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THE GLOBAL FINANCIAL & ECONOMIC CRISIS: TRANSMISSION CHANNELS & POLICY RESPONSE IN THE ARAB WORLD

Daniela Gressani and Auguste Tano Kouame[1]

Introduction: - Global and Economic Aspects of the Crisis: Two aspects of the current crisis are important to stress. The first is its global nature. As you know, this crisis started last year in the US and European financial markets but spread quickly to developing countries. The second is its economic impact. Before the crisis erupted, many countries, and many developing countries in particular, were already suffering from the impact of very substantial food and fuel price increases, which had translated into higher inflation and current account deficits. As a result, the financial crisis has quickly become an economic crisis, and already many developed countries are in recession, and developing countries are seeing weakening growth.

The World Bank predicts that this global financial and economic crisis will see GDP growth decline from 2.5% in 2008 to 0.9% in 2009 in the world economy; and in developing countries, from 6.3% in 2008 to 4.5% in 2009. Global trade volume is expected to decline in 2009, for the first time since 1982 (by -2.1%), and job creation will also slow down. Global poverty may well increase again, after the accumulated impact of high food and fuel prices pushed some 100 million more into poverty last year.

Impact on Arab Countries: Financial markets in Arab countries have been less affected than elsewhere, but stock markets have experienced declines in their indices, and some financial institutions have shown clear signs of weakness.

Many countries, however, are already experiencing the impact of the crisis on the real economy. Most Arab countries face a decline in export growth as a result of the global economic downturn and, for oil producing countries, lower oil prices. In addition, lower tourism revenues, lower remittances, lower foreign direct investment and possibly also lower foreign aid will weaken their economic performance.

The nature and importance of the links between the different parts of the Arab World and the global economy will be very important in determining the impact of the crisis; but so will their initial fiscal and current account positions. Governments with stronger fiscal and external positions will be better able to respond to the impact of the crisis.

Transmission Channels: To better understand the transmission channels between the global financial and economic crisis and individual country performance, it may be useful to group Arab countries in four groups:

1. *Countries with strong economic links to the GCC.* Lebanon, Jordan, Yemen and to some extent, Egypt will be more affected through lower tourism, remittances and FDI from the GCC economies.

2. *Oil-producing countries with large social needs and comparatively weaker fiscal balances.* Algeria, Libya, Iraq, Syria and Sudan have significant oil revenues, but

[1] Daniela Gressani, Vice-President, MNA and Auguste Tano Kouame, Acting Chief Economist, MNACE.

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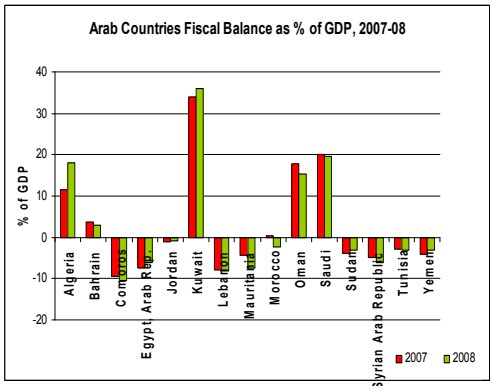
entered the crisis with fiscal deficits and large social commitments, which makes it difficult to adjust expenditures during the downturn.

3. *Countries with strong economic links to Europe.* Morocco, Tunisia and to some extent Egypt will feel the strongest impact of the crisis through depressed European demand for imports but also through lower tourism, remittances and FDI.

4. *The GCC economies*. These countries have entered the crisis in very strong fiscal and external balances, and are in the best position to absorb the consequences of the crisis. They will however suffer from lower oil prices as long as the global downturn affects demand.

Arab Countries, Fiscal Balance as % of GDP, 2007-08



Source: World Bank data

Due to data limitations, the West Bank and Gaza, Qatar, Libya, Iraq, Somalia, and UAE, Djibouti were not included.

Policy Response: Many Arab countries have already responded to the crisis with measures to support their financial systems and ease monetary policy. Several countries have also announced fiscal stimulus packages that are tailored to the relative importance of the different transmission channels discussed earlier. For example, Egypt has announced a stimulus package geared towards infrastructure investment, which could help offset declining FDI. Tunisia has announced measures to support SMEs, which are facing declining demand from Europe.

As the ability of countries to address the impact of the global crisis on their economies is closely linked to their ability to increase public spending or introduce measures to encourage private spending in the short term, the size and speed of their policy response will be affected by their fiscal space. As can be seen from the preceding graph, there is a very large variation among Arab countries in this dimension.

The Private Sector and the Business Environment: There is strong evidence from earlier crises that improving the business environment, so that the private sector can adapt to changing opportunities, is one of the most important factors needed for a country to come out successfully from an economic crisis. This is also one of the most important factors determining the ability of an economy to take advantage of the next global recovery.

As can be seen from the graph below on the Doing Business indicators, this is an area where most Arab countries can make great progress. While these indicators do not assess the full picture of the business environment, which also includes well-functioning institutions and availability of basic services, the Doing Business indicators are very helpful in identifying the strengths and weaknesses in a country's business regulations, property rights, access to credit and enforcement of contracts.

Ease of Doing Business Rankings -- Arab Region in the World

Source, World Bank data, Doing Business Indicators, 2009

As the graph above shows, some countries and especially the GCC economies have made remarkable progress in the ease of doing business, and are now comparable to OECD countries. However, several other countries in the Arab World, even those that have recently made outstanding progress, for example Egypt, still have a large amount of room for improvement. Furthermore, as a group, the economies of the Arab World lag significantly behind many other parts of the world.

Trade Policy: An important factor in determining the success of different economies in overcoming the crisis will be their trade policies. In the Arab World and elsewhere, the global crisis is affecting countries that are more closely integrated in the world economy faster. Yet, rolling back the still incomplete integration of Arab countries with one another and with the world economy will not help coming out of the crisis.

The World Bank Group and the Crisis: The Bank is working with its partners in the Arab World and elsewhere to help in overcoming the crisis. It is focusing its efforts on accelerating financial support to developing countries, both through lending and through the concessional support provided by IDA.

In addition, in recent months, the Bank has mobilized some $900 million in grant support for countries hit especially hard by large increases in food and fuel prices.

Support is also accelerating for private investment through new programs in trade finance, bank recapitalization, infrastructure financing and SME support by the IFC. MIGA is also stepping up its activities. Perhaps most important, the World Bank has been working with countries to help identify specific vulnerabilities to the global financial economic crisis, and measures to address them.

Contact MNA K&L:
Nadir Mohammed, Director, MNA Operational Core Services Unit
David Steel, Manager, MNA Development Effectiveness Unit

Regional Quick Notes Team:
Omer Karasapan, Dina El-Naggar, Roby Fields, Najat Yamouri, and Aliya Jalloh
Tel #: (202) 473 8177