Food and Global Crises impacts on Middle East and North African Region: What lesson can we learn for the future?

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Abstract

The recent crises concerning food and finances highlight the extreme fragility of the MENA countries and question the sustainability of the development processes. The economic and social impacts of these crises on the economies of the MENA region signal the magnitude of the challenges facing the region and the need to reorient its development policies. This paper intends to provide a comprehensive analysis of economic and social impacts of the two crises to help understanding, on one hand, the magnitude of the problem facing the region, and the need for a reorientation of the region's development policies, on the other.

Key Words: Food Crisis, Financial Crisis, MENA Region.

JEL Classification: D53, E44, F41, Q11, Q25.

Introduction

The high growth rates in some MENA countries have created the impression of sustainable development, but this is misleading. Many factors indicate that the development process applied since the 1970s, has failed to deliver its promise. Despite massive investments in infrastructure, in schools and in health, the MENA region in general still suffers from major shortcomings and from development results that are far below expectations.

As a consequence of the excessive reliance on raw material exports for foreign exchange earnings and on foreign markets as a source of industrial products and food items, the region is essentially faced with four challenges: growth volatility, distorted production structure and a mismatch between key economic activities, high unemployment levels, especially among young people, and food security risk. Weak governance and corruption, which have handicapped human and institutional progress in the region, are additional development bottlenecks.

The last decade has confirmed a general trend of an increasingly unstable global economy. The recent crises concerning food and finances highlight the extreme fragility of the MENA countries and question the sustainability of the development processes. The economic and social impacts of these crises on the economies of the region signal the magnitude of the challenges facing the region and the need to reorient its development policies. The social stress and economic instability caused by these challenges give a good indication of what might be expected in the future.

The recent dilemmas give a better perception of what might be expected in the future and provide an important lesson about the potential risks to the region. This paper intends to provide a comprehensive analysis of economic and social impacts of the two crises to help understanding, on one hand, the magnitude of the problem facing the region, and the need for a reorientation of the region's development policies, on the other.

In order to assess the magnitude of the problems, we analyse in the second section the impacts of the recent food crisis on the economies of the area. The third section deals with the financial effects and the real effects of the global crisis. The fourth section concludes and offers the main policy recommendations.

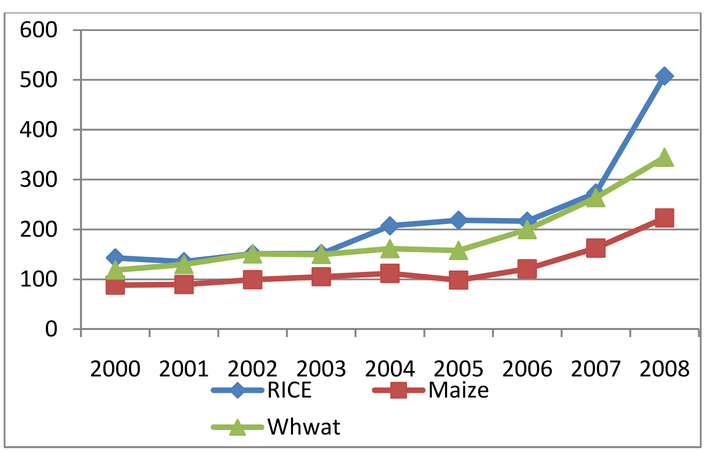
2. MENA region facing food crisis

The food crisis now -- and perhaps for many years to come—is foremost among the concerns of the world in general, as well as among all developing countries and the MENA countries in particular, as these have a very low sovereignty in terms of food supply.

Food prices increased dramatically in 2006 and 2007. This increase was more marked during 2008 when prices recorded their highest levels. According to the FAO, the average increase in food prices between 2005-2006 was almost 8 per cent but peaked at about 24 per cent during 2006-2007. Cereals, sugar and vegetable oil have increased steadily since 2006. In 2007 the price of wheat rose 90 per cent, a total mark-up of almost 180 per cent over three consecutive years, while food prices in general rose 83 per cent. Food prices, during the first quarter of 2008, were 53 per cent higher than the 2007 level.

Figure 6

International Grain Prices (nominal/tone)

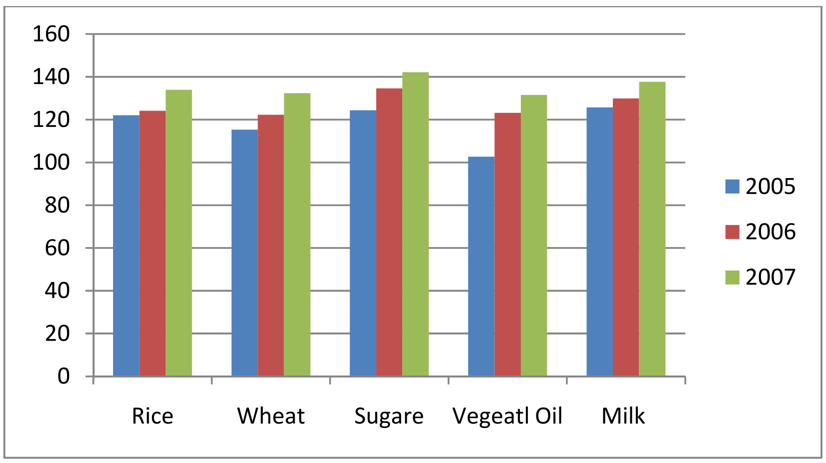


Source: Food and Agriculture Organization

This sharp increase in food prices has had considerable effect on many countries faced with the food deficit problem. Price hikes in the MENA region during 2006-2007 were, on average, between 21 and 115 per cent. Yemen, Bahrain and Tunisia recorded price increases for certain products of 140 per cent, 125 per cent and 25 per cent, respectively (Arab League, 2009). Only the rich countries such as Saudi Arabia, Algeria, Kuwait and Oman, which continue to subsidize food products, have succeeded to tame prices.

Figure 7

Grain prices in MENA region

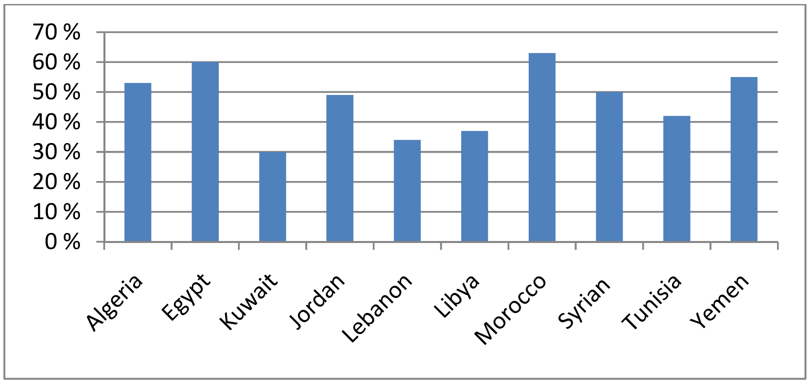


Source: Arab Organization for Agricultural Development

In the MENA region, rising food prices have taken on a dimension that is quite particular, given, first, that a large share of the household budget is devoted to food consumption and second, that the region imports about 50 per cent of its food needs. Moreover, the region is among the world's most arid areas; diminishing water resources for agriculture and inefficient management of water resources have limited the capacity to feed the region's own population. Consequently, any variations in food prices will have an impact, with possible social instability ramifications.

Figure8

Share of food in total expenditure



Source: FAO (2007)

According to FAO (2007), food consumption, on average, accounts for more than 50 per cent of the household budget; in Morocco, for instance, this share exceeds 60 per cent. In addition, a high proportion of the region's population lives on the threshold of poverty. According to specialists, raising the poverty line from $2 to $3 a day would double the number of poverty-stricken people from 45 million to 92 million. Consequently, with the large number of extremely vulnerable people, rising food prices can undermine the human development gains achieved over the last decade. Indeed, estimations by Ruslan Yemtsov (2008) indicate that a 30 per cent mark-up in food prices will increase poverty in Egypt by 12 per cent, whereas extreme poverty would go from 40 per cent to 54 per cent in Djibouti, after a 21 per cent food price increase.

Many countries in the region have already witnessed massive protests following food price mark-ups. In Egypt, for example, where 40 per cent of the population live on less than $2 per day, the 500 per cent increase in bread prices started riots in April 2008, after which the government allocated US$2.5 billion in new subsidies on bread, banned rice exports, and distributed bread to the poor. Public sector wages have also risen by 30 per cent. In Jordan, the cost of basic foods increased 60 per cent in one year, but luckily the country has not seen a repeat of the 1996 riots, and protests have been more peaceful. In early 2008, the Jordan government decided to increase public sector wages and to abolish taxes on commodities. Violent demonstrations in

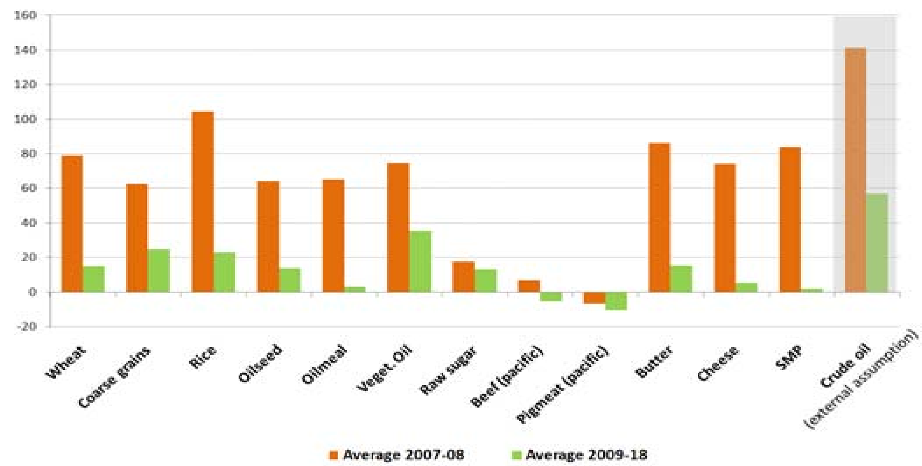
Morocco, protesting the higher price of bread, prompted the government to cancel a 30 per cent price increase. Yemen witnessed violent riots after mark-ups on wheat, rice and cooking oil and it is estimated that with rising food prices, poverty could increase on a national level by 6 per cent in Yemen. Increases in poverty are also projected for Djibouti (14 per cent), Egypt (12 per cent) and Morocco (4 per cent). In addition, it is likely that food price increases will delay many of the fiscal reforms that had been adopted before the crisis.

As one of the world's most water-scarce regions with a high dependency on climate-sensitive agriculture, the situation in MENA is likely to deteriorate in the future. With less groundwater available for agriculture, the region's dependency on trade deepens. Agriculture in the region, in general, faces difficulties and yields are expected to fluctuate more radically. Nevertheless, despite the overall similarity in climate, the MENA states when examined in detail reveal enormous diversity: there is the frequent juxtaposition of a harsh desert environment and intensively cultivated agriculture land.

The Mediterranean countries rely on sparse winter rainfall and short rainy seasons to grow cereals, legumes and low-yield arboriculture as well as raise sheep and goats on fragile grazing land. Pasture degradation due to over-grazing, associated with the increasing demand for meat and milk from expanding urban populations, has forced farmers to import larger quantities of food and fodder. In the Nile valley, agriculture is based on intensive irrigation. Huge population pressures and lack of rainfall force this region to rely heavily on maximizing food production per unit of land, which, in turn, increases the risk of salinization, water pollution and water scarcity. The extremely arid Arabian Peninsula depends almost entirely on crop irrigation but is devoid of any major river systems like the Nile. Instead, they utilize groundwater from wells, but this water layer is being depleted much faster than can be replenished by the limited rainfall. Although this region is sufficiently rich to consider desalinated seawater, it is too costly an option for agriculture.

Figure9

Percent change relative to 1997-2006 average



Source: OECD (2008)

Despite the apparent downward trend in prices, many experts believe that food prices will remain at a higher level than in 2004. Indeed, several countries continue to devote a more important share of agriculture production to biofule. The general tenancy is to apply greater control over food exports and higher tariffs. Moreover, depleted international food reserves and rising oil prices are likely to result in higher food prices.

Accordingly, scarcity of water resources and food security risk are among the future challenges of the MENA region. Agriculture output is expected to decrease by 21 per cent by 2008 and for countries like Morocco and Algeria, it could drop roughly 40 per cent (Cline, 2007). Moreover, the high salt content in much of the available water further complicates irrigation efforts, limiting the potential for additional development of irrigated agriculture in the region.

3. Global economic downturn

The current financial and economic crisis, while having a global impact, is clearly also affecting certain areas more severely than others, and the MENA region may be amongst the worst affected. This might be surprising to some, given the perceptions of the region's wealthy due to its oil riches, its ample foreign exchange reserves that should tide the countries over, or its banking system not being exposed to adverse changes in the global financial. But these are a delusion for the MENA economies for at least three reasons: (i) Prices for raw materials, particularly petroleum and phosphate, the main export item of the region, have dropped sharply. In addition, global demand for textiles, which represent a significant proportion of exports for Egypt, Tunisia and Syria, has also decreased. (ii) The demand for transport and tourism has declined, threatening tourism globally. (iii) In addition to the anticipated increase in unemployment as a consequence of the slowdown in local production, employment opportunities for the redundant labourforce in the main destination countries will fade.

3.1. Financial effects of the crisis

The impact of the global crisis on the stock exchange markets of the MENA region varies considerably from country to country. The Gulf states (first group) are the most adversely affected by the crisis, if we consider the loss of major overseas investments, especially in the United States and Europe (about 55 per cent of Gulf investments are in the United States). This is apparent mainly as the sharp decline of the region's stock markets (20-60 per cent), and the cancellation of major projects. The effects were noticeable at the beginning of the crisis in countries (for example, United Emirates Arab) with close links with financial markets. The stock market indices have recorded a drop of 30-60 per cent in the last quarter of 2008, costing investors US$600 billion in direct stock market losses.

The global financial crisis has induced a devastating shortage of capital in the banking sectors. For example, losses to Kuwait's Gulf Bank totalled US$1.54 billion in 2008. The Gulf governments have been forced to pump money into the banks in efforts to salvage these. For example, the Qatar government has offered an investment package valued at US$5.3 billion to the banking sector and Abu Dhabi Central Bank has intervened with US$32.7 billion to ensure the liquidity of UAE banks.

Table 12

Estimated 2008 Gains and Losses of Gulf funds $ billion

	Capital gains	**Gains as share**

		of Dec 2007 portfolio
Emirates	-183	-40%
Kuwait	-94	-36%
Qatar	-27	-41%
SA	-46	-12%
GCC total	-350	-27%

Source: Sestser and Ziemba (2009)

Before the crisis, the size of government investment abroad by the Golf countries was assessed at about US$1.8 trillion, with approximately 60 per cent held in dollars. According to many analysts, the sovereign funds of the Gulf Arab states could be exposed to losses reaching as high as 30 per cent, particularly with respect to funds maintained in the US banking system, perceived earlier as stable.

The crisis has affected indirect financing, whether funded by local banks, which have become more reluctant, or by foreign banks, which have blocked a numerous lines of credit. The real estate market has also been hit, which led to a lack of liquidity and a slowdown in real estate development.

The financial crisis quickly triggered a decline in the demand for goods and a contraction of bank credit. Raw material prices have fallen dramatically, particularly oil which lost more than two-thirds of its value within a few months. Indeed, as a result of speculation, oil price rates fell in the last three months of 2008 to less than US$40 a barrel, after increasing from US$90 to US$148 a barrel at the beginning of the year.

According to the Colliers International 2009 Report the global economic crisis has impacted heavily on the Gulf real estate market, causing considerable decline in the real estate capital values and rents. In Dubai, average residential sales prices fell 42 per cent since the last quarter of 2008, while residential rental rates dropped on average 20-40 per cent. In Abu Dhabi, the impact of the crisis was less acute, as the decline in residential real estate value was around 20 per cent. In Qatar, rents for newly constructed office space have declined 10-15 per cent during the first quarter of 2008. Residential real estate sales have collapsed due to the lack of funding and greater uncertainty over the future.

It may, therefore, be difficult for many countries in the region to continue with the ambitious development projects that were initiated or planned during the last five prosperous years. In order to avoid budget or current account deficits, most governments were reluctant to expand projects, thus contributing to the contraction of the economy.

3.2. Real effects of the crisis

The direct effect of the global slump on the economic activity of the developed countries, the diminishing household purchasing power resulting from rising unemployment as well as the added uncertainty about the future have significantly reduced demand for exports and tourist travel within the region. Thus, the slowdown of the international economy has resulted in declining economic activity and increased unemployment, particularly as the lack of international liquidity limits recourse to external finance.

The financial crisis and associated recession in the major capital markets have been reflected primarily as a decline in exports. The critical position of the MENA region is explained by its wide exposure to foreign markets, and the problem is amplified by the fact that these economies depend on primary goods for exports and food and manufactured goods for imports. In addition, the European and the American markets represent about 35 per cent of MENA exports and 47 per cent of its total imports. For countries like Morocco and Tunisia, European trade contributes more than 70 per cent of total trade.

Despite the fact that statistics for quantifying the impact of the crisis are not yet available for all countries of the region, its negative outcomes have started to appear. Compared to the previous quarter, exports in Egypt, Jordan, Lebanon, Morocco and Tunisia decreased in the first quarter of 2009 by approximately 26 per cent, 13 per cent, 7 per cent, 28 per cent and 13 per cent, respectively (based on official data). Compared to the previous year exports in Algeria and Syria decreased in 2009 by approximately 45 percent and 25 per cent, respectively. However, for the biggest gas exporter in the region -- Qatar -- exports are expected to increase by 35 per cent.

In the services markets, a significant decrease has affected the demand in international travel and tourism, and transport services in general, causing stagnation and cancellation of orders for new ships and aircraft. Tourism has declined significantly in countries catering to international tourists, and revenues from this source have decreased in Egypt and Morocco in the first quarter of 2009 by almost 10 per cent and 19 per cent, respectively, compared to the same period a year ago. The exception is Tunisia, which witnessed a 4 per cent improvement in tourism revenues, and is explained by the increased number of visitors from Algeria and Libya, representing about 40 per cent of all visitors.

It is expected that the demand for immigrant labour will slow down as a result of the decline in economic activity in the host countries, particularly in the construction and building sectors. According to rather pessimistic estimates, foreign labour to the Gulf Arab states will decrease 30 per cent in 2009. It is also expected that remittances in general will stagnate in the medium term, particularly if the crisis lasts for more than a year. Remittances from Egyptians, Lebanese, and Jordanians, who constitute a lion's share of the workers in the Gulf Cooperation Council states and Libya, declined during the first half of 2009. The same applied to Morocco, which sends workers to the EU states, especially France and Spain. According to official data, remittances dropped by 13 per cent in Morocco, 20 per cent in Egypt, 2.5 per cent in Lebanon and 58 per cent in Jordan.

If we take into account the fact that remittances, on average, constitute 6 per cent of the GDP of the labour-sending countries, their reduction could cause a decline in the economic growth rate of the mother country. The impact of a decline in remittances will be amplified by the multiplier effect, as remittances normally contribute to support private consumption and domestic investment. These are in addition to informal transfers and assistance in the form of cars, machines, tools and household items, clothing, and other items. These transfers are more important than foreign aid or direct investments received by the mother countries, particularly for the Maghreb, Egypt, Sudan, Jordan, and Lebanon. As the transfers have a significant impact on the macroeconomic performance, it seems that a decline in the amounts will have considerable impact.

Recent years have seen a marked improvement in the investment climate in many MENA countries and as a consequence investment flows have increased. Indeed, between 2005 and 2006, the increase in FDI was nearly threefold in Tunisia and more than 50 per cent in Libya, Saudi Arabia, Sudan and Egypt. In general, the MENA region in 2007 received about 5 per cent of global direct investment flows. The ratio of FDI to gross capital formation exceeds 30 per cent in the UAE and Saudi Arabia, despite the fact that these two countries are net capital exporters; by contrast, FDI to gross capital formation has risen to nearly 98 per cent in Jordan and Bahrain, to nearly 50 per cent for Egypt, Libya, Tunisia, and 6.6 per cent in Algeria.

The expansion over the last year has been led in general by exports, and powered by FDI which provided the capital to bridge the gap between domestic savings and development needs in the recipient countries, thus contributing to the creation of new jobs. FDI is not merely the means of opening new markets for multinational companies but also a way for achieving higher productivity through technology transfers. The MENA countries, in return, offer a young, educated, low-cost workforce. In addition, the states of the region guarantee a low corporate-tax rate and modern infrastructure. Low cost is one of the most important pillars of a country's attractiveness, consequently increased inflation and higher labour costs will be a major concern for the MENA region. Indeed, the fact that they have no flexibility to apply the fiscal instruments needed to uplift the economy, utilizing monetary policy could make these countries too expensive and may dampen the appeal of the region for foreign investments.

According to estimations, foreign direct investment for 2009 is expected to decline by 17 per cent in Egypt, 69 per cent in Jordan, 18 per cent in Kuwait, 41 per cent in Lebanon, 10 per cent in Arabia Saudi, and 50 per cent EAU. Official data show that in the first half of 2009, FDI dropped 36 per cent in Tunisia, 34.5 per cent in Morocco and 65 per cent in Jordan.

It is expected that the global crisis will increase unemployment in the region. According to the Arab Labor Organization, the number of unemployed will increase, as a repercussion of the economic crisis, by at least 3.6 million during the biennium 2009–2010, bringing the unemployment rate to a level 1-2 per cent higher than in the pre-crisis period. Unemployment may be exacerbated by the fact that some of the MENA countries (Egypt, Jordan, Sudan and Syria) may be severely affected by the economic contraction in the Gulf states, which is forcing a large numbers of workers to return home; their numbers are expected to decline in the host countries by 30 per cent in 2009. In addition, remittances by MENA expatriates, accounting for 6 per cent of the GDP of the labour-sending countries, are expected to decline, leading to a slowdown in the economic growth rates of the mother countries.

4. Concluding remarks and policy recommendations

The MENA region finds itself at a crossroad, faced with new opportunities but also challenged by real social and economic debacles. Development programmes implemented by the different states have failed to deliver significant results, and essential reforms are needed if these are to remain viable in the global economy.

Diversification of the economy continues to be a major challenge for the region in general. Many experts call for urgent action to address the main causes of economic vulnerability in the region and to enhance its resilience to external shocks. Moreover, it becomes vital that MENA countries improve the overall quality of governance and raise their economic competitiveness. Improvements to macroeconomic management as well as institutional reforms are essential to enhance efficiency and facilitate the absorption of new technology.

What we have learned from the food and financial crises?

From our analysis, we can conclude that the development process in the region has already reached its limit and can no longer meet the region's needs in terms of development and stability. A new development strategy based on the knowledge economy has become more than urgent in order to establish the foundation for sustained development.

Indeed, despite 35 years of active effort and vast amounts of money, economic achievements have fallen far short of the population's aspirations; the region remains extremely fragile and dependent on the economic conditions and policies of the industrial countries. Even if important foreign exchange reserves have helped certain countries within the region to overcome many economic crises, the financial cost of support has been relatively high. Moreover, it appears that the fragility of the region could worsen in the future, if account is taken of the risk of greater fluctuations in food and oil prices. The likely depletion of the region's water resources, combined with severe climate changes, will introduce greater challenges.

Despite the apparent heterogeneity of MENA, available financial and human resources are important assets that could, with better management, establish the foundation for sustained development throughout the region. Even if regional integration currently appears to be difficult to achieve, it remains the only option for the region. Geographic proximity may play a key role in promoting economic integration and improving intra-regional trade and investment.

However, geographic proximity *per se* cannot influence trade among neighbouring countries if these are underdeveloped and lack trade potential. Geographic proximity can give an additional stimulus to trade only if the preconditions for dynamic growth exist. Consequently, to improve intra-regional trade among the MENA countries, a dynamic mechanism needs to be envisaged. The emergence of virtuous trade circle among the MENA states needs that leader countries be developed first before attempts at regional integration are made, and the leader would then be utilized by neighbouring nations as a vehicle (pivot country) or an engine for industrialization and development. Intraregional trade could be used by the lead countries to supplement their international trade in order to overcome the limited size of local markets, thus remedying the scarcity of resources, enhancing production efficiencies by developing economies of scale and achieving higher production capacities as a result of the better allocation of domestic resources. Regional trade can be used by other countries to boost competition in the domestic market and improving terms of trade due to cheaper imports.

In the final analysis, the MENA countries should coordinate their efforts and develop a regional plan for agricultural and industrial investment, and adopt regional projects for improving education and training. Strong, modern institutions could represent a safeguard against future crises as well as develop the capacities of the region to absorb external shocks. Better governance and greater freedom are essential to address the various sources of vulnerability and to increase the resilience of the region. The potential social costs that the region could support justify the need to invest more effort in this direction.

Appendix

Table A 1: Share of Agricultural labor force

	Share of Agricultural labor force in total labor force	**Share of female in agricultural labor force**
Algeria	23.3	52.2
Bahrain		
Comoros	71.9	50.9
Djibouti	76.9	48.7
Egypt	30.7	48.4
Jordan	10.3	69.7
Kuwait	1.1	1
Lebanon	2.8	39
Libya	4.6	66.3
Mauritania	51.6	51.7
Morocco	33.5	85.2
Oman		
Qatar		
Saudi Arabia	7.5	8.2
Sudan	57.4	38.2
Syria	26.1	65
Tunisia	23.1	41.8
United Arab Emirates	4.1	
Yemen	46.4	44.1

Source: FAO (2008)

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