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Economic crisis in the Middle East and North Africa

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Executive summary

IN THE 2010S, the economic situation in the Middle East and North Africa (MENA) deteriorated as a result of lower oil and other commodity prices, a new round of domestic political instability, continuous intra-regional conflicts, stalled economic and governance reforms and, finally, the COVID-19 pandemic.

THE GROWTH OF REAL GDP, which slowed after the global financial crisis of 2008-2009, further decelerated in the second half of the 2010s and became negative in 2020 as result of the COVID-19 shock. Fiscal balances have deteriorated, even in the oil-exporting countries, and public debt has grown rapidly.

MENA COUNTRIES CONTINUE to face numerous long-term socio-economic and institutional challenges including high unemployment (especially youth unemployment), low female labour-market participation rates, the poor quality of education, costly and ineffective public sectors, high military and security spending, high energy subsidies and trade protectionism. Only comprehensive long-term reform programmes can address these challenges.

THE EUROPEAN UNION is MENA's second largest trading partner after the region itself, and is one of two main sources of foreign direct investment and a major aid donor. However, given the critical importance of the MENA region to its own security and stability, the EU's engagement in conflict resolution and in supporting economic and political transformation of the region is insufficient and should be intensified. The EU should also update and upgrade its existing association agreements with the countries of the Southern and Eastern Mediterranean, including their free trade provisions.

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1 Introduction

In the 2010s, the economic situation in the Middle East and North Africa (henceforth MENA) deteriorated as a result of lower oil and other commodity prices, a new round of domestic political instability, continuous intra-regional conflicts, stalled economic and governance reforms and, finally, the COVID-19 pandemic. Deteriorating macroeconomic trends were seen in slower growth rates (which almost everywhere turned negative in 2020), worsening fiscal and external balances, increasing public debt and, in several cases, higher inflation. There has been no visible progress in resolving long-term structural and institutional challenges including high unemployment, especially of young people, a low female labour market participation rate, the poor quality of education, costly and ineffective public sectors, high military and security spending and high energy subsidies (see Dabrowski, 2018).

In this Policy Contribution we analyse the factors behind this deterioration of economic performance and the main socio-economic policy challenges faced by the region. We make recommendations aimed at improving the economic and social situation, including how the European Union can support their implementation. Our analysis covers the following issues: political and geopolitical developments (section 2), the macroeconomic situation before COVID-19 (section 3), external economic relations (section 4), the direct and indirect impact of COVID-19 (section 5), long-term development challenges (section 6), EU policy towards the region (section 7) and recommendations on anti-crisis policies and reforms (section 8).

For our purposes, we include in MENA 18 Arabic-speaking countries (Algeria, Bahrain, Djibouti, Egypt, Iraq, Jordan, Kuwait, Lebanon, Libya, Mauritania, Morocco, Oman, Qatar, Saudi Arabia, Sudan, Tunisia, the United Arab Emirates (UAE), and Yemen) and Iran[1].

2 Political and geopolitical developments

The 2010s started with hopes for democratisation and inclusive economic transformation in the MENA region, which had long suffered from political authoritarianism, massive human rights violations and dysfunctional socio-economic systems. In December 2010, a mass protest movement (called popularly the Arab Spring) started in Tunisia and then spread quickly to Egypt, Yemen, Bahrain, Libya and Syria. A year and half earlier, in mid-2009 a similar mass protest (called the Green Movement) erupted in Iran. Even earlier, the United States-led intervention in Iraq in 2003 caused the collapse of the bloody dictatorship of Saddam Hussein and created a political window of opportunity to build a democratic and less-oppressive political system.

Unfortunately, these hopes have not been realised. A decade later, only Tunisia can be considered a tentative success story of political (but not necessarily economic) transition,

1 International organisations apply different regional grouping patterns. For example, the World Bank (see https://datahelpdesk.worldbank.org/knowledgebase/articles/906519-world-bank-country-and-lending-groups) does not include Mauritania and Sudan, but does include Israel, Malta, and the West Bank and Gaza. Until April 2019, the IMF World Economic Outlook database added Afghanistan, Pakistan and Somalia (see https://www.imf.org/en/Publications/WEO/weo-database/2019/April/select-countries?grp=2440&sg=All-countries/Emerging-market-and-developing-economies/Middle-East,-North-Africa,-Afghanistan,-and-Pakistan). Since October 2019 it has used a much broader geographical category of Middle East and Central Asia, which also includes post-Soviet countries of Caucasus and Central Asia (see https://www.imf.org/en/Publications/WEO/weo-database/2020/October/select-countries?grp=2400&sg=All-countries/Emerging-market-and-developing-economies/Middle-East-and-Central-Asia). The United Nations Development Programme (UNDP) operates with a category of Arab States, which excludes Iran but adds Comoros, Somalia and Palestine (see https://www.arabstates.undp.org/content/rbas/en/home.html).

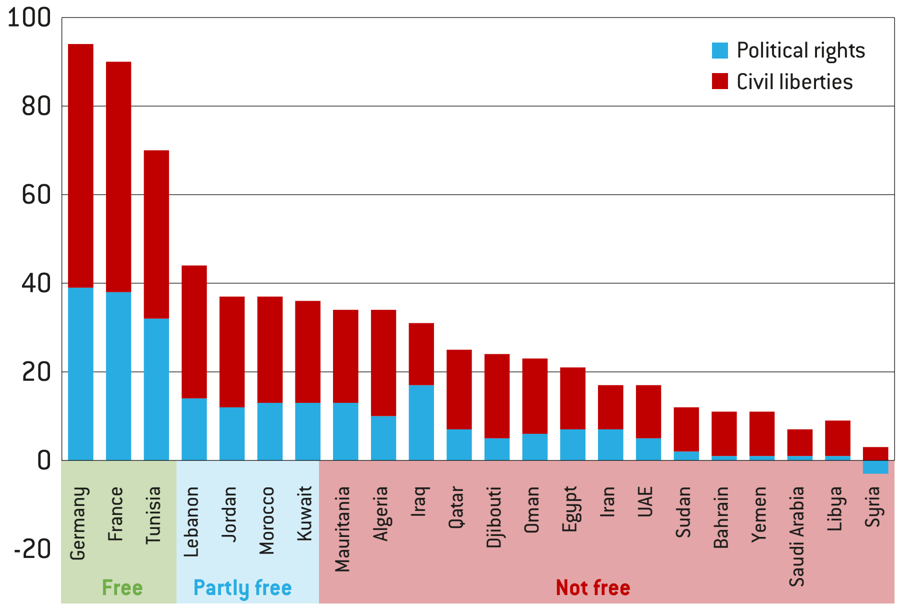
while in other countries oppressive authoritarian regimes have returned. Five countries – Lebanon, Jordan, Morocco, Kuwait[2] and Mauritania – have been ranked 'partly free' (Figure 1), yet they are only just within this category. All remaining MENA countries are considered 'not free'.

In 2018-2019, popular protests led to resignations of long-ruling dictators in Algeria and Sudan, but have not yet brought about visible democratisation progress.

The failure of peaceful political transition at the beginning of 2010s, and military engagement on the part of players including Iran, Russia, Turkey, Saudi Arabia, UAE, Qatar, Egypt, the US, the United Kingdom and France led to protracted violent conflicts in Syria, Libya, Yemen and Iraq. As result, Syria, Libya and Yemen can be considered failed states. If one adds old unresolved conflicts including that between Israelis and Palestinians, between Algeria and Morocco (on the status of Western Sahara), the Darfur conflict in western Sudan, the regional rivalry between Iran and Saudi Arabia, between Saudi Arabia and Qatar, and conflict around the Iran nuclear programme and associated international sanctions, the MENA region looks as extremely unstable. The authoritarian nature of political regimes further increases the risk that violence and conflicts will spill over.

Political instability and numerous conflicts not only affect economic development negatively in the region (in particular, intra-regional trade, transportation, transit, tourism and the inflow of foreign investment) but also generate negative security, economic and social spillovers to other regions, especially Europe. Examples of such spillovers include 'exports' of political radicalism and terrorism, repeated waves of political refugees and irregular migration, and risks to uninterrupted hydrocarbon supplies.

Figure 1: Freedom House's Global Freedom Scores in MENA countries (compared to Germany and France), 2020



Source: Bruegel based on https://freedomhouse.org/countries/freedom-world/scores. Note: Scores on a scale of 0-100 with higher scores indicating greater political freedom.

2 Jordan, Kuwait and Morocco can be considered as sort of constitutional monarchies.

3 The macroeconomic situation pre-pandemic

The growth of real GDP in MENA, which became slower after the global financial crisis (GFC) of 2008-2009, further decelerated in the second half of 2010s (Table 1). Two broad categories of countries can be distinguished: (i) those directly affected by high-intensity conflicts (Iraq, Libya, Syria and Yemen) and international sanctions (Iran) and (ii) others.

The first category experienced high growth volatility (Libya is the extreme case) determined by changing conflict and sanction intensities, and declining hydrocarbon prices since 2014 (Figure 2).

Figure 2: Crude oil, Dubai Fateh, $/barrel, 2000-2020

Source: Bruegel based on IMF World Economic Outlook database, October 2020.

Table 1: MENA: annual growth of real GDP (compared to EU average), %, 2015-2029

Country	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
EU average	2.1	1.9	-0.7	0	1.7	2.5	2.1	3.0	2.3	1.7	-7.6
Algeria	3.6	2.8	3.4	2.8	3.8	3.7	3.2	1.3	1.4	0.8	-5.5
Bahrain	4.3	2.0	3.7	5.4	4.4	2.5	3.6	4.3	1.8	1.8	-4.9
Djibouti	4.1	7.3	4.8	5.0	7.1	7.7	6.7	5.4	8.4	7.5	-1.0
Egypt	5.1	1.8	2.2	3.3	2.9	4.4	4.3	4.1	5.3	5.6	3.5
Iran	5.7	3.1	-7.7	-0.3	3.2	-1.6	12.5	3.7	-5.4	-6.5	-5.0
Iraq	6.4	7.5	13.9	7.6	0.7	2.5	15.2	-2.5	-0.1	4.4	-12.1
Jordan	2.3	2.7	2.4	2.6	3.4	2.5	2.0	2.1	1.9	2.0	-5.0
Kuwait	-2.4	9.6	6.6	1.2	0.5	0.6	2.9	-4.7	1.2	0.4	-8.1
Lebanon	8.0	0.9	2.5	3.8	2.5	0.2	1.5	0.9	-1.9	-6.9	-25.0
Libya	3.2	-66.7	124.7	-36.8	-53.0	-13.0	-7.4	64.0	17.9	9.9	-66.7
Mauritania	2.6	4.2	4.5	4.2	4.3	5.4	1.3	3.5	2.1	5.9	-3.2
Morocco	3.8	5.2	3.0	4.5	2.7	4.6	1.0	4.2	3.0	2.2	-7.0
Oman	2.0	2.6	9.1	5.1	1.4	4.7	4.9	0.3	0.9	-0.8	-10.0
Qatar	17.7	11.3	4.7	5.6	5.3	4.8	3.1	-1.5	1.2	0.8	-4.5
Saudi Arabia	5.0	10.0	5.4	2.7	3.7	4.1	1.7	-0.7	2.4	0.3	-5.4
Sudan	3.9	-3.2	-17.0	2.0	4.7	1.9	3.5	0.7	-2.3	-2.5	-8.4
Tunisia	3.5	-1.9	4.1	2.8	2.9	1.2	1.2	1.9	2.7	1.0	-7.0
UAE	1.6	6.9	4.5	5.1	4.3	5.1	3.1	2.4	1.2	1.7	-6.6
Yemen	7.7	-12.7	2.4	4.8	-0.2	-28.0	-9.4	-5.1	0.8	2.1	-5.0

Source: Bruegel based on IMF World Economic Outlook database, October 2020. Notes: red text indicates IMF staff estimates or forecasts; data on Syria is not available.

The second category is very diverse: it includes net oil exporters and importers, countries belonging to all income groups, countries that enjoy relative political stability and those suffering from internal political tensions and low-intensity conflicts. Nevertheless, with few exceptions (Djibouti, Egypt) growth rates were low and declining everywhere, in some cases (Sudan, Lebanon) already becoming negative before 2020.

As a result, because of high rates of population growth, GDP *per capita* was either stagnating or declining long before the COVID-19 pandemic. This may not be an existential challenge for the high-income Gulf monarchies but is certainly a challenge for a large group of lower-middle- and low-income countries. The poorest countries such as Mauritania and Yemen found themselves in the most desperate situations.

Inflation remained at the one-digit level in most MENA countries except for Sudan, Iran, Egypt, Libya and Yemen (Table 2), where it was two-digit in all or part of the period of 2010-2019. In Sudan, it reached 72.9 percent in 2018.

Table 2: MENA: end-of-year inflation, % (compared to the EU average), 2010-2019

Country	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
EU average	2.5	2.8	2.4	0.8	-0.1	0.2	1.1	1.5	1.6	1.6
Algeria	2.7	5.2	9.0	1.1	5.3	4.4	7.0	4.9	2.7	2.4
Bahrain	1.0	0.2	2.6	4.0	2.5	0.8	2.3	1.3	1.9	1.7
Djibouti	2.8	7.6	1.1	1.1	3.4	-1.6	2.4	-0.8	2.0	3.3
Egypt	10.2	11.8	7.2	9.9	8.3	11.3	14.0	29.8	14.4	9.4
Iran	19.8	20.6	41.3	19.6	16.2	8.4	11.8	8.3	54.1	26.0
Iraq	3.3	6.0	3.6	3.1	1.6	2.3	-1.5	0.2	-0.1	0.1
Jordan	5.6	3.0	6.3	3.0	1.6	-1.7	1.2	3.5	3.8	0.7
Kuwait	6.0	3.1	4.4	2.7	3.0	3.0	2.6	1.0	0.4	1.5
Lebanon	4.6	3.1	10.1	1.1	-0.7	-3.4	3.1	5.0	5.6	7.0
Libya	3.3	26.6	-3.7	1.7	7.1	16.9	24.0	28.0	-1.2	4.6
Mauritania	6.1	5.5	3.4	4.5	5.0	-2.8	2.8	1.2	3.2	2.7
Morocco	1.8	0.5	2.1	0.2	1.5	0.6	1.7	1.7	0.1	1.0
Oman	4.2	3.3	2.9	0.3	1.0	0.1	1.1	1.6	0.9	0.1
Saudi Arabia	5.4	2.7	3.6	2.5	1.8	1.2	1.2	-1.3	2.2	-0.1
Sudan	15.4	18.9	44.4	41.9	25.7	12.6	30.5	25.2	72.9	57.0
Tunisia	3.5	3.4	5.4	5.2	4.4	3.8	4.2	6.2	7.5	6.1
UAE	1.7	0.2	0.6	1.4	3.1	3.6	1.6	2.0	3.1	-1.9
Yemen	12.5	23.2	5.8	8.1	10.0	34.0	11.9	47.0	14.3	6.2

Source: Bruegel based on IMF World Economic Outlook database, October 2020. Notes: data on Syria and Qatar is not available.

The fiscal situation is less promising. In 2019, all MENA countries except for Iraq, Kuwait, Mauritania and Qatar ran general government (GG) deficits (Table 3). Libya also recorded a GG surplus but it was a temporary rebound after several years of record-high deficits. In three cases (Bahrain, Lebanon and Sudan) deficits exceeded 10 percent of GDP in 2019.

Compared to the first half of the 2010s, in the second half, the most striking difference concerned hydrocarbon producers (Algeria and Gulf countries). Once running fiscal surpluses and accumulating them in sovereign wealth funds, since 2014 (and the collapse of the oil price) they have been spending these resources at a rapid rate. In particular, this has been the case for Saudi Arabia, Bahrain, Oman, Algeria and Iraq. A limited increase in oil prices in 2017-2019 allowed a reduction in the (large) fiscal deficits of Algeria, Iraq, Oman, and Saudi Arabia, and a return to fiscal surplus in Qatar and UAE.

Among net oil importers, Egypt, Jordan, Tunisia and Lebanon have made little or no progress when it comes to fiscal consolidation, even if the first three benefited from IMF programmes.

Apart from changes in hydrocarbon prices, fiscal balances in Iraq[3], Libya and Yemen have been affected by a changing intensity of conflicts (there is no data for Syria). In Iran, it has been determined by changes in oil prices and the international sanctions regime.

Table 3: MENA: General government net lending/borrowing (compared to the EU average), % of GDP, 2010-2019

Country	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
EU average	-6.0	-4.1	-3.5	-2.8	-2.4	-1.8	-1.3	-0.8	-0.4	-0.6
Algeria	0.0	-0.1	-4.4	-0.4	-7.3	-15.3	-13.1	-6.6	-4.5	-5.6
Bahrain	-5.8	-1.5	-5.5	-9.7	-1.6	-18.4	-17.6	-14.2	-11.9	-10.6
Djibouti	-1.0	-1.2	-2.0	-4.2	-6.9	-15.4	-8.3	-4.5	-2.8	-0.8
Egypt	-7.4	-9.6	-10.0	-12.9	-11.3	-10.9	-12.5	-10.4	-9.4	-7.4
Iran	2.6	0.6	-0.3	-0.9	-1.1	-1.8	-2.3	-1.8	-1.9	-5.5
Iraq	-4.2	4.7	4.1	-6.1	-5.6	-12.8	-13.9	-1.6	7.8	0.9
Jordan	-7.8	-9.8	-14.3	-10.1	-8.5	-8.4	-3.7	-3.6	-4.7	-6.0
Kuwait	26.0	33.3	32.4	34.1	22.4	5.6	0.3	6.3	9.0	5.4
Lebanon	-7.5	-5.9	-8.4	-8.8	-6.2	-7.5	-8.9	-8.6	-11.3	-10.5
Libya	12.5	-17.2	28.6	-5.1	-73.8	-130.8	-113.2	-43.5	-0.2	2.2
Mauritania	-0.5	0.1	1.7	-0.7	-2.6	-2.4	0.1	0.5	3.4	2.8
Morocco	-4.3	-6.6	-7.2	-5.1	-4.8	-4.2	-4.5	-3.5	-3.7	-4.1
Oman	5.6	9.4	4.6	4.7	-1.1	-15.9	-21.3	-14.0	-7.9	-7.1
Qatar	7.1	7.3	10.5	21.6	15.4	21.7	-4.8	-2.5	5.9	4.9
Saudi Arabia	4.4	11.6	11.9	5.6	-3.5	-15.8	-17.2	-9.2	-5.9	-4.5
Sudan	0.1	-2.3	-7.4	-5.8	-4.7	-3.8	-4.6	-6.5	-7.9	-10.9
Tunisia	-0.5	-3.4	-5.1	-7.4	-3.3	-5.2	-6.2	-5.9	-4.6	-3.9
UAE	0.6	5.3	9.0	8.4	1.9	-3.4	-2.8	-2.0	1.9	-0.8
Yemen	-4.1	-4.5	-6.3	-6.9	-4.1	-8.8	-8.5	-4.9	-7.8	-5.3

Source: Bruegel based on IMF World Economic Outlook database, October 2020. Note: red text indicates IMF staff estimates; data for Syria is not available.

The deteriorating fiscal accounts unavoidably led to expansion of both gross and net public debt (Table 4). While the GG net debt statistics do not cover all MENA countries, they make it clear that since 2015 hydrocarbon producers have reduced their net fiscal reserves.

In the analysed period, GG gross debt-to-GDP increased in most countries, sometimes at a rapid pace. The group of highly-indebted countries includes Sudan (over 200 percent of GDP in 2019), Lebanon (over 170 percent of GDP), Bahrain (over 100 percent of GDP), Jordan, Egypt, Mauritania and Tunisia (between 70 percent and 100 percent of GDP). The World Bank estimated that 11 MENA countries were already on unsustainable fiscal paths in 2019 (before the pandemic hit). That is, their primary fiscal balances could not stabilise their debt-to-GDP ratios (World Bank, 2020).

The situation in Lebanon got out of control, leading to the country's sovereign default on 7 March 2020 (*The Economist*, 2020). The tragic explosion in Beirut harbour and the resignation of the government in August 2020 has delayed debt restructuring negotiations and an application for IMF assistance. Default and lack of rapid anti-crisis response caused a substantial depreciation of the black-market exchange rate of the Lebanese pound and an inflation shock.

3 In 2014-2017, Iraq had to fight the Islamic State of Iraq and Levant.

Table 4: MENA: General government gross and net debt (compared to the EU average), % of GDP, 2010-2019

Country	General government gross debt							General government net debt						
	2010	2013	2015	2016	2017	2018	2019	2010	2013	2015	2016	2017	2018	2019
EU average	80.6	88.5	86.7	85.9	83.3	81.3	79.2	63.8	71.1	70.0	69.4	67.1	65.4	64.0
Algeria	10.5	7.6	8.7	20.5	27.3	38.2	46.3	-33.7	-29.5	-7.6	13.3	21.6	25.4	30.5
Bahrain	29.7	43.9	66.4	81.3	88.1	95.0	103.4							
Djibouti	27.9	24.6	40.2	45.9	48.2	46.5	38.5	27.1	22.7	38.2	44.0	46.3	45.5	38.3
Egypt	69.6	84.0	88.5	96.8	103.2	92.7	83.8	57.1	73.7	78.8	88.2	93.9	81.3	74.4
Iran	12.7	10.7	39.7	46.2	38.2	40.3	44.7	2.9	-5.6	23.0	33.1	24.5	27.9	41.0
Iraq	53.5	32.0	56.8	64.3	58.9	48.9	46.9							
Jordan	59.4	75.6	78.4	77.4	76.0	75.1	78.0	57.5	72.2	75.8	74.4	73.6	73.9	77.3
Kuwait	6.2	3.1	4.7	10.0	20.5	14.8	11.8							
Lebanon	136.8	135.3	140.8	146.2	149.7	154.9	174.5	127.6	126.0	134.4	140.5	144.1	150.6	169.2
Mauritania	43.9	40.0	58.7	56.6	55.1	61.4	58.1	43.3	38.7	57.5	55.7	54.0	59.0	57.1
Morocco	49.0	61.7	63.7	64.9	65.1	65.3	65.8	48.5	61.2	63.1	64.4	64.7	65.0	65.5
Oman	5.8	5.0	15.5	32.7	46.4	53.2	63.1	-19.6	-28.8	-22.8	-1.0	13.4	32.1	41.5
Qatar	30.4	30.9	35.5	46.7	51.6	46.5	56.2							
Saudi Arabia	8.4	2.1	5.8	13.1	17.2	19.0	22.8	-36.9	-50.9	-35.9	-17.1	-7.7	-0.1	5.0
Sudan	62.4	76.7	66.5	58.6	159.2	186.7	201.6							
Tunisia	39.2	46.8	55.4	62.3	70.6	78.2	72.3							
UAE	19.5	16.0	16.7	19.4	21.6	20.9	27.3							
Yemen	42.4	48.2	57.0	72.3	77.4	74.5	76.5	38.3	46.7	56.1	71.3	76.6	73.8	75.8

Source: Bruegel based on IMF World Economic Outlook database, October 2020. Note: red text indicates IMF staff estimates or forecasts.

4 External economic relations: trade, investment and migration flows

4.1 Trade policies and participation in trade agreements

Thirteen MENA countries belong to the World Trade Organisation. Algeria, Iran, Iraq, Lebanon, Libya, Sudan and Syria remain outside[4]. All MENA countries except Djibouti and Iran belong to the Pan-Arab Free Trade Area (PAFTA), a regional trade agreement. There are also two smaller sub-regional agreements: the Agadir Agreement signed by Egypt, Jordan, Morocco and Tunisia, and the Gulf Cooperation Council (GCC)[5], which includes six Gulf monarchies. While PAFTA and Agadir Agreement can be considered as 'shallow' agreements limited to trade in goods and reduction of import tariffs (WTO, 2011, Table C1, p. 110), the GCC is a customs union, with the ultimate aim that it will become an economic and monetary union, following the European experience. However, since 2017 it has been partly paralysed because of the Saudi-Qatari conflict (see section 2).

In terms of trade beyond MENA, Algeria, Egypt, Jordan, Lebanon, Morocco, Syria and Tunisia have free trade agreements (FTA) with the EU, signed in the 1990s and 2000s (see section 7). These agreements are limited, in most cases, to tariff reduction (not always their

4 See https://www.wto.org/english/thewto_e/whatis_e/tif_e/org6_e.htm.

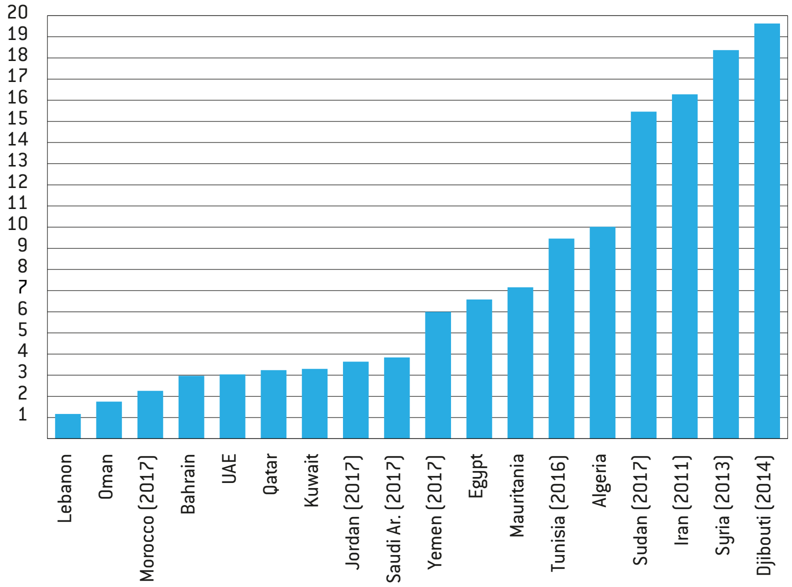
5 See https://www.wto.org/english/thewto_e/whatis_e/tif_e/org6_e.htm.

complete elimination), the elimination of import quotas for industrial goods and the protection of intellectual, industrial and commercial property rights. Only Morocco[6] and Tunisia[7] have more comprehensive agreements, which also partly cover trade in agricultural products. Both countries have also started negotiations on a Deep and Comprehensive Free Trade Area with the EU, although these are far from reaching a conclusion.

Egypt, Jordan, Lebanon, Morocco and Tunisia also have FTAs with the European Free Trade Area (EFTA), and Egypt, Morocco, Syria and Tunisia have FTAs with Turkey. Bahrain, Jordan, Morocco and Oman have FTAs with the US, which cover goods, services and investment. Jordan has an FTA with Canada, and the GCC with Singapore. Djibouti, Egypt, Libya, Sudan and Tunisia belong to the Common Market for Eastern and Southern Africa (COMESA).

Despite their participation in various FTAs (see Biondi and Demertzis, 2017, for a comprehensive overview), MENA countries are not champions of trade openness (Figure 3). Only in Lebanon, Oman and Morocco were the weighted averages of the effectively applied tariffs (that is, after implementation of all respective FTA provisions) below 3 percent in 2018. In Bahrain, the UAE, Qatar, Kuwait, Jordan and Saudi Arabia, they were between 3 percent and 4 percent. In Yemen, Egypt, Mauritania, Tunisia and Algeria they varied between 6 percent and 10 percent. In four countries – Sudan, Iran, Syria and Djibouti – they exceeded 15 percent. Apart from tariffs, most MENA economies are characterised by high non-tariff barriers, which are particularly damaging for small firms (Kamal and Zaki, 2018) and poor Logistic Performance Index rankings (Peridy and Ghoneim, 2015).

Figure 3: MENA: effectively applied import tariff rates in percent on non-agricultural and non-fuel products, annual weighted average, 2018 or the latest available data



Source: Bruegel based on http://unctadstat.unctad.org/wds/TableViewer/tableView.aspx (as of 20 November 2020). Note: data on Iraq and Libya is not available.

Overall, securing greater trade openness and trade-related economic benefits in the region will require a comprehensive policy approach on various fronts: joining the WTO by countries which remain outside, 'deepening' of WTO membership by current WTO members by joining various plurilateral agreements, unilateral reductions of tariffs and non-tariff bar-

6 See http://ec.europa.eu/trade/policy/countries-and-regions/countries/morocco/.

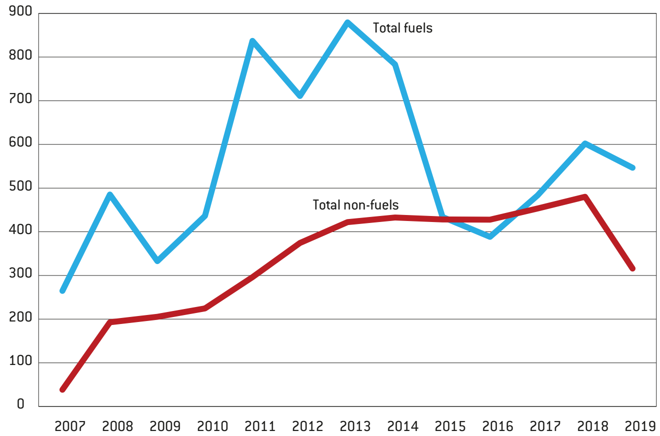
7 See http://ec.europa.eu/trade/policy/countries-and-regions/countries/tunisia/.

riers, improving macroeconomic stability and business and investment climates, deepening existing FTAs, and resolving political and military conflicts (see Neaime, 2018).

4.2 Trade flows

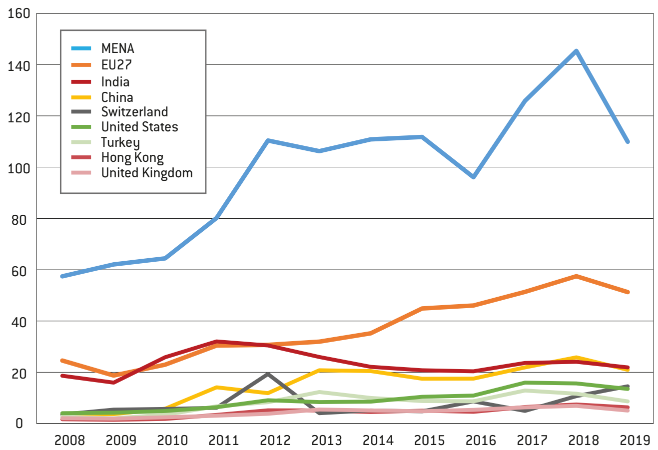
Trade flows for much of the MENA region have been driven by hydrocarbon exports for many decades, as the region hosts some of the world's largest oil and natural gas producers. That said, the share of fuel exports has decreased since the GFC. While in 2007, non-fuel exports were less than 15 percent of total exports, in 2015 non-fuel exports overtook total exports (Figure 4). In 2019, though fuel exports dominated again, they remained within the same order of magnitude. A comparison of Figures 2 and 4 suggests that fluctuations in the oil price have had the biggest impact on changes in the relative weight of fuel exports (their biggest fall followed the oil price collapse in 2014). While 2020 data is not yet available, one can only imagine that the decline in the oil price will have a similar effect (see section 5).

Figure 4: Exports from the MENA region, $ billions, 2007-2019



Source: Bruegel based on WITS.

Figure 5: Non-fuel exports from the MENA region by country or region of destination, $ billion, 2008-2019



Source: Bruegel based on WITS.

The falling share of fuel exports can be seen as a positive development for a region that is looking for structural diversification and trying to reduce its dependence on hydrocarbons (see section 6.1), as demand for them will fall as a result of decarbonisation and they will get progressively cheaper. However, there is still a long way to go: fuel exports make up almost two thirds of total MENA exports and this share is much higher in the oil-exporting countries.

Nevertheless, non-fuel exports have also grown substantially in absolute terms, almost eight-fold in the twelve-year period (from $38 billion in 2007 to $316 billion in 2019).

In terms of trade geography (Figure 5), in 2019 around 35 percent of total regional trade was with other MENA countries. Intra-regional trade has been growing at a faster pace than total trade, and has increased its share of the total (from 30 percent in 2008). Greater economic integration in the MENA region is good news, especially given the large number of hot and frozen conflicts (section 2), and still substantial trade barriers (section 4.1). Should these conflicts be resolved and trade barriers removed, the size of intra-regional trade and other economic cooperation would be even greater.

The EU is the region's second largest trading partner, although its share of MENA exports fell substantially in the aftermath of the GFC (only in 2019 was the 2008 share surpassed). Much of this trade is with France and, to a lesser extent, Spain.

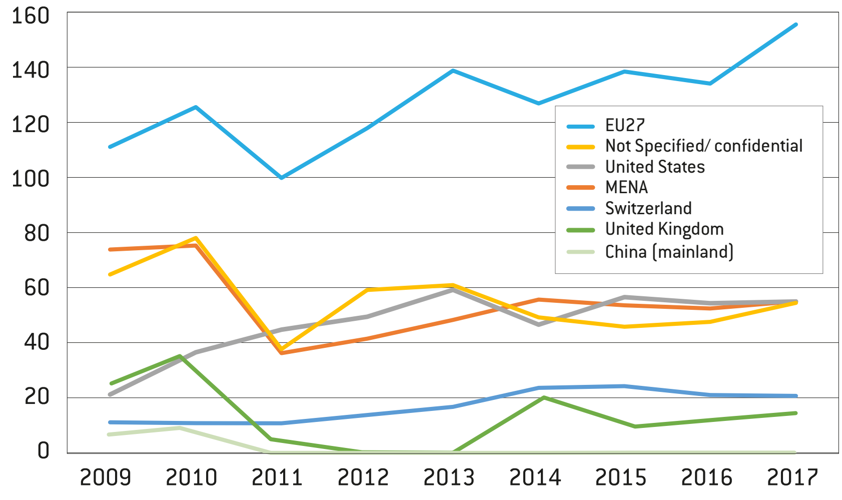
China has tripled its share of MENA exports (from around 2 percent to over 6 percent). Perhaps most surprising is the small percentage of non-fuel exports that go to the US, even if these grew from 2 percent to 4 percent of the total between 2008 and 2019.

In summary, while the EU remains an important trading partner, and recipient of over 15 percent of MENA non-fuel exports, the greatest source of development appears to be the region itself, with trade among MENA countries growing throughout the analysed period.

4.3 Foreign investment

From an investment standpoint, the situation is somewhat different. The EU is by far the largest investor in the region, while investment from other MENA countries is relatively modest, and fell in the 2010s, both in terms of absolute value and more substantially as a share of the total (Figure 6). Meanwhile, during this period, foreign direct investment (FDI) from the EU and, especially, the US grew above average.

Figure 6: FDI into the MENA region, $ billions



Source: Bruegel based on Damgaard *et al* (2019). Note: Damgaard *et al* (2019) tried ascertain the genuine origin of investment, or ultimate investing country (UIC), to account for the fact that much FDI is re-routed through tax havens. However, we have not used their 'UIC'variable, but rather 'Inward FDI, non-SPEs' (special purpose entity), as the UIC data is missing data for key countries and exhibits no values before 2013. We crosschecked the shown 2017 values with 'UIC' values and they were similar for all source countries except China, where UIC values were around three times higher, but still negligible (less than 0.1 percent of total FDI into the region). Furthermore, the Damgaard *et al* (2019) 'non-SPE' characteristic should already filter out some of the investment rerouted through investment vehicles in jurisdictions with low capital-gains tax. Nevertheless in some of the intermediate years in Figure 6 Chinese values appear to have been underestimated by official statistics, even though they remain small no matter the variable chosen.

Other important players are also western (including Switzerland and the UK) while around 15 percent is unspecified or confidential (although the share of this is falling gradually). Meanwhile, Chinese FDI is negligable. Finally, perhaps most worryingly, total FDI into the region increased little during the period: average annual growth was under 4 percent between 2009 and 2017.

4.4 Migration, refugees and remittances

The major differences between MENA countries in *per-capita* income levels (section 6.1) have generated intra-regional migration flows. There is also a darker dimension, with conflict forcing large numbers of refugees to flee and set themselves up in neighbouring countries.

Table 5: Five-year net migration (as a percentage of final year population)

Net Migration	1997-2002	2002-2007	2007-2012	2012-2017
Algeria	-0.6%	-1.0%	-0.4%	-0.1%
Djibouti	-1.2%	-1.5%	0.7%	0.5%
Egypt	-0.1%	-0.4%	-0.3%	-0.2%
Iran	-0.1%	-0.8%	-0.7%	-0.3%
Iraq	-1.1%	-3.9%	4.1%	0.1%
Jordan	-1.8%	10.4%	13.1%	0.5%
Kuwait	1.2%	19.1%	17.3%	4.9%
Lebanon	13.2%	-0.6%	21.5%	-2.2%
Libya	-0.4%	-2.0%	-4.8%	-0.2%
Morocco	-2.2%	-1.8%	-1.1%	-0.7%
Oman	0.6%	10.0%	25.3%	9.4%
Qatar	33.4%	75.1%	27.5%	7.3%
Saudi Arabia	3.4%	4.3%	5.9%	2.0%
Sudan	-1.9%	-3.0%	-1.5%	-0.6%
Syria	-2.2%	1.9%	-26.4%	-12.5%
Tunisia	-1.4%	-0.4%	-1.4%	-0.2%
Bahrain	21.2%	26.3%	3.2%	16.0%
UAE	34.2%	58.2%	3.0%	2.1%
Yemen	-0.6%	-0.3%	-0.3%	-0.5%

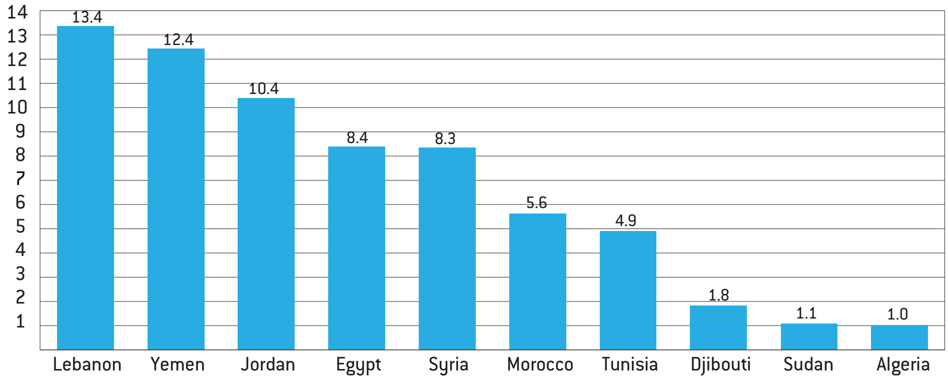
Source: Bruegel based on World Bank WDI, last update 14 October 2020.

Overall, most countries in the region are seeing net population outflows, with negative net migration in at least two of the four five-year periods shown in Table 5. Eight out of the twenty countries had negative net migration in all four periods (Algeria, Egypt, Iran, Libya, Morocco, Sudan, Tunisia and Yemen). This contrasts starkly with very large positive net migration into the Gulf states, especially labour migration from Asia and, partly, from the region. In Qatar, net migration between 2002 and 2007 equaled three quarters of the 2007 population.

For several decades, regional conflicts (section 2) have generated large numbers of refugees. The post-Arab Spring conflicts have exacerbated this phenomenon. In several MENA countries, refugees make up a large share of the domestic population. Most notable are Jordan and Lebanon. Around 30 percent of the Jordanian population has refugee origins (largely Palestinian). The situation in Lebanon is more recent and thus somewhat more precarious. The number of refugees relative to the population more than doubled between 2010 and 2019, to over 20 percent, as result of the civil war in Syria.

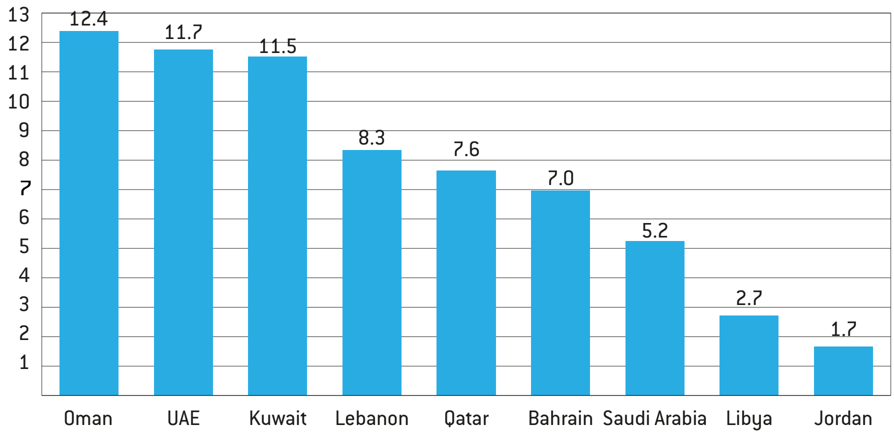
Personal remittances reflect the economic effects of migration flows, including refugees. In a number of MENA countries (Yemen, Jordan, Egypt, Syria, Morocco and Tunisia) incoming remitances contribute to balance of payments in significant way (Figure 7). They come not only from the Gulf but also from the EU, US and other destinations. On the other hand, outgoing remittances are substantial balance-of-payments items in Gulf countries, which import much of their labour forces (Table 5). In Lebanon, both incoming and outgoing remittances account for substantial shares of the country's GDP, with the former prevailing.

Figure 7: Incoming personal remittances to MENA countries, percent of GDP, 2019



Source: Bruegel based on http://unctadstat.unctad.org/wds/TableViewer/tableView.aspx. Note: includes data on countries, for which data is available and where incoming remittances exceed 1 percent of GDP.

Figure 8: Outgoing personal remittances from MENA countries, percent of GDP, 2017



Source: Bruegel based on http://unctadstat.unctad.org/wds/TableViewer/tableView.aspx. Note: includes data on countries, for which data is available and where outgoing remittances exceed 1 percent of GDP.

5 The impact of COVID-19

The COVID-19 pandemic has caused an additional negative shock to the already stagnant and fragile macroeconomic situation in the MENA region, including through the effects of the health crisis and lockdown measures, temporary interruption of supply chains, dramatic declines in tourism revenues and labour remittances, and lower oil prices.

The pandemic's effects are hard to forecast but according to the October 2020 IMF projection (last column of Table 1), GDP will fall in every country in the region except Egypt.

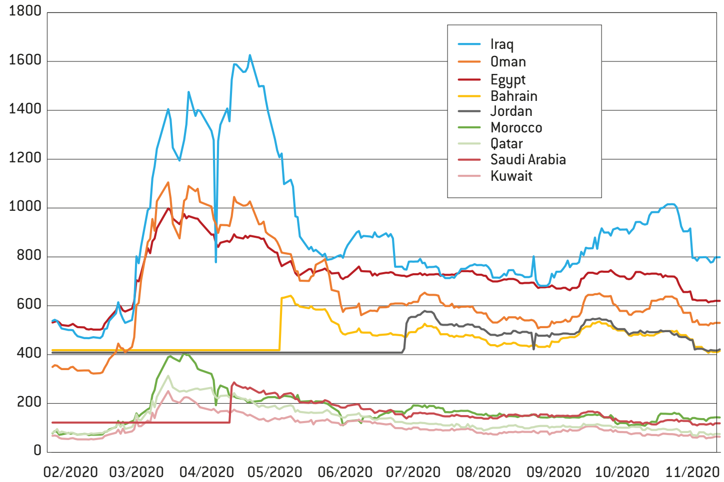
Oil producers were additionally hit by the collapse of oil prices in March 2020, driven both by the fall in global demand and the breakdown of coordination between suppliers (though this was partially rebuilt in April 2020, stabilising somewhat prices at a low level).

The deep recession, lower GG revenues and higher expenditure will further deteriorate fiscal balances and debt-to-GDP levels, which may soon lead to more sovereign defaults.

At the end of February and in early March 2020, the region broadly was hit by capital flight: the IMF estimated portfolio capital outflows of about $6 billion to $8 billion, numbers that they conceded might be even larger given the lack of official figures (IMF, 2020b). However, the magnitude of this shock was smaller than in other emerging markets, especially in Latin America and the countries that made up the former Soviet Union (Dabrowski and Dominguez-Jimenez, 2020a, 2020b).

Figure 9 shows the spreads between the dollar-denominated debt and US Treasuries (UST) in selected MENA countries[8]. It shows that, while spreads widened significantly in the first days of the crisis, market confidence has largely recovered in most cases, with spreads nearing their pre-COVID levels. This improvement in market sentiment is partly explained by the significant monetary and fiscal policy response in advanced economies, which has loosened global financing conditions. Countries with high credit ratings (oil producers) and lower credit-rated countries such as Egypt have all managed to maintain market access, both with dollar-denominated and local-currency bonds.

Figure 9: Spread between sovereign dollar-denominated debt and UST, basis points, February – November 2020



Source: Bloomberg.

Depreciation of MENA currencies has been modest (except the Lebanese pound) and they largely recovered (sometimes even with a positive margin) after the initial fall in March-April 2020. However, most MENA currencies are pegged to the dollar, and data is lacking on changes in the international reserves of MENA central banks in the analysed period (these are reported with a delay). Furthermore, not all MENA currencies are fully convertible.

To help address COVID-19-related economic and social consequences, the IMF has provided emergency assistance to several MENA countries. For example, Egypt, Jordan and Tunisia have received emergency assistance under the Rapid Financing Instrument, while Djibouti and Mauritania have benefited from the Rapid Credit Facility (which includes concessional servicing terms). Neither of these instruments includes *ex-post* conditionality. Therefore, it is less likely they will trigger structural reforms (which progressed slowly under the 'standard' IMF assistance programmes). Morocco has drawn from its precautionary credit line, the IMF-supported programme in Jordan has been modified, and a new Stand-By Arrangement with Egypt was approved (IMF, 2020b).

8 Lebanon was removed as its values were off the scale, between 2500 and 5000 basis points for the analysed period.

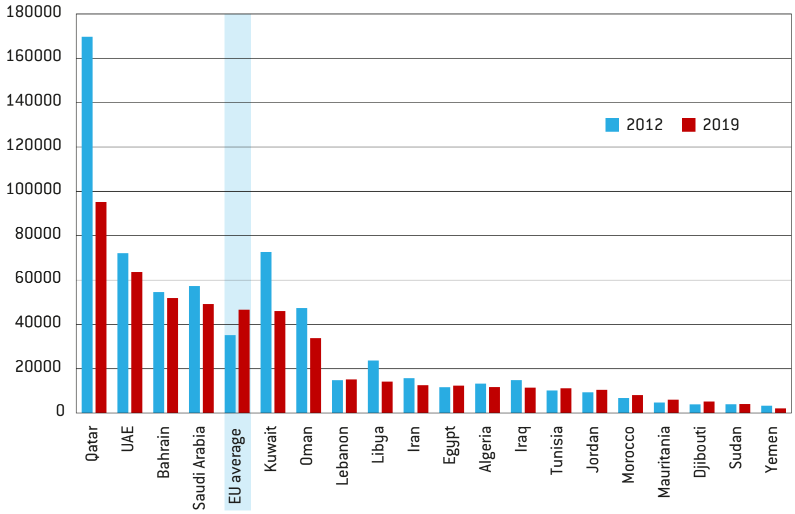
6 Development, structural and institutional challenges

Among numerous developmental, structural and institutional challenges faced by MENA economies, we analyse four: (1) differences in individual countries' development levels and dependence on natural-resource, mainly oil, rents; (2) high unemployment, especially among women and young people; (3) pour quality of education; and (4) excessive military spending.

6.1 Development level and dependence on natural-resource rents

MENA countries differ in levels of economic development measured by GDP *per capita* in purchasing power parity (PPP) terms (Figure 10). In 2020, six Gulf monarchies belonged to the high-income group, according to the World Bank classification[9]. Lebanon, Libya, Iran, Iraq and Jordan are included in the upper-middle-income category. Algeria, Djibouti, Egypt, Mauritania, Morocco, Syria and Tunisia are classified as lower-middle-income economies, while Sudan and Yemen are low-income ones.

Figure 10: GDP *per capita*, current prices, PPP, international dollars (compared to EU average), 2012 and 2019



Source: Bruegel based on IMF World Economic Outlook database, October 2020. Note: data on Syria is not available.

Availability of oil and other natural-resource rents (Table 6) is the main factor determining GDP *per capita* in the region. High dependence on natural-resource rents in most MENA economies makes them vulnerable to fluctuations in oil (Figure 2) and other commodity prices. Indirectly, changes in oil and commodity prices also have an impact on less resource-dependent economies, including Lebanon, Tunisia, Jordan and Egypt, through various channels of intra-regional spillovers (section 4).

Traditionally, oil and natural gas rents from the Gulf countries spill over to other MENA economies via outgoing foreign investment, demand for labour migrants, intra-regional tourism and other services and, to a lesser degree, via intra-regional trade (section 4). The Gulf monarchies have also played a donor role in relation to their lower-income neighbours

9 See https://datahelpdesk.worldbank.org/knowledgebase/articles/906519-world-bank-country-and-lending-groups. Interestingly, the IMF considers them as emerging-market and developing economies rather than advanced economies; see https://www.imf.org/en/Publications/WEO/weo-database/2020/October/select-countries?grp=2400&sg=All-countries/Emerging-market-and-developing-economies/.

and those affected by conflicts (section 7.3). However, with the oil price decline and shrinking oil rents in the second half of the 2010s, regional market spillover effects and donor funding opportunities diminished. Worse, the split inside the Gulf Cooperation Council (the conflict between Saudi Arabia and Qatar) and mushrooming intra-regional conflicts (discussed in section 2) have diverted an increasing part of Gulf donor resources from humanitarian and development projects to military purposes and support for opposing parties. Regional donor cooperation and coordination have also collapsed.

Table 6: MENA: natural-resource rents (compared to the EU average), percent of GDP, 2011-2018

Region/country	Oil rents			Natural gas rents			Mineral rents			Total natural resources rents		
	2011	2016	2018	2011	2016	2018	2011	2016	2018	2011	2016	2018
EU average	0.1	0.0	0.0	0.1	0.0	0.0	0.1	0.0	0.0	0.4	0.2	0.2
Algeria	27.3	10.0	15.8	4.0	2.0	3.1	0.2	0.1	0.0	31.5	12.1	18.9
Bahrain	4.3	1.8	2.3	3.9	1.4	2.0	0.0	0.0	0.0	8.3	3.2	4.3
Egypt	9.8	2.3	5.3	2.3	0.4	1.2	0.5	0.2	0.3	12.5	2.9	6.8
Iran	24.8	11.5	15.6a	2.3	1.5	1.8a	1.4	0.5	0.7a	28.5	13.5	18.1a
Iraq	50.8	30.5	45.4	0.3	0.2	0.3	0.0	0.0	0.0	51.2	30.6	45.7
Jordan	0.0	0.0	0.0	0.1	0.0	0.0	2.6	1.1	0.6	2.6	1.2	0.6
Kuwait	61.2	32.1	42.5	0.7	0.5	0.6	0.0	0.0	0.0	62.0	32.6	43.1
Libya	44.4	21.0	42.4	1.9	1.1	1.0	0.0	0.0	0.0	46.4	22.1	43.4
Mauritania	2.9	0.4	0.6a	0.0	0.0	n/a	32.1	13.1	14.9a	35.1	13.5	15.5a
Morocco	0.0	0.0	0.0	0.0	0.0	0.0	3.4	2.0	1.5	3.5	2.0	1.5
Oman	46.1	18.3	26.9	3.6	1.5	2.3	0.2	0.0	0.0	50.0	19.8	29.2
Qatar	32.8	11.8	16.6	8.1	3.6	4.7	0.0	0.0	0.0	40.8	15.3	21.3
Saudi Arabia	49.3	19.4	28.7	1.2	0.5	0.7	0.0	0.1	0.1	50.5	20.0	29.5
Sudan	21.4	1.2	6.4	0.0	0.0	0.0	1.5	5.2	12.7	22.9	6.4	19.1
Tunisia	5.3	1.3	2.6	0.7	0.2	0.3	0.6	0.5	0.2	6.5	2.0	3.1
UAE	28.8	10.8	16.6	1.3	0.5	0.8	0.0	0.0	0.0	30.1	11.4	17.4
Yemen	23.4	0.9	2.6	3.0	0.0	0.0	0.0	0.0	0.0	26.4	0.9	2.6
MENA	**29.8**	**11.7**	**18.9**	**1.9**	**0.8**	**1.1**	**0.5**	**0.2**	**0.1**	**32.12**	**12.7**	**20.1**

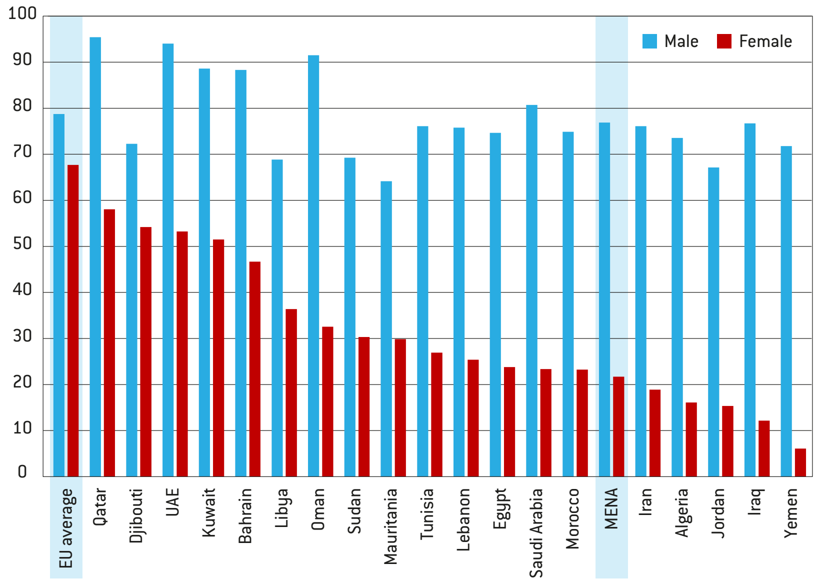
Source: Bruegel based on World Bank's World Development Indicators, last updated 15 October 2020. Notes: data on Syria is not available; natural resource rents for Djibouti and Lebanon amount to zero; a = 2017.

Figure 10 and Table 6 show that hydrocarbon exporters and conflict-affected countries experienced drops in their natural-resource rents and GDP *per-capita* levels between 2012 and 2019. Nevertheless, the income gap between Gulf countries and remaining part of the region remains substantial. Not only are living standards in Gulf monarchies generally much higher than in other MENA countries, the quality and density of infrastructure and the quality of healthcare and other public services is also substantially better. This has been particularly evident during the COVID-19 pandemic.

6.2 Labour market participation and unemployment

Labour markets in MENA countries have long underperformed, and there is no hope for improvement any time soon. The labour market participation rate is lower than in other regions, largely due to the very low labour-market engagement of women (Figure 11). In only four countries – Qatar, Djibouti, UAE and Kuwait – does the female labour-market participation rate exceed 50 percent (in Bahrain it is also close to this level). In other countries it is much lower, especially in Yemen, Iraq, Jordan, Algeria and Iran.

Figure 11: MENA, labour-force participation rate, % of males and females aged 15-64, modelled ILO estimate (compared to the EU average), 2019



Source: Bruegel based on World Bank's World Development Indicators, last updated 15 October 2020.

Table 7: MENA, unemployment total, women and young people (15-24), % of labour force, modelled ILO estimate (compared to the EU average), 2015-2019

Country	Total unemployment			Female unemployment			Youth unemployment		
	2015	2017	2019	2015	2017	2019	2015	2017	2019
EU average	10.0	8.1	6.7	10.2	8.4	7.0	24.1	20.0	16.8
Algeria	11.2	12.0	11.7	16.7	21.1	21.1	29.7	29.6	29.5
Bahrain	1.1	0.7	0.7	3.7	2.8	3.0	5.3	3.9	4.6
Djibouti	10.6	10.4	10.3	10.8	10.5	10.4	20.9	20.8	20.8
Egypt	13.1	11.7	10.8	24.9	23.1	22.1	34.3	32.9	31.1
Iraq	10.7	13.0	12.8	22.2	31.0	30.4	21.4	25.5	25.1
Qatar	0.2	0.1	0.1	0.9	0.6	0.4	0.6	0.5	0.4
Oman	3.6	3.0	2.7	13.2	12.4	11.9	15.0	13.4	13.2
Iran	11.1	12.1	11.4	19.5	19.9	18.6	25.9	28.0	27.4
Jordan	13.1	15.1	14.7	22.7	24.0	23.3	30.9	35.4	35.0
Lebanon	6.4	6.2	6.2	10.4	10.1	9.9	17.7	17.4	17.6
Kuwait	2.2	1.8	2.2	4.7	4.8	5.5	15.3	13.7	15.8
Mauritania	9.8	9.6	9.5	12.2	12.0	12.1	15.1	14.8	14.8
Morocco	9.5	9.2	9.0	10.4	10.7	10.4	20.9	22.3	22.1
Saudi Arabia	5.6	5.9	5.9	21.7	20.3	22.1	29.2	26.9	28.6
Sudan	17.3	17.1	16.5	30.0	29.5	27.8	32.6	32.4	31.4
Tunisia	15.2	15.4	16.0	22.4	23.1	23.4	34.2	34.8	36.3
UAE	1.9	2.5	2.3	4.7	7.1	6.0	6.5	7.9	7.3
Yemen	13.4	13.2	12.9	25.3	25.5	24.9	24.6	24.4	24.0
MENA	**10.1**	**10.2**	**9.8**	**18.2**	**18.6**	**18.1**	**27.0**	**27.4**	**26.9**

Source: Bruegel based on World Bank's World Development Indicators.

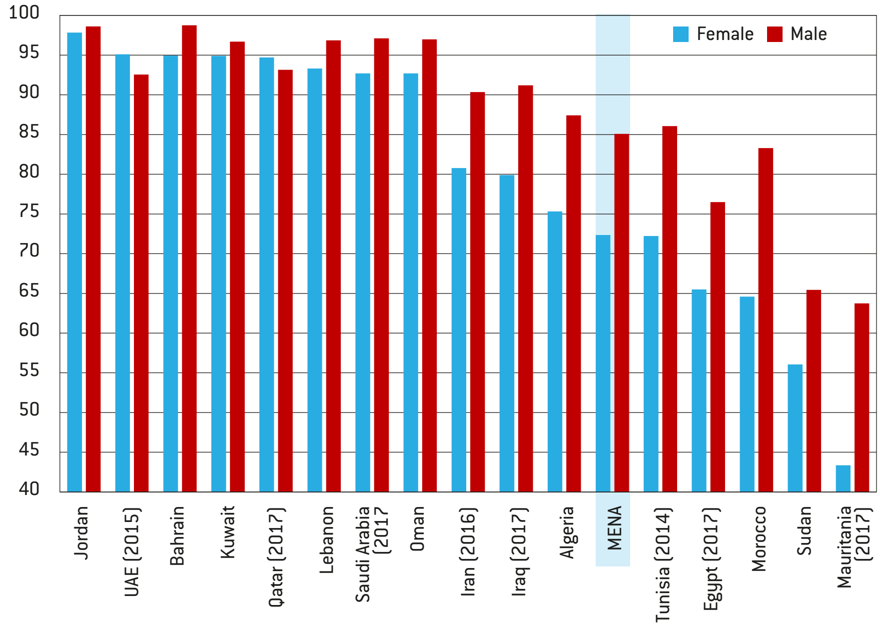
Even this reduced labour force supply exceeds demand, at least in the official sector. Slow economic growth in 2010s (section 3) was insufficient to generate enough jobs for the rapidly growing labour force. This is easily identifiable in Table 7, where little improvement, if any, can be noticed. Approximately half of MENA economies record two-digit unemployment figures. High-income Gulf countries are the exception. Traditionally they face a domestic labour force deficit and import substantial labour from Asia and other MENA countries. Female and youth unemployment rates look even worse than total unemployment figures, with just a few exceptions (Bahrain, Qatar and the UAE).

6.3 Education shortcomings

Unsatisfactory labour-market performance can be at least partly explained by unsatisfactory education levels (other factors include slow growth, labour market rigidities, cultural barriers, gender inequality, poor business climates, corruption and nepotism).

Figure 12 shows that there are substantial literacy gaps in approximately half of the region, especially with respect to females. Only Gulf countries, Jordan and Lebanon look better, but they are also below European or East Asian standards.

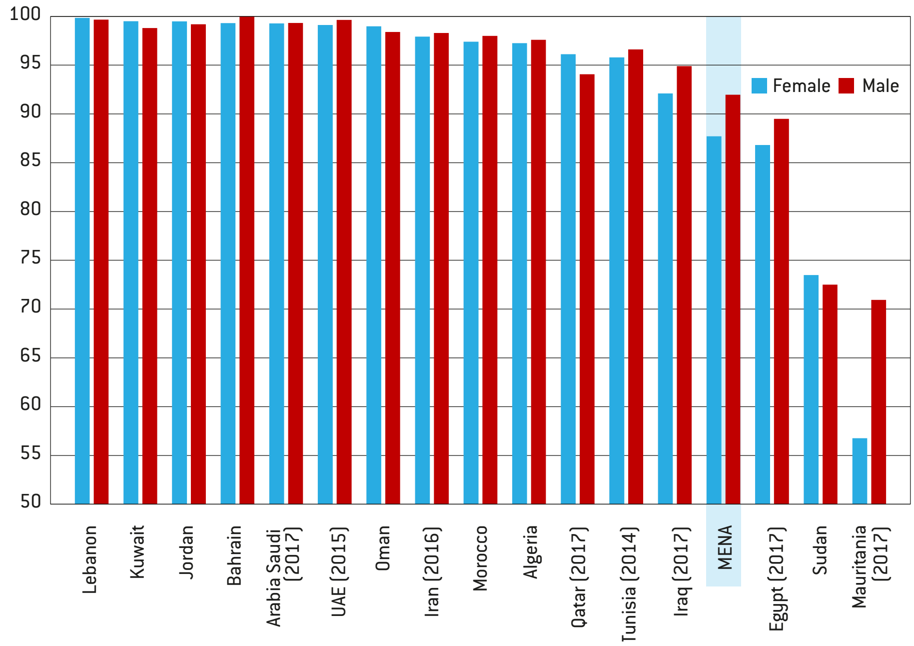
Figure 12: MENA, adult literacy rates, % of males and females aged 15 and above, 2018 or the latest available data



Source: Bruegel based on World Bank World Development Indicators, last updated 15 October 2020. Notes: data on Djibouti, Libya, Syria and Yemen is not available

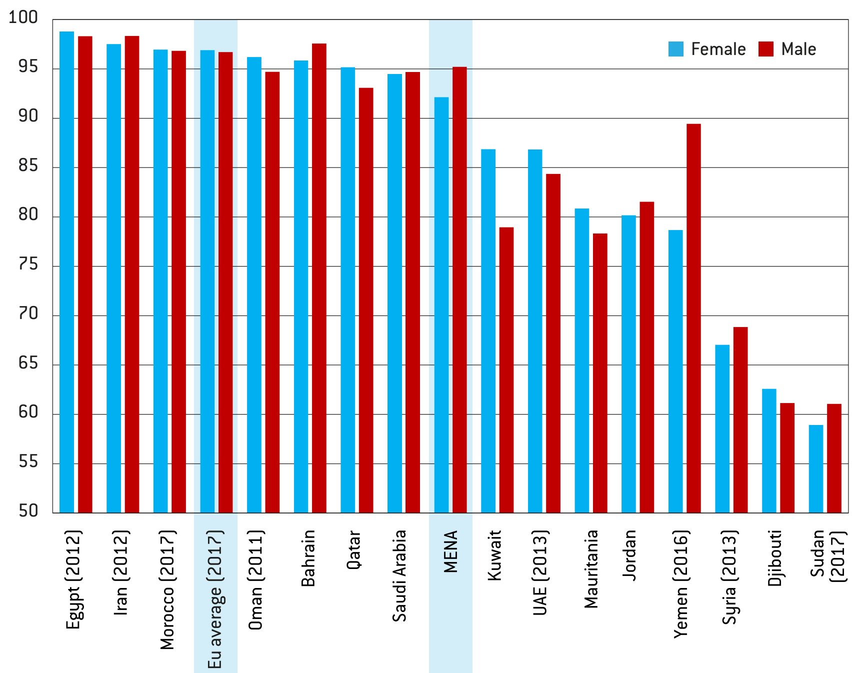
While one may argue that data on adult literacy is burdened with legacies of the past, we also look at youth literacy rates (Figure 13). They look better than adult rates, and there is less gender inequality across the region. In Lebanon, Kuwait, Jordan, Oman and Sudan, the female literacy rate is even higher than that of men. However, in Egypt, Sudan and Mauritania, youth literacy rates are still low, especially for girls. Most likely, the situation is similar in Djibouti, Libya, Syria and Yemen, for which there is no recent data.

Figure 13: MENA, youth literacy rates, % of males and females aged 15-24, 2018 or the latest available data



Source: Bruegel based on World Bank World Development Indicators, last updated 15 October 2020. Notes: data on Djibouti, Libya, Syria and Yemen is not available.

Figure 14: MENA, primary schools, net enrolment, % of the respective age cohort (compared to the EU average), 2018 or the latest available data

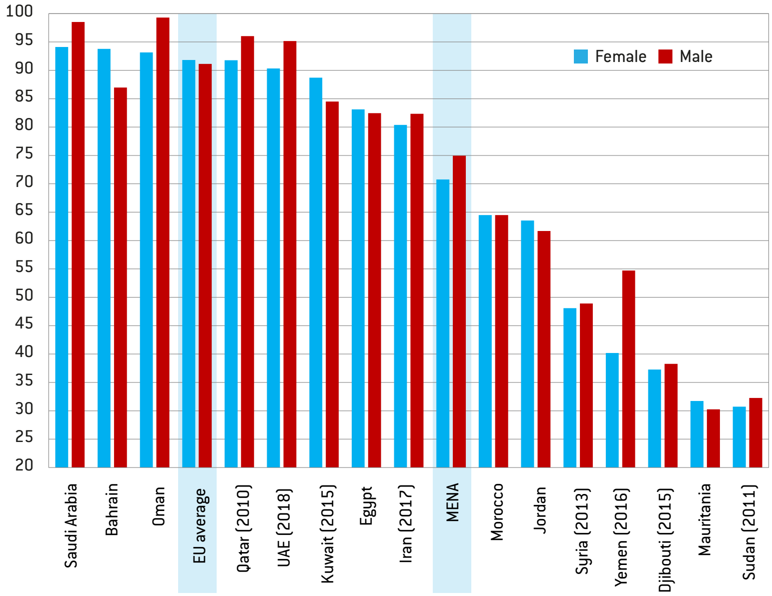


Source: Bruegel based on World Bank World Development Indicators, last updated 15 October 2020. Notes: data on Algeria, Iraq, Lebanon, Libya and Tunisia is not available.

Table 14 confirms the limited access to primary education in several of the region's low- and lower-middle-income countries. However, in some high-income countries, such as Kuwait and UAE, the situation does not look rosy either (the net enrolment rate is below 90 percent). Interestingly, school enrolment data (Figure 14) does not fully correspond to youth literacy rates (Figure 13). Egypt reports the highest enrolment rates in the region while its youth literacy rate does not look favourable. Kuwait, the UAE and Jordan seem to represent the opposite case – incomplete primary schooling rates and relatively high literacy rates. This sort of statistical contradiction can suggest either low quality of education statistics, low quality of education, or both.

Figure 15 presents data on secondary school enrolment. Again, enrolment rates are low in several countries: Sudan, Mauritania, Djibouti, Yemen, Syria and, to a certain degree, Jordan and Morocco. Data on Algeria, Iraq, Lebanon, Libya and Tunisia is not available. Female enrolment rates are lower than male rates, with a few exceptions including Bahrain, Kuwait, Egypt, Jordan and Mauritania, where they are higher.

Figure 15: MENA, secondary schools, net enrolment, % of the respective age cohort (compared to the EU average), 2018 or the latest available data



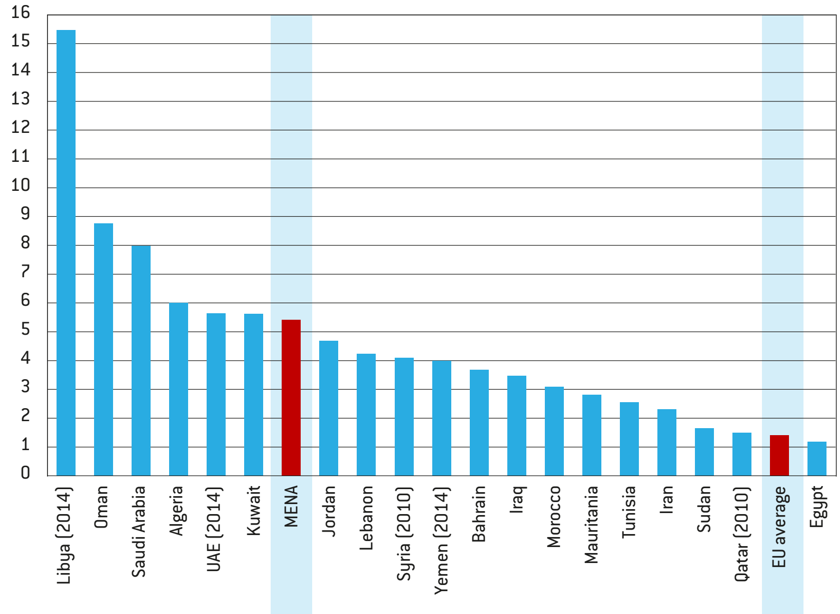
Source: Bruegel based on World Bank World Development Indicators, last updated 15 October 2020. Notes: data on Algeria, Iraq, Lebanon, Libya and Tunisia is not available.

The quality of education, apart from a very small number of elite schools and universities, is rather low (AHDR, 2003), characterised by outdated curricula and teaching methods (Ghanem, 2016b), high levels of teacher absenteeism (Devarajan, 2016) and poor results in international student tests (El Mahdi *et al*, 2011). Consequently, the quality of human capital in the region is below its potential, with negative consequences for economic development.

6.4 Excessive military spending

While most MENA countries suffer from high and increasing fiscal deficits and public debts and lack of sufficient financial resources to provide basic public services and infrastructure investments, they overspend for military and public security purposes. Despite a substantial reduction compared to the 1980s and 1990s, military expenditure as a share of GDP remains high (Figure 16), both for the entire MENA region and individual MENA countries. It exceeds 4 percent of GDP in Libya, Oman, Saudi Arabia, Algeria, UAE, Kuwait, Jordan, Lebanon and Syria, sometimes by a large margin. This is substantially higher than the EU average of 1.4 percent, or the 2 percent defence spending commitment expected of NATO members (though this can encompass other activities, and a number of NATO members do not spend at this level).

Figure 16: MENA, military expenditure, % of GDP (compared to the EU average), 2019 or latest available data



Source: Bruegel based on World Bank World Development Indicators, last updated 15 October 2020. Note: data on Djibouti is not available.

7 EU policy towards MENA

The EU foreign, trade and development assistance policies traditionally concentrate on ten Southern and Eastern Mediterranean countries (SEMC), which are the EU's immediate neighbours: Morocco, Algeria, Tunisia, Libya, Egypt, Jordan, Israel, the Palestinian Authority, Lebanon and Syria.

Since the 1990s, the political and economic framework of EU-SEMC cooperation has undergone several changes. On a multilateral level, this began with the launch of the Barcelona Process in November 1995, which had three major aspects (Dabrowski, 2014):

- Political and security dialogue, aimed at creating a common area of peace and stability underpinned by sustainable development, rule of law, democracy and human rights;
- Economic and financial partnership, including the gradual establishment of a free-trade area;
- Social, cultural and human partnership, aimed at promoting understanding and intercultural dialogue between cultures, religions and people, and facilitating exchanges between civil society and ordinary citizens.

In 2004, all SEMC were included in the European Neighborhood Policy (ENP), together with six countries of the former Soviet Union[10]. In 2008, on the initiative of then French president Nicholas Sarkozy, the Barcelona Process was institutionally upgraded through

10 See [https://ec.europa.eu/home-affairs/what-we-do/policies/international-affairs/european-neighbourhood-policy_en.](https://ec.europa.eu/home-affairs/what-we-do/policies/international-affairs/european-neighbourhood-policy_en)

the creation of the Union for the Mediterranean (UfM), which included all EU countries, EU actual and potential candidates, nine SEMC (all but Libya), Mauritania and Monaco. The UfM led to a number of joint projects in the areas of environment, energy, prevention and response to natural and man-made disasters, education and small business[11].

In implementing the Barcelona Process and the ENP, the EU signed association agreements with eight SEMC (all but Libya and Syria) in the 1990s and 2000s. These agreements cover several areas of cooperation. Apart from trade, investment and other economic issues, provisions cover areas including political dialogue, social and cultural matters, and controlling illegal migration.

7.2 Cooperation with other MENA countries

Outside its immediate neighbourhood, the EU's policy goals and cooperation instruments are more selective and less systematic. In 1988, the EU signed the Cooperation Agreement with the GCC. It was to be followed by an FTA, but the negotiation has been suspended several times by the GCC side[12].

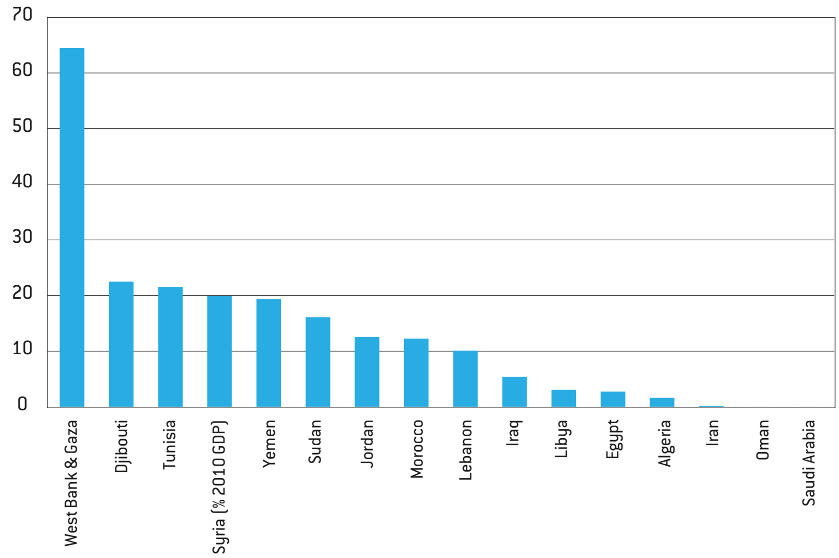
EU diplomacy was instrumental in reaching the Joint Comprehensive Plan of Action (JCPOA) in July 2015 between Iran and the international community represented by five permanent members of the United Nations Security Council, Germany and the EU – popularly referred as the Iran Nuclear Deal. Unfortunately, the US left this agreement in 2018.

EU activities towards the remaining MENA countries (Djibouti, Iraq, Mauritania, Sudan and Yemen) have been dominated by development assistance and humanitarian aid.

7.3 EU aid to the region compared to other donors

The EU has been a major provider of development assistance to the region in recent decades. Between 2007 and 2019, around €84 billion was granted to the region (Figure 17), with the primary sources being the European Commission (€22 billion), Germany (€21 billion) and France (€15 billion)[13].

Figure 17: EU assistance to the region by recipient country or territory 2007-19 (as a percentage of 2019 GDP)

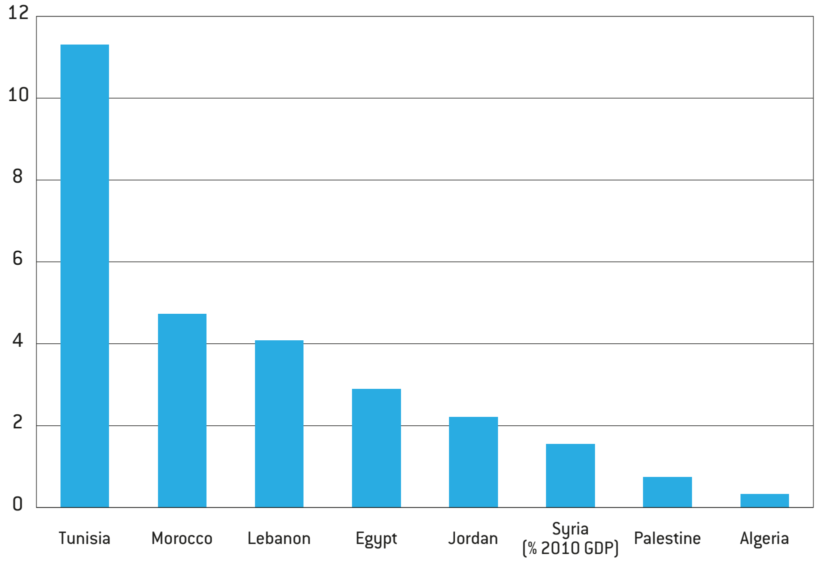


Source: Bruegel based on https://euaidexplorer.ec.europa.eu/. Notes: includes the UK, which was an EU member during the time period exhibited; 2010 GDP used for Syria, latest available.

11 See http://www.eeas.europa.eu/euromed/index_en.htm.
12 See https://eeas.europa.eu/regions/middle-east-north-africa-mena/338/gulf-cooperation-council-gcc-and-eu_en.
13 Data from EU Aid Explorer; https://euaidexplorer.ec.europa.eu/.

The European Investment Bank (EIB) has also been fairly active in SEMC, with around €21 billion in regional projects between 2007 and 2020 (Figure 18), around €6 billion of which is classified as aid (and therefore included in Figure 17).

Figure 18: EIB-financed projects in MENA by recipient country/ territory 2007-2020 (as a percentage of 2019 GDP)



Source: Bruegel based on EIB and IMF World Economic Outlook, October 2020. Notes: 2010 GDP used for Syria, latest available.

The US has been an even larger provider of aid to MENA. According to USAID, they provided around $180 billion to the region over the same time period. An important caveat here is that most US aid has a military rather than civilian character. Military aid is far more volatile, thus increasing the variability of the total. For example, between 2007 and 2019 over 50 percent of aid to Egypt had a military character in each year except 2014. In 2012, military aid to Egypt as a share of total US aid to Egypt reached 94 percent; in 2019 it was 89 percent[14].

GCC countries are the third major source of assistance to the region. While data is patchy, they have provided substantial amounts of aid to their neighbours both for civilian and military purposes (section 6.1). According to its own platform, Saudi Arabia has provided nearly $48 billion in aid, with the biggest recipients being Yemen ($17 billion), Syria ($6.2 billion) and Egypt ($2.4 billion)[15]. Similarly, according to its ministry of international cooperation, the UAE has given around $47 billion in aid since 1970[16].

8 The way ahead and reform priorities

Dealing with the COVID-19 health emergency is the immediate and most important challenge for the MENA region. Some countries lack medical capacity and have shortcomings in related areas such as sanitation. The most fragile countries have around 17 million internally-displaced people and close to 3 million refugees, which puts them in a more

14 See https://explorer.usaid.gov/cd.

15 See https://data.ksrelief.org/home/index, cumulative values, since the establishment of the Kingdom of Saudi Arabia (1932).

16 See https://www.arabianbusiness.com/uae-has-donated-47bn-in-overseas-aid-over-last-44-years-614297.html

precarious situation (IMF, 2020a).

Uncertainty will prevail in the coming months. Subsequent waves of the pandemic and the associated containment measures may continue to be a major obstacle to recovery. Hardship and increasing poverty may provoke social unrest in already politically fragile states.

Reform in the region has been slow in recent years, and since the pandemic the priority has shifted towards handling the health and economic shocks. However, once the pandemic ends and immediate recovery takes place, the focus should turn to rebuilding of fiscal buffers, lowering debt and raising international reserves. The liabilities of state-owned enterprises present an additional source of vulnerability. For hydrocarbon-dependent countries, economic diversification should be a priority in light of the oil price collapse and the expected progress in 'greening' the global economy.

Other structural and institutional obstacles to sustainable, more-balanced and socially-just economic growth include, among others, bureaucratic barriers to business activity, corruption, poor governance, outdated regulations, trade protectionism, restrictions to foreign investment, limited currency convertibility, underdeveloped infrastructure, poor quality of public services, especially education, and social exclusion. These barriers should be removed through implementation of comprehensive reform programmes with the support of international donors, including, prominently, the EU. The shape of the needed reform has been known for many years, but there has never been serious implementation.

Resolving regional conflicts should also help with economic and social progress by offering a substantial peace dividend. Here the EU should play a more active role, especially in the context of visible US disengagement and increasing interference by other players (see section 2). This requires a more active and united European diplomatic effort, firm support for democracy building, the rule of law and human rights, and explicit condemnation of contrary practices. EU financial and technical aid in various forms should be better targeted with better-designed conditions.

To help in the economic and social transformation of the region, the EU should update and upgrade its existing FTAs with those partners who are ready for such a step, while strengthening inter-regional cooperation frameworks (within the UfM) in areas including environmental protection, green energy, education (for example, by offering a large number of scholarships to MENA students), research, culture and legal migration.

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