
<td>13</td>
<td>6.2</td>
<td>6.5</td>
<td>5.5</td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>7.5</td>
<td>8.6</td>
<td>5.8</td>
<td>3.8</td>
<td>4</td>
</tr>
<tr>
<td>Somalia</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Sudan</td>
<td>5.8</td>
<td>1.9</td>
<td>1.1</td>
<td>3.2</td>
<td>2.5</td>
</tr>
<tr>
<td>Syria</td>
<td>3.4</td>
<td>-3.4</td>
<td>-21.8</td>
<td>-22.5</td>
<td>-</td>
</tr>
<tr>
<td>Tunisia</td>
<td>3.6</td>
<td>-0.2</td>
<td>4.1</td>
<td>2.8</td>
<td>3</td>
</tr>
<tr>
<td>UAE</td>
<td>1.7</td>
<td>3.9</td>
<td>4.4</td>
<td>5</td>
<td>5.2</td>
</tr>
<tr>
<td>Yemen</td>
<td>5.7</td>
<td>-12.8</td>
<td>2</td>
<td>3.5</td>
<td>2.6</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>5</td>
<td>2.7</td>
<td>7.7</td>
<td>3</td>
<td>3.5</td>
</tr>
</tbody>
</table>

b. Lessons and Challenges

There are some important lessons learned from the Arab Spring. While the top-line economic indicators and numbers on growth often looked good, too many people were being left out. It is now much clearer that more equal societies are associated with greater economic stability and more sustained growth.

While each country in the Region must find its own path to change, the recent turmoil of events in the Arab world has highlighted several deep-rooted common development challenges. The most significant challenges, although the list is by no means an exhaustive one, can be grouped under four major categories: high unemployment, food insecurity, weak governance and inequitable growth. These challenges are not new and have been lingering for decades. What is new is the importance assigned to these challenges following the intense public reaction since early 2011, especially with respect to the pressing need to create sustainable job opportunities and to increase the currently low levels of food security in the region.

c. Points of Strength and Risk Factors

The Arab Countries have many similar and different features at the same time. Their major points of strength are that they share one language, a common and rich culture, youthful populations, close and strategic geographical proximity and economic diversity and complementarity.
The Arab history of fragmentation has been reflected on their economic cooperation and left the region vulnerable to internal and external challenges and has stifled development.

The following Table reflects some of the major economic strengths and risks in selected Arab Countries. The major challenge that all of them face is high unemployment, besides the high rates of disguised unemployment that is well abundant in the public sectors.

The Table also reveals common strengths in the major Arab oil exporting countries, for being strategically important as major world sources of hydrocarbons, with high revenues and incomes and strong liquidity indicators. These features enabled to afford a relatively supportive business environment, and most importantly for some of them to plan long-term development strategies – a privilege that is quite rare and lacking in the region. Nevertheless, the high reliance on oil and natural gas revenues and slow economic diversification leads to continued high exposure to fluctuations in world economy and commodity prices.

The heterogeneity of the Region is reflected in the different strengths and weaknesses of the three sub-regions, namely the oil-rich countries, the oil-importing countries and the least developed countries. Countries like Lebanon and Jordan have relatively good educated workforces, but are challenged by infrastructure shortages and their small market sizes, in addition to inefficient Government bureaucracy.
Some of the other diversified Arab economies like Egypt enjoy relatively large domestic markets. Others like Tunisia have solid and diversified economic platforms. Yet most of these countries are either under political transition and internal war struggles, or at least, like Lebanon and Jordan, affected by their consequences. The common challenges that most of them share are, besides unemployment, relatively high rates of poverty, fluctuations in remittances, high debts and large fiscal imbalances.

The combined and accumulating effects of prevailing challenges in most of the Arab Countries led to a relatively restricted business environment and limited opportunities for the private sector.

**Strengths and Risks in Selected Arab Countries**

<table>
<thead>
<tr>
<th>Country</th>
<th>Strengths</th>
<th>Risks</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Algeria</strong></td>
<td>• Strong Hydrocarbon resources, with gas reserves estimated to last a further 55 years at current rates of extraction, and crude oil a further 20 years. • Strong liquidity indicators, supported by a period of sustained high oil prices. • Foreign debt management is much improved following repayment in the 1990s and debt ratios and obligations are low.</td>
<td>• High unemployment and underemployment. • Lack of economic diversification, over-dependence on oil and gas (97% of export earnings). • Banking sector dominated by state enterprises that have to absorb losses from public sector companies. • Limited private sector opportunities and restrictive business environment.</td>
</tr>
<tr>
<td><strong>Bahrain</strong></td>
<td>• Relatively (in regional context) diversified economy, with oil, manufacturing (including aluminum and petro-chemicals) and financial sectors. • Pro-business and commercial and trading environment rated highly by independent international assessments.</td>
<td>• Regional volatility. • Despite economic diversification, there is still a dependence on oil revenues, directly (own output) and indirectly (regional influence).</td>
</tr>
<tr>
<td><strong>Egypt</strong></td>
<td>• Large domestic market and strategic position between the regional Middle Eastern and</td>
<td>• Nascent transition &amp; regional uncertainties. • Poverty and unemployment pressures have</td>
</tr>
<tr>
<td>Country</td>
<td>Key Features</td>
<td>Challenges</td>
</tr>
<tr>
<td>---------</td>
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<td>-------------</td>
</tr>
<tr>
<td>African markets.</td>
<td>Relatively diversified economy and sources of FX generation: including oil and gas, tourism, Suez Canal and a manufacturing base. Internal financial assistance and from the region (particularly the GCC) remains supportive. External debt repayments are comfortable.</td>
<td>The difficult and protracted political transition has slowed the rebound in economic performance, with consumption and investment (domestic and foreign) awaiting clarity of policies.</td>
</tr>
<tr>
<td>Iraq</td>
<td>Substantial hydrocarbon reserves &amp; Fiscal and current account surpluses. High FX and strong import cover &amp; Low external debt.</td>
<td>Domestic &amp; regional instability. High reliance on oil implies that Industry and export base are highly concentrated.</td>
</tr>
<tr>
<td>Jordan</td>
<td>Sound Arab &amp; international relations provide political, financial and technical support. Frequent debt rescheduling reduced external debt service to manageable levels.</td>
<td>High unemployment, lack of natural resources other than phosphates. Remittances subject to fluctuations in oil prices affecting supporting GCC Countries. Fiscal &amp; current account deficits.</td>
</tr>
<tr>
<td>Kuwait</td>
<td>World’s sixth largest proven oil reserves. High income, net creditor status. Strong oil and gas revenues generate large fiscal and current account surpluses and “excess” earnings are invested in foreign assets and/or used to supplement an oil account that is for the use of future generations. Low external obligations Generally supportive business environment.</td>
<td>Exposure to oil price and output cycles contributes to growth volatility. Industry is capital intensive and job creation is weak for a growing population. High degree of public ownership and control of oil and gas sectors results in a generally weak private sector.</td>
</tr>
<tr>
<td>Lebanon</td>
<td>Regional Support from GCC States. Large Lebanese Diaspora provides a major source of funding. Lebanese debt remains financially marketable and the country has been able to raise international financial support. Ownership of public debt is largely domestic, or with the Diaspora. Educated workforce. Sound Banking System. Strong FX reserves and import cover.</td>
<td>Regional &amp; neighbouring instability. Large fiscal deficits and high public debt (among the highest in the world when expressed as a percentage of GDP). Wide current account deficits.</td>
</tr>
<tr>
<td>Morocco</td>
<td>Economic resilience to volatile agricultural output, particularly resulting from periodic drought. Geographic proximity to a very large potential</td>
<td>Poverty &amp; unemployment remain high. Long-running dispute over the sovereignty of Western Sahara affects adversely relations with neighbouring Algeria and</td>
</tr>
</tbody>
</table>
Market (Europe) for international investors and traders.
- Improved external debt and debt service ratios.

**Oman**
- Abundant oil and gas resources, substantial foreign asset base & strong fiscal & current account surpluses.
- High dependence on oil & gas export earnings.
- Proven oil reserves have a 16 years limited time horizon at current rates of extraction.

**Qatar**
- Large reserves of hydrocarbons, including the world’s third-largest proven reserves of natural gas (after Iran and Russia)
- Long-term development strategy that has accelerated diversification away from upstream oil and gas
- Continuing high rates of GDP growth
- Fiscal and current account surpluses.
- Large foreign asset base (SWF of USD115bn).
- Despite the active policy of economic diversification, the economy relies heavily on hydrocarbons and this leaves it vulnerable to changes in levels of global activity and in international commodity prices.

**Saudi Arabia**
- Natural resource base (oil and gas).
- Strategic importance as an oil exporter with spare capacity to balance international markets and stabilize oil prices.
- Large asset base and strong FX reserves
- Fiscal and current account surpluses.
- Strong international assessments of the business environment.
- Dependence on international oil prices and only limited economic diversification.
- High unemployment and underemployment.

**Tunisia**
- Political transition has been relatively peaceful compared with Egypt, Libya, Syria and Yemen. A consensual approach to the political transition gives hope for progress.
- Although the economy has been affected adversely by recent events, it has a solid platform.
- Relatively diversified economy.
- Political system still in transition.
- The transition has not improved job creation.
- Over 50% of exports are destined for European markets and weakness in those economies limits Tunisia’s export growth.
- Textiles and clothing account for around 20% of exports and global markets are very competitive.

**UAE**
- Abundance of hydrocarbon resources.
- Large asset holdings & investments overseas.
- Actively diversifying economy, strong & relatively liberal business and trading environment.
- Healthy fiscal & current accounts.
- High dependence on global & regional markets & developments.
- Economy dependent on fluctuations in international oil markets.
- Speculative flows in stock and real estate markets provide concerns and necessitate monitoring.

**Source:** Figures and information were compiled from national and international sources.
d. Unemployment

The Arab world has the highest unemployment rate in the world. It is estimated that this rate has deteriorated from 14% before the events of the “Arab spring” in 2011 to no less than 16% currently\textsuperscript{15}. The region has the highest jobless rates in the world, with youth and female unemployment at staggering levels. This happens while sectors like tourism, information technology, banking and construction are booming in many countries, but employers face difficulties in finding the necessary technical skills. By encouraging the private sector to invest in the education field, Governments can promote career oriented schools that prepare students for the workplace.

On the other hand, high population growth leads to large numbers of young people entering the workforce every year, while growth in the Region has not been sufficient to create an appropriate number of jobs. The major reason for this is the low level of economic integration between the member countries of the Region. In fact the Region is considered to have the lowest levels of intra-regional trade in the world despite preferential market access provided by the Greater Arab Free Trade Area (GAFTA), besides significant geographical proximity. Trade potential exists, but is as yet untapped due to non-tariff obstacles. The International Trade Center (ITC) estimates that the removal of obstacles to trade within the Region provides potential to increase total trade of member countries of GAFTA by 10% and create at least 2 million jobs\textsuperscript{16}. 
The Table below illustrates the change in unemployment rates in selected Arab Countries during 2004 – 2013.

**Selected Countries Unemployment Rates, 2004-2013**  
(% of Labor force)

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>Algeria</td>
<td>17.7</td>
<td>15.3</td>
<td>12.3</td>
<td>13.8</td>
<td>11.3</td>
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<td>10.0</td>
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</tr>
<tr>
<td>Egypt</td>
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<tr>
<td>Tunisia</td>
<td>-</td>
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<td>18.3</td>
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<td>Jordan</td>
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</tbody>
</table>

*Source: JPMorgan Chase.*

### e. Food Security

Rising food prices are of particular concern for Arab countries because of their rapidly growing populations, limited water and arable land resources, and significant dependence on international food markets. The lack of appropriate policies and programs play a major role in aggravating the problem of food insecurity and make the Region one of the most
vulnerable to fluctuations in the prices of food products in the international markets.

Unlike most other regions in the world, the number of undernourished in the Arab world showed an alarming increase, as it climbed from an average of 13 million for the period 1990 – 1992 to an average of 25 million for the period 2010 – 201217.

Despite the existence of vast agricultural potentials in many Arab countries, notably Sudan, and the importance of this sector as a lead sector for economic growth and rural development, agriculture has not been used to its full potential in most Arab countries because of anti-agriculture policy biases and under investment. The Region needs to invest better in managing water resources and improving irrigation and agricultural productivity and devise incentives for private investment in modern agricultural and irrigation methods.

The current private sector investment in food production agro-activities in the Arab world, including agriculture and food industries, are quite modest in view of the limited capital invested that is estimated at only $357 million18. This sum is less than 1% of the annual Arab imports bill of major food commodities that is estimated at around $41 billion and expected to reach $63.5 billion in 203019. The Region is considered as the largest world net importer of cereals, with imports at around a quarter of the total world imports20.
IV. Reflections on Investment and Investment Climate in the Region

The private sector, with its financial weight and skill for innovation, has the potential to contribute in reversing the down side trends in the Arab economies. But first, Governments need to give it some room to operate. The public sector cannot continue to be the driver of economic growth throughout the Arab region. Private investment in the Arab Countries, with varying degrees between countries, lacked the size and dynamism observed in other regions, even before the onset of the transitions across the region\textsuperscript{21}. This is mainly due to domestic restrictions and long standing obstacles hindering the free movement of trade and investment between the Arab Countries. The Arab private enterprises are mainly medium and small-sized firms that proved to be critical for job creation. They generally face many burdensome and costly impediments that tend to make them less productive than elsewhere, while foreign investment is lagging behind other world regions, as shown in the following Chart. The tiny and declining share in investment inflows to the Arab world show their respective modest positions, with respect to developing countries in particular, and to other world regions in general.
Value and trends of FDI Inflows
in Main World Groups and the Arab Countries
2008 – 2013
($ million)

During 2008 – 2013 foreign direct investment inflows to the Arab world noticed a continued decline from $ 96.2 billion in 2008 to $ 48.5 billion in 2013, a decrease of approximately 50%\textsuperscript{22}. There are no signs that the situation will improve in 2014 and 2015, as the intensity of the regional tensions in a number of countries is still persisting and adding more ambiguity and uncertainty that discourage investments, despite the fact that few countries from the GCC group have seen a steady improvement in attracting domestic, regional and international investments. Only two countries by themselves, namely UAE and Saudi Arabia, account for 40% of the total FDI inflows to the Arab world in 2013, with 21% to the first country and 19% to the second one\textsuperscript{23}.

The same situation applies to the inter-Arab investment flows that are generally very modest. According to recent available information, these flows registered a major decline by 73.3% from $ 6.8 billion in 2011 to $ 1.8 billion in 2012\textsuperscript{24}. It can be estimated that 2013 witnessed a better performance, thanks to the new open opportunities for private domestic and international investment in the UAE, Iraq and Morocco. But instability and continued deteriorations witnessed in 2014 in Syria, Libya, Iraq, Yemen, Palestine and others will surely weigh heavily on the mood for investment in turbulent countries and in the region as a whole. Along with every decline in investment, the number of new job opportunities will surely decline by more than the rates of decline in investment, thus worsening an already aggravated unemployment rates.
V. Low integration in Regional Trade

In 1997 the Arab States established the Greater Arab Free Trade Area (Gafta) for gradually exempting goods of Arab origin from customs duties and other fees and charges, in addition to lifting of all non-tariff barriers on trade between member countries. Although its requirements were supposed to be completely fulfilled in January 2005, it is still facing many restrictions. Although elimination of tariffs achieved significant progress, a number of countries are still applying long negative lists of exceptions that significantly reduce the number of exchanged goods benefiting from GAFTA preferential advantages.

According to a survey conducted in 2013 by the General Union of Chambers of Commerce, Industry and Agriculture in Arab Countries (GUCCIAAC), non-tariff barriers stood as major obstacles to the free movement of trade between the Arab Countries. The survey covered the following categories:

- Customs tariffs.
- Fees equivalent to customs tariffs.
- Non-tariff barriers, including seven items, namely: extensively long time to cross borders, technical barriers, financial barriers, barriers on licenses, monopolies, price control and restrictions on quantities.
- Cost of transportation.
- Obtaining entry Visas.
The results of the survey showed that except for two major impediments, namely the long time spent to cross borders between the Arab Countries and the high cost of transportation; the negative responses were below 50% of the total number of participants in the survey\textsuperscript{26}. Complaints about the time consumed at the borders came at the top of the reported obstacles, as 52.81\% of the responses reported negatively on this issue\textsuperscript{27}. This is mainly due to inefficient handling and execution of transactions, manual inspections, repetition of procedures at different borders and poor infrastructure.

Those that claimed to face high transportation costs accounted for 51.69\%\textsuperscript{28}. It is estimated that the time consumed for trade at the borders account for 40\% of the total travel time. This accounts for about 30\% of the total travel costs and leads to an increase in the cost of shipments, and may sometimes reach as much as 80\% of the total value of the commodities, as compared with only 20\% for the world average\textsuperscript{29}.

In the third place came the difficulties associated with obtaining entry Visas at 47.19\% for those that answered negatively.

The following Table illustrates the relative order of eleven barriers specified in GUCCIAAC survey (in ascending order from the lower barriers to the higher barriers). It shows that technical restrictions came in the fourth rank at 46.07\% for negative responses. It was followed by the financial restrictions as reported by 44.94\% of the total participants, non-application of full elimination of tariffs as reported by 38.20\%, restrictions on licenses for imports and exports at 32.58\%, price control on certain commodities at
24.72%, monopoly exercised on certain commodities at 21.35%, restrictions on quantities at 20.22% and application of fees that are similar in effects to customs tariffs at 16.85%.

Barriers Facing GAFTA in 2013
Measured in percentage of negative responses to GUCCIAAC Survey (89 Companies)

<table>
<thead>
<tr>
<th>Barriers</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fees Similar to Tariffs</td>
<td>16.85%</td>
</tr>
<tr>
<td>Quantity restrictions</td>
<td>20.22%</td>
</tr>
<tr>
<td>Monopoly on some goods</td>
<td>21.35%</td>
</tr>
<tr>
<td>Control on prices</td>
<td>24.72%</td>
</tr>
<tr>
<td>Liscences barriers</td>
<td>32.58%</td>
</tr>
<tr>
<td>No elimination of Tariffs</td>
<td>38.20%</td>
</tr>
<tr>
<td>Financial barriers</td>
<td>44.94%</td>
</tr>
<tr>
<td>Technical barriers</td>
<td>46.07%</td>
</tr>
<tr>
<td>Difficult Visa entries</td>
<td>47.19%</td>
</tr>
<tr>
<td>High transportation costs</td>
<td>51.69%</td>
</tr>
<tr>
<td>Long time to cross borders</td>
<td>52.81%</td>
</tr>
</tbody>
</table>

VI. Limitations faced by Arab Banks

It is no exaggeration to say that banking and finance represent the second most important sector in the Arab world after oil and gas. This is especially true of Arab banking, which has come a long way in the last half century – from humble beginnings in commercial banking to full-service universal banks and to notable financial centers, especially in the Gulf. By the end of 2013 the banking sector realized growth of 15.4%, with total assets at $3 trillion, compared with 2.6 in 2012\textsuperscript{30}. Net banking profits increased by 20% in the same period and are expected to reach $40 billion by the end of 2014. Now there are 80 Arab banks among the top 1000 banks in the world.

Equally impressive has been the rise of financial centers as magnets for regional investments and capital, prominent among which is the Emirate of Dubai whose financial center (DIFC) has close to 1000 financial firms. Perhaps as important, Arab banks have managed to evade most of the financial troubles of recent years, thanks to a conservative banking culture, secure reliance on domestic and regional markets, and stable ownership structure.

Of course, the Arab world could still be tied down with more political uncertainty and banking prospects could suffer as result, but certainly the building blocks for a solid banking sector have been laid. Yet the role of Arab banks in development in many countries in the region is still
undermined and constrained by the old fashioned regulatory platforms and systems.

On the other hand, the Arab capital markets remain not as strongly developed, with market capitalization only close to 60% of GDP and the private bonds market is less than 5% of GDP\textsuperscript{31}. Equity markets are still stuck in volatility and lack of liquidity and institutional investors.

Regulations need to change to allow for more space for private sector investments, more ability for raising capital for companies and wider and deeper integration between the Arab markets. Reforms must focus on modernizing and easing companies and securities laws, harmonizing regulatory procedures, relaxing limits on foreign ownership, improving disclosure and the protection of minority rights, increasing the limit on free floats, simplifying the IPO processes and increasing transparency and governance.

VII. Economic Reform Priorities

a. Business regulations need to change

While the State is imperative for policy formulation and setting transparent regulatory frameworks, the private sector in the Arab Countries needs to be given enough room to contribute to sustained economic growth and job creation.
The unemployment challenge in the Arab world cannot be resolved without major strides in economic competitiveness, as only a strong and dynamic private sector can create a sufficient number of jobs to absorb the growing young workforce. A competitive and innovative private sector is essential to preventing the Arab world from lagging behind other emerging regions.

There is no region in the world where supporting the private sector is as important as it is in the Arab world. The region has abundant pools of capital, several hubs of innovation and gifted with talented youth. What is really missing is a conducive and stable investment climate that will help boost the confidence of private investors and create a critical mass of entrepreneurs that can help unleash the full potential of the region. The private sector cannot be expected to fill the gap in investment needs and create jobs to secure youth employment for millions of graduates in the Arab world in the face of outdated corporate and investment regulations.

The business climates in countries with ample capital reserves, like the GCC Countries, are with varying degrees, relatively more supportive. However, the situation is different in other parts of the Arab world, where struggling with regulations, in many cases, drains entrepreneurs’ energy and time, and makes investors reluctant to support ventures. Setting up a company in Beirut or Amman might take as long as a month, whereas starting a business in the United States could happen in 24 hours. Apart from specific zones, establishing a company in the Arab region is relatively difficult, because of the paperwork required, from registering a corporate name and logo, to coping with ownership restrictions on foreigners, to
complying with labor laws. The list is endless and filling its criteria wastes time, money and efforts.

Many Arab States in the region have already begun to improve their business environments by simplifying regulations, opening up the financial sector and reducing restrictions on trade and investment. Several oil-importing countries are already undertaking adjustment measures. Yet the challenge of removing subsidies or restraining wage growth and Government expenditures during a period of high social unrest should not be underestimated.

For the countries affected by political unrest, the burden of rising debt and debt service obligations, and limited access to financing, has increased the urgency of public finance reform. However, pressing social expenditure priorities have emerged and countries may need to apply short-term expansionary expenditure measures during the transition that can be reversed later in time. In these countries the primary challenge remains to secure normal security conditions that are imperative for economic and social stability and to restore investment confidence.

Other Arab countries, like Morocco and Jordan, already introduced some structural reforms that were welcomed by the business communities. Morocco’s reform agenda aimed at restructuring the subsidy system and enhancing the investment climate for the sake of achieving rapid and more inclusive economic growth, while providing buffer reserves against external shocks.33
In Jordan, the Government has committed itself to introduce new investment incentives. New policies were introduced to revive the energy sector, including greater use of renewables, long-awaited exploitation of Jordan’s substantial deposits of shale oil, and the construction of a nuclear generating station\textsuperscript{34}. Jordan’s efforts were highly supported by the international funds, as recently, the World Bank’s International Finance Corporation and several other international finance institutions finalized a $221 million loan package to support the first privately owned wind farm in Jordan\textsuperscript{35}. However, it will take several years before these undertakings significantly reduce the need for imported hydrocarbons.

Likewise, the GCC Countries also introduced some reforms that target better macro-economic policies. According to recent country reports published by the IMF, the Saudi Government had made progress on reforming the State budget, while Qatar had made progress in fiscal planning and in improving financial regulation. As for Kuwait, the Government has committed to decrease public spending and reduce subsidies provided for fuel, energy, water and food. Recently a new law was passed in the UAE to support the growth of small and medium enterprises (SMEs) and boost entrepreneurship in the country. The law requires federal Government entities to allocate at least 10% of their purchasing, servicing and consulting budgets to SMEs. Furthermore, SMEs will have increased access to finance and will be granted land for industrial or agricultural projects.

But there is much more to be done. The Arab Governments have to scale up their reform policies and programs. There are three key areas for reform that could help improve the business climate. They are:
- Effective regulatory environment for firms.
- Adequate access to finance.
- Supportive public infrastructure.

The Arab Governments need to embrace long-term strategic visions for their economies, and give innovative companies a chance to flourish by encouraging competition. A business culture based on clear, modern and fair regulations needs to be encouraged. Governments are responsible for fostering a regulatory environment that is conducive to creating business opportunities for achieving sustainable economic growth and stable employment levels. The States need not to invest massive amounts of capital in domestic markets. Rather the States’ role is to set pro-investment policies and to regulate and monitor the regulations to make sure that they are fairly applied. As a matter of fact, what attracts investors first and foremost, even before an opportunity arises, is the rule of law. For example, Hong Kong is thriving as an international hub for business because of the rule of law and fairness in dealings. It is the independent judiciary that is the main reason for this prized prosperity. Corporate laws and judiciary systems in many Arab Countries lag behind their counterparts in developed and developing economies.

b. Switching to renewable energy

In many Arab Countries unreliable electricity supplies are a major constraint to private sector development. According to a survey conducted by the World Bank, over 50% of firms in the Middle East and North Africa
(MENA) identify shortfalls in electricity as a significant problem. A reliable power supply is important for economic growth. It is also critical for ensuring further private investments in the region. The World Bank survey reveals that the region experiences more power outages, and with longer durations, than any other region in the world.

The best alternative to face this problem is to invest in renewable energy. According to estimates, renewables could potentially produce 200,000 Megawatts of power annually in the whole region. Actually the renewable energy sector is not only the perfect solution for power shortfalls and deficits, but also a potential rewarding investment opportunity for investors from the private sector.

Many Governments in the region, like the UAE and Jordan have identified some targets in this sector. But for the industry to take off, it needs a lot more regulatory support. The Arab Governments need to enact transparent regulations for the power sector that encourage private investment.

c. Encourage entrepreneurship

Recent World Bank data shows that the number of startups in the region increased by eight times between 2005 and 2011. Around 120 venture capital transactions were completed in 2009 and 2010, compared with only 62 between 2006 and 2008. This demonstrates that an entrepreneurial spirit is quite vivid in the region. But still, there are not enough of these ventures to drive economic growth potentials.
According to a Forum that was held during March, 2014 in Beirut\textsuperscript{39}, there are many difficulties and obstacles that are holding the market back. The major ones include, besides unstable political situation and security hardships in the region, lack of funds, lack of supporting systems, relatively small scale markets, lack of domestic and regional cooperation, bureaucratic and time consuming regulatory systems and lack of training on different aspects of business. According to the World Bank, only about 6% of firms in the region have access to loan or line of credit with a bank, in comparison with 30% in South Asia and 48% in Latin America\textsuperscript{40}.

Nevertheless, a number of Arab Countries introduced new promising initiatives, such as the mentioned earlier UAE new Law to support SME’s and entrepreneurship, loans provided in recent years by the Lebanese banking sector under the instructions and support of the Central Bank of Lebanon\textsuperscript{41}, and Kuwait’s recent allocation of $ 7 billion to be invested in startups.

d. Infrastructure development

Infrastructure is an important driver of economic competitiveness in the present globalized investment landscape. Yet the divergence between the need for infrastructure and the ability of Governments to deliver continues to widen in the Arab non-oil countries, creating a bottleneck for growth and diversification.
A major breakthrough was achieved at the Arab Economic Summit that was held in Kuwait in January 2009 in which the Arab leaders launched several major pan-Arab projects to develop and link infrastructure in transportation between the Arab Countries, including roads, railways and other major infrastructure frameworks, such as electricity grids. But these projects need a long time to before they become rewarding, besides the fact that their progress is limited by public indebtedness of many individual countries and lack of financial resources necessary to implement their shares of the projects.

With many countries across the Arab region facing fiscal constraints, the private sector has an opportunity to play a key role in developing vital infrastructure projects. The Arab Governments should focus on creating a transparent regulatory and institutional framework in which the private sector can operate. Only three non-oil Arab countries in the region introduced public – private partnership (PPP’s) laws, namely Jordan, Egypt and Kuwait. Yet partnership has been effective in many Arab Gulf countries since many years, especially in power and water desalination projects. The later countries are not short of capital, but wanted to benefit from the experiences of the private sector. However, it is essential to establish the necessary framework regulations in these countries to avoid the expenses incurred in withdrawing projects after launching them, a pattern that happens at a high rate.
According to a recent Lebanese study\textsuperscript{43}, there are four major factors for success of PPP’s in the Arab world. They are the following:

- Commitment and willingness of the public sector.
- A Modern law for PPP’s that sets a sound and transparent methodology for conducting contracts.
- Establishment of a specialized public entity to supervise and administer the deals, as this kind of partnership requires high skills in different juridical, economic, technical and financial aspects.
- Availability of specialized skills in this sophisticated financial field in potential financing Arab banks.

The following Table shows World Bank data on logistics and infrastructure indicators relating to trade and shipping, where countries’ listing is sorted according to the quality of port infrastructure in ascending order from worst to best\textsuperscript{44}. The Table shows wide disparities in the performance of the Arab Countries in this respect.
## World Bank Trade Facilitation Indicators, 2014

<table>
<thead>
<tr>
<th></th>
<th>Logistics performance index (1-5 worst to best)</th>
<th>Burden of customs procedures (1-7 worst to best)</th>
<th>Lead time (days)</th>
<th>Documents (number)</th>
<th>Liner shipping connectivity index (0-100 low to high)</th>
<th>Quality of port infrastructure (1-7 worst to best)</th>
<th>Freight costs to the United States (S)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Algeria</td>
<td>2.41</td>
<td>2.7</td>
<td>8</td>
<td>39</td>
<td>8</td>
<td>9</td>
<td>6.9</td>
</tr>
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<td>Yemen</td>
<td>2.89</td>
<td>3.3</td>
<td>3.1</td>
<td>3.6</td>
<td>6</td>
<td>9</td>
<td>19</td>
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<tr>
<td>Mauritania</td>
<td>2.4</td>
<td>3.3</td>
<td>8</td>
<td>7</td>
<td>8</td>
<td>8</td>
<td>6.5</td>
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<tr>
<td>Libya</td>
<td>2.28</td>
<td>2.9</td>
<td>2</td>
<td>4</td>
<td>7</td>
<td>9</td>
<td>7.3</td>
</tr>
<tr>
<td>Syria</td>
<td>2.6</td>
<td>2.9</td>
<td>3</td>
<td>4</td>
<td>8</td>
<td>9</td>
<td>16.5</td>
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<tr>
<td>Tunisia</td>
<td>3.17</td>
<td>3.8</td>
<td>2</td>
<td>1</td>
<td>4</td>
<td>6</td>
<td>5.6</td>
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<tr>
<td>Egypt</td>
<td>2.98</td>
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<td>2</td>
<td>3</td>
<td>8</td>
<td>10</td>
<td>57.5</td>
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<td>3</td>
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<td>3.4</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>7</td>
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<td>3</td>
<td>5</td>
<td>5</td>
<td>7</td>
<td>22.7</td>
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<td>3</td>
<td>5</td>
<td>7</td>
<td>55.5</td>
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<tr>
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<td>5</td>
<td>6</td>
<td>5</td>
<td>7</td>
<td>59.7</td>
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<td>2</td>
<td>2</td>
<td>5</td>
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<td>3.4</td>
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<td>9</td>
<td>10</td>
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</tr>
<tr>
<td>Djibouti</td>
<td>1.8</td>
<td>..</td>
<td>..</td>
<td>..</td>
<td>5</td>
<td>5</td>
<td>20.3</td>
</tr>
<tr>
<td>Somalia</td>
<td>1.34</td>
<td>..</td>
<td>..</td>
<td>..</td>
<td>..</td>
<td>..</td>
<td>4.2</td>
</tr>
<tr>
<td>Sudan</td>
<td>2.1</td>
<td>..</td>
<td>3</td>
<td>8</td>
<td>7</td>
<td>7</td>
<td>9.3</td>
</tr>
<tr>
<td>W Bank &amp; Gaza</td>
<td>..</td>
<td>..</td>
<td>..</td>
<td>..</td>
<td>6</td>
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</tr>
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<td>World</td>
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<td>4.1</td>
<td>4.2</td>
<td>5.9</td>
<td>6</td>
<td>7</td>
<td>..</td>
</tr>
</tbody>
</table>

**Source:** Deducted from World Bank data, April 2014.
VIII. Conclusion

The Arab world is rich with potential and opportunities. It has a large and growing consumer base and is located at the intersection of Asia, Europe and Africa. The region has a rapidly growing and young population that are capable of being valuable human resources, complemented by the abundant natural resources, especially for being home to 60% of the world’s oil and around 40% of its gas reserves. It offers significant investment opportunities for those with a long-term investment horizon and willing to take risks.

Structural reforms need to target the most significant impediments, in particular bureaucratic inefficiency and corruption, tax systems that do not support competitiveness, difficulties and inequalities in access to finance, low female labor force participation, and labor regulations that are not supportive to job creation.

Many of the necessary reforms are difficult to implement in the Arab Countries that are facing political transitions. Yet some can be pursued immediately to help improve confidence. For example, streamlining business regulations related to starting a business, registering property, or obtaining permits and electricity, providing training programs for the unemployed and unskilled, improving customs procedures, and deepening trade integration between the Arab Countries.

The private sector can play a significant role. But it will only do so in an improved business environment through smarter regulations and adequate financing to small and medium-sized firms. A more inclusive economy also
involves providing better regulations to encourage the real economy sectors and SME’s that are behind the majority of private sector employees, the right conditions for more youth and women to enter the job market, education that matches students’ skills with needs of modern business, and better functioning labor markets.

For the Arab economy to gain momentum and develop into sustainable and higher growth, structural impediments to private economic activity has to be tackled. A weak business and legal environment, and limited access to bank credit in some countries, hinder private sector growth, especially for small and medium-sized enterprises. Reforms, when taking into account the specificities of each country, can accelerate productivity, boost private sector investment and export competitiveness, create jobs, and most importantly enable the Arab economies to embrace their generations.

Although the journey of transition might take some unpredictable twists and turns, and even prove perilous on some occasions, the final destination is clear. It is to unleash the potential of a better future for all.

The policy makers in the Arab world are in the driver’s seat to take effective measures. In the first place to strengthen macroeconomic stability and replace untargeted subsidies with more effective social safety nets. To improve the quality of government expenditure for the sake of responding to the real needs of the population, raise productive public investment levels and lower the debt that minimizes lending to the private sector.
Yet for macroeconomic stability to sustain, it is fundamental to focus on shifting away from the economic structures of the past. It is imperative to invest in modernization and in opening up to regional and global integration and diversifying the region’s economies. This in turn lays the groundwork for inclusive growth and more opportunities for all.

The way forward needs many purposeful actions to be pursued and taken as follows:

1) **For wider and deeper trade:**
   a) Elimination of non-tariff barriers to trade within the region.
   b) Harmonization of Arab trade policies and regulations.
   c) Extend the scope of GAFTA to include trade in services.
   d) Invest in upgrading trade-related infrastructure to enhance competitiveness, including roads, ports, airports and storage and handling facilities.
   e) Facilitate the flow of trade regionally and internationally, through building institutional capacity, allowing labor mobility, incorporating technology, streamlining and simplifying all trade related procedures, mainly customs.

2) **For more export diversification:**
   a) Improve the investment climate and eliminate obstacles that hinder free market forces.
   b) Provide incentives for market driven entrepreneurial dynamism in the services sectors and high value added products.
   c) Improve access to trade financing, particularly to the small exporters with limited resources.

3) **For creating jobs:**
   a) Advocate the necessary resources for human development and developing skills.
   b) Modernizing education services, especially technical and vocational education, to meet the needs of the private sector and the changing market demand.
4) **For food security:**
   a) Formulate a common Arab strategy for food security.
   b) Build and strengthen safety nets.
   c) Enhance food supply by focusing on introducing investment incentives and on agricultural productivity and efficient yields through increased R&D investments and more efficient management of scarce resources, namely water and arable land.
   d) Reduce exposure to market volatility by improving supply chain efficiency and policy measures to address inefficiencies.

5) **For macroeconomic soundness and stability:**
   a) Rationalize public spending for more fairness, more efficiency and more inclusive growth. This necessarily implies more privatization and more spending on education and education and research systems that result in productive employment, and less subsidies that primarily benefit those who do not need it.

6) **For better transparency and governance:**
   a) Strengthen independent judicial systems.
   b) Enforcement of the rule of law.
   c) Fostering accountability of Government policies and appropriate dissemination of information to citizens and business communities.

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