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ECONOMIC CRISIS IN THE ARAB WORLD

Iraq's invasion of Kuwait in August 1990 is the most striking example of the political pressures that have been unleashed by the recent economic difficulties in the Arab world[1]. Since 1982 most Arab oil producers have seen a substantial fall in their revenues. Their governments have tried to adjust by reducing public spending and by borrowing heavily from abroad. These adjustments have had a particularly harsh impact on the poorer Arab states, affecting both their aid receipts and remitted earnings from labourers in the richer Arab countries. Tensions between the rich and the lower income Arab states have worsened; in the case of Kuwait this may have contributed to the invasion (See Box 1).

This Briefing Paper considers the causes of the economic crisis of the 1980s against the background of the fluctuating oil fortunes and new political movements. Some of the poor Arab countries, such as Yemen, Jordan and Algeria seem to have suffered substantially from the Gulf War outcome, although others such as Egypt have gained. The Gulf war may have marked the end of attempts to achieve cohesion in the Arab world through economic means, although it did trigger a sudden unexpected recovery of Arab aid flows.

The Economic Crisis

The roots of the present economic crisis lie in the decisions that were made about how to invest the region's oil income during the 1970s. Between 1973 and 1982 the Arab States earned in excess of $1,000bn on petroleum and oil products. The scale of this cash windfall was without precedent in the developing world. It exceeded the total value of exports from Japan during the same period.

The benefits of the oil boom were most apparent in those Arab countries with high petroleum earnings and small populations (see Table 1). Originally relatively underdeveloped, these states experienced dramatic improvements in living standards. Between 1970 and 1985 literacy rates rose from 16% to 60% in the United Arab Emirates and increased from 9% to 58% in Saudi Arabia. Infant mortality rates halved between 1970 and 1985. However, social transformation was less dramatic. The monarchic rulers of these states (except Libya) saw petrodollars as an important way of reinforcing a traditional social order. They discouraged the creation of a domestic working class by importing migrant workers while employing many of their own citizens in well remunerated public service jobs.

The Arab states which lacked significant petrol deposits but had larger populations also benefited from the oil boom. The repatriated earnings of Arab migrant workers became an important source of income. In addition, the richer states allocated part of their revenues to their poorer neighbours as economic assistance. This was partially motivated by Arab solidarity and partially by prudence: the bulk of the aid went to the militarily powerful middle income states (Iraq, Jordan, Syria and Tunisia) or to poor states with large armies (Egypt and Morocco). By 1980 the rich states were giving their poorer Arab neighbours $7.9bn a year in economic

Box 1: Economic factors in the invasion of Kuwait

Economic ambition as much as nationalist fervour could have prompted the invasion of Kuwait. In 1980 Iraq was one of the richer Arab states, enjoying large petroleum revenues and the benefits of a high level of social development. But the war with Iran cost Iraq at least 100,000 lives and $241 billion, more than Iraq had earned since it started exporting oil. To finance the military Iraq had to borrow $80 billion. By 1990 Iraq was paying $4 billion in annual debt service, running a $23 billion fiscal deficit and trying to find the funds with which to rebuild the country after the war.

In 1990 Kuwait was also facing difficult economic circumstances due to the decline in the oil price. As a result Kuwait reduced foreign aid to Iraq, suggested that Baghdad should repay debts contracted during the Iran-Iraq war and pumped oil in excess of its OPEC quota, thus affecting the price of Iraq's exports. These actions brought a violent response from Saddam Hussein because they threatened the revenues that Baghdad needed to cope with the damage caused by the war. By invading Kuwait, Saddam Hussein hoped not only to secure Kuwait's banks and oil fields but to pressurise the other rich Arab states to stop over-pumping oil and to forgive Iraq's debts.

[1]The Arab world refers to the eighteen countries in which Arabic is the language of the majority of the population: Algeria, Bahrain*, Egypt, Iraq, Jordan, Kuwait*, Lebanon, Libya*, Mauritania, Morocco, Oman*, Qatar*, Saudi Arabia*, Sudan, Syria, Tunisia, the United Arab Emirates* and Yemen (* denotes the high income Arab states).

assistance out of an Arab aid worldwide total of $9.5bn (see Table 2). From 1973 to 1989 cumulative official assistance from Arab donor countries to Arab recipient countries amounted to $55bn. If net workers' remittances are added ($87bn), flows to Arab recipient countries between 1973 and 1989 totalled $142bn. These financial flows represented on average nearly a fifth of recipient country imports, over 20% of total investment and about 5.5% of GNP.

Despite the large increase in revenues, the Arab states have had mixed success with development. The high income states have managed to raise the living standards of their citizens. As a result of government food subsidies, the region became one of the best fed areas in the developing world. But despite the wealth of the minority, by 1988 the real purchasing power parity adjusted annual per capita GDP in the Arab world was less than in South America (Table 1). Annual population growth in the Arab world (except in Egypt and Tunisia) is also higher than the developing country average. Iraq, Jordan, Libya, Oman, Qatar, Saudi Arabia, Syria and Yemen have population growth in excess of 3% per annum. Outside the main cities, medical facilities and clean water are scarce. Apart from the rich Arab states, adult literacy levels are lower than many other developing countries. Overall, the standard of living remains below the developing country average despite the funds that oil revenues have made available for development.

One of the reasons for the poor development record in the more populous Arab states, in comparison to Asian developing countries, has been their failure to develop a manufacturing capability. By far the largest share of the increase in manufacturing that has occurred has been in the high-income oil exporting countries and in the expansion of refining and petrochemical plants which are not very labour intensive. On average industrial workers account for less than 15% of the work force in the Arab world.

Furthermore the investment strategies of the rich Arab states have not directly benefited the region as a whole. The rulers of the high income Arab countries generally deposited their petrodollars with foreign banks and invested abroad. Workers' remittances and foreign aid only recycled a fraction of the earnings from the high income countries to the low or middle income countries.

Where there has been domestic investment this has been dominated by political and defence considerations. High cost prestige projects became commonplace and military expenditure rose sharply during the oil boom. Arab governments spent $346bn on expanding their armies between 1973 and 1985. Of this more than $86bn was spent on importing weapons.

Economic policies have also contributed to the current crisis. Many of the middle and low income states pursued highly interventionist economic programs that involved networks of price controls, overvalued currencies and a complex system of trade restrictions. Almost all the Arab states kept interest rates low to make it easy for citizens to obtain credit. Energy, food, water and housing were subsidised. All of these policies were only sustainable in the context of a continuing flow of petrodollars.

Table 1. Development Indicators

	GNP per capita $ (1989)	*Population millions (1990)*	*Real GDP per capita PPP$ (1988)*	*Life expectancy at birth (1990)*
High Income				
U.A.E.	18430	1.6	19440	70.5
Qatar	15500	0.4	11800	69.2
Bahrain	--	0.5	9490	71
Saudi Arabia	6020	14.1	9350	64.5
Oman	5220	1.5	9290	65.9
Kuwait	16150	2	5320	73.4
Libya	5310	4.5	7250	61.8
Middle and Low Income				
Syria	980	12.5	4460	66.1
Iraq	--	18.9	3510	65
Tunisia	1260	8.2	3170	66.7
Jordan	1640	4.0	2570	66.9
Algeria	2230	25	2470	65.1
Morocco	880	25.1	2380	62
Lebanon	--	2.7	2250	66.1
Egypt	640	52.4	1930	60.3
Yemen	650	11.7	1560	51.5
Sudan	--	25.2	970	50.8
Mauritania	500	2	960	47
Arab World	--	212.3	3115	61.1
Southern Africa	--	91.1	2750	55.1
Southeast Asia	--	443.7	2194	62.7
South America	1950	295.4	4302	66.8
USA	20910	248.8	17615	75.9
UK	14610	57.2	13060	76.0

Calculated from UNDP *Human Development Report*, 1991 and World Bank *World Development Report*, 1991.
Note: -- not available

After the oil boom

Since 1982 the flow of petrodollars has begun to diminish due to falling world oil prices. High crude prices during the 1970s had prompted energy conservation in the industrialised countries and encouraged the development of alternative sources of supply outside the Middle East. Oil exporters in the Middle East responded to declining prices by expanding production but this led to an oversupply. Arab oil revenues dropped from $178bn in 1980 to $41bn in 1986.

Arab states responded in several ways. The high income Arab states were able to cover the gap between what they spent and what they earned by using capital reserves accumulated during the oil boom years. The poorer states were equally affected by the fall in the oil price due to the decline in receipts from the high income countries but they lacked similar reserves. Initially, they resorted to borrowing from foreign governments or commercial banks. By 1986 the middle and low income Arab states had accumulated over $100bn in foreign debt. In 1986 Egypt's foreign debt stood at $43bn, followed by Algeria ($23bn), Morocco ($18bn), and Sudan ($10bn). Relative to GDP, the foreign debts of Egypt, Jordan and Morocco were larger than those of Brazil, Mexico or Poland.

As it became apparent that another oil boom was unlikely, the Arab states reduced the amount of Arab aid they were prepared to give and attempted to cut government expenditure. The poorer countries faced a decline in the value of both workers' remittances and the amount of Arab aid they received. Between 1980 and 1988 the two major donors Saudi Arabia and Kuwait, cut foreign aid by 63% and 91% respectively. In the same period the total value of inter-Arab aid transfers dwindled from $8.7bn to $2.3bn. This pattern however changed again as a result of the Gulf crisis (see **Arab Aid** below).

As their revenues shrank, the poorer Arab states found it increasingly difficult to meet payments on their loans and sought the support of the International Monetary Fund (IMF). The IMF's insistence on economic reform involved making unpopular cuts in food and price subsidies which resulted in riots in many countries. At least 160 people died in riots in Tunisia and Morocco in 1984. The economic austerity plan in Algeria resulted in the October 1988 insurrection in which 159 people died.

The riots and demonstrations that followed in the wake of economic austerity programs have played an important part in the movement towards democratisation in the Arab world. The governments of Egypt, Algeria and Jordan all staged parliamentary elections following the riots to recoup some of the popularity they lost by imposing adjustment programs. However among the parties that have gained in the elections have been Islamic fundamentalists, who have been quick to link the hardships that have resulted from IMF austerity plans with a rejection of the role of the west in the Arab world. These groups have portrayed Islamic rule as a way of reducing income disparities and limiting the corruption of the elite, at a time when there is widespread disenchantment with Arab socialism's ability to achieve similar objectives.

The Gulf War and the Economic Crisis

The Gulf War - the invasion of Kuwait, August 1990; Desert Storm in January 1991 - was partially the product of the economic crisis in the region and has heightened the economic difficulties that Arab countries will face during the 1990s. The war has created 5-6 million refugees; the immediate consequence of the invasion of Kuwait was a run on Gulf banks that has severely weakened the banking system in the region; tourists have avoided the region, depriving Jordan and Egypt of $2bn in hard currency. Anticipating a wide conflict, Saudi Arabia, Egypt, Iran and Israel all made major new arms purchases. The Gulf states also had to commit large amounts to cover the cost of US combat operations. Within three months of the conflict Saudi Arabia had already committed $17bn, Kuwait $16bn and the United Arab Emirates $4bn.

The total cost of reconstruction inside Iraq has been estimated at over $200bn. Damage to Kuwait is also extensive. Reconstruction is being hampered by the policy of ridding the country of those migrant workers, who are seen as supporters of Saddam Hussain. Similar policies have been attempted in Saudi Arabia and other Gulf countries as a way of castigating those states that supported Iraq. This has particularly affected Jordan and Yemen among the poorer Gulf states.

For the rich Gulf states, the war has led to serious but short-term budgetary problems, but for the poorer Arab states the war has been a major economic setback. They are already burdened with debt and the economic lifeline of workers' remittances has been severed. Contrary to some expectations, the initial rise in the oil price in response to the crisis was short-lived. Windfall gains from the higher oil price have not matched the cost of the conflict. Saudi Arabia's oil profits were $15bn higher in 1990 than pre-crisis predictions, but the crisis imposed at least $30bn of unanticipated costs on the Kingdom. The loss of employment cost Yemen over a fifth of its hard currency revenues. Egypt and Jordan lost $3.5bn in anticipated workers' remittances. Overall, Egypt appears to have benefitted from the conflict. By supporting the coalition against Iraq, Egypt was able to persuade the United States to cancel $6.7bn of debt and Egypt's Gulf Arab allies cancelled additional debt worth $6.5bn.

Arab Aid

The 1980s had seen a downturn in the provision of development assistance by Arab countries. Arab aid, which in 1980 had totalled $9.5 bn (almost as much as the United States and Japan combined), had by 1989 fallen to a mere $1.5bn. Saudi Arabia's aid:GNP ratio was by 1989 still much higher, at 1.49%, than any of the OECD donors but far less than the 4.87% achieved in 1980. Kuwait's aid:GNP ratio fell to 0.4% in 1988, well below that of the OECD front-runners, and it recovered only slightly to 0.54% in 1989 (see Table 2).

In 1990, however, there was a massive recovery in Arab aid in what the Development Assistance Committee of the OECD call 'an unexpected development [which] was related to the Gulf crisis'. Arab aid more than quadrupled to $6.3bn, with Saudi Arabia trebling its aid to $3.7 bn and the government-in-exile of Kuwait and the Kuwait Fund managing to raise disbursements tenfold to almost $1.7 bn, Kuwait's largest amount in real terms for a decade.

In the case of both donors the largest recipient in 1990 was Egypt. At $2.3 bn, Egypt became the largest beneficiary of Arab aid overall with 40% of bilateral disbursements. Egypt had not held such a position since 1978. On the other hand, many countries which had been major recipients of Arab aid in the past did not give support to Kuwait during the invasion. Jordan, Sudan, Yemen and the Palestinians are therefore likely to suffer from the new alignment and do not benefit from the sudden recovery of Arab aid.

Table 2: Aid by Arab Countries 1980 and 1986-90

	1980	1986	1987	1988	1989	1990
			$ millions			
Arab Countries	9 539	4 498	3 290	2 262	1 487	6 312
of which:						
Saudi Arabia	5 682	3 517	2 888	2 048	1 171	3 692
Kuwait	1 140	715	316	108	169	1 666
			Aid as percentage of GNP			
Arab Countries	3.26	1.81	1.24	0.85	0.54	--
of which:						
Saudi Arabia	4.87	4.67	3.88	2.64	1.49	3.89
Kuwait	3.52	2.89	1.20	0.40	0.54	--

Source: OECD *Development Cooperation*, 1991 Report.

While Egypt and Turkey (a non-Arab country) do gain from the current aid surge, this may not last beyond 1992. In the past, trends in the Arab world's aid programmes closely reflected the waxing and waning of oil revenues. The 1990 surge is an exception to this rule, but given that Saudi Arabia and Kuwait now face substantial war-related obligations and reconstruction costs, and the oil price has yet to recover, it is doubtful whether winners in the aid realignment will be provided with concessional development finance at this level in years to come.

Conclusion

In many countries in the Arab world the economic hardship that has resulted from the war is likely to ferment further conflict. Even those governments which do not have to cover the costs of the conflict will have to make even deeper and more unpopular expenditure cuts as a result of lower revenues. The rapid rise in popularity of Islamic parties in countries like Algeria, where the FIS was banned after leading in the ballot, is in part attributable to the economic difficulties felt by the Arab world.

Some of the adjustments to government expenditure made in response to falling revenues, may lay the groundwork for future economic growth. Governments are reducing their spending on imports of food and other goods. The network of subsidies for consumers and businessmen that had reduced the incentive to produce is being trimmed. If these initiatives are maintained oil revenues in the coming decade are more likely to be channelled into projects that can contribute to economic development. But attempts to change the pattern of petrodollar spending are fraught with political risks. Imports and subsidies have been the foundations of power for many Arab leaders. Many Arabs resent 'adjustment' and western systems of credit. Their governments' failure to translate the oil boom into a sustained improvement in living standards may encourage the supporters of Islamic conservatism.

The Gulf war has exacerbated the economic problems of the Arab World. It has undermined the old networks of trade, aid and remittances that sought to reduce the disparities between different Arab states. The diversion of funds to cover the cost of the war has deepened the economic crisis that the Arab world faces as a result of falling oil revenues. After the long boom, the countries of the Arab world face a difficult adjustment period, when falling living standards may lead to further political instability.

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