

A US dollar bill is shown, partially obscured by a thick red rope that is knotted around it. The bill is crumpled and folded, with the knot positioned in the center. The background is dark and textured.

THE STATE OF FINANCING DEVELOPMENT IN THE ARAB REGION



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**THE STATE OF
FINANCING DEVELOPMENT
IN THE ARAB REGION**



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“We can choose to bemoan the lack of financing for the 2030 Agenda in a world awash with so much unproductive and unrewarding finance or we can grasp the opportunity to reshape finance according to our urgent collective needs.”

António Guterres

FOREWORD

Financing is the bloodline of the 2030 Agenda on Sustainable Development. Yet, four years following the adoption of the Global Financing for Development Framework enshrined in the Addis Ababa Action Agenda, the Arab financing gap continues to rise with trillions needed in quality investments of all kinds (public, private, multilateral, plurilateral, bilateral, concessional, blended, debt-gearred, traditional and innovative) to achieve the 2030 Agenda in the Arab region.

The cost of conflict, instability and the region's post-conflict reconstruction adds to the massive task and risks diverting attention away from financing the 2030 Agenda. Financing for development is not happening neither at the pace nor magnitude that can turn conflicts, poverty, inequality and other socio-economic hardships into the equitable, inclusive sustainable development promise of the 2030 Agenda. More common Arab action is required to counter the current trend of more resources flowing out of the region than those flowing in and to ensure that those resources flowing in are indeed effectively invested in support of implementing the Agenda 2030 in all countries of the region.

Recognizing the global challenge of sustainably financing development needs of developing countries, the United Nations embarked on an ambitious reform agenda to deliver on the 2030 Agenda. In support of this reform, regional commissions emerge as a critical part of the United Nations development policy support system: a connective tissue between global and local levels providing regional perspectives and analytical services, policy advocacy to address

regional financing for development challenges and support the development of a wide range of regional norms, standards and conventions.

Through this first edition of The State of Financing Development in the Arab Region, the United Nations Economic and Social Commission for Western Asia (ESCWA) provides to a broad range of stakeholders (governments, civil society, business associations, regional development funds and non-governmental organizations) a thought-provoking regional assessment of the Arab region's financing for development (FfD) status, challenges and risks. This is in recognition of the need to develop a common diagnosis of the FfD challenge to allow policy makers to consider urgent collective action to reverse the outflow trend of financing flows and to encourage investments in Agenda 2030 challenges in all countries of the Arab region.

The choices we make today, will be critical for tomorrow's financing decisions and sustainable development outcomes. It is the collective responsibility of all stakeholders to optimally utilize the framework for global financing for development and assess both its viability and utility for regional financing contexts and national capacities to finance development. We must act now to ensure that we do not reach a point where corrective actions are no longer durable or are preempted as the Arab region's financing needs continue to grow.

Rola Dashti

Under-Secretary-General of the United Nations and Executive Secretary of the Economic and Social Commission for Western Asia

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EXECUTIVE SUMMARY

The FfD outlook for the Arab region remains turbulent. The prognosis stems, in no little measure, from a strained socioeconomic fabric that risks being frayed by the biases of the status quo. The ability of Arab societies to withstand, adapt and recover from cascading global and regional crises is withering. Yet, it is this very region that demonstrates a unique form of resilience as it continues to finance development both within the region and in other parts of the world.

A compelling finding drawn from the analysis of direct and indirect FfD exposures reveals that between 2011 and 2016, for every \$1 gained/mobilized through prime cross-border FfD channels, the region lost/returned \$2.5 to other regions, including high-income bracket economies.¹ The situation challenges the dominating development narrative as the region appears to be witnessing a FfD reflux.² Substantial resources are flowing out of rather than into the region, constituting a leakage or, at best, an opportunity lost to finance the region's own reconstruction and sustainable development imperatives.

The Arab region continues to contend with escalated levels of violence and conflicts and is witnessing the largest crisis of forced displacement since World War II. Today, over 148 million people in the region live in conflict-affected or unstable environments of varying intensity.³ Particularly vulnerable are the 29 million forcibly displaced⁴ and the more than 56 million people dependent on humanitarian assistance.⁵ Under current trajectories, the region may well be set to consume half of the projected increase in global humanitarian financing by 2030.

The cost of conflict is rising unabated, with an estimated \$752–\$856 billion lost

in terms of economic activity as well as material damage to productive capacities. The rising death toll constitutes a more critical concern to reconciliation given that no price tag can be placed on the loss of life that remains largely unaccounted for in empirical assessments. Excessive military expenditure, running at two-and-a-half times higher than the global average share in output growth, coupled with the hefty reconstruction bill for war-torn economies, risks further diverting attention away from the financing requirements of neighbouring countries that are, or have been, affected by conflict.

A regional race to the bottom to spur growth and counter underinvestment in critical social infrastructure is not only fuelling beggar-thy-neighbour dispositions, but is also breeding harmful tax competition and fiscal incentives that erode the tax base and consequently potential tax revenue. Domestic resource mobilization efforts are, nonetheless being pursued to broaden the tax base (mostly through regressive redistribution), remove tax exemptions and rationalize inefficient fossil-fuel subsidies (both in terms of consumption and production patterns). However, the resources mobilized domestically may fall short of achieving the Sustainable Development Goals (SDGs) if the informal sector remains unintegrated in the formal economy and insulated from the overall planning and implementation of the SDG reform agenda.

The regions' fiscal space continues to be strained in reaction to the pace of consolidation needed to reduce long-standing fiscal vulnerabilities and break the cycle of poverty regeneration. Severe pressures on public finances along with the implementation of de-risking practices, including losses in Arab banking correspondent relations, are

having a toll on both financial inclusion and efforts to bridge the small and medium enterprise (SME) financing gap (by 2017, unmet SME credit demand amounted to \$159 billion).⁶ Savings from low oil prices and reduced subsidies allowed room to increase spending on infrastructure, health care, education and social services. However, the pace of consolidation remains imperilled by chronic current account imbalances and oil price rises and, on a more systemic level, as some key oil producers become importers by 2030.

The region is bearing the brunt of the double jeopardy arising from commodity price volatilities and a decline in terms of trade. Both have contributed to the displacement of \$97.6 billion out of the region between 2011 and 2016. The protracted delivery of the 0.7 per cent target for official development assistance (ODA), for its part, is undermining the global FfD framework as large portions of aid budgets (11 per cent of Donor Assistance Committee [DAC] allocations) are diverted to cover in-donor refugee costs.

The threat of a “lost generation” of Arab youth looms large as more than 92 million decent jobs need to be created by 2030 (equivalent to an annual investment bill of \$220 billion).⁷ However, with long-term investments subdued (nearly 63 per cent short of their record highs) along with lower-than-potential international private finance (as reflected by profit repatriation intensities for foreign direct investment [FDI], which have outpaced FDI inflows), inequalities are set to become more acute within the different segments of Arab societies. This comes at a time when oil-rich Arab economies are investing almost \$3 trillion in sovereign wealth funds outside the region. Resource-rich economies are also financing the public debt of many developed economies, including through their holdings of United States of America Treasury securities, which exceeded the entire external

debt stock owed by their non-oil Arab counterparts.

Significant shifts in the patterns of migration, both legal and illegal, are ensuing in the search for jobs to secure the vital flow of remittances, a bloodline for more than 24 million migrant families in order to meet basic household needs and ameliorate living conditions. The current norm, whereby 2.8 times more remittances are sent out of the Arab region than the dollar equivalents retained in the region, may prove economically and socially unsustainable. Equally, high-cost corridors are depriving the region of \$1.7 billion in annual development finance and, to the extent that their transfers are not monitored, risks creating a security hazard or a tax-relevant opportunity lost.

The Arab region’s FfD resilience is also undermined by \$60 billion worth of leakages arising from fraudulent non-oil trade misinvoicing, including those stemming from illegal settlements and Israeli-occupied territories in the West Bank, Gaza Strip and East Jerusalem. Illicit financial flows (IFFs) associated with drug trafficking, illicit trade in small arms, light weapons and antiques and undeclared oil trade activity on the part of non-state actors continues to impede financial deregulation and erode domestic resource mobilization capacity.

Considering these conditions, the new global FfD framework remains a normative ideal that is being continuously challenged by the region’s FfD idiosyncrasies. In fact, between 2011 and 2016, the region seems to have turned into:

- A net exporter of both capital and primary income (for every \$1 of FDI the region generated, a corresponding \$1.8 left the region);
- A lender of first resort (with the net stock of claims and liabilities/outflows lending to international banking and non-financial institutions amounting to \$223 billion);

- A debt service financier (for every \$1 of debt inflows the region received, a corresponding \$1.5 was paid back in arrears on outstanding debt stocks);
- A medium for illicit transfers (since 2014, IFFs outpaced the region's combined inflows of FDI and ODA; and between 2011 and 2015, for every \$1 of total trade proceeds, 8 cents are lost due to trade-based money laundering);
- A net exporter of private capital, namely, remittances (for every \$1 of remittances generated and retained in the region, \$2.8 are sent elsewhere with 7 cents on the dollar lost to high-cost corridors);
- An ODA grantor (Arab ODA represents, on average, 83 per cent of non-DAC ODA and for every \$1 the region received

in ODA, 65 cents are returned through bilateral and regional funds).

To put these numbers into perspective, according to the 2016 Arab Sustainable Development Report, the Arab region was said to require \$3.6 trillion in gross fixed capital formation to finance the SDGs. At the time, this hefty bill did not account for the negative net resource transfers (NRTs) or the financing reflux witnessed by the region. If current trends continue however, the Arab region will be required to conjure an additional \$2.3 trillion by 2030 to achieve the SDGs. Put differently, if the region's negative FfD exposure is reversed, the Arab region could well be placed on a path to meet most of its SDG bill and continue to finance sustainable development in other regions.

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ABBREVIATIONS AND NOTES

AAAA	Addis Ababa Action Agenda
ACCESS	Arab Citizens Common Economic Security Space
ACU	Arab Customs Union
AfDB	African Development Bank
AMF	Arab Monetary Fund
AsDB	Asian Development Bank
BEPS	base erosion and profit sharing
BIS	Bank of International Settlements
Brexit	British exit from the European Union
BRICS	Brazil, Russia, India, China and South Africa
CBR	correspondent banking relationships
CGAP	Consultative Group to Assist the Poor
DDA	Doha Development Agenda
DESA	United Nations Department of Economic and Social Affairs
ESCWA	United Nations Economic and Social Commission for Western Asia
Eurodad	European Network on Debt and Development
FDI	foreign direct investment
FfD	financing for development
FfDo	Financing for Development Office
GATT	General Agreement on Tariffs and Trade
GCC	Gulf Cooperation Council
GCI	Global Competitiveness Index
GDP	gross domestic product
GER(s)	gross excluding reversal(s)
GFI	Global Financial Integrity
GNI	gross national income
GVCs	global value chains
IATF	Inter-agency Task Force on FfD
IDB	Islamic Development Bank
IDMC	Internal Displacement Monitoring Centre
IDP	internally displaced persons
IFFs	illicit financial flows

IMF	International Monetary Fund
LAS	League of Arab States
LDCs	least developed countries
Mol	means of implementation
MFN	most favoured nation
MSME	micro, small and medium enterprise
MTS	multilateral trading system
NDB	New Development Bank
NRT	net resource transfers
OCHA	United Nations Office for the Coordination of Humanitarian Affairs
ODA	official development assistance
OECD	Organisation of Economic Co-operation and Development
SDG	Sustainable Development Goal
SDR	special drawing right
SDT	special and differential treatment
SME	small and medium enterprise
SVE	small and vulnerable economies
TOSSD	total official support for sustainable development
UNCTAD	United Nations Conference on Trade and Development
ToT	terms of trade
TRIPs	Trade-Related Intellectual Property Rights
UNHCR	United Nations Office of the High Commissioner for Refugees
UNRWA	United Nations Reliefs and Works Agency for Palestine Refugees in Near East
WITS	World Integrated Trade Solutions Database
WB	World Bank
WTO	World Trade Organization



INTRODUCTION



Implementation of the 2030 Agenda on Sustainable Development may still be in its early stages, but the pathways to finance development have been years in the making with their roots dating back to the proclamation of the First United Nations Development Decade in 1961. By September 2015, as the 2030 Agenda was being formalized, the international community had already set in place iterative solutions to finance the breadth of ambition embodied in the 17 Sustainable Development Goals (SDGs). Financing for Development (FfD) re-surfaced, following the mixed experience of the Millennium Development era, only this time around to serve as a prime means of implementation (MoI) for the 2030 Agenda.

The new global FfD framework that emerged from the Addis Ababa Action Agenda (AAAA) secured the highest political commitment to turn global sustainable development aspirations into national and regional realities. The framework seeks to mobilize the resources necessary to finance development through conventional financial channels (such as taxes, official development assistance [ODA], foreign direct investment [FDI] and remittances) and by leveraging non-financial means of implementation (including trade expansion, deepening regional integration and advancing technological change and pro-poor pro-employment regulatory frameworks) as well as by exploiting innovative sources of financing (such as Islamic finance instruments, blended financing and other debt funding structures).

A key feature of this framework emanates from the requirement that all FfD commitments are to be rigorously monitored, assessed and reviewed. The monitoring and assessment aspects are meant to ensure that the framework does not meet the same fate as its predecessors, whereas the review dimension aims to strengthen it, to ensure that it remains viable throughout 2030⁸. Two mandates on monitoring and follow-up are built into the framework. The first tasks the United Nations to develop transparent measures of FfD progress.⁹ The second requires United Nations regional commissions to monitor the implementation of the framework and provide analysis of regional FfD realities and to turn available data into useful actionable information.¹⁰

Monitoring progress of the new FfD framework remains an arduous task. The complexity arises not least from the need to subject more than 150 global commitments to national and regional realities to offer a nuanced or case-sensitive understanding of the benefits, as well as trade-offs and/or risks associated

with different types of financing.

Determining how different means of financing interact to provide fiscal space in any given country is equally complex.¹¹ The structural differences between the AAAA and the 2030 Agenda make it difficult to track progress on similar targets across the two. While the success of the 2030 Agenda is based on a set of goals with quantifiable targets, the success of the new FfD framework hinges on qualitative dispositions associated with creating normative conditions aimed at bridging financing gaps.

An absence of standard tools to track progress on implementation or to measure FfD holistically, the lack of a single database on those commitments, and the complexity arising from situations in which no one, simple policy or measure can be used as a basis for solutions, all constitute obstacles to monitoring progress. The World Economic Situation and Prospects 2017 report concludes that relying on a single measure to assess FfD results can distort assessments of the resources available to any given country. Rather, it favours a more elaborate approach based on a scorecard of measures.

This report offers a first attempt to depict the state of Arab FfD. It is designed to serve as a regional monitoring tool and an analytical compendium of cross-border FfD exposures. In doing so, the report tests the malleability of the global framework against the context and conditions in the Arab region. It captures the dynamics associated with the region's prime cross-border (direct and indirect) capital inflows such as FDI; capital equity; private philanthropic contributions; remittances; small and medium enterprise (SME) financing gap; and ODA dynamics among others. It factors in changes in external debt stocks; banking reporting claims and liabilities as declared by the Bank of International Settlements (BIS); international trade; debt and interest forgiveness; innovative financing; and

humanitarian financing. It also captures the corresponding outflow channels: remittances; illicit hot money narrow outflows and trade misinvoicing; profits repatriated by foreign investors; ODA; principal payments on outstanding public and publicly guaranteed long-term debt and privately non-guaranteed, and International Monetary Fund (IMF) credits; interest arrears on foreign debt (short- and long-term, and privately non-guaranteed); humanitarian aid; excessive military expenditure; and the cost of remittances.

The report takes into consideration the full array of officially supported financing channels that have been proposed to develop a measure of the total official support for sustainable development (TOSSD) and goes further to estimate FfD dynamics in the region based on net resource transfers (NRTs) accruing from financial and non-financial flows, as well as opportunity costs. Many international institutions have employed the methodology of estimating NRTs, using a variety of definitions. This report expands on them by tallying, in addition to financing channels, non-financial means of implementation and FfD opportunity costs (including those associated with conflict, humanitarian crisis, illicit finance,

trade misinvoicing, excessive military expenditures, terms-of-trade adjustments, and the high cost of remittance transfers).

Although the state of Arab FfD factors in the regional impact of global risks, conclusions may not be free from inherent biases due to the diverse range of methods employed for assessing those risks and the lack of standardized data on how different financing channels interact at the regional level. The report is not intended to be a substitute for national or global monitoring mechanisms, but rather to complement them by offering a monitoring and assessment exercise that paves the way for concerted regional FfD action.

This report is recommended for policymakers, experts and practitioners working in the field of financing and sustainable development within and outside the Arab region, as well as for the general public. It provides a compendium of the state of cross-border FfD in the Arab region. It is intended to serve as a regional monitoring, awareness-raising and advocacy tool. It is intended to subject the financing opportunities availed by the AAAA to regional contexts and national realities to ensure that the pathways remain open to achieve the 2030 Agenda on Sustainable Development.

CHAPTER 1 OVERVIEW

Humanitarian
Assistance
0.05¢

Private
Capital
Transfer
Costs
1¢

Interest
Payments
on Foreign
Debt
4¢

Trade
Misinvoicing
37¢

Principal
Repayments
on Foreign
Debt
11¢

Hot
Money
Narrow
13¢



0.1¢
Debt and
Interest
Forgiveness

0.3¢
Private
Philanthropic

2¢
Net
Foreign
Equity

3¢
Humanitarian
Assistance

21¢
Private
Finance:
Remittances

6¢
Net FDI

Excessive
Military
Expenditures

65¢



Primary
Income
on FDI

35¢

Private
Finance:
Remittances

56¢

\$2.5

LOST

ODA
(Bilateral
and Funds)

10¢

Liabilities
of the BIS

18¢



2016

9¢

Innovative
and Islamic
Financing

10¢

External
Debt

13¢

Claims
of the
BIS

15¢

Bilateral and
Multilateral
ODA

21¢

International
Trade



\$1

GAINED

A. THE COST OF CONFLICT AND DISPLACEMENT

The world is facing its most acute crisis of forced displacement, far beyond that witnessed during World War II. The forcibly displaced population breached 65.6 million, of which 40.3 million were internally displaced; 22.5 million maintained refugee status (including 5.3 million Palestinians registered by the United Nations Reliefs and Works Agency for Palestine Refugees in the Near East [UNRWA]); 2.8 million sought asylum; and 10 million remained stateless.¹²

By 2016, the Arab region became host to more than 41 per cent of the world's internally displaced persons (IDPs) and 37 per cent of the global refugee population. In terms of country of origin for refugees, the Arab region accounts for 58 per cent of the world's refugee population.¹³ Assuming a cost per refugee of less than half the average incurred by Donor Assistance Committee (DAC)—Organisation of Economic Co-operation and Development (OECD) countries as in-donor refugee costs (excluding Palestinian refugees registered by UNRWA),¹⁴ the opportunity cost of improving fiscal space arising from hosting refugees in the region could reach \$18.6 billion a year. These are modest estimates as the true costs are obscured by failure to account for crowding-out effects and the strains placed on host countries' public services.

By employing the methodology put forward by the High-level Panel on Humanitarian Financing to estimate the minimum cost for preserving the life of people most in need (of whom there were some 58.2 million in 2017)¹⁵ according to the United Nations Office for the Coordination of Humanitarian Affairs), the humanitarian assistance gap in the Arab region runs as high as \$26.5 billion. Under such a trajectory, the region is set to consume more than half of the projected increase in global humanitarian aid by 2030.¹⁶

Globally, the economic cost of violence amounted to \$14.3 trillion in 2015 (13.4 per cent of the world's gross domestic product [GDP]) or the equivalent of the combined economies of Brazil, Canada, France, Germany, Spain and the United Kingdom (before Brexit).¹⁷ Conflicts not only impede sustainable development, but also reverse decades of development gains. Between 1946 and 2016, the Arab region witnessed 59 episodes of conflict with the ensuing peace in almost half of these episodes lasting less than 10 years.¹⁸ The Arab region accounts for more than 40 per cent of global battle-related deaths since 1946.¹⁹ The cost of violence poses an opportunity cost commensurate to the effect of indirect financial outflows that could have otherwise been harnessed to finance development.

In its Survey of Economic and Social Developments in the Arab Region 2015–2016, ESCWA estimated that conflicts since 2011 had led to a net loss of \$613.8 billion in economic activity and an aggregate fiscal deficit of \$243.1 billion (equivalent to 6 per cent of the Arab region's GDP between 2011 and 2015). Taking as its basis the methodology applied by Rothers and others (2016) published by IMF staff to account for the impact of conflicts in the region,²⁰ the results reveal a loss of \$752 billion between 2011 and 2015. This methodology is broader as it covers the direct costs incurred by four conflict-afflicted countries (Iraq, Libya, the Syrian Arab Republic and Yemen) and the indirect spill-over effects on neighbouring economies. Like any quantitative assessment, however, the results can be no more than subjective approximations.²¹ Additionally, after three years of conflict, the GDP of conflict-affected Arab countries declined by between 6 and 15 per cent, two times more than any conflict-affected country in the world, while corresponding Arab neighbouring countries lost nearly 2 per cent of their GDP in comparison to 1.4 per cent elsewhere.²²

Geopolitical and regional insecurity place considerable strains on FfD propensities as they undermine financial autonomy, restrict fiscal space and drive up military expenditures. Excessive military expenditure weighs heavily on the capacity of States to achieve the SDGs. Based on the findings of the Stockholm International Peace Research Institute, global military expenditures represent 2 per cent of the global GDP, whereas Arab countries spend two-and-a-half times higher than this figure.²³ The opportunity lost or “peace dividend” accrued from diversion of resources to non-military investments relative to the global average amounts to \$75 billion per year.

B. DOMESTIC PUBLIC RESOURCES

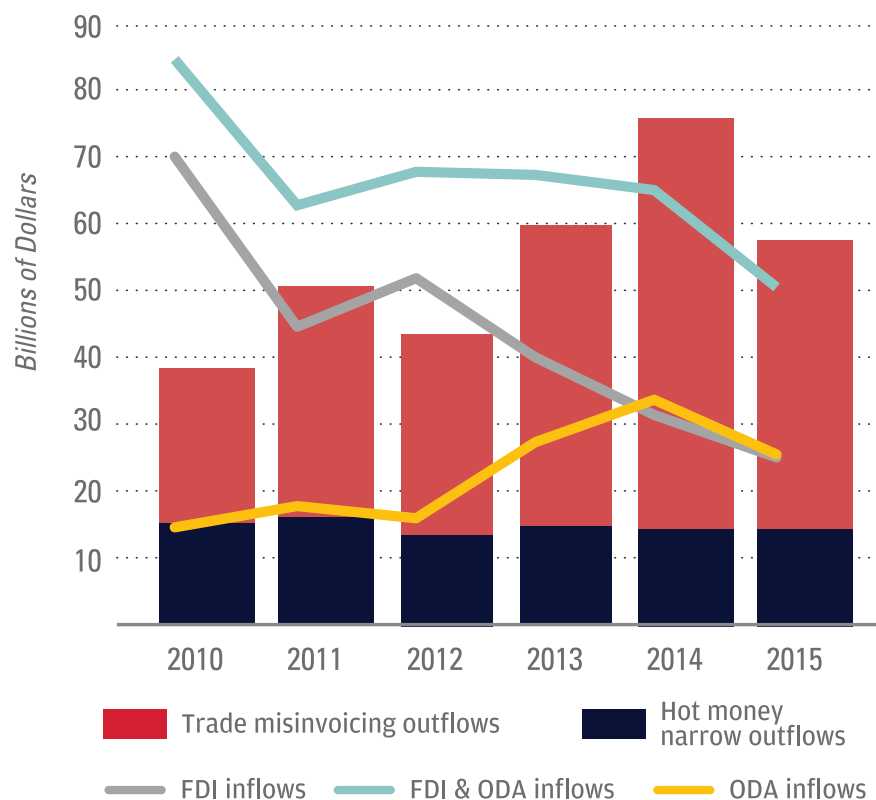
The Arab region’s potential to mobilize domestic resources remains meagre. Average revenues to GDP for non-resource rich Arab countries are below those of other developing regions and have, by and large, remained stagnant over the past decade. Natural resource-endowed Arab countries, on the other hand, maintain higher fiscal space as they rely on hydro-based revenues. Sustaining such revenues, however, remains contingent on oil wealth, production and consumption elasticities, and on changes in international oil prices. For this category of countries, the tax component of total revenue as a percentage of GDP is negligible, whereas in the case of non-resource rich countries, taxes constitute the major source of revenue. Yet, indirect or regressive taxes on both goods and services constitute the main source of tax for this category of countries. As such, illicit financial flows arising from trade

misinvoicing practices, including the illicit or undeclared trade in oil, tend to have a compound effect on Arab economies as they strive to raise their domestic resource mobilization propensities.

In general, developing countries lost \$7.8 trillion in 2015 due to the cross-border movement of Illicit Financial Flows (IFFs).²⁴ Trade misinvoicing pathways accounted for 83.4 per cent of all measurable illicit outflows between 2004 and 2013. Estimates of other types of IFFs are hard to assess given that no tool or process can effectively measure the clandestine nature of the underlying activities such as bulk cash transfers, corruption, organized crime and money laundering. This report is primarily concerned with providing a conservative baseline estimate of the magnitude of trade fraud or trade-based money laundering, which has a direct impact on domestic public resources available for financing sustainable development.

Trade misinvoicing in the Arab region in non-oil trade amounted to \$482.7 billion on aggregate between 2008 and 2015. More than 74 per cent of illicit outflows between 2011 and 2015 were associated with trade misinvoicing, or gross excluding reversals (GERs), which constitute the sum of over-invoicing of imports and under-invoicing of exports. ESCWA estimates that the region’s average illicit financial flows (IFFs) through trade misinvoicing, averaged 8.2 per cent of total non-oil trade with the world, or the equivalent of \$60.3 billion a year between 2008 and 2015. Since 2014, illicit financial outflows have outstripped the combined aggregate of total ODA and FDI inflows (see figure 1).

Figure 1.

Illicit financial flows outstrip FDI and ODA to the Arab region

Source: Based on Global Financial Integrity, 2017; ESCWA, 2018; UNCTAD, 2018; OECD, 2018a.

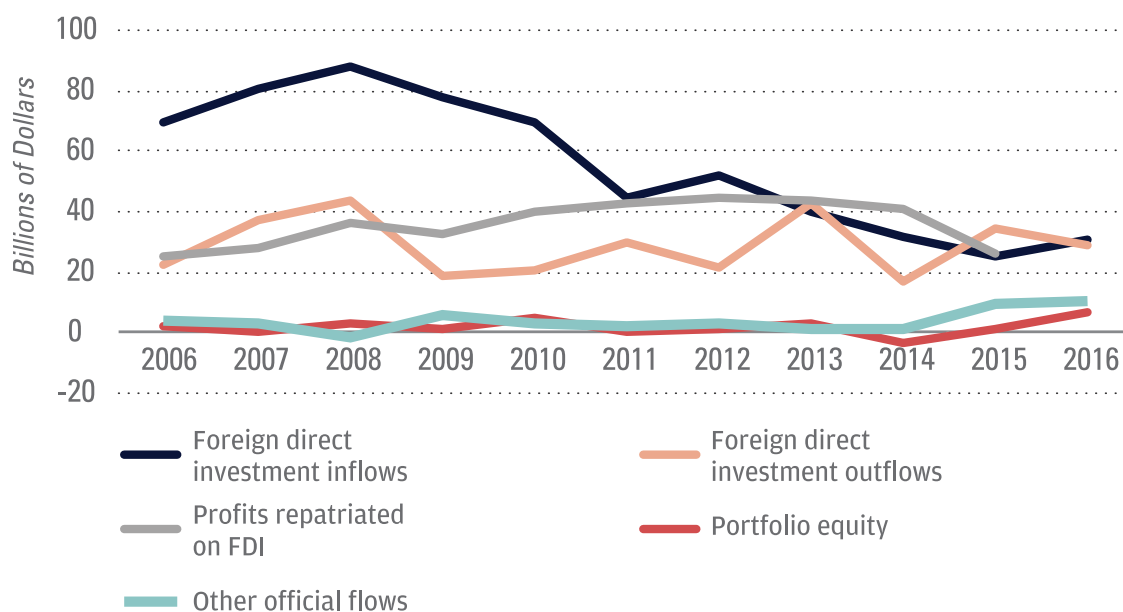
Note: ODA inflows include intraregional and extraregional ODA received by the Arab countries.

C. DOMESTIC AND INTERNATIONAL PRIVATE BUSINESS AND FINANCE

The Arab region received \$32.4 billion in FDI in 2016 (4.8 per cent of total such investment in developing countries), but witnessed in turn an outflow of \$36.2 billion. The volatility of FDI inflows can be attributed largely to risks associated with a period that witnessed declining commodity

prices, especially for crude oil, metals and minerals. Between 2011 and 2016, the average annual inflow of FDI, portfolio investments and other official flows into the region amounted to \$44 billion, compared with outflows along the same channels of \$70 billion²⁵ (see figure 2).

Figure 2.
The State of Investment in the Arab region



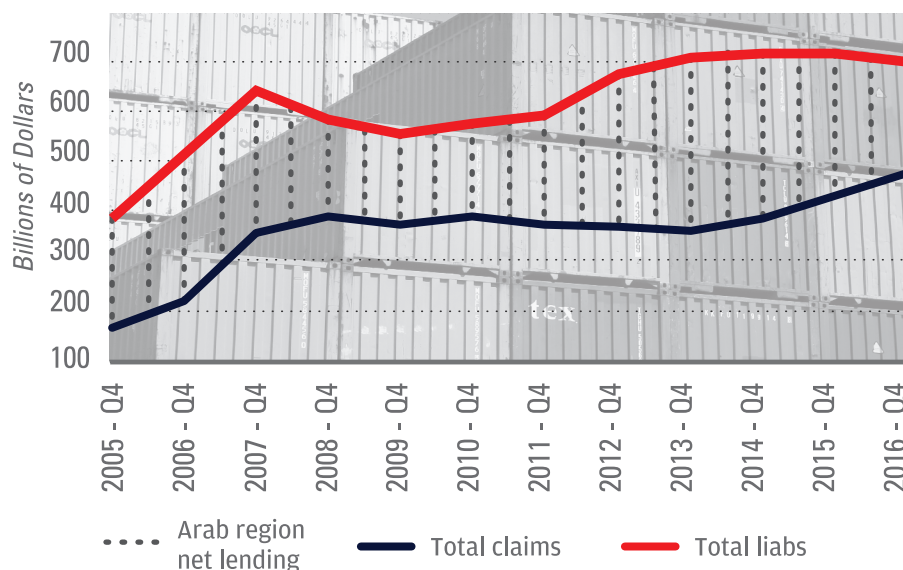
Source: Based on IMF, 2017a; UNCTAD, 2018; OECD, n.d.

Primary income on FDI repatriated outside the Arab region averaged \$39.95 billion per year between 2011 and 2015. Oil-rich Arab economies generated 69 per cent of the total profits repatriated by foreign nationals. Combining incoming and outgoing FDI with repatriation of profit, it would appear that the region has become a net exporter of capital as for every dollar received in FDI, \$1.8 leaves the region.

As FDI became more risk averse, countries in the region resorted to beggar-thy-neighbour efforts to attract inward investment. At the same time, sovereign wealth funds benefitted from

fiscal incentives designed to encourage investment in rich economies. By some estimates, the capital stock of those funds amounted to \$3 trillion in 2018. Those outflows, however, are small compared with the money managed by leading foreign financial institutions. Indeed, cross-border deposits by Arab clients with leading international banks outside the region (liabilities) have been persistently higher than borrowings from them (claims). The region thus remains a net lender and is capitalizing international banks with a net total stock of outflows of \$223.4 billion in 2016 (see figure 3).

Figure 3.

Arab region: International Banking Claims and Liabilities

Source: Based on the Bank for International Settlements, 2018.

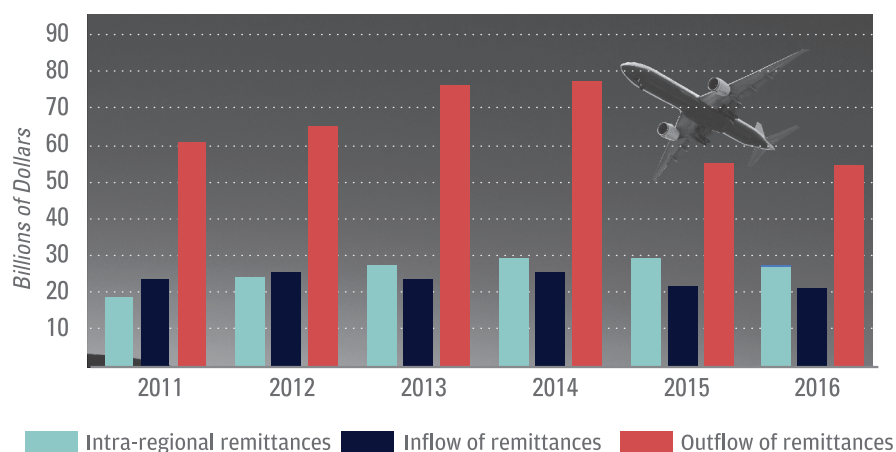
The Arab region is a source and destination for migrant remittances. Remittances into the region amounted to \$21.4 billion in 2016, representing 5 per cent of total remittances sent to developing countries according to the World Bank (2018). Intra-regional remittances (\$27.1 billion in 2016) are discounted as they are generated and retained in circulation within the region. Remittances sent by all foreign nationals residing in the region to non-Arab countries fell from \$60.4 billion in 2011 to \$54.3 billion in 2016. The upshot is that, for every \$1 of remittances flowing into the region between 2011 and 2016, \$2.8 flowed out (see figure 4)²⁶.

Traditionally, most remittances flowing into the Arab region have been used to finance household consumption, education and health. These encourage the development of human capital and thereby stimulate growth in the long run. However, only a small portion is

channelled into investment and the accumulation of physical capital that can help to achieve sustainable development. Considerable heterogeneity exists in the region with respect to the remittances–growth correlation. According to some studies, the investment of remittances has, to varying degrees, had a positive effect on growth in Djibouti, Egypt, Jordan, Lebanon, Morocco, Oman and the Sudan.

The cost of repatriating remittances in the Arab region remains a structural problem and accounts for large development finance leakages. The cost of sending remittances from Saudi Arabia to Egypt averaged 14.57 per cent of the total amount sent in the fourth quarter of 2016, but only 1.45 per cent of the totals sent to Nepal according to the World Bank. Had those costs been reduced, as called for in the AAAA and SDG-10, the Arab region could have saved \$10.2 billion between 2011 and 2016 and used those savings to finance development.

Figure 4.
Flow of remittances in the Arab region



Source: Based on World Bank, 2018c.

D. INTERNATIONAL DEVELOPMENT COOPERATION

ODA received by Arab countries in 2016 totalled \$26.96 billion.²⁷ That figure represented approximately 17 per cent of total ODA (OECD-Development Assistance Committee [DAC] and Non-DAC) to developing countries. At the same time, according to the OECD, donor countries spent 11 per cent (\$15.96 billion) of their ODA to host refugee populations.²⁸ In normative terms, such spending should not be considered ODA, since it is not restricted to developmental objectives. That figure reached 15 per cent on average for DAC–European Union countries.²⁹

However, the region saw other official flows,³⁰ mainly in the form of grants for commercial or export promotion, trade facilitation, official bilateral transactions and net acquisitions issued to the private sector, rise to \$10.4 billion in 2016 (around two times higher than the regional average between 2011 and 2016). Private philanthropic grants also increased, with an inflow of \$630 million in 2015, compared with \$244 million in 2011.

Arab donors have historically accounted for most ODA granted by non-DAC countries. Between 1970 and 2016, Arab

ODA outflows represented 83 per cent of non-DAC ODA and 11 per cent of total DAC ODA.³¹ According to the Arab Monetary Fund, the cumulative aggregate of total Arab bilateral ODA between 1970 and 2016 reached \$216.22 billion and bilateral ODA by Arab countries totalled \$13.54 billion in 2016. Nearly all is provided by five Gulf Cooperation Council (GCC) countries (Saudi Arabia, Kuwait, Oman, Qatar and the United Arab Emirates). In 2016, their combined ODA represented 1 per cent of their gross national income (GNI), surpassing the United Nations' 0.7 per cent target.

Total ODA provided by Arab development funds³² in 2016 amounted to \$19.99 billion (52.5 per cent of which took the form of extra-regional concessional lending outflows to other regions). From their establishment until 2016, those funds provided a cumulative aggregate ODA of \$184.2 billion (according to the Arab Monetary Fund, Arab countries received 54 per cent, or \$99.46 billion, and a total of \$84.74 billion in ODA outflows were provided to developing countries, least-developed countries, and small and vulnerable economies [SVEs]). In sum, the Arab region witnessed a record high outflow of ODA in 2016, amounting to

\$19.4 billion, with concessional lending by Arab funds accounting for 54 per cent of total extra-regional Arab ODA. In effect, between 2011 and 2016, for every \$1 the region received in ODA inflows, \$0.65 left the Arab region.

E. INTERNATIONAL TRADE AS AN ENGINE FOR DEVELOPMENT

An inclusive, non-discriminatory and equitable multilateral trading system (MTS) is a prime mean for achieving SDGs and, indeed, the AAAA urges members of the World Trade Organization (WTO) to conclude negotiations on the Doha Development Agenda (DDA). However, it is this very objective that has continued to elude the WTO since 2001 and has resulted in the adoption of new approaches that have undermined the intactness of the DDA's single undertaking. In addition, the multilateral trading system seems to have received a further blow as a result of the intransigencies that emerged at the WTO Eleventh Ministerial Conference held in Buenos Aires in December 2017, which was followed by a retraction from multilateralism giving way to the resurgence of unilateral trade and investment protectionism.

With regard to the commitment to achieve inclusivity, only 13 Arab countries have been granted membership of the General Agreement on Tariffs and Trade (GATT)/WTO since 1987, and several Arab accession requests are still pending. The State of Palestine, on its part, was barred from being granted permanent observer status at the WTO although, in normative terms, it should be able to exercise trade autonomy through the Paris Protocol on Economic Relations.

Trade impacts sustainable development in two opposing ways: it can help spread efficient and less-polluting technologies, and it can generate the wealth to pay for it.³³ Yet, sustainable development does not appear to be of prime concern to the WTO and is not prominently featured in the WTO rule book. At most it is dealt

with obliquely and does not necessarily carry a legally binding obligation.³⁴ The Agreement Establishing the World Trade Organization only mentions sustainable development in its preamble with no legally binding mechanisms or incentives included to promote or safeguard it. In fact, inconsistencies can even arise between upholding non-discriminatory multilateral trade principles and the promotion of sustainable development practices. If a key objective of FfD is to serve as the means of implementation for SDGs, then there is a need for countries to avail themselves of the policy space necessary to regulate (the right to regulate) in the interests of achieving those SDGs. As such, the international trade reform agenda should seek embedding 'trade justice' norms in the WTO, rather than merely settle for normative 'trade equality' dispositions.

In 2015 and 2016, the Arab region became a net importer of goods, in part due to the drop-in commodity prices, leading to current account deficits in most Arab countries and thereby shrinking foreign reserves and increasing external debt. Exports totalled \$649.1 billion (around half, \$351.7 billion, in oil revenue), while total imports into the region amounted to \$778.6 billion according to IMF Dots/UN-COMTRADE. Deteriorating terms of trade between 2006 and 2008, and again between 2010 and 2014, were driven by a variety of factors, including political instability, multiple structural deficiencies and the erosion of trade preferences. On average, between 2011 and 2016, the region's deteriorating terms of trade have resulted in \$16.2 billion annually in indirect lost trade opportunities/revenues³⁵.

Deepening Arab trade integration is an alternative source of trade-led growth. Evidence suggests that intra-regional trade has a positive influence on the GDP performance of the Arab region with the overall effect on GDP of trade in goods higher than that of trade in services.³⁶ This is due to the fact that the liberalization of

intra-trade in services has stalled unlike in the case of goods that are circulating in the region under preferential duty-free conditions within the Greater Arab Free Trade Area. In order to fully exploit the potential influence of trade on growth, regulatory and structural reforms that reduce trade barriers and/or service liberalization should be encouraged. Between 1995 and 2010, estimates show that every 10 per cent increase in intra-regional trade leads to an average of 0.08 percent GDP growth. The ensuing period between 2011 and 2015 was the exception due to the political turmoil that engulfed the region at the time.³⁷

With the launch of the Arab Customs Union (ACU) by 2021, a substantial share of the Arab region's imports could well be circulating freely within its boundaries. One important implication of this endeavour for the trade-growth trajectory is that by 2030 the Arab region would thereby become host to trade preferences for at least 110 countries from five continents. By that time a substantial share, if not all, of the region's imports would be in free circulation or at least receive some form of border and beyond-the-border preference. Under these conditions, the already narrow scope to raise trade taxes, whether in the form of tariffs, quotas requiring licensing, tariff-rate quotas, para-tariffs and/or other fiscal charges having equivalent effect to mobilize FfD resources or promote nascent technologies/industries as envisaged by the AAAA, would be further eroded.

F. DEBT AND DEBT SUSTAINABILITY

Although the Arab region has witnessed, as elsewhere in the world, the accumulation of high gross public and external debt stocks, its debt dynamics otherwise stand in contrast to international trends. While net debt flows to developing countries had become negative by 2015, the Arab region witnessed a surge in debt inflows needed to offset constraints on financing and the fiscal space, arising

from political transition and turmoil in the region. Overall, borrowing by developing countries around the world from official creditors has steadily declined since the early 2000s, but that is not the case in the Arab region. Globally, the rise in debt over the past years has been driven by private non-guaranteed and corporate short-term borrowing, whereas in the Arab region it has resulted from the swelling of public and publicly guaranteed debt.

By 2015, the different measures employed to gauge the fiscal and financing impact of the rising debt stocks, including the share of debt servicing to government revenues in the Arab region, exceeded the corresponding averages for low- and middle-income countries, reversing the previous prevailing situation. External debt repayments by Arab countries, including principal and interest payments on public and private sector short-term and long-term debt and IMF charges, amounted to \$20.15 billion in 2016 (\$5.91 billion in interest and \$14.25 billion in principal).³⁸ In 2016, no debt relief measures, either in principal or as interest repayments, were recorded, although four countries (the Comoros, Mauritania, the Sudan and the Syrian Arab Republic) had traditionally received such relief.³⁹

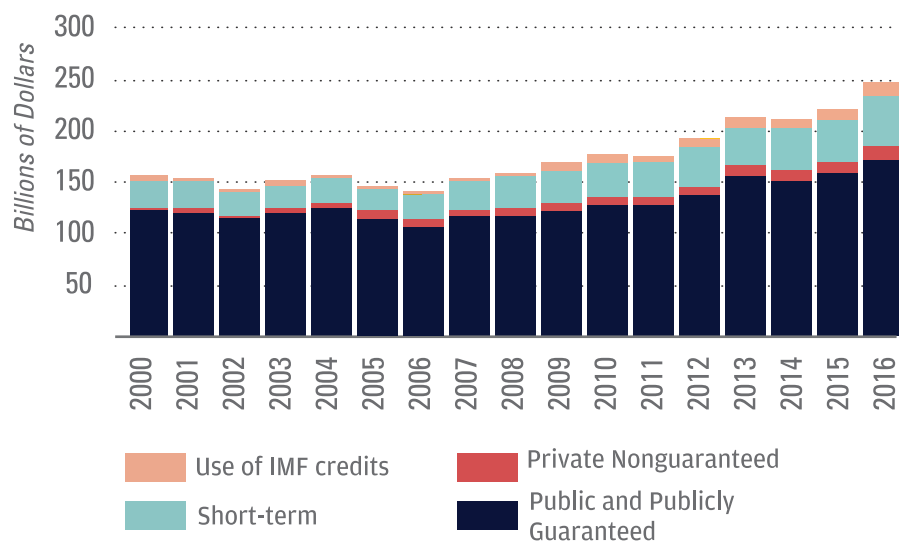
In a reversal of the earlier situation, calculations of net transfers on external debt⁴⁰ show that between 2011 and 2016, for every \$1 dollar of debt inflow into the Arab region, \$1.5 was paid back in arrears on the outstanding debt stock.⁴¹ According to a joint survey prepared by the IMF and Arab Monetary Fund (AMF), 84 out of 216 Arab banks have been subjected to some form of de-risking. Between 2012 and 2015 there was a significant decline in the scale and breadth of correspondent banking relationships (CBRs) in the region. The number of account closures also appears to have increased with 63 per cent of Arab banks reporting the closure of CBR accounts in 2015, as opposed to 33 per cent in 2012. Reasons cited include

the overall risk-averse stance of foreign financial institutions, changes in regulatory requirements in those institutions and

the deterioration of sovereign credit-risk ratings of some Arab countries.

Figure 5.

Arab external debt stock



Source: Based on World Bank, 2018a.

CHAPTER 2

DOMESTIC RESOURCE MOBILIZATION

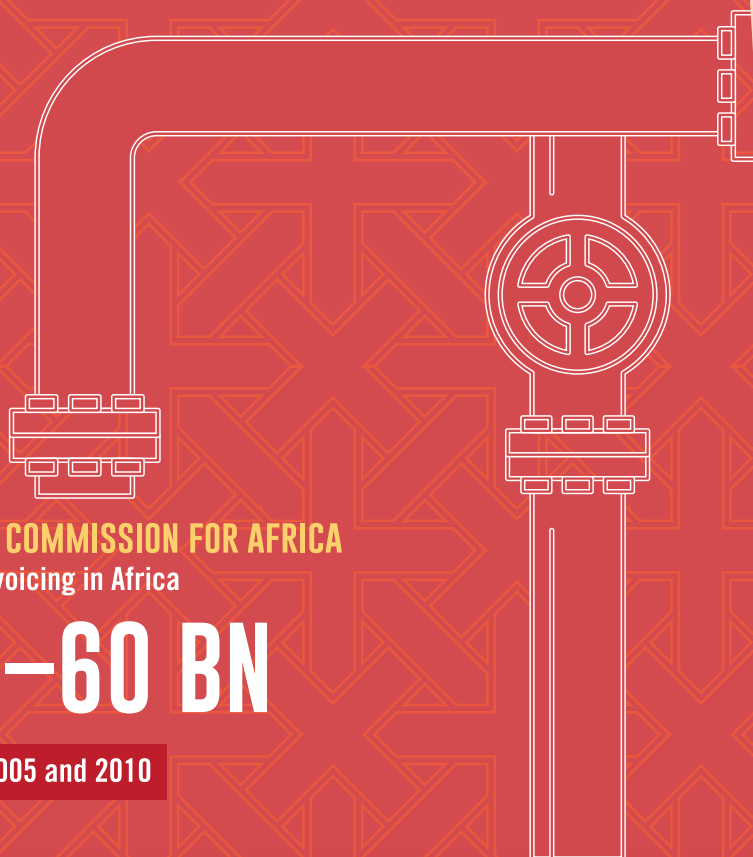
ANNUAL FINANCIAL

Between 20

*Illicit financial
developing coun
to \$509–*

*Trade misinvoici
developing coun
to \$363–*

2011



ECONOMIC COMMISSION FOR AFRICA

Trade misinvoicing in Africa

\$50–60 BN

Between 2005 and 2010

ECONOMIC COMMISSION FOR LATIN AMERICA AND THE CARIBBEAN

Trade misinvoicing in Latin America
and the Caribbean

\$50–100 BN

Between 2004 and 2013

ANNUAL ILLICIT
FINANCIAL FLOWS

Between 2005 and 2014:

Financial outflows from
developing countries amounted
to \$509–\$796 bn.

Trade misinvoicing outflows from
developing countries amounted
to \$363–\$651 bn.



ECONOMIC AND SOCIAL COMMISSION
FOR WESTERN ASIA

Trade misinvoicing in the Arab region

\$60–77 BN

Between 2008 and 2015

UNITED NATIONS CONFERENCE ON
TRADE AND DEVELOPMENT

Percentage of the value of exports lost due
to trade misinvoicing in some
commodity-dependent developing countries

67%

Between 2000 and 2014



Developing countries, including low-, middle- and high-income, resource-rich economies of the Arab region, face considerable challenges in mobilizing domestic resources for development. Fiscal space constraints are, more often than not, attributed to a narrow tax base, “hard-to-tax” sectors, weak tax administration (corruption), low levels of tax compliance and low taxpayer morale; tax evasion and/or avoidance and aggressive tax practices to name but a few.⁴² In addition, IFFs gather considerable attention as they constitute major leakages to domestic resource mobilization efforts in both developing and developed country formats. Over the past two decades, IFFs have continued to exploit the complexities that have arisen from over regulation and withered trading and clearance systems, and have thrived as a result of tax havens and the increasing operational sophistication of multinational corporations, especially those that operate without permanent establishments through global value chains (GVCs), with multiple domiciles undertaking ancillary services.

Curbing IFFs remains fundamental to the effective mobilization of domestic resources and the advancement of the FfD agenda. The adverse effects of IFFs have been highlighted by many international institutions, notably the Washington-based research and advisory organization Global Financial Integrity through its flagship publication entitled *Illicit Financial Flows from Developing Countries: 2004–2013*, which revealed that for every dollar of ODA received by the developing world, 10 dollars flowed out illicitly.⁴³ The OECD has also estimated the negative impact of IFFs, establishing that for every dollar granted to developing countries in ODA, 3 dollars left in the form of IFFs.⁴⁴ Irrespective of the methodologies employed, the implications are dire and point to the same outcome: it is impossible to adequately raise domestic resources if no international and regional action is taken to combat IFFs.

In the case of the Arab region, IFFs have closely matched the combined aggregates of both ODA and FDI flowing into the region. From the onset of political change in 2011, up to the adoption of the AAAA in 2015, the region lost \$0.50 on every dollar it gained in cross-border FfD inflows. Regional insecurity remains a daily source of and provocation for IFFs and trade misinvoicing in the region, whether a result of occupation, terrorism, corruption, transnational crime or a spate of militant activity. Curbing IFFs, therefore, requires a broad stream of actions to ensure that pathways remain open for deeper forms of Arab developmental regionalism and structural transformation to ensue both to support of the 2030 Agenda and to achieve the SDGs in their entirety, rather than in confined extract limitation to SDG 16 and 17.

A. GLOBAL ACTION ON IFFS

1. Normative international mandates and assessments

The AAAA presents a range of actions and commitments on IFFs including a normative commitment to substantially reduce them, with a view to eventually eliminating them by 2030. Other actions highlighted in this area include combating tax evasion, tax havens and corruption through strengthened national regulations and international collaborative action. Commitment to combating IFFs is also captured in SDGs. SDG-16 stresses the need to combat corruption and bribery, and to address IFFs and the recovery of stolen assets, all of which are considered critical to promoting economic growth and investment.

At its 71st session, the General Assembly adopted resolution A/RES/71/213 on the promotion of international cooperation to combat IFFs to foster sustainable development. The resolution expresses deep concern about the impact of IFFs, in particular those caused by tax evasion and corruption, on the economic, social and political stability and development

of societies. The United Nations Inter-agency Task Force on Financing for Development (IATF) recognizes the adverse socioeconomic and governance-related implications arising from IFFs, particularly as they continue to cause substantial resource leakages in developing countries. Those leakages occur through several channels of delivery that, directly and indirectly, affect a country's ability to increase and mobilize its domestic resources.

The growing literature on IFFs sheds only partial light on the magnitude of damages inflicted on developing countries. The developing world is estimated to have lost \$7.8 trillion in IFFs between 2004 and 2013 and the pace of growth of IFFs is said to be increasing at a rate of 6.5 per cent per year, or nearly twice as fast as the growth of global output.⁴⁵ Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) asserts that more \$1 billion was lost in 2013 in the form of IFFs in developing countries, and considers this estimate "presumably only the proverbial tip of the iceberg, however, as the real figure is likely to be much higher". Today, less than 1 per cent of global IFFs are seized by authorities, with the shadow economy estimated to be worth \$650 billion and the cost of the global economy of counterfeiting reaching \$1.7 trillion by 2015.⁴⁶ With progressive advances in blockchain technology and cryptocurrencies alongside discretionary trade facilitation measures, these figures are expected to rise exponentially.

The Panama Papers and the Bahama leaks provided compelling evidence as to how invasive and detrimental IFFs can be for sustainable development. Nevertheless, their impact on the Arab region remains more severe than in other regions owing to the scope and scale of its prolonged conflicts, civil wars, reconstruction needs, development challenges and deficits. With significant amounts of capital moving across borders undetected and profit shifting

practices on the part of multinational corporations, capital controls, trade and income taxes and other fiscal charges are circumvented, thereby stripping governments of legitimate revenues that could have otherwise been harnessed (including direct and indirect taxes) to serve sustainable development. Without these public domain resources, it would be difficult to carve out the necessary fiscal space to achieve SDGs or cover the costs of implementing national 2030 frameworks.

2. Multidimensional complexities associated with IFFs

Since the adoption of the AAAA in 2015, the multifaceted implications of IFFs have been recognized. They continue to undermine the rule of law, inhibit effective tax administration and revenue collection (tax evasion) and distort trade figures and erode gains from multilateral and preferential trade (trade misinvoicing), as well as worsen macroeconomic and security conditions (terrorist or conflict financing). However, to date, there is no multilaterally agreed definition of IFFs or one single methodology employed for their measurement or a consensus on their elements and scope.

To frustrate matters further, the term "illicit financial flows" is not defined in the AAAA or in the 2030 Agenda. Institutional stakeholders and national authorities, therefore, resort to various methodologies, and factor different elements and components into their IFF measures. This impedes attempts to provide comparable global and regional assessments, or develop a clear picture of IFFs across territories and periods of time. In an attempt to overcome this predicament, the United Nations IATF agreed that IFFs should cover any cross-border movement of illicit funds and assets that are a contravention of national laws and international conventions on tax evasion, also they should cover international trade fraud (including misinvoicing), criminal

activity (including money laundering and smuggling and trafficking in drugs, cultural objects, medicines, persons and natural resources), financing of organized crime and terrorism, and corruption.

Disagreements over whether tax avoidance (including aggressive tax planning and optimization, and transfer pricing) should be considered to be IFFs remains unresolved. Those flows might not necessarily be considered “illicit” in nature as they exploit loopholes in national and international regulatory frameworks.⁴⁷ There is agreement, however, over two conceptual underpinnings associated with IFFs, namely, that they constitute resources/ money that is illegally earned, transferred or used; and that they entail the crossing of international borders. As such, the following three types of flows were identified as IFFs: those originating from criminal activity; corruption-related IFFs; and trade/tax-related IFFs.

Indeed, bribery, public embezzlement and tax evasion, for example, adversely affect domestic public investments and erode the tax base. Criminal earnings primarily impact domestic investment, while multinational corporations’ profit shifting and aggressive tax practices erode the tax base. IFFs facilitate illegal tax evasion and can be associated with base erosion and profit shifting (BEPS), depriving Arab countries of crucial domestic resources for development. In contrast, the very “de-risking” global processes used to combat money laundering and terrorist financing may disproportionately adversely affect licit financing channels available to developing economies.

Illicit flows can also take place through physical bulk cash smuggling. This would not show up in any official statistics, so it is not quantitatively estimated here. Such cash smuggling could be a particularly acute issue when the industries generating the cash already operate in the underground economy of transnational

crime, such as the global illicit trade in drugs, small arms and light weapons, cultural property, and crude oil theft. Despite the difficulty in estimating the size of these illicit industries (given that trade in these goods is reported at neither end of the transaction), a recent report⁴⁸ provided estimates of the volume of these illicit industries, among other categories of transnational crime.

Despite gaps in coverage and unavoidable sources of error, the estimates presented here have real value in developing an understanding of the scope and particularities of the trade misinvoicing (and more generally, IFF) problem in the Arab region. These flows have a significant impact on formal private investment and domestic public revenues, and thus on development financing.

3. Measures of IFFs and trade misinvoicing

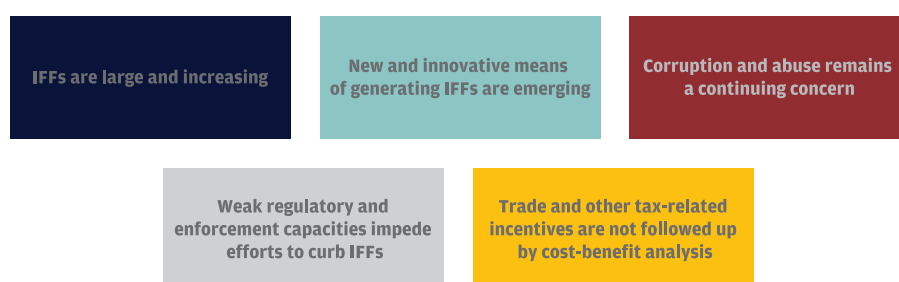
Work on improving measurement for the separate components of IFFs and modes of transfer are ongoing at multilateral and regional levels. There is a growing recognition that a single aggregate number for IFFs would provide a powerful tool for effecting policy changes. The United Nations IATF, for its part, agreed that as a first step to developing uniform broad-based estimations, it was critical to map the different components and current status of data to identify data gaps. Measuring IFFs *grosso modo* remains challenging, not least due to the clandestine nature of the underlying activities, be they transnational crime (money-laundering, proceeds of crime and stolen assets), corruption-based (evasion of capital account restrictions or exploitation of expenditure eligibility requirements among others), or associated with commercial activity (transfer pricing, undeclared offshore wealth). Yet, trade misinvoicing remains the dominant method for quantifying the trade-based components of IFFs.

Several international agencies and United Nations regional commissions have published estimations of trade-misinvoicing over the past few years. The Economic Commission for Africa provided estimates of trade misinvoicing for a number of African countries, reaching \$50 billion in average annual losses from IFFs. The same

conclusions were reached from a review of other related work undertaken by Global Financial Integrity, the African Development Bank (AfDB) and the United Nations Development Programme. In 2015, the High-Level Panel on Illicit Financial Flows from Africa provided some significant findings in this area (see figure 6).

Figure 6.

Findings of the High-Level Panel on IFFs from Africa



Source: United Nations Economic Commission for Africa, 2015.

In 2016, ESCWA dedicated a chapter in its first issue of the Arab Sustainable Development Report to address FfD, which touched upon the issue of IFFs. The Economic Commission for Latin America and the Caribbean followed suit and dedicated an entire chapter in its annual economic survey to estimate IFFs in Latin America and the Caribbean.⁴⁹ In the same year, the United Nations Conference on Trade and Development (UNCTAD) employed a methodology, albeit not free from contention, to analyse misinvoicing in primary commodities in a number of commodity-dependent developing countries and found them to be losing as much as 67 per cent of their export revenue to trade misinvoicing.⁵⁰

Even when the same methodologies are used to estimate trade misinvoicing, different estimates can be reached because of differing assumptions, components and data sets. For example, according to the Economic Commission for Africa's methodology, African countries lost around \$407 billion from trade misinvoicing over the period 2001–2010. Meanwhile, Global Financial

Integrity's analysis suggests that trade misinvoicing from Africa amounted to \$242 billion over the same period. A third approach used by Ndikumana and Boyce⁵¹ shows that estimated IFFs from 33 African countries amounted to \$353.5 billion over the period 2000–2010. The Economic Commission for Africa maintains that such disparities are the result of using different data sets and approaches.

B. IFFS AND TRADE MISINVOICING IN THE ARAB REGION

This report limits its quantitative examination of IFFs to estimates of trade misinvoicing, a method for moving money illicitly across borders, which involves deliberately misreporting the value of a commercial transaction on an invoice submitted to customs. Other studies⁵² have highlighted trade misinvoicing as the largest component of measurable IFFs globally, so it is prudent to focus on it in more detail. Though no estimation method will ever be exact, and each will always suffer from simplifying assumptions and less-than-ideal data – particularly in a research area where actions are intentionally hidden – the method employed

in this paper sheds some light on the issue of trade misinvoicing in the Arab region.

ESCWA identifies trade misinvoicing as a key conduit and a major component of IFFs. IFFs associated with trade misinvoicing pose severe structural, socioeconomic, governance and security complications for Arab economies. They constitute substantial leakages to domestic revenues that could have otherwise been harnessed to create the fiscal space to sustainably finance development. Misinvoicing is driven by country/regional idiosyncrasies and can provoke beggar-thy-neighbour dispositions. Trade fraud exacerbates income inequalities in as much as trade-based money laundering erodes tax revenues, impairs government expenditure eligibility requirements and undermines the rule of law, as well as a country's perception-based governance and corruption standing.

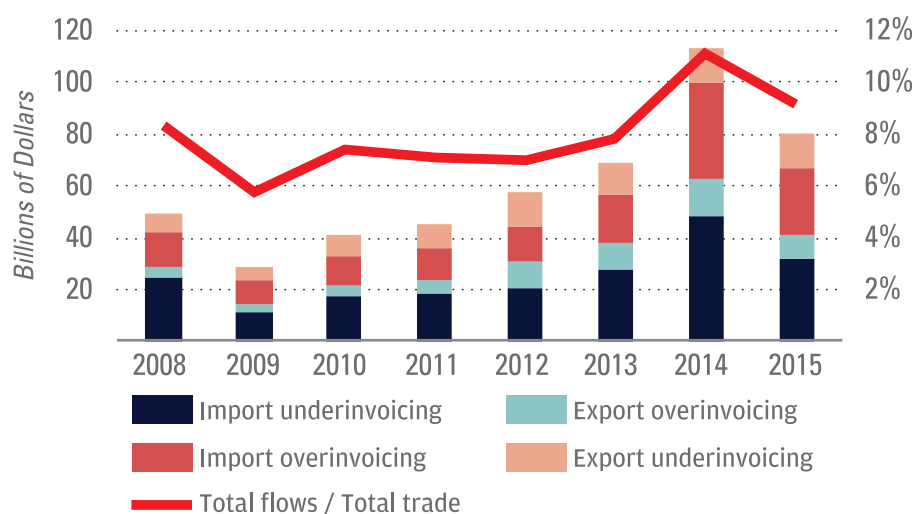
IFFs can also facilitate tax avoidance and illegal tax evasion. IFFs can be associated with BEPS, depriving Arab countries of crucial tax resources for development. Further, the very “de-risking” mechanism used internationally to constrain money laundering and terrorist financing may be disproportionately affecting the licit resources of the Arab region. As correspondent banking relationships are cut, it can lead to financial exclusion for vulnerable customers.⁵³ Only limited formal studies of the impact of de-risking have been carried out for the Arab region.⁵⁴ However, to the extent that this risk avoidance occurs on a wholesale basis (i.e., without a case-by-case risk

assessment of individual customers), businesses and citizens with otherwise legitimate interests may be forced to shift their activities into informality depriving governments of a tax-relevant resource.

Unfortunately, there have been very few studies on the development impact of IFFs in the Arab region. Though there have been countless studies approaching related issues from a security perspective, this crucial development angle has been broadly ignored.⁵⁵ The leading motivations behind trade misinvoicing in the Arab region can be broadly categorized as macroeconomic, governance-related and structural. Trade misinvoicing in the Arab region is evenly split between inflows and outflows.

In an attempt to provide a comprehensive account of illicit flows and trade misinvoicing in the region, ESCWA examined four channels through which trade misinvoicing occurs, so as to capture the diverse range of domestic resources leaked out of the Arab region that could have otherwise been harnessed for sustainable development, including those associated with tariff revenues and similar charges, duty drawback and export subsidy programmes (see figure 7). One main conclusion drawn from this analysis is that trade fraud is constantly evolving and remains ahead of the curve, both in sophistication and use of technology, outstripping detection. The forces driving global interconnectivity in trade, finance, communications and transport are the same as those making trade and financial systems vulnerable to trade-based IFFs.⁵⁶

Figure 8.

Trade misinvoicing by type

Source: ESCWA, 2018.

A cursory examination of trade misinvoicing in the context of regional trade agreements suggests that, Greater Arab Free Trade Area (GAFTA) countries have a lower level of trade misinvoicing in their trade with one another than with their external trade partners, with intra-Arab trade misinvoicing at 5.1 per cent of total non-oil regional trade (compared with 9.4 percent of non-oil external trade) over the period 2008–2015.

These findings raise several questions with respect to the enforcement of regional trade agreements (intra- and

extraregional). It also has implications for the establishment of an Arab customs union by 2021. The findings themselves are relevant to the ongoing negotiations on: an Arab common customs code; a common external tariff structure for the customs union; trade misinvoicing implications arising from non-unification of the harmonized commodity description system; customs declarations, fines and other related custom offences; and the operation of a revenue collection and clearing house mechanisms within the foreseen customs union.

CHAPTER 3

DOMESTIC AND INTERNATIONAL PRIVATE FINANCE



FOREIGN DIRECT INVESTMENT INFLOWS

Since political upheaval in 2011, with every **\$1 gained** in foreign direct investment inflows, **\$1.8 are lost** in foreign direct outflows and primary income.



Developed
39 COUNTRIES

\$1 TR



Developing
156 ECONOMIES

\$670 BN



Arab Region
22 COUNTRIES

\$32 BN

REMITTANCES

For every \$1 generated in remittance in the Arab region, \$2.8 are in turn repatriated to other regions and are lost due to the relatively high cost of transferring remittances.

\$1



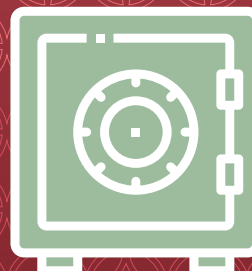
inflow

\$2.8

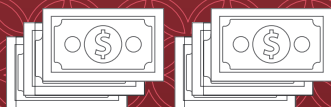


outflow

\$10 BN



Reducing the cost of remittances to 3% as mandated by the Addis Ababa Action Agenda, renders \$10 billion in remittance cost savings between 2011 and 2016.



Total outflows since 2011
remittances, FDI, and primary income:

\$807 BN



Total inflows since 2011
remittances and FDI:

\$369 BN

The new global FfD framework recognized domestic and international private business activity and investments as major drivers of productivity, inclusive growth and job creation. The succinct statement holds key potential for FfD to serve as a means of implementation of the 2030 Sustainable Development Agenda. Yet, current levels of domestic and international private finance remain insufficient to realize Arab developmental regionalism.

Over the past decade, the Arab region witnessed more than its fair share of negative net capital flows: a situation that challenges the traditional development narrative as private development finance has been flowing in reverse rather than inwards to serve the region's sustainable development. Moreover, as FDIs became scarce and risk averse, both developments in reaction to the 2008 global crisis and conflict, regional efforts to ensure a sustained flow of private finance gave way to competitive aptitudes and beggar-thy-neighbour tendencies. Intra-regional remittances continue to provide solace as they offer a relatively stable source of financing that offsets, to varying degrees, the negative flows associated with other forms of cross-border capital movements.

Under these conditions, the traditional narrative on improving investment climates and enhancing financial inclusion, including harnessing the potential of SMEs to generate jobs, becomes ever more frustrated. Empirical evidence suggests that to generate full and productive employment and to promote SMEs and micro, small and medium enterprises (MSMEs) as envisaged by the AAAA, the Arab region needs to conjure between \$290 and \$362.5 billion (constant 2011 prices)⁵⁸ in new credit facilities to enable these enterprises to create between 60 million⁵⁹ and 75 million⁶⁰ additional jobs by 2030 and ensure social and political stability.

These figures broadly resonate with the International Finance Corporation findings, suggesting at the time that the implied outstanding SME credit in the region was in the range of \$300 to \$360 billion.⁶¹ In 2017, the potential demand for SME finance reached \$183 billion. These financing needs, however, pale in comparison with the \$701 billion worth of Arab credit (deposits and loans) held by international banks and non-financial institutions. The Arab region's growth and employment needs can be accounted for if action is taken to expand SME credit and harness the significant share of SME activity that continues to be leaked into informality.

The first section of this chapter maps the landscape of international public and private finance before and after 2015 (the baseline year established by the AAAA to monitor the implementation and progress of FfD). The second section provides an analytical assessment (qualitative and quantitative) of the state of private finance in the Arab region including cross-border flows, and the main determinants affecting the mobilization of such finance, taking into account regional contexts and realities as emphasized by the AAAA.

A. GLOBAL TRENDS IN DOMESTIC AND INTERNATIONAL PRIVATE BUSINESS AND FINANCE

The AAAA recognizes that private international capital flows, particularly FDI, and a stable international financial system are vital to national development efforts. The new global FfD framework highlights the link between stable, long-term private finance, both domestic and international, and the achievement of sustainable development. The framework also recognizes the need to develop competitive investment climates, remove perceived cross-border constraints, reduce policy and risk uncertainties and promote capital markets.

1. Investment climate

The United Nations Inter-Agency Task Force on Financing for Development has identified several global benchmark initiatives to monitor the nexus between investment climates and competitiveness. It has found a positive correlation between removing regulatory impediments, red tape and other challenges facing businesses on the one hand and improvements in quantitative measures of competitiveness (institutional or policy-related) on the other. Economies that rank highly in terms of competitiveness indicators tend to have simpler governance structures for doing business, thereby creating enabling domestic conditions for sustainable private sector investment.

2. Cross-border capital flows and financial stability

By the end of 2015, global flows of FDI rose by 44 percent to \$1.92 trillion.⁶² A fraction of the rise was attributed largely to a surge in mergers and acquisitions (equity investments) that amounted to \$735 billion. By discounting these corporate reconfigurations, a moderate sign of increase in FDI flows of 30 per cent was registered. Developed countries' FDI inflows almost doubled to \$1.14 trillion, whereas FDI flows to developing countries reached \$744 billion in 2015. After the evident increase in global FDI in 2015, FDI retracted by 3 per cent in 2016 to reach \$1.87 trillion. During that year, intracompany loans reported a decline at the global level, whereas

mergers and acquisitions continued to increase to reach \$887 billion, the highest level achieved since 2007. In 2016, developed countries' FDI inflows slightly decreased to \$1.13 trillion, and inflows to developing countries declined to \$670 billion.⁶³

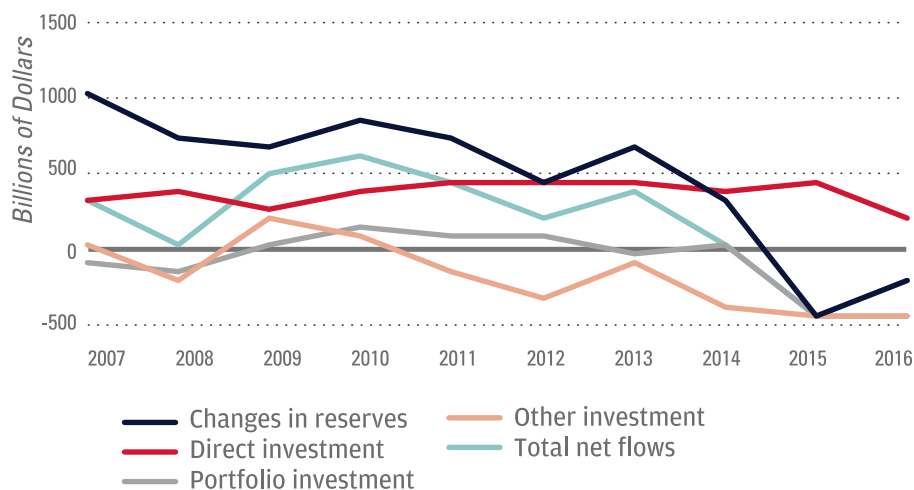
The pace of FfD inflows to developing countries appears to be slowing and has not translated into an equal expansion of productive capacity across countries, including the Arab region.⁶⁴ A key reason for this is the risks associated with the continued decline in commodity prices, especially the price of crude oil, metals and minerals. FDI patterns in developing countries are yet to be aligned with their aspirations of realizing structural transformation, social inclusion, environmental sustainability and achieving SDGs.⁶⁵

Total net capital transfers turned negative as developing countries recorded net financial outflows of \$446 billion in 2015 and \$430 billion in 2016.⁶⁶

Figure 9. shows changes in capital flows associated with direct and indirect investment, capital servicing, income and current transfers, and the net change in official international reserves in developing countries. These reversals in capital flows have not been witnessed since 1990. Moreover, such figures do not factor in flows of unrecorded (mostly illicit) capital, classified as leakages of domestic resources under the AAAA.

Figure 9.

Net financial flows to developing countries including the Arab region, 2007-2016



Source: Based on United Nations, 2017a.

Note: Direct investment as defined by the IMF is the category of international investment that reflects the objective of a resident entity in one economy in obtaining a lasting interest in an enterprise resident in another country.

International cross-border bank lending (cross-border bank claims plus local claims in foreign currencies) represents the largest form of cross-border capital flow. On a net basis, the “other investment” category (which includes bank claims) represents the largest capital outflow from developing countries, reaching \$465 billion in 2015 and around \$422 billion in 2016⁶⁷. The World Economic Situation and Prospects 2017 report indicates that “long-term lending to developing countries stagnated since the 2008 financial crisis and that the declining share of long-term claims shows that the growth of bank credit has been fuelled by short-term loans”.⁶⁸ The decline and volatility of total flows to developing countries, predominantly driven by shifts to short-term lending and the stagnation of long-term credit, hold severe implications for the 2030 Agenda at the global and regional levels.

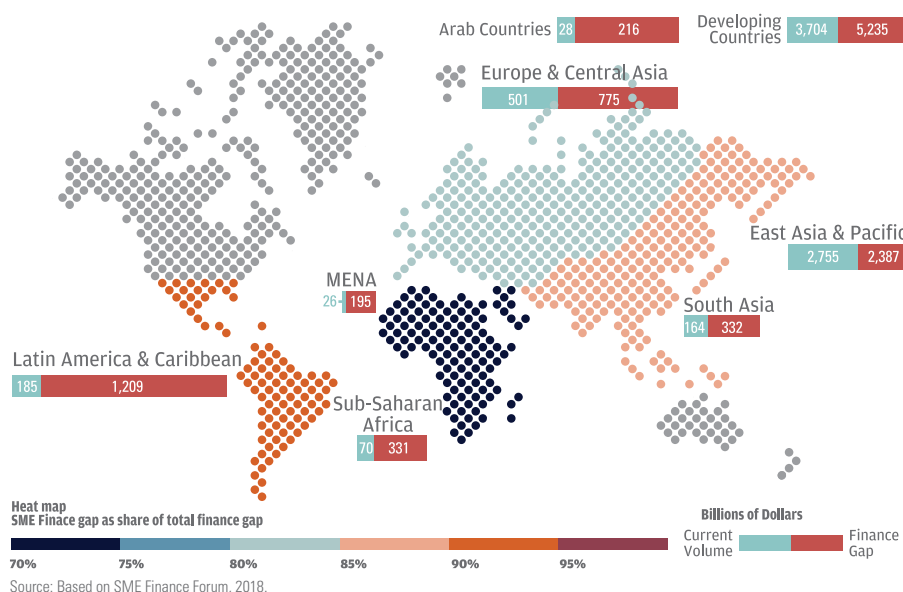
3. Financial inclusion

On average, 95 per cent of private enterprises across the world are SMEs, accounting for over 60 per cent of

employment and contributing between 16 per cent of GDP in low-income countries to 51 per cent of GDP in high-income countries.⁶⁹ Access to credit and financial services remains a constraint for SMEs and micro-enterprises. By 2010, the total unmet need for credit by all formal SMEs in developing countries was estimated at \$700–\$850 billion, and at \$2.1–\$2.5 trillion for micro-enterprises.⁷⁰ In 2017, according to the SME Finance Forum database, the finance gap by formal MSMEs amounted to \$5.2 trillion in developing countries, and to \$216 billion in the Arab region (see figure 10).⁷¹

Access to credit and financing is a major constraint to private sector development, and is linked to weak financial inclusion. The international community has renewed its commitment to strengthening financial inclusion under the AAAAA, an objective that resonates with SDG targets 1.4, 2.3 and 5.a, which mandate equal access to financial services for all, particularly for women. Moreover, SDG target 8.10 calls for enhancing the capacity of domestic financial institutions to improve access to banking, insurance and financial services for all.

Figure 10.

Formal SMEs' access to finance by region, 2017

Trade financing is an essential tool to enable the flow of trade through global supply chains and to support the growth of entrepreneurs and MSMEs. It is estimated that up to 80 per cent of global trade is supported by some sort of financing or credit insurance. Estimates also show that if trade financing to MSMEs increases by 10 per cent, global trade would grow by 1 per cent.⁷²

4. Remittances and private investment sustainability requirements

The AAAA underscored the importance of facilitating the flow of international remittances. The amount of money migrants transfer each year has been steadily rising over the last decade. International remittances totalled approximately \$573 billion in 2016.⁷³ Traditionally, remittances were considered a more stable means of financing than cross-border private capital flows; however, they too have been affected by the weakened global economy. The global average cost of remittances amounted to 7.4 per cent by the end of 2016,⁷⁴ remaining far above the target set in SDG-10.c (by

2030, to reduce the transaction costs of migrant remittances to less than 3 per cent and eliminate remittance corridors with costs higher than 5 per cent). Cutting remittance costs by five percentage points worldwide, as prescribed by the AAAA, could provide \$16 billion a year in additional development finance, equivalent to 11 per cent of DAC ODA in 2016.⁷⁵

B. REGIONAL TRENDS IN DOMESTIC AND INTERNATIONAL PRIVATE BUSINESS AND FINANCE

1. Investment climate in the Arab region

The Global Competitiveness Index (GCI) sets out the policies, institutions and other factors needed to establish sustainable paths to socioeconomic development. Although country rankings do not necessarily account for regional-/country-specific idiosyncrasies, the Index remains useful for tracking progress in the creation of a conducive and supportive environment for sustainable development. The 2016 GCI showed that the Arab region continued to exhibit several shortcomings, particularly in four domains: labour market

efficiency, business sophistication, innovation and higher education, and vocational training.

GCC countries scored higher than North African countries in almost all areas, except for market size. However, the

performance of Mashreq countries was hampered by a weak macroeconomic environment, investment climate and infrastructure. As shown in Figure 11, improvements associated with doing business in the Arab region correlate to a rise in competitiveness.

Figure 11.

Arab Competitiveness versus Ease of Doing Business



Source: ESCWA calculations based on World Economic Forum, 2016; World Bank, 2017d.

2. Cross-border capital flows in the Arab region

The AAAA recognizes FDI as a driver of productivity, inclusive economic growth and job creation. In this context, the new global FfD framework underscores the importance of managing volatilities associated with the movement of FDI across borders, and the need to foster long-term quality investment flows. Nonetheless, inward FDI flows in the Arab

region remain considerably volatile and do not reveal an expansion in productive capacities.

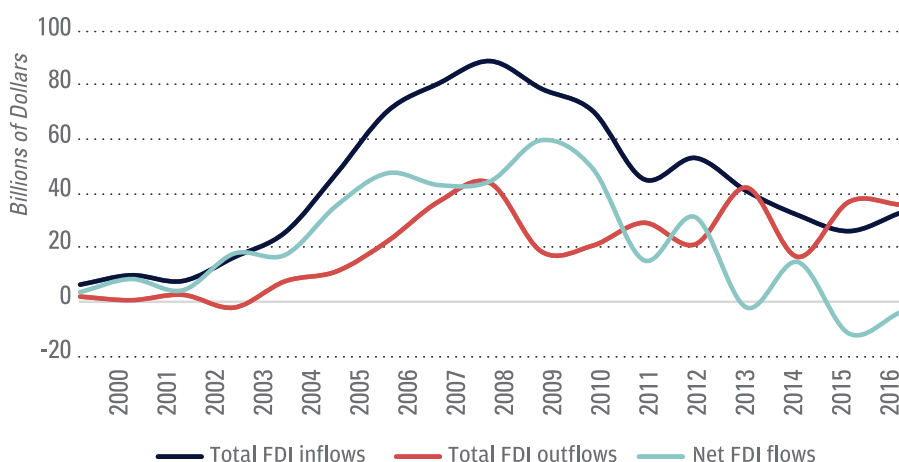
FDI patterns are yet to be aligned so as to realize SDG aspirations. By 2016, the region received \$32.4 billion in FDI inflows, increasing from \$25.7 billion in 2015, after inflows fell from an all-time high of \$88 billion in 2008. The 2015 drop in FDI inflows occurred while Arab countries were maintaining more than 750 bilateral

and international investment agreements. Between 2005 and 2016, oil-rich Arab economies were responsible for nearly 65 per cent of total FDI flows into the Arab

region. However, the region witnessed \$36.2 billion in outflows by the end of 2016, with a net FDI outflow effect of \$3.8 billion (see figure 12).⁷⁶

Figure 12.

FDI flows in the Arab region



Source: Based on UNCTAD, 2018

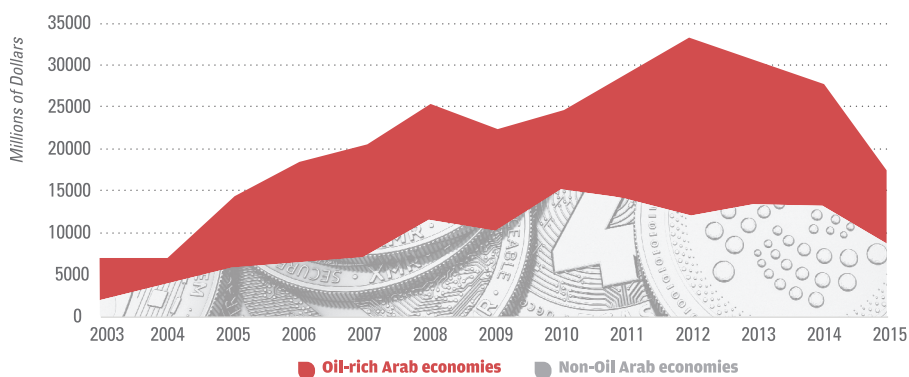
When these figures take into account the magnitude of repatriated profits on FDI (derived by foreign investors using primary income on direct investments), the situation challenges the contemporary view that FDI in the case of the Arab region constitutes a sustainable financing channel. According to statistics from the IMF, profits repatriated on FDI or reinvested in places other than in the Arab region averaged \$39.9 billion between

2011 and 2015 (see figure 13).⁷⁷

Oil-rich Arab economies accounted for 69 per cent of the total profits repatriated by foreign nationals outside the region between 2005 and 2015. In 2015, repatriated profits on FDI amounted to \$26 billion or 102 per cent of the value of FDI inflows, representing returns on investment, interest and income on equity, and fund shares.

Figure 13.

FDI profit outflows from the Arab region



Source: Based on IMF, 2017a.

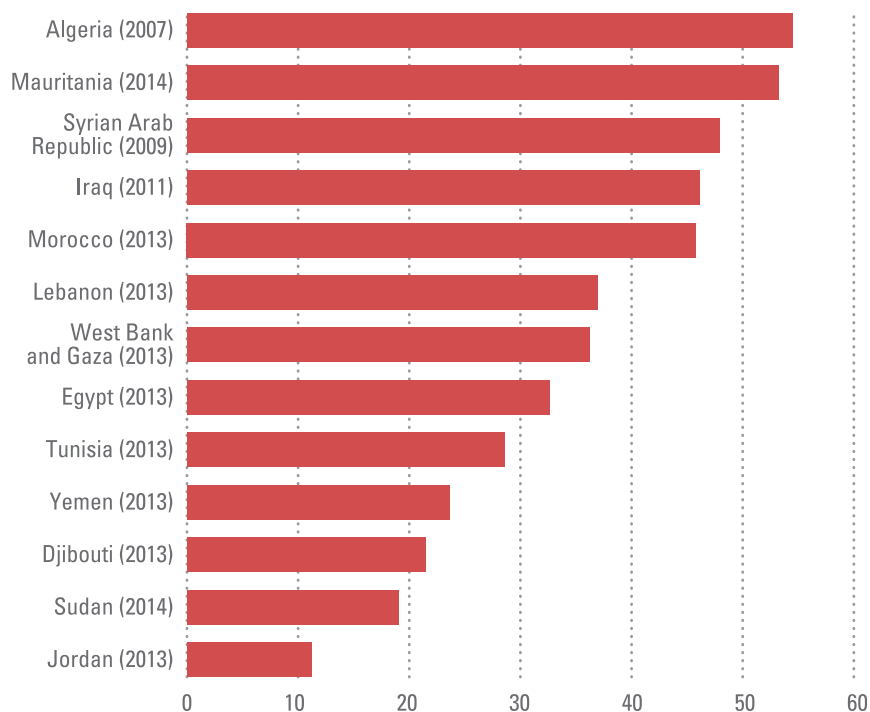
Between 2011 and 2016, total net cross-border capital flows from the Arab region turned negative. During this period, the region witnessed inflows of FDI, portfolio investments, and other official flows amounting to \$266 billion. However, the region also witnessed outflows on FDI and repatriated profits amounting to \$419 billion.⁷⁸ Arab intraregional investments remain meagre when compared with the total investments of Arab sovereign funds outside the region, estimated at \$2,979 billion⁷⁹ (representing approximately 40 per cent of total global wealth held in sovereign wealth funds).

3. Financial inclusion in the Arab region

SMEs and micro enterprises in the Arab region represent a comparable share of private sector contributions to GDP to those witnessed at the global level, and may even be higher due to the size of informal enterprises. The employment potential offered by such enterprises are therefore likely to be undercounted in official records due to informality. According to SME Finance Forum, most SMEs (97 per cent) in the Arab region are micro enterprises, whose promotion is positively correlated with development. However, the magnitude of the correlation remains subdued by the significant share of micro-enterprise activity discounted due to informality (see figure 14).

Figure 14.

Arab firms competing against informal enterprises (%)



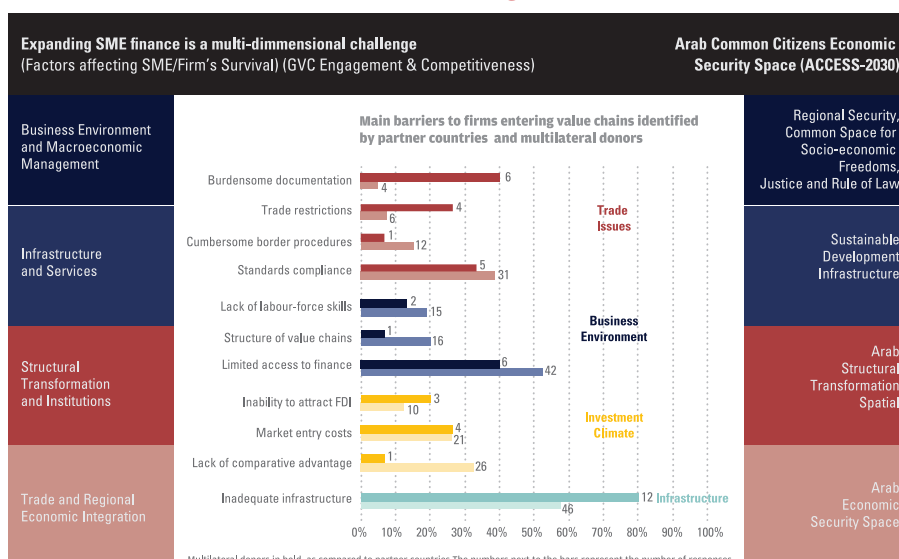
Source: Based on World Bank, 2018b.

Many policy interventions have been proposed over the years to migrate SME activities to the formal economy, including streamlining procedures, simplifying tax codes and regulations, and providing tax incentives. Another dimension worth recognizing is that SMEs engaging in foreign trade activities are more productive than non-trading firms. However, border barriers, trade finance and other non-tariff barriers constrain their engagement in international trade and their ability to connect to GVCs to draw on the technological prowess of international firms.

The poor coverage and scope of credit information available to banks along with insufficient collateral are often cited as reasons why banks remain reluctant to lend to SMEs. As a result, access to credit remains an obstacle to the expansion of the private sector. However, access to finance is not the only underlying issue constraining SME activities; rather it is a blend of three constraints (investment climate, business environment and trade barriers) that can be addressed through concerted national and regional action, as elaborated in the Arab Citizens Common Economic Security Space (ACCESS) framework,⁸⁰ including the four types of interventions proposed to foster Arab SME operations (see figure 15).

Figure 15.

Arab Vision 2030 and multidimensional challenges of SMEs



The capital structure of SMEs in the Arab region is less geared towards debt financing, although greater use of debt to finance SME activities has been found to significantly increase employment. Many countries across the region have increased their support for SMEs, including the recent directives issued by the Egyptian Central Bank mandating domestic banks allocate 20 per cent of their loan portfolio baskets to support

SMEs. On the regional front, the 2009 Arab Economic and Social Summit announced the establishment of a \$2 billion special fund to finance SME activities across the Arab region.

ESCWA estimates suggest that a 1 per cent increase in credit can increase the number of jobs by 1.01 per cent.⁸¹ Accordingly, to create 60–75 million new jobs by 2030 (to achieve full employment)

or to ensure social and political stability, the region would require \$290–\$362.5 billion (in 2011 constant prices) in additional credit to finance SME activities.

Inclusive finance strives to enhance access to financial services for both individuals and MSMEs. In developing countries, access to financial services is crucial to strengthening financial sectors and domestic resource mobilization, and can therefore make a significant contribution to social and economic development. In the Arab region, nearly 70 per cent of adults on average do not have a bank account.⁸² This figure exceeds 80 per cent in the developing countries of the region,⁸³ constituting the largest area of exclusion from formal financial services in the world. Similarly, access to formal credit is less than half the global average.⁸⁴

The Arab region in total, owing to the strong external financial wealth of the GCC, has remained a net lender to international banks and non-financial institutions, although its margin narrowed in 2016 (see Figure 11).⁸⁵ The total liabilities owed by international financial and non-financial institutions to Arab clients remains greater than the total claims of those institutions to Arab nationals. The differences between claims and liabilities reached their peak in 2013, registering nearly \$350 billion. Over the period 2000–2016, total liabilities to Arab clients of reporting banks exceeded their claims. By the end of 2016, the net liabilities of foreign banks and non-financial institutions amounted to \$223 billion, representing an opportunity cost of investing these assets in the region.

4. Remittances and aligning private investments with sustainability requirements

The AAAA recognizes the positive contributions of migrant remittances to financing inclusive growth and sustainable development. Commitment to mobilizing remittances as an international

private source of financing development is also captured in SDG-17. With a total migrant population estimated at more than 24 million,⁸⁶ remittance inflows into the Arab region have gained increasing importance over the past decade. Arab migrant remittances have increased three times, from \$11.5 billion in 2000 to \$48.5 billion in 2016, representing 11 per cent of total remittances sent to developing countries. However, while the number of intra-Arab migrants has increased significantly over the past 25 years, their proportion of the total number of migrant workers in the region grew from 42 per cent in 1990 to 52 per cent in 2010, and decreased slightly to 50 per cent in 2015,⁸⁷ indicating increasing numbers of foreign migrants from other regions as well.

The share of intraregional Arab remittances has steadily increased since the onset of political change in the region in 2011, reaching \$27.1 billion by 2016; whereas remittance inflows from other regions have stagnated, hovering at an average of \$23.5 billion per year between 2011 and 2016.

Over the last two years, ESCWA has conducted a series of studies to provide a conceptual foundation for understanding how remittances impact FfD. The studies examined the relationship between remittances and development, and the role of different stakeholders in enhancing the inflows of remittances to drive national development. The following three main findings were made with respect to the utilization of remittances for economic development: with the exception of a few countries, predominantly there is an absence of national strategies and policies designed to channel remittances into development; overall, financial and institutional infrastructure to support remittances are relatively weak, a situation that is aggravated by poor penetration of the banking system into remote areas; and there is a lack of sufficient and consistent data/information

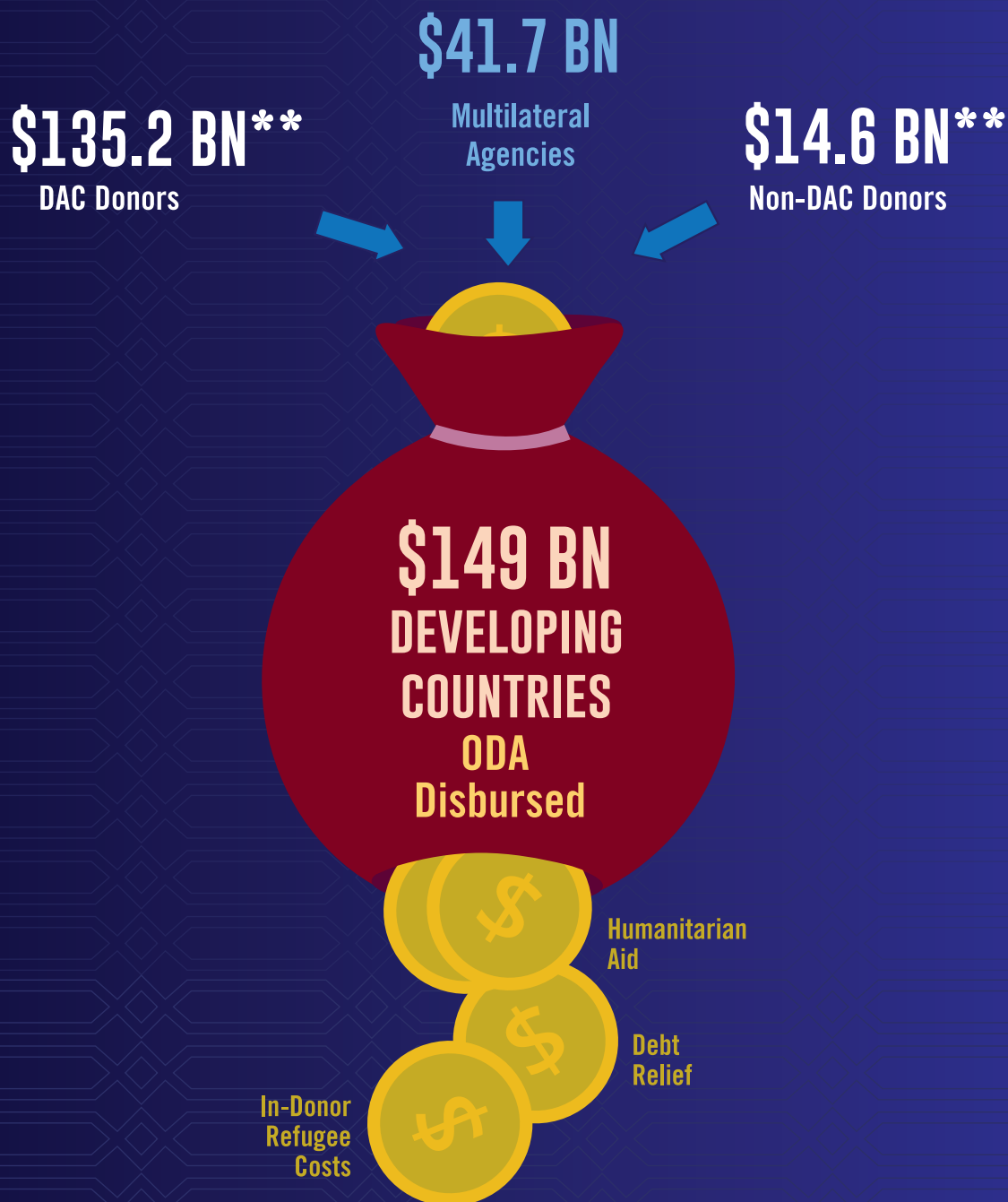
on remittances to provide tailored policy recommendations and harness remittances for development, especially regarding capturing the characteristics of remitters, identifying channels used to transfer money, and discerning the use of the transferred money by recipients (consumption versus investment).

Aside from the profit-driven private businesses and financial sector, the Arab region takes part in international

development cooperation that aims to support national and international development priorities. The next chapter provides insights into how the international development discourse has evolved to ensure that ODA is effectively spent, benchmarked and coordinated. But with the challenges and conflicts in the Arab region, the approaches are not sufficient to achieve SDGs by 2030 and further actions are required.

CHAPTER 4

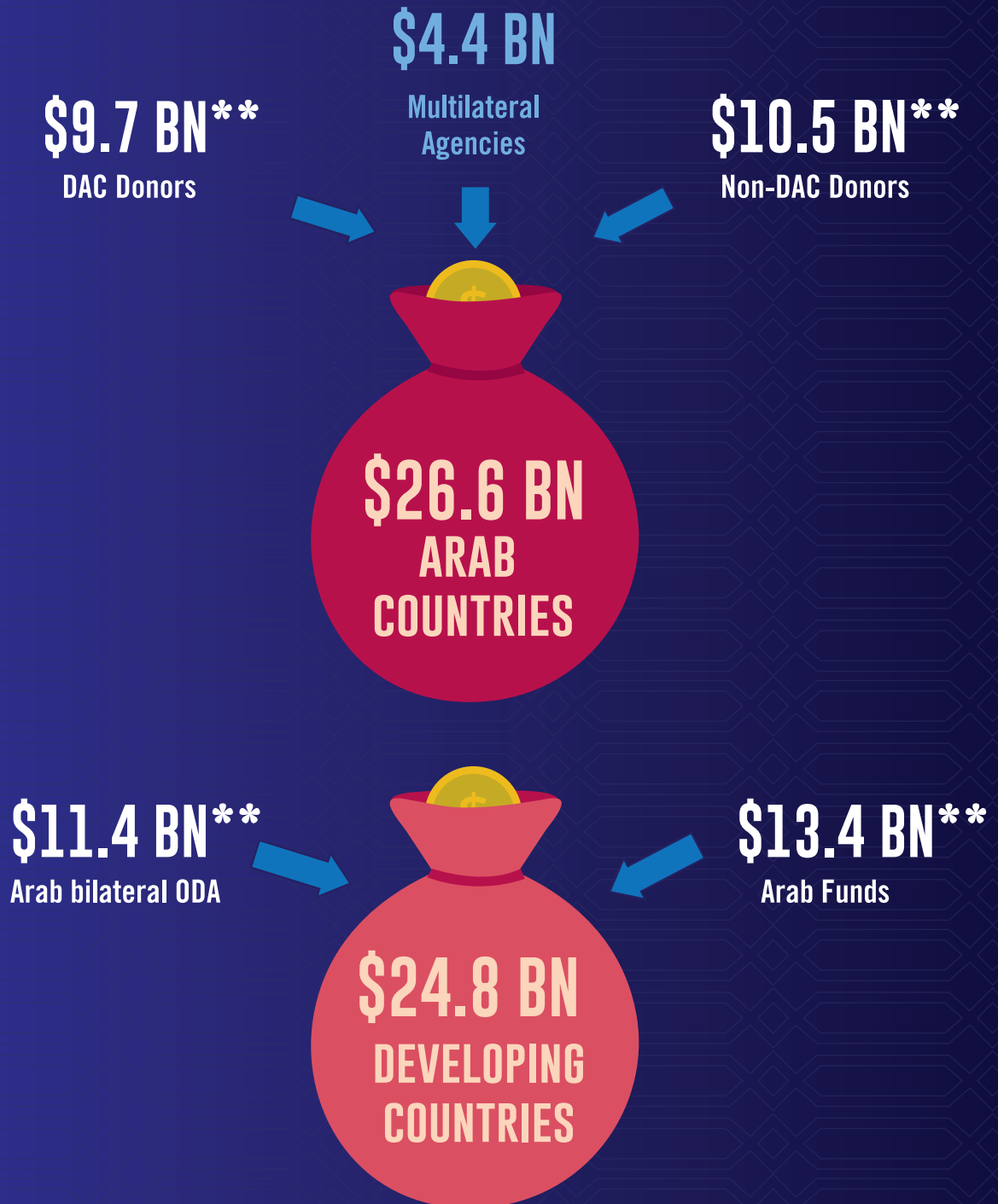
INTERNATIONAL DEVELOPMENT COOPERATION



*The figures are average ODA between 2011 and 2016

**Part of this total is given to multilateral agencies

ODA RECEIVED BY ARAB COUNTRIES



International development cooperation strategies have been pursued under various bilateral and multilateral formats, including through four United Nations Development Decades, the Millennium Development era and, more recently, the 2030 Agenda for Sustainable Development. However, only a handful of countries have fulfilled the commitment to increase official development assistance to 0.7 per cent of their gross national income.

The international development discourse is continuously shifting to ensure that ODA is being effectively spent, tied, benchmarked and coordinated. Today, the scope of ODA transcends its traditional development usages to accommodate humanitarian crises and in-donor refugee costs. It has been repackaged, relabelled and blended to complement South–South forms of cooperation, and to support the growing roles of multilateral and regional development banks.

International public financial flows have been lower than stated, less than promised, and have proven volatile. These flows should fall in line with agreed international commitments, not only in terms of addressing crises or humanitarian emergencies, but also in order to achieve development outcomes. Changes to the ODA definition and rules, that would allow more support to the private sector to be counted as ODA, should equally be reconsidered. ODA reporting needs to be disaggregated, and better coherence between humanitarian and development finance is required to keep development finance distinct from other types of expenditures; this also involves identifying the quantity of aid that is tied, both formally and informally.

The Arab region stands at the crossroads of this shifting discourse, given that it is both a source of and a destination for ODA. However, such assistance is not currently sufficient to implement the 2030 Agenda for Sustainable Development in the region, given the significant financial

flows leaving its territories. On average, 65 cents of every \$1 received in ODA by the region is disbursed to support other regions. New approaches are therefore needed to achieve the financing of SDGs by 2030. The political and security challenges currently facing the region further complicate the situation, with large sums of ODA being allocated to humanitarian causes and in-donor refugee costs.

A. INTERNATIONAL DEVELOPMENT COOPERATION: GLOBAL TRENDS

International development assistance remains a unique source of development financing, given its counter-cyclical influence on countries that are unable to fully access market-based forms of external investment. DAC and Non-DAC concessional development finance reached \$159 billion in 2016 (\$14.5 billion, or 9 per cent, was provided by non-members of DAC of the OECD).⁸⁸

OECD-DAC ODA rose following the 2007 global financial crisis, reaching \$144.97 billion by the end of 2016 and representing a 10.7 per cent increase in real terms compared with 2015.⁸⁹ Some argue, however, that those numbers are distorted as the rise in ODA was largely due to an increase in humanitarian aid and in-donor refugee costs. When in-donor refugee costs are excluded, ODA from OECD-DAC members increased by only 8.6 per cent between 2015 and 2016.⁹⁰

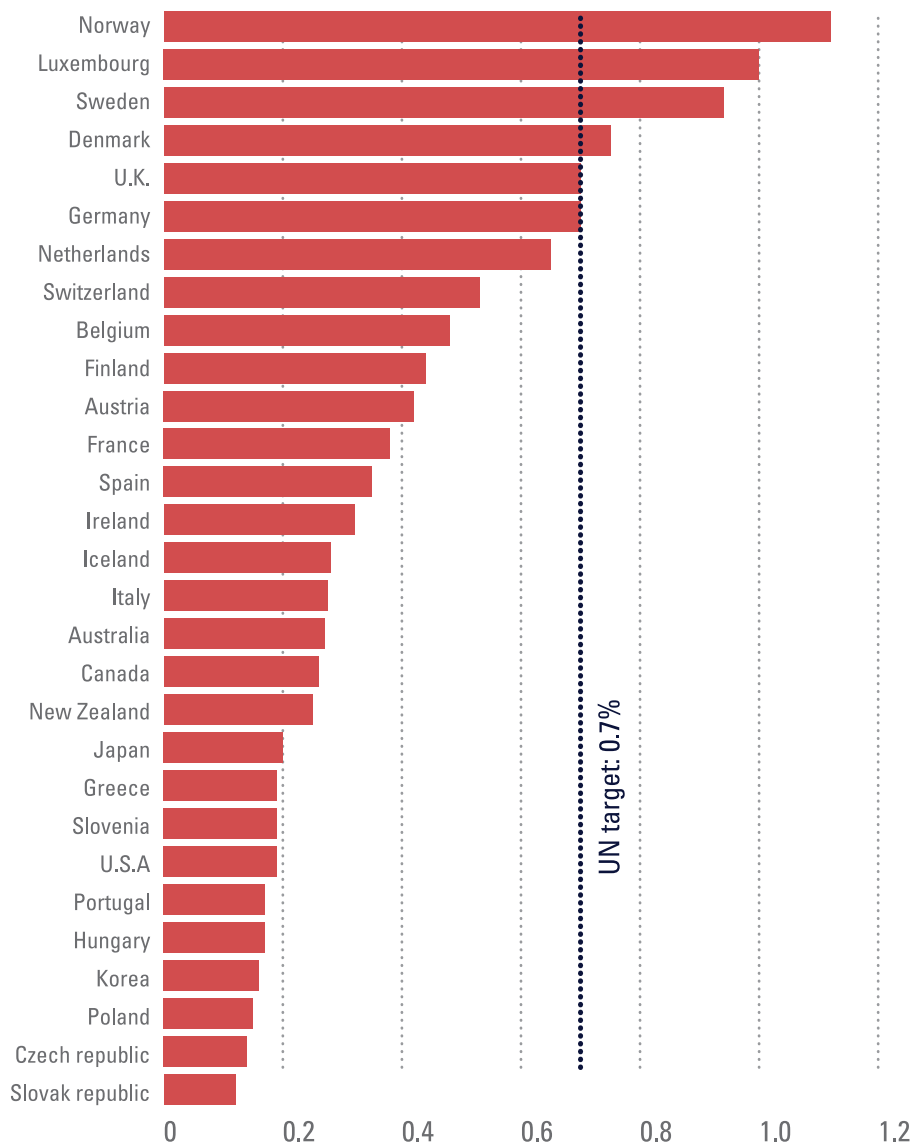
Nonetheless, ODA figures continue to fall short of the United Nations target for international aid spending of 0.7 per cent of gross national income (GNI) (with 0.15–0.20 per cent of ODA/GNI to be made available to least-developed countries). By 2016, only six DAC members met this target. In 2016, the combined ODA of DAC countries reached 0.32 per cent of their combined GNI, slightly increased from 2015 (0.3 per cent) (see figure 16). Accordingly, the AAAA recognizes that the 2002 Monterrey Consensus has not yet been fully implemented, and stresses the

need to follow-up on commitments and assess progress made in implementing the Monterrey Consensus and the Doha

Declaration to further strengthen the new global FfD framework.

Figure 16.

OECD-DAC Members' Net ODA as % of GNI in 2016



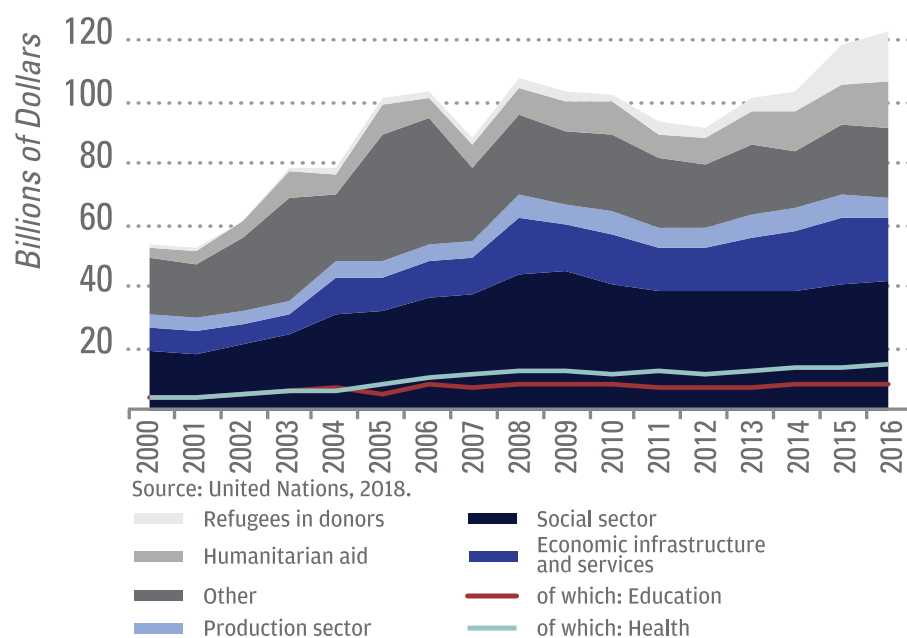
Source: OECD, 2018b.

According to a 2016 report by the Secretary-General on trends and progress in international development cooperation⁹¹, ODA to non-emergency situations fell in 2014 and 2015. Since 2010, increases in ODA have been mainly attributed to increasing humanitarian aid and in-donor

refugee costs. As such, ODA has remained largely unchanged in real terms over the last five years; rather, it has been rechannelled to address humanitarian aid and costs associated with hosting refugees in donor countries (see figure 17).

Figure 17.

Components of DAC donors' net ODA, 2000-2016



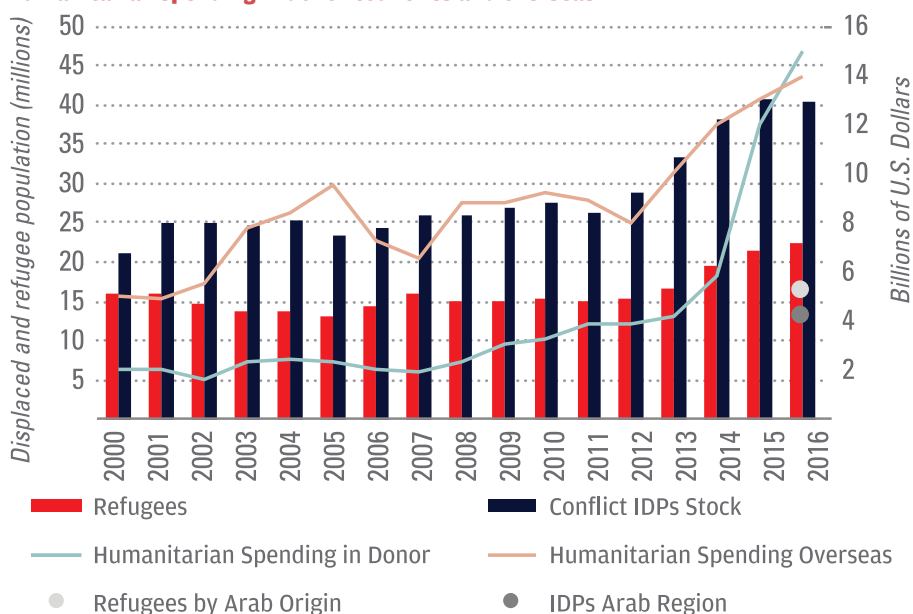
Source: United Nations, 2018.

Today, the world is facing its most acute forced displacement crisis. Data from the Office of the United Nations High Commissioner for Refugees show that by the end of 2016, the global, forcibly displaced population reached 65.6 million: 40.3 million were internally displaced, 22.5 million acquired/maintained refugee status, and 2.8 million sought asylum (see

figure 18). Around 10 million remained stateless. In 2016, 10.3 million persons became newly displaced due to conflict and persecution. On average, 20 people worldwide were displaced every minute of every day in 2016.⁹² Between 2008 and 2015, 203.4 million were displaced because of natural disasters.⁹³

Figure 18.

Displaced and refugee population compared with humanitarian spending in donor countries and overseas



Source: Internal Displacement Monitoring Centre, 2017.

International humanitarian assistance⁹⁴ to people affected by conflict and natural disaster totalled \$27.3 billion in 2016 (\$20.3 billion from Governments and EU institutions, \$6.9 billion from private donors).⁹⁵ In 2016, humanitarian aid from OECD-DAC countries increased by 8 per cent in real terms to \$14.4 billion.⁹⁶ ODA for in-donor refugee hosting, however, increased by more than double from 2014 levels to reach \$15.96 billion by 2016, constituting nearly 11 per cent of total ODA for that year.

Only four OECD countries do not factor refugee costs under ODA (Australia, Japan, Korea and Luxembourg). DAC rules allow countries to report in-donor refugee costs as part of their ODA commitments. This is evidenced by Austria, Germany, Greece, Italy and Iceland, whose refugee costs accounted for more than 20 per cent of their ODA disbursements in 2016.⁹⁷

According to the Centre for Economic and Social Research, almost 30 per cent of all international aid projects fail to meet their

development objectives. In 2015, around \$40 billion of total ODA (\$131.6 billion) provided by DAC countries was not put to effective use.⁹⁸ To complicate matters further, and contrary to conventional wisdom, ODA tends to be lower in countries where the depth of poverty is greatest.⁹⁹

Middle-income countries have seen their share of global ODA fall from just above 60 per cent in 2000 to around 50 per cent in recent years. In parallel, the use of less concessional instruments has become more prominent: ODA loans reached 45 per cent of gross ODA disbursements in 2015.¹⁰⁰

The AAAA recognizes that blended finance (the use of both concessional public financing and non-concessional private financing, and expertise from the public and private sectors) provides various channels for financing development. Between 2012 and 2015, the private sector mobilized approximately \$81.1 billion in official development financing.¹⁰¹ According to OECD, during this period, middle-income countries

received \$62 billion or 77 per cent of private sector investments, while 26 per cent targeted climate mitigation and adaptation (21 per cent for mitigation, only 1 per cent for adaptation, and 4 per cent for both) mainly through guaranteed and syndicated loans¹⁰². However, there is insufficient evidence to aggressively push for ‘blending’, as the impact of employing ODA to leverage additional private flows has been challenged.

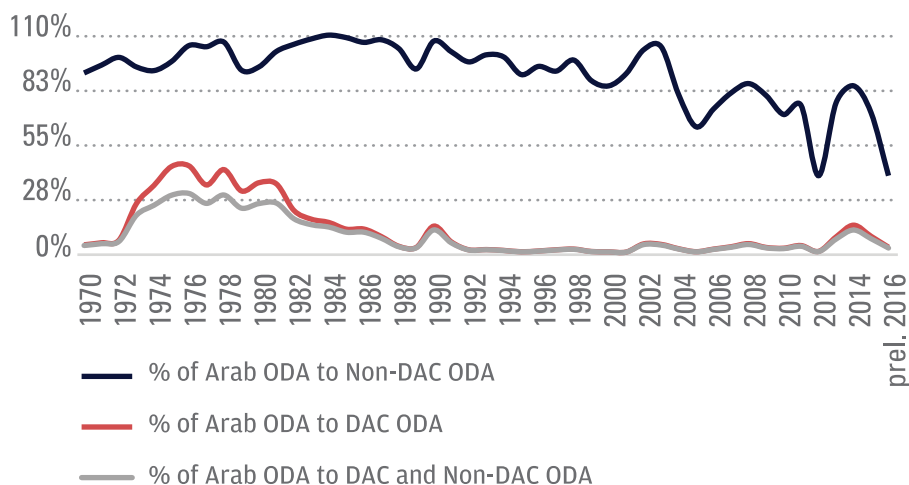
B. DEVELOPMENT COOPERATION: REGIONAL REALITIES

In 2016, total ODA provided to Arab countries amounted to \$26.95 billion (including Arab intraregional ODA). ODA granted exclusively by external donors, including OECD-DAC, amounted to \$22.3 billion in the same year.¹⁰³ Total ODA received by Arab countries (intra- and extraregional) accounted for 17 per cent of total aid extended to developing countries in 2016.¹⁰⁴ The results in 2016 show an increase in ODA by 5 per cent in Arab countries and 3 per cent in developing countries since 2015.

The Arab region is currently facing geopolitical turmoil. Today, it hosts 41 per cent¹⁰⁵ of the world’s displaced persons and 37 per cent of its refugee population, where 58 per cent of the global refugee population are from Arab countries (by origin).¹⁰⁶ It has the highest ratio worldwide of refugees as a percentage of total population. However, by employing the methodology adopted by the High-Level Panel on Humanitarian Financing to estimate the minimum cost of preserving the lives of forcibly displaced populations,¹⁰⁷ the humanitarian gap in the region amounts to \$26.5 billion, or 2.5 times larger than the humanitarian and refugee aid channelled into the region in 2015.

Between 1970 and 2016, around 90 per cent of Arab development assistance was provided by three countries: Kuwait, Saudi Arabia and the United Arab Emirates.¹⁰⁸ Total bilateral ODA (intraregional and extraregional) provided by Arab countries amounted to \$12.1 billion in 2015 and to \$13.5 billion in 2016 (a rise of 12 per cent). In 2015, ODA from Kuwait, Saudi Arabia and the United Arab Emirates accounted for 69 per cent of non-DAC ODA, and 9 per cent of total DAC ODA (see figure 19).

Fig 19.
Arab intraregional and extraregional ODA



Source: Based on data from OECD, 2018a.

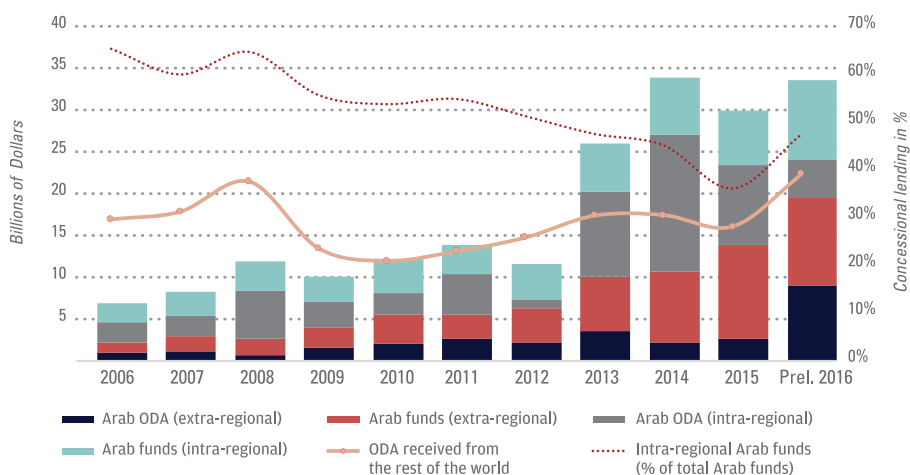
Note: Data for ODA from Saudi Arabia in 2016 is not available in the OECD-QWIDS database.

As a percentage of GNI, ODA from GCC countries amounted to 1 per cent in 2016, surpassing the 0.7 per cent target set by the United Nations. Despite the relative drop in oil prices in 2015, Arab ODA fell by only 0.27 percent of the total GNI for GCC countries from 2014. The cumulative aggregate of total Arab bilateral ODA between 1970 and 2016 reached \$216.7 billion.¹⁰⁹

The composition of Arab bilateral ODA has shifted significantly over the past decade. Until 2000, over two-thirds took the form of grants.¹¹⁰ Since then, the share of loans steadily dropped to 38 per cent between 2012 and 2016, with most aid currently provided as soft loans. During the same period, only 4 per cent of Arab development funds' operations took the form of grants (including technical assistance).¹¹¹

Figure 20.

Arab ODA, bilateral and regional funds, 2006-2016



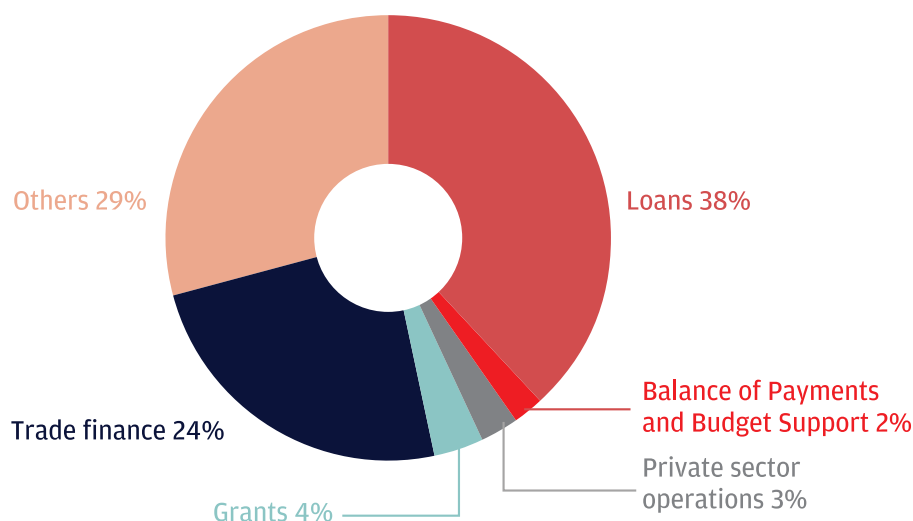
Source: Based on data from the Arab Monetary Fund, 2011, 2017; and OECD, 2018a¹¹⁸

Total ODA provided by Arab development funds amounted to \$19.99 billion in 2016, with 47.5 per cent (\$9.5 billion) provided to Arab recipients in 2016 compared with 36.1 per cent in 2015 (\$6.4 billion). Between 1970 and 2016, the cumulative aggregate ODA provided by Arab development funds to Arab countries reached \$99.5 billion (54 per cent) out of a total \$184 billion provided to developing and least-developed countries since the establishment of

those funds.¹¹² Arab financial assistance is largely concessional, with a grant element ranging from 30 per cent to 60 per cent, well above the 25 per cent threshold of the OECD-DAC countries.¹¹³ Debt forgiveness is not allowed under the charters of Arab financial institutions, in sharp contrast to OECD-DAC countries where debt relief has played a major role in aid flows, especially over the past decade (see figure 21).

Figure 21.

Arab development funds: distribution of operations, 2012-2016



Source: Based on data from the Arab Monetary Fund.

Note: "Others" include debt rescheduling and emergency relief.

According to a 2016 report by the Secretary-General,¹¹⁴ the most significant shifts in sectoral patterns in ODA disbursements since 2014 were decreases in debt relief and general budget support. The trend away from programme-based approaches, including budget support, can be partly attributed to an over-emphasis on short-term results. Arab donor countries have shifted away from reliance on grant-based aid since 2000. Today, nearly all Arab bilateral ODA reported to OECD-DAC is in the form of soft loans.

The AAAA underscores the valuable contributions of South–South cooperation as an important complement to North–South international cooperation for development. Arab ODA remains a key channel for providing development assistance, particularly in relation to other South–South forms of cooperation, including non-DAC ODA. While Arab aid flows have correlated to trends in petroleum prices, Arab national and multilateral financial institutions, given their capitalization, are not necessarily influenced by fluctuations in oil prices.

The AAAA recognizes the importance of multilateral development banks, noting that well-functioning national and regional development banks and institutions can play a dominant role in financing sustainable development, particularly in credit market segments where commercial banks are not fully engaged and large financing gaps exist. The AAAA also acknowledges the importance of establishing regional development banks to provide counter-cyclical financing.

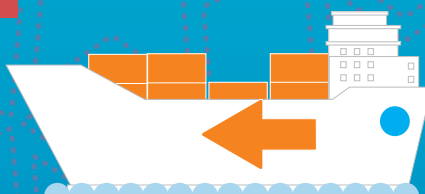
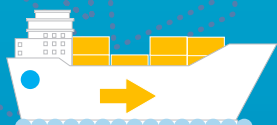
In this vein, several developing countries have established regional development banks to finance regional sustainable development priorities. For instance, it was suggested that the establishment of the New Development Bank (NDB), which aims to mobilize resources for development projects in BRIC (Brazil, Russia, India, China) countries, could provide concessional financing of \$9 billion by 2034.¹¹⁵ The Asian Infrastructure Investment Bank will provide an estimated \$15 billion in loans annually over the next 15 years. These regional development banks can leverage resources from various sources by issuing bonds

denominated in local or international currencies to finance regional sustainable strategies.

In its 2017 annual report, the United Nations Inter-Agency Task Force on Financing for Development recommended that as more countries pass per capita income thresholds, additional efforts will be needed to broaden eligibility criteria for concessional financing that more accurately reflects their continued vulnerabilities. In 2008, the Intergovernmental Group of Twenty-Four on International Monetary Affairs and Development suggested that the multiplier effect generated if developing countries were to allocate 1 per cent of their reserves to paid-in capital either to expand or create new regional development banks, would create an additional annual lending of approximately \$77 billion, and more than double the lending capacity of the World Bank, the Inter-American Development Bank (IADB), the Asian Development Bank (AsDB) and the AfDB combined.¹¹⁶

Given the situation in the Arab region today, some advocate reconsidering the 2015 review conducted by the Arab Monetary Fund on the operation of Arab financial institutions.¹¹⁷ At the time, the review concluded that existing Arab financial institutions and development agencies had adequately covered the financial needs of both Arab and developing countries. Accordingly, it was argued that the Arab region was not in need of new financing structures. However, to mobilize all sources of finance to achieve the 2030 Agenda, it would be prudent to consider new channels through which financing and investment decisions could be taken and streamlined to address regional development priorities, especially given the surmountable financing challenges that the Arab region may witness by 2030, including the gross fixed capital accumulation requirements needed to achieve SDG-8.1 and sustain a 7 per cent growth rate in non-oil Arab economies, which stands at \$105.5 billion per year (based on 2015 conditions), not to mention the resources needed to cover the cost of post-conflict reconstruction and deeper regional integration to achieve the 2030 Agenda and related Arab Joint Action(s).

CHAPTER 5 INTERNATIONAL TRADE AS AN ENGINE FOR FINANCING DEVELOPMENT

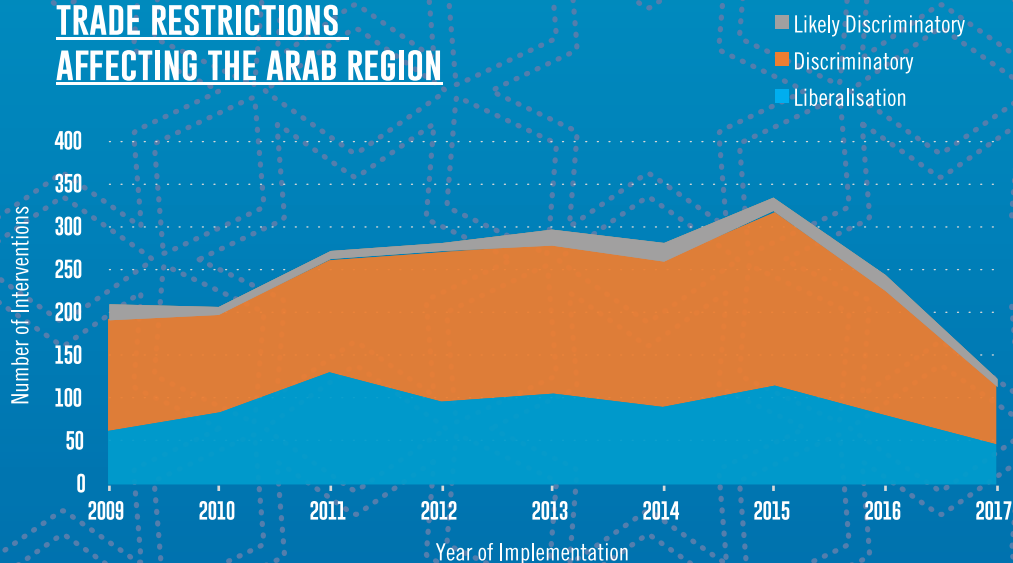


SINCE 2015
EXPORTS < IMPORTS

Trade in goods

Discriminatory restrictions imposed on Arab exports exceed liberalisation interventions.

TRADE RESTRICTIONS AFFECTING THE ARAB REGION



INDIRECT COMMODITY TRADE OPPORTUNITY LOSS

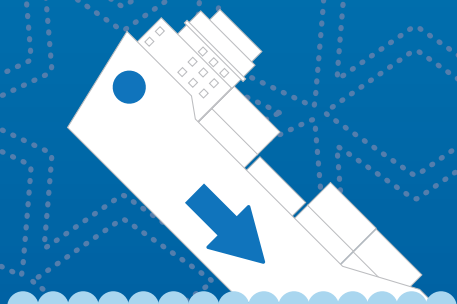
On average, between 2011 and 2016, the effect of the Arab region's declining terms of trade have been responsible for:

\$16.2 BN

per year

\$97.5 BN

on aggregate





80%

of global trade is supported
by trade finance



50%

of SME trade finance
requests are rejected

TRADE FINANCE GAP

\$1.6 TR
in the world

\$700 M
in Asia

\$125 M
in Africa

More than

1000

TRADE RESTRICTIONS

Ensuring that developing and least-developed countries have an opportunity to turn trade into a means of finance and spur growth remains key to the implementation of the AAAA. Failure to do so not only undermines the global FfD framework and the trade-led components of the 2030 Agenda for Sustainable Development, but also questions the viability of the contemporary trade equality agenda geared towards levelling the playing field among unequal players, which in itself is a source of injustice.

This chapter shows that the Arab region is not entirely free to take advantage of the normative trade tools and policies enshrined in the AAAA. For it to be able to do so, trade policy recalibrations are needed on regional and multilateral trade fronts through combating new forms of trade and investment protectionism, and through the review of the many extraregional trade agreements that the Arab region maintains to prioritize its own regional trade integration project. Arab trade integration offers a greater source of per capita growth for the region. Extraregional preferential arrangements alongside their rules of origin have left the region locked in low value-added niches within the global value chain game, thereby constraining technology spillovers and placing SMEs at a disadvantage.

Arab countries should also pursue a multilateral trade reform agenda rather than settle for trade equality norms. The region's terms of trade are arguably vulnerable, a situation that has considerably undermined the trade-growth nexus and the potential for intraregional trade to develop as a major source for financing regional sustainable development strategies alongside the 2030 Agenda.

A. TRADE WITHIN THE NEW GLOBAL FFD FRAMEWORK

The AAAA is the fourth attempt (following four United Nations development decades and the Millennium Development Goals) to advance the trade-growth and

development nexus. Sixty-five trade mandates were showcased through the AAAA to advance the nexus¹¹⁹ and accrue gains from meaningful trade opportunities. However, the implementation of the AAAA faces the same difficulties as its predecessors (the 2008 Doha Declaration on Financing for Development and the 2002 Monterrey Consensus), owing to the following five systemic and governance challenges:

- Normative aims are unsupported by affirmative action: Normative trade and development objectives are seldom supported by mechanisms to ensure that they are applied in practice. Grandiose trade objectives and goals promoted in New York continue to be in stark contrast to the Geneva mindset that dictates WTO rule-making. The WTO is an independent entity whose norm-setting prerogatives are not dictated by the United Nations. As such, the enforcement of normative principles requires an inter-agency convergence agenda in the field of international trade;
- The indiscriminate use of the term “trade” and its influence on growth and development: The AAAA overlooks how the different strands of trade influence growth. It considers multilateral trade, plurilateral trade, preferential trade, trade openness, trade liberalization, intra-industry trade and supply-chain trade as synonymous, although they influence the trade-growth nexus differently as each operates through distinct rules and forms of governance. Nonetheless, trade in the abstract was sought as an engine for development irrespective of the outcomes rendered by each strand, both in country-specific and cross-country situations. This issue raises the traditional questions of whether multilateral or regional trade are considered a driver of growth and development;
- Hinging FfD outcomes on the WTO: Another challenge facing the implementation of the trade-led

commitments of the AAAA is reflected in three distinct, yet ambiguous, commitments. The international community resolved to increase world trade in a manner consistent with SDGs. A stronger commitment then ensued to integrate sustainable development into trade policy at all levels, only to be followed by a third commitment that deferred the entire matter along the two earlier commitments to the WTO to study how trade can contribute to sustainable development;

- Trade equality or trade justice in realizing the FfD outcomes: The utilitarian bias embedded throughout the WTO rule-book poses another challenge to the implementation of the AAAA, inasmuch as the MTS was designed to promote “trade equality” but not necessarily “trade justice”. Trade equality is sought through embedded liberalism to safeguard cardinal principles, such as the most-favoured nation (MFN) and national treatment, to level the playing field among unequal players – itself a source of bias. Trade justice, however, is pursued as an exception to those general principles, sometimes on the basis of non-binding provisions including many special and differential treatment provisions (SDT) granted to developing and least-developed countries.

Bringing justice considerations into the trade-growth and development equation is a fundamental game-changer as the MTS has traditionally been developed and judged on utilitarian/mercantile conceptions. However, utilitarian notions do not sit well alongside principles of justice that rely on concepts such as non-discrimination, distributional equality and reciprocity. Utilitarian principles that aim to maximize aggregate benefits or overall welfare do not necessarily capture the injustices that arise when the playing field is levelled for unequal players;

- Preserving a rule-based MTS rather than promoting sustainable development: Sustainable development is not prominent in the WTO rule-book. At most, it is dealt with obliquely and does not seem to pose a binding legal rule. It is captured as a broad principle in the Marrakech Agreement. WTO agreements do not provide legal grounds to invoke sustainable development considerations. Incorporating sustainable development considerations into the multilateral trade rule-book might prove controversial (see box 1). By the World Trade Organization’s own logic, inconsistencies may arise from maintaining multilateral non-discriminatory trade openness while safeguarding or promoting sustainable development considerations.

Box 1. Climate change and trade: a conundrum

The Paris Climate Change Agreement recognizes the positive co-benefits arising from trade in mitigating and adapting to climate change, but does not specify the kind of action that can be taken without impinging on multilateral trade rules. Trade actions taken to combat climate change could place SDGs in conflict with WTO rules.

The legality of imposing border carbon adjustments or taxing imports on their embodied carbon, for example, might be contestable under the WTO. Similarly, WTO agreements on anti-dumping, subsidies and countervailing measures, and trade-related intellectual property rights (TRIPs) could be invoked to limit the subsidization and export of environmental goods, the development of nascent environmentally friendly industries and the transfer of the technologies needed to achieve this purpose.

The Paris Agreement acknowledges that nationally determined commitments can involve transferred mitigation outcomes (e.g. carbon market platforms), allowing for arrangements outside the multilateral process. The Paris Agreement provides possibilities for the creation of carbon market clubs, where countries exchange exclusive rights to trade emissions by generating tradable offset credits to meet their nationally determined commitments. Conflicts may arise, however, when procedures for emission trading or carbon pricing coalitions discriminate against WTO members. Disputes over such actions could produce significant litigation through the WTO dispute settlement mechanism.

Source: Compiled by ESCWA.

**B. SUSTAINABLE FINANCING GAINS FROM
INTERNATIONAL TRADE**

Promoting a transparent, predictable, inclusive, non-discriminatory and equitable MTS is considered key to financing SDGs. As such, the AAAA calls for redoubling efforts to conclude the Doha Development Agenda. However, this normative objective has eluded the international community since 2001.

To attain this objective, a different approach is needed to recalibrate the sustainable development and trade justice seeking dimensions of the Doha Development Agenda, so that developing countries can secure a share in the growth of world trade commensurate to their sustainable development needs. This remains the principal and outstanding goal to be achieved by the DDA and the WTO itself.

Empirical assessments have striven to validate the gains from concluding the Doha Development Agenda. It has been suggested that even if a “Doha-light” trade package of reforms was secured, the global economy could reap \$2.2 trillion in additional annual gains.¹²⁰ Moreover, by comparing the expected socioeconomic and environmental benefit of every dollar spent on the sustainable development targets, it was found that promoting international trade and lowering trade barriers could achieve far more per dollar spent than any other priority area of the AAAA.¹²¹ According to estimates by the Copenhagen Consensus, concluding the Doha Development Agenda could provide developing countries with \$2,011 for every dollar spent (see figure 22).

Figure 22.

Financial returns on SDG financingTRADE

Reduce world trade restrictions (full Doha) **\$2,011**

SCIENCE AND TECHNOLOGY

Increase skilled worker migration **\$15**

ILLICIT FINANCIAL FLOWS

Make beneficial ownership into public **\$49**



Exchange tax information automatically **Likely to be high**



Country-reporting for multinationals **Likely to be high**

POVERTY

End extreme poverty by money transfers **\$5**



Social protection system coverage **<\$1**



Better disaster resilience for the poor **<\$1**



Provide employment for all **<\$1**



Increase life satisfaction **<\$1**

Source: The Copenhagen Consensus, 2015.

C. TRADE GROWTH AND SUSTAINABLE DEVELOPMENT NEXUS**1. Global trends**

The factors that have prompted the expansion of world trade and output since 1986 are subject to many interpretations, but the fact that they coincided with a reduction in trade barriers is indisputable. By some accounts, 25 per cent of world trade growth was due to tariff reductions and trade liberalization is estimated to have generated three times the gains

POPULATION AND DEMOGRAPHY

Allow more migration **\$45+**



Discourage early retirement **Likely to be high**



Promote urbanization **Likely to be high**



Increase birth-rates in rich countries **<\$1**



Give public pension for young old ages **Low**

FOOD SECURITY AND NUTRITION

Reduce child malnutrition **\$45**



Research to increase yields **\$34**



Cut food-loss with roads and electricity **\$14**

■ Phenomenal
■ Good
■ Fair
■ Poor

arising from a reduction in transportation costs.¹²² Non-tariff measures also emerged as binding constraints on the trade-growth and development nexus; nonetheless, tariff cuts made it possible for intermediate goods to move across borders at each stage of production within GVCs, generating exponential trade activity in the pre-2007 period and explaining 50 per cent of the increase in global output.¹²³

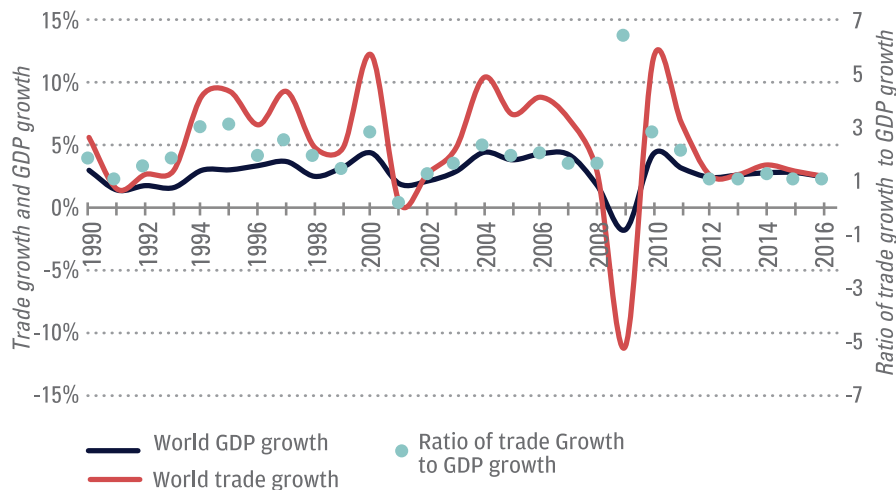
However, the pace of growth in world trade slowed following the global

economic crisis. In 2016, global trade expanded by a meagre 1.2 per cent, the third-lowest growth rate in the past 30 years.¹²⁴ The bi-directional correlation between trade and output growth lost steam as the elasticity between trade and output growth became less responsive (see figure 23). The income elasticity

of world trade became more elusive as global trade grew in terms of volume, while its value fell due to competitive devaluations, faltering primary commodity prices, and the cost inefficiencies arising from GVCs.

Figure 23.

Trade growth elasticities



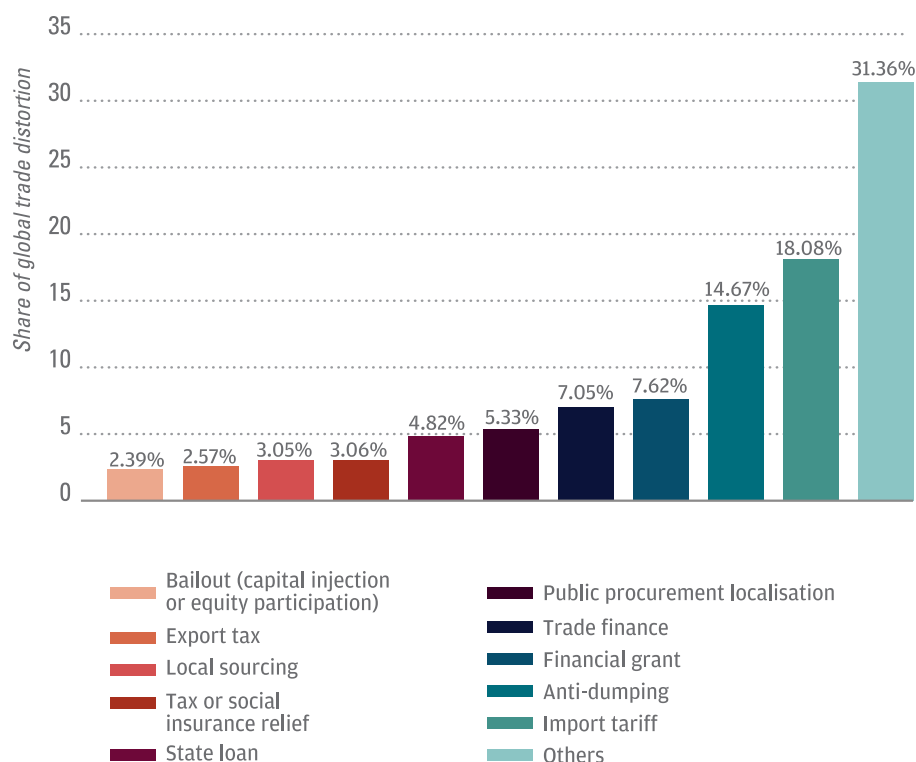
Source: Based on World Bank, World Integrated Trade Solutions, World Development Indicators; United Nations Statistics Division; and IMF.

The accumulation of post-crisis trade and investment protectionist measures distorted the trade-growth relationship. In addition, trade defence measures spiked, with more than 65 per cent of the new investigations launched by developed countries at the WTO. Cumulatively, nearly 1,500 trade restrictive measures have been adopted, with more than 1,000 imposed by developed economies. Only 25 per cent of those restrictive measures, in place since the 2007 financial crisis, have been removed.¹²⁵ A key problem in estimating the impact of trade on growth is that protectionism is highly correlated

with other growth-reducing policies. Such restrictions and trade policy practices blur the trade-growth causality (see figure 24).

According to the United Nations IATF, since 2015, WTO members are implementing more trade-facilitating than trade-restrictive measures, with the estimated trade coverage of import-facilitating measures (\$169 billion) exceeding import-restricting measures (\$79 billion), although regional differences exist.

Figure 24.

Top 10 global trade distortions, 2009–2017

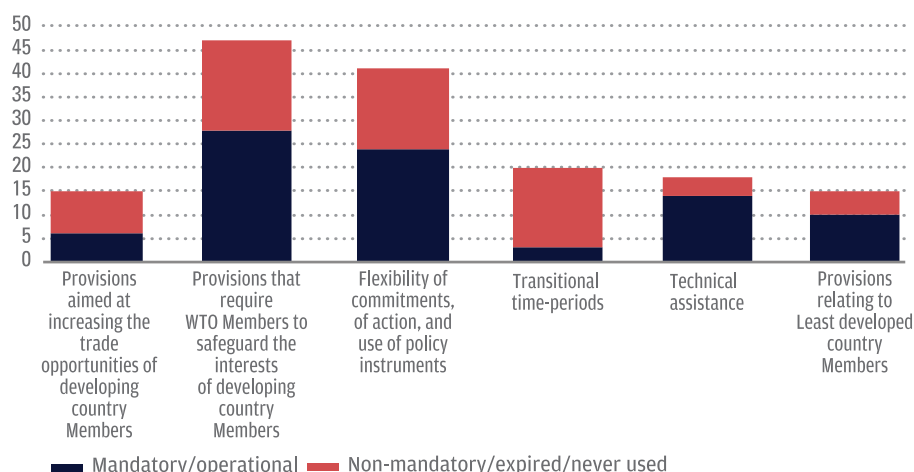
Source: Based on Global Trade Alert, 2018.

The trade-growth nexus is further undermined by the WTO special and differential treatment (SDT) system and provisions in WTO agreements (see figure 25). Around 45 per cent of those provisions have expired or never been used since the creation of the WTO, or are non-mandatory and hold no legal recourse. Mandatory provisions aimed at creating market access opportunities for developing countries account for no more

than 4 per cent of the entire SDT system. Nearly 85 per cent of the transitional periods have elapsed, and 41 per cent of the provisions allowing flexibility in implementing commitments and the use of policy instruments have either expired, never been invoked, or do not create any direct market access as they involve setting national inquiry points and the translation of documents.

Figure 25.

Operability of SDT provisions in favour of developing countries



Source: Based on WTO, 2002.

2. Regional trends

The importance of an inclusive MTS is emphasized in the AAAA. Yet, two decades after the creation of the WTO, only 13 Arab countries have been granted WTO membership. Several Arab countries' accession requests date as far back as 1987. The State of Palestine continues to be barred from receiving permanent observer status, although the Protocol on Economic Relations (Paris Protocol) has granted the Palestinians a separate customs territory/envelope in which to exercise economic and trade autonomy.

By 2015, the Arab region had become a net importer of goods. A decline in commodity prices caused most Arab economies to experience current account deficits. In 2016, total merchandise exports amounted to \$649.1 billion (\$351.7 billion or 54 per cent of which was attributed to oil revenues), while the total Arab import bill amounted to \$778.6 billion for the same year. The net value of the export deficit was \$129 billion in 2016. Between 2011 and 2016, the Arab region witnessed an opportunity cost of \$97.6 billion due to worsening terms of trade, which in turn explains the decline in foreign reserves and the rise in external debt trends.

Several factors explain this situation and why the trade-growth nexus in the region remains subdued: structural changes between trade and output witnessed in recent years; weak external demand associated in part with the sovereign debt crisis; falling primary commodity prices; and poor logistical performance. In addition, the Arab region remains one of the most restrictive regions in services trade, with a relatively high Services Trade Restrictiveness Index. The inefficient supply of services, provided mostly by the public sector, and the high cost of key backbone services, including transport, telecommunications, storage and distribution, are factors that discourage investment and restrain trade expansion potentials.

The trade-growth and development nexus was also stifled when Arab export competitiveness was adversely affected by heterogeneous regulatory frameworks associated with extraregional preferential trade agreements. Reliance on extraregional trade agreements to boost exports has impeded export competitiveness, given that they superimpose regulatory requirements and rules of origin that do not necessarily take into account sustainable development imperatives. In some cases, the cost of compliance with those rules exceeds

the benefits offered by regional trade agreements. Consequently, the composition of trade partners significantly impacts the trade-growth nexus.

D. TRADE AS A MEANS OF FINANCING ARAB DEVELOPMENT

A country can use trade policy to raise direct financial resources from two major channels: public-financing and private-financing paths. Through public financing paths, a country's participation in international trade generates public revenues in the following three ways:

- Direct revenues accruing from export proceeds: In 2016, the value of Arab exports amounted to six times the combined amount of FDI inflows,

remittances and ODA received by the region in the same year. These resources are, however, dependent on securing meaningful market access opportunities, both multilaterally and regionally. In fact, according to UNCTAD Key Statistics and Trends for 2016, the relative preferential margin that West Asian and North African countries maintain amounts to 2 percentage points' advantage over foreign competitors when trading within their region. Taking this further, estimates suggest that, on average, a 10 per cent increase in intraregional Arab trade would result in a GDP growth of 0.08 percentage points (see box 2);

Box 2. Growth from Arab regional trade integration

Deepening Arab regional integration is a source of growth for the Arab region. Estimates show that between 1960 and 2011, trade and tariff cuts had a positive influence on the region's GDP growth performance, and that the overall effect of trade in goods on GDP was higher than that of trade in services. This, however, is attributed to the relatively high restrictions facing intraregional trade in services, as revealed by the World Bank Services Trade Restrictions Database. For the trade-growth nexus to realize its full potential in positively influencing growth, regulatory and structural reforms that reduce trade barriers and encourage service liberalization remain a key policy choice.

An empirical assessment was undertaken to determine the effects of intraregional as opposed to extraregional preferential trade, and to establish their respective impacts on output growth performance in the Arab region. It was found that between 1995 and 2010, intraregional preferential trade had a larger impact on per capita growth in the Arab region: a 10 per cent increase in current levels of intraregional trade would cause GDP to grow by 0.08 percentage points on average. However, when the same assessment was undertaken for a different data period (1995–2015), the trade-growth relationship was unclear due to the 2011 political turmoil in the region. The results continue to validate some earlier assessments, which revealed that intra-Arab regional trade liberalization was a source of almost 9 per cent more capital growth than extraregional and Arab-European Union trade (Younes, 2010). Moreover, when the intensity of the conflict was factored, the latter strongly correlated with a reduction of intraregional trade.

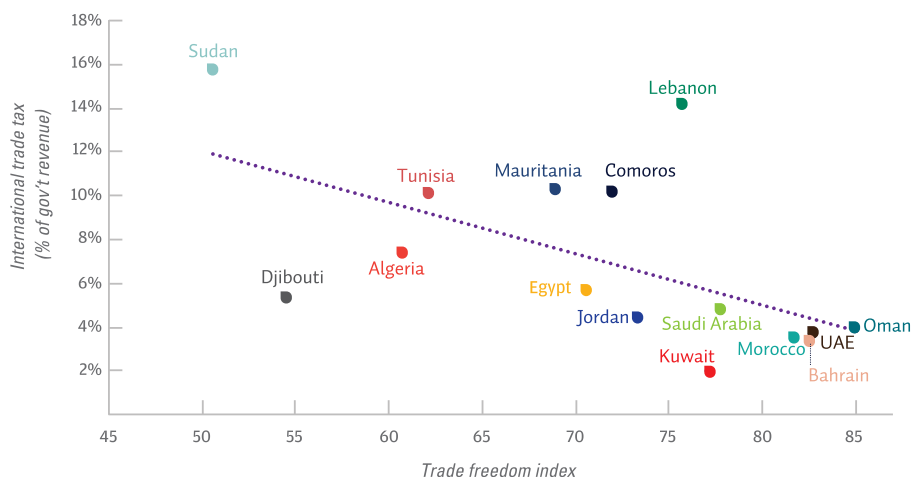
Source: Based on Younes, 2010.

- **Taxes on exports:** Export taxes and licensing fees have resulted in increased financial returns for some Arab countries. However, since Arab commodity exports only represent a small fraction of world exports (excluding oil products), the use of taxes on exports as a means of financing can adversely alter the terms of trade and diminish national welfare as the incidence of the tax falls on the domestic economy (producers) rather than external market (consumers). This argument has provoked a parallel discussion on the abolition of consular fees within both multilateral and preferential trade. There is consensus nonetheless to support the use of export taxes on raw materials and primary commodities, preferably when the export country holds a dominant market power. Yet, export taxes may have other indirect effects on sustainable development when they are imposed to justify the conservation of natural resources and combat trade-based money laundering;
- **Taxes on imports:** Custom duties in the Arab region have declined considerably due to unilateral, regional and

multilateral trade liberalization measures (see figure 26). For some countries, the loss in revenue was largely compensated for by domestic sales and value-added taxes. According to the Arab Monetary Fund, customs revenues represented nearly 4.2 per cent of total public revenue in 2016. Today, trade taxes average about 1 per cent of GDP in both resource and non-resource countries, and rarely exceed 2 per cent of GDP. Trade taxes as a proportion of total tax revenues declined on average from about 26 per cent in the early 1990s to 15 per cent in 2012.¹²⁶ Raising trade taxes remains contingent on the interplay between several intertwined policy priorities: renegotiating a trade justice multilateral trade agenda; the extent to which tariff overhangs can be exploited without adversely affecting welfare; the implications for regional integration aspirations and extraregional preferential trade agreements; the interaction between tariffs and domestic taxes; and the acknowledgment that trade taxes can distort trade and protectionism thus constituting a source of economic distortion.

Figure 26.

International trade tax versus trade freedom, 2016



Source: Based on data from the Arab Monetary Fund, 2017; The Heritage Foundation, 2018.

One of the main conclusions of *the Arab Development Outlook: Vision 2030*¹²⁷ was that by 2030, the Arab region would hold trade preferences from at least 110 countries across five continents through binding regional trade agreements. Most, if not all, of the region's imports by 2021 would be granted duty-free access, or at least receive some form of border and beyond-border trade preferences. Under those conditions, the narrow window to raise tariffs or impose seasonal or tariff rate quotas and fiscal charges would be further eroded.

In that case, the opportunity to employ trade taxes to finance development would not only be restricted by overhang margins maintained under the WTO, but also by three main binding constraints. The first is associated with a decision to establish an Arab customs union by 2021 which, if created in coherence with the Understanding on the Interpretation of

Article XXIV of the General Agreement on Tariffs and Trade (1994), would imply opting for relatively low common external tariffs to accommodate the Customs Union of the Gulf Cooperation Council (on the assumption that no compensatory adjustments or technical adaptation would be required by third countries). The second consideration is associated with the need to opt for a low common external tariff for an Arab customs union to maximize consumer welfare, given the modest influence that many countries have on their terms of trade owing to structural deficiencies. The third consideration involves a detailed review of how extraregional preferential trade agreements operate and how they would be technically adapted following the establishment of deeper forms of Arab integration beyond an Arab customs union.

CHAPTER 6

DEBT AND DEBT SUSTAINABILITY

THE GLOBAL DEBT BUBBLE

\$164 TR

Global Gross Debt
225% of Global GDP



External Debt
Developing Countries

\$6.88 TR



External
Arab Debt

\$247 BN

TOTAL EXTERNAL DEBT STOCKS BY TYPE IN 2016



Public and
Publicly Guaranteed

\$173 BN



Private
Nonguaranteed

\$11 BN



Use of IMF
credits

\$12 BN



Short-term

\$51 BN

Total External
Debt Stocks

\$247 BN

Between 2011 and 2016 for every **\$1 dollar of debt inflows** that the region received, correspondingly **\$1.5 was paid back in arrears** on the outstanding debt stock owed by the Arab region.

\$1



inflow

\$1.5



outflow

Commitments on debt sustainability and management contained in the AAAA address the interdependent objectives of debt crisis resolution (including debt relief and restructuring) and debt crisis prevention (through the development of tools and analysis for prudent public debt management, the promotion of new financial instruments and improved reliability of debt data). This chapter is concerned with debt crisis prevention, given that decision-making on sovereign borrowing rests with debtor countries themselves, and looks at whether debt financing is an appropriate means for funding development at this time in the Arab region.

Overall, debt dynamics in the Arab region are in stark contrast to international trends. The only point in common has been record-high external debt stocks. In 2015, while net debt flows into developing countries turned negative for the first time since the 2008 global economic crisis, the Arab region witnessed a surge in debt inflows. While borrowing by developing countries from official creditors (including the IMF) has, in general, declined steadily since 2000, the contrary is true of the Arab region. The rise in global debt has been driven by private non-guaranteed and corporate short-term borrowings, whereas, in the Arab region, it has been due to the swelling of public and publicly guaranteed debt.

The political and security situation in the region has fuelled a rise in the cost of sovereign borrowing. Living with debt could have been a component of a policy for maximizing welfare but for the “inconsistent trinity” that continues to challenge policy-makers: the impossibility of having a fixed foreign exchange rate, free capital movement and an independent monetary policy all at the same time. Given the extent of inequality and injustice in the region, current debt trends may well have an adverse impact on intergenerational

justice. Sustainable debt policy cannot be charity-based or dependent on exogenous and volatile sources of foreign currency-dominated external finance. Risks are growing of a renewed cycle of debt crises and economic disruption. Debt service indicators are deteriorating and vulnerabilities have increased, in particular in countries that used to benefit from debt relief. The accumulation of debt stocks may result in future insolvencies, and the lack of political support to develop comprehensive sovereign debt workout mechanisms is, in effect, having a toll over the region’s prospects in realizing debt sustainability and achieving the 2030 Agenda.

A. GLOBAL SITUATION

According to the United Nations Inter-Agency Task Force on Financing for Development, excessive borrowing can crowd out private credit and investment, and brings about an economy-wide risk premium. It has been argued that a debt-to-GDP ratio exceeding 90 per cent can constrain economic growth, and in some quarters, such as the European Union, debt ceilings are favoured. Although the IMF has conceded that there is no exact science on what constitutes too much debt, and some observers deny the existence of a set correlation between debt and economic growth, the general consensus is that debt is a claim on future wealth. Excessive borrowing and leveraging, along with unforeseen events, can sap lender optimism. Creditors cut lending, leading to a drop in creditworthiness, and seek higher premiums, creating a debt spiral. That can lead to a liquidity crunch and, subsequently, austerity policies, which tend to shrink the economy, making it harder to repay debt. The result is a debt crisis.

In order to determine what constitutes sustainable debt in a given country, the impact of global debt and capital market dynamics need to be factored in alongside

statistical examinations measuring debt against macroeconomic performance aside from GDP. Thus, the first part of this report analyses global debt dynamics and then provides an assessment of debt in the Arab region. The analysis is based on available longitudinal data and cross-sectional debt-time series. It is subject to change, depending on country-specific situations and/or region-wide developments, especially as many countries in the region have recently taken up additional sovereign borrowings (not yet captured by debt statistics) or have announced plans to do so.

Today, the world is witnessing the biggest debt bubble in history. Global gross debt (public and private: households, governments, financials and non-financial corporates) reached \$164 trillion dollars in 2016, the equivalent of 225 per cent of global GDP.¹²⁸ The external debt stocks of developing countries totalled \$6.88 trillion in 2016 with 21 per cent of the combined external debt stock of low- and middle-income countries owed by China.

The pace of private debt stock growth has been rising since the 2008 global economic crisis as a direct consequence of nominal interest rates turning negative (in other words, banks are being punished for not lending excess liquidity, a situation to be distinguished from negative real interest rates). The rise in global gross debt has been fuelled by social and economic losses (low commodity prices, subdued trade growth and volatile capital flows), environmental challenges (natural disasters, climate change and environmental degradation), and conflicts and humanitarian crises.

1. External debt financing

The total external debt of developing countries reached its highest levels by the end of 2014, with long-term debt constituting nearly 67 per cent of their external debt stock and most of it owed to private creditors. Short-term debt

amounted to \$2.2 trillion in 2014, a 77 per cent increase compared with 2010. In 2015, the external debt stock began to decline for the first time in two decades. That was mainly driven by repayments of \$811.6 billion, debt forgiveness and the relative downward effect of debt denominated in currencies other than the United States dollar.

Debt-to-GNI ratios in developing countries have been rising steadily since 2008, reaching an average of 26 per cent of GNI by 2016. That ratio is modest compared with levels reached in the early years of the twenty-first century. Declines in export revenues and widening public deficits driven by slow growth and commodity price slumps have triggered greater demand for external financing and led to significant increases in the external debt-to-GNI ratios. From the standpoint of debt sustainability, it is important to consider that debt remains multidimensional. Its analysis should factor in the composition of the debt stock itself and debt service outflows in relation to the country's capacity to repay arrears (for example, external debt as a percentage of GDP, national income and export revenues; and debt per capita).

While borrowing by developing countries from official creditors (including the IMF) shrank from 36 per cent to 14 per cent as a share of total external debt between 2000 and 2016, private external borrowing increased steadily, with the share of private non-guaranteed debt as an element of total external debt increasing from 27 per cent in 2005 to 37 per cent in 2016. The fall in borrowing from the IMF was associated with an aversion to that institution's lending conditions. The increase in private debt coincided with a rise in the share of short-term debt as a constituent of total external debt, which reached 31 per cent in 2013, before easing to 25 per cent in 2016.

External debt repayment by developing countries has increased as a portion of

government revenue and has reached its highest level since 2007. Average payments across 122 developing countries are said to have increased from 6.7 per cent of revenue in 2014 to 9.7 per cent by 2016.¹²⁹ That represents a hefty 45 per cent increase in debt service outflows, according to the Jubilee Debt Campaign. Net debt flows to developing countries in 2015 turned negative for the first time since 2008. According to International Debt Statistics, developing countries witnessed net debt outflows worth \$294 billion in 2015, a stark contrast to net inflows of \$533 billion in 2014, where it climbed to \$248 billion in 2016.

2. Domestic capital markets and innovative debt instruments

Dependence on bond issuances in domestic currency has grown in recent years. Those bonds are used to mobilize private capital (domestic and international) to finance domestic development. Domestic-currency denominated debt instruments can reduce currency mismatches for borrowers. The United Nations IATF noted in its 2016 annual report that, as a result of the increased volume of domestic sovereign debt, it has become increasingly important to address how sustainable bond issuances can be used in case of fiscal space distress and/or in case of difficulty in maintaining regular debt service payments.

As an alternative, the AAAA encourages the use of innovative financial instruments. Two schemes have been found to have significant implications for sustainable development financing: debt-swap arrangements (swapping a public debt obligation for a specified public expenditure programme, including debt-to-health and debt-to-education swaps) and State contingent financing instruments. The latter involve contractual provisions that make debtors' obligations contingent upon pre-defined events or data out-turns. They are therefore designed to provide automatic, market-

based protection against pre-defined shocks and/or remain contingent on macroeconomic performance.

Islamic finance in sharia-compliant instruments has gained considerable traction over the past decade. Some \$2 trillion has been mobilized through such instruments, and the total is expected to double by 2020. Some three-quarters of the industry is concentrated in the Arab region. *Sukuk* issuances (Islamic bonds) make up 14 per cent of the Islamic finance industry. In 2014, they were estimated at \$295 billion globally by the Union of Arab Banks.¹³⁰ Since 2010, they have grown at an annual rate of 35 per cent. The Islamic Development Bank (IDB) has also been exploring the use of Islamic social finance channels, namely *zakat* (mandatory alms-giving), to mobilize additional resources to finance social safety nets and associated infrastructure. In 2015, the total *zakat* circulating annually was estimated at between \$232 billion and \$560 billion.¹³¹

Other innovative proposals for channelling development finance include: taxes on currency and financial transactions; carbon and greenhouse emission taxes; air passenger levies; cap and trade schemes; and the leveraging of special drawing rights (SDRs). In 2010, the United Nations estimated that more than \$100 billion per year of "idle" SDRs in reserve-rich countries could be converted into long-term development finance.¹³² By one estimate, taxing CO₂ emissions could raise as much as \$1.9 trillion annually.¹³³ An additional \$100 billion per year could be mobilized if pledges for additional resources to support climate mitigation and adaptation are met by 2020.¹³⁴ It has been estimated that a currency tax of half a basis point on all trading in the four major currencies (the dollar, euro, yen and pound sterling) would yield \$40 billion per year.

There is renewed interest among policymakers in benefitting from State contingent debt financing instruments. GDP-indexed bonds could help to mitigate the growing vulnerability of the external

debt positions of developing countries. However, such instruments are contingent on investor confidence and their appeal would hinge on assigning them wide interest differentials. The drawback is that an issuing country may face higher repayments if its GDP rises after the date of issuance. Nonetheless, by adopting GDP debt indexation, the debt service-to-GNI ratios of developing countries move more closely to their GNI, which improves their ability to pay off debt.

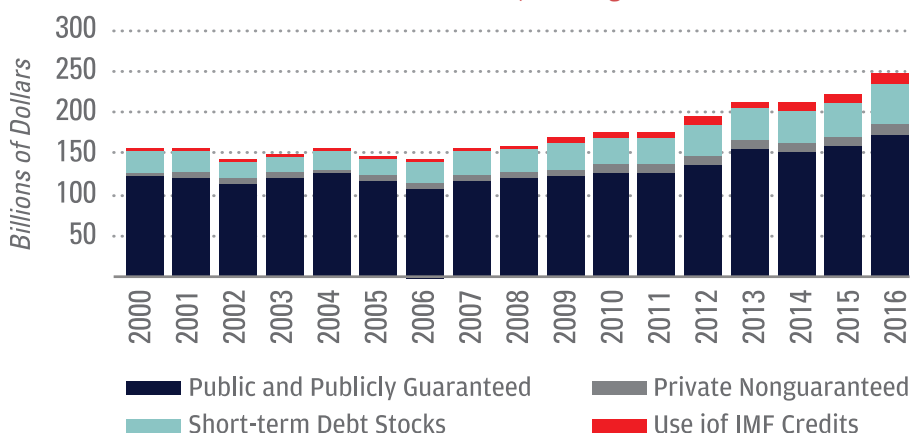
B. REGIONAL DYNAMICS

According to the United Arab Emirates Ministry of the Economy, total foreign debt in the Arab region reached \$922 billion in 2015¹³⁵. The Economist Intelligence Unit puts it at \$987 billion¹³⁶. International debt

statistics published by the World Bank in 2017 show that the total external debt stock owed by nine low- and middle-income Arab economies (including short-term debt, long-term private non-guaranteed debt, long-term public and publicly guaranteed debt, and IMF credits) peaked at \$247 billion in 2016 (see figure 27 – Overview). That figure is just over the \$210 billion in financing provided to the United States of America by Kuwait, Saudi Arabia and the United Arab Emirates through their Treasury bill holdings.

Figure 27.

External debt stock of middle-income economies, Arab region (2000-2016)



Source: Based on World Bank, 2018a.

Reliable data and statistics in the Arab region on external debt, wealth assets and contingent liabilities are patchy. According to the World Bank's International Debt Statistics, for example, the external debt stock of Sudan is \$21.1 billion. In reality that country's debt stood at \$52.4 billion in 2016.¹³⁷ Under the "zero option" agreement, Sudan is to retain all external liabilities after the secession of South Sudan provided that the international community commits to deliver debt relief. Without such a commitment, the debt would be

apportioned between the two countries according to a negotiated formula.

The case of the State of Palestine is also complex. At a meeting of the Ad Hoc Liaison Committee for the Coordination of International Assistance to Palestinians, held in New York on 19 September 2016, urgent donor support was requested to address the financial and debt crises facing the Palestinian economy (a \$600-million financing gap). That critical situation was not the result of excessive borrowing but of the manipulation

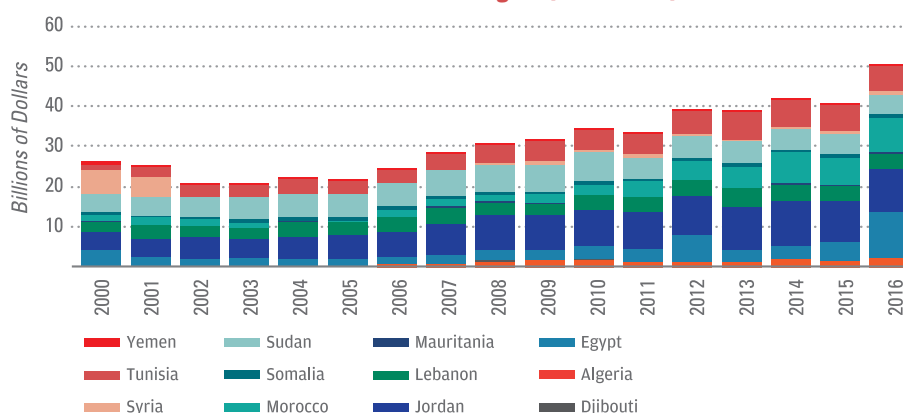
by Israel of the clearance revenue mechanism, which deprived Palestinians of revenues and, according to the IMF, led the State of Palestine to the brink of a debt crisis. Such complexities, along with those associated with conflict, political transition and low oil prices need to be taken into consideration as part of the debt distress analysis.

Public and publicly guaranteed debt represented 70 per cent of the Arab region's

total external debt stock in 2016. Public external debt has been closely associated with the liabilities incurred and implicit subsidies received by large public sector enterprises, which remain heavily vested in financial markets through state-owned banks. Short-term external debt constitutes 20 per cent of the total debt in the Arab region, less than the 25 per cent average for developing countries (see figure 27).

Figure 28.

Short-term external debt stocks in the Arab region (2000-2016)

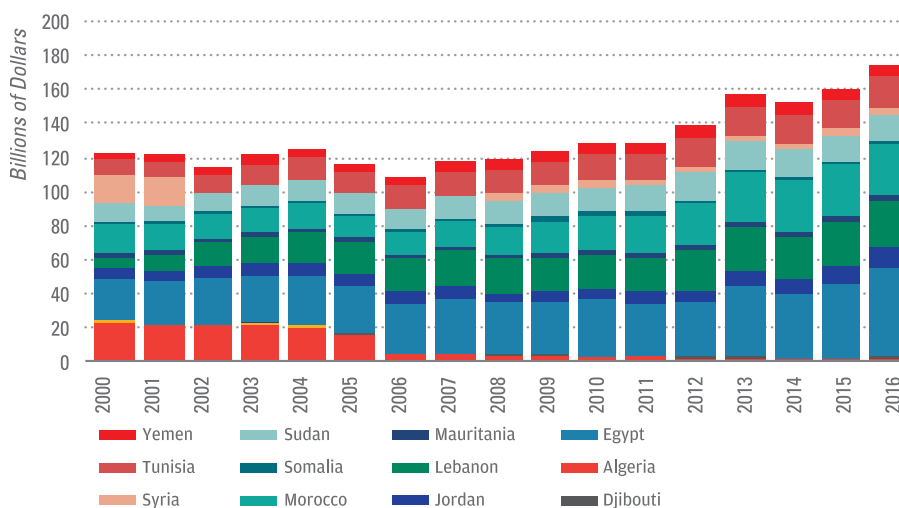


Source: Based on World Bank, 2018a.

By the end of 2016, Egypt, Morocco, Lebanon, Jordan and Tunisia accounted for more than three-quarters of all long-term public and publicly guaranteed debt held by non-oil-producing Arab economies (see figure 29). Morocco accounted for 59 per cent of private non-guaranteed external debt held by those countries, followed by Jordan (21 per cent) and Tunisia (10 per cent). They were

also among the top external borrowers of short-term debt, with Egypt accounting for 24 per cent, Jordan accounting for 21 per cent, followed by Morocco (18 per cent) and Tunisia (13 per cent). With Lebanon, they ranked top among Arab economies to witness rising external debt per capita, ranging from \$5,321 in Lebanon to \$2,869 in Jordan and \$135 in Algeria.

Figure 29.

Public and publicly guaranteed external debt in the Arab region (2000-2016)

Source: Based on World Bank, 2018a.

Private, non-guaranteed debt (long-term external obligations of private debtors that are not guaranteed for repayment by a public entity) represented 4 per cent of the total debt stock in the Arab region in 2016, compared with the significant corporate and private debt in developing counties, averaging 37 per cent. That situation may indicate that Arab private sector operators have not fully exploited capital markets and/or have been inadequately positioned to tap them in the face of competition from higher yielding assets in emerging markets. However, according to a report by the AMF, it can also be attributed to: sluggish growth; the crowding-out of private sector borrowing by the increasing issuance of public debt; the rising value of the dollar and associated growth in interest rate differential spreads; and pressures to devalue currency faced by 10 Arab countries, most of them non-oil producers. Other reasons include increased transfer risk and exchange rate restrictions that may have prevented the repayment of obligations.

The situation also points to increased “de-risking”. Since 2008, the declining appetite for risk among international

financial institutions and tighter global scrutiny of money-laundering have fuelled a tendency to de-risk. Institutions may pass on the cost of heightened regulatory scrutiny to private customers in the form of higher fees, restricted credit and fewer services and products. Businesses unable to absorb the added burden may, in effect, see services discontinued and their financial exclusion increased.

In the Arab region, access to formal credit is less than half the global average and remains an obstacle to expansion of the private sector. According to a survey produced in 2013 by the WTO and OECD¹³⁸, firms identified access to credit as the second-greatest deterrent to doing business in the Arab region. That finding is reiterated in successive World Bank Doing Business reports, which confirm that securing business funding is hindered by the poor coverage, scope and quality of credit information available to banks, and by the quality of the legal and regulatory frameworks.

More disturbingly, according to a joint IMF–AMF–World Bank survey released in 2015, 39 per cent of the surveyed 216 Arab banks had experienced a significant

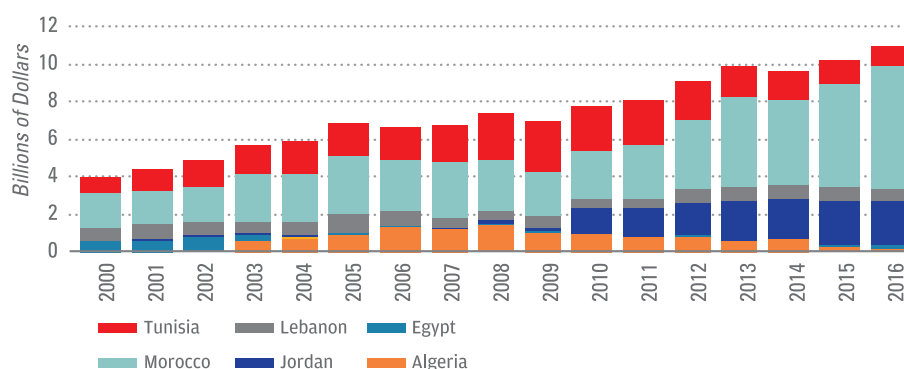
contraction in the scale and breadth of their CBRs between 2012 and 2015. The level of account closures also appears to be increasing, with 63 per cent of Arab banks reporting the closure of CBR accounts in 2015, as opposed to 33 per cent in 2012.¹³⁹ The termination or restriction by financial institutions of CBRs with banks operating in the Arab region has been associated with: the loss of risk appetite on the part of those institutions; changes in legal, regulatory or supervisory requirements in them; the unprofitability of certain CBR services and products; and the sovereign credit risk rating in Arab countries.

The rate of growth of private non-guaranteed debt in the Arab region is not

necessarily a guarantee against currency mismatches (see figure 30), as when the dollar appreciates because of an interest rate differential or when national currencies depreciate. A rising dollar not only drives up the cost of servicing debt, but means that more domestic currency has to be posted as collateral. According to the IMF (2016), every annual percentage-point increase in the private debt-to-GDP ratio exceeding the average increases the probability of financial crisis by 0.4 per cent. It has been said that the increase in private debt in Morocco between 2014 and 2015 would have raised the probability of government de-risking measures by 9 per cent had that country been subject to an economic shock.

Figure 30.

Private non-guaranteed debt in non-oil Arab countries (2000-2016)



Source: Based on World Bank, 2018a.

As a percentage of GDP, total external public debt in the Arab region increased from 22.4 per cent in 2015 to 26.8 per cent in 2016. That figure disguises still more significant increases in the debt-to-GDP ratio registered by a number of Arab least-developed countries including Djibouti (88.8 per cent) and Mauritania (48.8 per cent). Among low- and middle-income Arab economies, the external public debt for Tunisia and Lebanon has risen steadily since 2011, according to the AMF reaching record highs of debt-to-GDP ratios of 69.4 per cent and 54.8 per cent respectively

in 2016. Egypt maintained the lowest debt-to-GDP ratio of the region's non-oil economies in 2015 and Comoros achieved the same in 2016. In Morocco, the comparatively low debt-to-GDP ratio of 29.9 per cent in 2016 nevertheless represented an increase of around 25 per cent in external public debt stocks since 2011.¹⁴⁰

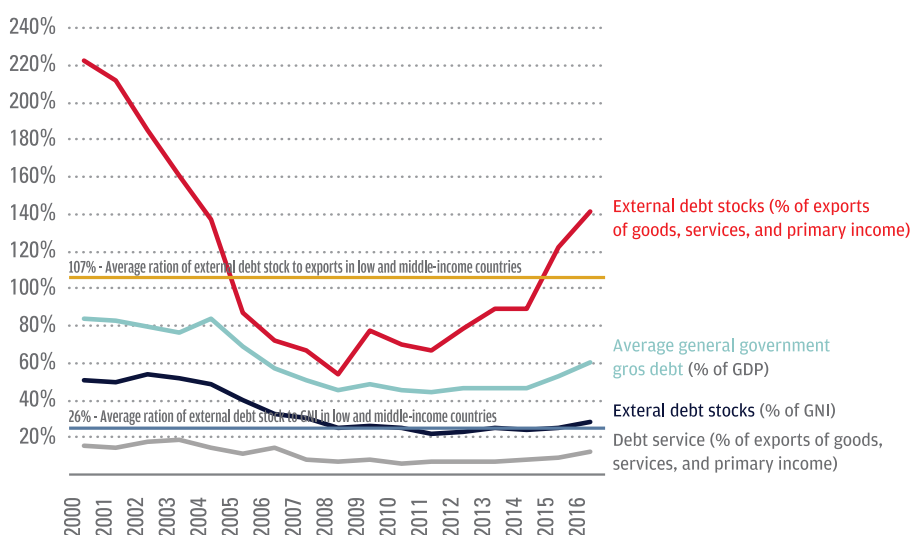
Debt-to-GNI ratios in the Arab region have been rising steadily since 2011, in 2016 exceeding the average registered for developing countries (26 per cent). Jordan, Lebanon, Mauritania and Tunisia have the highest debt-to-GNI ratios in the region.

Using the available data on external debt stocks and GNI for the Arab countries, the external debt-to-proceeds from exports and primary income in the region amounted to 142 per cent in 2016 (see figure 31), compared with an average of

107 per cent for low- and middle-income countries. Since 2011, the external debt-to-GNI, debt-to-exports and gross government debt-to-GDP ratios in Arab countries have all risen.

Figure 31.

Weighted average debt ratios in the Arab region (2000-2016)



Source: Based on World Bank, 2018a.

However, when debt service is indexed to provide an indication of repayment and sustainability potentials, Lebanon stands out. Its ratio of debt service to government revenue (excluding grants) reached approximately 38 per cent by 2014, well above the regional average of roughly 12 per cent. Nonetheless, that relatively high ratio represents a significant drop from 90 per cent in 2004,¹⁴¹ which was largely attributed to high gross domestic debt. At the time, Lebanon's external debt had increased due to the sovereign and commercial borrowing arrangements that resulted from the Paris II Conference, which took place on 23 November 2002. The steep drop in the debt service ratio ensued from the rescheduling of maturities and decreases in lending costs due to the Paris aid package, also following a 28 per cent increase in government revenue between 2002 and 2004 (as a result of the 2002

reforms that witnessed a widening of the tax base, improvements in tax administration and the introduction of value-added and consumption taxes). Thus, while debt accumulation continued at a slower pace (due to high interest rates on domestic debt), the debt-to-revenue ratio remained more or less stable (as the Central Bank intervened to buy government Treasury bills and resell them at discounted rates, temporarily bearing the cost of such a spread).

This stability in the debt-to-revenue ratio is confirmed by external debt servicing as a percentage of Lebanon's export revenue – this percentage stood at 18.6 per cent in 2014. Indeed, the IMF and other international financial institutions have concluded that a debt-to-GDP ratio of 185 per cent in Lebanon is “less alarming than in other countries” and that, with broad money supply (M3) at nearly three times the size of GDP, it is possible to allow for

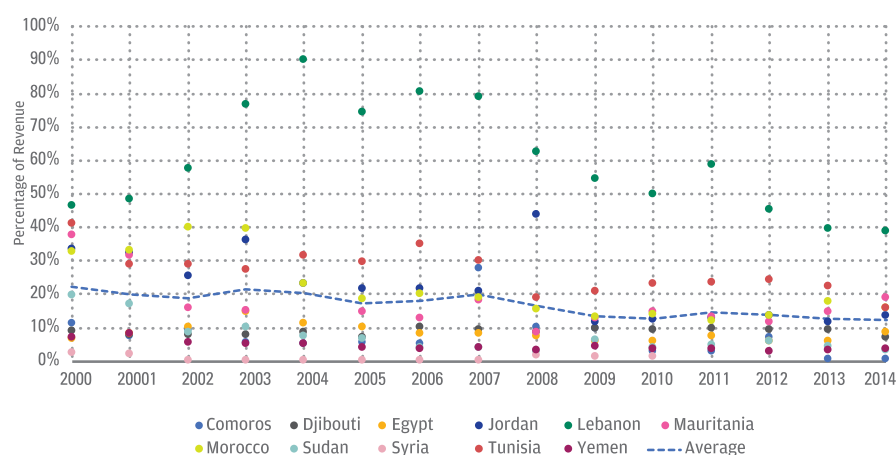
higher debt-to-GDP ratios (albeit for a transitional period only) without the risk of imminent collapse. Broad money supply in Lebanon stood at 2.7 times its GDP in 2016.¹⁴² The situation is slightly different, however, in Jordan, Mauritania and, to a lesser extent, Tunisia, where the debt service-to-government revenue ratios have been increasing in tandem with rises across several other indicators, including debt service to exports, the debt stock to GNI, debt to reserves and external debt per capita (see figure 32).

In 2016, market-based debt (bonds) constituted nearly 95 per cent of public

and publicly guaranteed debt in Lebanon, as opposed to 4 per cent in Egypt, 51 per cent in Jordan, 17 per cent in Morocco and 26 per cent in Tunisia. They are among the few non-oil economies in the region that were able to leverage debt financing from international markets unassisted, albeit not free from an interest rate spread. At a time when ODA from OECD-DAC members and non-DAC ODA is withering, some argue that external debt could be leveraged by contracting it at concessional rates from multilateral institutions, or with the assistance of loan guarantees, as in the cases of Egypt, Jordan and Tunisia.

Figure 32.

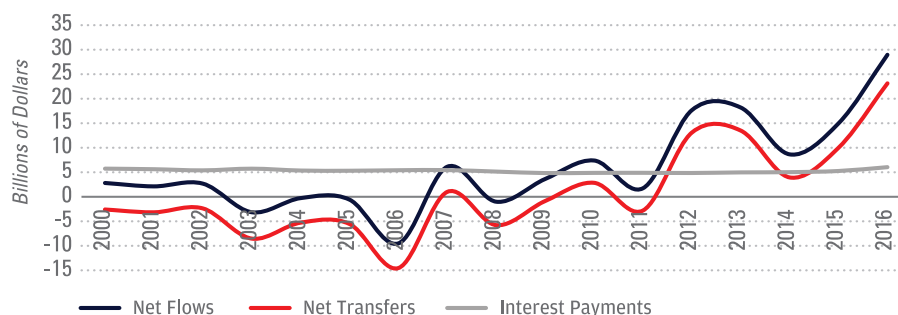
Debt service as a portion of revenue in non-oil Arab countries



Source: Based on World Bank, 2018a.

Figure 33.

Debt flows and transfers in non-oil Arab economies



Source: Based on World Bank, 2018a.

By calculating the net transfers on external debt, the analysis reveals that, since the turn of the century, the Arab region for the most part witnessed net outflows until 2011 (see figure 33). The accumulation of external debt from 2011 was associated with a moderate increase in interest repayments (25 per cent on average from 2011 to 2016), indicating that net debt inflows have mostly come in the form of concessional aid or lending. However, in the same period, it was found that, on average, for every dollar of public and publicly guaranteed debt borrowed annually in the Arab region, \$2 was paid back as principle and interest arrears on the outstanding debt stock.

C. OBSERVATIONS ON DEBT DYNAMICS

There can be no one-size-fits-all norm regarding a sustainable level of external debt stock, and relying entirely on debt-to-GDP ratios as a measure can be misleading. At one point, the public debt-to-GDP ratio in Japan reached a high of 247 per cent, yet debt remained relatively benign in relation to its macroeconomic foundations and growth resilience¹⁴³. Argentina (2001), Greece (2009) and the Russian Federation (2014) faced sovereign debt crises with considerably lower debt-to-GDP levels at 127 per cent, 152 per cent and 35 per cent respectively.¹⁴⁴ Some have argued that as long as the debt-to-GDP ratio remains fairly stable over the medium term, debt stock is sustainable irrespective of its level. The World Bank considers foreign debt to be unsustainable when its ratio-to-export revenues exceed 150 per cent,¹⁴⁵ which would suggest that the exposure to external debt of all Arab non-oil economies is unsustainable. The IMF considers that countries seeking access to its resources, and in which the projected debt-to-GDP ratio exceeds 50 per cent, with a current or projected gross financing needs-to-GDP ratio above 10 per cent, require close scrutiny.¹⁴⁶

Each sovereign debt crisis is driven by its own debt and growth idiosyncrasies.

However, one common feature that emerges from the study of debt crises around the world during the past century is that they were all preceded by a rise in private and corporate debt, in absolute terms and in relation to GDP. Once accumulated, private debt can constrain demand and eventually lead to a loss of confidence (downgrade in credit worthiness). The situation can be aggravated, as was the case with the eurozone crisis that began in 2009, when this is coupled with massive cross-border capital outflows that trigger interest rate hikes and/or currency depreciations that raise the cost of servicing debt and feed inequality.

The growth trajectory of private and corporate debt in the external debt profiles of non-oil producing Arab countries may seem benign, as it has remained relatively stable over the years, unlike in a number of emerging economies. The ratio of private non-guaranteed and short-term debt to GNI in Egypt and Lebanon is much lower on average than in low- and middle-income countries globally. The exception is Jordan, where the ratio amounted to 33 per cent in 2016. In other non-oil Arab economies, private debt has been close to non-existent, a situation that, however, reveals another predicament: the private sector's inability to tap capital markets.

The political and security situation in the Arab region has effectively raised the cost of public borrowing. The increase in sovereign bond spreads and the associated rise in debt and in the cost of debt servicing have been amplified where large net foreign liabilities and large foreign currency debts exist. Third-party debt guarantees go some way to mitigating the situation, dampening the spreads on external bond issuances. Some Arab countries, such as Egypt and Morocco, have resorted largely to domestic currency bond issuances to finance their fiscal deficits. However,

excessive domestic debt is associated with high interest rates, which reduce the level of private fixed capital formation and crowd out private and foreign direct investment. External debt assessments therefore need to factor in three other priority areas of the AAAA: fiscal space and domestic resource mobilization; international development cooperation; and international private finance.

In deciding whether external debt should be encouraged, beyond current levels, in order to finance sustainable development (through Keynesian-type public investment and/or increased social expenditures), the social returns on such investment/expenditure need to be weighed against the possible rise in sovereign spreads and costs associated with growing public or external debt. The question that needs to be asked is: will the level of external debt put a country on the wrong side of the debt Laffer curve (when the accumulation of debt beyond a certain ceiling adversely affects growth)? Moreover, the investment (capital or social) is subject to diminishing returns, and their intensity remains contingent on whether there is a need to raise taxes to service the higher demand for external debt (in other words, a U-shaped debt Laffer curve with different tipping points for different economies).

Arab economies face the double jeopardy arising from high external debts stocks, costly debt servicing and, at times, even higher public domestic debt. It has already been noted that domestic borrowing, although limiting currency risk, can generally carry a higher interest rate than bilateral official financing and international market borrowing, and excessive domestic borrowing can provoke a domestic banking crisis and crowd out private credit and investment.

An “inconsistent trinity” influences debt management strategies in Arab countries and their ability to maintain: a fixed/managed exchange rate or price

stability (in order to reduce exchange rate risks and manage debt burdens); sovereign debt sustainability based on free capital flows (reducing reliance on foreign borrowing and anchoring the issuance of local bonds); and independent monetary policies or financial stability. In order to retain access to international capital markets, economies have to choose between reducing currency risks by stabilizing the exchange rate, thereby hitching interest rates to foreign rates and forgoing autonomous monetary policy, or stabilizing the domestic economy by adjusting interest rates to domestic conditions, but letting the exchange rate fluctuate.

The analysis shows that, by 2016, several non-oil Arab economies were showing signs of debt distress as many breached their historic averages in all but a few debt indicators.

At one extreme, Djibouti, Mauritania, Somalia, the Sudan and Yemen show high levels of distress, alongside debt service fatigue (debt-to-export proceeds in Djibouti, Mauritania, and the Sudan ranged between 222 per cent and 454 per cent). The deteriorating terms of trade in Mauritania led its debt service-to-exports ratio to an all-time high of 222 per cent in 2016. Djibouti, Somalia and the Sudan require debt relief measures to regain access to external financing (as in the case of the Comoros, which was granted a debt relief package that resulted in a decline in all of its debt and debt service indicators). External debt in those economies is unsustainable, as reflected by the continued stockpiling of late arrears.

The external debt exposure of Lebanon is also leaning to the high-risk end of the spectrum. This is reflected in the growing spreads that have come with consecutive credit downgrades as a result of the country maintaining the highest ratios of debt to GDP, GNI and external debt per capita in the region. Debt service

consumes nearly 38 per cent of government revenues and remains highly sensitive to the volatility of remittance inflows and the domestic financial sector's willingness to buy government debt. With soaring debt service, the refinancing cost associated with extending the maturities of domestic short-term debt would be substantial, leaving limited room to consider an excessive external financing or borrowing strategy.

In Jordan, private and short-term debt have been rising in absolute terms and in relation to its overall debt stock leading to hikes in risk premiums matching those experienced by advanced emerging economies. Gross debt in Jordan witnessed successive leaps over the five years to 2016. The rising public domestic debt stock seems to be restraining growth recovery and private investment. Structural adjustments and fiscal consolidation were deemed needed to boost growth and generate sufficient revenues to service debt, and in part explaining the reason behind the latest economic crises the country witnessed in 2018.

Tunisia remains vulnerable to exchange rate swings that could translate into higher debt service burdens. The country's external vulnerability indicators worsened by 50 per cent in the five years until 2015. External debt stock in relation to GDP, GNI and export revenues is among the highest in the region and has deteriorated since 2011. Nonetheless, Tunisia has announced plans to explore the appropriateness of further external borrowing, given growing financing needs.

Of the non-oil producing Arab countries, Egypt holds the largest external debt stock, mainly in the form of medium- to long-term public guaranteed debt owed to multilateral institutions. Government domestic public debt denominated in foreign currencies (considered part of the external debt) holds a one-year maturity and is mainly held by State-owned banks.

That situation creates interest rate and exchange rate risks for public banks and aggravates the debt burden (debt to export proceeds) and debt affordability (interest payments to government revenue). Because the country's Medium-Term Debt Management Strategy advises against increasing foreign currency borrowings to deal with the fiscal deficit and carry out necessary social infrastructure spending, there are plans to increase external debt by 6 per cent in order to raise between \$1.5 billion and \$3 billion a year until 2019.¹⁴⁷

External debt in Morocco has been rising since 2006 to reach \$46.3 billion in 2016, which is a 46 per cent share of GNI.¹⁴⁸ Its external debt profile holds limited risks given the long maturities associated with its multilateral debt. However, debt stock in terms of GNI and export proceeds increased beyond their five-year average baseline. External vulnerability indicators remain resilient, however, as fiscal consolidation has progressed and inflows of FDI reduce the need for external borrowing. Strong export growth has also helped to lower the debt service-to-export ratio.

In recent years, oil-exporting economies have faced growing fiscal deficits (which, according to the IMF, could reach \$294 billion between 2018 and 2022).¹⁴⁹ That problem has been addressed by running down reserves and through domestic bond issuances purchased by domestic banks (which have since witnessed declining profitability and tightened liquidity). External sovereign bond issuances and *sukuks* reached \$72 billion in 2016, more than five times their 2015 levels.¹⁵⁰ Kuwait, Oman and Saudi Arabia plan to further tap international debt markets. Iraq, however, abandoned plans to issue sovereign bonds due to the prohibitive interest rates sought by investors. Indeed, the prospects for tighter global liquidity associated with a normalization of United States interest

rates and a weaker growth outlook would raise the cost of market-based issuances. Those conditions exacerbate the challenges facing the region and may lead to a growth in sovereign borrowing spreads. Sovereign yields on GCC, dollar-denominated bonds, for instance, increased by 10 basis points in 2016.¹⁵¹

According to the Global Sovereign Indebtedness Monitor, 116 countries are showing signs that debt is reaching critical levels, and the debt situation in 89 developing countries worsened in the four years to 2015. It cites Jordan, Lebanon, Mauritania, the Sudan, Tunisia and Yemen as being vulnerable and likely to witness renewed debt distress/crises.

A three-pronged strategy is essential to ensure that debt remains a viable means

of sustainably financing the region's development. It should include: a strong component of debt relief mustered multilaterally to aid countries facing a heightened risk of debt distress; a structural and deleveraging component for non-oil Arab economies (based on growth, raising consumption and a return to normal interest rates/inflation); and a balance sheet deleveraging component to avoid the crowding-out of the private sector, underinvestment and tightening liquidity (through debt repayment, asset purchases and restructuring private debt), as well as to overcome de-risking practices that have compelled Arab banks to curtail CBRs with foreign banks, thereby hindering access to capital markets.

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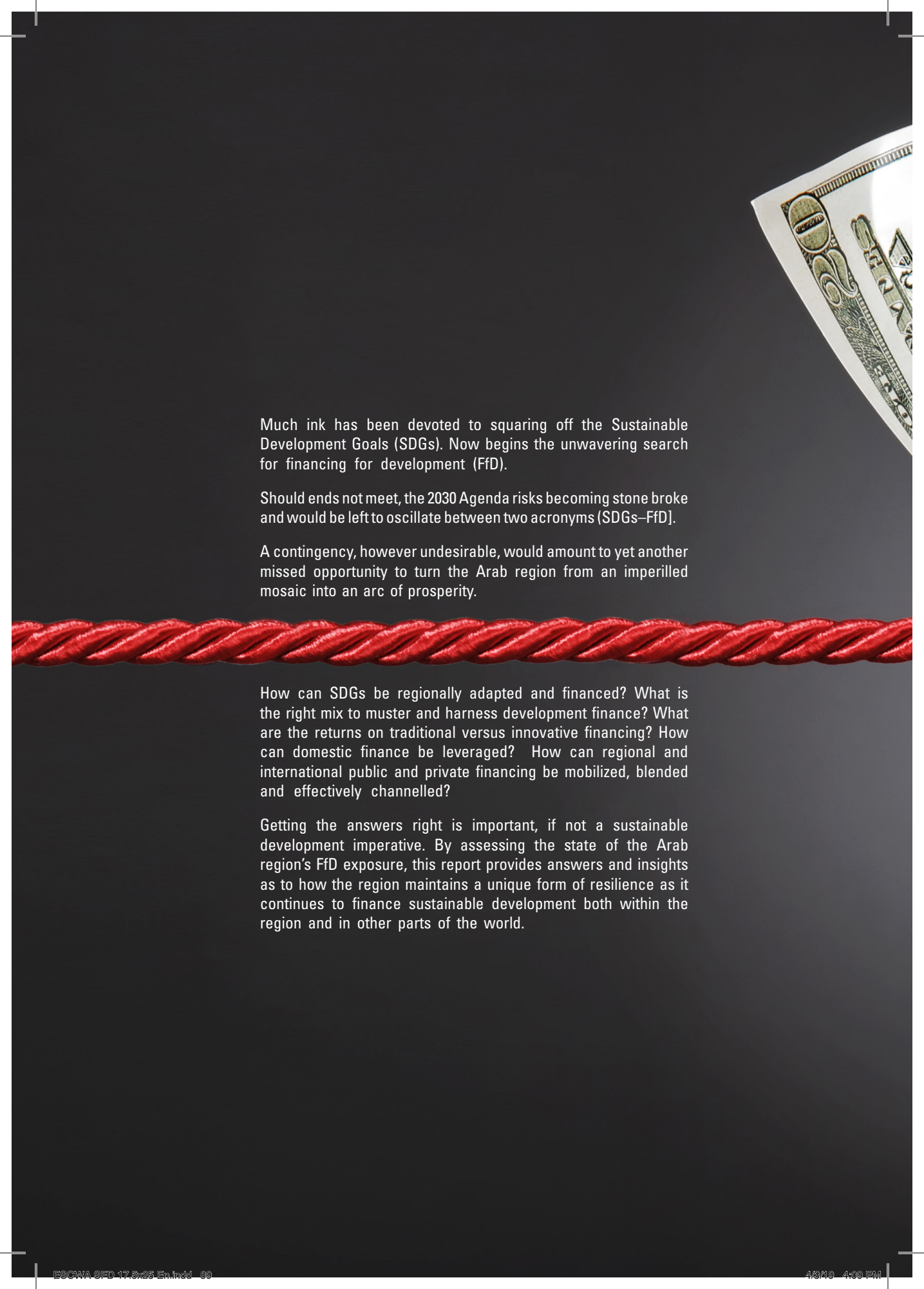
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ENDNOTES

- 1 If the terms of trade effect is included the region loses \$2.7 with every \$1 gained.
- 2 This conclusion resonates with similar findings suggesting that "rich countries aren't developing poor countries; [but rather] poor countries are developing rich ones" (Hickel, 2017).
- 3 ESCWA, 2017a. ESCWA calculations based on data from UN DESA, World Population Prospects 2017.
- 4 ESCWA calculations, based on data from United Nations High Commissioner for Refugees (UNHCR), 2017a; United Nations Relief and Works Agency for Palestine Refugees in Near East (UNRWA), 2017; Internal Displacement Monitoring Centre and Norwegian Refugee Council, 2012 (for IDPs in the Syrian Arab Republic in 2011, since UNHCR's support to IDPs in the country only started in 2012).
- 5 Based on data from United Nations Office for the Coordination of Humanitarian Affairs (OCHA), 2016a, 2016b, 2016c, 2017a, 2017b, 2017c, 2017d, 2018.
- 6 SME Finance Forum, 2018.
- 7 United Nations Development Programme, 2011.
- 8 United Nations, 2015, para. 131.
- 9 Ibid., para. 129.
- 10 Ibid., paras 125–130.
- 11 A/70/278.
- 12 Office of the United Nations High Commissioner for Refugees (UNHCR), 2017a.
- 13 According to the Internal Displacement Monitoring Centre, 2016; UNCHR, 2017a. Calculations are based on the following figures: the total IDPs and total refugees in the Arab region in 2016 were 16.3 million and 8.3 million respectively (including 5.3 million Palestinians registered by UNRWA). The total IDPs and refugees in the world from all origins were 40.3 million and 22.5 million respectively. The total refugees in the world from Arab origins were 13 million (including Palestinian refugees registered by UNRWA); United Nations Economic and Social Commission for Western Asia (ESCWA), 2017b.
- 14 According to the Organisation for Economic Co-operation and Development (OECD), 2016c, the average cost per refugee in DAC countries ranges between \$12,882 and \$13,053 per year. Assuming only half of the costs are incurred in the Arab region (around \$6,000), 3.1 million refugees would cost the region \$18.6 billion annually.
- 15 People in need in Djibouti, Iraq, Libya, State of Palestine, Libya, Mauritania, Somalia, the Sudan, the Syrian Arab Republic and Yemen according to the United Nations Office for the Coordination of Humanitarian Affairs (OCHA), 2018.
- 16 United Nations, 2016.
- 17 Institute for Economics and Peace, 2015.
- 18 Rothers and others, 2016.
- 19 Uppsala Universitet, Department of Peace and Conflict Research, 2016.
- 20 Based on a technical report written by Rothers and others at the IMF on the Economic Impact of Conflicts and the Refugee Crisis in the Middle East and North Africa (Rothers and others, 2016), countries in conflict in the region are said to be susceptible to a reduction of 5.2 per cent in real GDP growth with a GDP growth reduction of 1.7 per cent in affected neighbouring countries. The net loss in economic activity for the entire Arab region amounted to \$752 billion between 2011 and 2015 (\$242.9 billion loss for conflict-affected countries (Iraq, Libya, the Syrian Arab Republic and Yemen); \$166.5 billion loss in eight affected neighbouring countries; and \$342.4 billion in GDP growth for GCC countries).
- 21 Quantitative assessments, no matter how complicated, provide subjective approximations and employ different methodologies, assumptions, datasets and geographical denotations, thereby frustrating any attempt to establish comparability or even draw generalized conclusions. In fact, the IMF concedes that model predictions and quantitative assessments are tempered by the randomness of the underlying data it seeks to explain and by the validity of the theories used to derive its equations, and no economic model can be a perfect description of reality (Ouliaris, 2017).
- 22 Gaub, 2017.
- 23 SIPRI Military Expenditure database. Available at www.sipri.org/databases/milex. The average military expenditure is based on the military expenditure expressed as a share of GDP of 16 Arab countries.
- 24 Financial Transparency Coalition, 2016.
- 25 The average profit repatriated from FDI between 2000 and 2015 is used as an approximate figure for 2016 to estimate the average outflows.
- 26 ESCWA calculations are based on the World Bank Remittances and Migration data. The figures are based on available data.
- 27 This figure is from the OECD-QWIDS database and it includes ODA received by the Arab countries and ODA sent by Saudi Arabia to the Middle East region.
- 28 OECD, 2018b.
- 29 Ibid., 2018b.
- 30 Transactions by the official sector with countries on the List of Aid Recipients, which do not meet the conditions for eligibility for Official Development Assistance or Official Aid, either because they are not primarily aimed at development, or because they have a Grant Element of less than 25 per cent.
- 31 Based on OECD-QWIDS database. Data for Saudi Arabia isn't available for 2016.
- 32 The Coordination Secretariat of the Arab National and Regional Developmental Institutions, the IDB and the OPEC Fund for International Development (the Coordination Group) consist of 10 institutions. They include four national entities (the Abu Dhabi Fund for Development, the Kuwait Fund for Arab Economic Development, Qatar Development Fund and the Saudi Fund for Development) and six regional organizations (the Arab Bank for Economic Development in Africa, the Arab Fund for Economic and Social Development, the Arab Gulf Programme for United Nations Development Organizations (AGFUND), the Arab Monetary Fund, the IDB and the OPEC Fund for International Development).
- 33 Brack, 2005.
- 34 World Trade Organization, n.d.
- 35 The indicator 'terms if trade adjustment' is from the World Bank, WDI database and the analysis is based on Zafar, 2004.
- 36 Karam and Zaki, 2014.
- 37 Regression analysis undertaken by ESCWA shows a significant and positive relation between intra-regional trade in goods and GDP growth between 1995 and 2010. However, when the period between 2011 and 2015 is introduced into the sample, that relation becomes insignificant. The data was extracted from the World Bank's World Integrated Trade Solution (WITS); IMF and World Bank databases.
- 38 Data for oil-rich Arab countries, except Algeria, is not available as part of this assessment.
- 39 According to the World Bank, 2017c.
- 40 Net debt inflows, both long- and short-term and including bonds and commercial loans, received less interest payments from both official and private creditors. Net flows on external debt are disbursements on long-term external debt and IMF purchases, minus principal repayments on long-term external debt and IMF repurchases. Up to 1984, this calculation included only long-term external debt and IMF flows. Since 1985, the calculation has included the change in stock of short-term debt (excluding interest arrears on long-term external debt).
- 41 Debt stocks include public and publicly guaranteed, short-term and privately guaranteed debt, as well as IMF credits.
- 42 International Monetary Fund, 2011a.
- 43 Kar and Spanjers, 2015.
- 44 Spotlight on Sustainable Development, 2016.
- 45 Kar and Spanjers, 2015.
- 46 World Economic Forum, 2015.
- 47 The World Bank, for example, does not perceive aggressive tax planning and profit-shifting practices as IFFs.
- 48 May, 2017.
- 49 United Nations Economic Commission for Latin America and the Caribbean, 2016.
- 50 United Nations Conference on Trade and Development, 2016a.
- 51 United Nations Economic Commission for Africa, 2015.
- 52 Kar and Spanjers, 2015.
- 53 Erbenová and others, 2016.
- 54 International Monetary Fund and Union of Arab Banks, 2015.
- 55 Within the related literature on capital flight, some studies exist, such as: Almounsor, 2008.
- 56 World Economic Forum, 2015.
- 57 The ESCWA illicit financial flows report illustrates how the use of alternate sources and methods can create different estimates of IFFs. Some lower figures for Djibouti, Iraq, Libya and Somalia were excluded due to data limitations rather than lack of misinvoicing, although there have been numerous reports of illicit or undeclared trade in oil and antiquities, among other items.
- 58 Based on cost of new job from ESCWA, 2012.
- 59 ESCWA, 2015.
- 60 IMF, 2011b.
- 61 International Finance Corporation, 2013.
- 62 UNCTAD, 2018.
- 63 Ibid.
- 64 UNCTAD, 2016b.
- 65 United Nations, 2017a.
- 66 Ibid.
- 67 Ibid.
- 68 Ibid.
- 69 Edinburgh Group, n.d.
- 70 Stein, Goland and Schiff, 2010.
- 71 International Finance Corporation, 2017; SME Finance Forum, 2018.
- 72 Ahn, 2011; WTO, 2016.
- 73 World Bank, 2018c.
- 74 The average global cost of remittances averaged 7.32 per cent by the end of the second quarter of 2017.
- 75 World Bank, 2017b.
- 76 UNCTAD, 2018.
- 77 IMF, 2017a. Data is missing for the following countries: Qatar, Mauritania, Somalia and the United Arab Emirates. The following countries have missing data for some years: Algeria (2004), Bahrain (2015), the Comoros (2013–2015), Kuwait (2004–2008), Libya (2014–2015), the Syrian Arab Republic (2011–2015), the State of Palestine (2007) and Yemen (2004).
- 78 Data for profits repatriated is incomplete for 2016. Hence the average for the past 10 years is used as an estimate. Primary income is used to estimate profits repatriated. Data is based on the IMF, 2017a. Data is missing for some Arab countries.
- 79 Argam, 2018.
- 80 ESCWA, 2015.
- 81 ESCWA, 2012.
- 82 Chehade and others, 2017.
- 83 Ibid.
- 84 World Bank, 2015.

- 85 Total liabilities to residents in the Arab region are the liabilities reported by the banks in the reporting countries for locational banking statistics. Total claims of residents in the Arab region are the claims reported by banks in the LBS-reporting countries. These liabilities and claims mostly represent deposits and loans from residents in Arab countries. Hence, bank claims are money borrowed by the Arab region, and liabilities are the money lent. The data represents the total liabilities and claims for the fourth quarter of every year for data reported only by banks for all instruments. See <http://stats.bis.org/bis-stats-tool/org.bis.stats.ui.StatsApplication/StatsApplication.html>.
- 86 According to the International Labour Organization, 2015, there are 232 million migrants globally, 150 million of which are migrant workers (including 11.5 million migrant domestic workers). The Arab region accounts for 11.7 per cent of all migrant workers and hosts 50.8 per cent of all male migrant domestic workers in the world.
- 87 ESCWA, 2017b, p. 21.
- 88 OECD, 2018a.
- 89 OECD, 2018b.
- 90 OECD, 2017, 2018b.
- 91 E/2016/65.
- 92 UNHCR, 2017a.
- 93 UNHCR, 2017b.
- 94 Humanitarian aid is an ODA sector that aims specifically to save lives, alleviate suffering and maintain and protect human dignity during, and in the aftermath of, emergencies. It includes disaster prevention and preparedness, reconstruction relief, relief coordination, protection and support services, emergency food aid and other emergency and distress relief. International humanitarian assistance includes DAC humanitarian aid and aid provided by non-DAC and private donors. However, it remains distinct from the traditional ODA definition, which includes flows provided by official agencies to promote economic development and welfare in developing countries, and is concessional in character with a grant element of at least 25 per cent.
- 95 Development Initiatives, 2017.
- 96 OECD, 2017.
- 97 OECD, 2018b.
- 98 Kohli, 2016.
- 99 United Nations, 2014.
- 100 United Nations, 2017b.
- 101 OECD, 2016a
- 102 Ibid
- 103 These totals are based on the OECD-QWIDS database. Data for ODA sent by Saudi Arabia is not yet available from the OECD database. The second figure is estimated based on the ODA sent to Arab countries from all donors excluding ODA sent by Arab countries.
- 104 OECD, 2018a
- 105 UNHCR, 2017a
- 106 Ibid
- 107 United Nations, 2016
- 108 Arab Monetary Fund, 2017.
- 109 Arab Monetary Fund, 2017.
- 110 World Bank, 2010
- 111 Arab Monetary Fund, 2017
- 112 Arab Monetary Fund, 2017
- 113 World Bank, 2010
- 114 E/2016/65.
- 115 Griffith-Jones, 2014
- 116 Griffith-Jones, Griffith-Jones and Hertova, 2008.
- 117 Arab Monetary Fund, 2017.
- 118 Data for Arab ODA is preliminary for 2016, as the ODA data sent by Saudi Arabia to Arab countries is not available for that year. Arab ODA data is underestimated for some countries. The reporting Arab countries for ODA are Saudi Arabia (except for 2016), Kuwait and the United Arab Emirates. Moreover, there might be an overlap between ODA and Arab financial institutions since some national funds are covered in both. Further complications are due to the fact that ODA covers disbursements, whereas financial institutions cover commitments of total financial assistance.
- 119 The mandates include: eliminating trade restrictions; expanding trade finance; prohibiting certain forms of subsidies; promoting a non-discriminatory and equitable; and strengthening the consistency and compatibility of regional trade agreements with the WTO.
- 120 This estimation is based on a package of measures, including the implementation of the agreements on trade facilitation (\$960 billion); international services (\$1039 billion); digital economy (\$147 billion.); the implementation of the decision on Duty-Free Quota-Free (\$7.1 billion.); elimination of agricultural subsidies (\$5 billion) and food export controls (\$45.5 billion.); and the liberalization of environmental goods (\$9.5 billion). See Hufbauer and others, 2013.
- 121 The Copenhagen Consensus, 2015.
- 122 Baier and Bergstrand, 2001.
- 123 Yi, 1999; WTO, 2014, p.95.
- 124 United Nations, 2017a.
- 125 Azevêdo, 2016.
- 126 Mansour, 2015
- 127 ESCWA, 2015.
- 128 Giles, 2018.
- 129 Jubilee Debt Campaign, 2017.
- 130 Union of Arab Banks, 2015.
- 131 Soyan Financial Consultancy, 2017.
- 132 E/2012/50/Rev. 1 - ST/ESA/341.
- 133 Jakob and others, 2015, p. 22.
- 134 E/2012/50/Rev. 1 - ST/ESA/341.
- 135 United Arab Emirates, Ministry of Economy, 2016, p. 19.
- 136 Economist Intelligence Unit, 2017, p. 4.
- 137 IMF, 2017b.
- 138 OECD and WTO, 2013.
- 139 AMF, IMF and World Bank, 2016.
- 140 AMF, 2017.
- 141 Based on IMF, 2017c; World Bank, 2018a; World Bank, World Development Indicators.
- 142 <https://data.worldbank.org/products/wdi>.
- 143 Lennard, 2015.
- 144 The Economist, 2014.
- 145 Economics Online, n.d.
- 146 IMF, 2013.
- 147 Egypt, Ministry of Finance, 2015.
- 148 AMF, 2017
- 149 IMF, 2018, p. 6.
- 150 Seetharaman, 2017
- 151 Economist Intelligence Unit, 2017.



Much ink has been devoted to squaring off the Sustainable Development Goals (SDGs). Now begins the unwavering search for financing for development (FfD).

Should ends not meet, the 2030 Agenda risks becoming stone broke and would be left to oscillate between two acronyms (SDGs–FfD).

A contingency, however undesirable, would amount to yet another missed opportunity to turn the Arab region from an imperilled mosaic into an arc of prosperity.

How can SDGs be regionally adapted and financed? What is the right mix to muster and harness development finance? What are the returns on traditional versus innovative financing? How can domestic finance be leveraged? How can regional and international public and private financing be mobilized, blended and effectively channelled?

Getting the answers right is important, if not a sustainable development imperative. By assessing the state of the Arab region's FfD exposure, this report provides answers and insights as to how the region maintains a unique form of resilience as it continues to finance sustainable development both within the region and in other parts of the world.