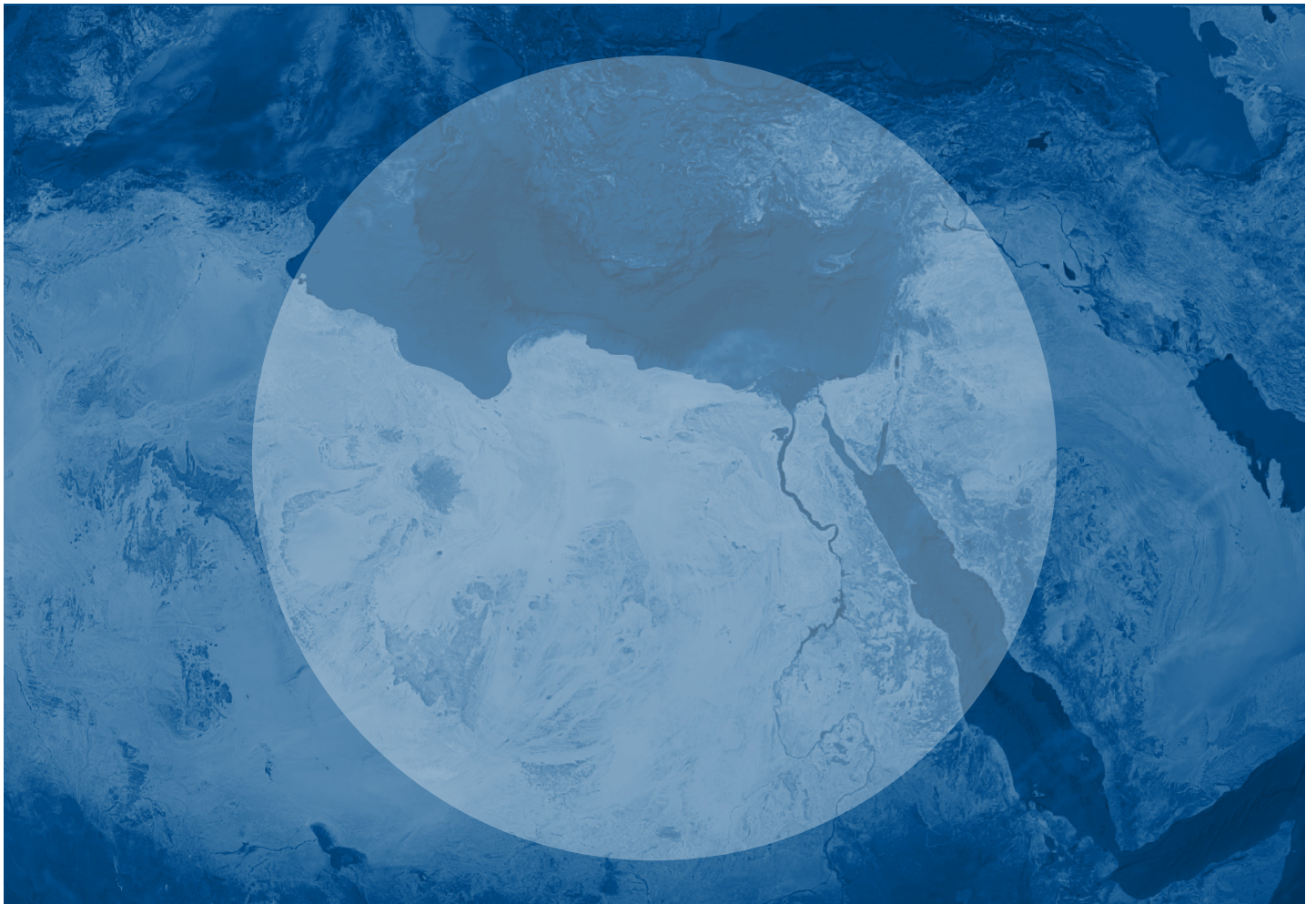


Briefing

# The New Economic Context for the Arab World



# The world is changing

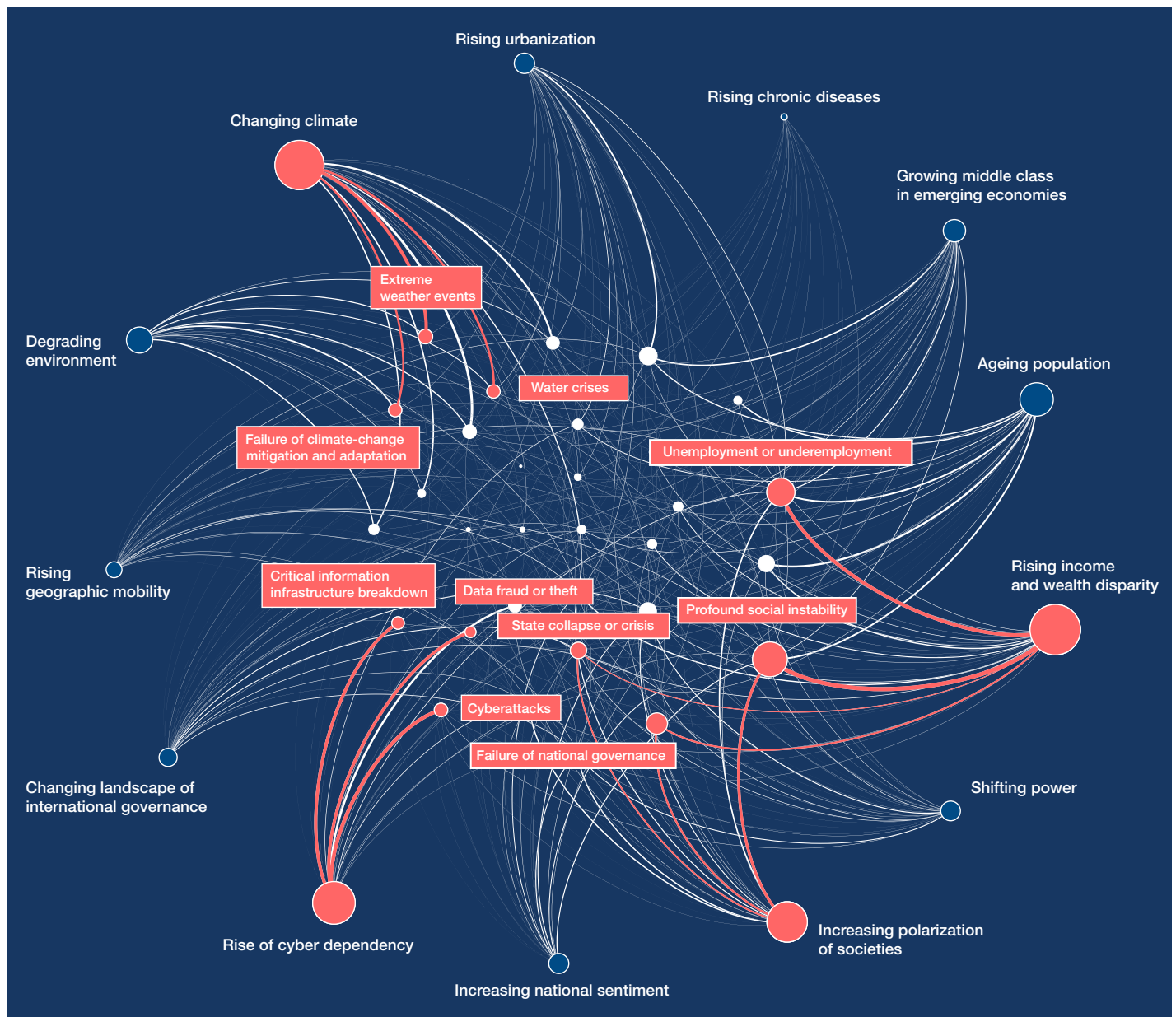
The world is changing at an unprecedented pace. In the medium and long term, Arab societies and economies will experience widespread change on the back of underlying global trends and potential risks.

Based on the assessment of experts across different stakeholder groups and areas of expertise, Figure 1 identifies the trends which will most likely shape global development in the next decade and maps their interconnection with a list of selected risks. The results are dominated by three macro areas: environment, economy/ society and technology.

Climate change is poised to exacerbate water crises and extreme weather events and might lead to a failure in adaptation. The rise of cyber dependency – driven by the increased use of information and communication technologies (ICTs), robotics and artificial intelligence – exposes countries to the risk of data fraud, cyberattacks and breakdowns of critical information infrastructure. The increase in income and wealth disparities and polarization of societies is feeding social instability and unemployment in many parts of the world, and could lead to failures of national governance and even state collapse in some countries.

Also available at <http://widgets.weforum.org/new-arab-context>

Figure 1. Main global trends and risks associated with them



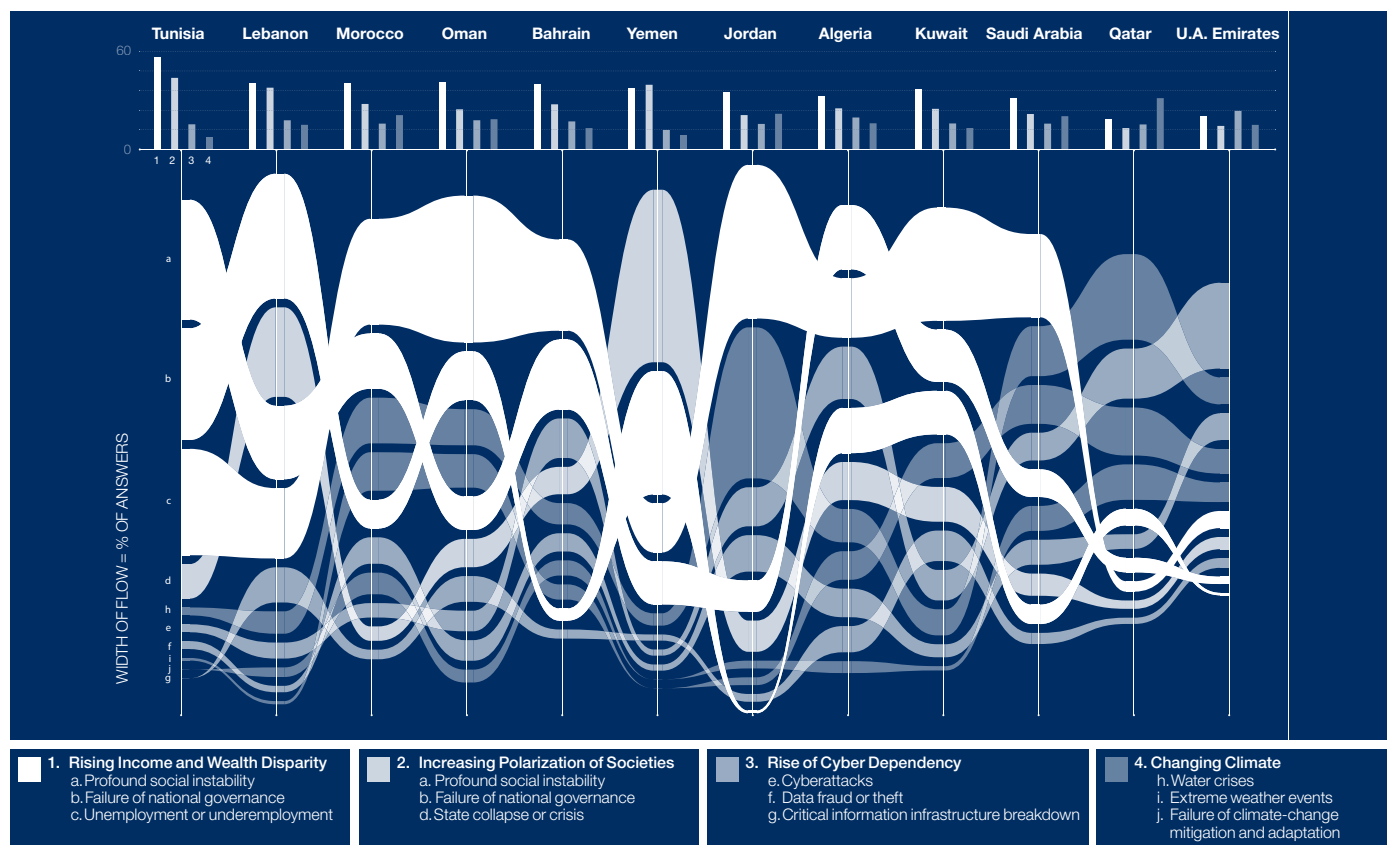
Source: World Economic Forum Global Risk Report 2017

# How will these changes affect the Arab World?

Not all countries are exposed to the same trends and risks in the same way. While trends are global in nature, the pace at which they will affect a specific region or economy will depend on the intensity at which they are manifesting themselves in that region and on the region's preparedness to react to the consequences (both risks and opportunities) that they might trigger.

Based on previous research from the World Economic Forum, the inclusion of a new indicator<sup>1</sup> aims to proxy the degree to which each trend is likely to affect countries in the Arab World. The indicator takes into account the degree of concern of the private sector in each country about selected risks and weighs it by the extent to which those risks are driven by the global trends selected (Figure 2).

Figure 2: Potential impact of global trends on Arab countries and level of concern of private sector about risks associated with them



Source: World Economic Forum elaboration based on Global Risks Report 2017. Data for Egypt not available

Rising income inequality and wealth disparity is the trend with the highest potential impact on the region. As it slowly recovers a new equilibrium and stability after the Arab Spring, Tunisia appears the country where rising income inequality and wealth disparities might have the strongest impact, followed by Oman and Morocco.

But businesses across the entire region show their concern about long-term unemployment or underemployment (61% in Jordan), profound social instability (47% in Tunisia) and failure of national governance (49% in Lebanon). At the other end of the spectrum, countries such as Qatar and the United Arab Emirates (UAE) have so far managed to cope better, in the views of the local businesses, with the consequences of increased inequality.

Closely linked to income inequality, polarization of societies is as well poised to affect the region in the future as it also exacerbates the risk of social instability and failure of national governance. State collapse is a concrete risk in Yemen

(68% of businesses selected as a risk of major concern) and is also in the mind of one-third of the executives in Lebanon.

Climate change and cyber dependency can also have significant impact on the region. In the first case, countries with more fragile environmental and geographic conditions are less likely to successfully adapt to climate change and to its consequences. Businesses in Jordan (60%) and Qatar (34%) are worried about water crises, as both countries have already experienced shortages in recent years.

Cyber dependency is more likely to hit in those countries where ICTs have developed more and a failure of critical information infrastructure or a cyberattack could have larger effects. In the UAE, one-third of companies are worried about cyberattacks and one out of 10 sees data frauds as one of the risks of major concern.

Beyond these four global and emerging trends, the region faces a number of specific risks, which are more directly linked to its economic structure. The recent

fall in oil prices has uncovered once again the risks associated to excessive dependence on raw materials and lack of economic diversification.

Several countries in the region have had to take measures to maintain fiscal budgets under control, privatize national assets and facilitate private sector development outside of the oil and mining industries. Yet, in 2016 42% of businesses were concerned about energy price shocks in Saudi Arabia, 45% in Qatar, 49% in Bahrain, 50% in the UAE, 52% in Oman and 62% in Kuwait.

Closely linked to oil price shocks, fiscal crises were also on the watch list of executives in the region, staying high in the mind of 31% of them in Saudi Arabia, 34% in Kuwait, 41% in Algeria and 47% in Bahrain.

Finally, asset bubbles fuelled by excessive and unsustainable investment of oil revenues in previous years concerned 39% of executives in Qatar, 43% in Kuwait and 51% in the UAE.



# What is the status of economic progress in the Arab World?

The Arab World is a diverse region with countries showing very different economic, social and political conditions. Table 1 summarizes a number of indicators that shed light on the performance of the Arab countries in key areas of economic development:

- **Competitiveness** – The set of institutions, policies and factors that determine the level of productivity of a country
- **Inclusive development** – Broad-based and sustained progress in living standards, encompassing wage and non-wage income as well as economic opportunity, security and quality of life

- **Networked readiness** – Preparedness to reap the benefits of emerging technologies and to capitalize on the opportunities presented by the digital revolution and beyond
- **Enabling trade** – Institutions, policies, infrastructures and services facilitating the free flow of goods over borders and to their destination
- **Doing business** – Ease of starting a business, dealing with construction permits, getting electricity, registering property, getting credit, protecting minority investors, paying taxes, trading across borders, enforcing contracts and resolving insolvency

Table 1. Arab World performance across different measures of economic development

	Global Competitiveness	Inclusive Development	Networked Readiness	Enabling Trade	Doing Business
U.A.Emirates	5.26	n/a	5.27	5.23	76.89
Qatar	5.23	n/a	5.18	4.78	63.66
Saudi Arabia	4.84	n/a	4.81	4.33	61.11
Kuwait	4.53	n/a	4.21	4.07	59.55
Bahrain	4.47	n/a	5.07	4.79	68.44
Jordan	4.29	3.50	4.22	4.73	57.3
Oman	4.28	n/a	4.31	4.67	67.73
Morocco	4.20	3.89	3.95	4.60	67.5
Algeria	3.98	n/a	3.21	3.51	47.76
Tunisia	3.92	3.94	3.92	4.02	64.89
Lebanon	3.84	n/a	3.80	4.03	55.9
Egypt	3.67	2.94	3.66	3.72	56.64
Yemen	2.74	2.87	n/a	2.95	39.57

Source: World Economic Forum/World Bank Group

Countries’ performance is generally aligned across these five dimensions, but there are differences and nuances. Delving into the 12 pillars of competitiveness allows to better explain them and to highlight areas for reform.

The Gulf countries perform generally better across most dimensions of economic progress, although indicators for inclusive development are not available. The UAE and Qatar have successfully invested and implemented reforms in order to make their economy more resilient to shocks and reduce reliance on oil and gas. They now rank 16 and 18, respectively, in terms of competitiveness, 26 and 27 in networked

readiness, 23 and 43 in enabling trade, and 26h and 83 for doing business.

These two countries lead the region across most pillars of competitiveness, and in particular in terms of innovation (UAE 25 and Qatar 18 globally) and business sophistication (13 and 18). Since the fall of oil prices, the macroeconomic environment in the UAE has slightly deteriorated (38) while Qatar’s has shown greater resilience (2).

Trade and ICTs are powerful levers for diversification, but some of the Gulf countries punch below their weight when it comes to these dimensions. Saudi Arabia, for example, was able to climb to the 29th

position in competitiveness, but still lags at 33, 67 and 94 in terms of networked readiness, enabling trade and doing business. Similarly, Kuwait ranks 38, 61, 87 and 102 across these four dimensions.

Both countries can benefit from relatively good, although deteriorating, macroeconomic environments and stable institutional frameworks, but lag further behind when it comes to higher education and training, labour market efficiency, technological readiness and innovation. The only Arab country in the G20, Saudi Arabia also benefits from the largest market size in the region.

The only exception in the region is Yemen, which remains problematic across most dimensions of economic and social development, as the country is torn by long-standing tensions and violence.

North Africa shows a relatively homogenous level of competitiveness, but there are larger differences in the ease of doing business, enabling trade and the level of networked readiness. Morocco (49 globally) leads across all dimensions and punches above its weight in terms of enabling trade. In the context of its strategy to promote the country as a manufacturing and logistics hub within the Mediterranean, the government has already implemented a number of trade facilitation reforms and

invested in infrastructure, but there is still room for improvement for Morocco to fully establish its role.

To ensure long-term competitiveness and inclusive development, Morocco will also need to address the issues it faces in the labour market (124), higher education and training (104), and innovation (96). Algeria follows in terms of competitiveness (87), but lags further behind in networked readiness (117) and enabling trade (121). A common thread across most of North Africa, labour market inefficiencies severely affect Algeria (132), Tunisia (133) and Egypt (135) – all three countries being plagued by

persistently high levels of unemployment, especially among the youth.

The Levantine economies benefit from better trade integration with the rest of the world, but their competitiveness is hindered by a number of structural and contextual challenges. Health and education (both basic and advanced) are the main strengths of Jordan and Lebanon, with the former also benefiting from a solid institutional framework (34 globally). The macroeconomic environment is problematic for both countries, and particularly Lebanon (136 globally), with high levels of public debt, budgetary deficits and deflation.

Table 2. Arab World performance across selected pillars of competitiveness

	Macro economic environment	Labor market efficiency	Technological readiness	Business sophistication	Innovation
U.A.Emirates	5.28	5.17	5.82	5.25	4.57
Qatar	6.72	5.00	5.35	5.20	4.87
Saudi Arabia	4.71	4.30	5.01	4.52	3.69
Kuwait	6.31	3.67	4.33	4.02	2.96
Bahrain	3.88	4.55	5.15	4.42	3.61
Jordan	3.75	4.04	3.90	4.37	3.73
Oman	4.46	4.10	4.40	3.94	3.26
Morocco	5.08	3.55	3.69	3.82	3.11
Algeria	4.83	3.25	3.08	3.31	2.93
Tunisia	4.16	3.24	3.73	3.61	3.03
Lebanon	2.27	3.85	4.01	4.18	3.40
Egypt	2.68	3.15	3.26	3.71	2.75
Yemen	2.00	3.10	2.21	3.18	2.16

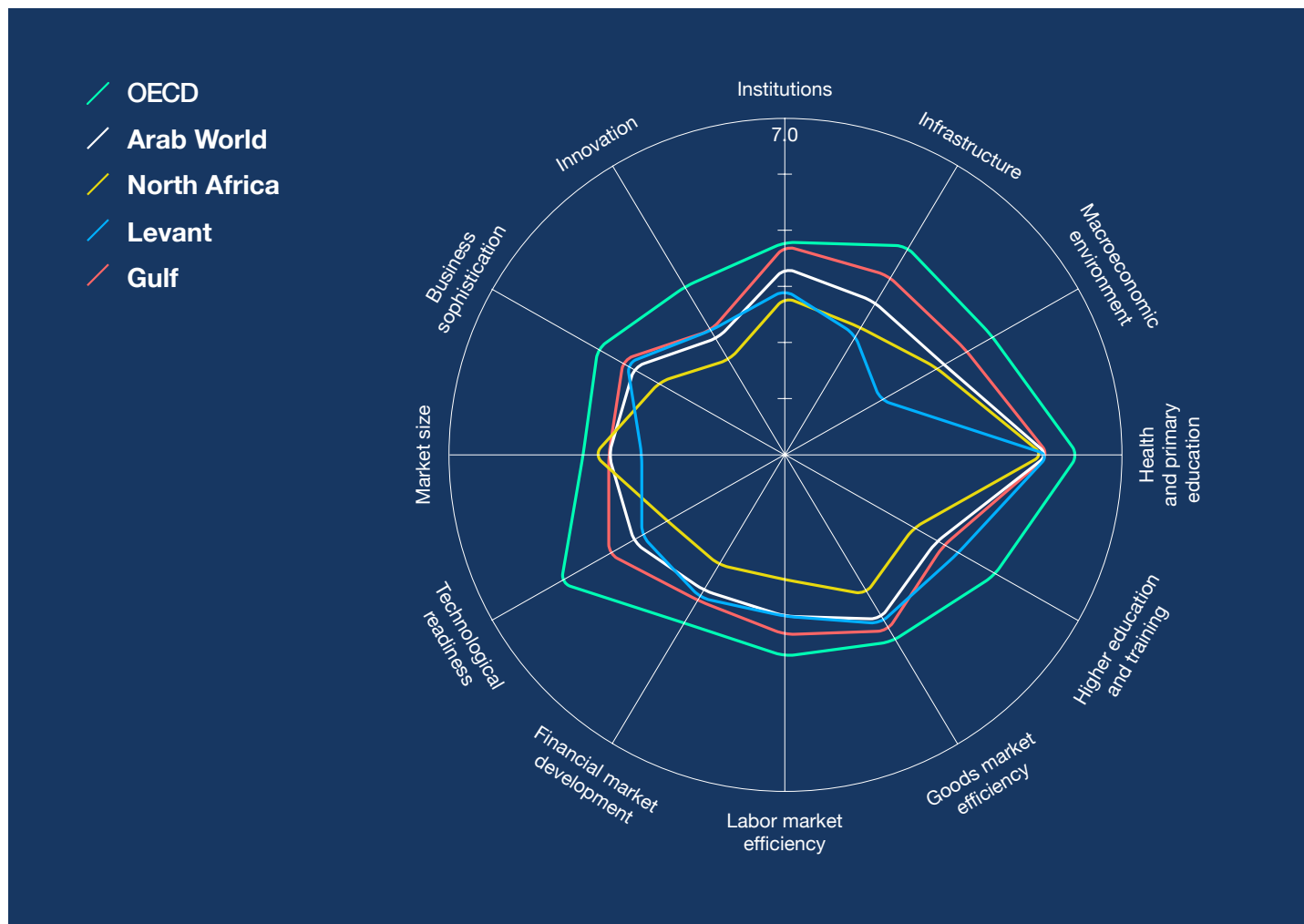
Source: Global Competitiveness Report 2016-2017

# What policies are needed for the future?

Overall, the Arab World enjoys high levels of health and primary education and potentially large markets to tap into. Management practices show a good level of sophistication, but most businesses still lack the capacity to innovate and upgrade towards higher value-added productions. As technology continues to transform the way economies and societies work and the Fourth Industrial Revolution unfolds its effects, improving the region's technological readiness will also be fundamental to enable companies to innovate and keep pace with the rest of the world.

Inefficient labour markets and insufficient levels of higher education and training are among the long-standing weaknesses of the Arab World, particularly of North African countries (Figure 3).

Figure 3. Arab World and OECD performance across the 12 pillars of competitiveness



Source: Global Competitiveness Report 2016-2017

These problems have been exacerbated by the fall in oil prices and other shocks that have hit different parts of the region in recent years. On the one side, oil-exporting countries have experienced a sharp deterioration of their macroeconomic environment and were forced to review expenditures and raise taxes, confirming their exposure to the market cycles of fuels and raw materials. In countries such as the UAE and Saudi Arabia, these events urged governments and businesses to explore strategies to further diversify their economies and move away from oil dependency. On the other side, oil-importing countries have generally benefited from a lower energy bill. However, some of them, particularly in the Levant, were negatively impacted by conflicts and geopolitical tensions in the area and had to devote significant resources to face the challenges stemming from them.

As the world changes and the global trends are set to affect the region, the Arab World will need to face a number of risks driven by these trends as well as specific ones which stem from its current economic structure. In light of this and of the weaknesses and areas for reform identified within its competitiveness landscape, it

seems possible to identify at this stage four key challenges that the Arab World needs to address:

1. Transitioning away from natural resources and diversifying the economy
2. Increasing the role of the private sector and diminish the state's intervention in the markets
3. Ensuring opportunities are available for the youth and its rising workforce
4. Mastering the Fourth Industrial Revolution and improving the innovation ecosystem

Common to all these challenges is the need to let the Arab World unlock its entrepreneurial potential and allow innovative ideas to become successful market products and private businesses to start, scale up and expand on the international markets.

World Bank figures show that with only one newly registered firm per 1,000 working age adults, the countries in the Middle East and North Africa are among the ones with the lowest level of entrepreneurship in the world.<sup>2</sup> A mature "entrepreneurship ecosystem" should follow and support the entrepreneur at each stage of the enterprise development, from original

concept to feasibility and monetization, and from there to growth, optimization and innovation.

However, Arab countries still face a number of challenges which discourage the creation of new companies and hinder the growth of existing ones: bankruptcy laws prevent debt restructuring and discourage SME lending; labour regulations decrease the flexibility of the workforce and limit the availability of talent from abroad; and country-level regulations make the region a fragmented market for goods and services and hamper intra-regional trade and investment.

Yet, the Arab world can boast a number of success stories, with exponential growth in recent years: the Jordanian online service provider Maktoob was sold to Yahoo! for \$165 million in 2009; Talabat, a Kuwaiti online platform for food delivery, was sold to Rocket Internet for \$170 million in 2015; and Souq.com, an e-commerce website based in the UAE, was sold to Amazon in 2017 (the value of the operation has been estimated at \$650-700 million. In the UAE alone, equity investments in tech start-ups jumped from \$100 million in 2014 to \$1.7 billion in 2016.<sup>3</sup>

## Voice of the youth

In a region where one-third of the population is below the age of 15, addressing future challenges will have to pass through the empowerment of youth and the huge pool of talent, energy and resources it represents.

Through the responses of about 1,000 young people aged 18-35 from the region, the Global Shapers Survey 2016 sheds some light on the views of the Arab youth on their countries, on the institutions and on the factors they deem most important for their empowerment.

When asked to identify the three most serious issues affecting their country, the Arab youth surveyed noted: government accountability and transparency/corruption (49%); lack of economic opportunity and employment (41%); and lack of education (37%) (Figure 4). Education was the most pressing issues among the youth in North Africa (54%), but only sixth in the Gulf countries, preceded also by religious conflicts (28%), gender inequality and lack of inclusion (27%), and lack of political freedom and excessive political instability (23%). This latter issue was also third most cited by the youth in the Levant countries, at 35% of responses.

**Figure 4. Voice of the youth: Most serious issues affecting the Arab World today**

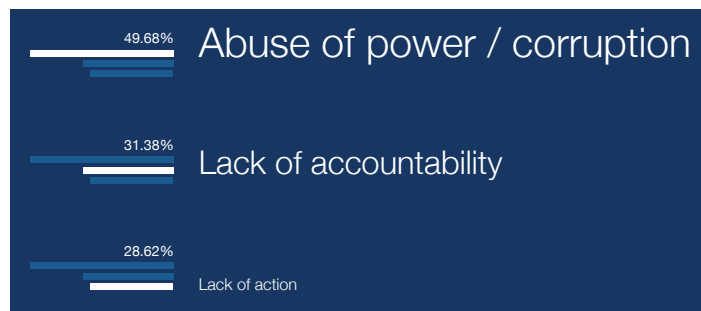


Source: Global Shapers Annual Survey 2016

Corruption and public sector misconduct were chosen as the biggest source of frustration towards governments throughout the Arab World, cited by 50% of interviewees (64% in the Levant). Lack of accountability (31%) and lack of action (29%) followed as second and third main reproaches in most of the region (Figure 5). In North Africa, insincerity and dishonesty were identified by 32% of responses, second most cited factor after abuse of power and corruption.

Confirming the key role of entrepreneurship to address the future challenges of the region and in particular to ensure youth empowerment, approximately one out of two youth throughout the Arab World has selected the possibility to create a business and embark in an entrepreneurial project as a key factor for their empowerment (Figure 6). In the Levant countries, this was preceded by the presence of a fair and justice system and followed by the need of transparency in governance, while in the Gulf the presence of free media and social media and the possibility to engage with government were second and third most important factors.

**Figure 5. Voice of the youth: Factors of frustration towards governments in the Arab World**



Source: Global Shapers Annual Survey 2016

**Figure 6: Voice of the youth: Important factors for youth empowerment in the Arab World**



Source: Global Shapers Annual Survey 2016

## The Arab World Competitiveness Report 2017

To delve into these issues and investigate what reforms the Arab World has to implement and what the private sector can do to face future challenges and ensure long-term competitiveness, the World Economic Forum and the World Bank Group are partnering to publish the 2017 edition of the *Arab World Competitiveness Report*, the seventh to be published by the World Economic Forum since 2002. The report will bring together the expertise

of both institutions in this domain and will seek the engagement of governments, academia and the private sector. A number of consultations will be held prior to publication and workshops organized to disseminate and turn the findings of the report into action. The publication of the report is expected in fall 2017.

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The World Economic Forum, committed to improving the state of the world, is the International Organization for Public-Private Cooperation.

The Forum engages the foremost political, business and other leaders of society to shape global, regional and industry agendas.

<sup>1</sup> These trend impact coefficients (TICs) combine the results of the World Economic Forum's Global Risks Perception Survey and of the Executive Opinion Survey 2016.

Formally:  $TIC_{ct} = connection_{ct} \times concern_{ct}$ , where  $connection_{ct}$  is the number of times experts in the Global Risk Perception Survey have identified a causal link between trend  $t$  and risk  $r$ , and  $concern_{ct}$  is the percentage of times risk  $r$  was selected by businesses in country  $c$  among the ones of highest concern over the next decade, based on the Executive Opinion Survey Results should be interpreted keeping in mind that, once the causal link between trends and risks is established through the assessment of the respondents to the Global Risk Perception Survey, the connection between trends and countries is exclusively based on how concerning those risks are in the perception of companies. These perceptions can be driven by a number of reasons that go beyond the effective threat represented by those risks and the level of preparedness of the country. This approach also assumes that global trends are occurring with the same intensity in all countries. This assumption is unlikely to be equally valid for all trends and should of course be tested or, alternatively, additional data should be collected to factor in these differences.

<sup>2</sup> Data from World Bank Doing Business Database on Entrepreneurship (average for MENA excludes Malta)

<sup>3</sup> CB Insights

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