



COVID-19 and its impact on Arab economic integration



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Economic and Social Commission for Western Asia

COVID-19 and its impact on Arab economic integration



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United Nations publication issued by ESCWA, United Nations House,
Riad El Solh Square, P.O. Box: 11-8575, Beirut, Lebanon.

Website: www.unescwa.org.

22-00262

Key messages

- *The global economy has witnessed a tectonic shift in economic geography over the past few decades. The G7 nations, which used to account for around half of global gross domestic product (GDP) (in purchasing power parity terms), have seen their share decline to less than a third in recent years.*
-
- *Arab countries display large differences in natural resources and factor endowments. The convergence hypothesis suggests that other things equal, countries with lower per capita incomes grow faster than higher per capita income countries, leading to a secular convergence of per capita income between countries.*
-
- *Arab countries did not substantially benefit from greater global or regional integration during the pre-COVID-19 period. A tectonic shift to Asia is an important change, given that Asia is a leading trade and economic partner.*
-
- *As China increases its investments in the Gulf Cooperation Council (GCC) subregion and the wider Arab region as part of its Belt and Road Initiative, the Arab region should build on those linkages to further integrate into global value chains.*
-
- *The COVID-19 pandemic resulted in a sharp deterioration in fiscal balances in the Arab region: across all countries, decline in economic activity and domestic demand meant a decline in revenues, while oil-exporting countries also suffered a massive drop in oil revenues.*
-

Contents

Key messages	iii
Introduction	1
1. Impact of COVID-19 on Arab economies, and on global and regional integration	25
A. Impact on income and output in Arab countries	25
B. Impact of COVID-19 on trade	29
C. Impact of COVID-19 on labour, flows and remittances	40
D. Impact of COVID-19 on capital market developments	46
2. Lessons from the pandemic and policy proposals to support Arab regional and global integration	51
A. Trade and investment	54
B. Labour and rights of establishment	56
C. Banking and capital market integration	56
D. Other policy proposals	57
References	59

List of tables

Table 1. International migrant workers: numbers and ratios by region	19
Table 2. Regional stock markets correlation, intra-regionally and with relevant global indices	22
Table 3. Quarterly estimates of working hours: the world and Arab countries	42
Table 4. Employment at risk in the Arab region, by sector, 2020	44

List of figures

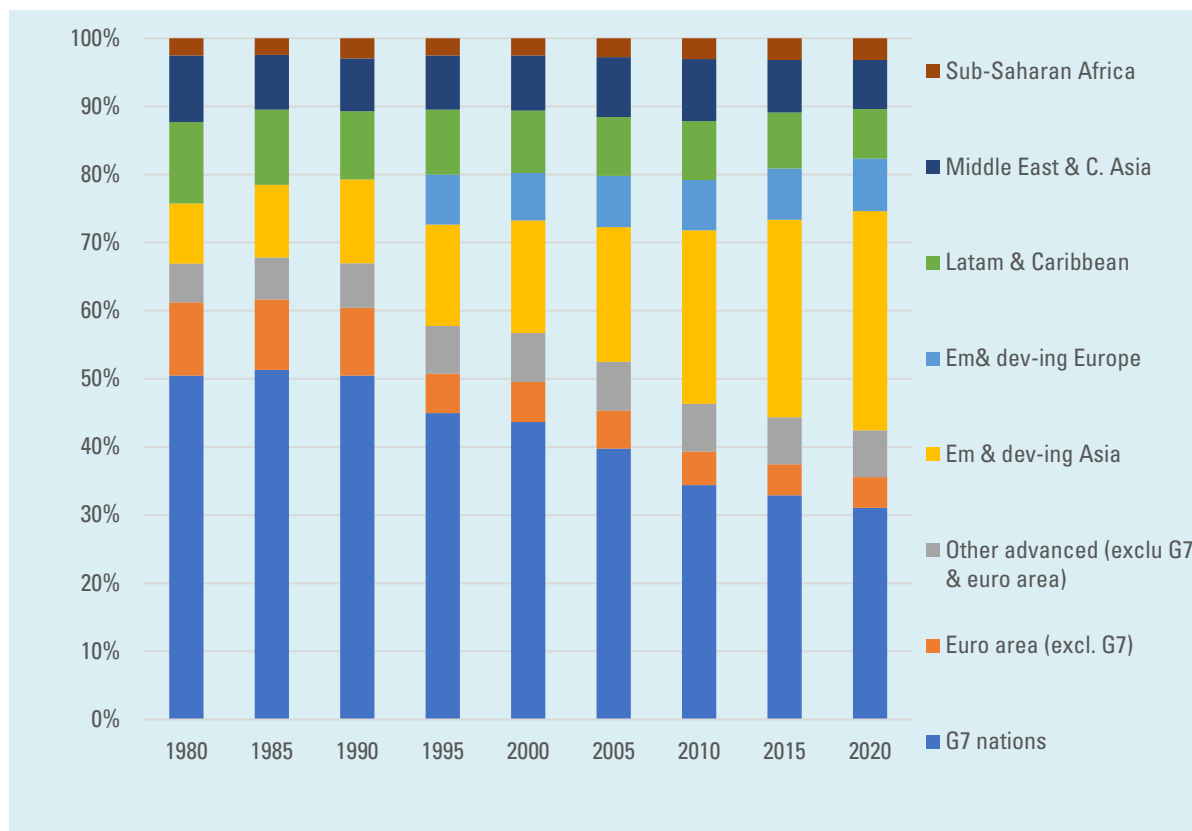
Figure 1. Share of global GDP by region, based on PPP	1
Figure 2. GDP growth (Constant prices, percentage year-on-year)	2
Figure 3. σ -convergence: dispersion of GDP per capita in the Arab region	4
Figure 4. Absolute β -convergence: relationship between real GDP per capita and initial GDP per capita	4
Figure 5. Share of exports by region (Percentage of total export), 1980-2020	5
Figure 6. Share of FDI investment (Percentage of global FDI inflows), 1980-2020	6
Figure 7. Sum of exports and imports of goods and services	7
Figure 8. Sum of exports and imports of goods	7
Figure 9. Sum of exports and imports of services	8
Figure 10. Intra-group exports as a percentage of group's total exports, by subregion, 1995-2000	8
Figure 11. Intra-group exports as a share of total exports by subregion, 1995-2000	9
Figure 12. GCC intra-group exports, exports to other Arab countries and to the world	9
Figure 13. Services exports as a percentage of world services exports, 2005-2020	11
Figure 14. Services imports as a percentage of world services exports, 2005-2020	12
Figure 15. Services Trade Restrictiveness Index, 2016	13
Figure 16. Two-way investment flows into the Arab region	14
Figure 17. Two-way investment flows into Arab subregion region	14
Figure 18. Greenfield FDI into Arab countries, 2003-2020	15
Figure 19. New capital investment in the Arab region, 2019	16

Figure 20. Top investing countries by capital expenditure, 2019	16
Figure 21. FDA in Arab countries by sector, 2019	17
Figure 22. FDA in Arab countries (Capital expenditure) by sector, 2019	17
Figure 23. Total migrant stock at mid-year by region	18
Figure 24. Remittance inflows into Arab major labour exporting countries	20
Figure 25. Remittance outflows from Arab major labour exporting countries	20
Figure 26. Equity market performance in the Arab region	21
Figure 27. Emirati stock market correlation with Saudi Arabia has strengthened over time	23
Figure 28. Correlation of Saudi Arabia with MSCI World and S&P is slightly higher than that of the United Arab Emirates	23
Figure 29. Merchandise trade by region, 2020	28
Figure 30. GCC exports to the Arab region	29
Figure 31. Maghreb exports to the Arab region	30
Figure 32. Mashreq exports to the Arab region	30
Figure 33. GCC exports to the world	31
Figure 34. Maghreb exports to the world	31
Figure 35. Mashreq exports to the world	32
Figure 36. FDI inflows into Arab countries, 2020 versus 2019	35
Figure 37. Greenfield FDI to Arab countries, 2020	35
Figure 38. New FDI as a percentage of total projects in the Arab region, 2020	36
Figure 39. New capital investment in the Arab region, 2020	37
Figure 40. Arab countries investing in the region, 2020	37
Figure 41. FDI by sector in Arab countries: capital investments	38
Figure 42. Capital investment in inter-Arab projects by sector	39
Figure 43. Origin of migrants in the Arab region, 2020	41
Figure 44. Top remittance recipients in the Arab region (Billions of dollars) 2021 vs. 2020.	45
Figure 45. Top remittance recipients in the Arab region	46
Figure 46. Equity market performance in the Arab region	47
Figure 47. Discretionary fiscal response to the pandemic in selected Arab countries	51
Figure 48. Fiscal balance	52
Figure 49. Public debt	53
Figure 50. Digital and sustainable trade facilitation, 2021	54
List of boxes	
Box 1. Oil production and consumption	26
Box 2. Tourism sector in the Arab region has yet to recover from pandemic fatigue	32
Box 3. Agriculture sector in the Arab region	47

Introduction

The global economy has witnessed a tectonic shift in economic geography over the past few decades. The G7 nations, which used to account for around half of global GDP (in purchasing power parity (PPP) terms), have seen their share decline to less than a third in recent years. Emerging Asia now accounts for about a third of global GDP, up from under 10 per cent in 1980. This tectonic shift was largely driven by the rise of China and its entry into the World Trade Organization (WTO) in 2000, which in turn allowed the country to stamp its footprint as a major global economic powerhouse. In contrast, the Arab region is one of the least dominant players in the global economy, with only sub-Saharan Africa trailing behind.

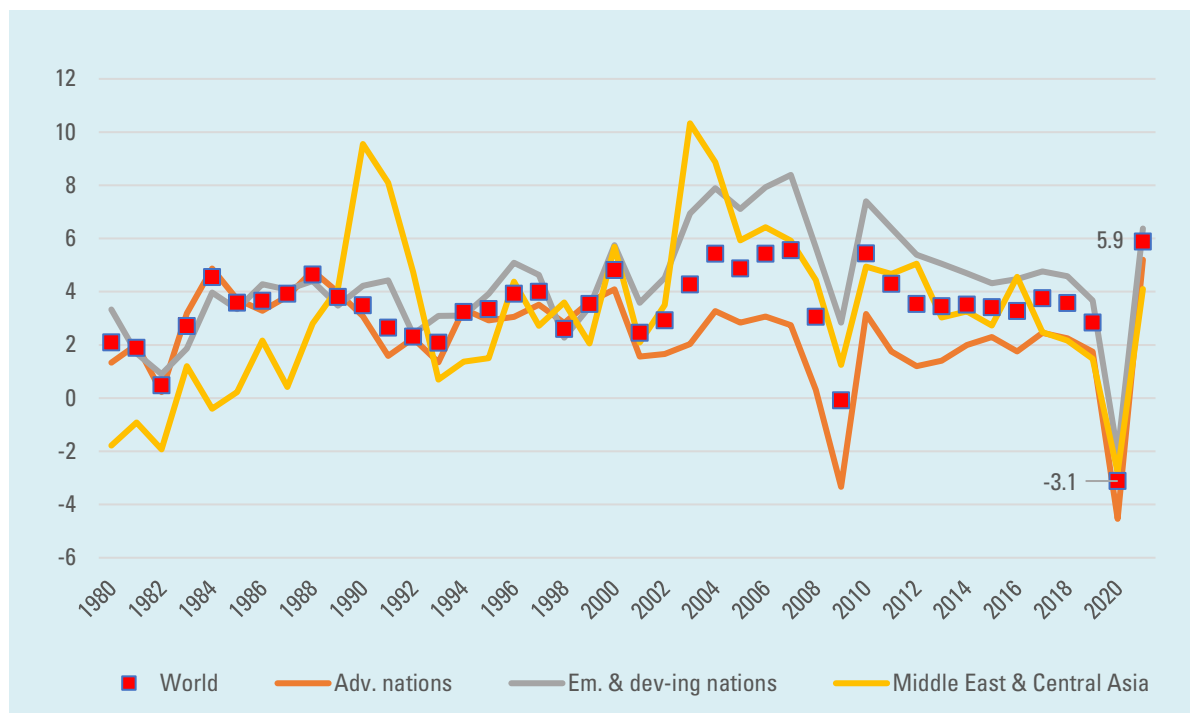
Figure 1. Share of global GDP by region, based on PPP



Source: IMF (Oct 2021 World Economic Outlook database); ESCWA calculations.

The spread of the COVID-19 pandemic in 2020 added an additional layer of uncertainty¹ to global growth prospects, which had recorded an average growth of just 2 per cent following the dip resulting from the financial crisis of 2007-2008. Growth in emerging markets had been outpacing that of developed countries during this period, until the pandemic hit. Growth declined across all regional groups, but the severity of the pandemic was felt most in developed countries.

Figure 2. GDP growth (Constant prices, percentage year-on-year)



Source: IMF (Oct 2021 World Economic Outlook database); ESCWA calculations.

The economic impact of the pandemic has trickled down through two main channels. Firstly, supply shocks: factory closures led to disruptions in manufacturing and production, with an initial period of dislocation in global supply chains. With transport infrastructure and the logistics sector operating at below full capacity, spillover effects resulted in delays and sharply higher shipping/ air cargo costs (an issue that remains unresolved to date), resulting in inflationary pressures and curtailing domestic and international trade. Productivity losses due to plant shutdowns and absenteeism also added to the shocks. Secondly, demand shocks: the pandemic led to heightened uncertainty and panic, resulting in a decline in consumption (which was compounded by a decline in labour incomes from job losses/shorter working hours) and investment (for businesses). Sectors requiring person-to-person contact, including travel and tourism, hospitality, retail and leisure services, were

¹ The Global Economic Policy Uncertainty Index (www.policyuncertainty.com/global_monthly.html) surged to a peak in May 2020.

directly and severely affected by this demand shock. Initial financial market losses² were also accompanied by capital outflows³ from emerging market economies (EMEs) – both patterns reversed after most countries responded with sizeable policy stimulus packages.

With the pandemic still ongoing, global supply chain disruptions continue to be a major concern, along with rising inflation and the new Omicron variant. The International Monetary Fund (IMF), in its October 2021 World Economic Outlook, projected cumulative GDP losses of around \$5.3 trillion over the next five years should the COVID-19 vaccine gap not be bridged. Unfortunately, the global vaccine gap is growing wider: booster shots are being rolled out in high-income countries while over 50 countries have vaccinated less than 25 per cent of their populations, and some low-income countries have less than 10 per cent vaccinated with at best one dose. The result has been an unbalanced growth recovery with emerging market economies, including many Arab economies, lagging behind advanced economies.

A. Convergence and output dependence in the Arab region

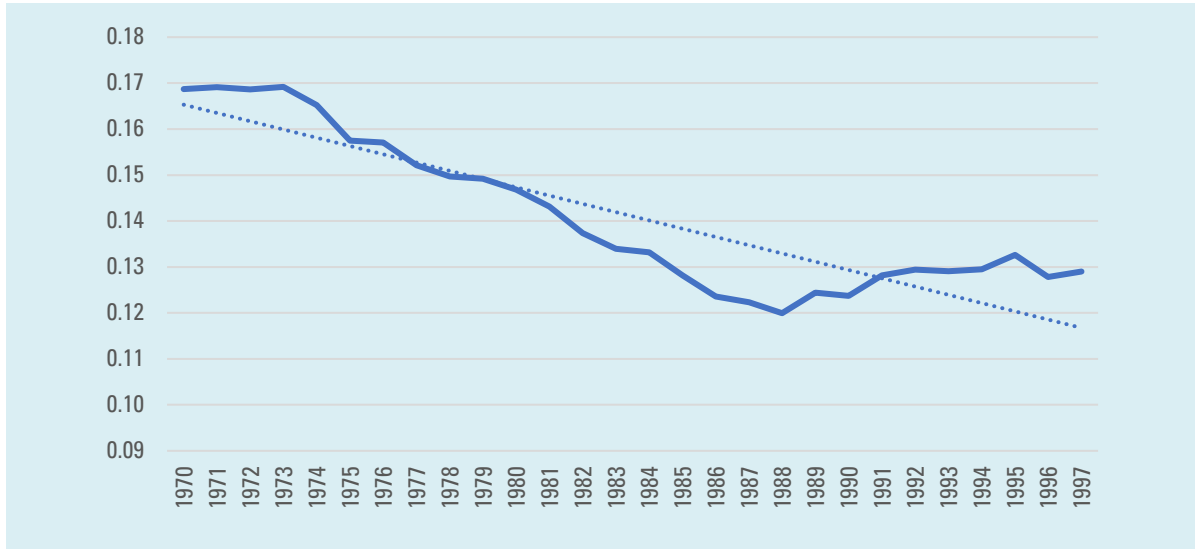
Arab countries display large differences in natural resources and factor endowments, from natural resource-rich but labour-poor countries (mainly GCC countries and oil producers), to labour-rich but natural resource-poor countries (largely Mashreq and Maghreb countries, excluding Libya), along with large differences in per capita incomes. The convergence hypothesis suggests that, other things equal, countries with lower per capita incomes will tend to grow faster than higher per capita income countries, leading to a secular convergence of per capita income between countries. The present study examines whether the two main concepts of convergence⁴ are visible in the Arab region: if there is a falling dispersion of income over time (σ -convergence); and if poorer countries grow more rapidly than rich ones and their per capita incomes converge in the long run.

For the purpose of the present study, long term GDP per capita data from the Penn World Table⁵ is used for the period 1970-2019 to understand convergence in the Arab region. The σ -convergence, which measures the dispersion rate of GDP per capita, is calculated using the coefficient of variation (standard deviation divided by the mean). Even though there are a few years when the dispersion increased (early 1990s), for the full period, the dispersion of per capita income has shown a decline or sigma convergence at the level of the region. Arab developing countries are gradually and slowly “catching up”. A country-by-country breakdown shows that countries like Algeria, Egypt, Jordan, Morocco and Tunisia gained the most over time. Meanwhile, oil-exporting countries posted a

-
- 2 The Global Equities Index (MSCI World Index), after a period of initial sell-off, displayed a 15 per cent return for all 2020 (buoyed by tech stocks while energy lagged behind).
 - 3 OECD estimates point to around \$103 billion being withdrawn from EMEs from March to May 2020, with equity inflows plummeting first, followed by debt flows (by November-December 2020, portfolio flows had rebounded). (OECD, 2021).
 - 4 The Solow Model (neo-classical growth theory), using the Cobb-Douglas production function, indicates that economies converge to a long-term equilibrium, meaning that the farther a country is from its long-term income level, the faster it grows (“catching up”). The endogenous growth theory (Lucas) posits that technological developments in a country will depend on how far the technological level lags behind the most developed country.
 - 5 Penn World Table version 10.0, available at www.rug.nl/ggdc/productivity/pwt/?lang=en.

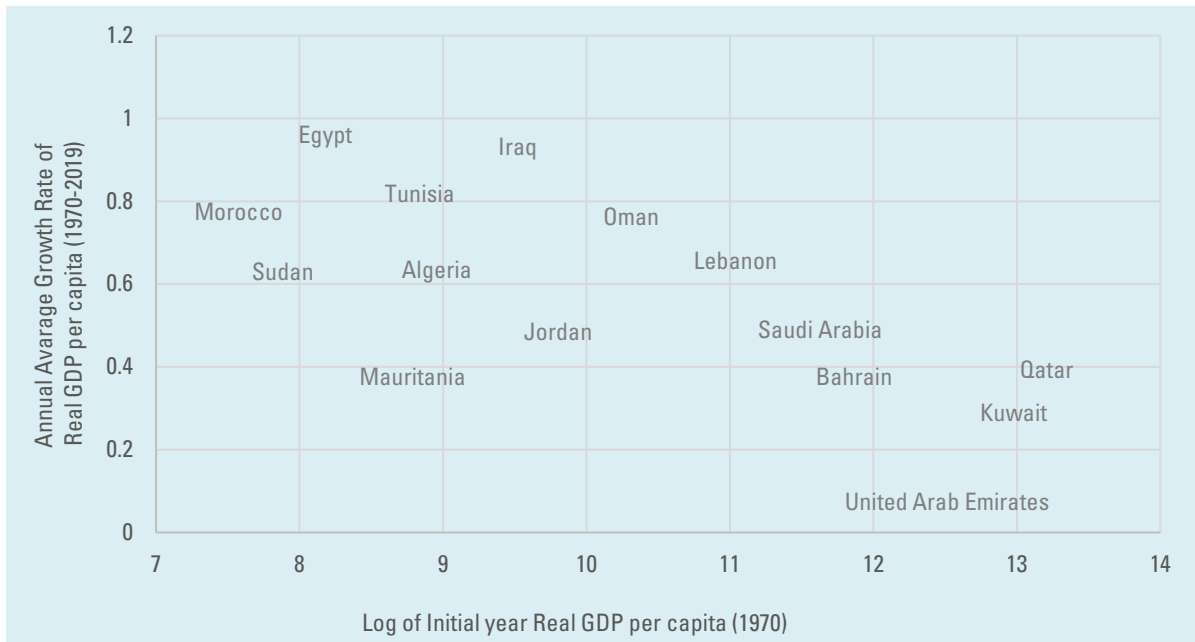
decline in the average growth rate of real GDP per capita during this period. Consequently, the real per capita GDP “distance” has narrowed, resulting in a decline in the dispersion.

Figure 3. σ -convergence: dispersion of GDP per capita in the Arab region



Source: Penn World Table version 10.0; ESCWA calculations.

Figure 4. Absolute β -convergence: relationship between real GDP per capita and initial GDP per capita



Source: Penn World Table version 10.0; ESCWA calculations.

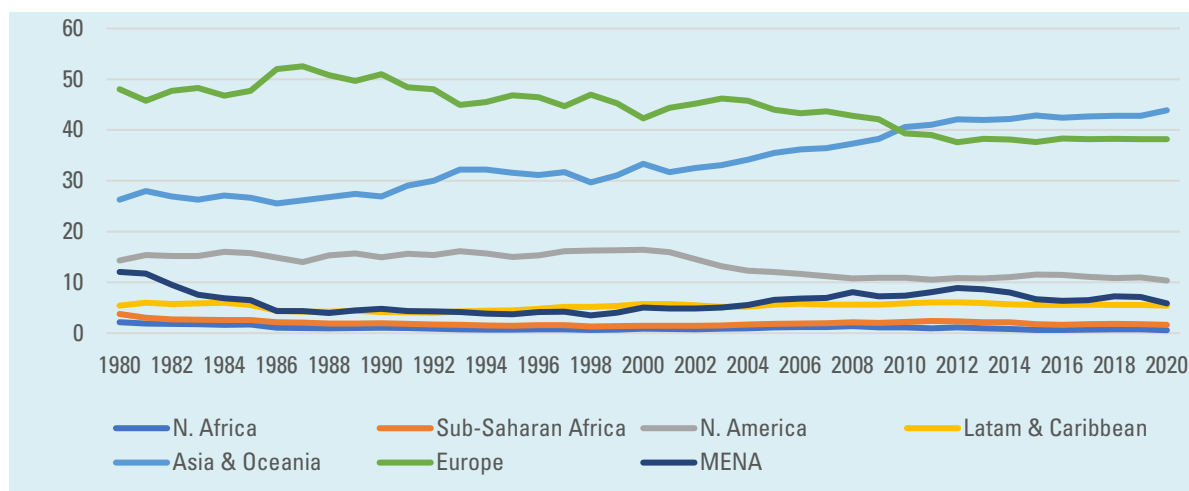
Checking for absolute (unconditional) β -convergence shows that for the period 1970-2019, regions with lower initial GDP per capita experienced relatively higher average growth rates (left-most part of figure 4). Meanwhile, richer oil exporting nations (right-most section of figure 4) posted a relatively slower growth during the period. This indicates the presence of unconditional β -convergence, visible as a negative relationship between income growth per capita and initial income per capita.

The process of convergence can be accelerated through greater economic integration. Divisions and barriers between countries created by geography, politics, poor infrastructure and inefficient policies act as an impediment to economic growth, development and convergence. Regional economic integration is a process in which two or more countries agree to eliminate economic and other barriers, with the end goal of enhancing productivity, achieving greater economic interdependence, and enjoying the resulting economic benefits from increased trade, investment and the unimpeded flow of factors of production. Simply put, regional economic integration requires cooperation and agreement between countries on: trade and investment and labour barriers, laws and regulations; competition policy, investor rights, rights of establishment, product standards, public procurement and intellectual property rights; transport, ICT, water, resources and infrastructure; macroeconomic, fiscal and financial policies; and provision of common public goods (shared natural resources, security). A combination of agreements and reforms allow countries to integrate goods, services and factor markets, thereby facilitating the flow of trade, capital, resources, people, technology and knowledge.

B. Weak global economic integration is in the Arab region

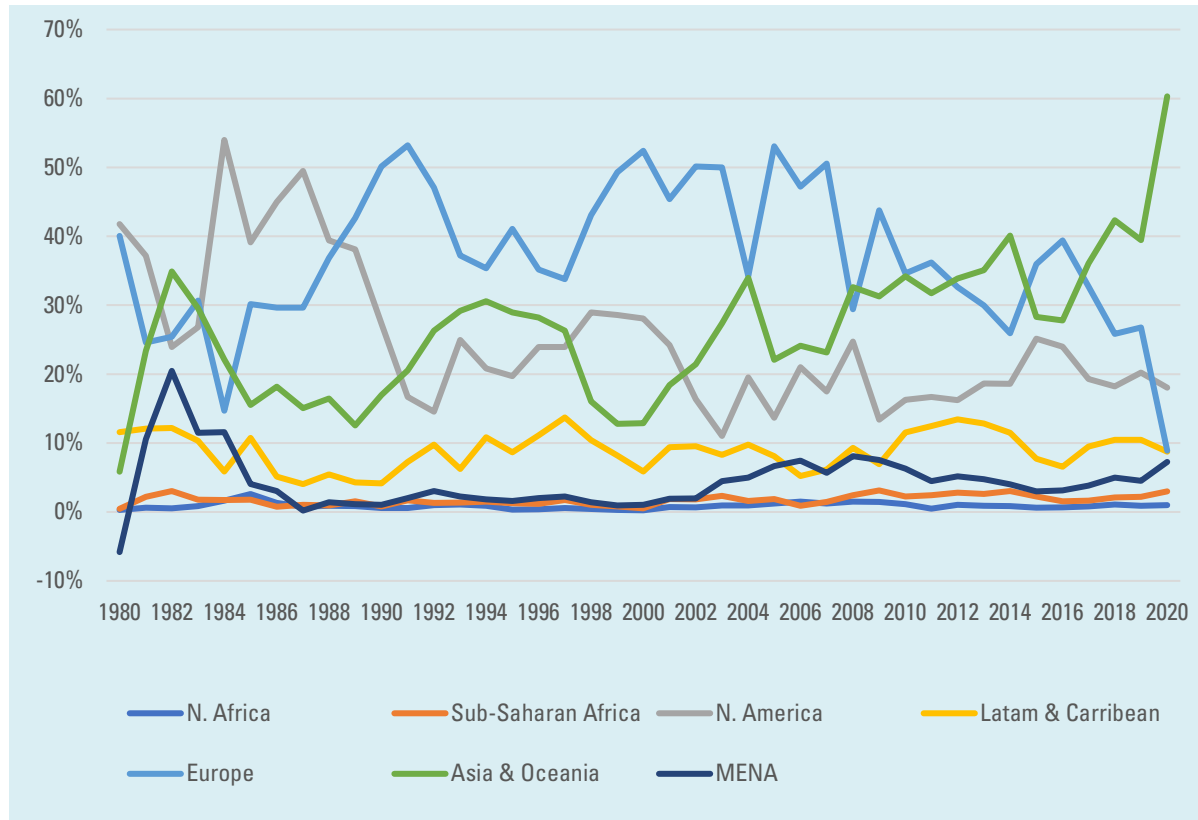
Before delving into the impact of COVID-19 on the Arab region, the present study examines the trends in trade and investment flows, and in labour and related remittances flows to understand how integrated Arab countries are in the global economy.

Figure 5. Share of exports by region (Percentage of total export), 1980-2020



Source: ESCWA calculations.

Figure 6. Share of FDI investment (Percentage of global FDI inflows), 1980-2020



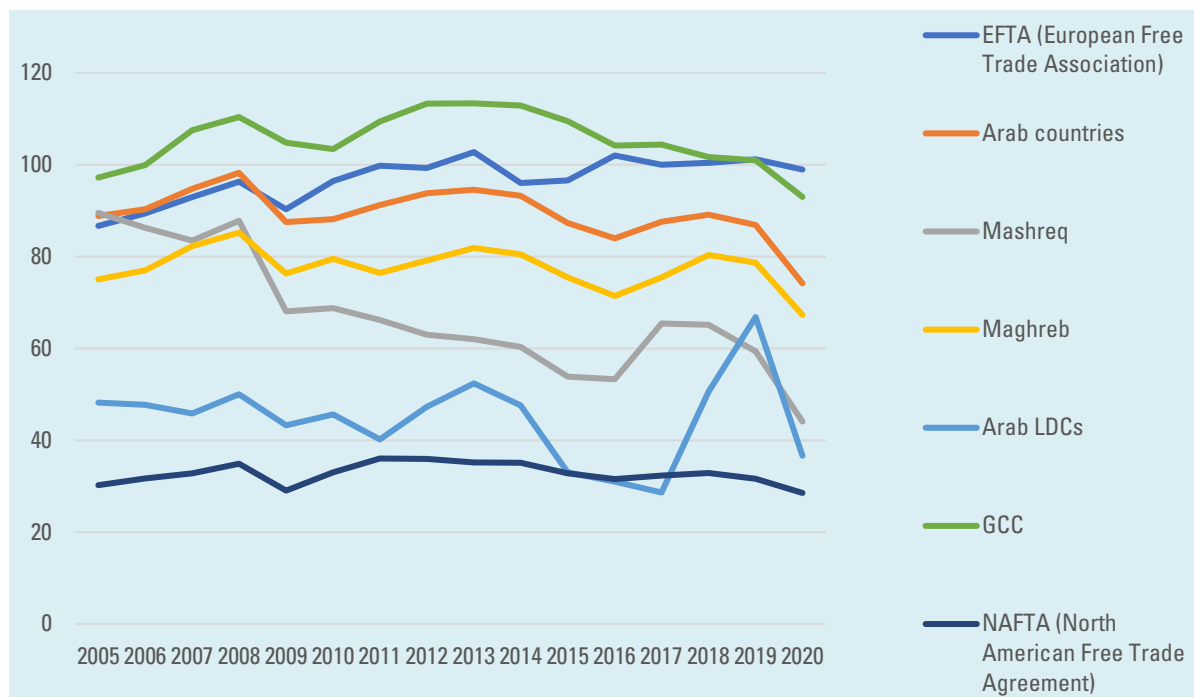
Source: ESCWA calculations.

With respect to the share of external trade (in goods) and foreign direct investment (FDI) inflows as part of the global total, the Arab region falls at the lowest end of the global spectrum. Accounting for just 5.8 per cent of overall global exports trade and 7 per cent of FDI inflows, the region fares just better than sub-Saharan Africa (for both FDI and trade) and Latin America (for trade).

C. Trade patterns in the Arab region

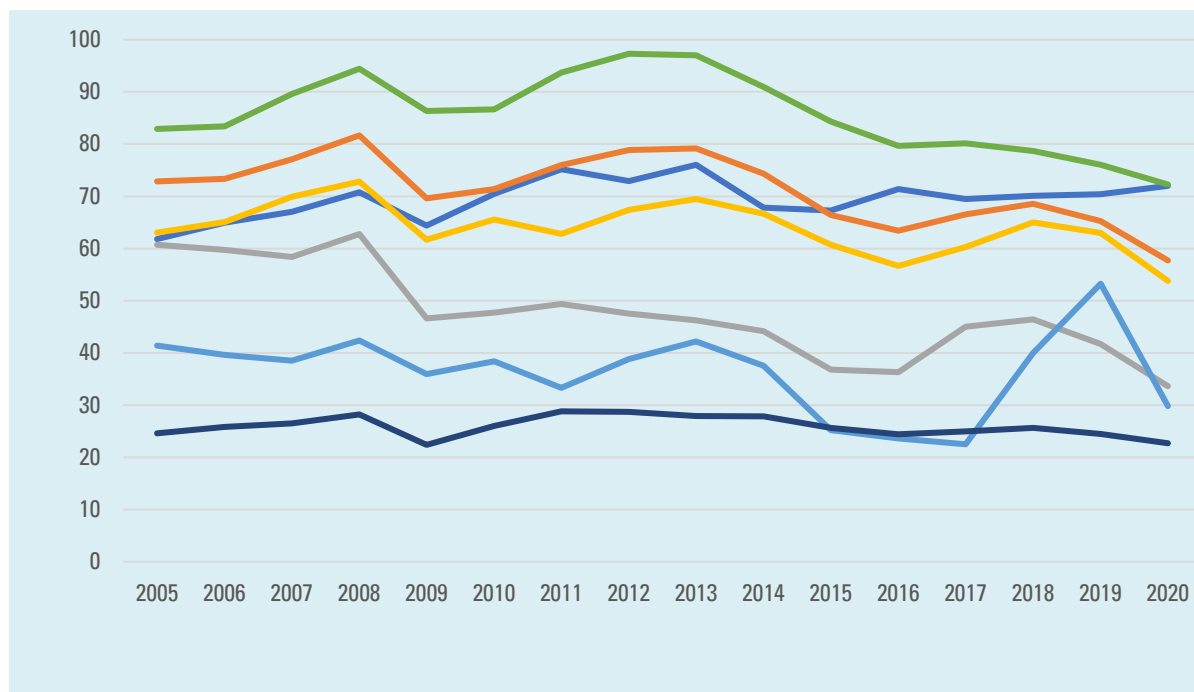
Trade openness for the region (the ratio of exports and imports of goods and services to GDP) varies by subregion. The GCC subregion's openness is the highest, though comparable to that of the European Free Trade Association, the reasons are vastly different. The GCC subregion is not only largely dependent on oil exports (49 per cent of total exports in 2020), but also has a high reliance on imports (food and manufactured goods imports accounted for 11.3 per cent and 70 per cent of total imports, respectively, in 2020). Furthermore, other Arab subregions show a declining trend in trade openness during the period 2005-2020, with the Maghreb's share dropping at a faster pace than other subregions.

Figure 7. Sum of exports and imports of goods and services (Percentage of GDP)



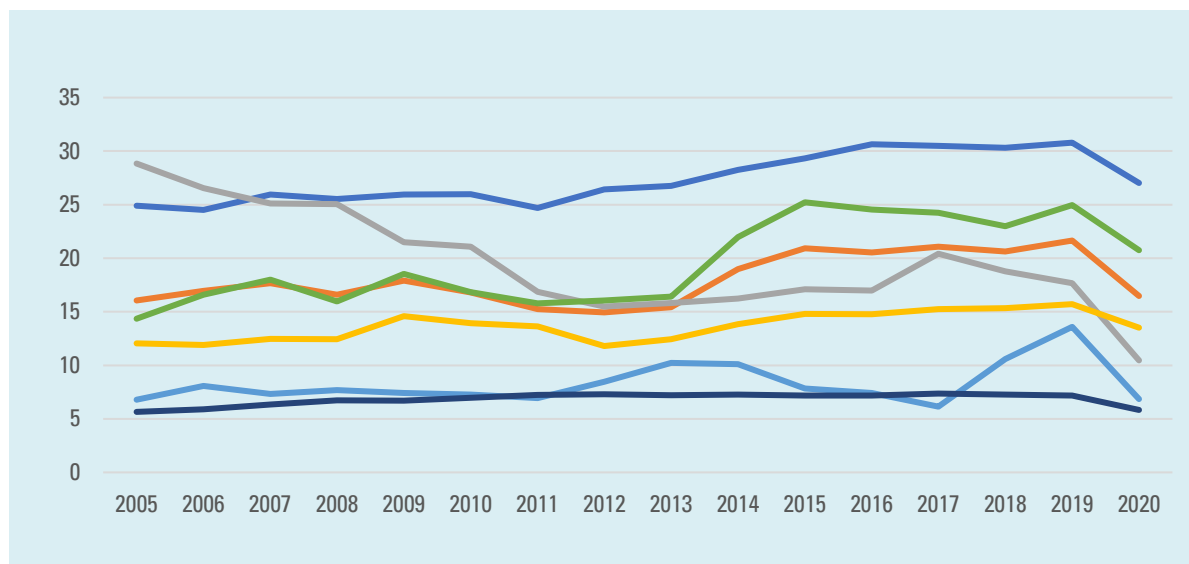
Source: ESCWA calculations.

Figure 8. Sum of exports and imports of goods (Percentage of GDP)



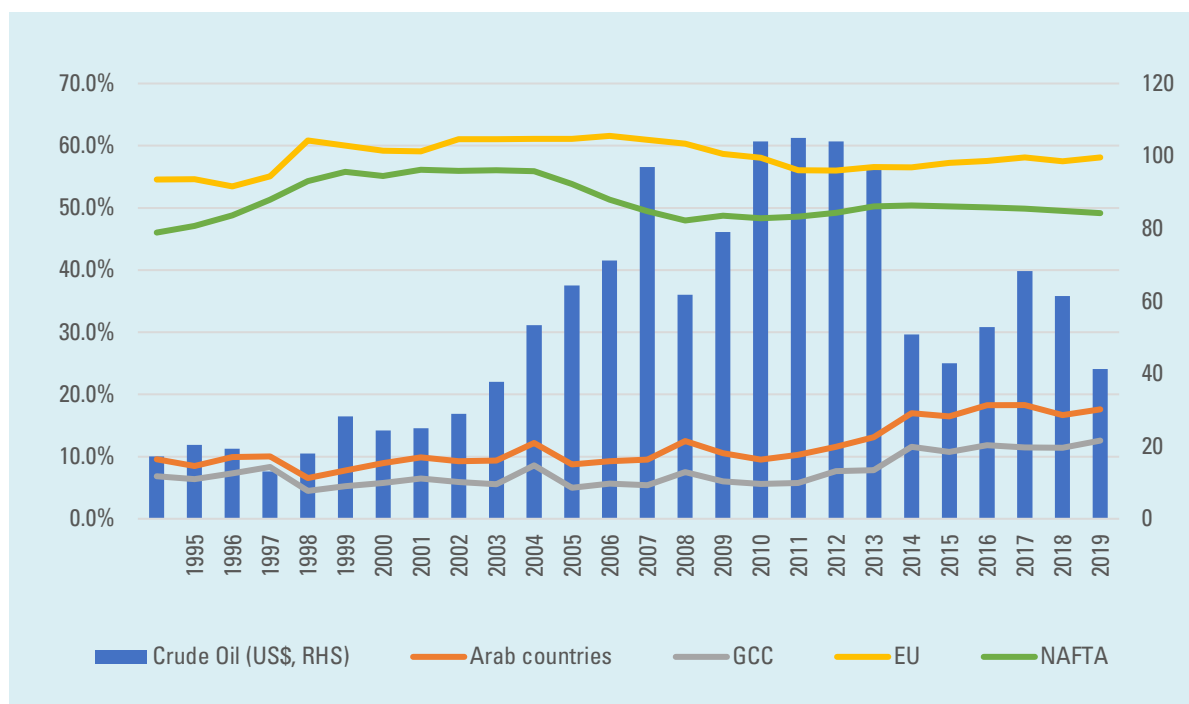
Source: ESCWA calculations.

Figure 9. Sum of exports and imports of services (Percentage of GDP)



Source: ESCWA calculations.

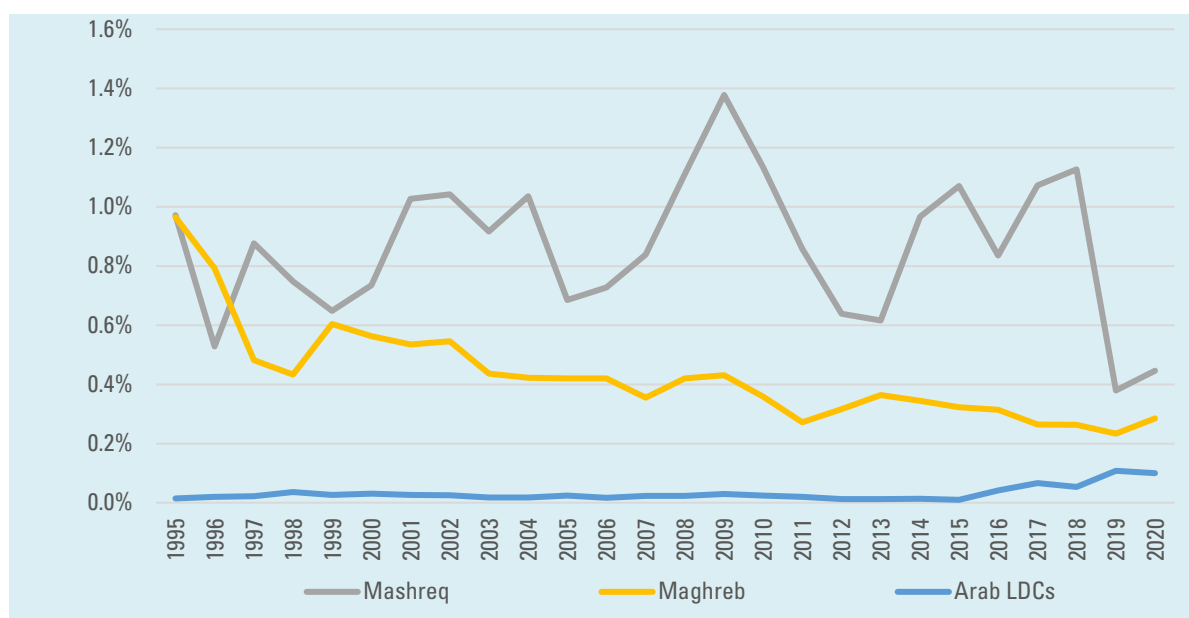
Figure 10. Intra-group exports as a percentage of group's total exports, by subregion, 1995-2000



Source: ESCWA calculations.

Note: UNCTAD classifications are as listed: GCC includes Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates; Mashreq nations refer to Egypt, Iraq, Jordan, Lebanon, State of Palestine and Syrian Arab Republic; Maghreb includes Algeria, Libya, Morocco and Tunisia; Arab LDCs are Comoros, Djibouti, Mauritania, Somalia, Sudan and Yemen.

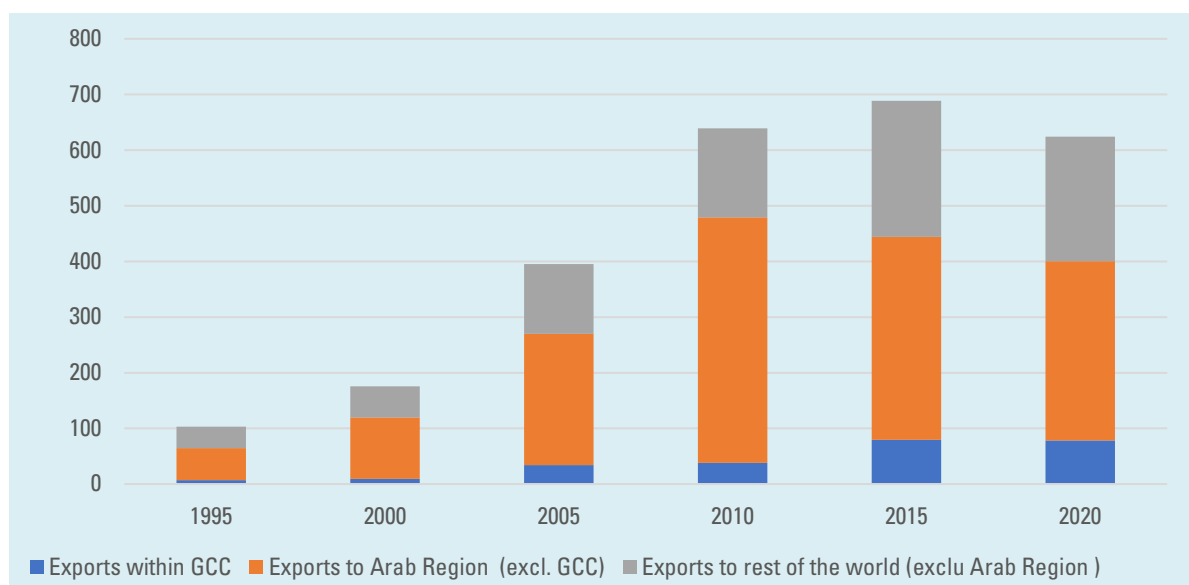
Figure 11. Intra-group exports as a share of total exports by subregion, 1995-2000



Source: ESCWA calculations.

Note: UNCTAD classifications are as listed: GCC includes Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates; Mashreq nations refer to Egypt, Iraq, Jordan, Lebanon, State of Palestine and Syria; Maghreb includes Algeria, Libya, Morocco and Tunisia; Arab LDCs are Comoros, Djibouti, Mauritania, Somalia, Sudan and Yemen.

Figure 12. GCC intra-group exports, exports to other Arab countries and to the world (Billions of dollars)



Source: ESCWA calculations.

Note: UNCTAD classifications are as listed: GCC includes Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates; Mashreq nations refer to Egypt, Iraq, Jordan, Lebanon, State of Palestine and Syrian Arab Republic; Maghreb includes Algeria, Libya, Morocco and Tunisia; Arab LDCs are Comoros, Djibouti, Mauritania, Somalia, Sudan and Yemen.

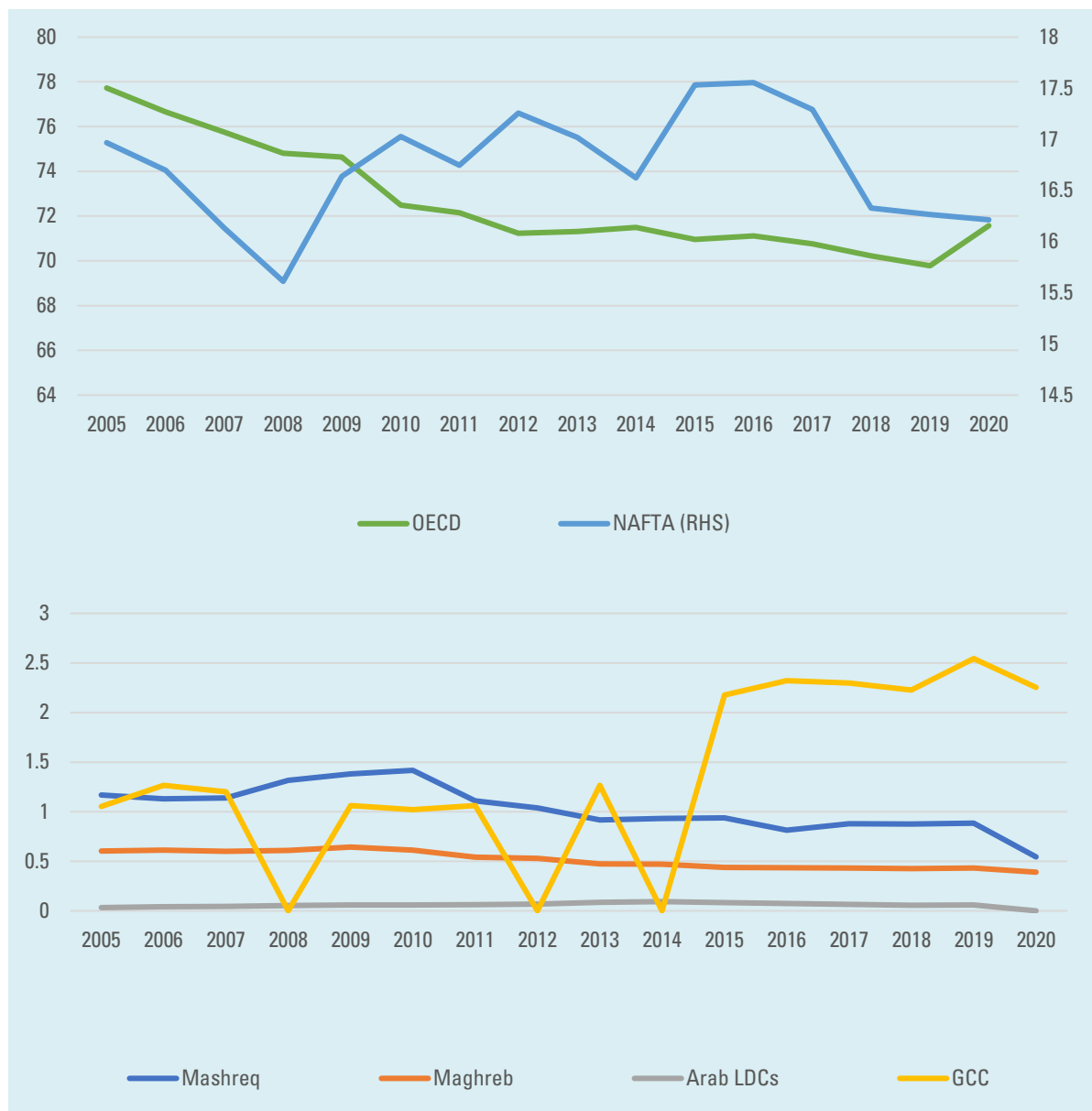
Despite multiple regional trade agreements in the Arab region,⁶ intraregional trade is weak. Arab countries export about 18 per cent of their total exports to within their subgroup. Export trade between GCC countries nudged up to around 13 per cent in 2020, from a low of 4.5 per cent in 1999: a large part of this is re-exports (not noted separately in the data). The United Arab Emirates has been a major re-export hub in the GCC subregion for years, while Saudi Arabia saw an uptick in re-exports to record highs in 2021. Periods of higher oil prices coincide with larger oil export receipts, and subsequently result in an increase in imports of goods and services. In both these groups (GCC and the Arab region), the uptick was stronger in the period after 2012. In contrast, intra-group exports among Maghreb countries have slipped from close to 1 per cent of their total exports in mid-1990s to a trivial 0.2 per cent in 2019. Mashreq countries have seen volatility in their share of intra-group trade, falling to 0.4-1.4 per cent over the period 1995-2020, in part due to violence and wars. The trend indicates that the GCC share of exports to the wider Arab region will rise, denoting growing integration of the rest of the region with the GCC subregion. In turn, given the growing integration of the GCC subregion with the rest of the world, it acts as a channel for greater global integration of non-GCC countries.

Trade in services

The share of the region's services trade (4-6 per cent of global services trade) has edged up over the period 2005-2020. However, it pales in comparison with OECD countries, which account for over two-thirds of the global services trade. Within the region, the GCC accounts for the bulk of services trade. Within the GCC, United Arab Emirates remains the key driver with its exports share rising from just 0.1 per cent in 2005 to 1.5 per cent in 2019, followed by Saudi Arabia (0.4 per cent in 2019) and Qatar (0.3 per cent). Travel and transportation were the largest sectors within the services sector – unsurprising, given the tourism inflows. Saudi as a religious tourist destination saw travel accounting for 66 per cent of its total services trade till 2019, but this dropped to 40 per cent in 2020 due to Covid19 restrictions. For Qatar, transport has a share of more than 55 per cent of its services trade. However, these sub-sectors are relatively lower value-added and for greater integration, a move to more knowledge intensive services would benefit the region.

6 Trade agreements signed by Arab countries can be accessed via the Arab Trade Gateway, available at <https://ata.unescwa.org/>.

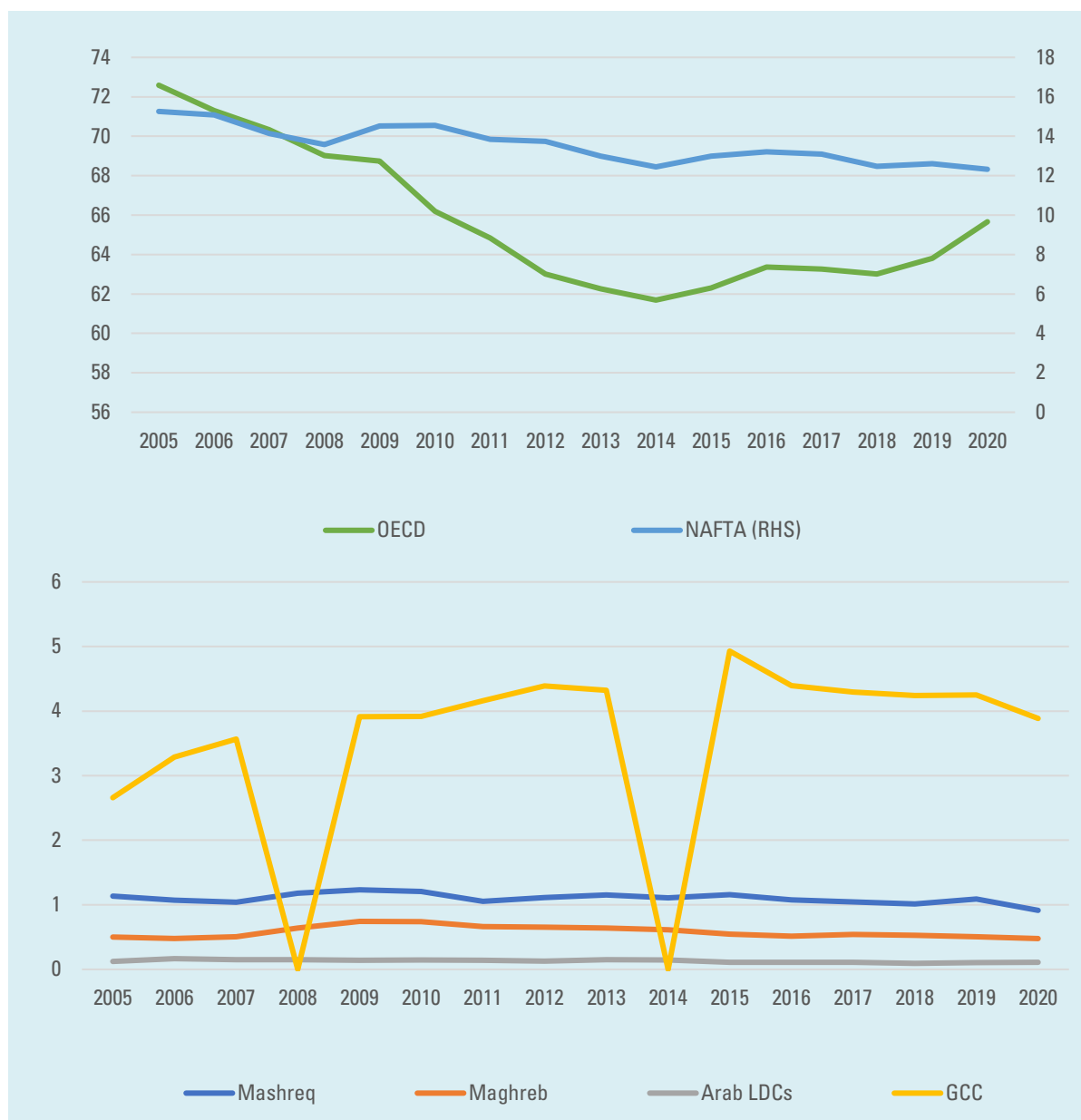
Figure 13. Services exports as a percentage of world services exports, 2005-2020



Source: ESCWA calculations.

Note: UNCTAD classifications are as listed: GCC includes Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates; Mashreq nations refer to Egypt, Iraq, Jordan, Lebanon, State of Palestine and Syrian Arab Republic; Maghreb includes Algeria, Libya, Morocco and Tunisia; Arab LDCs are Comoros, Djibouti, Mauritania, Somalia, Sudan and Yemen.

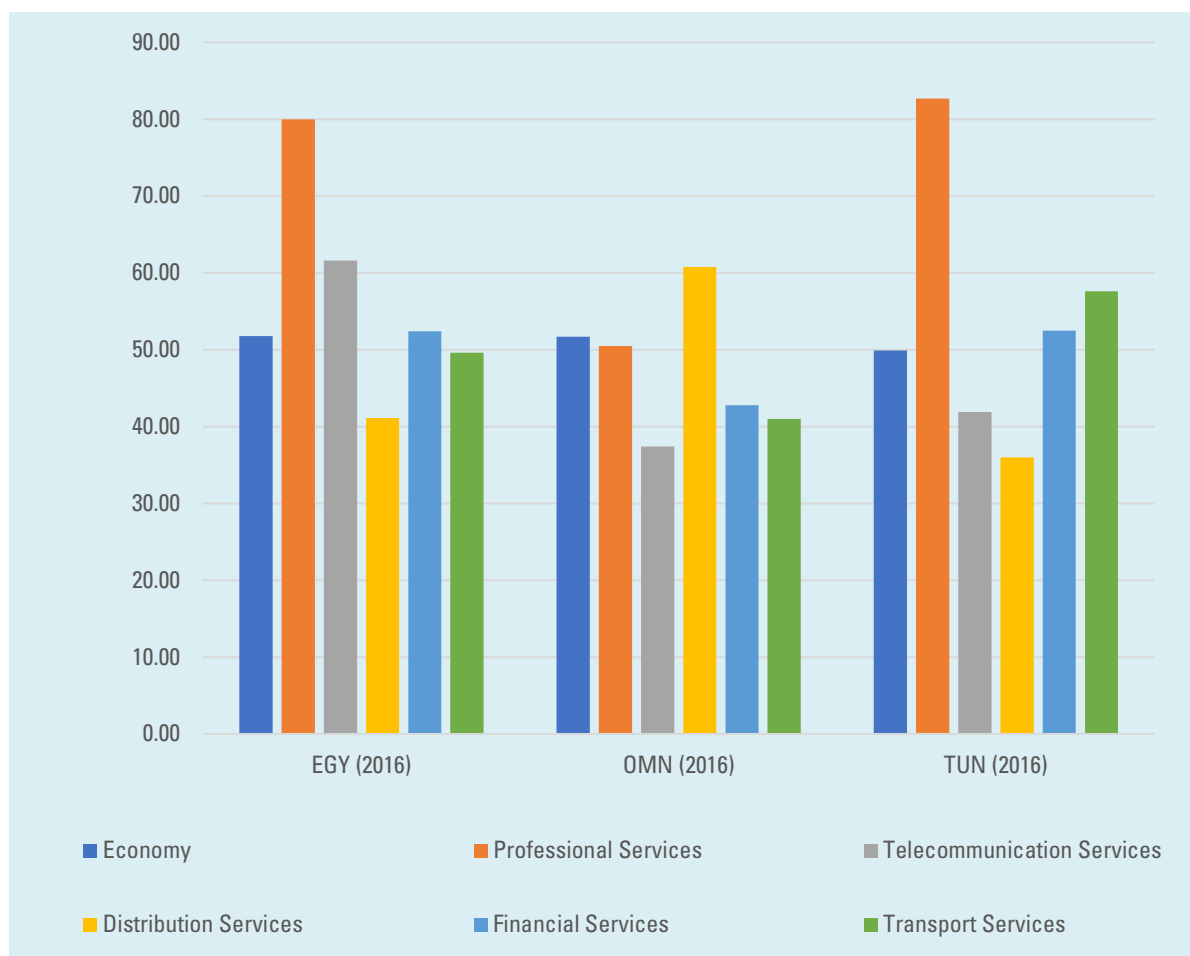
Figure 14. Services imports as a percentage of world services exports, 2005-2020



Source: ESCWA calculations.

Note: UNCTAD classifications are as listed: GCC includes Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates; Mashreq nations refer to Egypt, Iraq, Jordan, Lebanon, State of Palestine and Syrian Arab Republic; Maghreb includes Algeria, Libya, Morocco and Tunisia; Arab LDCs are Comoros, Djibouti, Mauritania, Somalia, Sudan and Yemen.

Figure 15. Services Trade Restrictiveness Index, 2016

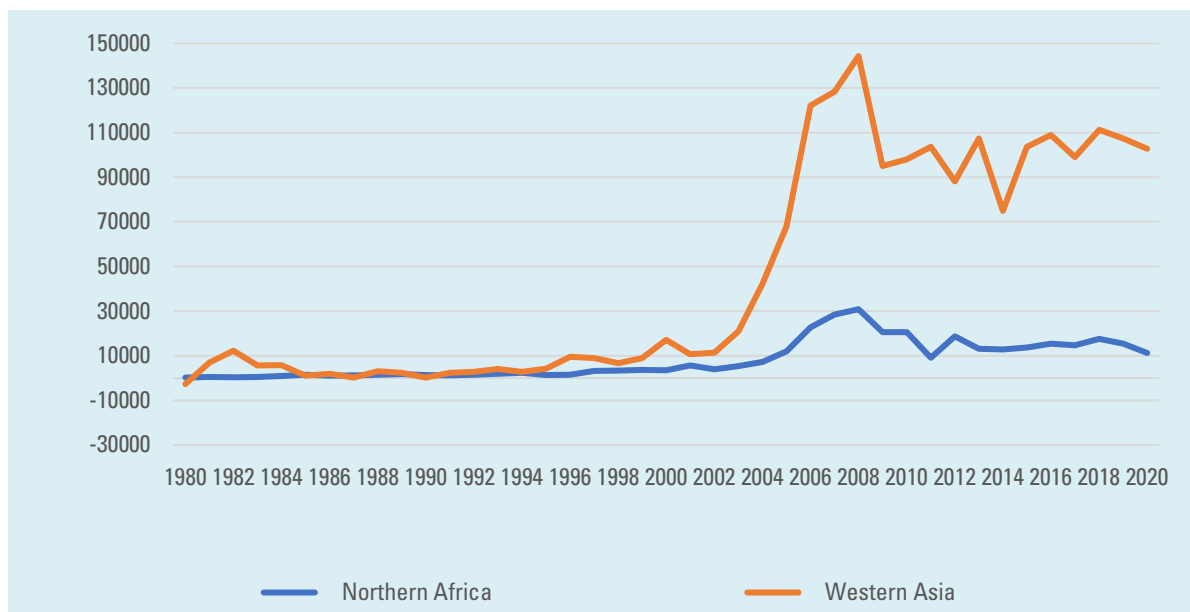


Source: ESCWA calculations.

Trade in services is the fastest growing component of international. Arab countries need to focus on growing trade in services (including e-services) and on removing trade barriers, rather than just focus on tourism. The Services Trade Restrictiveness Index⁷ found that the GCC subregion displayed the most restrictive policies: the highest barriers to trade are present in telecom and professional services. For the Arab region, professional and transportation services were the most restrictive. Furthermore, a stronger services sector would also support export diversification policies, help bridge gender gaps and lead to greater women's economic empowerment, given women's higher participation in the services sector.

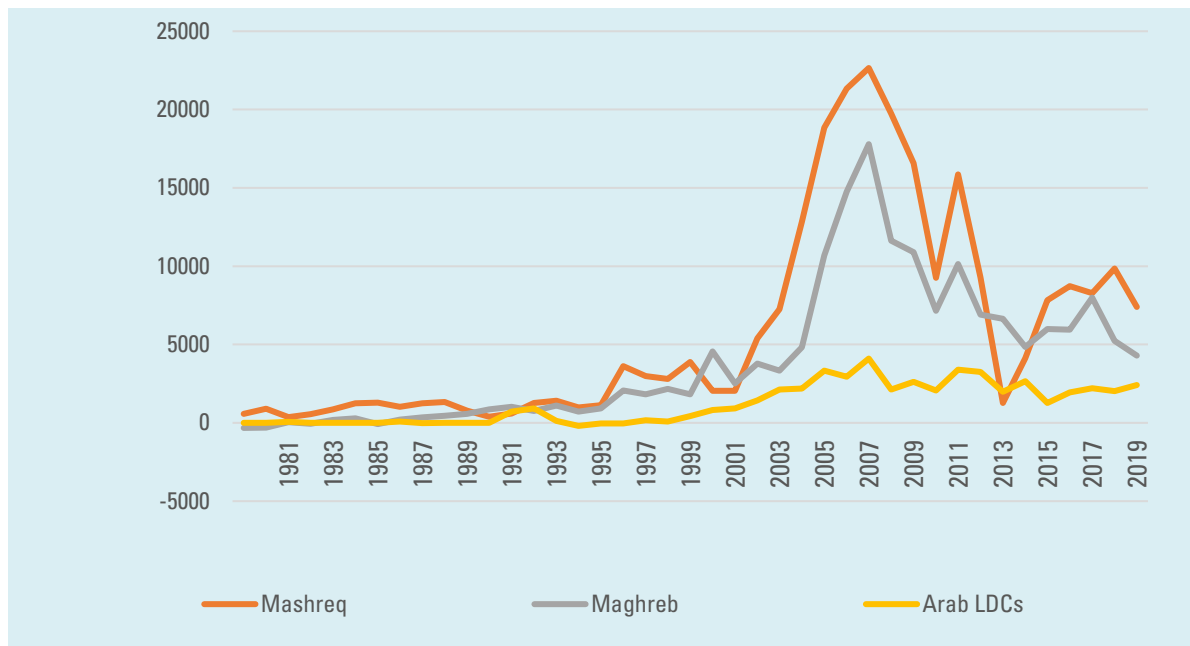
⁷ Borchert and others, 2012b.

Figure 16. Two-way investment flows into the Arab region (Millions of dollars)



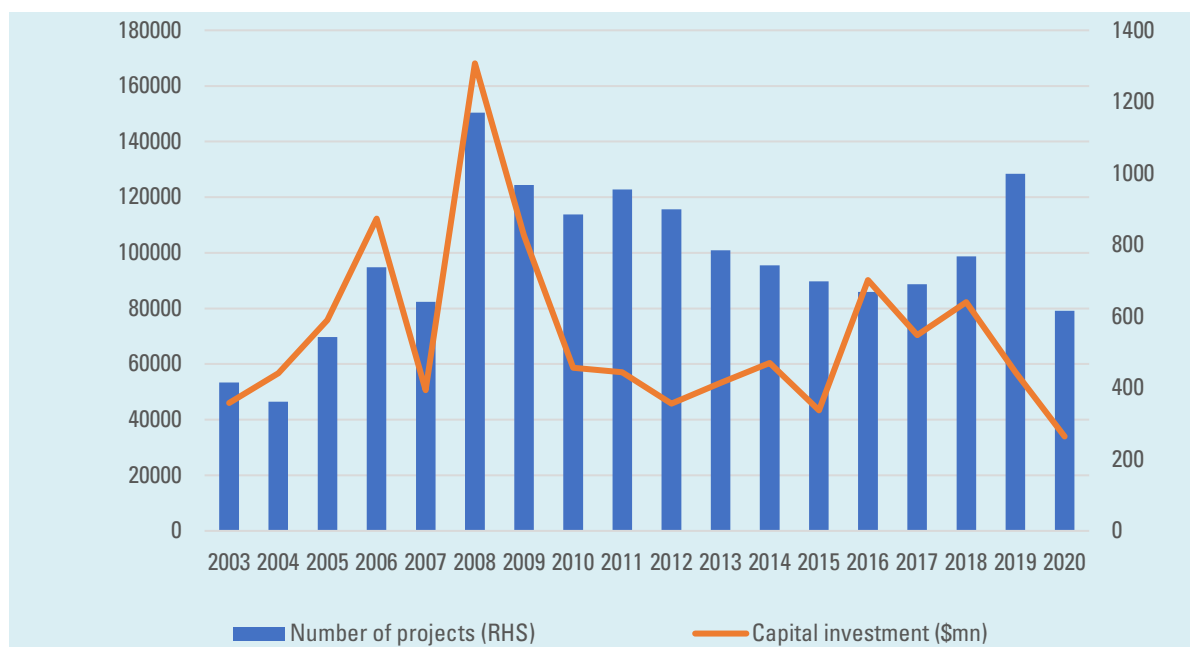
Source: ESCWA calculations.

Figure 17. Two-way investment flows into Arab subregion region (Millions of dollars)



Source: ESCWA calculations.

Figure 18. Greenfield FDI into Arab countries, 2003-2020



Source: Arab investment and export credit guarantee corporation (Dhaman).

D. FDI patterns in the Arab region

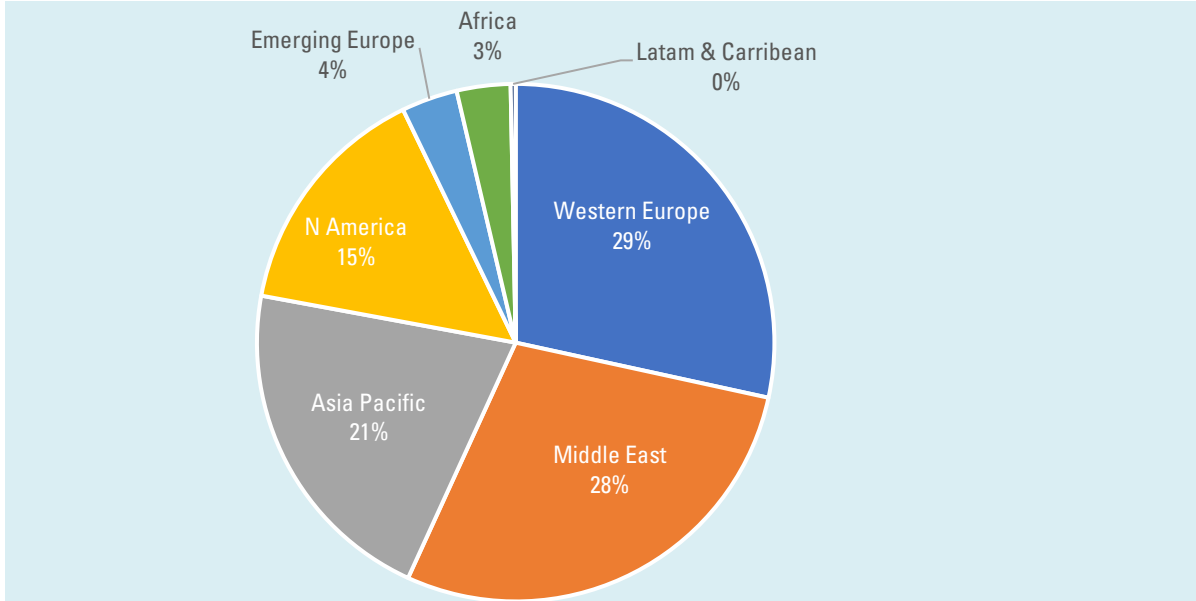
FDI inflows into the Arab region increased sharply in the early 2000s, but weakened after peaking in 2008 (\$88 billion). The increase was largely due to inflows into the GCC subregion, with capital investment concentrated into the energy, real estate/construction, and chemicals sectors. Other than the GCC subway, two-way investment flows (inflows and outflows) into the Mashreq and Maghreb subregions have been weak, accounting for roughly 0.4 per cent and 0.2 per cent of global FDI, respectively, compared with over 3 per cent in the GCC subregion.

Greenfield FDI into Arab countries reveals that while the number of projects has remained within an annual range of 600-1000 (after the 2008 peak), capital investment has been falling. During the period 2003-2019 (pre-COVID-19), a cumulative investment of \$1.2 trillion was invested in around 13,000 projects in the Arab region. While this indicates an average of \$95 million per project, this is distorted by the massively larger investment per project in the oil and gas sector. The United Arab Emirates stands out in the FDI picture: almost two thirds of projects tracked during the period 2003-2019 were based in the country. The sheer economic size of Egypt, Saudi and the United Arab Emirates works in their favour as the top destination countries for FDI.

The main sources of FDI inflows into the Arab region are quite diverse, with Western Europe, Asia-Pacific and North America among the top investing regions. The GCC subregion is also an active investor in the region. China made significant investments in the region during the period 2003-

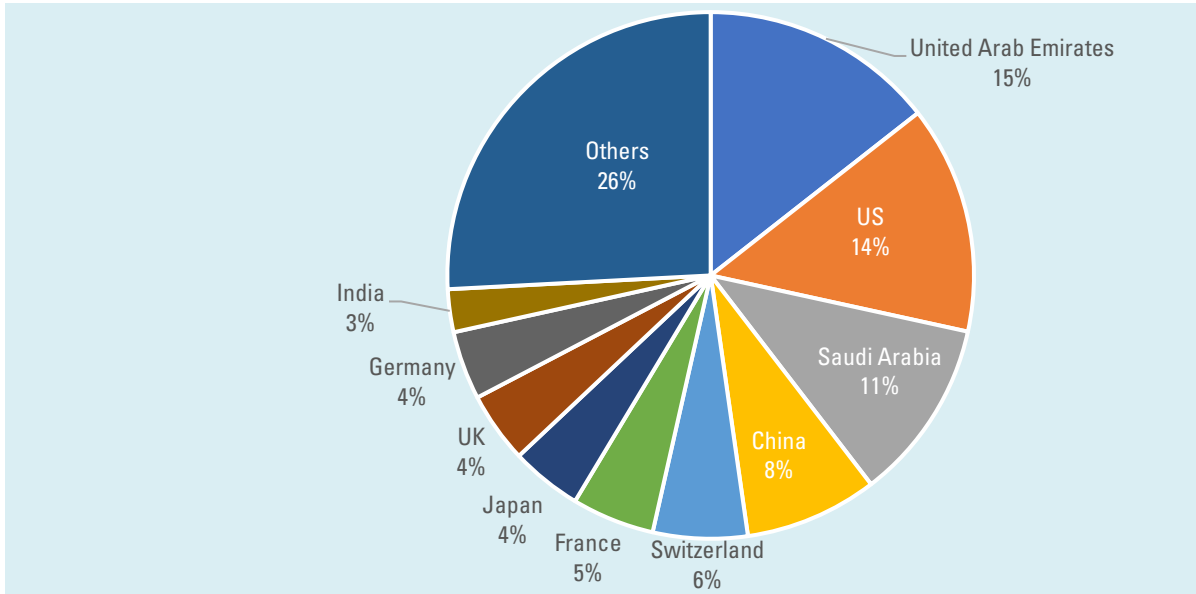
2019: over the entire duration, the country invested in 305 projects, with a total capital investment of \$61.7 billion. The period 2016-2019 saw China investing in an average of 40 projects in the Arab region. Figures 19 and 20 show investments in the Arab region in 2019, by region and top investing nations.

Figure 19. New capital investment in the Arab region, 2019



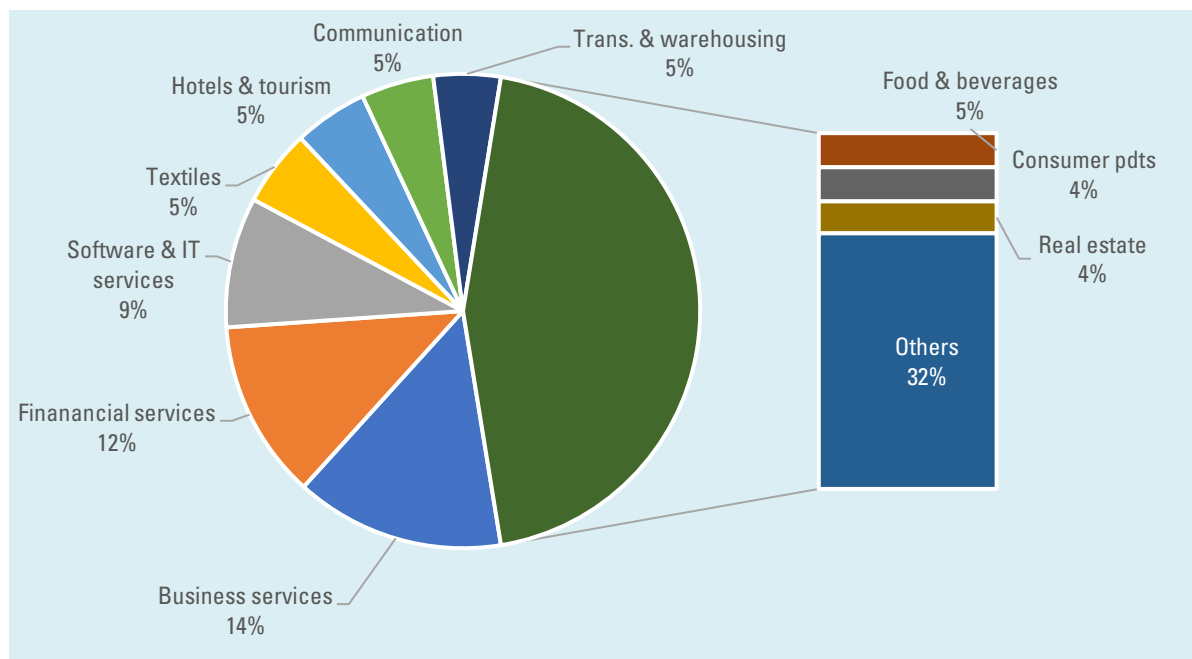
Source: Arab investment and export credit guarantee corporation (Dhaman).

Figure 20. Top investing countries by capital expenditure, 2019



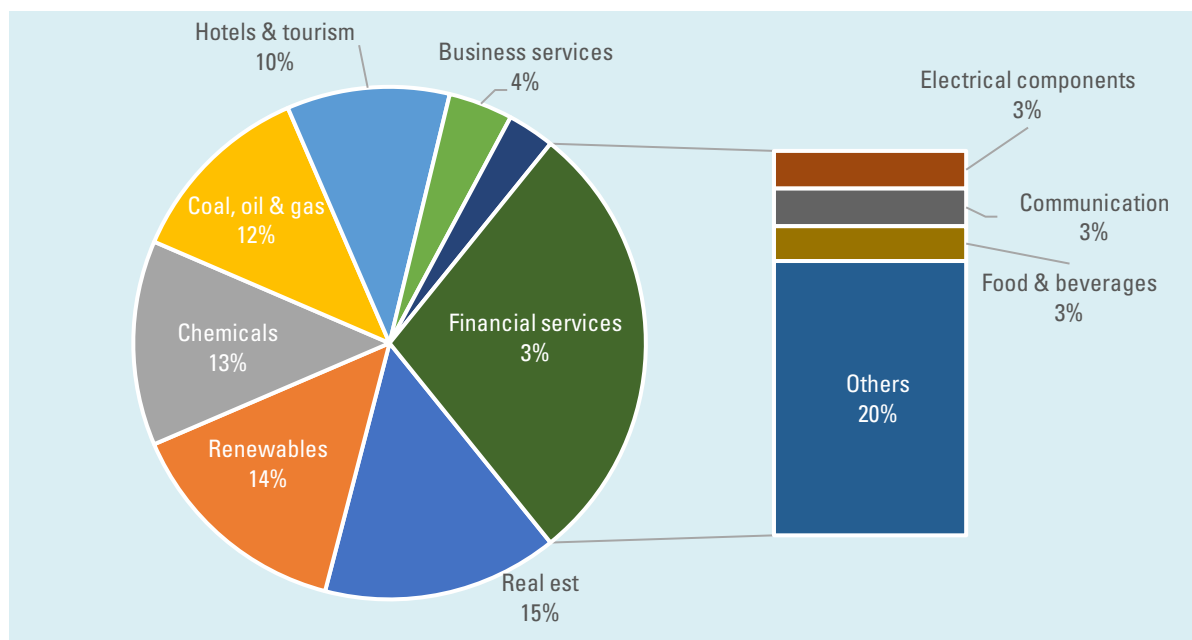
Source: Arab investment and export credit guarantee corporation (Dhaman).

Figure 21. FDA in Arab countries by sector, 2019



Source: Arab Investment & Export Credit Guarantee Corporation (Dhahran); ESCWA calculations.

Figure 22. FDA in Arab countries (Capital expenditure) by sector, 2019

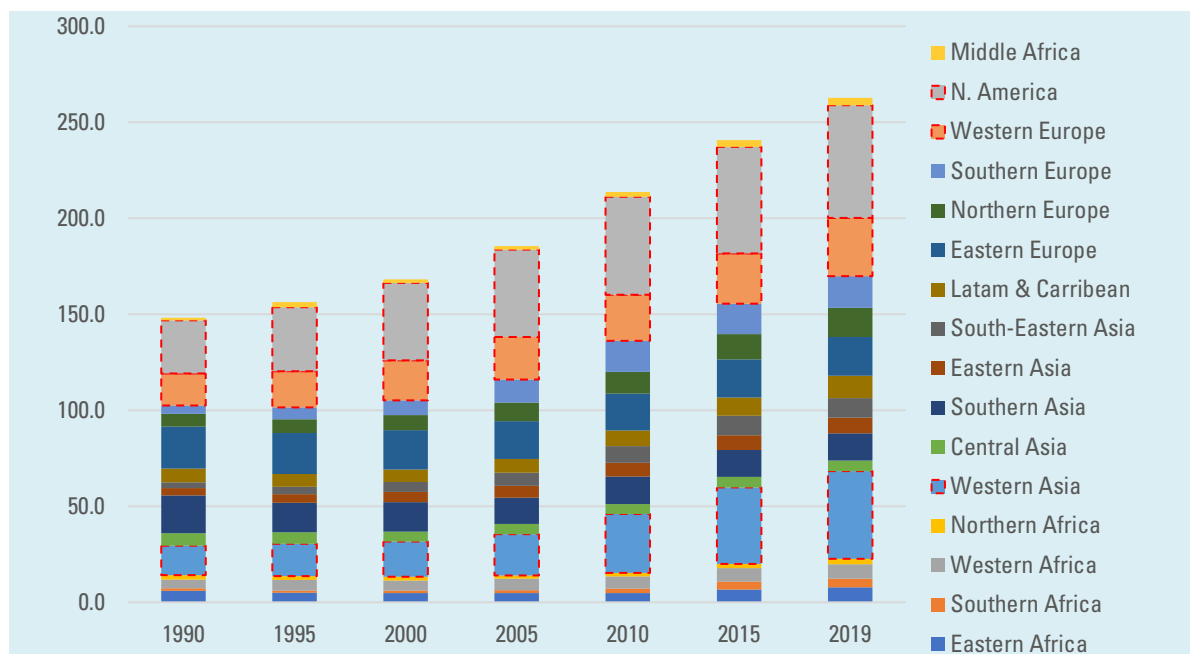


Source: Arab Investment & Export Credit Guarantee Corporation (Dhahran); ESCWA calculations.

Further breaking down FDI in the Arab region in 2019, sector concentration is apparent. Real estate dominates in terms of capital expenditure (\$9 billion into 44 projects), followed by renewables (a recent trend, given clean energy ambitions and commitments). Together, the oil and gas and chemicals sectors accounted for a fourth of total investments in 2019, but not in number of projects given the large capital investment required in these sectors. Two other sectors feature in both number of projects and capital expenditure: the financial sector (12 per cent of projects and 3 per cent of capital expenditure) and hotels and tourism (5 per cent and 10 per cent of total number of projects and capital expenditure, respectively): investment per sector stands respectively at around \$13.5mn and \$12.9mn.

E. Labour and remittance flows in the Arab region

Figure 23. Total migrant stock at mid-year by region



Source: ESCWA calculations.

On a global basis, North America, Western Europe, and Western Asia (with dashed red borders in figure 23) together account for about half of incoming migrants. This pattern has remained broadly similar over time, given that they are high-income nations.

In 2019, the International Labour Organization (ILO) estimated that there were 169 million migrant workers globally, concentrated in Northern, Southern and Western Europe (24.2 per cent), North America (22.1 per cent) and the Arab countries (14.3 per cent). These regions have been labour importers for many decades, but migrants' share as a percentage of total workers is highest in Arab countries (35.6 per cent in 2013, rising to 41.4 per cent in 2019). Both Western Europe and North

America have seen their shares decline between 2013 and 2019 as a result of rapid growth in Asia. Arab countries also have another unique characteristic: the difference in labour participation rates between migrants and local populations is the highest. A caveat is that the data also include refugee flows, which have been rising in recent years.

Table 1. International migrant workers: numbers and ratios by region

Migrant workers (million)	Distribution of international migrant workers (percentage)				Migrant workers as a proportion of all workers (percentage)		
	2019	2013	2017	2019	2013	2017	2019
Northern Africa	1.2	0.5	0.7	0.7	1.1	1.6	1.6
Sub-Saharan Africa	12.6	5.3	7.2	7.4	2.2	2.9	3.0
Latin America and the Caribbean	5.9	2.9	2.7	3.5	1.5	1.4	1.9
North America	37.4	24.7	23.0	22.1	20.2	20.6	20.0
Arab region	24.1	11.7	13.9	14.3	35.6	40.8	41.4
East Asia	4.8	3.6	6.0	2.8	0.6	0.6	0.5
South East Asia and the Pacific	12.1	7.8	7.1	7.2	3.5	3.3	3.4
South Asia	7.1	5.8	4.5	4.2	1.3	1.0	1.0
Northern Southern and Western Europe	40.9	23.8	23.9	24.2	16.4	17.7	18.4
Eastern Europe	13.4	9.2	8.1	8.0	9.2	9.1	9.4
Central and Western Asia	9.4	4.7	5.2	5.6	10.0	11.1	12.0
Total	169.0	100.0	100.0	100.0	4.4	4.7	4.9

Source: ILO, Global Estimates on International Migrant Workers, 2020.

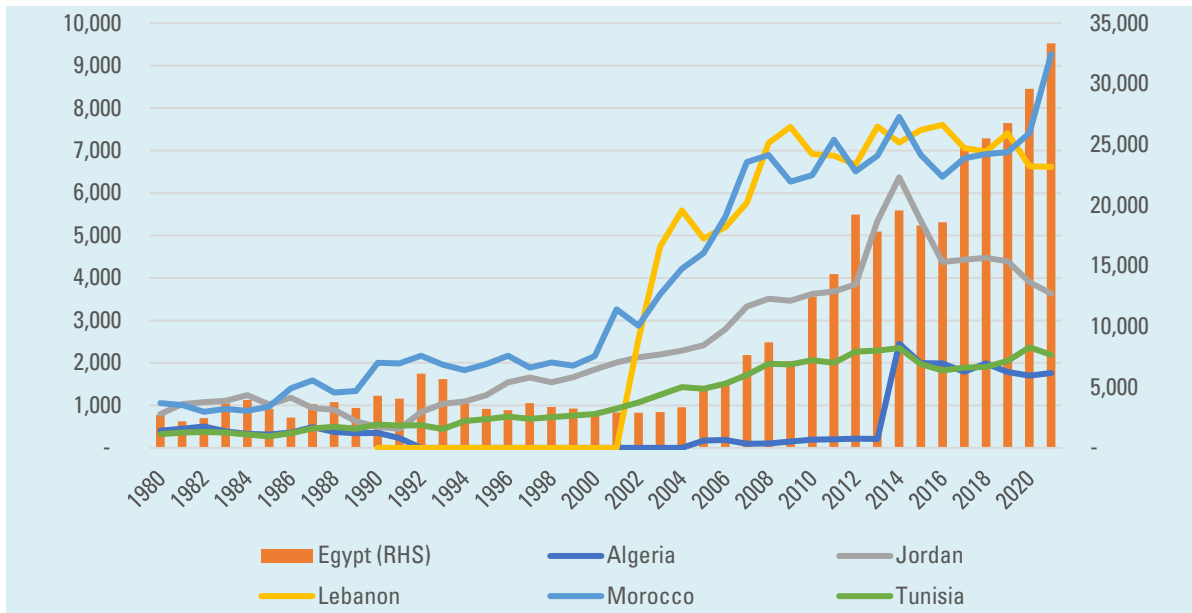
Not only has the GCC subregion seen a rapid increase in migrants (supported by oil wealth and economic development), but these migrants also account for a high proportion of total populations (an estimated 88 per cent in the United Arab Emirates, close to 80 per cent in Qatar, 72 per cent in Kuwait, 45 per cent in Bahrain, and 38.3 per cent in Saudi Arabia).⁸ According to the United Nations Department of Economic and Social Affairs (DESA) data, the GCC subregion also features as part of the top migration corridors from Asia: India-United Arab Emirates (close to 3.5 million in 2019), India-Saudi Arabia (2.5 million), Indonesia-Saudi Arabia (1.6 million), Pakistan-Saudi Arabia (1.5 million), India-Oman (1.4 million), and Bangladesh-Saudi Arabia (1.3 million). Meanwhile, from North Africa, migration happens to both Europe and the GCC subregion. However, there is a distinct pattern, dictated by geographical proximity and economic integration, with migrants from the north-west region (Algeria, Morocco and Tunisia) moving to Europe, while those from the north-east (Egypt) tend to migrate to the GCC sub region.⁹

⁸ International Organization for Migration, 2020.

⁹ According to DESA data, almost 12 million North Africans were living abroad in 2015, with roughly half in Europe and 3.3 million in the GCC subregion (<https://www.un.org/en/desa/244-million-international-migrants-living-abroad-worldwide>).

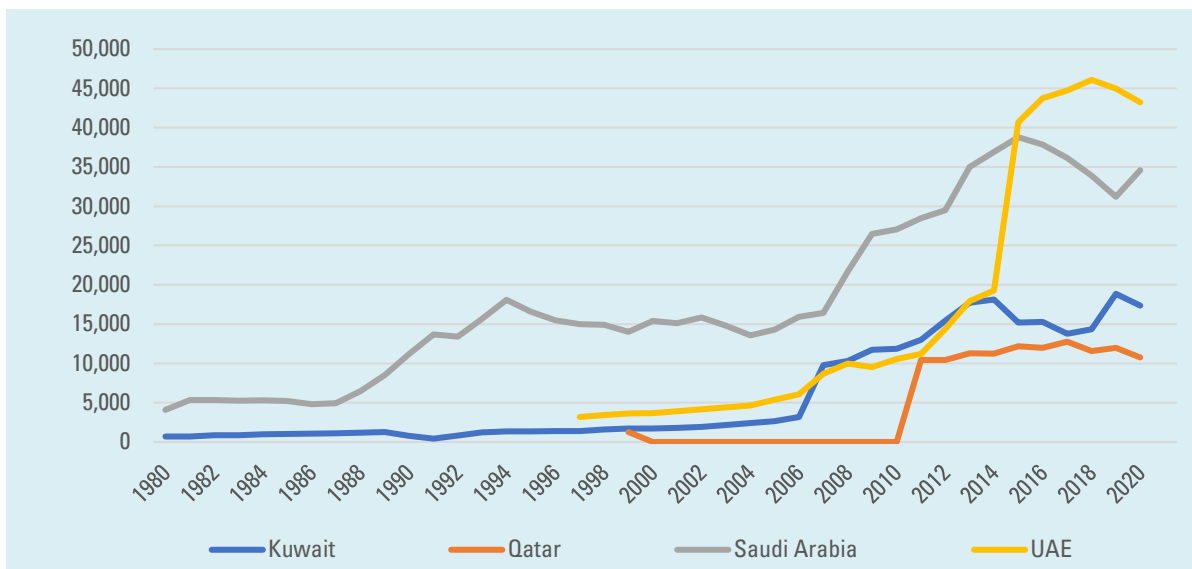
Details of intraregional migration indicate that outside of conflict countries (the State of Palestine, the Sudan, the Syrian Arab Republic and Yemen) that have seen the largest outflows, Egypt has the highest number of migrants. In 2019, Egyptians moved to Saudi Arabia and the UNITED ARAB EMIRATES (938k and 886k respectively) while the other major corridors were Jordan-Saudi Arabia (234k) and Lebanon-Saudi Arabia (150k).

Figure 24. Remittance inflows into Arab major labour exporting countries (Millions of dollars)



Source: World Bank, Migration and development brief 35, 2021.

Figure 25. Remittance outflows from Arab major labour exporting countries (Millions of dollars)



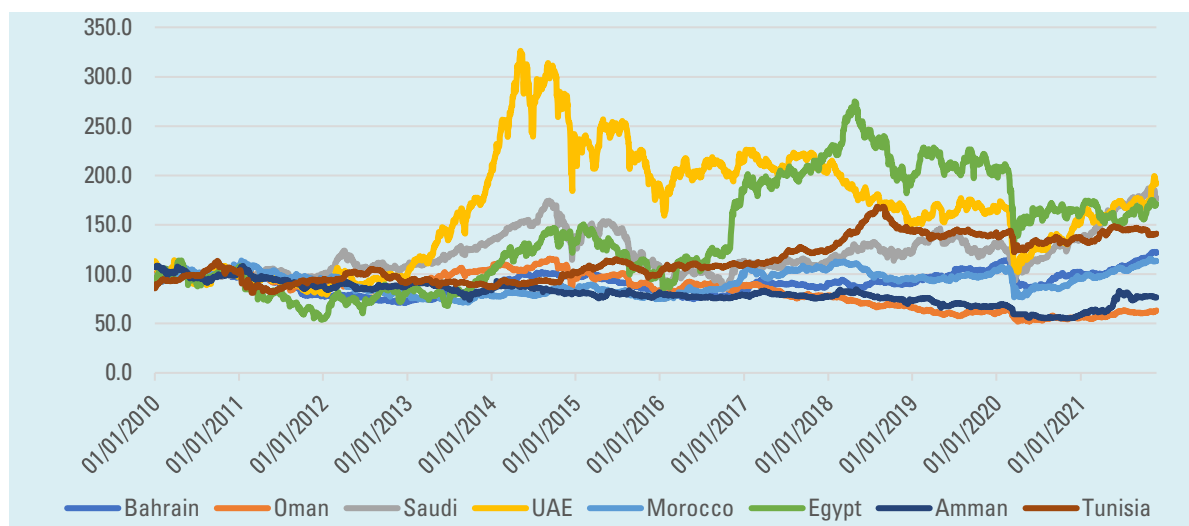
Source: World Bank, Migration and development brief 35, 2021.

Given the high share of Arab labour importing countries, it comes as no surprise that Saudi Arabia and the United Arab Emirates are among the top three remittance sources globally (behind only the United States). Saudi Arabia used to account for the highest remittance amounts among GCC countries, but the United Arab Emirates has surpassed it since 2015, following Saudization efforts and the war in Yemen. Egypt saw a significant jump in remittances receipts after 2016, supported by the devaluation of the Egyptian pound and progress in economic reforms. Morocco is the second highest remittance recipient in the region, estimated at \$7.2 billion in 2020 (7.4 per cent of GDP). In terms of dependence on remittances, Lebanon and the West Bank and Gaza top the list (32.9 per cent and 17.1 per cent of GDP, respectively, in 2020).

F. Equity market integration in the Arab region

One measure of financial integration¹⁰ is whether cross-country equity market returns are correlated over time. The Arab region's equity markets are dominated by Saudi Arabia, which accounts for more than 60 per cent of total market cap as at 7 March 2022, and is more than five times the size of the Abu Dhabi Stock Exchange (the second largest in the region). In 2019, Aramco IPO brought much cheer to regional equity markets alongside the inclusion of Saudi Arabia into emerging market indices (following the United Arab Emirates and Qatar previously, while Kuwait was included in 2020). However, markets in the GCC subregion, despite their inclusion in global indices and many financial liberalization measures, continue to be sidelined by global investors. To a large measure, these markets generally continue to be illiquid, with a large retail investor base, remain highly concentrated in a few sectors (banks, real estate and insurance), and display substantial volatility, associated with oil price volatility, political developments such as the Arab uprisings, and international factors such as the 2007-2008 financial crisis.

Figure 26. Equity market performance in the Arab region (Indexed, 2010=100)



Source: Refinitiv Datastream; ESCWA calculations.

¹⁰ Another measure would be cross-border exposure of banks in the Arab region. The data, however, is not available.

For the full period, the results show regional markets to be most correlated with Emirati markets, while some of the other larger markets (Egypt and Saudi Arabia) are also correlated with the MSCI emerging markets index. Correlation between GCC markets is higher than with global/developed/emerging market indices. Markets with low correlation with global markets can be seen as a diversification opportunity (lower portfolio risk-return profile) for international investors. However, in the case of the Arab region, many of the markets are small and performance-wise linked intricately to idiosyncratic country-specific factors. Furthermore, these regional markets often have entry barriers for international and/ or institutional investors, which need to be removed to support market growth and integration.

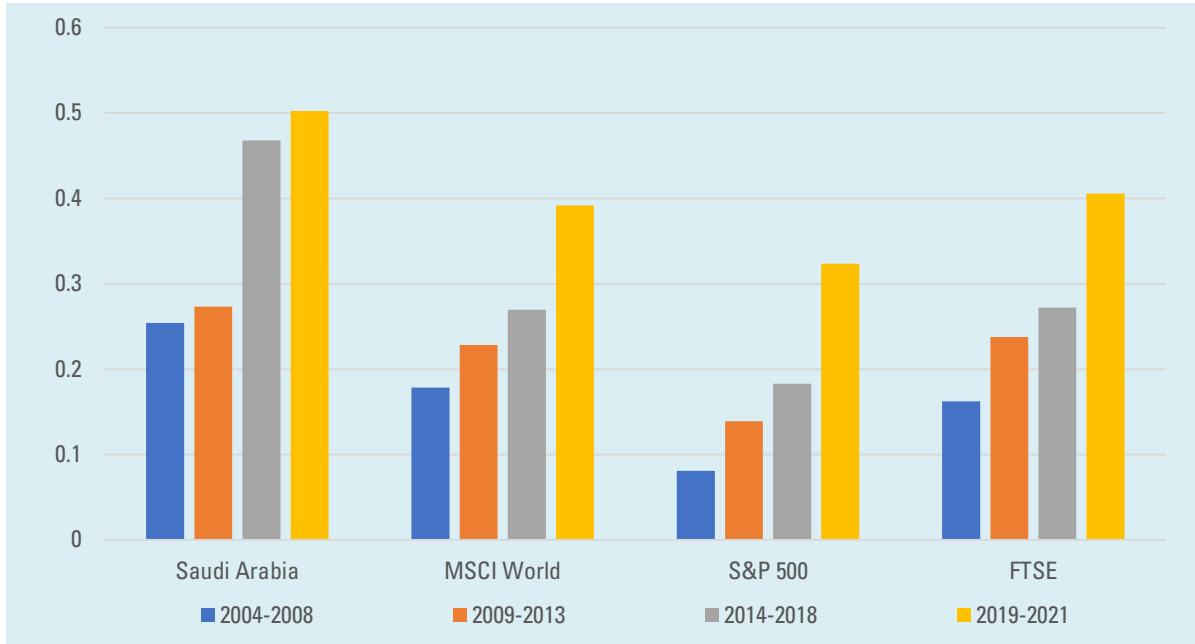
Table 2. Regional stock markets correlation, intra-regionally and with relevant global indices

	United Arab Emirates	Amman	Bahrain	Egypt	Morocco	Oman	Saudi Arabia	Tunisia	S&P 500	Stoxx	FTSE	Emerging Markets	MSCI World
United Arab Emirates	1.000000	0.202780	0.233081	0.297085	0.119638	0.332368	0.315526	0.092273	0.145519	0.247638	0.231770	0.312533	0.232248
Amman	0.202780	1.000000	0.150968	0.161383	0.094388	0.239268	0.104446	0.076680	0.021006	0.074381	0.060018	0.112540	0.063014
Bahrain	0.233081	0.150968	1.000000	0.131647	0.105162	0.231743	0.105094	0.055026	0.054952	0.108191	0.098788	0.127753	0.098102
Egypt	0.297085	0.161383	0.131647	1.000000	0.130467	0.215894	0.212456	0.062493	0.111265	0.210203	0.191528	0.291698	0.193655
Morocco	0.119638	0.094388	0.105162	0.130467	1.000000	0.092059	0.091683	0.070496	0.086807	0.117724	0.112591	0.144333	0.132319
Oman	0.332368	0.239268	0.231743	0.215894	0.092059	1.000000	0.190365	0.102735	0.071676	0.156187	0.155728	0.233961	0.155410
Saudi Arabia	0.315526	0.104446	0.105094	0.212456	0.091683	0.190365	1.000000	0.085359	0.173790	0.219036	0.202857	0.258551	0.230492
Tunisia	0.092273	0.076680	0.055026	0.062493	0.070496	0.102735	0.085359	1.000000	0.007378	0.075669	0.064966	0.090658	0.040527
S&P 500	0.145519	0.021006	0.054952	0.111265	0.086807	0.071676	0.173790	0.007378	1.000000	0.606412	0.577757	0.472031	0.905774
Stoxx	0.247638	0.074381	0.108191	0.210203	0.117724	0.156187	0.219036	0.075669	0.606412	1.000000	0.926823	0.667769	0.803759
FTSE	0.231770	0.060018	0.098788	0.191528	0.112591	0.155728	0.202857	0.064966	0.577757	0.926823	1.000000	0.645787	0.773404
Emerging Markets	0.312533	0.112540	0.127753	0.291698	0.144333	0.233961	0.258551	0.090658	0.472031	0.667769	0.645787	1.000000	0.700189
MSCI World	0.232248	0.063014	0.098102	0.193655	0.132319	0.155410	0.230492	0.040527	0.905774	0.803759	0.773404	0.700189	1.000000

Source: Refinitiv Datastream; ESCWA calculations.

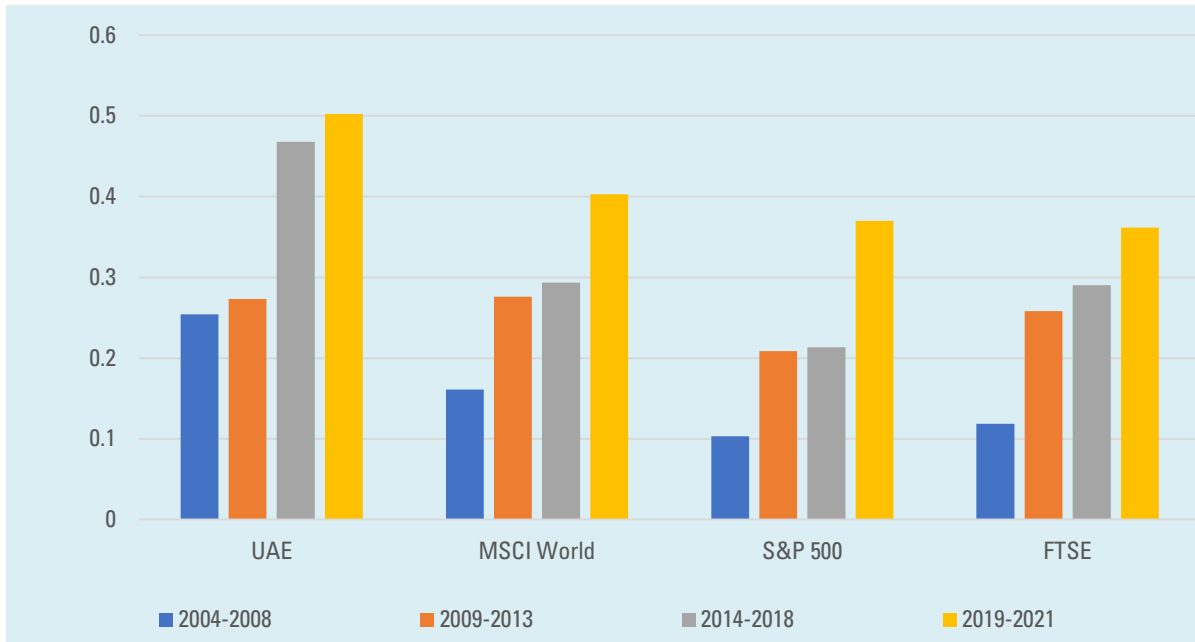
Dividing the period into five-year samples, the correlation between Emirati and Saudi markets has increased over time, and that Saudi Arabia (given its size) is more affected by movements in the MSCI World Index and S&P 500 than the United Arab Emirates. GCC countries increased their global and regional financial markets integration in the pre-pandemic period.

Figure 27. Emirati stock market correlation with Saudi Arabia has strengthened over time



Source: Refinitiv Datastream; ESCWA calculations.

Figure 28. Correlation of Saudi Arabia with MSCI World and S&P is slightly higher than that of the United Arab Emirates



Source: Refinitiv Datastream; ESCWA calculations.

To sum up, countries in the Arab region did substantially benefited from greater global or regional integration during the pre-pandemic period. A tectonic shift to Asia is an important change, which the region should build upon given that Asia is a leading trade and economic partner. As China increases its investments in the GCC subregion and the wider Arab region as part of its Belt and Road Initiative, the Arab region should build on those linkages to further integrate into global value chains. While linkages have been strongest in labour movements, there is potential to improve other areas of integration.

1. Impact of COVID-19 on Arab economies, and on global and regional integration

The pandemic has left a deep mark on the global economy, with all regions posting a decline in output. Global growth dipped by 3.1 per cent in 2020 according to IMF, with the Middle East and North Africa region posting a 3.2 per cent drop (only Egypt grew in 2020, by 3.6 per cent). The second quarter of 2020 saw the sharpest declines: there was a supply shock given factory closures, supply chain disruptions, increasing prices of disrupted raw materials supply, and a tightening of credit. Weaker economic growth resulted in lower consumer spending (from workplace closures, quarantines), delays in business investments, and a fall in aggregate demand amidst higher uncertainty. Overall, 2020 was characterized by GDP contraction; weak domestic demand; supply chain disruptions; a shift to remote working and online learning; and a roll-out of monetary and fiscal stimulus by Governments.

Countries reacted to the pandemic by introducing various levels of stringency (such as remote working, and the closure of educational institutions and non-essential shops, public parks and beaches), rolling out fiscal stimulus packages for pandemic-affected sectors (trade, tourism, hospitality) and SMEs/businesses/individuals, including loan guarantees. Central banks eased monetary policy (quantitative easing), cut policy rates, and introduced additional regulatory support for the banking sector and financial markets. However, there was a distinct gap in the magnitude and speed of fiscal and monetary policies: developed countries' support packages since the start of 2020 stood at around 25 per cent of GDP, while those of low-income countries was under 3 per cent of GDP.¹¹ Furthermore, with the unequal distribution of COVID-19 vaccines, the gap has only widened further, causing an uneven global recovery.

A. Impact on income and output in Arab countries

The immediate effects of the pandemic were similar in the Arab region compared with the rest of the world: negative economic effects resulting from lockdowns, and a subsequent decline in economic activity. In addition, GCC countries and other oil-exporting nations were also simultaneously adversely affected by lower oil prices, with spillover effects into the non-oil sector. Economic growth in the GCC subregion fell the sharpest (-4.8 per cent year-over-year in 2020 from 2 per cent in 2019), while oil importers' growth dipped by 0.6 per cent compared with a 3.3 per cent growth in 2019.¹² This double whammy resulted in a substantial decline in non-oil GDP growth,

11 IMF Fiscal Monitor, October 2020.

12 IMF, 2021.

from 2.7 per cent in 2019 to -3.9 per cent in 2020. With closed borders, there was a significant decline in the operations of the non-oil sector, with most GCC countries depending on the tourism and hospitality sector. Spillover effects were visible in travel and hospitality (airlines and hotels were requesting staff members to go on unpaid leave, hotels rates were cut to off-peak rates), tourism (including MICE, given the number of cancellations/ rescheduling of major events), entertainment and leisure activities (movie theatres, theme parks), and retail (although e-commerce activity increased).

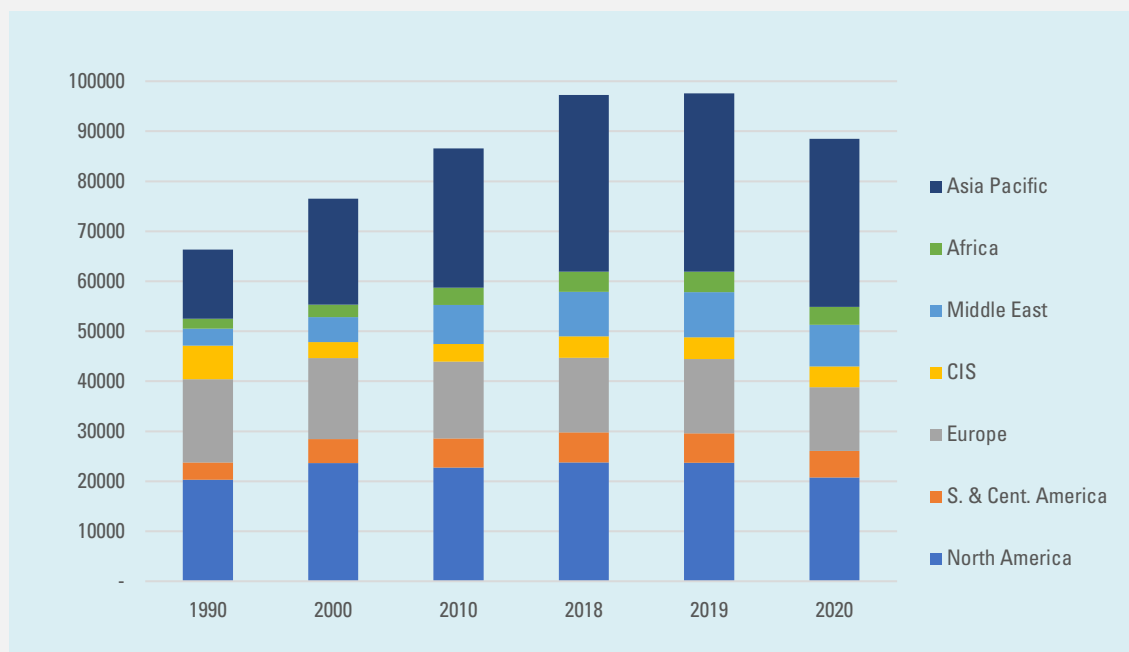
Oil exporters benefitted from the bounce back in commodity prices from the second quarter of 2020, with the OPEC+ also deciding to gradually increase production. Countries with a larger share of GDP.

Box 1. Oil production and consumption

The pandemic had a significant impact on Arab oil-producing countries. Global oil consumption fell by a record 9.1 million barrels per day (bpd) (or 9.3 per cent) to its lowest level since 2011. With mobility extremely restricted during the initial phase of the pandemic, not only was remote working leading to less use of personal and public transport, but even the use of jet fuel slumped with most flights grounded for a few weeks.

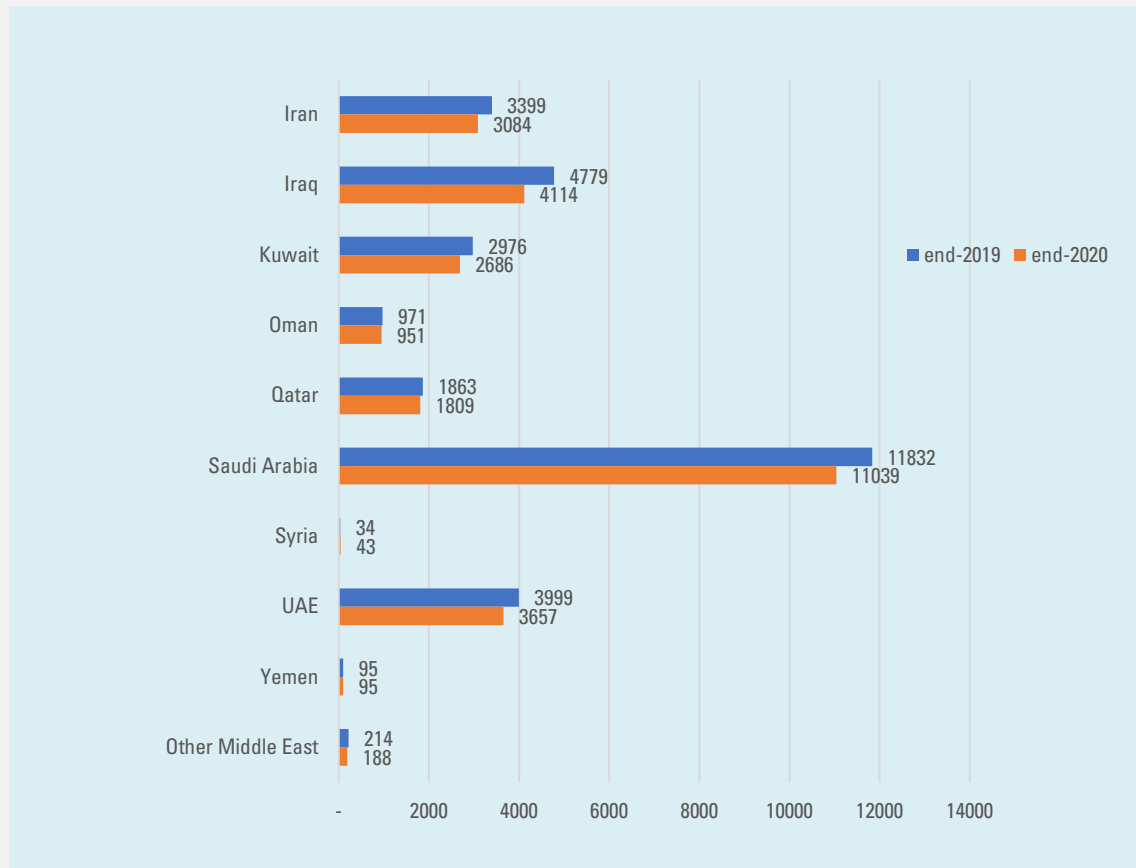
The share of oil consumption in 2020 declined in both North America and Europe, while increasing slightly in Asia. In the Arab region, oil production fell by 8.3 per cent in 2020, compared with an annual growth rate of 1.9 per cent in the period 2000-2019.

Figure A. Share of oil consumption, 2020



Sources: BP Statistical Review of World Energy 2021; ESCWA calculations.

Figure B. Oil production in the Arab region

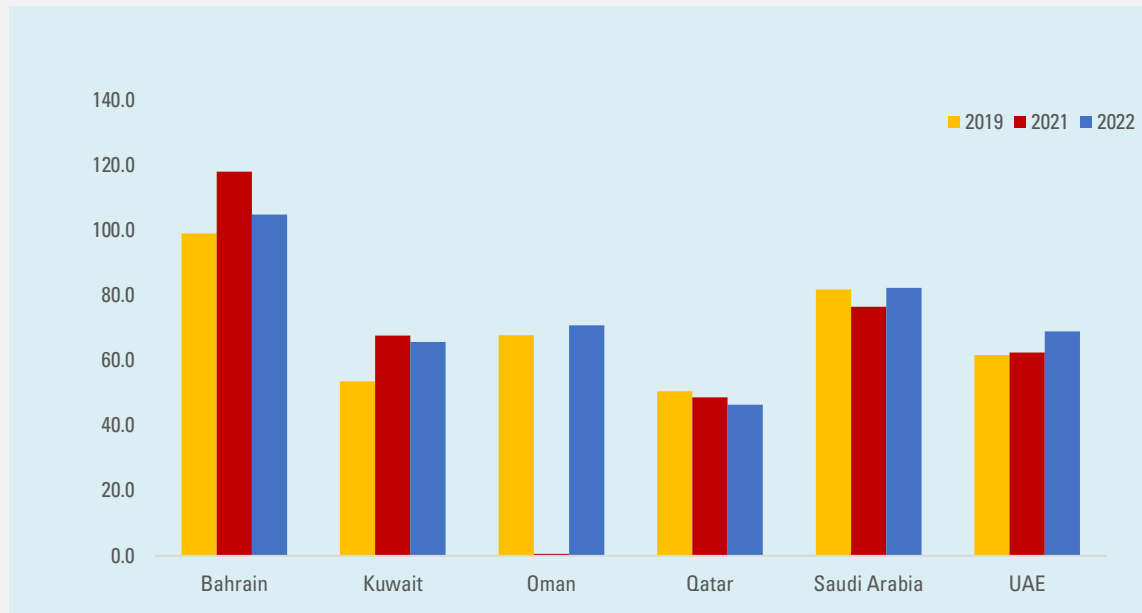


Sources: BP Statistical Review of World Energy 2021; ESCWA calculations.

Global oil production fell by 6.6million bpd in 2020, recording the largest decline in post-war history, with OPEC accounting for two thirds of the decline. From the OPEC group, Libya (-920,000 bpd) and Saudi Arabia (-790,000 bpd) saw the largest declines, while the Russian Federation (-1.0mn bpd) and the United States (-600,000 bpd) led non-OPEC reductions. There were two distinct phases related to oil supply in 2020: the period until April 2020 saw oil inventories accumulate at a record pace, while demand plummeted. Brent reached a low of around \$20 per barrel and the West Texas Intermediate turned negative. From April 2020, OPEC+ agreed to cut oil production which was extended till July 2020. During this period, demand slightly recovered as countries eased their lockdowns. The next phase starting in August 2020 saw demand edge up and oil prices increased gradually to around \$50.

For oil-exporting countries, the sharp oil price shock came at a time when growth was declining, fiscal breakeven oil prices were higher (except for Qatar and Saudi Arabia), and stimulus measures had to be introduced. The following options were available to countries that were highly dependent on oil revenues for spending: apply spending cuts; drawdown international reserves at the central banks; request support from domestic sovereign wealth funds; or borrow from international/regional markets. As a result, fiscal balances deteriorated across the region, more severely for oil-exporters (-8.6 per cent of GDP) than oil importers (-7.1 per cent of GDP).

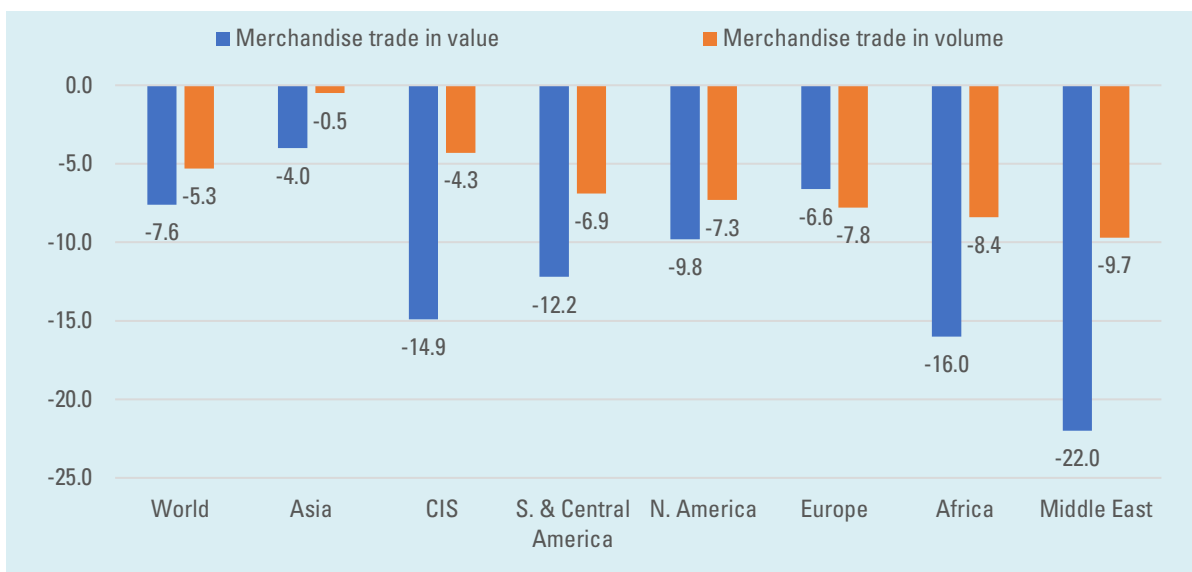
Figure C. Fiscal breakeven price



Sources: IMF (Oct 2021 World Economic Outlook database); ESCWA calculations.

originating in tourism and travel suffered larger declines in activity, with the effects persisting as long as travel restrictions were in place and until virus transmission subsided. The rollout of vaccines from end-2020 led to a recovery in 2021, though disparate across countries.

Figure 29. Merchandise trade by region, 2020



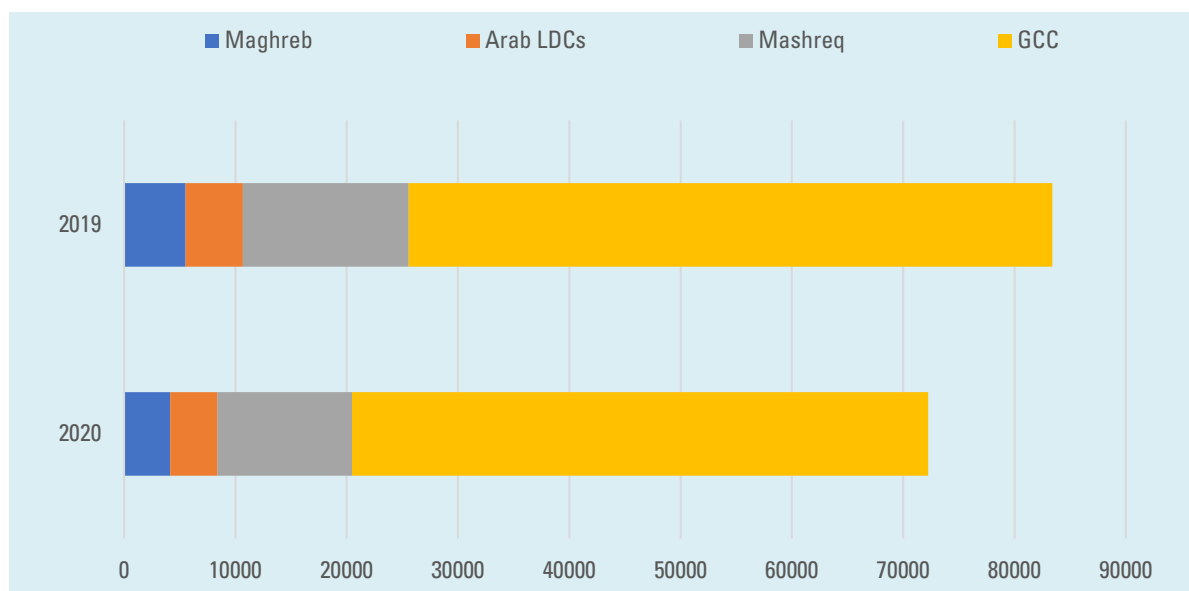
Source: World Trade Statistical Review 2021; ESCWA calculations.

B. Impact of COVID-19 on trade

The COVID-19 pandemic depressed global trade in both goods and services. With the rollout of vaccines and gradual economic recovery to “normal”, trade has bounced back, with the WTO estimating merchandise trade to recover by 10.8 per cent year-on-year in 2021 from a drop of 5.3 per cent in 2020.¹³ This implies a higher volume of global trade compared with pre-pandemic times. Services trade was more severely affected, with travel exports (including tourism and related services) plunging to \$549 billion from \$1468 billion in 2019.¹⁴ All regions experienced declines in merchandise trade in 2020, and the Arab region was no exception. However, the Arab region’s decline was the sharpest across all regions (-22 per cent year-on-year in value, and -9.7 per cent year-on-year in volume), given the decline in energy prices and exports (due to a fall in global demand).

As noted above, the evidence on trade shows that both the GCC subregion and the Arab region’s diversified countries¹⁵ have become more integrated with Asia over time, while the Maghreb remains more integrated with Europe. Each subregion’s trade with the rest of the Arab region remains quite dismal: less than 5 per cent for the Maghreb and around 10 per cent for both the GCC subregion and the Mashreq.

Figure 30. GCC exports to the Arab region



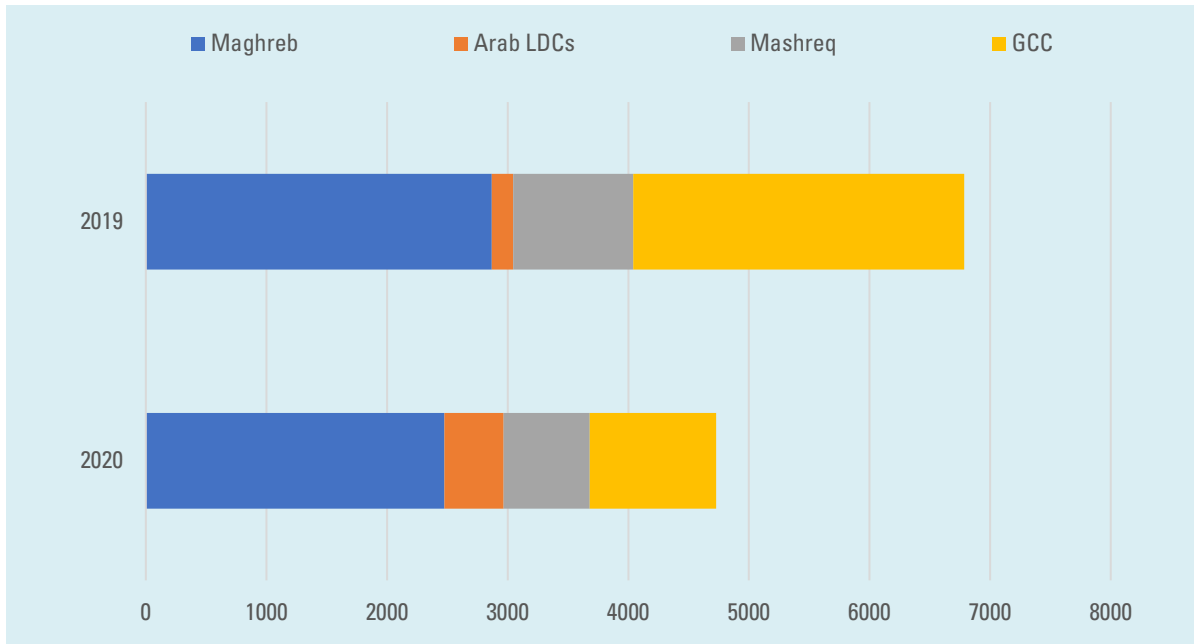
Sources: IMF DOTS; ESCWA calculations.

13 WTO, 2021a.

14 WTO, 2021b.

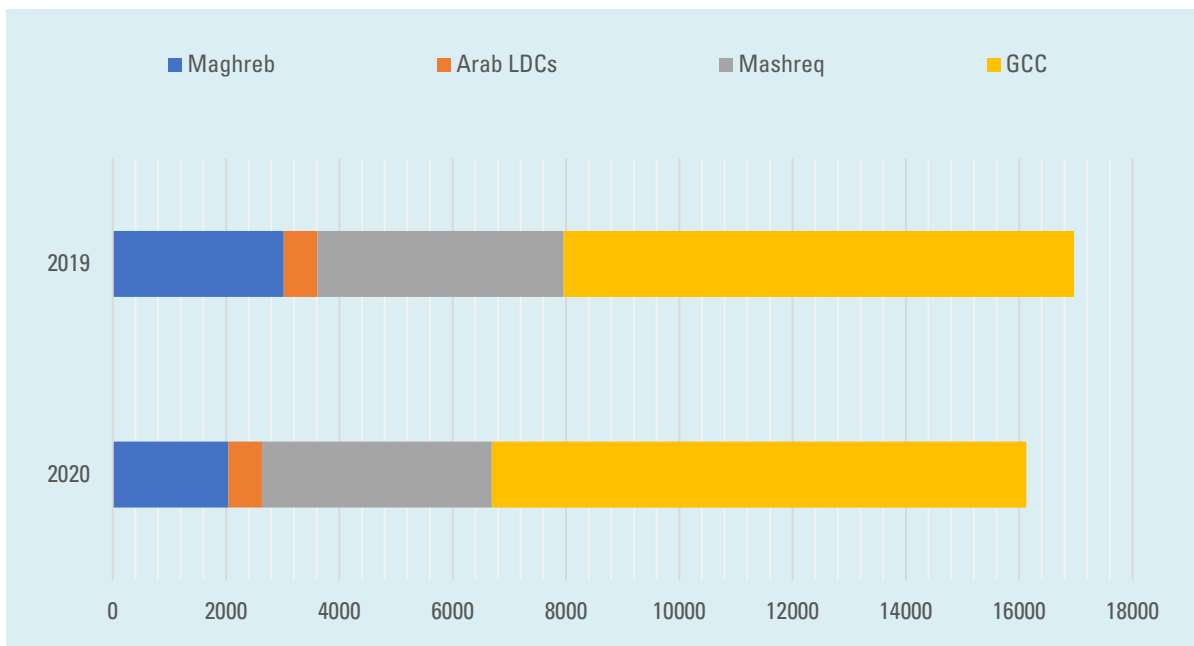
15 Egypt, Iraq, Jordan, Lebanon and the Syrian Arab Republic (www.unescwa.org/sites/default/files/pubs/pdf/user-guide-arab-economic-integration-system-indices-english_1.pdf).

Figure 31. Maghreb exports to the Arab region



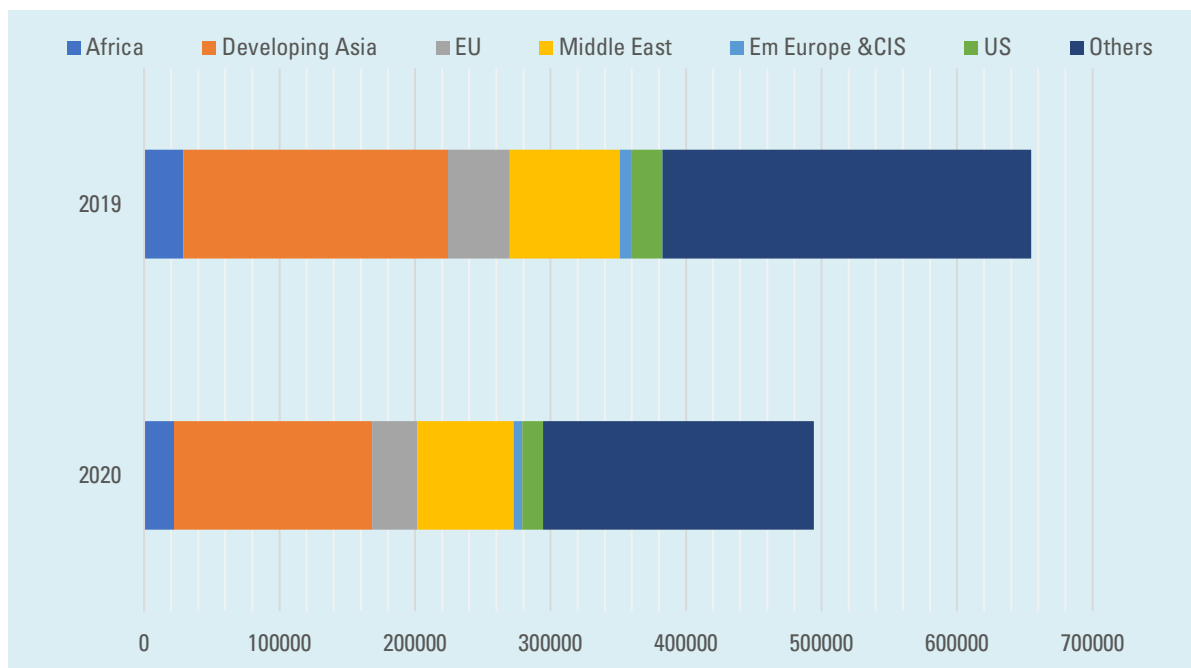
Sources: IMF DOTS; ESCWA calculations.

Figure 32. Mashreq exports to the Arab region



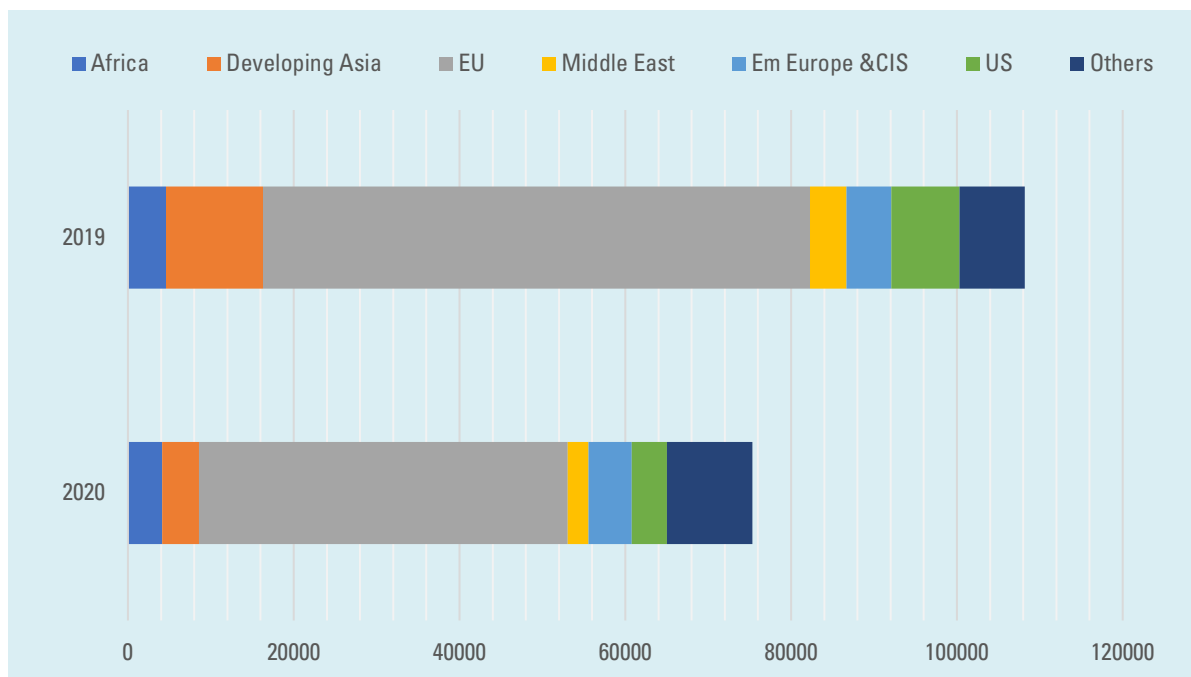
Sources: IMF DOTS; ESCWA calculations.

Figure 33. GCC exports to the world



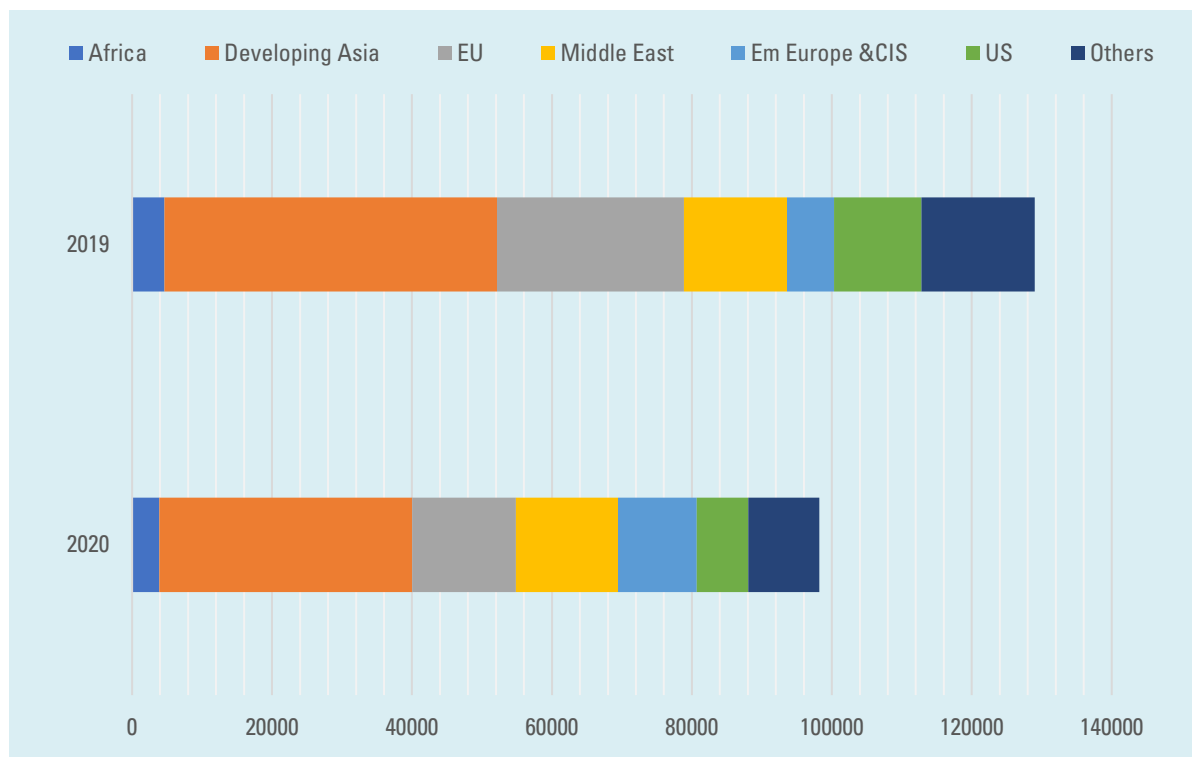
Sources: IMF DOTS; ESCWA calculations.

Figure 34. Maghreb exports to the world



Sources: IMF DOTS; ESCWA calculations.

Figure 35. Mashreq exports to the world



Sources: IMF DOTS; ESCWA calculations.

In the Arab region, although goods trade declined across all subregions, Maghreb exports to the region declined more sharply in 2020. Maghreb trade with the GCC subregion slipped in both 2019 and 2020 compared with previous years' roughly 18 per cent share. Arab diversified countries' integration with the GCC subregion has been rising overtime, and accounts for around 50-60 per cent of exports within the region.

Box 2. Tourism sector in the Arab region has yet to recover from pandemic fatigue

While oil prices have recovered from the lows seen in 2020, tourism continues to be one of the major sectors significantly hit by the pandemic, especially so when borders were completely closed. In the Arab region, many countries are dependent on tourism, both in terms of value added and employment. The cessation of international travel in the first quarter of 2020 resulted in a major drag on growth. The World Travel and Tourism Council estimates that the total contribution of travel and tourism to GDP declined by 51.1 per cent year-on-year in 2020 in the region (compared with 49.1 per cent globally), and jobs fell by 17.4 per cent year-on-year (equivalent to 1.2 million jobs) compared with 62 million jobs globally (or a 18.5 per cent drop). Figures A and B show the dependence of Arab countries on tourism.

Figure A. Growth in international tourist arrivals (Percentage change compared with 2019)

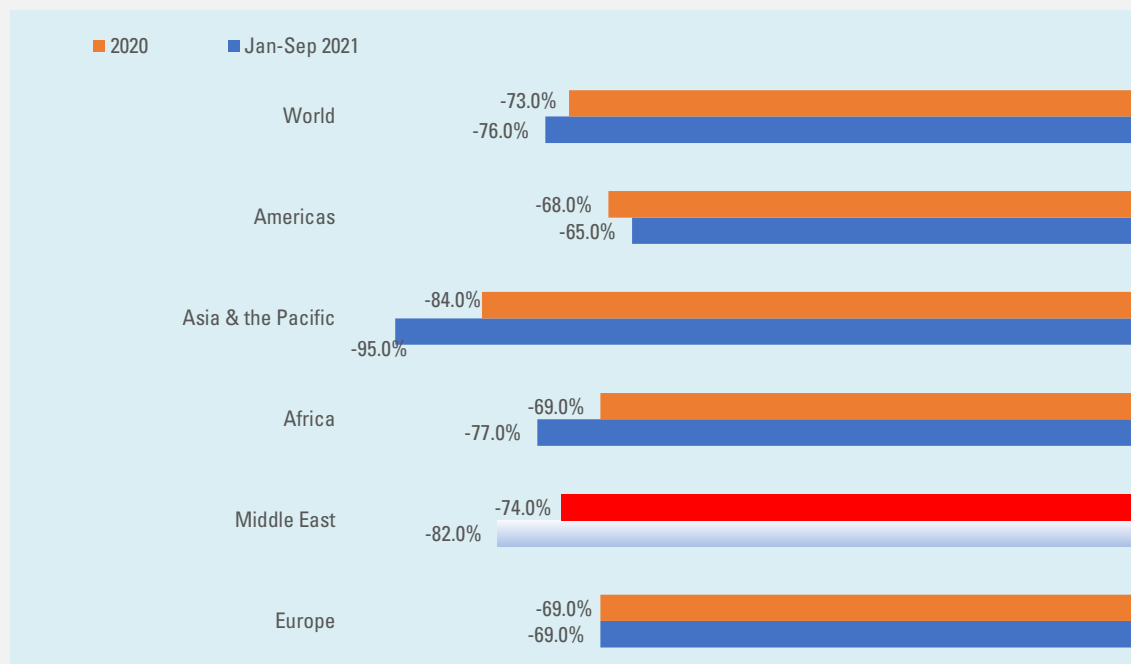
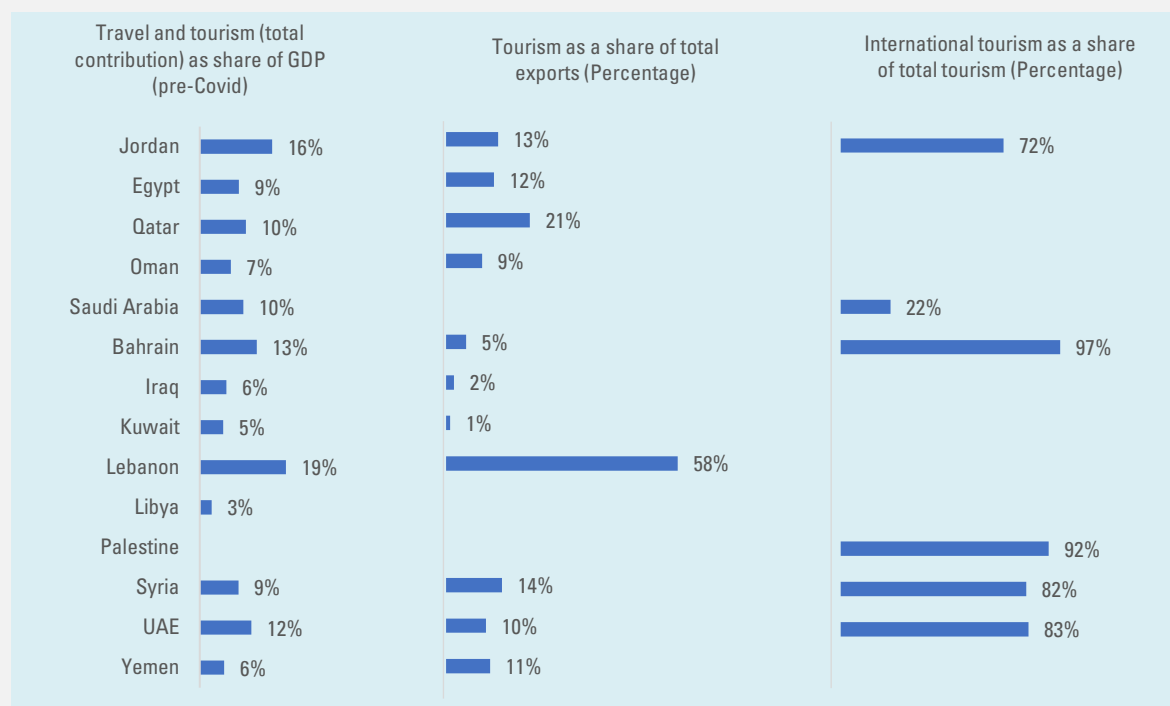


Figure B. Contribution of tourist destinations in the Arab region (Pre-pandemic)



Source: ESCWA calculations.

Given the region's reliance on international tourism (compared with regional or domestic), the widespread travel restrictions across the United States, Europe and Asia (especially China) left a lasting impact. International tourist arrivals in the region fell by 74 per cent in 2020 slightly more than the global average of 73 per cent. Recovery is unlikely to reach pre-pandemic levels in 2021. As the COVID-19 vaccination pace picks up and international travel resumes, recovery might be underway by mid-2022.

International Tourist Arrivals in the Middle East, by country (comparison with 2019)

	World (Percentage)	Arab Region (Percentage)	Jordan (Percentage)	Saudi Arabia (Percentage)
2020	-73	-74	-76	-76
January 2020	1	9	12	5
February 2020	-14	4	16	-14
March 2020	-65	-73	-59	-65
April 2020	-97	-99	-100	-97
May 2020	-95	-99	-100	-95
June 2020	-91	-98	-96	-91
July 2020	-79	-96	-96	-79
August 2020	-76	-94	-97	-76
September 2020	-77	-85	-93	-77
October 2020	-82	-83	-90	-82
November 2020	-85	-82	-87	-85
December 2020	-84	-82	-84	-84

Source: ESCWA calculations.

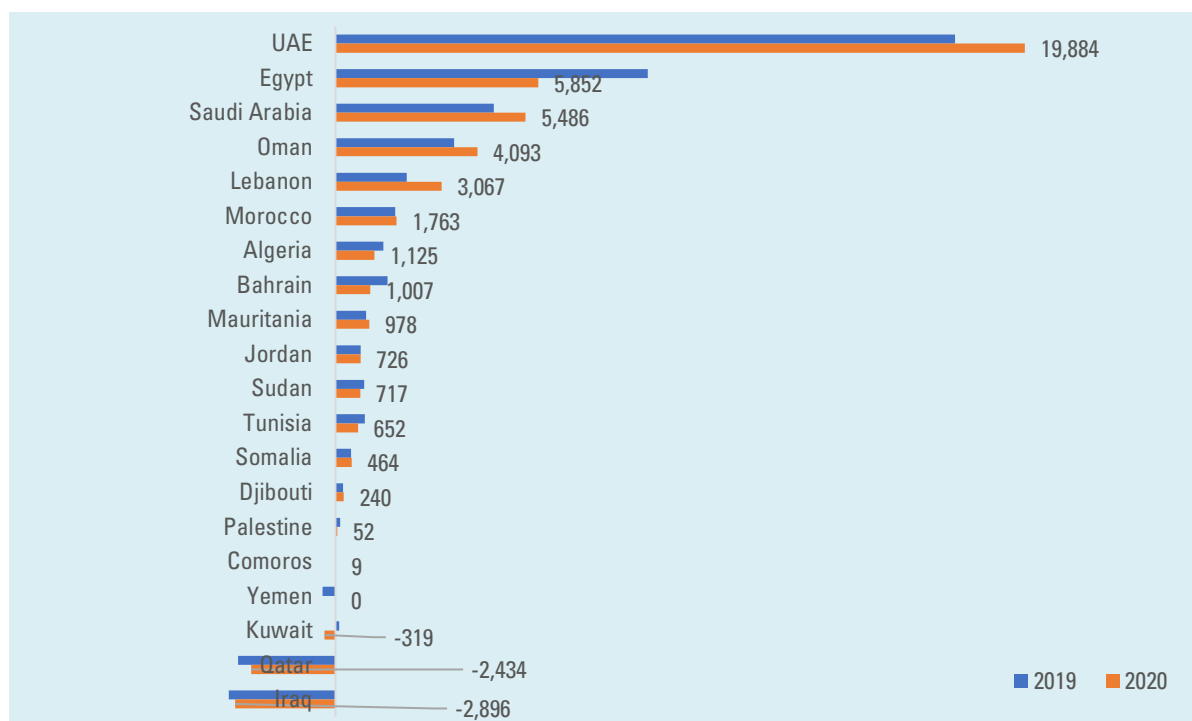
Interestingly, tourism is one of the strong pillars of oil-dependent countries' diversification strategy. The United Arab Emirates, which is highly reliant on international and regional tourists, posted a steeper decline of 60.3 per cent in travel and tourism GDP in 2020. In Bahrain and the United Arab Emirates, international tourism as a percentage of total tourism stands at 97 per cent and 83 per cent, respectively in 2020, according to WTO.

Bucking the global trend, FDI inflows into Asia increased in 2020 (+4 per cent year-on-year to \$535 billion).¹⁶ Within Asia, inflows into West Asia grew by 9 per cent to \$37 billion, supported by both the United Arab Emirates (thanks to acquisitions in the energy sector) and Saudi Arabia (given investments in financial services, retail, e-commerce and ICT). Unpredictably, inflows into Lebanon also increased despite the turmoil.¹⁷ The United Arab Emirates retained its spot among the top five home nations (preferred destination in terms of emigration) with respect to outflows, although the value dropped by 10.8 per cent to \$18.9 billion.

¹⁶ UNCTAD, 2021.

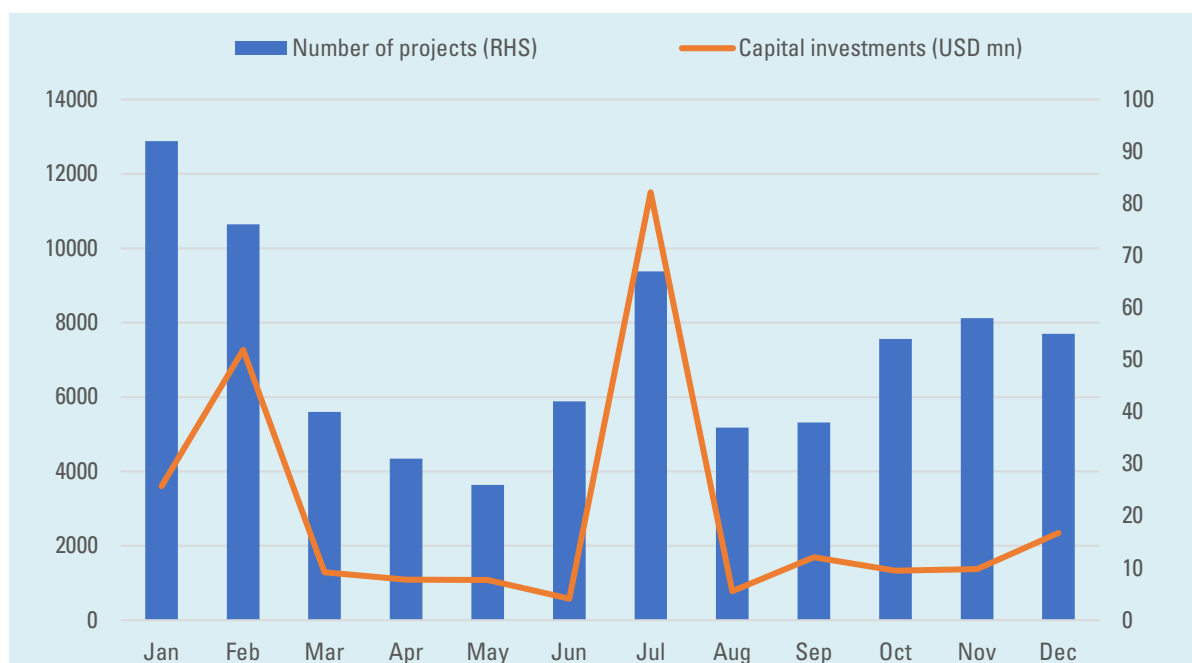
¹⁷ These could be mislabeled remittances.

Figure 36. FDI inflows into Arab countries, 2020 versus 2019 (Millions of dollars)



Source: ESCWA calculations.

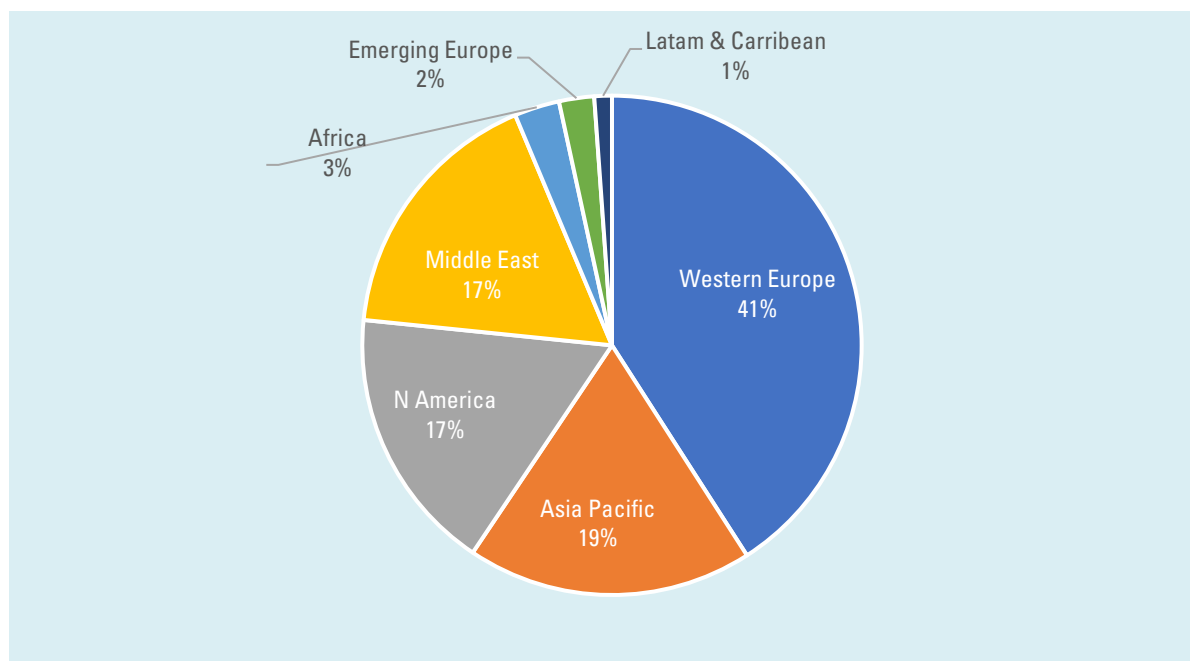
Figure 37. Greenfield FDI to Arab countries, 2020



Source: Arab Investment & Export Credit Guarantee Corporation (Dhman).

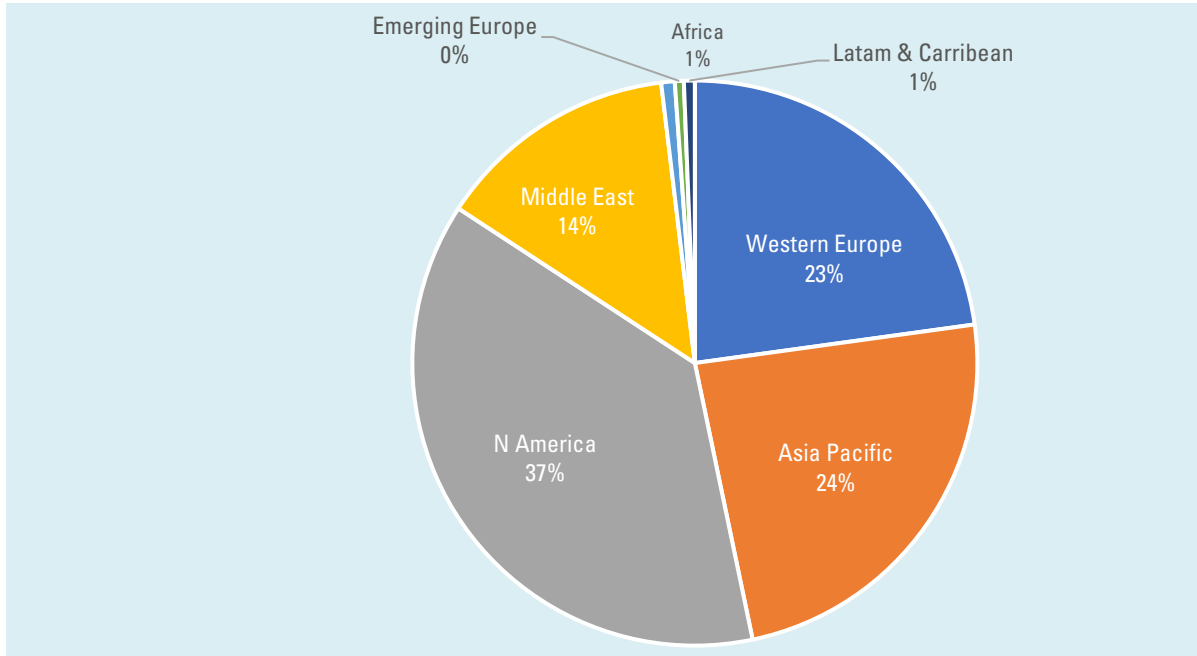
figure 37 shows the performance of investment inflows by month. The second quarter of 2020 was the most affected in terms of FDI inflow, given the rising uncertainty stemming from the pandemic and related pause on major projects. July 2020, however, saw the announcement of two of the largest investments in 2020: a \$5 billion hydrogen plant in NEOM, and another a \$4.2 billion oil refinery in Oman. The top five investments in 2020 were all energy projects (four in the GCC subregion and one in Iraq). There was diversity in terms of the source of investments. While Western Europe topped the list in terms of number of projects (41 per cent), in terms of capital investment it accounted for just 23 per cent. In the case of North America and Asia Pacific, however, the share of capital investment was much higher than the allocation by number of projects, highlighting the higher value of projects in the oil and energy sectors. Intra-regional investment accounted for less than a fifth of the number of projects, and a much smaller share of 14 per cent of total capital investment.

Figure 38. New FDI as a percentage of total projects in the Arab region, 2020



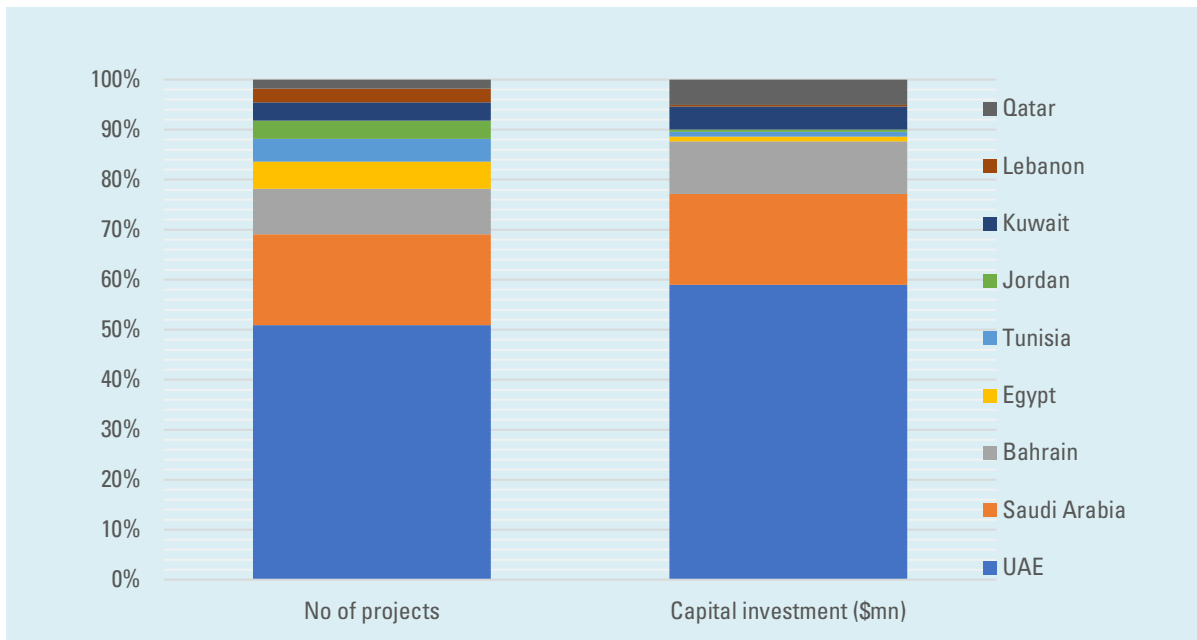
Source: Arab Investment & Export Credit Guarantee Corporation (Dhaman); ESCWA calculations.

Figure 39. New capital investment in the Arab region, 2020 (Percentage)



Source: Arab Investment & Export Credit Guarantee Corporation (Dhamaan); ESCWA calculations.

Figure 40. Arab countries investing in the region, 2020

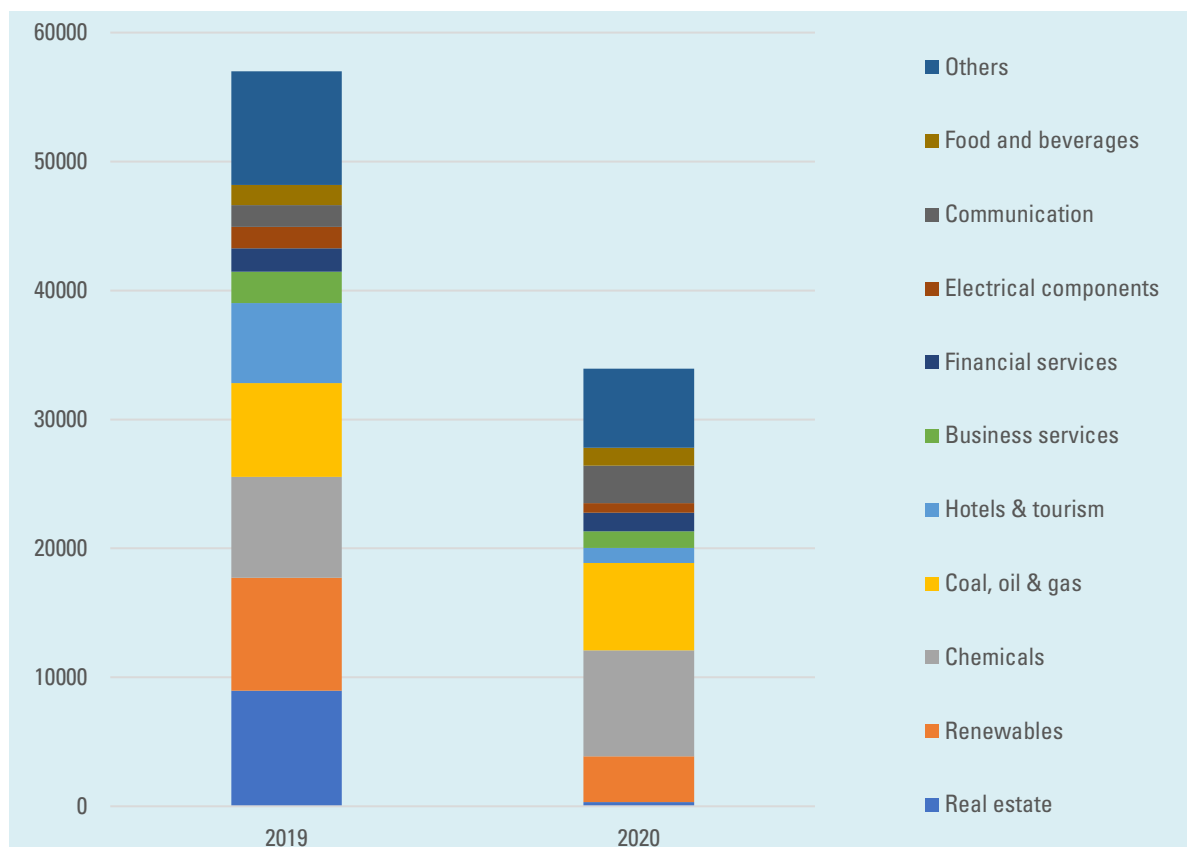


Source: Arab Investment & Export Credit Guarantee Corporation (Dhamaan); ESCWA calculations.

Examining the breakdown of Arab countries investing within the region (figure 40) reveals the dominance of capital-rich countries. Bahrain, Saudi Arabia and the United Arab Emirates together accounted for more than three quarters of the number of projects, and close to 90 per cent of total capital expenditure. Qatar invested in two projects last year, with an average combined size of \$121.3 million: roughly three times higher than the average of all projects in the region put together.

The Arab Investment and Export Credit Guarantee Corporation, using FDI Markets data, publishes information on greenfield FDI to Arab countries.¹⁸ This data shows a drop in both the number of projects (-38 per cent year-on-year) and capital investment (-40 per cent to \$57 billion) into the region during the pandemic. Unsurprisingly, investment in the real estate sector dried up in 2020 given the uncertainties. Among the top sectors attracting FDI, only the chemicals and communications sectors gained in 2020.

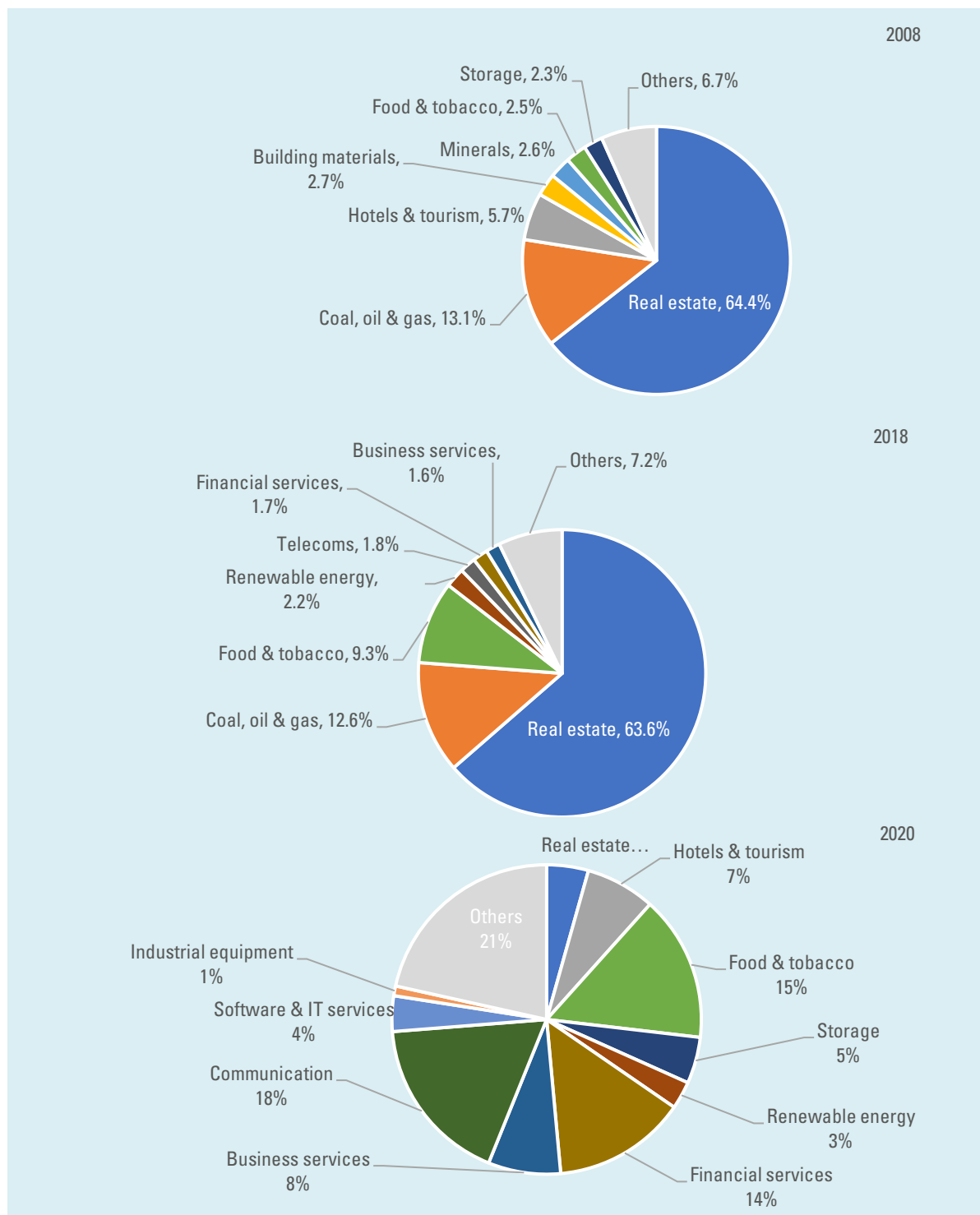
Figure 41. FDI by sector in Arab countries: capital investments (Millions of dollars)



Source: Arab Investment & Export Credit Guarantee Corporation (Dhahran); ESCWA calculations.

18 Greenfield investments represent more than 80 per cent of total FDI projects in most oil-importing Arab economies.

Figure 42. Capital investment in inter-Arab projects by sector



Source: Arab Investment & Export Credit Guarantee Corporation (Dhman); ESCWA calculations.

The sector composition of inter-Arab FDI flows also changed in 2020. The most striking change is the share of the real estate sector: a drop to just 4 per cent of the total from a steady 64 per cent share in both 2008 and 2018. Another is the rise in renewable energy projects (both in number and value), with one of the top five inter-Arab projects being the water desalination plant project in Abu Dhabi.¹⁹ Furthermore, investments in services increased: financial services (14 per cent in 2020 compared with 1.7 per cent in 2018), business services (8 per cent in 2020 compared with 1.6 per cent in 2018), and communication and business services (18 per cent and 8 per cent, respectively, in 2020). Hotels and tourism continue to attract investments given the importance of the sector in overall contribution to GDP in many Arab countries. It remains to be seen if inter-Arab flows into these “new” sectors are restricted to the pandemic years or if it indicates a permanent shift.

In an important policy response to the COVID-19 crisis, many Arab countries implemented structural reforms in 2020 in a bid to attract investors. New free zones were established²⁰ (with multiple incentives for setting up new companies);²¹ company/investment laws were changed²² to attract foreign companies to set up; new strategic sectors/projects were identified for increasing private sector participation; and new visas²³ were issued to attract firms/entrepreneurs working in innovative fields, among others. It remains to be seen if these changes result in a permanent increase in FDI inflows, and more importantly if the “new” sectors will retain their advantage (instead of reverting back to the dominance of the real estate sector).

C. Impact of COVID-19 on labour, flows and remittances

The United Nations estimates that growth in the global stock of international migrants likely declined by 2 million to 281 million by mid-2020. Saudi Arabia (with 13 million migrants) and the United Arab Emirates (with 9 million migrants) were among the top host countries – a list topped by the United States (with 51 million migrants). To understand this intraregional pattern, the Arab region is split into North Africa and Western Asia (as per the United Nations classification). North Africa attracted migrants from Eastern Africa (44 per cent of total), followed by Western Asia (29 per cent), and from within North Africa (11 per cent). In contrast, more than 75 per cent of migrants into

19 This is also reflective of the global shift. In 2020, renewables FDI totalled \$85.5 billion globally (-11.2 per cent year-on-year), while greenfield investment into coal, oil and gas plunged to around \$44.1bn (-62.3 per cent).

20 At the Future Investment Initiative Summit, held in January 2021, the Ministry of Investment of Saudi Arabia announced plans to establish 20 new special economic zones, with investor-friendly regulations.

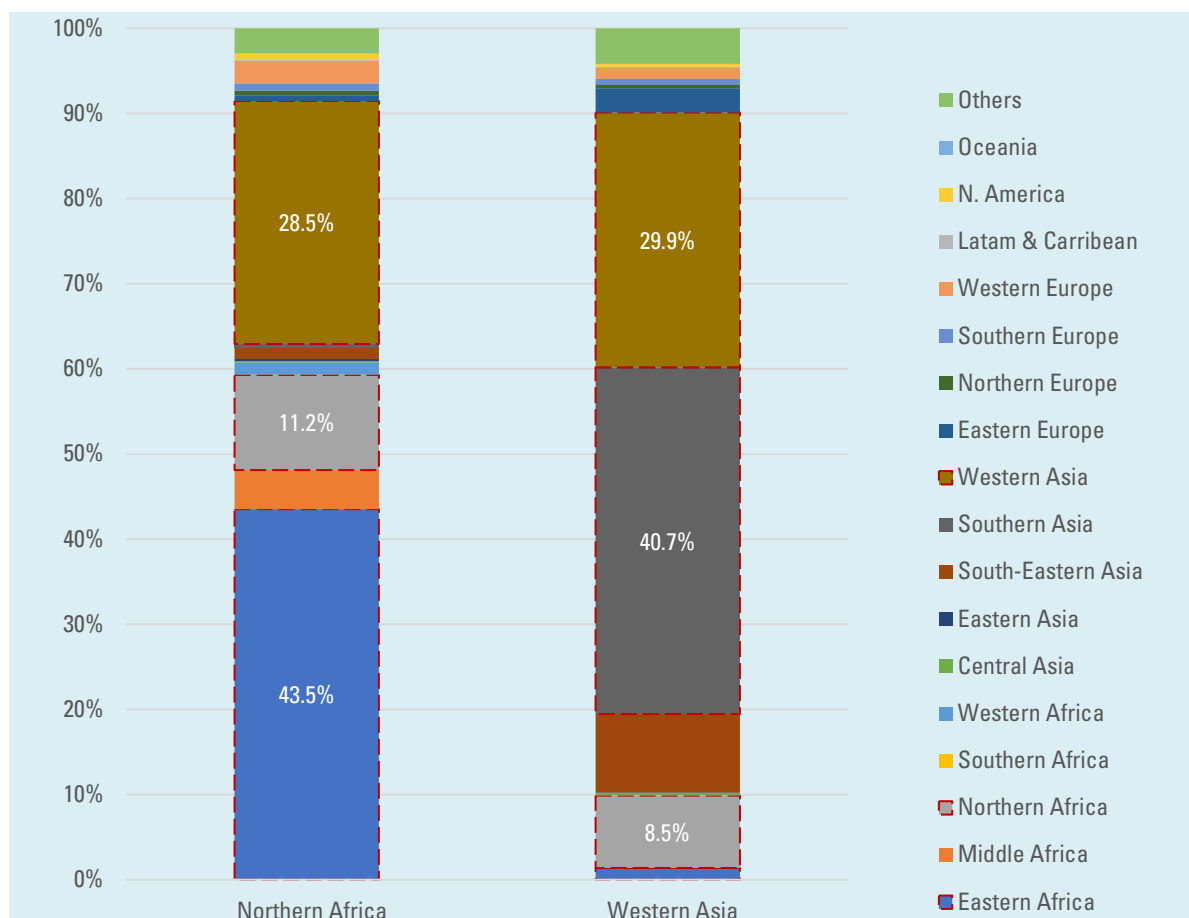
21 The financial free zone in Dubai, the Dubai International Financial Centre, waived annual licences for new companies until the end of 2020, and announced a 10 per cent discount on renewal fees for existing licences.

22 Foreign companies establishing in the United Arab Emirates do not need an Emirati shareholder or agent under the new Commercial Company Law, which came into effect on 1 June 2021.

23 The United Arab Emirates has been the most active on this front, offering 10-year renewable visas for investors, entrepreneurs, chief executives, scientists, frontline workers, computer programmers and outstanding students, among others. A remote working programme allows remote workers to obtain a residence permit in the United Arab Emirates, to live in the country while employed overseas.

Western Asia came from South Asia (40.7 per cent), Western Asia (29.9 per cent) and Northern Africa (8.5 per cent).

Figure 43. Origin of migrants in the Arab region, 2020



Source: ESCWA calculations.

COVID-19 played havoc with labour flows and livelihoods. Job losses among migrants in the early months of the pandemic led to an outflow to countries of origin. For others, rigid stringency measures in the early months of the pandemic (second quarter of 2020) meant that some people had to work from home, while others faced job losses or shorter work hours. ILO estimates that compared with the second quarter of 2019 (pre-pandemic), working hours fell sharply by 18.7 per cent globally, with Arab countries worse off at close to 20 per cent. Working hours recovered in 2021, but the Arab region remain the worst affected across all regions.²⁴

²⁴ ILO estimates disclose that for every 14 persons fully vaccinated in Q2 2021, one full-time equivalent job was added to the global labour market. The relatively slow pace of vaccination in the region (excluding GCC) could also be one of the reasons holding back recovery.

The region's job market is characterized by extremes. Employment in the public sector is substantial: a 2018 IMF study²⁵ on public sector wage bills found that average public employment as a percentage of the working-age population was nearly double when compared with the average in emerging market and developing economies. Latest data from ILO shows that in Oman,²⁶ the public sector accounted for 78.8 per cent of total employment in 2020 (largely Omani citizens); in it reached a high of 52.8 per cent in Djibouti in 2017, and around 37 per cent in Algeria in the same year. Other Arab countries, including Egypt, Jordan, the State of Palestine, Saudi Arabia and Tunisia, stayed within the 20-30 per cent range (every fifth job is in the public sector). Job redundancy is close to impossible in the public sector; and hiring in the public sector possibly increased in 2020 given additional jobs created in the health sector.

Moreover, the Arab region is characterized by a large informal sector, especially in countries with high unemployment rates and a large influx of refugees. ILO estimates that 68 per cent of employment is informal in the region.²⁷ Such employees were severely hit by the pandemic: being physically present for jobs that pay daily wages implied that movement restrictions led to loss in jobs, with little to no social safety nets. Such workers also have limited access to health care.

Table 3. Quarterly estimates of working hours: the world and Arab countries (Percentage change and full-time equivalent jobs rounded to the nearest 100,000)

	Change in working hours relative to Q4 2019 (adjusted for population aged 15-64)		Equivalent number of full-time jobs (48 hours/week)	
	World (percentage)	Arab countries (percentage)	World	Arab countries
Q1 2020	-4.9	-2.3	-142,000,000	-1,200,000
Q2 2020	-18.7	-19.4	-543,200,000	-9,800,000
Q3 2020	-7.4	9.3	-217,000,000	-4,700,000
Q4 2020	-4.5	-5.0	-131,900,000	-2,500,000
Q1 2021	-4.5	-7.2	-131,400,000	-3,700,000
Q2 2021	-4.8	-6.5	-140,100,000	-3,400,000
Q3 2021	-4.7	-6.5	-136,900,000	-3,400,000
Q4 2021	-3.2	-4.5	94,600,000	-2,400,000

Source: ILO, ILO Monitor: COVID-19 and the World of Work, 2021.

25 IMF, 2018.

26 ILO, 2020a.

27 ILO, 2019.

Employed women and young people were disproportionately affected by the pandemic. Women in the Arab region lost an estimated over 700,000 jobs,²⁸ given their employment in the informal sectors and in SMEs. Women's participation in household labour increased, as did supporting the education of children during the period of school closures (and later during distance learning programmes). As for Arab young people, even prior to the pandemic, youth unemployment in the Arab region was estimated at 26.4 per cent in 2020, up from 22.9 per cent in 2019,²⁹ with disparities between male and female youth unemployment being the highest across all regions (19.7 per cent for males and 42.2 per cent among females in 2019).

Another segment that has borne the brunt of the pandemic is refugees. The Arab region is one of the top regions from where refugees originate: the Syrian Arab Republic alone accounts for 6.8 million forcibly displaced persons from a total of 84 million globally as at mid-2021.³⁰ Moreover, about 73 per cent of refugees live in countries neighbouring their countries of origin. All this adds to the worrisome prospect of pandemic-hit unemployment rates staying higher for longer.

Meanwhile, children's education was also affected by the pandemic, which will have severe repercussions on future job prospects. UNICEF estimated that close to 37 million children (almost 40 per cent globally) were not able to learn with distance learning programmes: a challenge for low-income households within and across Arab countries.³¹

The immediate social ramification of job losses is that low-income households could slip into poverty. The World Bank estimates that 192 million persons in the Arab region could be pushed into extreme poverty (up from 176 million in 2021)³². As a result, long-term scarring effects can be expected on affected economies, leading to greater inequality and higher poverty rates.

GCC countries witnessed a different effect from the pandemic: not only were these countries hit directly by the virus, they were also negatively impacted by lower oil prices. With strains on both the oil and non-oil sectors, and given the largely migrant population, job losses resulted in an exodus to countries of origin (based on anecdotal evidence, including remittance data, as related data is largely unavailable).

Sector-wise, person-to-person jobs (accommodation, hospitality, food and beverages, real estate services, retail) have a very high-risk level of losing their jobs, as do those in sectors affected by closures/movement restrictions (transport & logistics, manufacturing, wholesale and retail trade). The lowest risk levels were in public administration (because of job stability and security), the health

28 ESCWA, 2021.

29 ILO, 2020b.

30 www.unhcr.org/refugee-statistics/.

31 UNICEF, 2021

32 World Bank (2021c). In August, the World Bank estimated a 52 percentage points increase in poverty (compared with pre-pandemic levels) for refugees, while in Lebanon (which is battling an economic, social and political crisis) it is projected to rise by 38 percentage points (World Bank, 2021a and b).

sector (need for more doctors and nurses during the pandemic), and education (albeit switching to online learning).

Table 4 indicates that close to 20 per cent of the workforce in the Arab region works in the agricultural sector, which is labour-intensive, has low productivity levels, and is dependent on the weather. Along with wholesale and retail trade (15 per cent) and the construction sector (13 per cent), these sectors account for roughly half of the workforce in the region. While public administration stands at just 9.2 per cent of the total workforce in the Arab region, there are significant disparities within the region. Public sector wage bills are much higher compared with other emerging markets and developing economies (EMDE): in the GCC subregion and Algeria, it is 3.6 percentage points higher than EMDE, while wage bills were 2.3 percentage points higher in oil-importing countries.³³ Furthermore, State-owned enterprises add to this low productivity-low returns model: the OECD³⁴ estimates that State-owned enterprises in the Arab region account for 20-50 per cent of value added and 30 per cent of employment, while other studies have consistently found that State-owned enterprises report massive annual losses (a World Bank study places the share of losses between 0.6-6 per cent of GDP).³⁵

Table 4. Employment at risk in the Arab region, by sector, 2020

	Risk level	Employment (thousands)			Sectoral share
		Total	Male	Female	
Agriculture, forestry and fishing	Low-medium	25,262	18,524	6,738	19.9
Mining and quarrying	Medium	1,373	1,299	74	1.1
Manufacturing	High	12,395	10,507	1,887	9.8
Utilities	Low	1,225	1,147	78	1.0
Construction	Medium	16,537	16,371	166	13.0
Wholesale and retail trade; repair of motor vehicles and motorcycles	High	18,876	16,826	2,050	14.9
Transport, storage and communication	Medium-high	9,033	8,634	399	7.1
Accommodation & food service activities	High	3,734	3,341	392	2.9
Financial and insurance activities	Medium	1,179	918	260	0.9
Real estate, business and administrative activities	High	4,789	4,112	677	3.8
Public administration & defence, compulsory social security	Low	11,721	10,088	1,633	9.2
Education	Low	9,251	4,736	4,514	7.3
Human health and social work activities	Low	3,814	1,994	1,820	3.0
Other services	Medium-high	7,549	4,740	2,809	6.0
Total		126,736	103,238	23,498	100.0

33 IMF, 2018.

34 OECD, 2012.

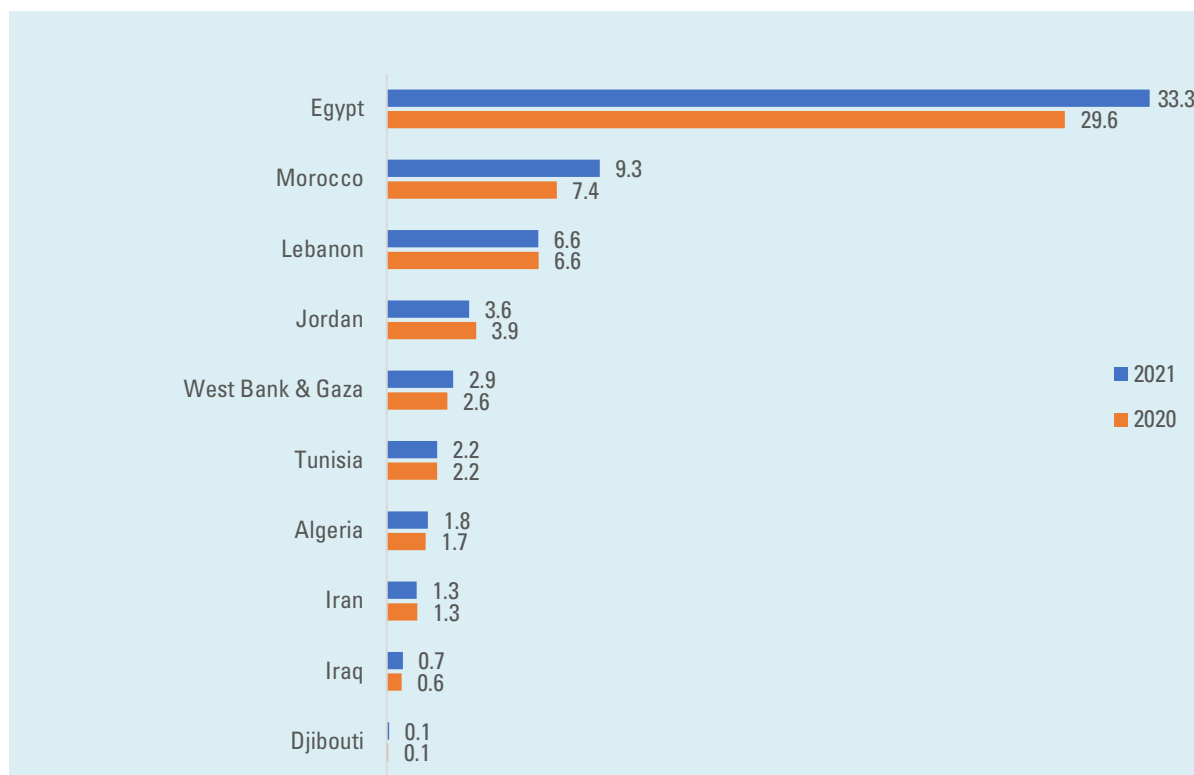
35 World Bank, 2015.

Source: "Towards a Productive and Inclusive Path Job Creation in the Arab Region", ILO report 2021.

While some sectors can be considered more resilient during the pandemic years, in the long-term, the region needs to rethink its strategy and reduce sector concentration so as move to sectors that result in higher productivity levels.

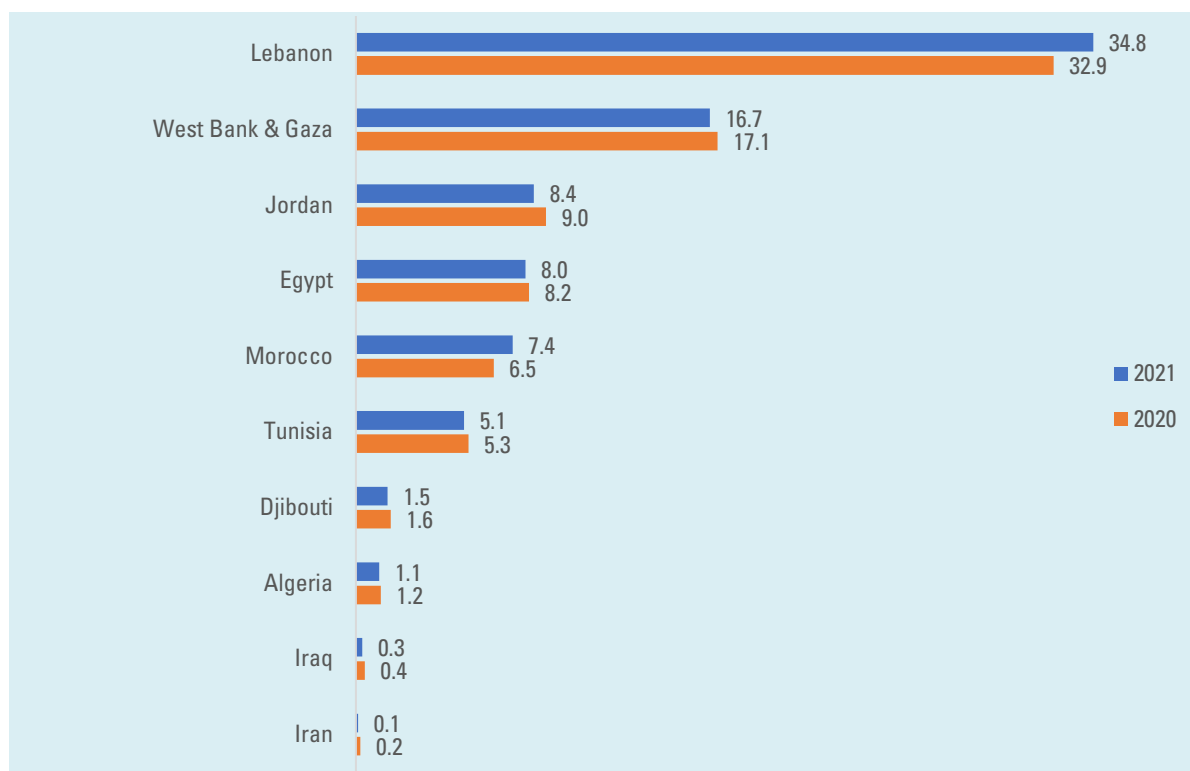
With respect to remittances, in line with their status as top migrant nations, the United States, the United Arab Emirates and Saudi Arabia saw the largest outflows of remittances. Remittances fell in the second quarter of 2020, but recovered quickly and remained resilient (including into 2021). Egypt continued to see a surge in remittances: a trend seen since the liberalization of the currency (+11 per cent to a record high \$30 billion). Lebanon saw a decline in reported remittances in 2020 to \$6.6 billion from \$7.4 billion the year before, given the economic and political turmoil in the country. Actual remittances were likely higher and in cash to avoid the banking system and frozen deposits. The country still tops the list in terms of remittances as a percentage of GDP (at 32.9 per cent in 2020 and an estimated 34.8 per cent this year), given the sharp drop in GDP.

Figure 44. Top remittance recipients in the Arab region (Billions of dollars) 2021 vs. 2020.



Source: World Bank, Migration and development brief 35, 2021.

Figure 45. Top remittance recipients in the Arab region (Percentage of GDP)

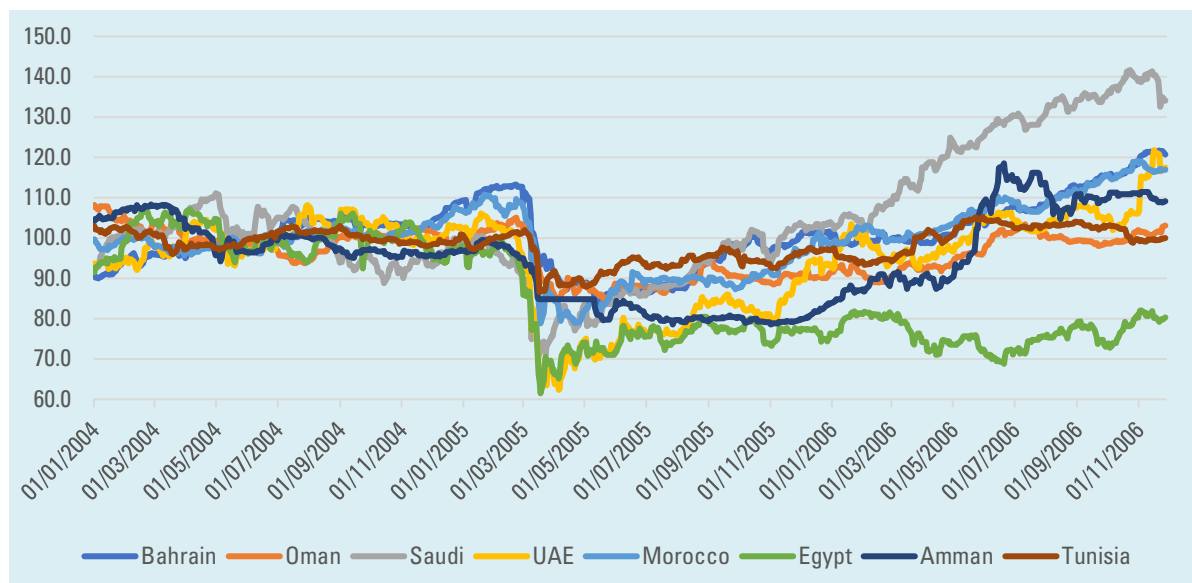


Source: World Bank, Migration and development brief 35, 2021.

D. Impact of COVID-19 on capital market developments

Figure 46 shows that the bigger markets of Saudi Arabia and the United Arab Emirates recovered well after the pandemic, as did Bahrain which shows a very strong correlation with those two countries during the period 2020-2021. The performance of Egypt dropped significantly in 2020, but it was coming off a few years of strong performance given the country's commitment to and implementation of an economic reform programme. The recent moves to greater liberalization and opening up of GCC markets increases the potential for the listing of companies from the region, leading to increased integration and capital flows.

Figure 46. Equity market performance in the Arab region (Indexed, 2019=100)

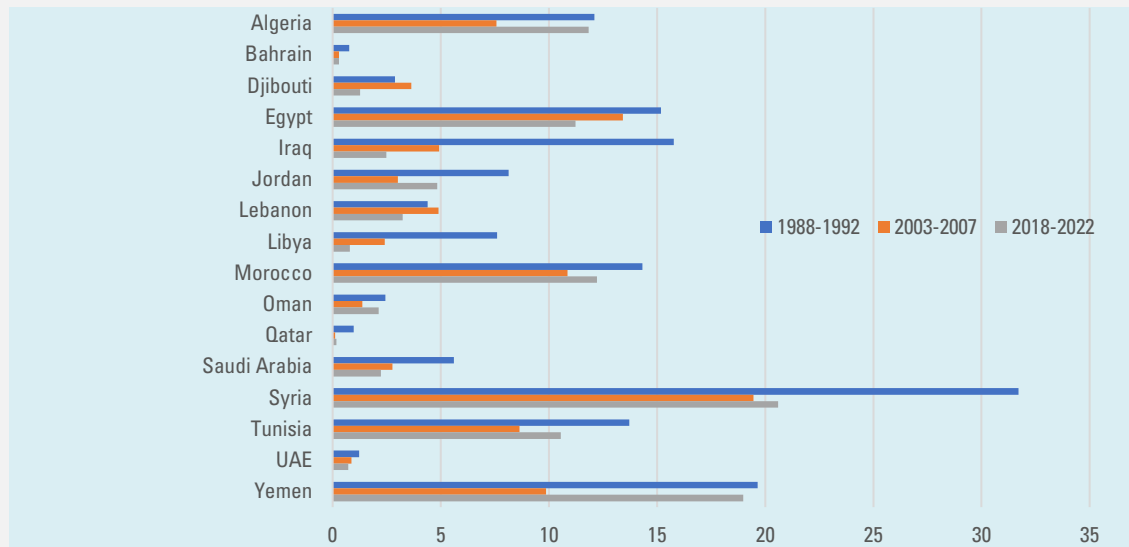


Source: Refinitiv Datastream; ESCWA calculations.

Box 3. Agriculture sector in the Arab region

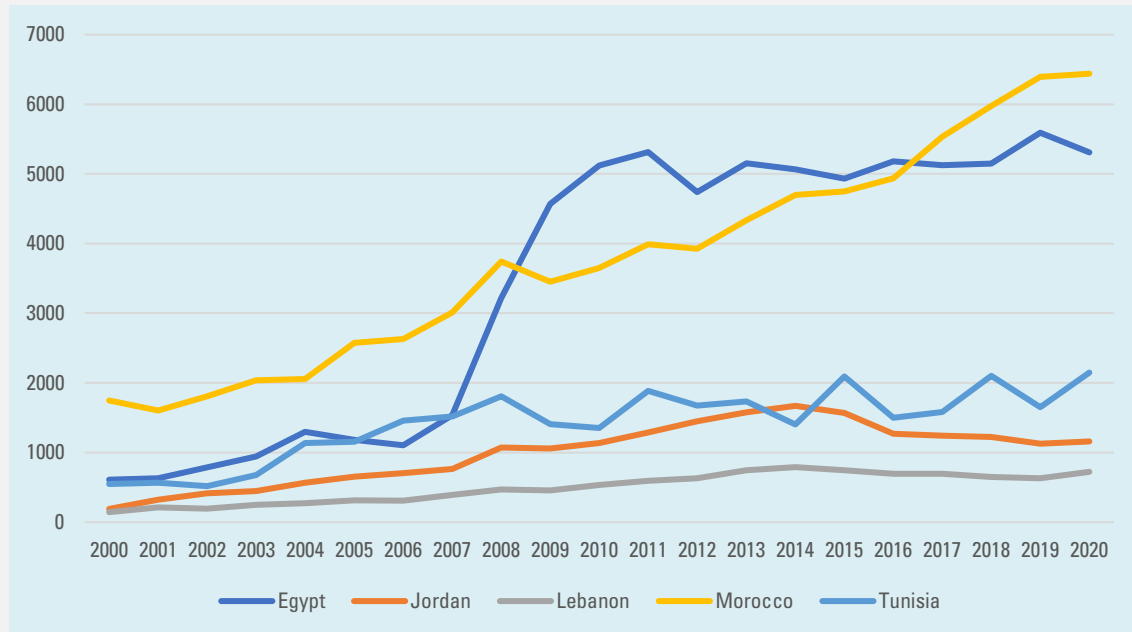
Even though the agriculture sector accounts for a large share of employment in the Arab region, less than 5 per cent of the land is arable in two thirds of Arab countries. The region is home to 6 per cent of the global population, but has just 1 per cent of freshwater resources. Being the most water-scarce region globally, 17 Arab countries are below the water poverty line. Though desalination is becoming more common, some countries continue to use groundwater instead, thus depleting this non-renewable natural resource.

Figure A. Agriculture value added (Percentage of GDP)



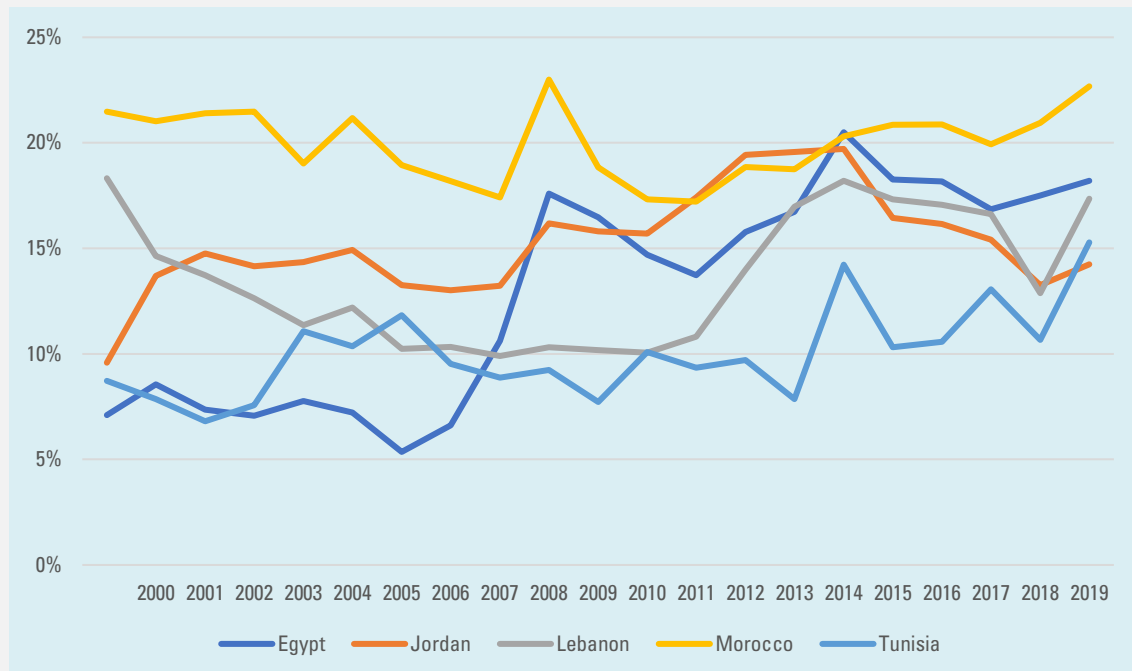
Source: FAO (AquaStat); ESCWA calculations.

Figure B. Export of agricultural products (Millions of dollars)



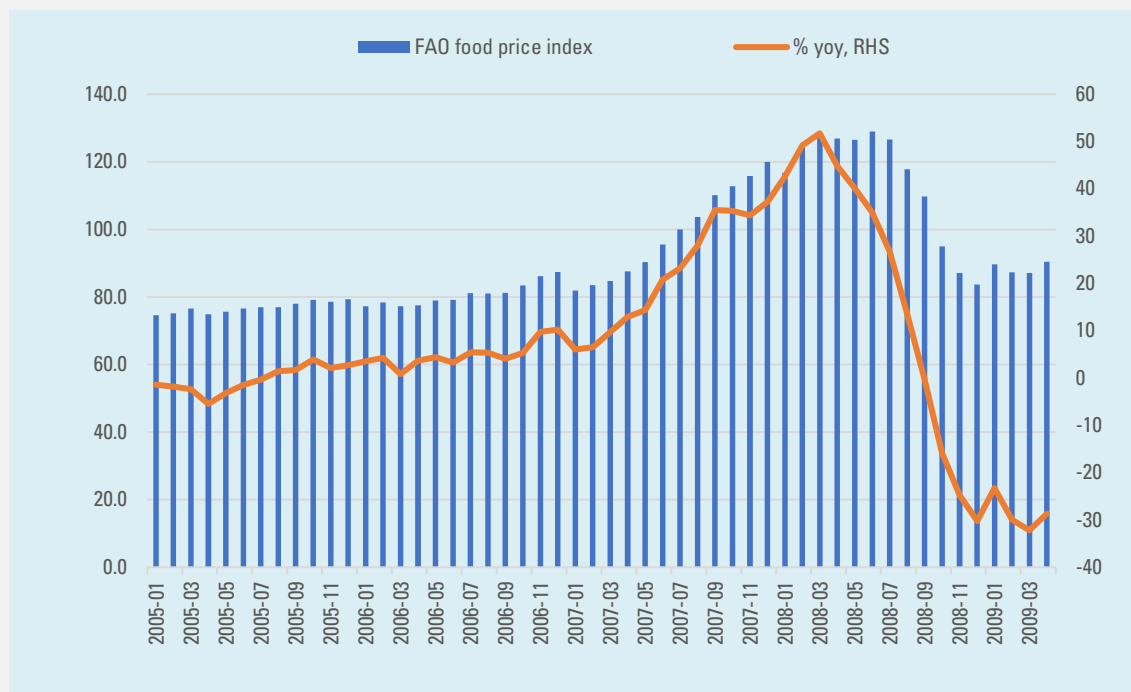
Source: FAO (Aquastat); ESCWA calculations.

Figure C. Food exports as a percentage of total merchandise exports



Source: : FAO (Aquastat); ESCWA calculations.

Figure D. Global food prices



Source: ESCWA calculations.

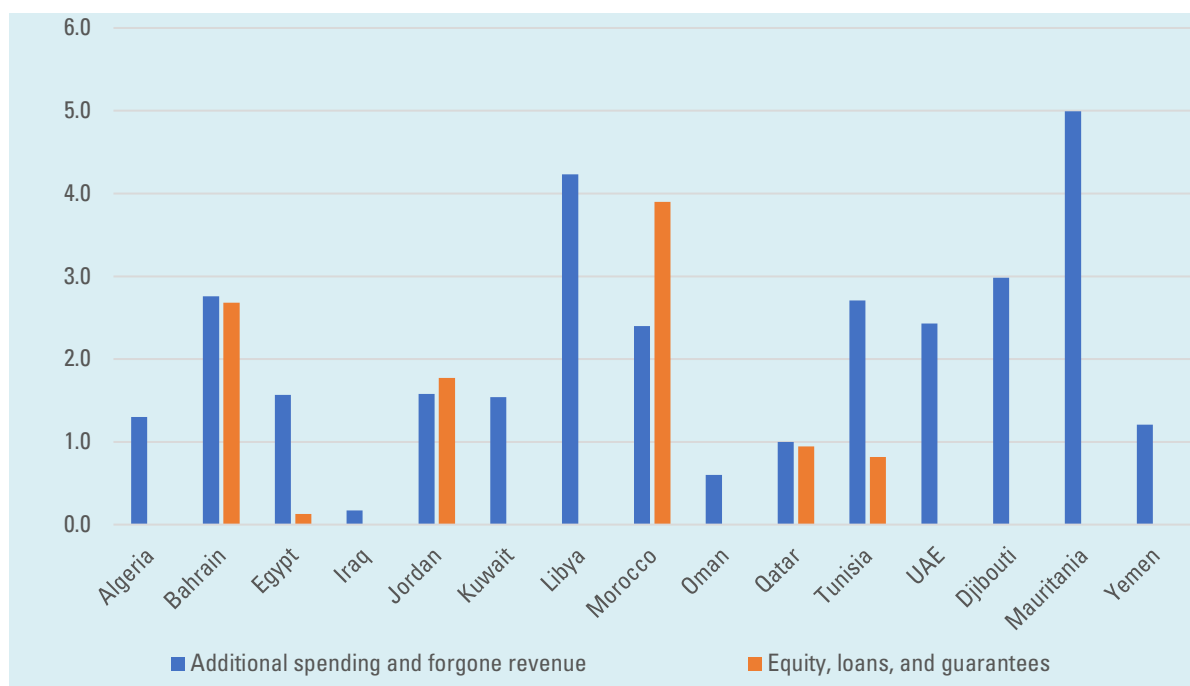
The pandemic had a direct impact on the agriculture sector, initially owing to movement restrictions that limited labour and the ability to sell the output. Indirectly, the sector was impacted due to supply chain disruptions (including logistics and transport), and a shift in consumer demand (away from food services). Prior to the pandemic, agriculture value added as a percentage of GDP stood at over 10 per cent in a few Arab countries: Algeria, Egypt, Morocco, the Syrian Arab Republic and Yemen (the latter two also impacted by conflict). While GDP breakdowns for 2020 are not available yet in many Arab countries, data on agriculture exports indicate a successful year overall (only Egypt registered a 5 per cent year-on-year decline in agricultural product exports). This is in line with the global picture, wherein production of all major commodities increased in 2020. Food prices started to rise gradually towards end 2020 (as per the FAO food price index), and by November 2021 increased to the highest level since June 2011. Global efforts to minimize supply chain disruptions seem to have limited the increase in food prices compared with during the global financial crisis 2007-2008.

The pandemic has forced the Arab region to rethink food security, and the GCC subregion its over-dependence on food imports. GCC countries are investing in agritech (such as vertical farming and desert agriculture), and investing internationally to secure food supplies. Egypt and Morocco are moving towards more sustainable agriculture. In war-torn countries like Yemen, funding is being disbursed by international financial institutions to restore agricultural production (agricultural exports were 94 per cent lower in 2020 compared with the pre-war period). For the Arab region, the agriculture sector can be a major source of greater regional integration, given the food import requirements of the GCC subregion and the agricultural potential of Mashreq and Maghreb countries.

2. Lessons from the pandemic and policy proposals to support Arab regional and global integration

The pandemic resulted in a sharp deterioration in fiscal balances in the Arab region. Across all countries, decline in economic activity and domestic demand meant a decline in revenues collected, while the oil-exporting countries also suffered a massive drop in oil revenues. Spending increased substantially (stimulus measures along with additional health-care costs and capacities, such as testing and vaccination centres), thus resulting in a widening of fiscal deficits. Arab oil exporters and importers saw fiscal deficits rise to 8.6 per cent and 7.1 per cent of GDP, respectively, in 2020. Both fiscal and monetary support were rolled out as the COVID-19 pandemic spread, with countries with less fiscal space resorting to borrowing or, if possible, drawing down on international reserves at central banks. Discretionary fiscal responses to the pandemic differed across the region (figure 47).

Figure 47. Discretionary fiscal response to the pandemic in selected Arab countries (Percentage of GDP)

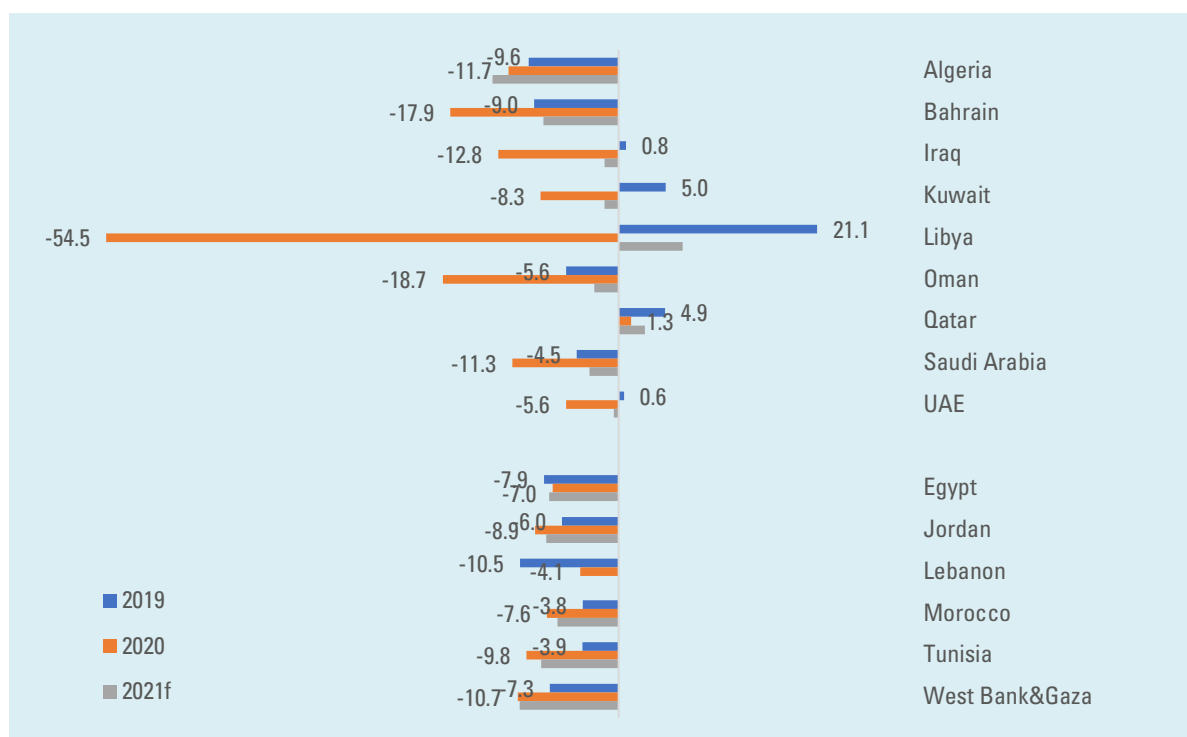


Source: IMF, Fiscal Monitor: Strengthening the Credibility of Public Finances, 2021.

Central banks, given the peg to the dollar and lack of monetary policy independence, issued guidelines to banks and financial institutions, including incentives to reschedule or grant deferrals on credit instalments, or reduce fees and commissions. Additional measures included facilitating access to and availability of cheaper credit (especially for SMEs), and a case-by-case review of nonperforming loans and/or defaults during the period. In countries with flexible exchange rates, initial currency depreciation was followed by partial reversal later (in some cases foreign exchange interventions were used to reduce volatility), while most central banks also cut policy rates. The bottom line is that faced with a real supply shock and linked demand shock, fiscal policy stimulus is more likely to have a lasting impact to tackle the spillovers from the virus outbreak (such as subsidies for international airlines in some GCC countries) rather than monetary policy measures.

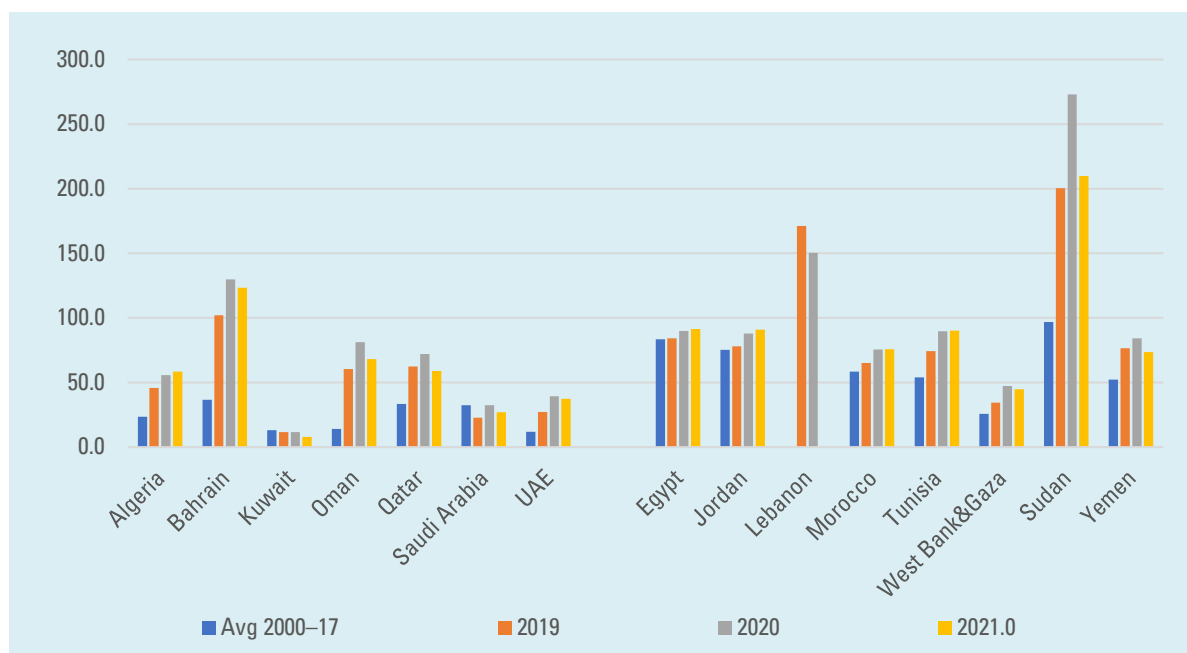
As pandemic-related stimulus measures are gradually phased out, the fiscal deficit is expected to narrow substantially to 3.9 per cent for oil exporters in 2021, aided by the surge in oil prices. For oil importers, the deficit is estimated to decline modestly to 7 per cent of GDP. Government debt has increased, ranging from oil exporters at 44.7 per cent of GDP (from 37.2 per cent in 2019) to oil importers at 97.1 per cent (from 91.1 per cent in 2019). In both cases, there is considerable variation between countries within subregions (figures 48 and 49). Countries with extraordinarily high public debt levels, such as Bahrain, Egypt, Lebanon and Oman, will need to undertake fiscal consolidation measures to bring deficits under control. Furthermore, many Governments have also borrowed heavily from domestic banks, thereby crowding out credit to the private sector.

Figure 48. Fiscal balance (Percentage of GDP)



Source: IMF Regional Economic Outlook Statistical Appendix (Oct 2021); ESCWA calculations.

Figure 49. Public debt (Percentage of GDP)



Source: IMF Regional Economic Outlook Statistical Appendix (Oct 2021); ESCWA calculations.

Two immediate concerns related to government debt and corporate borrowing are: the imminent policy hikes from monetary tightening by the Federal Reserve, leading to lower liquidity in global financial markets and higher interest payments in the future; and an earlier than anticipated withdrawal of policy stimulus, which could lead to an increase in non-performing loans, bankruptcies and defaults. The challenge will be greater for countries with limited fiscal space.

The Arab region, with its conflict countries and labour exporting/oil importing countries, also had a unique set of issues related to policy support during the pandemic. With a large informal sector (and labour force), some Arab countries were unable to provide adequate social safety nets when required. This was especially true in countries hosting large refugee populations (that were not on the registry), leading to deepening inequality, poverty and food insecurity. In 2020, the region contained 20 per cent of the world's acutely food insecure people, which is extremely high compared to its 6 per cent share of the global population. Conflict countries like the Syrian Arab Republic and Yemen are worse off, with 12 million and 24 million persons, respectively, affected by food insecurity.

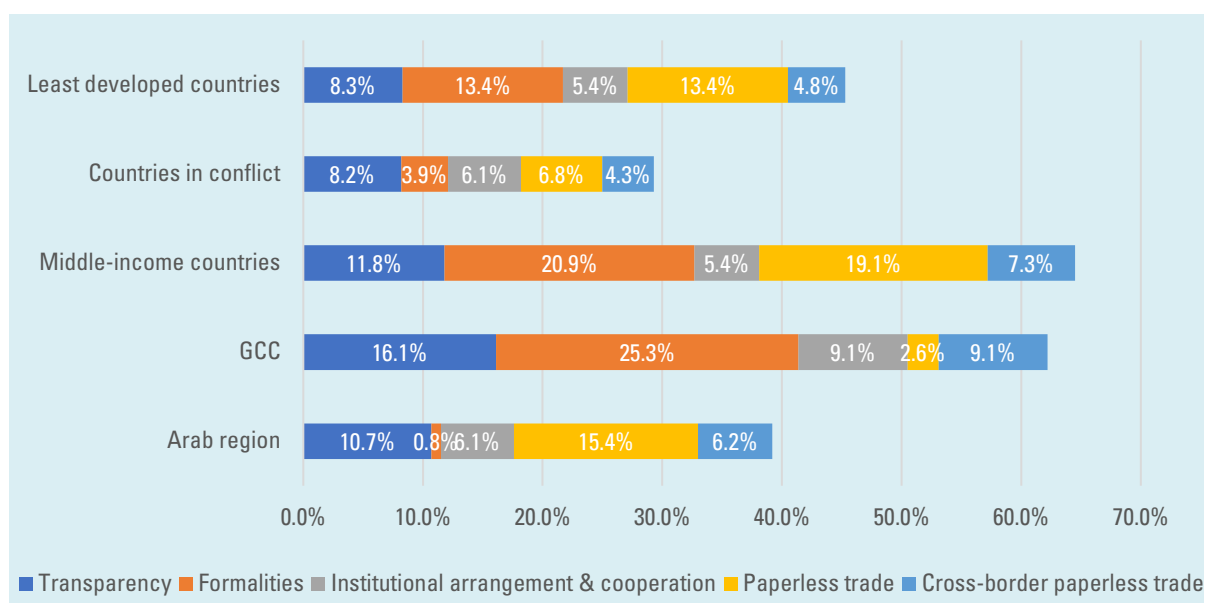
The bottom line is that the pandemic has accentuated regional gaps, placing oil importing/ labour-exporting countries at a relative disadvantage for various reasons, including delays in COVID-19 vaccine rollout, weak public health investments, and limited fiscal space. To emerge stronger from the pandemic and strengthen regional integration, policies need to be multi-pronged and coordinated.

The following policy proposals are categorized similarly to the discussion in the previous chapters.

A. Trade and investment

The main way to improve trade flows and deepen inter-regional trade is focusing on trade facilitation measures, including digital trade facilitation, automation and streamlining procedures. OECD estimates that that full implementation of the WTO Trade Facilitation Agreement,³⁶ which came into force in February 2017, will reduce trade costs in the Arab region by 10.5 per cent. Greater cooperation among regional peers to implement digital trade facilitation measures simultaneously would be a win-win: these could range from the creation of an electronic single window, registration of information online, or the implementation of a cross-border paperless trading system.

Figure 50. Digital and sustainable trade facilitation, 2021



Source: ESCWA Arab Trade Gateway (<https://tfm.unescwa.org/Dashboard>).

With the services trade growing rapidly, the Arab region would benefit from developing new “deep trade agreements”, including the broad category of services and digital services, such as e-services and ecommerce. From evidence on services trade restrictiveness, it is clear that the GCC subregion and the wider Arab region are highly restrictive, thereby hampering the growth of the services economy, the diffusion of new technologies, and the integration of the region’s services sectors. Services trade policies are typically much more restrictive than tariffs on imports of goods, particularly in professional services and telecommunications. The pandemic has resulted in many facilitation measures, especially to help cross border-digital trade, remote working/learning and online business operations, such as the United Arab Emirates allowing VoiP operations. As countries open up and digital services become mainstream in a post-pandemic world, it is

36 www.wto.org/english/tratop_e/tradfa_e/tradfa_e.htm#II.

necessary to remove any barriers to services. “Servicification” – putting a premium on the role of trade in services to power national economies – will be an important strategy for Arab countries going forward. It is better to be more integrated from the start than collaborate at a later stage.

Integration into global value chains (GVCs) will also support greater integration via greater economic diversification and sustainable economic development. The limited integration into GVCs in the Arab region has so far been mostly in low-value added activities, and in a few export products/markets resulting in limited gains. Asia Pacific is a prime example of the benefits of participating in GVCs:³⁷ expansion of GVCs allowed for domestic firms to strengthen regional links based on comparative advantages, such as technology parts produced in highly industrialized Korea that are assembled in Viet Nam.

The expansion of trade and services and GVC integration offer strong support to women’s participation in the workforce, as follows:³⁸ developing countries that doubled manufacturing exports saw women increase their share of total manufacturing wages to 30 per cent from 24 per cent (thanks to increased employment and higher pay); in developed countries, women employed in the services sector increased to more than 66 per cent in 2017 from 45 per cent in 1991, while in developing nations they increased to 38 per cent from 25 per cent; and GVC integration creates jobs³⁹ and raises wages, while also having indirect benefits on livelihoods (decisions related to education and delaying marriage and childbirth).

New trade and investment agreements with key partners are another way towards greater regional and global integration. New agreements with the GCC subregion and Asia are good starting points. GCC countries have historically supported Arab economies with economic and humanitarian aid. Given the subregions growing trade and investment links with the Arab region, agreements to build trade capacity would be a win-win for all. This would be an effective policy instrument to help restore growth, create jobs, and reduce geostrategic risk. Furthermore, existing trade agreements themselves could be amended to become more effective: a recent World Bank paper finds that provisions related to antidumping, competition policy, technical barriers to trade, and trade facilitation are associated with enhancing the trade-increasing effect of trade agreements.⁴⁰

In addition, new investment needs to emerge (“digital FDI”), including digital services, e-commerce, fintech and agritech. The region needs to move away from established sectors like real estate and oil and gas to “new” emerging sectors. This would require Governments to develop sector-specific rules and regulations, and remove investment barriers on traditional sectors like telecom, retail, transportation and the media.

37 These countries initially contributed to the most labour-intensive activities in the production process, while gradually moving into more sophisticated portions of the value chain.

38 World Bank and World Trade Organization, 2020.

39 Women working in GVCs have a 10-percentage-point higher probability of holding a formal job relative to women working in sectors that are not highly integrated into GVCs.

40 Breinlich and others, 2021.

B. Labour and rights of establishment

Labour integration has been prominent in the Arab region. To further support this, countries should consider facilitating regional labour mobility using common labour cards/visas, and easing restrictions, such as sponsorship systems, that can lead to market distortions. This can be complemented by facilitating skills validation and recognition of qualifications, which would be of particular benefit to refugees who find it difficult to get jobs in host countries. With the shift to digital working likely to become a permanent feature in a post-pandemic world, it is important to promote inclusiveness. To that end, countries must increase their investment in digital infrastructure, enhance digital literacy, ensure data privacy, and promote lifelong learning. Moreover, as new jobs emerge, they must take steps to avoid skills gaps. Furthermore, measures should target relatively more vulnerable labour market segments, like women and young people. More generally, liberalization of the rights of establishment would also support integration in a post-pandemic world by providing incentives for investment (including FDI), the establishment of new businesses, and job creation.

While facilitating regional labour flows is beneficial, labour exporting countries should consider measures to avoid a “remittance trap”⁴¹ and related brain drain. While supporting a country’s balance of payments, remittances are usually spent on household consumption and domestic investments like real estate, placing upward pressure on prices, including asset prices. In addition, the loss of high-skill human capital results in lower productivity growth in the home economy, and reduced productivity of the remaining low-skill workers. Governments in Mashreq and Maghreb countries need to take the initiative to address the brain drain challenge through policies aimed at improving the competitiveness of domestic industries (technical vocation, lower costs of doing business, upgraded infrastructure), and by ensuring that young educated persons are provided with adequate seed funding and financial assistance to become entrepreneurs and establish start-ups. Similarly, developing the digital economy would allow labour to remain in their home country, with the ability to work online – a borderless “global” employee.

C. Banking and capital market integration

A number of reforms would support greater integration of financial markets and financial linkages. These include allowing “passporting” for regional banks, and the removal of barriers (like minimum capital, governance, legal and regulatory restrictions) to enhance financial integration, resulting in more competitiveness, greater inclusion, more choice, and lower prices for consumers. To that end, unified rulebooks for financial services based on international standards and best practices need to be developed for the Arab region, implying greater harmonization of financial regulation and supervision standards across the region.

The size of capital markets in the region has been dominated by the banking sector (accounting for about two thirds of the total size), with a low share of debt financing. This can be remedied through

41 Chami and others, 2018.

the establishment of well-functioning government bond markets that would encourage a more stable domestic investor base, improve competition, and foster corporate debt markets. Given the nature of equity markets in the region, policy measures to integrate small fragmented domestic markets into a single regional market, with a specific focus on supporting SMEs to access growth capital/finance, would also support greater financial integration in the region. By further allowing liberalization of capital markets, it would facilitate regional listings. This would help investors focus more on sector diversification than country diversification within their optimal portfolios.

The rapid growth in fintech entities in the past few years has risen from a need for greater financial inclusion in the region. From mobile wallets to facilitating cross-border remittances, fintech has enabled better access to basic financial services, lowered costs⁴² (increased affordability), improved accessibility, and increased the transaction processing speed. During the pandemic, such digital channels have helped Governments reach vulnerable sections of the population faster. Going forward, the region needs to optimize on these developments by building the necessary financial infrastructure (regulatory framework, payment systems), improving digital literacy, and encouraging public-private collaboration for the benefit of the financial ecosystem.

However, these changes need to be supported by a move towards greater regional harmonization of legal, tax and regulatory systems (and potentially coordinated supervision and regulation) in order to expand market size and access.

D. Other policy proposals

Regional integration of energy and transport/logistics infrastructure would allow Arab countries to become more integrated, not only among themselves but also with the global economy. Investment in core infrastructure, telecommunications, transport and logistics – mainly in non-GCC countries – would support diversification into non-resource intensive activities, such as manufacturing and services, and cut delays and improve market access.

In a post-pandemic world, when countries develop strategies for job creation and become more diversified and inclusive, State-owned enterprises can be a challenge. State-owned enterprises are usually characterized as being less efficient and have low productivity and efficiency levels, deterring competition. Ensuring fair competition should be a major reform to move to a level playing field with the private sector.

Policy coordination for common challenges in the region, including climate resilience, food security and ensuring financial stability, would also support greater economic integration. Lastly, there must be adequate institutional support: a regional body should be given both powers and accountability to facilitate and implement integration policies. This, along with cooperation with international institutions, would push towards greater regional economic integration.

42 According to the World Bank, the average global cost to send remittances in the form of cash is 6.8 per cent, while a fully digital transaction drops the cost to 3.3 per cent and reduces issues of liquidity.

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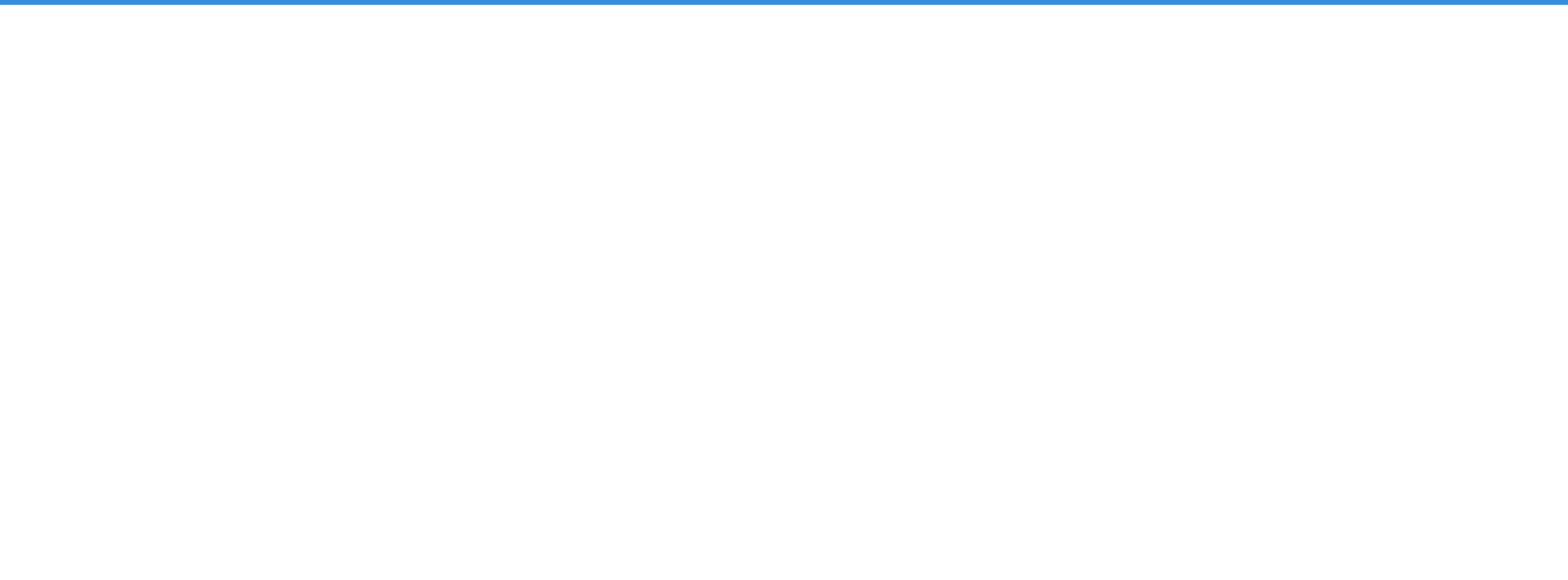
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As the Covid19 pandemic spread globally, most nations witnessed both economic and social challenges. Affected by the aftermaths of depressed demand (initially) to supply chain disruptions (later), international trade has yet to recover to its pre-pandemic levels; nor has tourism, given the various variants and related restrictions in the last 2 years. With a disparate effect on economic sectors, loss of jobs has widened inequality and poverty in many parts of the world.

This paper explores the pandemic's impact on the Arab world's global and regional economic integration. In terms of output, oil exporters faced a double whammy of lower domestic demand and supply shocks along with lower oil prices and exports, while tourism-dependent nations took a severe hit. The Middle East's decline in international and regional trade was sharpest across all regions and the decline in services trade was even harsher. FDI into the region during the pandemic flowed into the United Arab Emirates and Saudi Arabia with intra-regional flows accounting for just 14 per cent of the total (and GCC the main players). With respect to labour, there was evidence of reverse migration alongside resilient remittances, but the recovery will be long drawn out for those in the informal sector (especially women and young persons). Overall, the GCC nations seem to be the main drivers of greater regional (and indirectly of greater global) economic integration and Mashreq countries becoming increasingly integrated with the GCC.

To enhance regional integration in a post-Covid world, the Arab world needs to rethink its trade and investment policies (agreements with key partners in the GCC and Asia, reduce restrictions related to trade in services, strengthen links to the global value chain, invest in digital trade) while allowing for greater mobility of labour and enhance financial (and capital market) linkages. Last, but not the least, policy coordination is paramount to address some of the common challenges facing the region like mitigating the risks of climate change and food security (among others).

