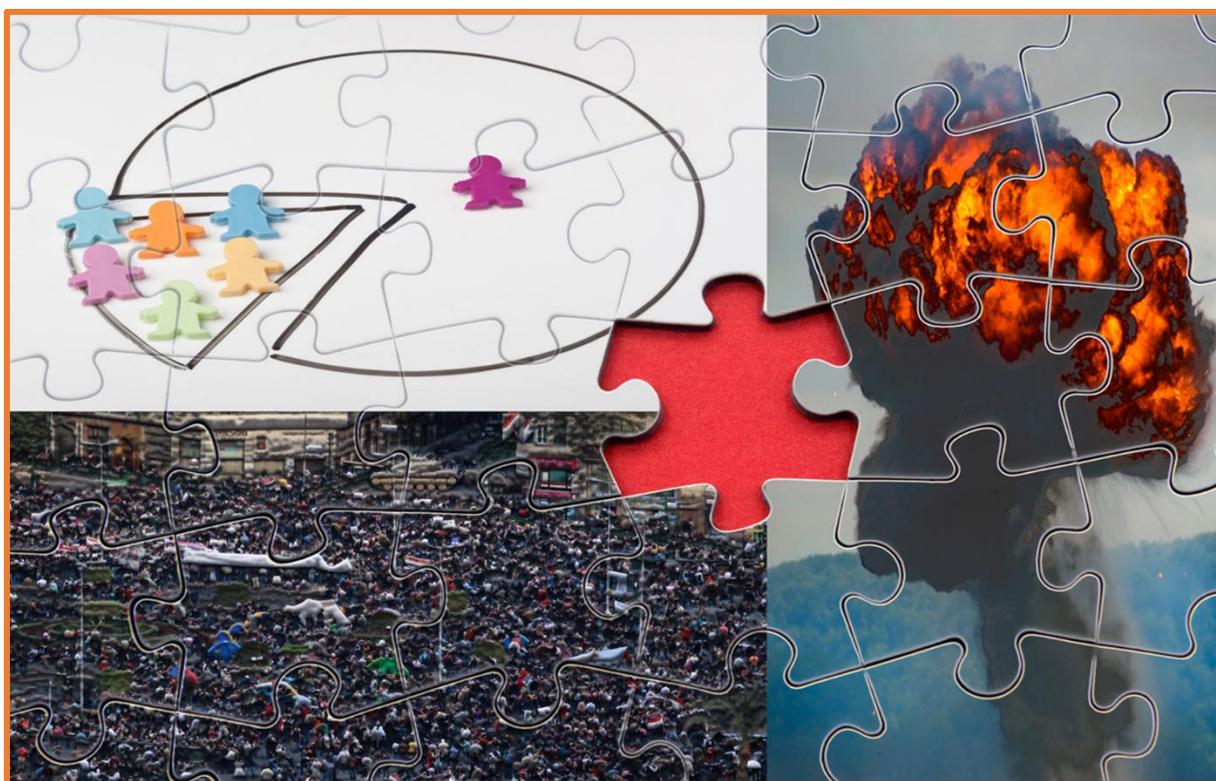


WORLD BANK MIDDLE EAST AND NORTH AFRICA REGION
MENA ECONOMIC MONITOR

**Inequality, Uprisings, and Conflict
in the Arab World**



October 2015

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MENA ECONOMIC MONITOR

Inequality, Uprisings, and Conflict in the Arab World

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The MENA Economic Monitor is a product of the Office of the Chief Economist of the Middle East and North Africa Region of the World Bank. Part I of the report discusses the short-term, global and regional macroeconomic outlook. Part II focuses on the relationships between inequality, uprisings, and conflict in the Arab World. Part III of the report contains country notes. The report was prepared under the guidance of Shantayanan Devarajan, Chief Economist, Middle East and North Africa Region of the World Bank.

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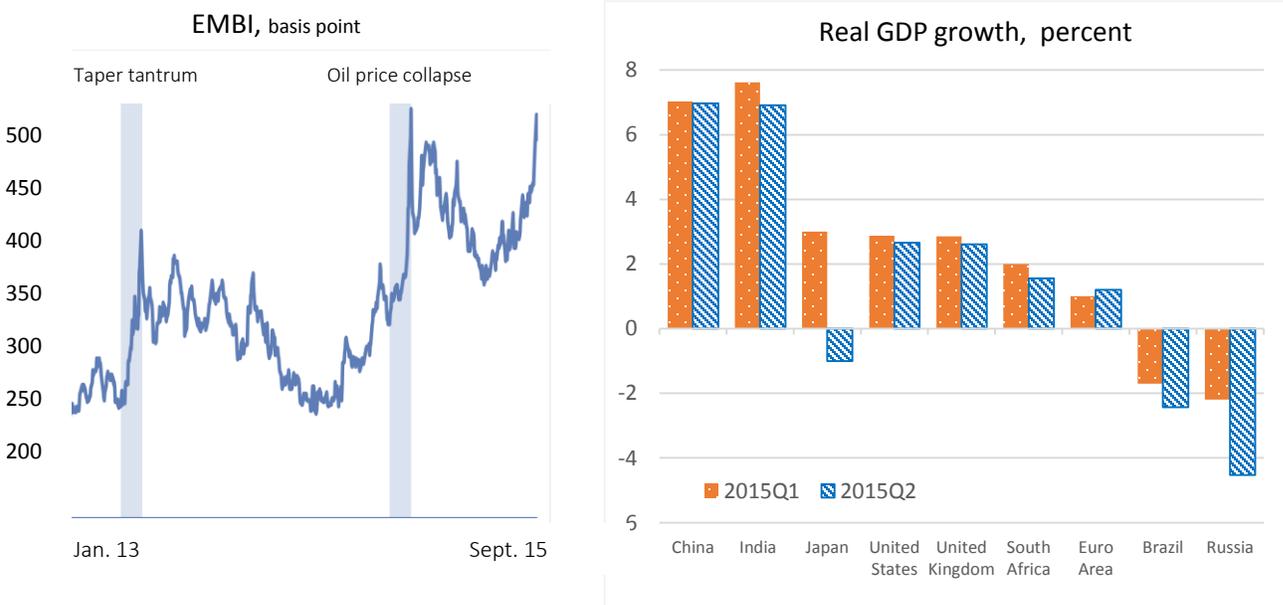
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RECENT ECONOMIC DEVELOPMENTS AND PROSPECTS

The Global Outlook

Over the last three months, global markets have been unusually volatile. Commodity prices have been under downward pressure with indices of agriculture, metals and energy all declining and oil prices falling below \$46 per barrel in August, their lowest level since 2008. Volatility in currencies and stocks increased significantly in July and August following a 40 percent correction in China’s stock market from its June high, along with an unexpected depreciation of China’s currency, the renminbi, in August. Combined with uncertainty about the timing of a U.S. Federal Reserve interest rate hike, the commodity price weakness and correction in Chinese stock prices sparked a sharp sell-off across emerging market currencies and equities. Developing country borrowing costs rose in line with higher risk-aversion, with the Emerging Market Bond Index (EMBI) spread increasing by 23 basis points between end-July and mid-September (Figure 1.1, left panel). Outflows from emerging-market bond and equity funds were significant in August; the pace appears to have slowed in September.

Figure 1.1 Recent developments in the global economy



Source: World Bank.

Recent data show that global growth struggled to gather momentum in the second quarter of 2015, with activity in the Euro Area and Japan slowing, growth in China continuing to decelerate, the economies of Russia and Brazil contracting and those of other major commodity exporters weakening (Figure 1.1, right panel). Looking forward, PMI surveys are still firmly in expansionary

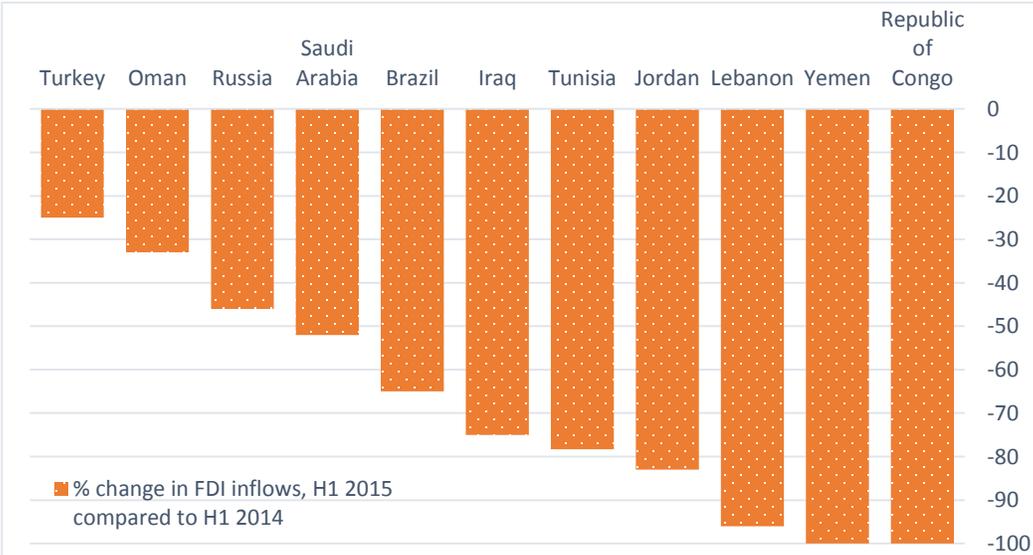
territory in high-income countries, but point to contraction in developing countries. In June, the World Bank predicted global GDP growth of 2.8 percent in 2015, slightly up from 2.6 percent in 2014. Against the backdrop of disappointing data outcomes and turbulence in global financial markets, even the modest pick-up in global growth anticipated in June for the year 2015 will likely not materialize.

Global inflation remains low, reflecting the continued dampening effect of low commodity prices, sluggish wage growth in advanced economies, and overcapacity in China. Nevertheless, inflation increased in a number of large emerging markets this year particularly Brazil, Russia, Indonesia, Malaysia, Colombia, Chile, Turkey, South Africa, and Egypt. This was mostly a result of significant currency depreciations, and to a lesser extent, increases in administrative prices and indirect taxes.

Following slower growth in the emerging economies, global trade witnessed a slowdown of about 4 percent in the first half of 2015 compared with the second half of 2014. The fall, the first since 2009, was driven by a significant contraction in import demand from emerging markets, including those in Asia and Central and Eastern Europe.

In addition, lower commodity prices and the turmoil in the Middle East together with expectations of the U.S. interest rate hike have significantly slowed greenfield capital flows to developing countries. According to estimates from *fDi Markets*, greenfield investments in a large number of countries, mostly the emerging markets, declined dramatically in the first six months of 2015 compared to the same period of last year (Figure 1.2).

Figure 1.2 Greenfield investment globally



Source: fDi Markets

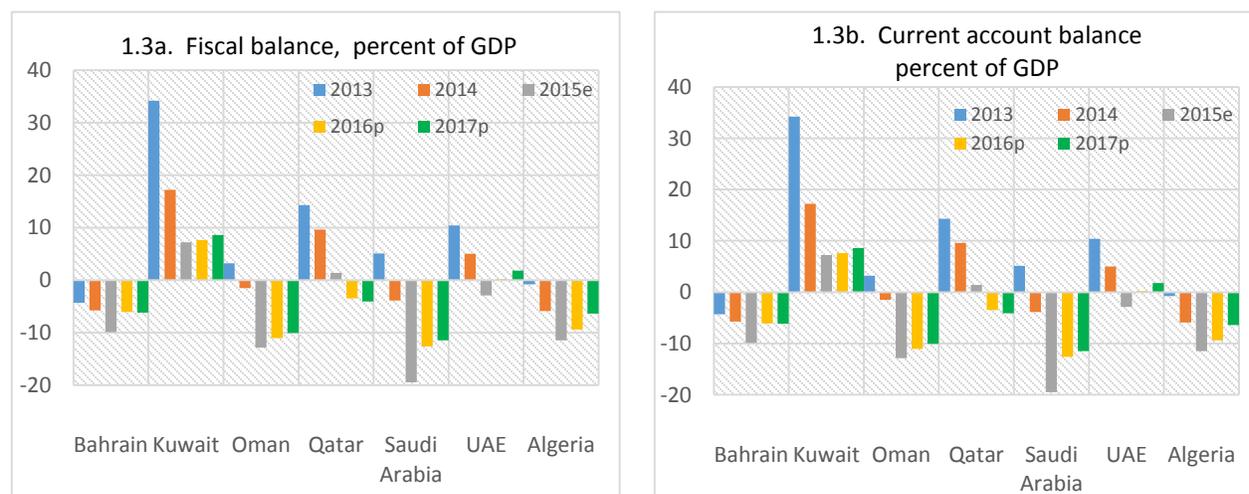
The Outlook for the Middle East and North Africa

Against this backdrop of a slowing global economy, the MENA region is stagnating. Continued low oil prices, the escalation of conflicts, and civil wars make the short-term prospects for a growth recovery slim. The World Bank estimates regional GDP growth to stay at around 2.8 percent in 2015, lower than predicted in April. While growth is slightly higher than last year, overall growth in the region has not exceeded three percent for over three years (Table 1.1). In a positive scenario of decreasing tensions in Libya, Iraq, and Syria, together with recovery in the Euro area that could boost external demand, growth in the region could rebound to 4.4 percent in 2016 and the following year. However, if current circumstances persist, overall growth is not expected to recover any time soon.

Except for Egypt, Morocco and Iran, almost all MENA countries are growing slowly, but for different reasons. The GCC and Algeria are suffering from low oil prices and the lack of fiscal adjustment. GCC economies are expected to grow at 3.2 percent in 2015, down from 3.9 percent a year earlier as low oil prices have severely hit these economies. For the same reasons, growth in Algeria is expected to remain at 2.8 percent in 2015.

Fiscal positions in oil exporters are worsening. A surplus of about 5.4 percent of GDP in 2013 is expected to turn into a deficit of about 9.8 percent of GDP in 2015 in the GCC countries and even higher in Algeria. For the Gulf States, this means a deficit of US\$136 billion in 2015 with Saudi Arabia bearing about US\$129 billion (or a deficit of 19.5 percent of GDP in 2015); surpluses in Kuwait and Qatar are expected to halve in 2015 (Figure 1.3a). Current account balances will follow the same pattern and surpluses are expected to shrink rapidly in 2015 (Figure 1.3b).

Figure 1.3 Fiscal and external balances

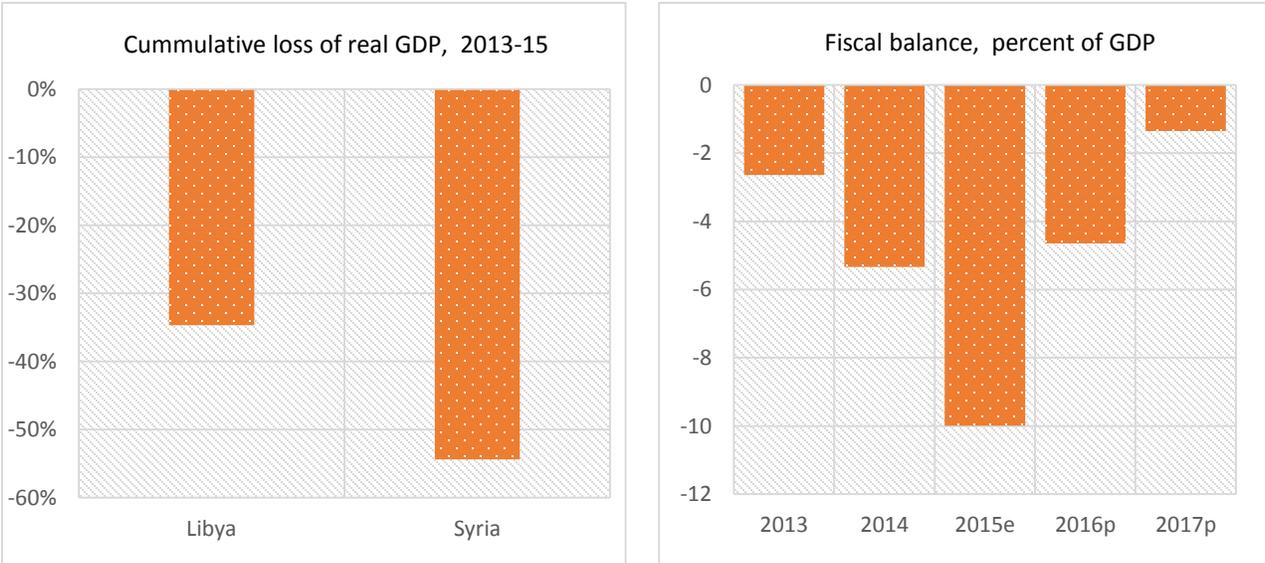


Source: World Bank. e stands for estimate and p for projection.

Although some countries, particularly Saudi Arabia and UAE, have started rethinking their huge spending on subsidies, the macroeconomic imbalances will likely spillover to 2016 and the following year if oil prices remain at their low levels and governments maintain their current spending scheme.

MENA’s developing oil exporters (except for Algeria and Iran post sanctions) are facing a double hit of low oil prices and civil war (Mottaghi, 2015). The escalation of conflict and sabotage of oil fields in the majority of developing oil exporters are expected to keep the average growth rate at a low level. Conflicts in Libya, Yemen, Iraq and Syria have severely hurt these economies (Figure 1.4).

Figure 1.4 Economic situation in developing oil exporters



Source: World Bank. e stands for estimate and p stands for projection.

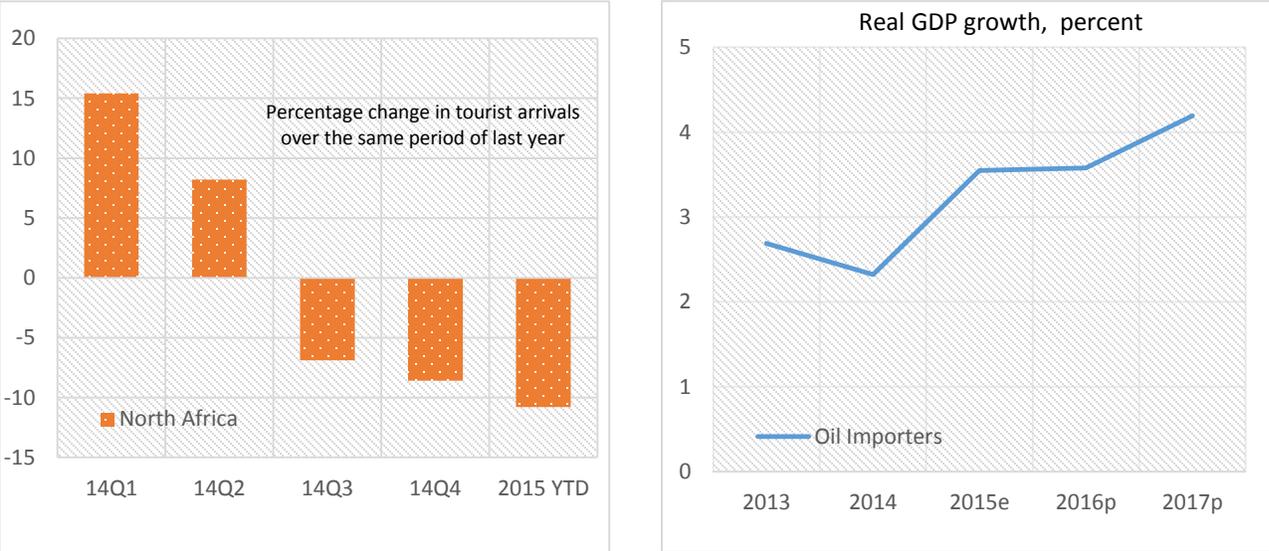
The majority of the developing oil exporters saw a decline of about 40 percent or more in their output, with significant damage to their oil sectors and a fall in oil production (estimates for Yemen are not available). Conflict has escalated in Yemen resulting in a catastrophic humanitarian emergency, massive displacement of people, and severe destruction of civilian and public infrastructures. The Syrian war and regional conflicts have displaced more than 11 million people, 7.6 million internally and 4.1 million as refugees to neighboring countries. In addition to the domestic impact of conflicts, bordering countries such as Lebanon and Jordan have been experiencing a slowdown in growth and a worsening fiscal stance mostly as a result of increased spending on hosting refugees and disruptions in trade (see below). Overall growth for the group of developing oil exporters is expected to reach 1.3 percent in 2015, slightly higher than last year, mainly due to a likely slow recovery in Libya and Iraq.

The Iranian economy is expected to recover and grow faster in 2016 and beyond following the nuclear deal reached on July 14, 2015. With the lifting of sanctions and Iran’s reintegration into the global economy, an additional 1 million barrels a day of crude oil will eventually hit the international oil market, lowering oil prices by an estimated 13 percent (Ianchovichina, Devarajan, Lakatos, 2015). This would negatively affect the already weak economies of oil exporters but to a lesser degree Iran. The additional oil production could boost growth in the Iranian economy outweighing the negative impacts of falling oil prices (Devarajan, Mottaghi, 2015).

Both the fiscal position and external balances of this group of developing oil exporters is expected to worsen in 2015 to the tune of deficits of 10.3 and 8.4 percent of GDP respectively. Libya stands out with a fiscal deficit of over 55 percent of GDP and current account deficit of 70 percent of GDP in 2015 (Table 1.1). Wages and salaries in Libya account for 60 percent and subsidies for a quarter of total government spending. In a scenario where conflicts subside and oil prices recover, these countries may see improvements in their fiscal and external balances in 2016 and beyond.

MENA’s oil importers are being hurt by terrorist attacks, spillovers from neighboring wars, slow growth in the Euro zone and political uncertainty. Security tensions and sluggish external demand have weighed heavily on economic activity in the majority of the oil importers in the MENA region. Foreign investment and tourism have suffered (Figure 1.5).

Figure 1.5 Economic situation in oil importers



Source: World Bank and UNWTO. YTD stands for year to date; e stands for estimate and p stands for projection.

As a result of two terrorist attacks and protracted stagnation in the Euro area, the Tunisian economy is expected to slow down in 2015. Real GDP growth is projected to drop to 0.8 percent, from 2.3 percent last year, with further downside risk for 2015. The Palestinian economy is recovering from a recession following last year's war in Gaza. The economies of Lebanon and Jordan are estimated to slow down due to the spillovers from the conflicts in Syria and Iraq and lack of investment. The number of refugees entering these two countries have been on the rise, reaching 1.1 and 0.6 million in September in Lebanon and Jordan respectively, squeezing their already tight fiscal space.

Only two countries, Egypt and Morocco, may experience a growth recovery in 2015 but risks are still on the downside. In the wake of corruption charges against some ministers, Egypt's cabinet resigned in early September. The new government, appointed in late September, may change again following parliamentary elections. Under the scenario of reinforced security and reforms, growth in Egypt is expected to hover around 4 percent in 2015 and the following year. Morocco's economy is heavily agriculture-based and growth could swing up or down depending on weather conditions.

A further drop in oil prices coupled with current fiscal spending schemes could keep the MENA region on the edge. Some of the oil exporters in the region have been tapping into their reserves and Sovereign Wealth Funds (SWF) to cushion the impact of low oil prices. In Libya, foreign reserves are expected to drop by 50 percent in 2015, reaching about US\$50 billion compared with more than US\$100 billion two years ago. In Saudi Arabia, a reduction in foreign reserves of more than US\$60 billion this year and another US\$80 billion next year is expected. But even those with significant reserves have seen new exploration projects and drilling halted. In January, for example, Royal Dutch Shell halted its Al-Karaana petrochemicals project in Qatar due to falling oil prices. This situation, if not reversed, will eventually hurt the MENA economies by lowering their ability to invest domestically and elsewhere in the region.

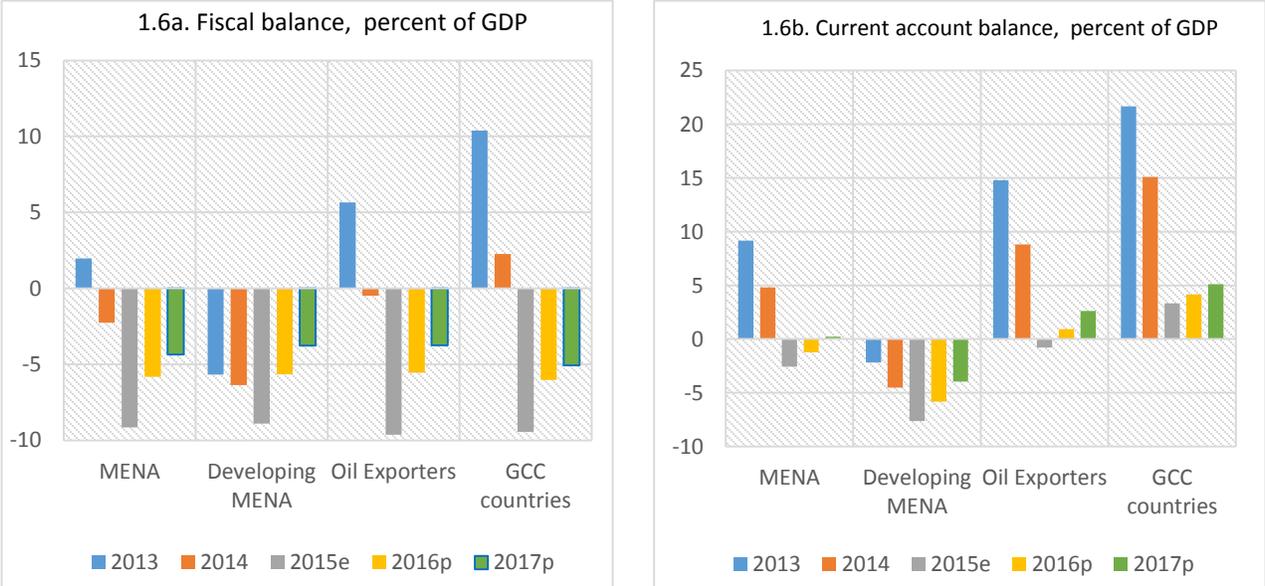
MENA's investment needs are high and the shortage of foreign capital have made the situation even worse. There are estimates that Egypt needs an additional US\$30-35 billion in investment and another US\$10 billion in infrastructure development over the coming years, but little has been pledged. Jordan needs over US\$6 billion in investment per year to put the economy on a higher growth path and Tunisia is expecting to increase investment by an additional 7 percentage points of GDP over the next 5 years. Iran post sanctions needs hundreds of billions dollars to upgrade its oil fields to bring production back to pre-sanctions levels.

All of the developing countries in the region are in need of financing. Cheap oil and lack of fiscal adjustments have severely deteriorated MENA's fiscal space. An overall fiscal surplus of about 2 percent of GDP in 2013 is expected to turn into a deficit of 9.2 percent of GDP in 2015 for MENA as a whole. This is the result of a sharp increase in fiscal deficits in oil exporters, dominated by

the GCC countries (Figure 1.6a). By the same token, MENA’s external account surplus of the past two years is expected to turn into a deficit of about 2.6 percent of GDP in 2015 (Figure 1.6b). The main reasons are falling oil prices which started in 2014 and reduced the surplus in the group of oil exporters by 50 percent (see Box 1.1), and weak economic recovery in the Euro area, which has reduced external demand for oil and non-oil exports. If oil prices rebound and external demand for exports recover, MENA’s external position could improve in 2017.

In sum, since the Arab Spring of 2011, the MENA region has seen a slowdown in growth, an escalation of violent conflict and civil war and, more recently, substantial fiscal pressure from lower oil prices. In the next section, we explore how the region got to this state. In particular, we examine whether inequality or other factors contributed to the uprisings of 2010-11, as well as to the ensuing conflicts that have spread to many parts of the region.

Figure 1.6 MENA’s fiscal and external positions



Source: World Bank.

Box 1.1 The impact of emerging markets turmoil on some MENA countries

The recent turbulence in China's stock market and its spillover to other emerging markets have lowered growth prospects for these economies. With the exception of Eastern European economies, which are connected to a slowly improving European Union, and India, middle-income emerging markets are revising their growth forecasts downwards. The slowdown in China and the weak recovery in Europe and the United States has also affected commodity markets, particularly oil prices, which have been on a declining trend since June. The turmoil in emerging markets could affect the countries in MENA through several channels, but in different ways.

Gulf countries. These countries are affected through two channels: first, the fiscal sustainability of current public expenditure programs, including subsidies, will critically hinge on the duration of weak oil prices. With the exception of Kuwait, break-even prices for both budget and current account balances have already been reached in GCC countries, suggesting that either reserves or sovereign wealth funds are being tapped or public debt is accumulating. Should oil prices remain at their current lows, Bahrain, Oman and even Saudi Arabia would deplete their reserves in a few years unless public spending is reeled back. Second, the valuation of Sovereign Wealth Funds (SWF) and reserves could be affected by the U.S. decision to raise interest rates, and its attendant effect on bond prices.

Mashreq countries. The major impact of the turmoil in emerging markets would be through the two channels of oil prices, and external financing. The first is the more important one as financial markets in Mashreq countries are not fully integrated into the global financial markets. Lower oil prices are expected to significantly impact Iraq, Syria, and to some extent Iran and widen their financing gaps (both fiscal and balance of payments). For Iran, the lifting of sanctions would still be the main driver of the economy over the next few years. Jordan, while an oil importer (see next paragraph) could be negatively affected by the fall in oil prices in that grants and remittances from the GCC may decline. Positive impacts are also expected: low oil prices are good news for both Lebanon and Jordan (as oil importers). This will improve both countries' balance of payments and fiscal positions (especially Lebanon's because its considerable subsidy bill would be lower), and help boost net disposable income of consumers.

Maghreb countries. All four Maghreb countries are poorly connected with the rest of the world except for oil and gas (Algeria and Libya) and tourism and remittances (Morocco and Tunisia). Indeed, with capital controls in place and underdeveloped stock exchanges, all four countries are relatively shielded from short-term global financial turbulence and contagion. However the slowing down of China and other emerging markets would dampen global demand and thus slow the Maghreb's nonoil exports. Secondly, the depreciation of the Chinese and other emerging market currencies would boost their competitiveness, thereby putting Maghreb products at a price disadvantage in third markets. Third, if the emerging market slowdown further depresses oil prices, this would have significant but asymmetrical consequences for oil-importing and oil-exporting Maghreb countries. Morocco and Tunisia could reap further benefits from lower oil prices, which would improve their current account through lower import bills; and fiscal account as the cost of fuel subsidies declines. The economies of Algeria and Libya would be even more seriously hurt by a new fall in oil prices, as oil accounts for more than 95 percent of their total exports and a significant share of their budget revenues.

Source: World Bank.

Table 1.1 Macroeconomic outlook

	Real GDP Growth, Percent					Fiscal Balance, Percent of GDP					Current Account Balance, Percent of GDP				
	2013	2014	2015e	2016p	2017p	2013	2014	2015e	2016p	2017p	2013	2014	2015e	2016p	2017p
MENA	2.2	2.8	2.8	4.4	4.6	1.8	-2.4	-9.2	-5.9	-4.5	9.0	4.6	-2.6	-1.3	0.1
Developing MENA	0.7	1.4	2.2	5.8	6.0	-5.9	-6.6	-9.1	-5.8	-4.0	-2.4	-4.7	-7.7	-6.0	-4.1
Oil Exporters	2.1	2.9	2.6	4.5	4.6	5.4	-0.7	-9.8	-5.6	-3.9	14.5	8.5	-0.9	0.8	2.5
GCC countries	3.4	3.9	3.2	3.2	3.4	10.4	2.3	-9.4	-6.0	-5.1	21.7	15.1	3.3	4.1	5.1
Bahrain	5.3	4.8	2.7	2.4	2.4	-4.3	-5.7	-9.9	-6.1	-6.2	7.8	5.3	-2.1	-0.7	-0.7
Kuwait	0.8	0.1	1.2	2.5	2.7	34.2	17.2	7.2	7.6	8.6	41.2	31.9	12.9	13.8	14.0
Oman	3.9	4.1	3.7	3.2	3.5	3.2	-1.5	-12.9	-11.1	-10.1	9.2	2.4	-1.8	-9.6	-10.8
Qatar	6.3	6.2	6.6	6.8	5.9	14.3	9.6	1.4	-3.5	-4.1	30.7	25.9	10.1	5.2	5.3
Saudi Arabia	2.7	3.6	2.8	2.4	2.9	5.1	-3.9	-19.5	-12.6	-11.5	18.2	10.7	-0.9	2.4	4.3
UAE	4.3	4.6	3.0	3.1	3.3	10.4	5.0	-2.9	0.2	1.8	18.5	13.7	5.0	5.9	6.3
Developing Oil Exporters	-0.5	0.9	1.3	7.2	7.0	-3.1	-5.8	-10.3	-5.0	-1.9	2.3	-2.8	-8.4	-5.3	-2.2
Libya	-13.6	-24.0	2.9	34.8	16.6	-4.0	-43.3	-55.2	6.5	16.3	0.0	-49.9	-69.3	-18.9	-4.1
Yemen, Rep.	4.8	-0.2	...	...	...	-6.9	-5.3	...	...	...	-2.9	-1.7	...	...	...
Algeria	2.8	4.3	2.8	3.9	4.0	-0.8	-5.9	-11.5	-9.4	-6.4	0.5	-4.2	-15.0	-13.8	-13.1
Iran, Islamic Rep.	-1.9	4.3	1.7	6.1	6.8	-0.9	-1.2	-2.6	-1.4	-0.6	6.1	3.8	-0.3	0.7	1.6
Iraq	8.4	-2.4	0.5	3.1	7.0	-5.9	-5.3	-16.2	-8.9	-2.8	1.3	-3.1	-7.3	-4.8	2.2
Syrian Arab Rep.	-20.6	-18.0	-15.8	10.1	10.4	-18.5	-22.3	-21.8	-17.3	-18.7	-14.7	-17.8	-12.7	-16.1	-10.4
Oil Importers	2.7	2.3	3.5	3.6	4.2	-8.9	-7.5	-7.9	-6.5	-5.9	-7.5	-6.8	-7.0	-6.6	-5.7
Egypt, Arab Rep.	2.1	2.2	4.2	4.6	4.9	-13.7	-12.8	-11.5	-10.5	-9.4	-2.3	-0.8	-3.7	-3.3	-2.7
Tunisia	2.3	2.3	0.8	2.8	3.7	-6.2	-4.1	-6.3	-4.1	-3.3	-8.3	-8.8	-8.4	-7.8	-6.9
Djibouti	5.0	6.0	6.5	7.0	7.1	-5.9	-12.0	-14.1	-12.5	-3.7	-23.3	-27.4	-27.7	-21.8	-13.4
Jordan	2.8	3.1	2.5	3.7	4.0	-11.4	-9.1	-4.1	-2.8	-2.0	-10.3	-6.8	-7.1	-6.8	-6.3
Lebanon	0.9	2.0	2.0	2.5	2.5	-9.4	-6.6	-7.2	-7.0	-9.8	-26.6	-26.7	-21.2	-21.9	-20.2
Morocco	4.4	2.6	4.7	2.7	4.0	-5.6	-4.9	-4.6	-3.7	-3.0	-7.5	-5.9	-4.8	-4.5	-3.7
West Bank & Gaza	2.7	-0.3	3.0	3.9	3.7	-12.6	-12.4	-11.8	-11.2	-10.6	-19.1	-10.9	-11.1	-12.0	-12.4

Source: World Bank, Syrian Central Bank, Syria Ministry of Economy and Planning, and UN-ESCWA.

Inequality, Uprisings, and Conflict in the Arab World

Introduction

The Middle East and North Africa (MENA) represents a puzzle. The region had been making steady progress in terms of the World Bank's twin goals of eliminating extreme poverty and boosting shared prosperity. The percentage of poor people, already low, was declining in all economies, except Yemen (Figure 2.1, Appendix Table 2.1). The incomes of the bottom 40 percent, measured at 2005 PPP-adjusted per capita expenditures, were growing faster than average expenditures in most Arab economies for which information was available (Figure 2.1). In fact, the ratio of expenditures of the bottom 40 percent to the average was higher than all regions except Latin America and the Caribbean (Figure 2.1).

Not only did MENA reach the Millennium Development Goals related to poverty reduction and access to infrastructure services (especially, drinking water and sanitation, and internet connectivity), but it made important strides in reducing hunger, child and maternal mortality, and increasing school enrollment (Iqbal and Kindrebeogo, 2015). Inequality of opportunity declined in some countries, according to evidence in Hassine (2011). Finally, expenditure inequality, measured by the Gini index, did not worsen in most MENA economies in recent years and remained low to moderate by international standards (Figure 2.2, Appendix Table 2.1).

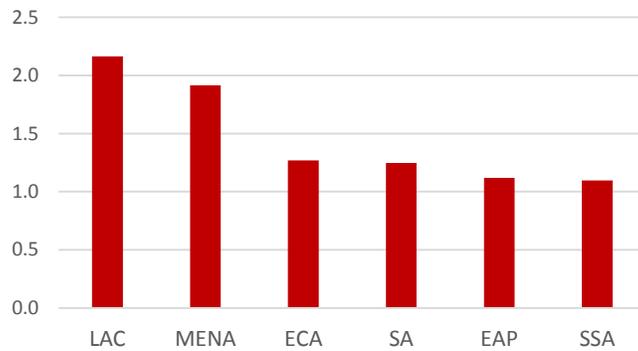
Yet, starting in late 2010 there were revolutions in Tunisia, Egypt, Yemen and Libya, a rebellion that has led to a protracted civil war in Syria, and widespread popular discontent in many other countries. The Arab Spring events caught the world by surprise. Standard development indicators failed to capture or predict the outburst of popular anger during the spring of 2011. What could explain this conundrum, which we refer to as the 'Arab inequality puzzle'? Was economic inequality much higher than suggested by household expenditure data? Or were the grievances linked to factors other than economic inequality, such as decline in the overall quality of life, growing corruption, and lack of freedom, among others?

Answers to these questions are beginning to emerge from new research on monetary inequality (Hassine, 2015; van der Weide et al. 2015a, 2015b; Johannesen, 2015) and subjective wellbeing in MENA (Arampatzi et al., 2015), conducted as part of a comprehensive study on economic inequality, uprisings, and conflict in the Arab world (Ianchovichina et al., 2015). This section of the MENA Economic Monitor summarizes the main findings emerging from this new research and proposes a possible answer to the Arab inequality puzzle.

Figure 2.1 Poverty rates and expenditure growth of the bottom 40 percent

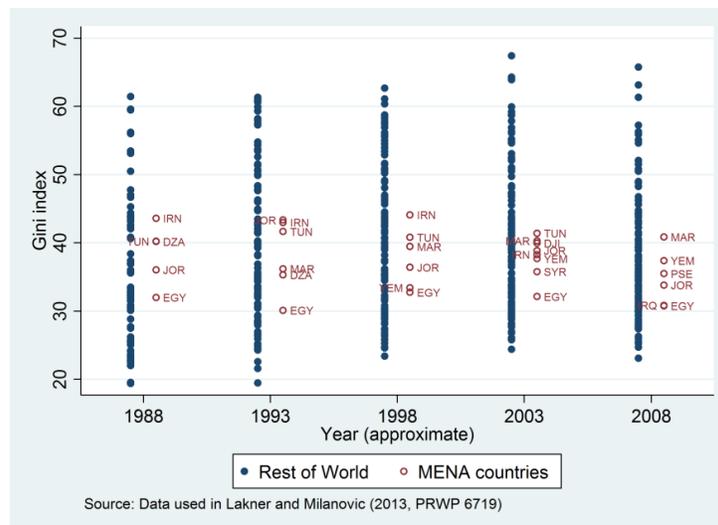


Ratio of bottom 40 growth to average growth



Source: Household Survey Data and World Bank, Global Shared Prosperity Database

Figure 2.2 Inequality – over time and across the world



We find that adjustments for biases in monetary measures of inequality, which are notoriously imprecise, are unlikely to reverse the pattern of low and declining expenditure inequality in the

region. Wealth disparities are greater but also harder to measure than expenditure or income inequality. As we show below, wealth concentration in publicly traded companies does not appear to be higher in MENA than elsewhere in the world, although the largest companies in the Arab world are either privately-owned or state-owned firms. There are also very few large companies as most firms remain informal and small (Schiffbauer et al. 2015).

Nevertheless, people felt stuck in such a world and the middle class in particular was frustrated. Measures of subjective wellbeing and determinants of life satisfaction corroborate this proposition. They show a precipitous decline in life satisfaction scores on the eve of the Arab Spring, especially for the middle class. These declines reflected perceptions of falling standards of living, related to the shortage of formal-sector jobs, the dissatisfaction with the quality of public services, and government accountability. Ordinary people were frustrated as they could not share in the prosperity generated by the relatively few, large and successful Arab firms. They struggled to get ahead by working hard. Reflecting diminishing marginal utility, the widespread system of subsidies could not compensate for all these problems; subsidies mattered less for the wellbeing of the middle class than they did for the wellbeing of the poor and vulnerable. The social contract of redistribution without voice stopped working. The middle class wanted more – it wanted voice, real opportunities and accountability.

If monetary inequality cannot explain the Arab Spring, can it nevertheless shed light on its aftermath? Since 2011, civil wars have broken out in four countries, terrorist incidents have risen and violent extremist groups like Daesh have taken control of parts of Iraq and Syria. Rather than economic inequality per se, we find that inter-group (ethnic and/or sectarian) inequality and its relationship with spatial inequality may have played a role in the increased incidence of conflict and radicalization in the MENA region.

Is Economic Inequality in Arab Countries High?

The Arab Spring uprisings brought issues of equity and inclusion to the forefront of public attention. The case of Egypt, in particular, generated considerable interest because income inequality was cited as one of the factors behind the Egyptian revolution (Hlasny and Verme, 2013; Nimeh, 2013; Ncube and Anyanwu, 2012; Osborn, 2011). The idea that income inequality is linked to political violence and revolutions is not new and can be traced to ancient times when social philosophers speculated that economic inequality is a fundamental cause of civil unrest (Muller, 1985). Today, there is a recognition that high income inequality is bad for social consensus and political stability which in turn could harm investment, sustainable growth, and progress in human development (Ostry et al., 2014); and that the tolerance for income inequality varies over time and across countries (Hirschman and Rothschild, 1973).

Measuring economic inequality is a difficult task, particularly in developing countries where comprehensive administrative information on income and wealth are generally unavailable.

Inequality measures are often based on household surveys that suffer from several well-known shortcomings. Apart from the difficulty of recalling income and wealth information correctly, survey respondents may under-report expenditures or deliberately leave out income and wealth that result from illegal or informal activities. In addition, these surveys typically include few individuals at the very top of the income distribution, although capturing accurately the “top one percent” is crucial to estimating inequality (Alvaredo, 2011). In MENA, these difficulties are compounded by the fact that access to household surveys is limited.

Thus, it is not surprising that to date few studies focused on economic inequality in Arab countries. Lack of access to and comparability of household surveys constrained cross-country analysis of expenditure inequality in the region. A recent paper by Hassine (2015) fills this gap and presents an in-depth comparison of expenditure inequality across 11 economies in the region, using harmonized micro-data from 18 household surveys and three different consumption expenditure aggregates, taking into account temporal and, in some cases, within-country variations in the cost of living.

Hassine (2015) confirms the relatively low levels of expenditure inequality in the region (Figure 2.3), but finds that the coverage of items in households’ expenditures has a significant effect on the Gini measures of inequality. The Gini index based on food and nonfood expenditures is on average 4.2 points higher than the Gini based on food alone; adding expenditures on durables and housing increases the Gini by about 0.5 points.

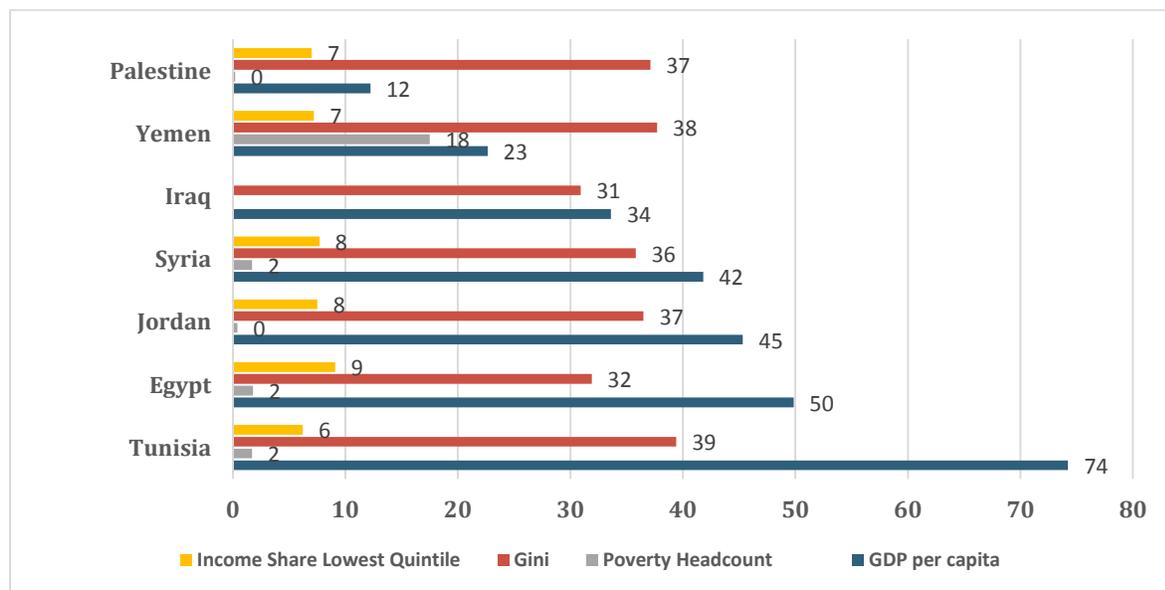
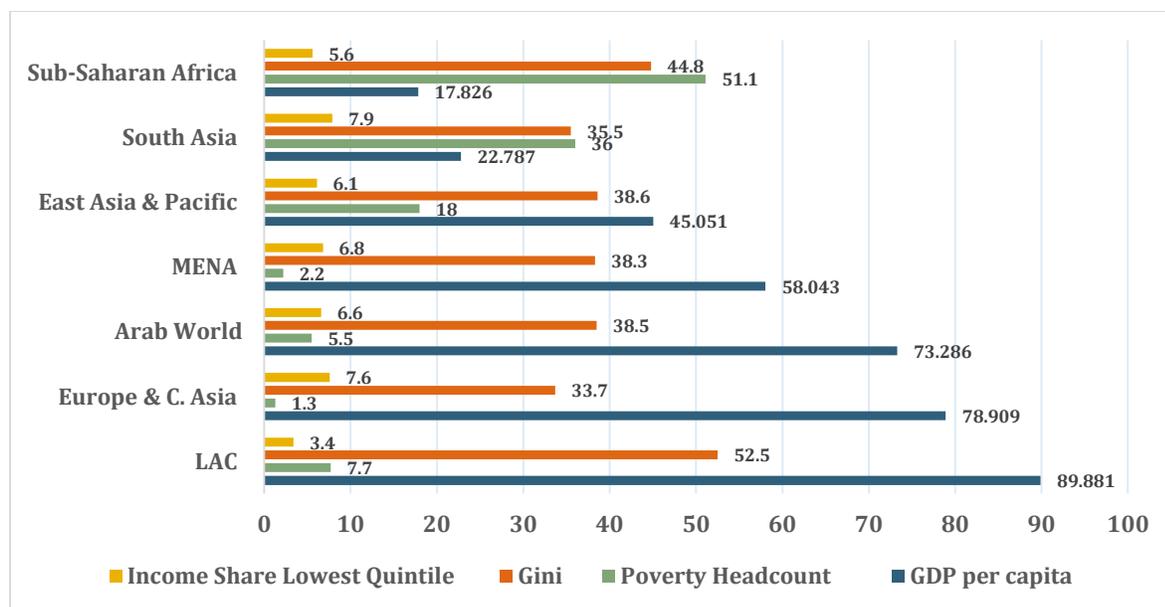
A diverse picture on expenditure inequality in MENA emerges from the analysis in Hassine (2015). There are no discernible patterns in the evolution of inequality through time and relative to average welfare. Over time, total expenditure inequality declined in Egypt, Jordan, and Tunisia, and increased in Syria, the Palestinian Territories, Djibouti, and Yemen, but the Gini index remained moderate in the region as a whole, averaging 0.385 (Figure 2.3).

Furthermore, there appeared to be no relationship between expenditure inequality and average per capita expenditures, or welfare. Both expenditure inequality and average per capita expenditures increased in Syria and the Palestinian Territories and decreased in Egypt. While there was an improvement in welfare with a decline in inequality in Jordan and Tunisia, the opposite was observed in Yemen and Djibouti (Figure 2.4). Thus, the low income and high inequality pattern deepened in Djibouti and Yemen; growth was more broadly shared in Jordan and Tunisia, but not in Syria and the Palestinian Territories; expenditures contracted in real terms in Egypt but most of the burden fell on top earners.

Relying on expenditure data from household surveys to gauge the extent of economic inequality and shared prosperity has well-known pitfalls, however. Expenditure inequality may be understated due to the tendency for the top tail of the distribution to be underrepresented (Atkinson et al., 2011). For this reason, analysts use administrative data, typically tax records, to

estimate the income of the very rich, and thereby obtain a more accurate description of the ‘true’ income distribution. However, the availability of tax record data, particularly in MENA countries, is still limited (Alvaredo and Piketty, 2014). The World Top Incomes Database (Alvaredo et al., 2015) includes no MENA countries. Furthermore, data derived from tax records become less useful as tax evasion becomes more pervasive, which is particularly important in developing countries, including some Arab economies.

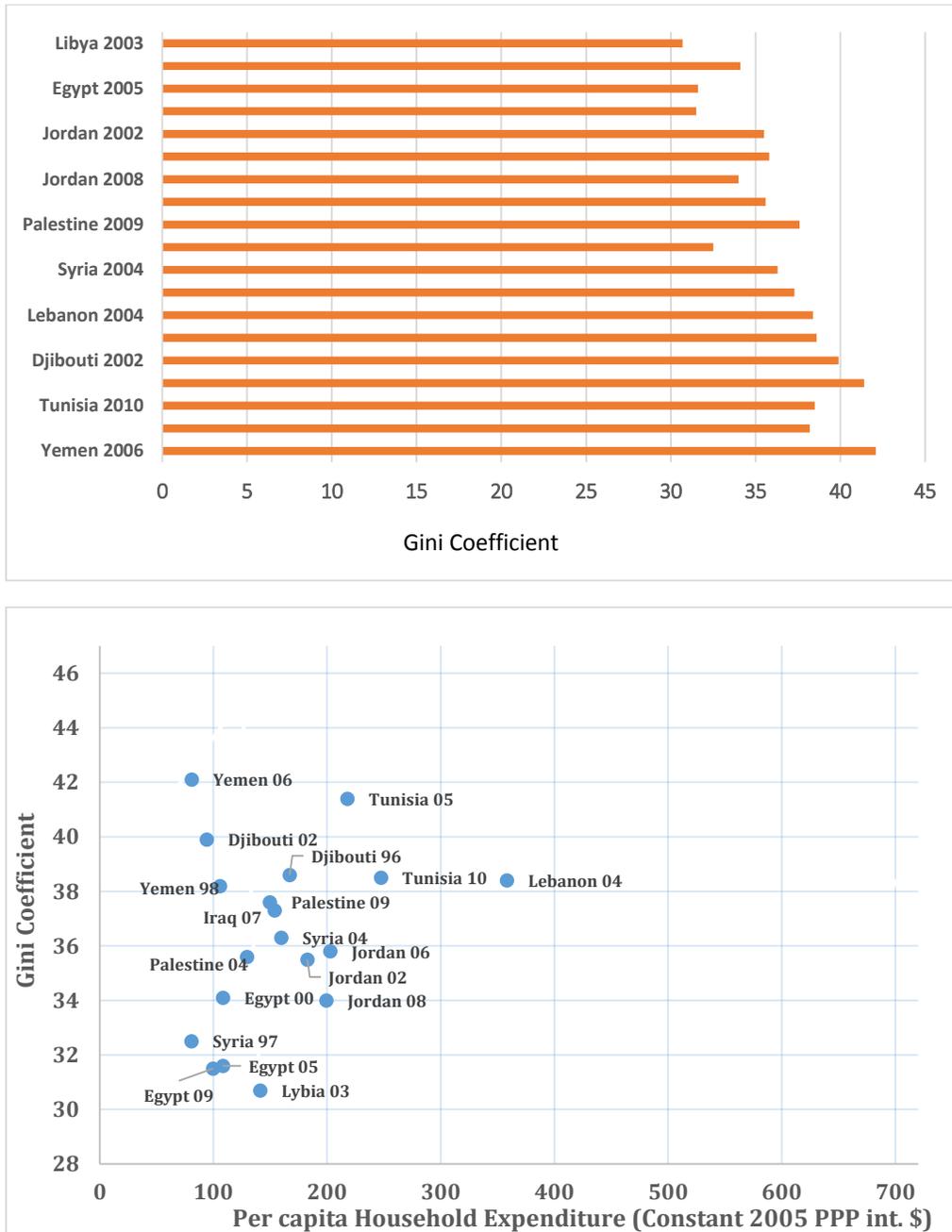
Figure 2.3 Arab region’s development context



Note: GDP is in 100 PPP, 2005 int. dollars; Poverty Headcount using \$1.25/person/day.

Source: Hassine (2015) using World Development Indicators (2013) and PovCal World Bank databases.

Figure 2.4 Comparisons of expenditure inequality in MENA



Source: Hassine (2015). Total expenditure per capita include expenditure on food, nonfood, housing and durables.

In the absence of tax data, Hlasny and Verme (2013) adjust the upper tail of the distribution using the Pareto distribution, often employed to describe the allocation of wealth and income in a society,¹ and find that expenditure inequality in Egypt does not increase substantially. However,

¹ The Pareto distribution shows well that a larger portion of the wealth of a society is owned by a smaller percentage of people.

their Pareto distribution is fitted using the household survey, which underestimates the top tail. Van der Weide et al. (2015a) get around this problem by estimating the upper tail of the distribution using market house price data from Egypt and a multiple imputation approach.^{2,3} The advantage of this approach is that market house price data are publicly available and relatively easy to obtain using technology; there is no systematic tendency for the data to understate home values, in contrast to income data which may be under-reported on tax returns; and the top end of the distribution is captured well in these data as market price information is applicable to homes owned by the top tail. Van der Weide et al. (2015a) then combine the top tail of the imputed consumption distribution with the bottom of the expenditure distribution obtained from the household survey.⁴ Their results suggest that different measures of urban inequality in Egypt are robust to corrections for missing top incomes (Table 2.1). The Gini coefficient hardly changes; the mean log deviation (MLD) measure changes only slightly; and the Theil index is the most sensitive, as expected. In general, this line of research indicates that expenditure inequality in MENA countries is unlikely to be much higher than suggested by current estimates.

Table 2.1 Inequality measures for urban Egypt corrected for missing top incomes

	Survey direct	Corrected for Missing Incomes (weight 1)	Corrected for Missing Incomes (weight 2)
Gini	33.7	33.7	33.6
Mean log deviation	18.7	19.5	19.4
Theil	21.9	26.2	26.3

Source: Van der Weide et al. (2015a).

Still, wealth inequality may be much higher and more socially divisive, but harder to detect than expenditure inequality. Measuring wealth is more complex than calculating income as data on wealth are scarce, especially in developing MENA. In order to get a glimpse of the concentration of wealth at the top of the income ladder, different sources of information must be combined and although each source may not be perfect, together they provide a picture of wealth concentration and inequality.

One way to assess the degree of wealth concentration in MENA countries and compare it to that of other countries is to use Forbes' data on the net worth owned by billionaires.⁵ According to these data, wealth concentration in the hands of billionaires is smaller in most MENA countries than in other countries at similar levels of development (Figure 2.5).⁶ To be sure, these data

² The approach is similar to the one adopted in Doudich et al. (2014).

³ They put together a dataset of real estate prices by extracting information from listings of homes for sale or rent, available at Egyptian websites.

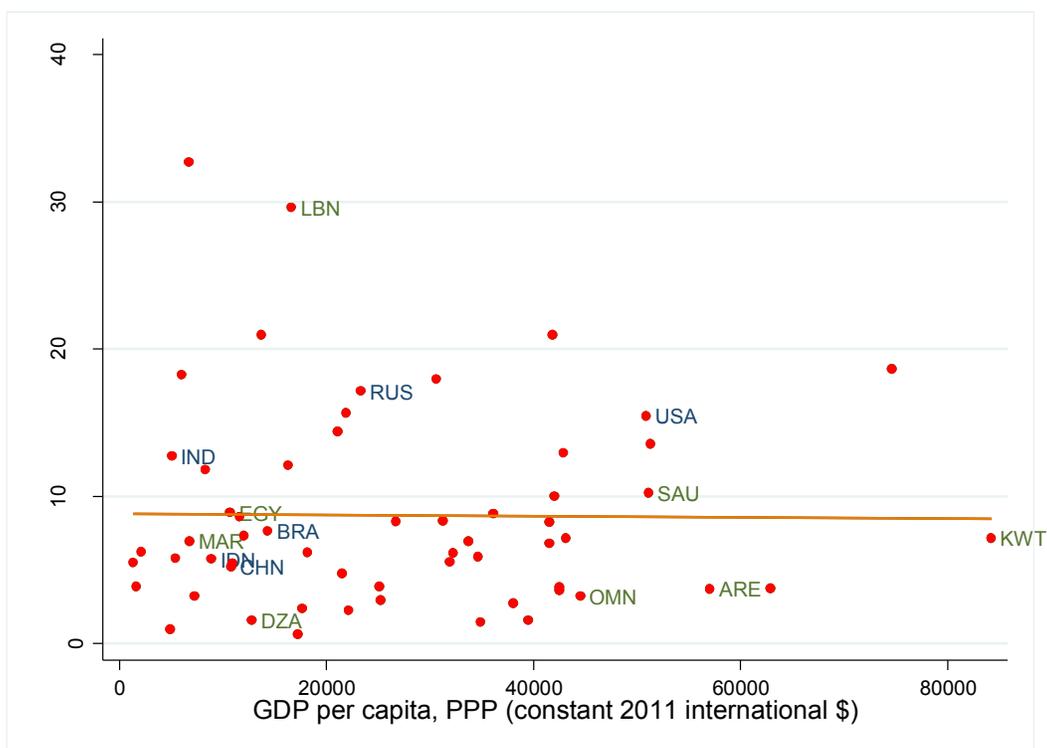
⁴ They follow the method in Alvaredo (2011) and Diaz-Bazab (2014).

⁵ The list is regularly updated and available at <http://www.forbes.com/billionaires/list/>.

⁶ However, wealth concentration increases in some MENA countries when the estimated wealth owned by current and former heads of state is included.

reflect mostly wealth in publicly traded companies and very few companies in the region are publicly traded (OECD, 2009). The 20 or so largest companies in most Gulf States, Egypt, Lebanon, and Morocco are not listed on national or world stock exchanges. Instead, they are either firms privately owned by prominent families or state-owned firms. In short, ordinary people cannot share in the prosperity generated by the most successful firms in the Arab countries. It also makes it hard to identify and track the wealth of the billionaires in the region.

Figure 2.5 Wealth concentrated in the hands of billionaires



Source: Ianchovichina et al. (2015) based on Forbes database of billionaires and World Bank data on GDP.

Another way to gauge the extent of wealth inequality is to estimate the size of wealth hidden in tax haven bank deposits, available in a dataset from the Bank of International Settlements (BIS) on cross-border bank deposits.⁷ The focus on bank deposits in tax havens is warranted for at least a couple of reasons. First, haven deposits offer advantages to individuals wishing to hide their wealth, notably banking secrecy and legal arrangements that nominally sever the tie between the assets and their owners. Such arrangements are likely to be most appealing to individuals who desire to hide their wealth status because the wealth may have been acquired through informal or illegal means. Second, bank accounts in foreign banks typically involve fixed costs that are prohibitive for individuals at lower wealth levels. The data on bank deposits in tax havens

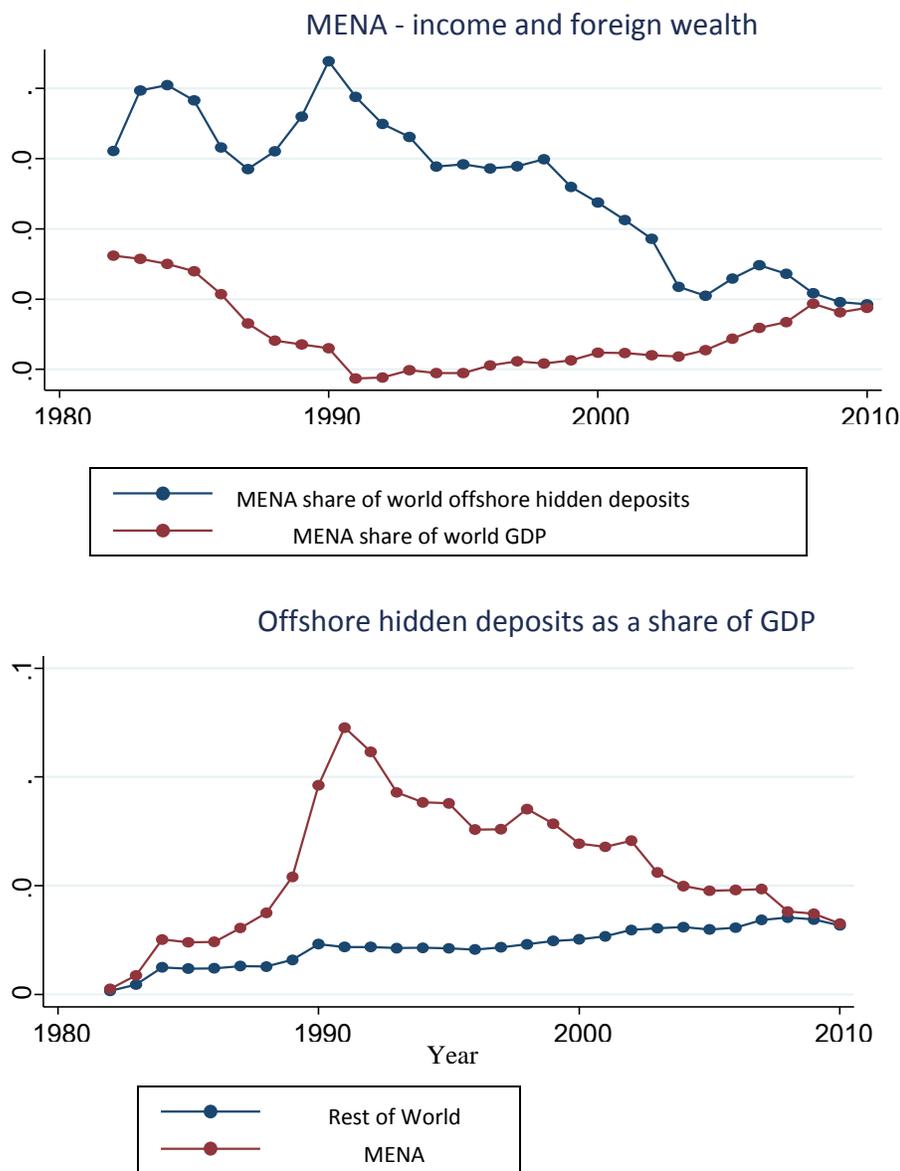
⁷ The dataset contains information on foreign-owned bank deposits in 43 countries – representing all major financial centers including tax havens – at the bilateral level.

therefore offer insights about the hidden wealth of the wealthiest who are under-represented in household surveys, even when these surveys have been corrected for missing observations at the top end of the distribution.

There are however important limitations to this dataset. It covers only bank deposits and excludes other types of hidden wealth such as bonds or equity owned through the haven accounts. Zucman (2013) estimates that bank deposits account for roughly one quarter of the financial wealth of the world's wealthiest individuals. The dataset does not distinguish among deposits belonging to individuals, firms, and governments, and assigns deposits to counterpart countries on the basis of immediate rather than ultimate ownership. Thus, if a resident of Tunisia owns a corporation in Panama, which in turn holds a bank account in Switzerland, the BIS statistics will record the Swiss account as belonging to a resident of Panama. Corporations, trusts, and other similar arrangements are frequently used by owners of hidden wealth to add layers of secrecy (FATF, 2011). Johannesen (2015) controls for this problem by excluding deposits recorded as belonging to havens because such deposits are very likely to reflect sham structures rather than true ownerships by haven residents.

Using this dataset, Johannesen (2015) studies the distribution of bank deposits in tax havens across countries and over time and find that historically hidden wealth has been considerably larger for MENA countries than elsewhere, but this difference has diminished rapidly in recent years (Figure 2.6). Furthermore, he finds no correlation between the shares of haven deposits in GDP and the level of expenditure inequality in MENA (Table 2.2). This suggests that wealth inequality and expenditure inequality are different concepts. Haven deposits capture a dimension of inequality that may have no relationship to the inequality captured by the survey measures. The size of haven deposits may also be indicative of other factors such as corruption, tax evasion, capital controls, and domestic financial sector development.

Figure 2.6 Hidden bank deposits



Source: Johannesen (2015)

Table 2.2 Correlation between the ratio of haven deposits to GDP and the Gini coefficient

	All countries	Low income	Mid income	High income	MENA	Non-MENA
Gini coefficient	0.000297 (0.000283)	0.000102 (0.000417)	0.000413 (0.000414)	0.00205* (0.00106)	-0.000723 (0.00674)	0.000398* (0.00024)
Constant	0.0115 (0.0113)	0.0153 (0.0165)	0.00617 (0.0172)	-0.035 (0.0351)	0.0721 (0.236)	0.00584 (0.00959)
Observations	113	38	58	18	7	106
R ²	0.010	0.002	0.017	0.189	0.002	0.026

Source: Johannesen (2015)

In sum, while existing measures of inequality may underestimate the true extent of economic inequality, the error due to the existence of hidden wealth in haven bank deposits has diminished over time and is currently not likely to be much larger in MENA countries than in the rest of the world. There is also no evidence of an inequality-growth link in the MENA region (van der Weide et al. 2015b).⁸

This conclusion is consistent with the profile of developing MENA countries as low expenditure inequality, high-redistribution economies.⁹ The post-independence, state-led economic model followed by MENA countries contributed toward poverty reduction and equity, but the model was becoming unsustainable by the early 2000s (Devarajan et al., 2015). Fiscal imbalances grew, reflecting disappointing growth in the 1980s and growing recurrent expenditures on public wages and food and energy subsidies. Substantial increases in international commodity prices in the 2000s and fast-growing domestic demand increased the fiscal cost of subsidies and provided impetus for initiating reforms of the subsidy programs (Devarajan et al, 2014). Most governments, however, continued to offer food and energy subsidies, as reforms were often partial or reversed under public pressure.¹⁰

Overall, the evidence emerging from the body of research in Ianchovichina et al. (2015) suggests that high and rising expenditure inequality has not been a factor in triggering the Arab Spring events. Wealth disparities, which are harder to measure, were likely greater and may have contributed to the uprisings. Ordinary people were frustrated as they could not share in the prosperity generated by the large Arab firms which were mostly privately owned or state owned firms. Indeed, the next section explores perceptions data showing that income inequality has not been at the top of grievances voiced prior to the Arab Spring. Instead middle-class people complained about the decline in their standards of living, related to the shortage of quality jobs, dissatisfaction with the quality of public services and government accountability.

Plummeting Perceptions of Wellbeing in the Wake of the Arab Spring

Measures of expenditure inequality and shared prosperity draw attention to the welfare of the poor and vulnerable; they have proven of limited value in understanding the factors behind the Arab uprisings and their aftermath. The main problem is that these measures do not reflect many factors important to subjective wellbeing such as quality of life, expectations about the future,

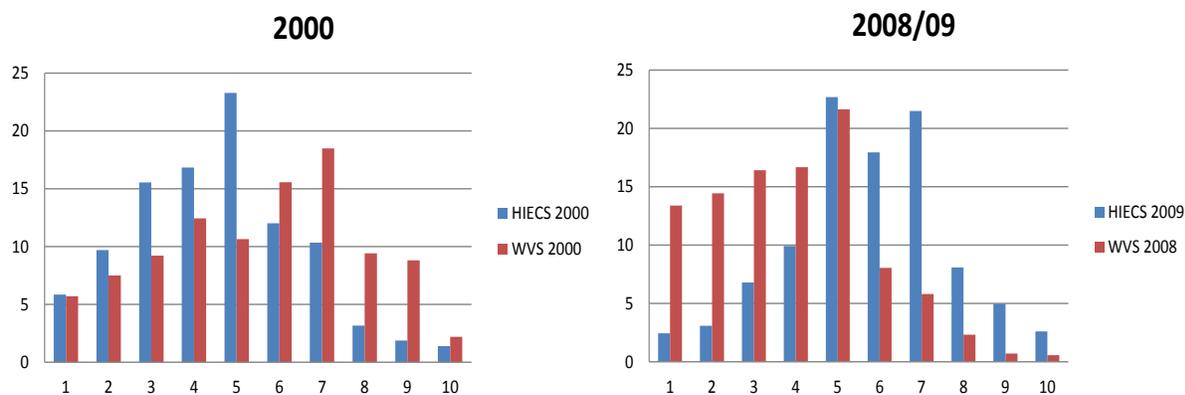
⁸ Van der Weide et al. (2015b) show this using provincial level panel data derived from household surveys for Egypt Jordan, Syria, Tunisia, and Yemen.

⁹ Benabou (2000) argues that with imperfect credit and insurance markets some redistributive policies can improve ex ante welfare and the popular support for redistribution decreases with inequality. Therefore, there might be multiple steady states: mutually reinforcing high inequality and low redistribution or low inequality and high redistribution.

¹⁰ See, for example, World Bank (2011a) and World Bank (2011b).

and changes not yet reflected or not measured well with objective data. According to Verme (2014), significant differences between objective and perception data and between the perceived and actual income distribution emerged in Egypt between 2000 and 2008. In 2000, people viewed themselves as more affluent than they were, but by 2008 it was the reverse, while household data showed that Egyptians became more affluent (Figure 2.7).

Figure 2.7 Reality vs. perceptions in Egypt (percent by decile)



Source: Verme (2014) based on World Value Survey (WVS) and Household Survey (HIECS) data for Egypt.

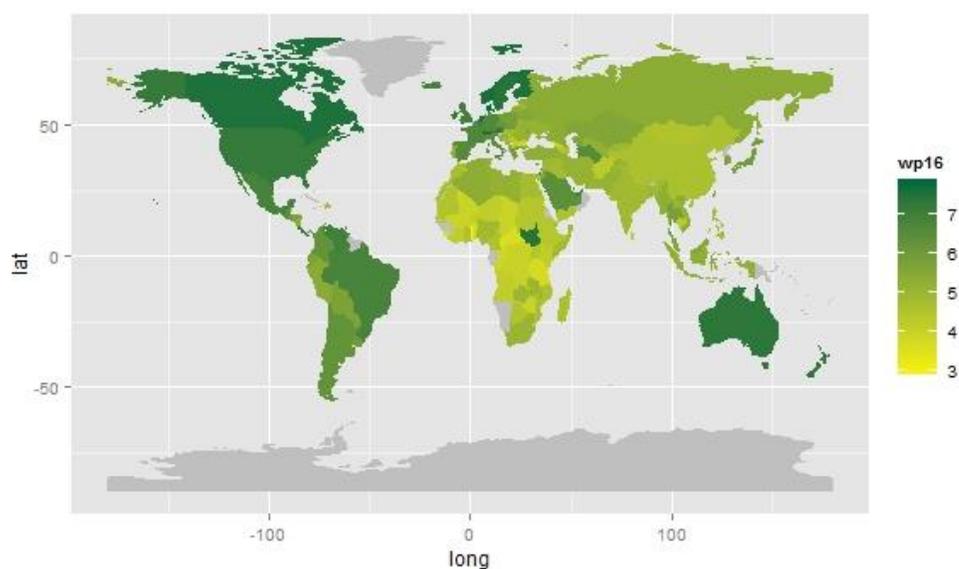
Many factors that affect the quality of life or people’s standards of living and in turn influence their life satisfaction are not well-captured in traditional expenditure data. Some of these factors pertain to the quality of public services, such as health, education, transport, electricity and other types of government services. Others refer to the quality of jobs available in the economy. Environmental quality, institutional quality, public safety, the fairness of the justice system, control of corruption, and political and economic stability also have significant influence on the quality of people’s lives.

In addition, expectations about the future play a role in life evaluations. Expectations may change over time as people calibrate their subjective wellbeing based on the ‘ideal’ they have for their personal life (‘reference point’) and based either on changes in domains important to their happiness (e.g., perceptions of corruption grow) or the importance of these domains for their personal wellbeing (e.g., control of corruption becomes more important to people’s quality of life).

Finally, objective indicators capture quantitative changes relatively well but even here they may not give a complete picture of economic changes and developments. Unemployment statistics, for instance, may improve as more people drop out of the work force; this translates into lower unemployment rates but indicates serious structural economic problems that force people to quit their active job search.

Ianchovichina et al. (2015) turn therefore to an analysis of subjective measures of wellbeing in the Arab world. Life satisfaction data from various sources, including the Gallup World Poll, show that just before the emergence of social discontent in several developing MENA countries, subjective wellbeing was low and plummeting. Life satisfaction, measured using the “Cantril Ladder” scores, captures people’s views on how closely their life fits their standard for a good life. The average scores in Arab countries were relatively low (Figure 2.8). The higher the score on the ladder, the closer one’s life is seen to their ideal life (identified with the maximum score of 10).

Figure 2.8 Average life satisfaction by country (2006-2012)



Source: Ianchovichina et al. (2015) based on Gallup World Poll data for Question WP16: “Please imagine a ladder, with steps numbered from 0 at the bottom to 10 at the top. The top of the ladder represents the best possible life for you and the bottom of the ladder represents the worst possible life for you. On which step of the ladder would you say you personally feel you stand at this time?”

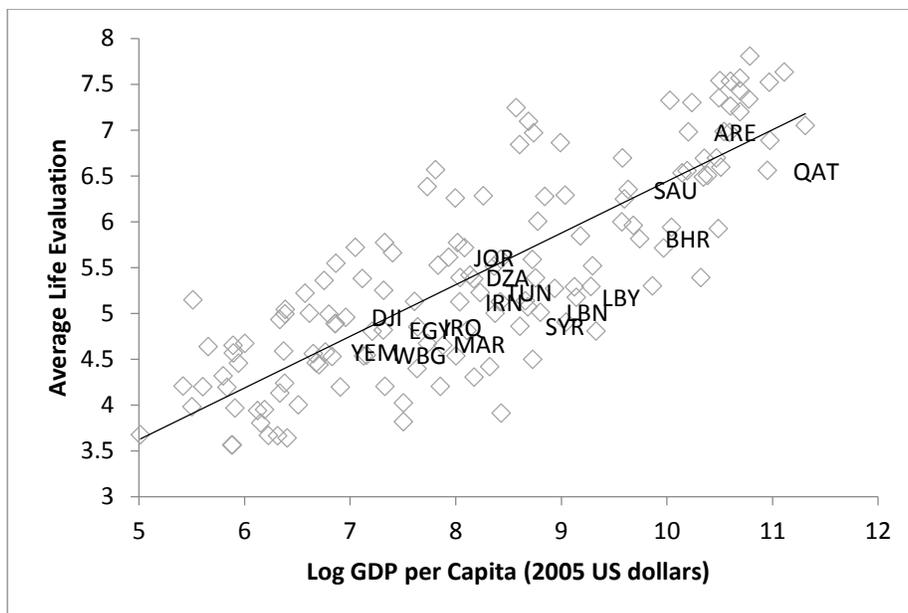
The Cantril Scale scores are ideal for analysis of shared prosperity issues, especially in Arab countries, for a number of reasons. By relying on the scores rather than on indexes that reflect index-maker’s opinions on what matters most,¹¹ one gives voice to the people and places primary importance on people’s evaluations of their own lives. The responses incorporate both monetary and non-monetary factors affecting subjective wellbeing and therefore can be used in analyses aimed at understanding the value people attach to a comprehensive set of factors and circumstances that improve their lives and contribute to their unhappiness.¹²

¹¹ Since there is uncertainty to what degree index-makers’ opinions matter, it is hard to treat an index as an overall measure of well-being or assess the extent to which variations in individual components are affecting overall scores.

¹² Population-based samples in each country enable cross-country comparisons.

On the eve of the Arab Spring, many Arab countries were relatively unhappy places. Life satisfaction in most countries was below the average for countries at similar stages in their development (Figure 2.9). Average life satisfaction was particularly low in Syria, the Palestinian Territories, Lebanon, and Libya. Happiness levels were higher in the GCC countries, although in their cases too, wellbeing levels were lower than expected given their high per capita incomes (Figure 2.9).

Figure 2.9 Average income and subjective wellbeing by country (2008-2011)



Source: Arampatzi et al. (2015) based on Gallup and World Bank data. Note: Sample includes 147 countries.

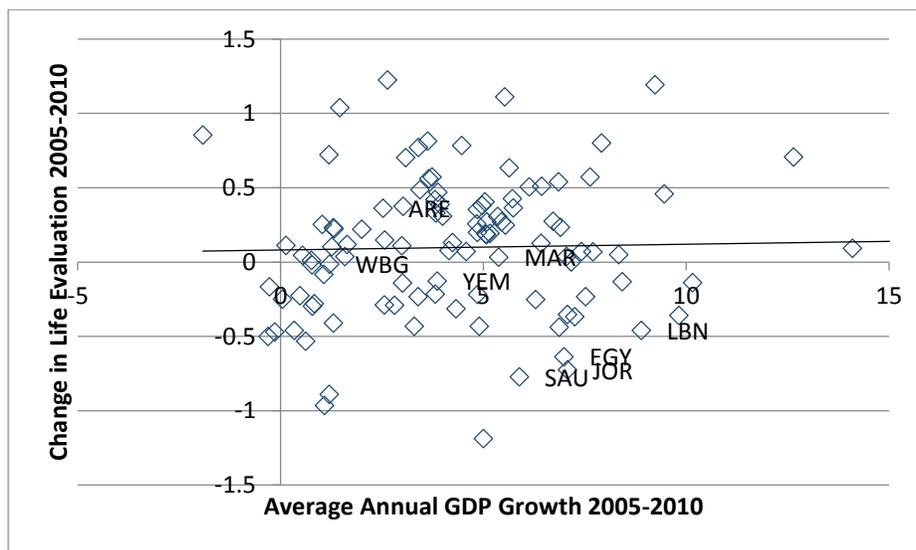
Life satisfaction declined in the years prior to the Arab Spring events (Figure 2.10). The period right after the global financial and economic crisis of 2008 was a difficult one for most economies in the world. The crisis triggered economic contractions and, in many cases, deep recessions in 2009-10. The MENA region was affected by this crisis but to a much smaller extent than developed economies and developing countries in other parts of the world (World Bank, 2011a). But the economic recovery in MENA was also much less vigorous than the recovery in countries that suffered sharp output contractions. The same factors that helped MENA countries avoid severe recessions – a large public sector and limited links to the global economy – constrained their growth recovery.

At the end of the decade, the MENA region was the only region in the world with a high incidence of steep declines in subjective wellbeing (Figure 2.11). The declines were more pronounced in the Arab Spring countries (Figure 2.12). In Egypt, for instance, average life-evaluation levels¹³

¹³ The scale ranges from 0 for the worst possible life to 10 for the best possible or ideal life.

plunged from 5.5 in 2007 to 4.4 in 2010 – a deep drop in the context of improvements observed in socio-economic statistics and growth in per capita incomes (see Figure 2.10). Thus, by the end of the 2000s, people in Egypt, Iraq, Syria, Tunisia, and Yemen were among the least happy people in the world (see Figure 2.8).¹⁴

Figure 2.10 Economic growth and change in subjective wellbeing



Source: Arampatzi et al. (2015) based on World Bank data and World Database of Happiness.

Arampatzi et al. (2015) refer to this phenomenon as the ‘unhappy development’ paradox. Using a reduced-form life-satisfaction model that incorporates individual perceptions about social conditions, personal characteristics, and other factors (shown to influence happiness), they assess the relative importance of different explanations of declining life satisfaction in developing MENA in the run-up to the Arab Spring. They narrow the social domains influencing life satisfaction in the region to three main areas: dissatisfaction with standards of living (or quality of life), unemployment, and ‘wasta’ (or the inability to get ahead without connections) (Figure 2.13). The same factors cited as reasons for the Arab Spring uprisings (Figure 2.14) appear to have negatively and significantly affected life satisfaction in MENA in the period immediately preceding the Arab Spring uprising.¹⁵

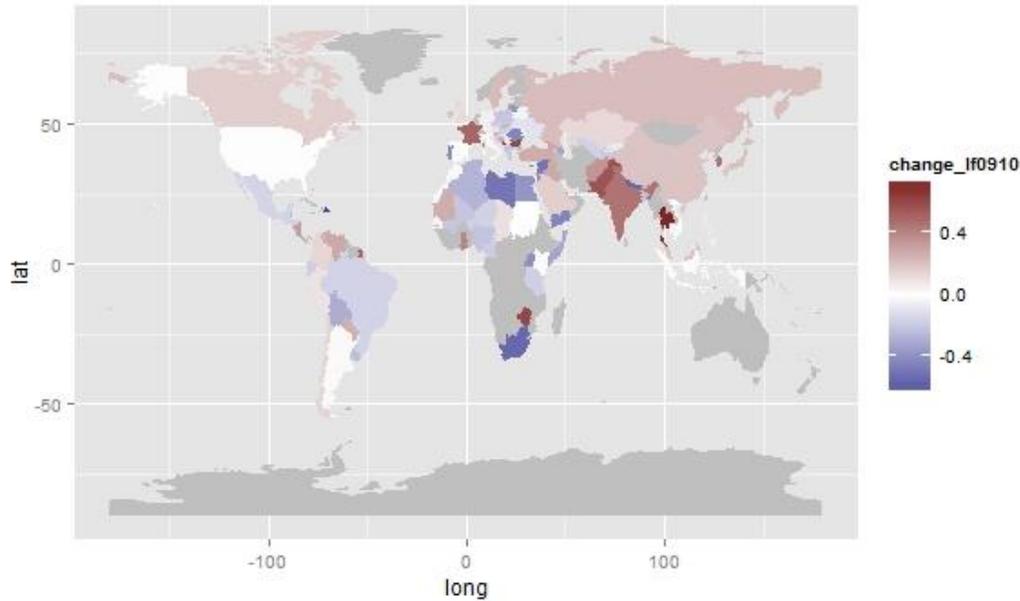
These results are echoed in statistics showing a rise in dissatisfaction with the quality of government services (Figure 2.15) that influence the quality of life in developing MENA in general, and the Arab Spring countries in particular. The percentage of people dissatisfied with the availability of affordable housing rose most dramatically, but there was also increase in the incidence of people dissatisfied with public transportation, quality healthcare, and availability of

¹⁴ The incidence of depression was also observed to be high in MENA, according to Ferrari et al. (2013).

¹⁵ In addition, in line with the empirical literature on happiness, Arampatzi et al. (2015) find that income, marriage and children, and advanced education are all positively and significantly associated with life satisfaction.

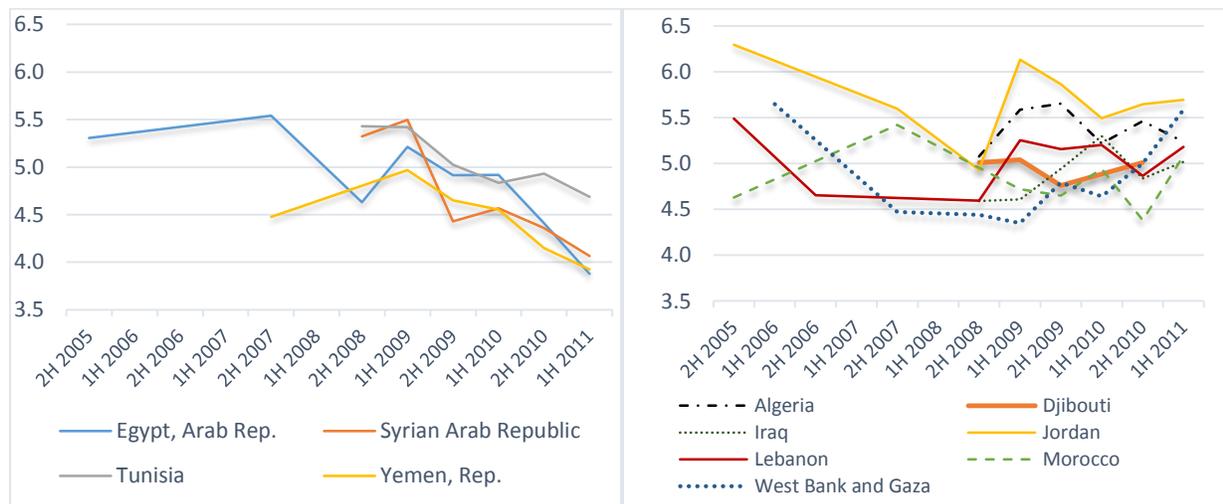
quality jobs. In Arab Spring countries, deterioration in average life satisfaction was also mostly driven by the increase in the percentage of people dissatisfied with their living conditions and the increased importance of perceptions about corruption for life satisfaction in these countries.

Figure 2.11 Change in life satisfaction, 2009-10



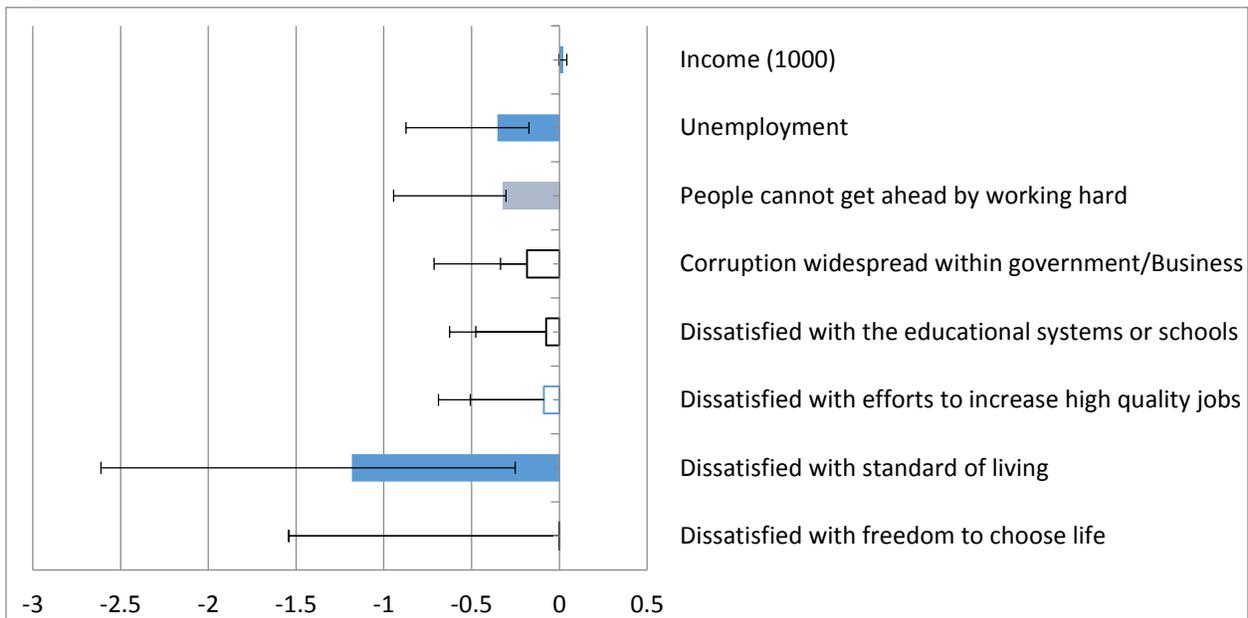
Source: Ianchovichina et al. (2015) based on Gallup World Poll data.

Figure 2.12 Evolution of life satisfaction during the second half of the 2000s



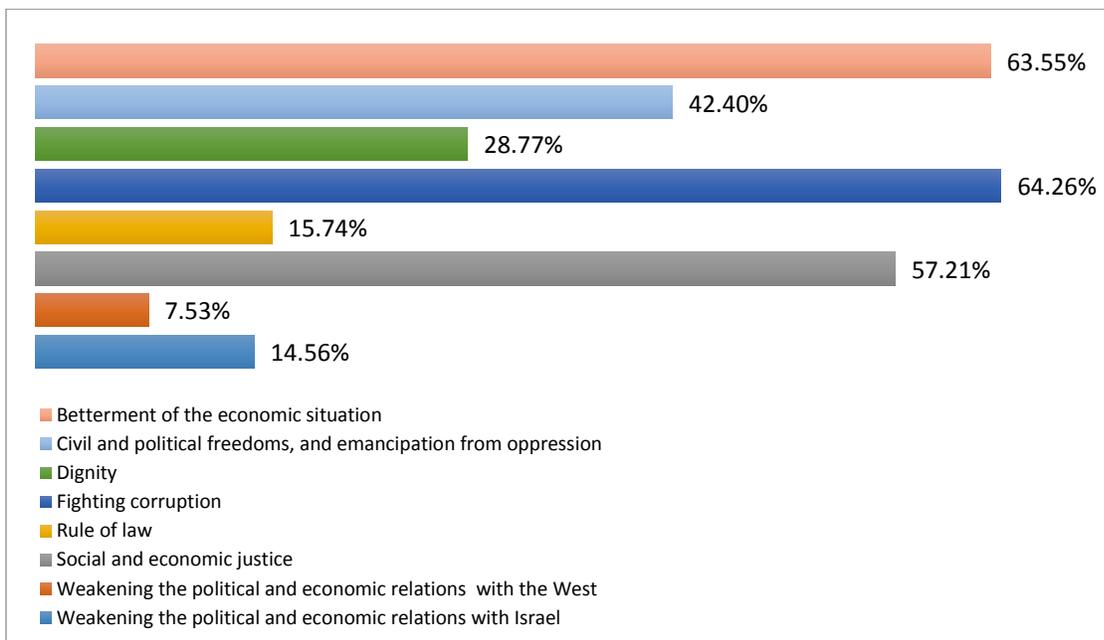
Source: Gallup World Poll data. Note: Not enough data points for Iran, Islamic Rep. and Libya.

Figure 2.13 Effects of different domains on life satisfaction in the Arab World



Source: Arampatzi et al. (2015). Note: Dark blue, light blue and white denote 1 percent significance level, 5 percent significance level, and no significance, respectively.

Figure 2.14 Main reasons for the Arab Spring uprisings (percent of surveyed who were asked to identify three main reasons for Arab Spring)



Source: Arab Barometer (2012-14).

These grievances were broadly shared and expressed the concerns of the lower and upper middle classes, not just the bottom 40 percent. Dissatisfaction grew among all economic classes, but it

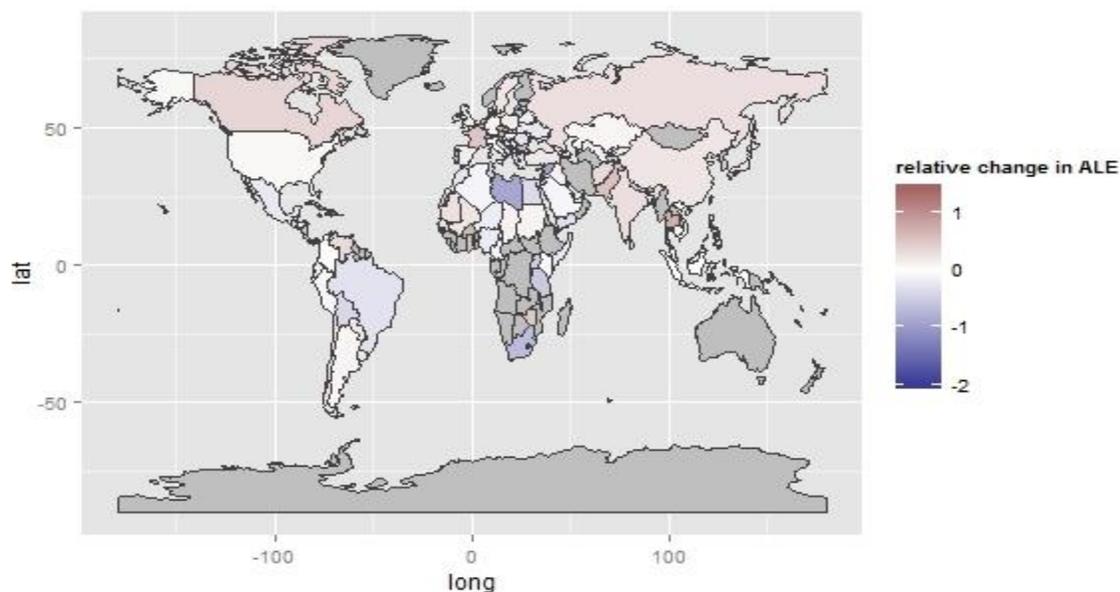
was more pronounced for the top 60 percent of the population than the bottom 40 percent (Figure 2.16), especially in Arab Spring countries – Syria, Libya, Tunisia, Egypt, and Yemen. Thus, the Arab Spring events appear to have been precipitated by broadly shared concerns that affected negatively the wellbeing of the middle classes.

Figure 2.15 Dissatisfaction with government services (percent dissatisfied)



Source: Arampatzi et al. (2015).

Figure 2.16: Change in life satisfaction of the top 60 percent relative to the bottom 40 percent, 2009-10



Source: Ianchovichina et al. (2015) based on Gallup World Poll data.

Grievances, Divisions, and Implications

A possible answer to the Arab inequality puzzle, therefore, lies in the wide-spread dissatisfaction of people, especially those in the middle 40 percent, with their quality of life. According to Arampatzi et al. (2015) this was the main grievance behind the plunge in life satisfaction in many MENA developing countries. The deterioration in life satisfaction was not captured in objective macroeconomic data, household surveys, and more generally in standard indicators of inequality, but was evident in perceptions data from value surveys. There was a marked rise in the incidence of dissatisfaction with several domains crucial to quality of life such as the quality of government services, corruption, and cronyism.¹⁶

Stated differently, the low levels of life satisfaction in developing MENA countries in the period preceding the Arab Spring uprisings did not reflect dissatisfaction with the level of income inequality or the income growth of the bottom 40 percent. Absolute poverty was low and the level of income inequality was moderate and declining during the 2000s. The unhappiness was instead associated with low standards of living, wide-spread corruption, and lack of fairness. Most people in the Middle East and North Africa had to work longer hours in the informal

¹⁶ See Schiffbauer et al. (2015), Rijkers et al. (2014), and Diwan et al. (2013) for analyses of the effects of cronyism in the Arab countries.

sector,¹⁷ face greater risks, pay more to get good quality healthcare, education, housing, transport and other basic services. Perceptions that people cannot get ahead by working hard became more prevalent. Young men were especially unhappy as they struggled to find decent jobs and start families.

These grievances were symptoms of the deep structural issues in Arab economies (Devarajan et al. 2015). The authoritarian model of government, prevalent in the developing MENA region prior to the Arab Spring, relied on a social contract, sometimes called the ‘authoritarian bargain’ (Yousef, 2004), which extended benefits such as free public education and health, energy and food subsidies, and guarantees for public employment in exchange for political support. The Arab Spring uprisings exposed the cracks in this model – the large and growing fiscal and external deficits, the weak institutions plagued by corruption, and the high incidence of rent-seeking practices that constrained the growth of the private sector. The capture of large segments of the economy by politically connected firms slowed down reform, innovation, and employment creation. Untargeted energy subsidies benefited not only consumers, but the corporate sector too, draining the fiscal resources of the state and biasing the structure of the economy towards capital-intensive industries. As a result few good jobs were created in the formal sectors (private and SOEs) and insufficient public funds were available for improving the quality of public services, physical infrastructure, and the environment. The old social contract stopped working and the middle class was particularly frustrated.

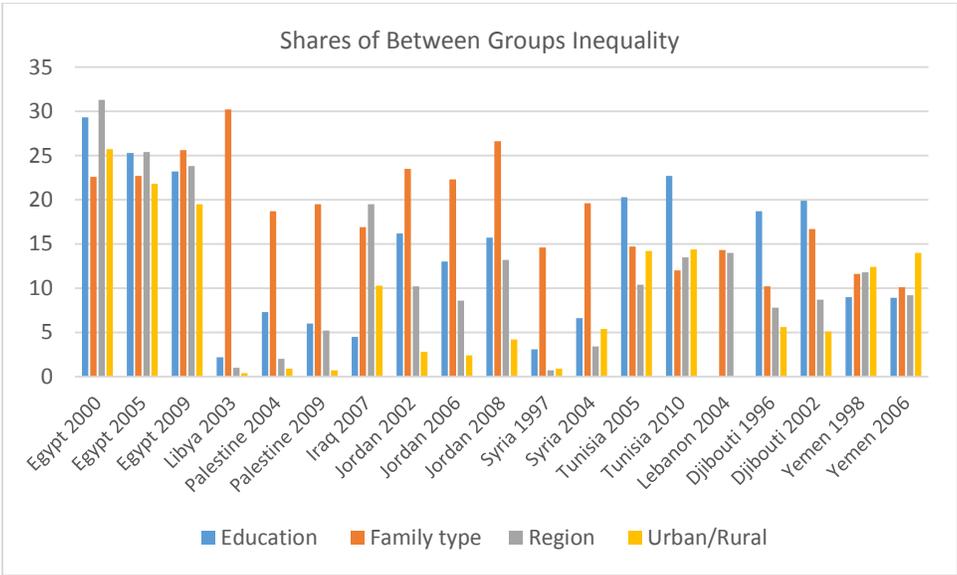
In 2011, the Arab people spoke loud and clear, voicing grievances crucial to their wellbeing. Yet, the Arab uprisings did not deliver the change people hoped for and the situation deteriorated significantly in some countries as uprisings morphed into civil wars. Importantly, many of the factors that made people unhappy before the Arab Spring are still present today. Economic reform stalled during the Arab Spring transitions so the structural impediments of the past have persisted. The civil wars in Syria, Iraq, Libya, and Yemen have erased years of development progress and inflicted wide-spread suffering and displacement on a scale not seen since World War II. In several countries, state services have collapsed and large areas are controlled by terrorist groups. Syria’s case has been most dramatic with hundreds of thousands killed, disabled, and impoverished and millions driven away from their homes and wide spread infrastructure destruction. The costs of the Syrian war and the spread of Daesh have cost the Levant region an estimated \$35 billion in lost output during the 3 year period since mid-2011 (Ianchovichina and Ivanic, 2014).

The reasons behind the civil wars in MENA are complex and go beyond the economic and wellbeing analysis here. However, one can draw valuable insights from ongoing work on

¹⁷ See Angel-Urdinola et al. (2011) for an in-depth discussion of labor market issues and informality in MENA and World Bank (2014) for discussion of these issues in Egypt.

inequality in the Arab world. While expenditure inequality in Arab countries was low to moderate prior to 2011, regional and rural-urban disparities were substantial contributors to overall inequality (Hassine, 2015). Regional differences were most significant in Egypt and Iraq (accounting for 20 percent or more of expenditure inequality) and rural-urban inequality contributed to expenditure inequality the most in Egypt and Tunisia. The contribution of spatial differences declined over time in Egypt, but increased in most developing MENA countries, including Syria, Tunisia, Yemen, and Jordan (Figure 2.17). In Syria, despite the overall increase in average incomes, expenditures of households in Northern Syria lagged behind. Similarly, people located in the Center West of Tunisia, where the Arab Revolts began, saw little improvement of average incomes over time.

Figure 2.17 Decomposition of expenditure inequality by household attributes



Source: Hassine (2014).

The persistence of a regional divide could lead to conflict, as argued by Lipton (1977), especially in low-income countries. According to Kanbur and Venables (2005), regional inequalities tend to be severe and on the rise, although they do not investigate their conflict potential. More recently, Alesina et al. (2012) explore the origins and consequences of between-ethnic inequality across countries by combining satellite images of nighttime luminosity with the historical homelands of ethnolinguistic groups. According to them, it is ethnic inequality, not spatial inequality per se or ethnic fractionalization, which has a significant and negative association with socioeconomic development, although naturally ethnic inequality is positively correlated with spatial inequality (Figure 2.18). In their view, ethnic inequality hampers development by generating hatred and envy, barriers to social mobility, a sense of unfairness, and in many cases, conflict.

The data in Alesina et al. (2015) show that in nearly all Arab Spring countries, and those where civil wars erupted (Syria, and Iraq), ethnic inequality was high. It was high relative to ethnic inequality elsewhere and relative to their own spatial inequality. By contrast, Saudi Arabia, Oman, Bahrain, and United Arab Emirates stand out with low ethnic inequality relative to other countries and relative to their own spatial inequality. In Jordan and Morocco, ethnic inequality is moderate and in line with the extent of spatial inequality in their economies. Worldwide, conflict-torn Sudan and Afghanistan have the highest degree of ethnic inequality, while the U.S. and Canada rank highest in terms of spatial inequality.

The case study literature offers many examples of an association between conflict and 'horizontal inequality' or inequality that coincides with ethnic, religious, or sectarian cleavages. Deprivation along ethnic, religious, and sectarian lines may enhance group grievances and thus facilitate mobilization for conflict (Stewart 2000, 2002). One of the few cross-country studies by Ostby (2008) found support for Stewart's case studies by systematically testing ethnically based horizontal inequalities across several developing countries. In a subsequent study, Ostby et al. (2009) apply GIS techniques to Demographic and Health Surveys to construct new disaggregated data on welfare and socioeconomic inequalities between and within subnational regions in 22 Sub-Saharan African countries and combine these data with geographical data on the location of conflict zones for the period 1986-2004. They find that the onset of conflict is more likely in regions with (1) low levels of education; (2) strong relative deprivation regarding household assets; (3) strong intra-regional inequalities; and (4) combined presence of natural resources and relative deprivation. The findings in this study provide support to the hypothesis that ethnic inequality matters for conflict and are consistent with Esteban and Ray's (2007) theory that increase in intragroup inequality will give more resources to the elites and at the same time decrease the cost of mobilizing the poor.

These findings are helpful in making sense of the situation in developing MENA after the Arab Spring where the probability of conflict has been much higher than in the rest of the world (Abu Bader and Ianchovichina, 2015). New research by Kiendrebeogo and Ianchovichina (2015) provides evidence that within MENA the incidence of people who think that it is morally justified to resort to extreme violence and target civilians is on the rise, although such views are also found elsewhere in the world. The risks of having such extreme views is higher among the youth, those who struggle in life, have limited freedom to make decisions about their life and are willing to sacrifice their life for an idea. Diab (2015) draws attention not only to the significance of grievances but also to dormant traumas that can be awakened and used as a tool to motivate ethnic hatred and conflict. Empirical evidence suggests that grievances alone do not lead to civil wars (Collier and Hoeffler, 2004). However, grievance-motivated uprisings can turn into civil wars if groups, which may organize along ethnic or sectarian lines, use shared traumas and grievances (past or present) to obtain public support among parts of the broader population and financing for their operation. Availability of external funding sources, natural resources, and illegal activities increase the payoff of conflict, raising its stakes and therefore its intensity.

In conclusion, the Arab Spring revolutions were triggered by growing and shared dissatisfaction with the quality of life rather than with high and rising expenditure inequality. The middle classes were particularly frustrated as their standards of living were deteriorating, reflecting shortage of formal sector jobs, the dissatisfaction with the quality of public services and government accountability. Ordinary people were unhappy that they could not share in the prosperity generated by the relatively few, large Arab firms and struggled to get ahead by working hard. Reflecting diminishing marginal utility, subsidies could not compensate for all these problems: subsidies mattered less for the subjective wellbeing of the middle 40 percent (M40) than they did for the subjective wellbeing of the bottom 40 percent. The old social contract of redistribution with limited voice stopped working for the M40, who wanted a say and real opportunities.

The spread of extreme violence in post-Arab Spring MENA appears to be linked to high inter-group inequality rather than economic inequality per se. Although grievances alone do not lead to civil wars, grievance-motivated protests and uprising can grow into civil wars if groups organized along sectarian and/or ethnic lines use the grievances to gain public support. In such highly polarized societies, the presence of natural resources and a high proportion of unemployed young men further increase the risks of conflict. Post-Arab Spring MENA seemed primed to fall into disarray.

Appendix Table 2.1 Poverty statistics (PPP \$1.25 per day)

Country	Survey year	Mean (\$)	Headcount (%)	Pov. gap (%)	Squared pov. gap	Watts index	Gini index	MLD index	Population (mil.)
Egypt, Arab Rep.	2008	114.02	1.69	0.38	0.18	0	30.77	0.16	78.32
	2004	112.51	1.99	0.39	0.16	0	32.14	0.18	72.84
	1999	112.19	1.81	0.32	0.11	0	32.76	0.18	66.46
	1995	97.84	2.46	0.34	0.09	0	30.13	0.15	62.06
	1990	100.88	4.46	0.6	0.14	0.01	32	0.17	56.84
Iran, Islamic Rep.	2005	197.67	1.45	0.34	0.16	0	38.28	0.25	69.73
	1998	251.94	1.26	0.19	0.05	0	44.1	0.33	63.13
	1994	233.61	1.42	0.28	0.1	0	43	0.31	58.81
	1990	202.44	3.85	0.97	0.42	0.01	43.6	0.33	54.87
	1986	226.84	4.19	0.9	0.32	0.01	47.42	0.39	48.26
Jordan	2010	224.99	0.12	0.03	0.01	0	35.43	0.21	6.05
	2008	199.52	0.07	0.01	0	0	33.82	0.19	5.79
	2006	210.02	0.38	0.1	0.05	0	37.72	0.24	5.54
	2002	175.55	1.16	0.16	0.04	0	38.87	0.25	5.04
	1997	151.56	1.51	0.31	0.13	0	36.42	0.22	4.46
	1992	174.15	2.77	0.5	0.16	0.01	43.36	0.32	3.73
	1986	221.54	n/a	n/a	n/a	n/a	36.06	0.21	2.74
Morocco	2007	161.17	2.52	0.54	0.22	0.01	40.88	0.29	31.01
	2000	133.66	6.25	0.94	0.22	0.01	40.63	0.27	28.79
	1998	129.78	6.76	1.15	0.31	0.01	39.46	0.26	28.08
	1990	155.43	2.45	0.35	0.09	0	39.2	0.25	24.78
	1984	112.9	10.29	2.11	0.59	0.02	39.19	0.27	21.75
Tunisia	2010	230.52	1.06	0.4	0.31	0	36.06	0.22	10.55
	2005	217.87	1.35	0.28	0.11	0	41.42	0.29	10.03
	2000	182.41	2.55	0.46	0.15	0.01	40.81	0.28	9.56
	1995	154.12	6.48	1.33	0.43	0.02	41.66	0.29	8.96
	1990	151.28	5.87	1.37	0.54	0.02	40.24	0.28	8.15
	1985	140.63	8.65	1.92	0.67	0.02	43.43	0.32	7.26
West Bank and Gaza	2009	306.33	0.04	0.01	0.01	0	35.5	0.21	4.04
	2007	272.36	0.4	0.12	0.07	0	38.65	0.25	3.83
Yemen, Rep.	2005	84.02	17.53	4.18	1.61	0.06	37.69	0.24	20.65
	1998	90.34	12.88	3	1.11	0.04	33.44	0.19	16.72
Algeria	1995	120.12	6.79	1.36	0.45	0.02	35.33	0.21	28.29
	1988	126.04	7.56	1.16	0.24	0.02	40.19	0.28	24.04
Djibouti	2002	93.5	18.84	5.29	2.19	0.07	39.96	0.27	0.77
Iraq	2006	109.33	2.82	0.42	0.12	0	30.86	0.16	28.43

Source: World Bank PovCal.

Country Notes

Algeria

Macroeconomic balances are deteriorating due to low oil and gas prices. The fall in oil and gas prices since mid-2014 has reduced export earnings and government revenues such that the current account and fiscal deficits are expected to widen in 2015 to around 15 percent and 11.5 percent of GDP, respectively. A poor wheat harvest and a 20 percent depreciation of the dinar since mid-2014 has put pressure on domestic prices and inflation is expected to rise to 5.1 percent this year. While the fiscal stance remains expansionary, growth is projected to slow to 2.8 percent in 2015.

The draft 2016 budget law contains some fiscal adjustment measures. The draft law proposes hikes in VAT applied to gasoil, increases in Customs tax rates applied to luxury goods and IT equipment, cuts in utility subsidies (electricity, gas and oil), and additional 10 percent cuts in other budgeted outlays. The draft also opens the door to the possibility of external borrowing. At the same time, Government has reiterated that budget cuts will not affect public services and the planned US\$223 billion investment program for 2015-19 will be fully executed.

Assuming a slight recovery of oil prices, growth should rise in 2016 but reserves will continue to decline. With the average oil price projected in the US\$60-65 range in 2016-2017, GDP growth may recover to around 3.9 percent. However, the 2016 current account and fiscal deficits are expected to remain high at 13.8 percent of GDP and 9.4 percent of GDP, respectively, and will be financed mostly by drawdowns from the oil fund. Between 2015 and 2016, international reserves and oil fund assets are projected to decline from 24 to 19 months of imports, and from 21 to 13 percent of GDP, respectively.

Structural impediments constrain economic dynamism. Besides reducing growth in public spending, key structural challenges include boosting production of oil and gas by encouraging foreign direct investment, reducing fuel subsidies, reforming the business climate and diversifying exports to reduce vulnerability to prolonged low oil prices. The volume of oil and gas exports has declined by 40 percent since 2005 due to aging conventional plants, lack of adequate (foreign) investment in upstream exploration, and rapid growth in domestic consumption of petroleum products. Rising consumption of petroleum products is mainly driven by extremely low domestic fuel prices. Algeria ranks 153rd among 185 countries in the Doing Business ranking. Oil and gas still represent about 97 percent of total exports.

There are several downside risks to the present outlook. Key economic risks include an extended decline in energy prices and further weakness in European growth. On the political side, internal social pressures could mount with adjustment measures and high youth unemployment. In addition, security risks arise from the active presence of radical factions and the threat they pose to oil operations in Algeria.

Key Economic Indicators

	2014e	2015f	2016f
Real GDP Growth (Percent)	4.3	2.8	3.9
Inflation Rate (Percent)	2.9	5.1	5.0
Fiscal Balance (Percent of GDP)	-5.9	-11.5	-9.4
Current Account Balance (Percent of GDP)	-4.2	-15.0	-13.8

Bahrain

Bahrain's growth momentum has slowed. The economy grew by 4.8 percent in 2014, down from 5.3 percent in 2013, reflecting a slowdown in the hydrocarbon sector and weak investment sentiment. Hydrocarbon GDP growth fell from 15.3 percent in 2013 to 3 percent in 2014. Near term prospects are even weaker and the economy is only expected to grow by 2.7 percent during 2015.

Macroeconomic balances have worsened. In the wake of the global financial crisis and political unrest, the government had been increasing subsidies and public sector wages and running modest fiscal deficits since 2009. The sharp drop in oil prices since mid-2014, however, has enlarged the fiscal deficit sharply, to 5.7 percent of GDP in 2014 and an expected 9.9 percent in 2015. The public debt to GDP ratio is expected to jump to 54 percent in 2015 and climb further to 60 percent by 2017. The current account balance is also on a declining trend and is expected to turn negative (at -2.1 percent of GDP) in 2015. In mid-February, S&P downgraded Bahrain to BBB- with a negative outlook due to the anticipated impact of low oil prices.

Some fiscal consolidation measures have been taken recently. Protests in parliament led the government to back down from implementing a 20 percent hike in diesel prices in 2014. Recently, however, the National Commission for Oil and Gas announced an increase and unification of natural gas prices for industrial users at US\$2.5 per million BTUs beginning April 2015. It plans to increase the price gradually to reach US\$4 in 2017. Fees for primary health care services have been increased in the budget for 2015.

Slow growth is projected for the medium term. Real GDP growth is projected to decline to 2.7 and 2.4 percent in 2015 and 2016 respectively, reflecting flat oil production and the resulting slowdown in public and private consumption. Owing to maintenance work, production at the Abu Saafa oilfield is expected to drop to 145,000 barrels/day in 2015. Future growth will come from an oil-refining upgrade (completion date pushed to 2018), the construction of a new aluminum plant starting in 2016, the expansion of the Bahrain International Airport, the completion of some retail projects, and GCC Development Fund projects, especially social housing. In addition, growth is expected to benefit from the financing committed by the wealthier GCC countries of up to USD10 billion over 10 years. Average inflation is expected to decline to 1.3 percent in 2015 and 2016, as global food prices drop, the US dollar strengthens and domestic demand weakens.

Key Economic Indicators

	2014e	2015f	2016f
Real GDP Growth (Percent)	4.8	2.7	2.4
Inflation Rate (Percent)	2.5	1.3	1.3
Fiscal Balance (Percent of GDP)	-5.7	-9.9	-6.1
Current Account Balance (Percent of GDP)	5.3	-2.1	-0.7

Djibouti

Economic conditions are currently strong. The economy is expected to grow by 6.5 percent in 2015, up from 6 percent in 2014. Djibouti owes its strong growth momentum in recent years to the surge in public and private investment in ports, the construction of a railway to Ethiopia and the construction of a major water pipeline. The external deficit is expected to stay roughly the same as in the previous year while the fiscal deficit is estimated to rise from 12 percent of GDP in 2014 to 14 percent in 2015.

Recent public investment projects carry medium term debt sustainability risks. Two large non-concessional loans were secured in recent years, equivalent to 60 percent of GDP, to finance infrastructure projects of railway and water pipelines to Ethiopia. As loan disbursement is completed in 2018 the debt stock will amount to 82 percent of GDP and repayment will begin to burden the fiscal accounts. Although the construction of the railway is underway, delays in sub-project implementation and the lack of clear institutional arrangements for managing the project remain critical downside risks that will lower growth prospects and possibly cost the budget. Moreover, as most activities supporting growth are expected to be tax-exempt, growth will not be accompanied by a significant increase in fiscal revenues. Hence, domestic revenues will fall as a percentage of GDP in 2016–19 compared with 2013–15.

The medium-term outlook is favorable but significant risks persist. Aggregate investment is estimated to rise to about 55 percent of GDP in 2015 from 48 percent in 2014 and public investment to 27.1 percent of GDP in 2015 from 20.7 percent in 2014. This should support growth of around 7 percent in 2016-17. Risks to growth and macroeconomic stability have risen; they include delays in the construction and efficient management of the new infrastructures, adverse economic events in Ethiopia, or security developments in neighboring countries, or in the Red Sea, and domestic social and political instability.

Political tensions are expected to increase as the campaign for presidential elections accelerates. President Guelleh is likely to run for a fourth term in elections scheduled for early 2016 in a context marked by political unrest persisting from the disputed parliamentary elections of 2013. In late 2014 the ruling party and the coalition of opposition parties announced they had reached an accord for the return of the opposition to parliament and political reforms including steps to ensure the organization of fair elections. Progress towards the implementation of these reforms has been limited.

Key Economic Indicators

	2014e	2015f	2016f
Real GDP Growth (Percent)	6.0	6.5	7.0
Inflation Rate (Percent)	3.0	3.0	3.5
Fiscal Balance (Percent of GDP)	-12.0	-14.1	-12.5
Current Account Balance (Percent of GDP)	-27.4	-27.7	-21.8

Egypt

Economic and political conditions are improving but retain traces of fragility. Growth during the first nine months of FY15 averaged 4.7 percent, triple its pace in the same period last year. The unemployment rate reversed course and inched downwards, reaching 12.7 percent in March 2015, compared to 13.4 percent a year earlier, but remains 4 percentage points higher than its level in FY10. At the same time, foreign exchange shortages have constrained imports including those used as inputs for production and exports. Headline inflation has been high at 11 percent in FY15. The political scene is much more stable than had been the case during 2011-2014 but sporadic terrorist attacks continue against military, policy, and judiciary targets.

Egypt's fiscal position has improved but remains unsustainable. The overall budget deficit is expected to decline to 11.5 percent of GDP in FY15, compared to 12.8 percent in FY14. This is a notable achievement since the FY14 fiscal position was helped by exceptional windfall receipts worth 4.8 percent of GDP (mainly financing from the Gulf and the liquidation of government deposits held at the Central Bank of Egypt (CBE). The improvement is due to such measures as: energy subsidies reform, containment of civil servants' wage bill growth (after four years of upsurge), and introduction of new taxes. The FY16 budget, ratified in June 2015, continues with similar consolidation efforts, though steps to introduce a VAT and adjust fuel products prices are still pending.

The external position remained under pressure in 2015. Though there were notable inflows from Gulf governments in the form of deposits held at the Central Bank of Egypt, they were partly offset by outflows due to repayments of debt to Qatar and of arrears to foreign oil companies. The external position benefited from a pick-up in net FDI inflows, an uptick in tourism, and the issuance of a US\$1.5 billion Eurobond. Net international reserves reached US\$18.1 billion in August 2015, US\$1.3 billion higher than a year earlier. Despite the gradual devaluation of the official exchange rate, a parallel market persisted though with only a narrow premium of 1.5-2 percent above the official rate in September 2015.

Egypt's main challenge is to sustain the economic recovery. This requires improving private sector access to foreign exchange and energy supplies while addressing the risk of policy slippage and delay. Government also faces the dual challenge of scaling up public infrastructure and social expenditures while reducing the overall fiscal deficit. This requires sustaining the pace of reforms while adopting pro-growth measures such as cutting wasteful expenditures, reallocating fiscal savings towards productive spending, and building efficient and well-targeted safety nets. Finally, there is significant uncertainty regarding the financing of announced mega-projects and the potential liabilities that may arise.

Key Economic Indicators

	2014e	2015f	2016f
Real GDP Growth (Percent)	2.2	4.2	4.6
Inflation Rate (Percent)	10.1	11.0	10.5
Fiscal Balance (Percent of GDP)	-12.8	-11.5	-10.5
Current Account Balance (Percent of GDP)	-0.8	-3.7	-3.3

Iran

A nuclear deal was negotiated in July and has since been ratified by several bodies. On July 14 2015, the P5+1 group (China, France, Germany, Russia, United Kingdom and United States) and Iran announced they had reached a Joint Comprehensive Plan of Action (JCPOA) relating to Iran's nuclear program. The UN Security Council met on July 20, 2015 and voted unanimously to endorse the JCPOA. The European Union approved the JCPOA on the same date. It also now appears that the agreement will not be blocked by the US Congress. Implementation of the JCPOA will involve lifting of all UN Security Council sanctions as well as multilateral and national sanctions related to Iran's nuclear program. The final adoption and implementation of the JCPOA could lead to the lifting of sanctions on Iran by the first quarter of 2016 thereby improving Iran's access to trade, technology and finance.

Following two years of recession, the economy recovered during Iranian FY2014 (March 2014-March 2015). Despite the sharp drop in the price of oil, Iran's main export, the economy expanded by 4.3 percent in 2014, after contracting by 6.6 percent and 1.9 percent in 2012 and 2013, respectively. This was due to the confidence-boosting impact of a new government (elected in July 2013), the initiation of talks to get a nuclear agreement, and the partial lifting of some sanctions in advance of a full agreement. As of August, 2015, the official and parallel market exchange rates were trading just 13 percent apart as compared to a gap of roughly 190 percent in the second quarter of 2012 when sanctions were tightened. The inflation rate declined from 45.1 percent in 2012 to 15.6 percent in June 2015.

The fiscal and external positions are sound despite the collapse in oil prices. The deficit of the central government was 1.2 percent of GDP in 2014, which represents a marginal deterioration compared to the deficit of 0.9 percent of GDP recorded in 2013. Government revenue rose by 21.1 percent to reach 14.6 percent of GDP in 2014. Meanwhile, as the value of oil exports declined, the current account surplus deteriorated from a surplus of 6.0 percent of GDP in 2013 to 3.8 percent in 2014. Foreign exchange reserves are estimated at US\$126.5 billion in 2014, which was equivalent to 18 months of imports.

The medium-term outlook is positive though risks remain from oil prices and geopolitical considerations. While growth will slow to 1.7 percent in 2015 due to low oil prices it is expected to soar to 6.1 percent in 2016 as the confidence-boosting effects of a successful nuclear agreement kick in. Much of the fillip to growth will come from increased oil production (rising to 3.6 million barrels per day in 2016) and from increased foreign and domestic investment. At the same time, the ongoing conflicts in Syria and Iraq will also determine how economic prospects change as will the pace of implementation of the JCPOA.

Key Economic Indicators

	2014e	2015f	2016f
Real GDP Growth (Percent)	4.3	1.7	6.1
Inflation Rate (Percent)	15.6	15.0	12.5
Fiscal Balance (Percent of GDP)	-1.2	-2.6	-1.5
Current Account Balance (Percent of GDP)	3.8	-0.3	0.8

Iraq

Economic conditions are poor due to low oil prices and the ongoing civil war. During 2014 and so far in 2015, Iraq has been affected adversely both by the state of war with Islamic State (IS) forces and the sharp decline in the price of oil, the country's main source of exports and revenues. Real GDP contracted by 2.4 percent in 2014 and is projected to expand only by 0.5 percent in 2015. Non-oil sectors of the economy were also affected by the prevailing insecurity which has caused the destruction of infrastructure, impeded access to fuel and electricity, destroyed business confidence, and disrupted internal trade and transport. The non-oil economy contracted by 7 percent in 2014 and is estimated to decline by an additional 7 percent in 2015. The one bright spot in the economy is the rise in oil production to 3.45 million barrels per day, mostly from southern oil fields.

Macroeconomic balances worsened in 2014 and 2015. The current account balance, which was in surplus in 2013, fell into a deficit in 2014 that is expected to widen to about 8.9 percent of GDP in 2015. Despite increasing production, revenues from oil exports are estimated to decline from US\$83 billion in 2014 to US\$63 billion in 2015. At the same time, imports have expanded in 2015 in part reflecting capital goods needed to expand oil production, but also because of the surge in government spending including security-related imports to combat IS. On the fiscal side, the deficit reached 5.3 percent of GDP in 2014 and is expected to soar to 16.2 percent of GDP in 2015. To contain the projected 2015 deficit, the authorities appear to be counting on under-utilization of the investment budget and external borrowing.

Near term economic prospects remain subject to major risks. Under the assumption of a modest recovery in oil prices, a significant ramp up of oil production, and a reduction in the disruptive impact of the war with IS, the economy is projected to grow by 3.1 percent in 2016. However, these prospects are subject to significant risks. On the external side, a weaker than projected global growth or higher than-expected supply of oil into the global market could put downward pressure on global oil prices. On the domestic side, the ongoing war with IS and other political tensions could take a turn for the worse which would have an adverse impact on the economy.

Iraq continues to grapple with problems of displacement and poverty. As a result of the ongoing conflict with the IS, 18,853 Iraqis died and 23,126 were injured in 2014. In addition, 3.2 million persons are considered to have become internally displaced as a third of Iraq's territory has been captured by the IS. The Kurdistan region has received a large influx of refugees fleeing Syria's civil war as well. Poverty in Iraq reached 22.5 percent in 2014 and is as high as 40 percent among displaced persons.

Key Economic Indicators

	2014e	2015f	2016f
Real GDP Growth (Percent)	-2.4	0.5	3.1
Inflation Rate (Percent)	2.2	3.0	3.0
Fiscal Balance (Percent of GDP)	-5.3	-16.2	-9.2
Current Account Balance (Percent of GDP)	-2.9	-7.3	-4.7

Jordan

After four years of gradual recovery, Jordan's economy is expected to slow down in 2015. This is mostly due to the effects of security spillovers from regional conflicts and include total trade route closures with Syria and Iraq. With over 628,000 registered Syrian refugees, Jordan grapples with a range of development challenges including a worsening labor market (average unemployment rate in the first half of 2015 (H1-15) reaching 12.5 percent compared to 11.4 percent in H1-14 with labor force participation rates concurrently increasing by 0.7 bps to 36.8 percent in H1-15). Inflation remains subdued, partly because of falling commodity prices and partly because of restrained public spending.

A modest recovery to 3.1 percent real growth in 2014 was unexpectedly cut short in Q1 2015. The slowdown to 2.0 percent growth in Q1-2015 (the slowest since Q3-2010) was led by a contraction in construction and 'hotels and restaurants' by 3.4 percent and 6.0 percent respectively, while growth was spurred largely by 'mining and quarrying' and agriculture. Private demand led growth from the demand side followed by a narrower trade deficit with public investment and government consumption negative contributors to growth (in real terms). Real GDP growth is projected at 2.5 percent in 2015, 100bps below the previous forecast, dragged down by Q1's events.

Fiscal and current account deficits have been well contained. The fiscal deficit has been improving in 2015, driven largely by lower expenditures. It is now projected to narrow to 4.1 percent by end-2015 including grants. The final review of Jordan's Stand-By Arrangement with the IMF was completed successfully, disbursing close to US\$ 400 million in July 2015. The current account deficit is expected to reach 7.1 percent of GDP by the end of 2015 which is not very different from the end-2014 figure of 6.8 percent. By end-May travel receipts were 14.8 percent, exports in goods 10.9 percent, and imports of energy goods 42.5 percent, all lower compared to the first five months of 2014.

Jordan's main challenge continues to be the management of security spillovers from Syria and Iraq. The baseline assumes that Q1-2015 events were largely a one-off occurrence except for lingering effects on trade. Downside risks include the exacerbation of regional conflicts as well as a substantial increase in oil prices which would reverse the current positive impact on the macroeconomy. Structural reforms related to energy diversification and the business climate bode well for medium-term growth.

Key Economic Indicators

	2014	2015f	2016f
Real GDP Growth (Percent)	3.1	2.5	3.7
Inflation Rate (Percent)	2.9	-0.1	2.9
Fiscal Balance Including Grants (Percent of GDP)	-9.1	-4.1	-2.8
Current Account Balance (Percent of GDP)	-6.8	-7.1	-6.8

Kuwait

GDP growth has slowed sharply in recent years. Since the oil sector is Kuwait's main growth engine, the collapse in oil prices in mid-2014 resulted in a collapse of GDP growth to 0.1 percent in 2014. Hydrocarbon GDP declined by 2 percent due to an ongoing dispute with Saudi Arabia and closure of a neutral zone oilfield with Saudi Arabia, as well as plummeting oil prices. The non-oil sector has grown at a faster pace of 3.5 percent because a combination of increased domestic consumption and some pickup in government capital spending and private investment.

Macroeconomic balances have worsened but Kuwait's fiscal position remains comfortable due to its high financial buffers. The fiscal surplus fell to 17.2 percent of GDP in 2014 from 34.2 percent of GDP in 2013, owing to lower oil revenues and higher spending. Financial buffers are estimated to be at 320 percent of GDP in 2014. International reserve assets are at a comfortable level of 8 months of imports (US\$33.2 billion). The current account surplus also fell to 31.9 percent of GDP in 2014 from 41.2 percent in 2013.

Government has begun implementing measures to contain current spending. In early 2015, the cabinet increased diesel and kerosene prices from 55 fils per liter to 170 fils per liter and reduced subsidies on aviation fuel (with potential saving of 0.5 percent of GDP). Also, some allowances for Kuwaitis travelling for healthcare abroad have been rationalized. A proposal is also being prepared to reduce subsidies for electricity that could generate revenues of about 1 percent of GDP each year and a reduction in usage by 20 percent. The introduction of a VAT and an increase in land rental fees are also being considered.

The near-term economic outlook is positive though with some downside risks. GDP growth is estimated to be around 1.2 percent in 2015 but to rise to 2.5 and 2.7 percent thereafter (2016-17). Infrastructure projects are expected to support non-hydrocarbon growth over the forecast period. The key projects include the modernizing of existing refineries, a new refinery, metro, airport expansion, causeway, seaport, and national railroad. Oil production is expected to remain flat at about 3 million barrels per day in 2015 and thereafter to increase by 2 percent per year as investments are made to enhance crude capacity. Inflation is projected to increase to 3.3 percent in 2015 as fuel subsidies are reduced. Downside risks to this scenario arise from slow implementation of public investment projects, the minimalistic approach to reducing the public sector wage bill, subsidies and transfers, a further decline in oil prices due to the removal of sanctions on Iran, and regional and domestic political tensions.

Key Economic Indicators

	2014e	2015f	2016f
Real GDP Growth (Percent)	0.1	1.2	2.5
Inflation Rate (Percent)	2.9	3.3	3.3
Fiscal Balance (Percent of GDP)	17.2	7.2	7.6
Current Account Balance (Percent of GDP)	31.9	12.9	13.8

Lebanon

Creeping political paralysis has rendered government ineffective. While public services related to electricity and water supply have long been in a state of partial collapse, the extent of government dysfunction was highlighted recently by a garbage crisis. Piles of garbage have been left uncollected on the streets, leading to sizable popular protests and demonstrations. Meanwhile, there has been no let-up in the pressure of refugees from the Syrian conflict; more than 1.2 million have been registered by the UNHCR, making Lebanon the largest host of Syrian refugees (in proportion to the population).

Economic activity continues to tick along at a modest pace despite the political dysfunctionality. Growth has been driven by a resurgent tourism sector and robust private lending as the Banque du Liban renewed its stimulus package in the amount of \$1 billion this year. In the first half of 2015, tourist arrivals rose by 16.4 percent, while lending to the private sector expanded by about 8 percent. On the other hand, the real estate sector has acted as a drag on growth, with construction permits and cement deliveries contracting by about 20 percent. Overall, growth is likely to remain at around 2 percent this year, unchanged from last year's pace.

The decline in oil prices has had net positive effects on the Lebanese economy. Fiscally, lower transfers to the state-owned Electricity du Liban are expected to help maintain a primary surplus in 2015. This is despite a small projected rise of 0.6 percentage points in the overall fiscal deficit to 7.2 percent of GDP due primarily to lack of the one-off revenue measures that boosted revenues in 2014. Externally, lower oil prices are expected to induce a 5 point narrowing of the current account deficit, which will nevertheless remain elevated at a forecast 21 percent of GDP.

Near term prospects are mixed. On the positive side, oil prices are expected to stay low and this will help avoid more pressure on the fiscal and current accounts which are already in strain. Overall, we expect real GDP to grow by 2 percent in 2015. On the negative side, it is hard to predict how regional turmoil will evolve beyond Lebanon's borders. Furthermore, with reasonable prospects for an increase in US interest rates this year, Lebanon is likely to follow suit and raise domestic interest rates to maintain the margin on USD and LBP deposits locally. This will reduce lending to the private sector and raise Lebanon's debt service costs, as new debt will need to be contracted at higher interest rates given the short average debt maturity of the current portfolio and the ongoing large gross financing needs

Key Economic Indicators

	2014e	2015f	2016f
Real GDP Growth (Percent)	2.0	2.0	2.5
Inflation Rate (Percent)	1.2	0.2	2.5
Fiscal Balance (Percent of GDP)	-6.6	-7.2	-7.0
Current Account Balance (Percent of GDP)	-26.7	-21.1	-21.9

Libya

The economy picked up modestly in 2015 despite political deadlock and disruptions to the oil sector.

Libya continues to have two rival political authorities in different parts of the country in a state of high tension. And its main oil fields, export terminals, and pipelines continue to be affected by strikes, security breaches, and technical problems. Nevertheless, oil production increased in 2015, after declining sharply in 2013-14, and is now running at an average 0.41 million barrels per day (which is only one fourth of the capacity of 1.6 million barrel per day (bpd). As a result, GDP is expected to rise by 2.9 percent in 2015, following a drop of 24 percent in 2014.

The fiscal deficit has risen dramatically. Currently, the country has two budgets, one adopted by each of the two parties to the conflict. So overall fiscal numbers have to be estimated from a variety of sources. These suggest that tax revenues may drop by 38.5 percent in 2015 mostly due to lower oil tax revenues. At the same time, wages and subsidies are also expected to decline in 2015. The wage bill will drop by 20 percent due to the use of the Personal Identification Number by the Central Bank for the payment of public employee salaries, while subsidies will be cut by 18 percent thanks to lower world commodity prices and better control of distribution networks. Nevertheless, because of the large drop in revenues, the fiscal deficit is expected to climb to just over 55 percent of GDP in 2015, up from an already high 43 percent of GDP in 2014.

The current account deficit has also risen dramatically. Oil exports slid from 61 billion dollars in 2012 to 18 billion in 2014 and further to 11 billion in 2015. This slide has converted what was a comfortable current account surplus of 29 percent of GDP in 2012 to a large deficit of 69 percent of GDP in 2015. To finance these deficits, the Central Bank drew US\$25 billion from its foreign reserves in 2014, and is expected to draw an additional US\$28 billion by end 2015. Foreign reserves are being depleted rapidly to an estimated US\$55 billion by end 2015 (down from US\$107.6 billion in 2013).

Near term prospects are highly dependent on how the political situation evolves. At the moment, the country is divided between rival armed groups. Until this internal conflict is resolved, a return to normal economic activity based on the country's enormous oil potential is not possible. Once that happens, we expect rapid economic growth. On the assumption that oil production triples to 1.2 million bpd next year, we can envisage an economic growth rate of close to 35 percent in 2016 tapering to 16.6 percent in 2017. Oil production at this level will bring down the fiscal and current account deficits rapidly.

Key Economic Indicators

	2014e	2015f	2016f
Real GDP Growth (Percent)	-24.0	2.9	34.8
Inflation Rate (Percent)	2.4	6.0	3.0
Fiscal Balance (Percent of GDP)	-43.3	-55.2	6.5
Current Account Balance (Percent of GDP)	-49.9	-69.3	-18.9

Morocco

After mixed performance in 2014, the Moroccan economy is picking up in 2015. Thanks to an exceptional 2014/2015 rainfall season, agricultural GDP is projected to increase by 14 percent and overall GDP growth to reach 4.7 percent in 2015. Inflation has been kept under 2 percent reflecting the continued prudent monetary policy and fall in international commodity prices. The overall unemployment rate declined to 9.3 percent by the end of July 2015.

Macroeconomic balances improved due to policy measures. Measures to reduce fuel subsidies and trim certain other expenditures will allow Morocco to reduce its fiscal deficit to 4.6 percent of GDP in 2015, the third decline in a row. Improvements on the external front have been more spectacular. The current account deficit, which had risen to 10 percent of GDP in 2012, was reduced to 4.6 percent of GDP in the first half of 2015. This reflected the combination of lower imports, as a result of the sharp fall in international oil prices, and higher exports from the “new” industries (automobile, aeronautics, and electronics) as well as from the agro-industrial sector. On the capital account side, financial inflows have been buoyed by relatively high FDI, support from the Gulf Cooperation Council (GCC), and financial assistance from development partners, including the World Bank Group.

Morocco’s near term economic outlook hinges on the pursuit of sound macroeconomic and structural policies. With a return to more normal rainfall conditions in 2015/2016, GDP growth is projected to slow to less than 2.7 percent in 2016. The 2016 Finance Law currently under preparation should confirm the authorities’ resolution to further trim expenditures and raise revenues and reduce the deficit to 3.7 percent of GDP. To improve further the investment climate, the Government announced its intention to proceed with justice reform, improve access to financing, especially for SMEs, and address access to land constraints. Assuming full implementation of these reforms, including the critical reform of the civil pension system, growth should exceed 4 percent over the medium term.

Morocco’s external position is also expected to strengthen over the medium term. The emergence of new growth drivers in higher value-added export industries (such as car manufacturing and aeronautics) and the expansion of Moroccan companies in Western Africa are potentially creating the conditions for Morocco to become a regional hub for trade and investment between Europe and Sub-Saharan Africa. External financing requirements constitute a moderate concern in the medium term, given the relatively low external debt, financial support from the GCC countries, and Morocco’s investment grade ratings on international markets. In July 2015, Morocco’s completed its second review under the IMF’s Precautionary and Liquidity Line (PLL), which will continue to serve as insurance against external shocks until mid-2016.

Key Economic Indicators

	2014e	2015f	2016f
Real GDP Growth (Percent)	2.6	4.7	2.7
Inflation Rate (Percent)	0.4	1.1	1.3
Fiscal Balance (Percent of GDP)	-4.9	-4.6	-3.7
Current Account Balance (Percent of GDP)	-5.9	-4.8	-4.5

Oman

Growth momentum is slowing. While 2014 saw real GDP growth of 4.1 percent, the momentum is expected to slow to 3.7 percent in 2015 and further to 3.2 percent in 2016. Oil production was at a medium-term peak of around 0.9 million barrels per day in 2014 though hydrocarbon GDP growth dropped to 0.4 percent because of the collapse in oil prices after mid-2014.

Macroeconomic balances are worsening. Spending initiatives (including public sector wage enhancements) and declining oil revenues led to a fiscal deficit of 1.5 percent of GDP in 2014; this is expected to jump to -12.9 percent of GDP in 2015 and to stay at elevated levels for several more years. The current account surplus dropped to 2.4 percent of GDP in 2014 from 9.2 percent in 2013 and is expected to go into a deficit of 1.8 percent in 2015 and widen further to -9.6 percent in 2016 as export earnings decline due to low oil prices. Deteriorating macroeconomic balances are becoming a major source of risk for economic performance and may put pressure on the currency as well.

The need for fiscal and structural reform is acknowledged by Government. Among fiscal reforms being considered are measures such as cost-reflective electricity tariffs for industrial and commercial users; increasing the price of diesel; increasing the corporate tax base, labor permits fees and excise duties; and introducing property taxes and VAT. Recent reforms undertaken include the privatization of minority stakes in Omantel and the doubling of the price of gas for industrial users in 2015. Meanwhile, some structural issues are being addressed through strategies to improve education, housing and social infrastructure as well as enhance the access of SMEs' to finance. The government is also amending the Labor Law to deal with issues related to dispute resolution and working conditions in the private sector and for women.

Medium term prospects are highly vulnerable to oil prices and the government's spending. As already noted, fiscal and current account balances are fast deteriorating as a result of low oil prices and high government spending. Government has plans to issue an Islamic bond in international debt markets and there has been talk as well of a contingency budget with spending cuts and non-oil revenues. The US-nuclear agreement may see oil prices soften further as more Iranian oil flows into global supplies. However, there may be upside gains for Oman as well from the lifting of sanctions on Iran.

Key Economic Indicators

	2014e	2015f	2016f
Real GDP Growth (Percent)	4.1	3.7	3.2
Inflation Rate (Percent)	1.0	1.5	2.0
Fiscal Balance (Percent of GDP)	-1.5	-12.9	-11.1
Current Account Balance (Percent of GDP)	2.4	-1.8	-9.6

Palestinian Territories

The political situation in the Palestinian territories remains precarious. The Gaza war of July 2014 took the Palestinian Authority (PA) and Israel further away from a peace deal. Since then, tensions have escalated as Israel has continued with its settlement expansion policy as well as home demolitions in the West Bank and East Jerusalem. Internally, reconciliation efforts encountered a major setback when the President reshuffled the national consensus government without Hamas's consent last August. Hamas has also been making unilateral decisions without consulting the PA, including entering into negotiations with Israel over a long-term truce in Gaza.

The Palestinian economy continues to suffer from the impact of last year's war in Gaza, but some recovery is underway and 2015 growth is expected to reach 2.9 percent. Real GDP declined by 0.4 percent in 2014 as a result of the war but now there are signs of a sluggish recovery. In Gaza, there has been a rebound in construction activity as well as in the wholesale and retail trade sector, leading to expected growth of 6.5 percent in 2015. Growth in the West Bank is expected to drop from the 5 percent recorded in 2014 to only 1.8 percent in 2015 due to the effects of a recent suspension of clearance revenues by Israel and heightened political uncertainty. Nevertheless, strong credit growth (around 15 percent) together with some growth in government spending are propping up consumption, which is expected to be the main source of growth in the West Bank in 2015.

The PA's fiscal situation remains extremely difficult with a projected financing gap of USD400 million in 2015. The PA has done exceptionally well during the first four months of 2015 in managing a severe liquidity squeeze caused by Israel's suspension of import taxes it collects on its behalf. These pass-through payments have since been resumed. Meanwhile, expenditures have risen by 8 percent mainly due to an increase in social assistance in Gaza, payment of electricity debt to Israel and some growth in health spending. The total deficit is expected to reach USD1.5 billion in 2015 while total aid to the PA treasury is projected at USD1.1 billion, leading to a financing gap of USD0.4 billion. As in previous years, the PA is expected to rely on the combination of borrowing from commercial banks together with arrears to the private sector and the pension fund to close the gap.

Downside risks to the projected economic outlook remain significant. First, if donor pledges do not materialize, the reconstruction process in Gaza, which is expected to be the main driver of growth, will be slower than expected. This, in addition to the ongoing blockade by Israel and Egypt, may exacerbate an already fragile environment and lead to renewed armed conflict. Second, the recent escalation of tension in the West Bank could have a negative impact on consumer and investor confidence there.

Key Economic Indicators

	2014e	2015f	2016f
Real GDP Growth (Percent)	-0.4	2.9	3.9
Inflation Rate (Percent)	1.7	1.6	2.6
Fiscal Balance (Percent of GDP)	-12.5	-11.9	-13.8
Current Account Balance (Percent of GDP)	-10.9	-11.1	-12.0

Qatar

Despite sharply lower oil prices since mid-2014, Qatar has maintained growth momentum. GDP grew by 6.2 percent in 2014 and will likely grow by 6.6 percent in 2015. This is due to growth in the non-hydrocarbon sector supported by high and rising levels of public spending (on both investment and consumption) and despite the decline in public revenues due to falling incomes from hydrocarbon exports.

Growth is being achieved at the cost of worsening macroeconomic balances. The 2015 fiscal surplus is expected to be 1.4 percent of GDP, sharply down from 9.6 percent in 2014. Similarly, the current account surplus is expected to narrow from 25.9 percent in 2014 to 10.1 percent in 2015. The fiscal balance will swing from surplus to deficit and external surpluses will continue to shrink in the near term as fiscal policy remains expansionary in view of planned government spending for the soccer World Cup to be hosted by Qatar in 2022.

Poor cross-governmental coordination is a key short-term risk. Investment planning (outside the hydrocarbon sector) has historically been decentralized, which has often translated into poor long-term planning, limited coordination with other existing or planned projects or strategies, absence of cost-benefit analyses, cost over-runs, and insufficient planning for recurrent costs. Qatar is trying to resolve these issues by establishing a Central Planning Office to oversee infrastructure investments, and setting up a Public Investment Management Unit at the Ministry of Finance.

The persistence of low oil and gas prices and high public spending pose medium term risks. Continued weakness in hydrocarbon markets will adversely impact revenues, economic growth, and financial sector health. Increasing gas market competition in the medium-term may further weaken Qatar's growth. The most prominent issue is the emergence of shale gas as a potentially major supply source in Europe and the United States. Australia is also expected to become the largest LNG producer globally, tripling its exports before the end of the decade. In light of the uncertain medium-term outlook for the gas sector, the development of the non-hydrocarbon sector is of even greater importance. The Government's strategy is to become a hub for a variety of sectors, including education, culture, and sports, with Qataris providing financing and filling upper executive positions, while expatriates ensure delivery. International scrutiny of the treatment of expatriate workers is also expected to increase in the run up to the 2022 soccer World Cup.

Key Economic Indicators

	2014e	2015f	2016f
Real GDP Growth (Percent)	6.2	6.6	6.8
Inflation Rate (Percent)	3.0	1.7	2.5
Fiscal Balance (Percent of GDP)	9.6	1.4	-3.5
Current Account Balance (Percent of GDP)	25.9	10.1	5.2

Saudi Arabia

The economy is growing at a modest pace due to low oil prices. The economy expanded by 3.6 percent in 2014 and is expected to grow by only 2.8 percent in 2015. Growth would have been even lower but for the government's decision to maintain a high oil production volume despite lower oil prices and to continue with an expansionary fiscal stance. Average inflation stood at 2.7 percent in 2014 and is expected to fall to 2 percent in 2015 as a result of lower oil prices and a strengthening US dollar (which is keeping Saudi import prices low).

The fiscal and external positions narrowed significantly in 2014 and both will be in deficit in 2015. The government's budget balance fell from a surplus of 5.1 percent of GDP in 2013 to a deficit of -3.9 percent of GDP in 2014 as oil prices and consequently government revenues declined. It is projected to plunge to -19.5 percent of GDP in 2015 as a highly expansionary fiscal stance remains in place. On the spending side this includes the award of large public sector salary and pension bonuses this year and enhanced military spending related to the Yemen war and other regional entanglements. Saudi Arabia has been financing its deficit by dipping into the central bank's large stock of foreign assets which is projected to decline from \$724 billion at end-2014 to a level of \$660 billion by end-2015. The government is also reportedly planning to issue around 27 billion USD of bonds to domestic banks during the remainder of the year, as it tries to slow the depletion of reserves. As for the current account, it is projected to fall into a deficit of -0.9 percent of GDP in 2015 as exports (primarily of oil) drop by over 30 percent compared to 2014.

Labor market policy remains an area of high priority for the government. To combat unemployment among nationals of as much as 11 percent, the government has been actively implementing education and skills measures as well as a quota-enforcement scheme called Nitaqat and an unemployment assistance scheme called Hafez. Enforcement of work permit rules for expatriates has been sharply tightened, resulting in an estimated 1.8 million repatriations since late 2013. However, measures such as the award of large salary bonuses to public sector employees work at cross-purposes to the employment objective, which requires making the Saudi private sector relatively more attractive to nationals.

The growth outlook remains broadly positive but risks exist in the fiscal stance. Overall GDP growth is forecast to be 2.4 percent and 2.9 percent in 2016 and 2017 respectively, aided by high oil production and a continued expansionary fiscal stance. The latter contains some risks, however. With oil prices forecast to remain low over the coming years, Saudi Arabia will need to keep an eye on long term fiscal sustainability.

Key Economic Indicators

	2014e	2015f	2016f
Real GDP Growth (Percent)	3.6	2.8	2.4
Inflation Rate (Percent)	2.7	2.0	2.4
Fiscal Balance (Percent of GDP)	-3.9	-19.5	-12.6
Current Account Balance (Percent of GDP)	10.7	-0.9	2.4

Syria*

Violent conflict in Syria over the past four years has taken a heavy toll. More than 250,000 Syrians have died (UN estimate) and more than 840,000 have been injured. In 2014, half the Syrian population had been forced to leave their homes (7.6 million internally displaced, 3.3 million refugees, and more than 1.5 million non-refugee migrants). As of September 6, 2015, 4.1 million Syrian were registered as refugees with the UNHCR, mostly in neighboring countries such as Iraq, Jordan, Lebanon, and Turkey, but also in Egypt and, increasingly, in European countries. More than 12.2 million in Syria are in need of humanitarian aid, including 5.6 million children (UNOCHA, Syrian Center for Policy Research-SCPR). Lack of access to health care and scarcity of medicines have created a catastrophic health situation.

The conflict has damaged public and private assets and severely reduced economic growth. The World Bank's Damage and Needs Assessment report of July 2015 estimated total damages of between US\$3.7 to US\$4.5 billion for the six cities covered. Aleppo is the most affected city accounting for roughly 40 percent of the estimated damage. While available estimates vary, Syria's GDP is thought to have contracted by an average of 15.4 percent per annum over the period 2011-14; a similar reduction is expected in 2015. This is due to the disruption of economic activity caused by the ongoing civil war and the associated sharp decline in oil production, down from 368,000 barrels per day in 2010 to around 40,000 barrels per day in 2015.

Fiscal and current account balances have worsened dramatically since the start of the conflict leading to a massive depreciation of the currency. The overall fiscal deficit has increased sharply since 2010 and is estimated to be around 22 percent of GDP in 2015. Total revenue fell to below 6 percent of GDP in 2014 and 2015 due to the collapse of oil and tax revenues. In response, government spending was cut, but not by enough to offset the fall in revenues. On the external side, revenues from oil exports decreased from US\$4.7 billion in 2011 to an estimated US\$0.22 billion in 2014, and are estimated to decline further to US\$0.14 billion in 2015. This underpins a current account deficit estimate of 13 percent of GDP in 2015. Total international reserves have declined from US\$20 billion at end-2010 to an estimated US\$2.6 billion at end-2014, and are estimated to fall further to US\$0.7 billion by the end of 2015. Depressed export revenue caused by the ongoing conflict and declining international reserves have caused a massive depreciation of the currency from 47 Syrian pounds per USD in 2010 to an estimated 305 pounds per USD at end-August 2015.

** The World Bank has no independent national accounts estimates for Syria for the period after 2010. All national accounts figures referred to in the text come from the Syrian Center for Policy Research (SCPR), the United Nations Economic and Social Commission for Western Asia (ESCWA), or Syrian government sources.*

Tunisia

Economic performance has been weak due to security incidents and political tensions. Following subdued growth of 2.3 percent in 2014 the economy has further weakened and is expected to grow by only 0.8 percent in 2015. This is largely due to ongoing political tensions and security incidents such as the two dramatic terrorist attacks, one at the Bardo Museum (March 2015) and other the Sousse holiday resort (June 2015). These tensions and slow growth in Europe have affected production in a wide range of sectors including mining, oil and gas, hospitality and transport. One of the few bright spots in the economy has been the agro-food sector (olives and derivate products, dates).

The current account position has not improved much despite exchange rate depreciation. The exchange rate depreciation observed in 2014 (-15 percent vs. the US dollar and -5 percent vs. the Euro) has had a limited impact on export growth, with the exception of mechanical goods. For the first half of 2015, an improvement in the trade balance was observed due to strong agricultural exports and the declining energy import bill. But this improvement has been offset by a deterioration in the service balance after the terrorist attacks of 2015.

The fiscal balance has worsened on account of the economic slowdown and the response to recent security incidents. The fiscal deficit is expected to increase from 4.1 percent of GDP in 2014 to 6.3 percent in 2015. This is due to lower tax revenues (impact estimated at 1.5 percent of GDP) as well as the need for additional public programs to rescue the tourism sector and stimulate investment in other sectors (resulting in additional spending worth 1.1 percent of GDP). This will be partly offset by additional savings on the energy bill resulting in lower transfers (-1.8 percent of GDP versus previous projections).

The economic outlook is affected by the lingering impact of domestic security and political tensions as well as weak growth in Europe. As noted above, growth is expected to experience a marked slowdown to 0.8 percent in 2015, due mostly to the impact of the terrorist attacks that happened earlier in the year and protracted stagnation in the euro area. Beyond 2015, we expect a modest growth recovery towards 3 percent in a positive scenario of accelerated reforms, continued reinforced security, an improvement in the regional situation (most notably a start of normalization in Libya) and a moderate acceleration in external demand. Continued political stabilization, as well as moderation in commodity and energy prices will also help underpin this recovery.

Key Economic Indicators

	2014e	2015f	2016f
Real GDP Growth (Percent)	2.3	0.8	2.8
Inflation Rate (Percent)	5.7	4.8	3.8
Fiscal Balance (Percent of GDP)	-4.1	-6.3	-4.1
Current Account Balance (Percent of GDP)	-8.8	-8.4	-7.8

United Arab Emirates

The economy is growing modestly as a result of global economic shocks since mid-2014. The UAE has been affected by low oil prices, sluggish global growth and the volatility of emerging market economies. As a result, while growth was a relatively robust 4.6 percent in 2014, it is expected to decline to 3.0 percent in 2015. Relative vigor in Dubai's service sector and Abu Dhabi's expansionary fiscal stance has prevented even slower growth.

Fiscal and external surpluses are shrinking. Continued high budgetary spending in the face of a sharp drop in hydrocarbon revenues cut the fiscal surplus from 10.4 percent of GDP in 2013 to an estimated 5 percent in 2014. It is expected to go into deficit of 2.9 percent in 2015. The current account surplus is also shrinking and is expected to be only 5 percent in 2015.

Credit to the private sector continued to grow and government-related entities (GREs) have improved their financial position. Lending to the private sector has been increasing (11.5 percent year-on-year in December 2014) and banks remain well-capitalized while non-performing loans continue to decline from their peak during the financial crisis of 2007-08. Dubai's GRE's have completed key debt restructuring plans and some have renegotiated to extend their debt maturities, thereby reducing debt-related risks.

Medium term growth will come largely from public spending and the non-oil sector. Non-oil growth in tourism-oriented sectors, real estate and construction, and services is likely to strengthen further in 2015. The non-oil economy is projected to expand at about 4 percent per annum in the coming years on the back of Dubai's strong core services sectors and Abu Dhabi's diversification efforts. The still-uncertain global economic and financial environment poses downside risks to this favorable outlook, although the UAE's sizeable foreign assets position provides a buffer. Oil prices could decline further once international sanctions against Iran are lifted and a significant supply of Iranian oil comes on the market. Furthermore, Dubai is implementing megaprojects which, if imprudently managed, could become a burden for its GRE's, its banks, and ultimately the government. This is especially important given Dubai's public sector and GRE debt profile featuring a total debt of around US\$143 billion with around half due in five years.

Key Economic Indicators

	2014e	2015f	2016f
Real GDP Growth (Percent)	4.6	3.0	3.1
Inflation Rate (Percent)	2.3	3.8	3.0
Fiscal Balance (Percent of GDP)	5.0	-2.9	0.2
Current Account Balance (Percent of GDP)	13.7	5.0	5.9

Yemen

Yemen faces an economic and humanitarian crisis as its civil war has intensified during 2015. Following the takeover of the government and the capital city of Sana'a by the Houthi rebel group in September 2014, the Yemeni civil war has intensified. Military conflict has spread to other parts of the country and has involved sustained bombing and airstrikes against rebel positions by an Arab Coalition led by Saudi Arabia. The escalated conflict has resulted in a catastrophic humanitarian emergency, increasing toll of civilian deaths and casualties, massive displacement of people, and severe destruction of housing and other infrastructure. In addition, the naval blockade imposed by the Arab Coalition since March has further aggravated the ongoing economic, food and medical crisis in the country.

Food stocks are low and the population at medical risk is rising. Stocks of food and medicines are exhausted and financing is lacking to replenish those. Recent estimates by the World Food Program suggest that the cost of food increased by 30 percent in July 2015 compared to February 2015 while the total food insecure population in the country is now estimated to be around 12 million or half the total population. Some 15 million people are in need of basic health care while the total population in need of humanitarian assistance is estimated to have reached 21 million (of which 9.9 million children). Furthermore, the Social Welfare Fund (SWF) could not disburse financial assistance to its 1.5 million household beneficiaries since December 2014.

Available estimates suggest that the economy will contract sharply in 2015. Pre-March estimates suggested that Yemen's GDP would contract by approximately 4 percent in 2015 (compared to a 0.2 percent contraction in 2014). However, the conflict has worsened since March and caused much greater disruption and damage than earlier anticipated. During the second quarter of 2015, oil and gas exports dropped by about 96 percent compared to the year before. As a result, the economy is likely to contract substantially in 2015. Annual inflation reached around 9 percent in 2014. While official consumer price indices in 2015 are still unavailable, inflation is expected to increase to double digits this year. Meanwhile, the fiscal situation is worsening as revenues from oil exports, taxes and aid have declined and expenditure needs keep mounting.

In the current situation of war and political uncertainty, the development outlook remains grim. Beyond the immediate food and medical emergency, substantial challenges remain, including continued instability of hydrocarbon revenues and exports, continued fiscal pressures and high financing needs, and growing environmental concerns. Unemployment will remain high, especially among the youth, and so will poverty and malnutrition. Serious environmental challenges, including the rapid extraction of scarce ground water, pose critical economic and social risks for future generations.

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