# THE INTERNATIONAL FINANCIAL SYSTEM, THE EXTERNAL SITUATION OF THE ARAB COUNTRIES AND THE GATT

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## Introduction

The deregulation and internationalisation process of the international financial system, started at the beginning of the 1970s and which speeded up sharply in the 1980s, led to a radical change in the volume and direction of the flow of financing, making it the most important element in international trade.

This evolution had diverse consequences on the world distribution of the accumulation of wealth and on the application of financial surpluses which, globally, were unfavourable for the developing countries and which, for this reason, cannot be ignored if we are seeking to analyse the probable effects of the Marrakesh Agreement.

Thus, in the case of this paper, which deals specifically with the Arab countries in the above mentioned international context, we consider it essential to begin with an outline of the current international financial system so that we can later analyse the economic situation of the Arab countries with regard to this conditioning, with the aim of evaluating the impact of the World Trade Organisation on these countries.

Obviously, important aspects of the socio-economic reality of the Arab countries have been left out, including each one's specific nature, although we have made an effort to refer to characteristics and situations most interrelated with the central theme of our work.

## 1 — A brief description of the origins and chief characteristics of the current international financial system

At the end of the 2nd World War, and following the Bretton Woods agreements, an international monetary system (IMS) of adjustable fixed parities was established, whereby the dollar acted as the standard currency equivalent to gold, making it the international reserve currency. Within this system, trade partners of the United States sought to accumulate dollar reserves in order to guard against possible current account trade deficits. In turn, the US had to act as an international banker; namely, supplying the other countries with the dollars they needed to make international payments.

Thus, up to the end of the 1960s, as US showed a trade surplus, international liquidity was achieved essentially through foreign payments by the US Government and through the export of American capital. Despite some crises, the worst of which was perhaps De Gaulle's 1964 announcement that the dollar's parity against gold was overvalued, the system worked satisfactorily and was able to secure great stability in the exchange rates of convertible currencies. This stability was possible only because in the countries emitting these

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currencies there was low inflation and full employment, permitting central banks to successfully control international capital movements.

However, at the end of the 1960s and at the start of the 1970s, a series of events brought about the collapse of the system. The US current account went into deficit, pushing up the balance of payments deficit and prompting concerted speculation against the dollar. In 1971, to halt this speculation, President Nixon decided to end the dollar's gold convertibility, although the dollar's parity against gold would remain unchanged. Consequently, the IMS changed from a gold-standard to a currency-standard system in which the dollar was still the currency of international reserves, though now with the peculiarity of no longer being subject to any constraint except, of course, its credibility with international economic agents. But in reality the dollar's special statute was only possible thanks to the common political and economic interests of the US and its main allies, which led each country's central bank to take joint measures in defense of the dollar's parity whenever it was threatened by speculative attacks.

Meanwhile, with the end of the dollar's convertibility, the growing American deficit started being financed by the export of dollars. This approach paved the way for an uncontrolled rise in international liquidity, insofar as the export of dollars fuelled the development of the euro-dollar market, itself a driving force behind the growth in liquidity because it was not subject to any national or international constraints. Under these conditions, the intervention by central banks in defence of the dollar's parity was fruitless and to a certain extent fanned speculation against the dollar, as the speculators knew they could never lose.

The main inspiration behind the growth in the euro-dollar market were companies and multinational banks, who by their size and international links provided for a surge in financial activity and consequently an ever greater mobility of capital in international markets which acted beyond the control of the central banks and ended by completely deregulating the international finance system. This process speeded up when petro-dollars emerging from the first oil crisis in 1973 were recycled through the system.

Indeed, one of the petroleum-producing countries' chief ways of investing surplus financing was to deposit funds on more or less long-term in the so-called euro-banks — that is, the international commercial banks. In turn, these banks recycled the petro-dollars either by lending to countries experiencing difficulties in their current account trade balance or by taking part in speculative operations, since because of the world recession the amassed petro-dollars exceeded financing requirements. Consequently, the international commercial banks came to play a key role not only in setting interest rates but also in establishing exchange rates, since the free circulation of capital in the euro-dollar market increased the level of interdependence between the various national economies while at the same time sharply restricting the central banks' power for control. This development swiftly brought about the end of the IMS of fixed parities, giving way to the IMS of flexible parities, formalized at the 1976 IMF Conference in Jamaica, as well as strengthening the role of the dollar as the new IMS's basic currency.

Contrary to expectations, the system of flexible parities has displayed great volatility in exchange rates, making exchange rate risks a pivotal factor in the profitability of various bonds traded on the international financial market. Thus, investors' forecasts of exchange rate variations became a key factor in deciding whether to invest, both in terms of where and how.

The modern theory of foreign investment regards exchange rates as the price of an asset, with variations obeying the same market forces as any other asset, attributing profitability ratings (the currency's interest rate) to each currency, corresponding, by definition, to the earnings yielded by a one-year loan in that currency. Thus, for each currency the profitability rating is the result of the interest rate on deposits in that currency and of the reevaluation rate (appreciation or depreciation) of the currency which, under the current circumstances of free circulation of capital, depends on the forecasts of exchange market operators. Consequently, a currency's profitability rating is influenced by the country's place in international trade and by the currency's role in the IMS. In particular, this means that when a country's current account trade balance shows a consistent deficit, the authorities should change the currency's parity in order to head off the threat of operators deepening the imbalances through speculative attacks. The only case in which this theory does not hold water is that of the US, but this exception stems from the dollar's role in the IMS and the importance of the US on the international stage, in both political and economic spheres, which leads the US's creditors to be interested in financing its debt and also carry part of the costs of the dollar's overvaluation.

Nevertheless, this situation, which contributes to exchange market instability, has spurred the growth in the flux of international short-term capital in which currency operations play a major role. Thus, in 1987, international currency transactions reached a daily average value of 420 billion dollars of which 90 % were not involved in trade or foreign investment (Armstrong, Glyn and Harrison, p. 303). In 1989, average daily currency transactions reached 650 billion dollars, and in 1992 hit the astronomic value of 1 trillion dollars. Meanwhile, the total value of world trade, measured in annual terms, went from 3 trillion dollars in 1989 to 3.58 trillion dollars in 1991. As for the world direct foreign investment (DFI) stock, it stood at 1.7 trillion dollars at the end of 1991; that is, exactly the same value as for portfolio bonds traded internationally in 1990 (Harrison and MacDonald, pp. 1 to 3). From these examples, it is possible to draw four fundamental conclusions: 1st — through the 1980s, the flow of capital became the dominant factor in international economic relations; 2nd — this flow is spurred by the creation of excess international liquidity in relation to the requirements of trade in goods and services and of DFI; 3rd — this excess international liquidity is absorbed by the growing supply of the most diverse financial products which have become a new type of commodity; 4th — the surge in currency transactions, a result of the current characteristics of the IMS, incites exchange market instability, so that short-term transactions become more and more predominant in the international flow of capital. It should also be added that most transactions in the financial and exchange rate markets take place at five centres (London, New York, Tokyo, Frankfurt and Singapore), which operate almost uninterruptedly thanks to the technological revolution in the telecommunications sector.

In this context, multinational companies operate on the international market to take advantage of exchange rate fluctuations, regarding currency investments as alternative or complementary to investments in other bonds which conditions their investment decisions. On the other hand, to protect against exchange rate risks, the multinationals have developed a series of instruments to manage their currency positions. Some of these instruments are the inclusion of clauses on currency payments — selling in currencies which are gaining value and buying

in currencies which are losing value — swap operations, staggered currency contracts, or leads and lags in international payments. As a whole, all these practices are based on forecasts on alterations in exchange rates and are used as much in investments as in debt bond operations. Consequently, the sums involved in such operations are huge, exercising a decisive influence on the relationship between the supply and demand of currency on the exchange market, so that they are at the root of most speculative movements.

The financial sector's supremacy, in the circumstances described above, has hurt developing countries, first of all because of the drop in resources available for DFI, made worse by the fact that most DFI is invested in OECD countries. Thus, the percentage of DFI in developing countries went from 28 %, in the period 1970-1974, to 18.5 % in 1985-1987 (Kenwood and Lougheed, p. 252). The evolution has to do with the increased competition between multinationals for control of the markets with the greatest buying power, which has resulted in a movement towards the concentration of capital due to the rise in mergers and acquisitions between those countries' companies (*World Investment Report,* 1992, p.19). Also, bank loans to developing countries have dropped, especially since the foreign debt crisis erupted, although the total debt of developing countries has continued to grow, going from 160.5 to 539.6 thousand million dollars between 1975 and 1982, reaching 876.9 thousand million dollars in 1987 (Armstrong, Glyn and Harrison, p. 291).

On the other hand, the high interest rates in OECD countries have had a negative effect on the economies of developing countries in a variety of ways. The fall in the growth rates of OECD countries led to a fall in the exports of developing countries and, subsequently, to a drop in the price of commodities exported. Simultaneously, the interest rates offered to developing countries have been pushed up, reflecting not only the state of the international financial market but also the risk factor resulting from the debt crisis. Meanwhile, on the other hand, the rise in interest rates has drastically increased the burden of debt-servicing (chart 1.1), to which should be added the effect of the overvaluation of the dollar, in which the developing countries' foreign debts are usually calculated. Furthermore, the overvaluation of the dollar currency has also contributed towards a worsening of the trade terms available to developing countries, as it has inflated the price of most of those countries' imports.

CHART 1.1

**Debt and debt-servicing of developing countries (DC's): transfer of resources 1981-87**

**Unit: billion dollars**

| | New loans to DC's | DC's debt servicing | Net transfers |
|---|---|---|---|
| 1981 | 124 | 89 | 35 |
| 1982 | 114 | 99 | 18 |
| 1983 | 99 | 82 | 7 |
| 1984 | 92 | 100 | − 8 |
| 1985 | 89 | 110 | −21 |
| 1986 | 86 | 116 | −31 |
| 1987 | 90 | 119 | −29 |

**Source:** World Bank, *World Debt Tables 1989.*

The solvency difficulties faced by most developing countries have discouraged the international financial market from taking portfolio bonds issued by bodies in those countries. Thus, according to available estimates (*World Investment Report,* 1992, p. 64), during the 1980s only 6 % of total world portfolio investment was directed towards bonds issued by developing countries.

In some cases, to meet their debt-servicing burden, the developing countries have turned to the international market in short-term capital, with the drawback of interest on these loans being particularly high. Indeed, insolvency situations, the impossibility of direct convertibility of their currencies and the high risk of devaluation make developing countries unattractive to investors operating in those markets. This is one of the reasons why some developing countries, of which Brazil is a prime example, use extraordinarily high interest rates, in the short term, to assure a sufficiently attractive net profit for resident or other investors, because this policy also aims to halt the flow of capital abroad as well as stop residents investing in black market currency purchases. But the speculative nature of most portfolio investments, in the short term, associated with high interest rates, has also fuelled spiralling inflation.

## 2 — The international flow of capital and the Arab countries

Although the Arab countries share many values and socio-cultural characteristics, there are plenty of differences between them in various aspects of their economies, political organisation and even social structure. Thus, both international organisations and researchers interested in these countries usually group them together according to certain criteria.

In our case, given the main aim of this paper, we have chosen to group them into those which produce oil and natural gas, and those which do not. This choice is based on the importance of this production within a regional and worldwide framework, thereby allowing us to understand better the position of each country in international trade and, in particular, the role of each of them in the international financial system.

### 2.1 — The oil and natural gas-producing countries

Most of the Arab countries are petroleum producers, but between them we should distinguish which base their economic activity essentially on the energy products industry. Under this description come Algeria, Libya, Iraq and the Gulf Cooperation Council countries, with the exception of Barhrain.

The productive structure of these countries, arising from the fact that they possess large reserves of crude, which are generally associated with important natural gas reserves, is reflected in their export structure, as petroleum products represent, for all of them, more than 90 % of the total value of their exports. The result is that if, on the one hand, these countries can benefit from the so--called oil income, on the other hand it makes them heavily dependent on the international petroleum market or international pressures which affect the distribution of production, as is the case of Iraq after the Gulf War.

To better understand this problem, it is worth citing the main conclusions of a study we carried out into the foreign accounts of Saudi Arabia and which we presented at the symposium «Portugal/Gulf Cooperation Countries: Investments and Industrial Cooperation», organised by the Arab-Portuguese Chamber of Commerce and Industry, which took place in Lisbon in June 1992.

Indeed, based on data from the World Bank's «World Tables», we can see that the increase in the petroleum profit from 1973 to 1982, following the rise in crude prices, allowed Saudi Arabia to accumulate high financial surpluses. Although these surpluses made it possible to finance domestic investment in infrastructure and in developing manufacturing industry, most of it was invested abroad, so that Saudi Arabia became an important exporter of capital. Meanwhile, the high crude prices practised on the world market paved the way for increased prospection and exploration for oil in many other countries. This fact, allied to the drop in world demand for oil, thanks essentially to the introduction of alternative energy and the increased efficiency in the production of energy from oil, brought an overproduction crisis in crude which erupted with the world crisis of 1982. From then on, Saudi Arabia's petroleum profit plummetted drastically, plunging its current account into deficit. Consequently, Saudi Arabia was forced not only to slash its capital exports but also to take out loans on the international market. In an early phase the loans were taken out on a short-term basis, which could be regarded as the «repatriation» of Saudi capital invested in the international financial system. However, in 1989, Saudi Arabia took out a loan of 600 million dollars from a syndicate of international banks and took out another international loan of 4.5 billion dollars in 1991 (The Middle East and North Africa, 1994). Finally, acording to a study published by Editions EMAM, in 1990 Saudi Arabia had an external debt of 19 billion dollars, representing about 20 % of its GDP.

Of course, the other major oil-producing Arab countries face external debt problems similar to those of Saudi Arabia (chart 2), with the exception of Libya, according to available data.

CHART 2

**Indicators of the external debt of the major oil-producing Arab countries, in 1990**

| | External debt (in billions of dollars) | External debt (as % of GDP) |
|---|---|---|
| Algeria | 25 | 43.6 |
| Libya | 4 | 3.7 |
| Saudi Arabia | 19 | 20 |
| U. A. E. | 11 | 35.5 |
| Kuwait | 10 | 33 |
| Oman | 2.5 | 29.4 |

**Source:** EMAM and *L'État du Monde,* 1993.

Although the external debt of these countries is related to the drop in oil income and the rise in the Balance of Services deficit, which was not unrelated to the overvaluation of the dollar, there are some differences between them which it is worth stressing.

In the case of the Gulf Cooperation Council countries, along with the high remittances from immigrants and the considerable weight of foreign aid to developing countries, there were also a certain number of problems related to the policy of the Arab banks in the international financial market. Indeed, in the second half of the 1970s some Gulf countries began to set up banking institutions aimed essentially at financing investments and foreign trade operations, since as a matter of principle these banks refused to carry out speculative kinds of operations and other financial operations in bonds in which the dividends might come from interest rates or other gains associated with exchange rate variations. This specific nature of the banks made it difficult to set up branches in western Europe and the US, because these countries made it a condition that for the branches of Arab banks to be granted the statute of commercial bank they must include bonds issued by the local governments in their net assets. Meanwhile, efforts by some western banks to attract potential clients of the Arab banks suggests that behind the institutional obstacles put up against the creation of branches of Arab banks in western Europe and the US, there was also concern about competition, as the Arab banks offered their clients more advantageous conditions. Despite these problems, the Arab banks succeeded in setting up branches in some western countries in the form of property finance and commercial trade corporations. However, the depression caused by the drop in oil income put many of these banks' clients into difficult situations, increasing bad debts and even causing some bankruptcies, with disastrous effects on the services and capital accounts of the Gulf Cooperation Council countries. At the same time, the changes taking place in the 1980s in the international financial system, briefly described above and which led to a surge in trade in financial services and, in particular, in speculative kinds of operations, also had a negative effect on the Arab banks, insofar as they remained aloof from the dominant trends in the international capital market because they regarded them as going against the principles of Islamic ethics.

As for Algeria, its external debt has its root in the taking out of high loans on the international market during the 1970s to finance economic development and, in particular, natural gas exploration. This policy prompted rapid economic growth, but at the same time caused a worsening of the defict in the services balance due to the external debt responsibilities. The dividends from oil revenue allowed for a break in the deepening debt process between 1980 and 1983, but the erosion of oil revenue forced Algeria to have to fall back once more on the international financial market, from 1983 onwards, although its external accounts still showed fairly comfortable results insofar as the high trade surplus made it possible to pay off the debts. Meanwhile, the collapse of energy prices, from 1986 onwards, caused a sudden worsening of the current account, forcing the Algerian state to increase its external debt within a very difficult international context for obtaining loans from consortiums of multinational banks, due to the pressure from the US and IMF which were more interested in channelling the flow of financing towards Latin America and some southeast Asia countries. As an alternative, Algeria turned to look for financial resources from some EU countries which have granted it some loans, although lower than requirements, which has led to a rise in the net transfer abroad of Algerian financial resources (chart 3). It should also be noted that the frequent inclusion of clauses imposing conditions on the deployment of these loans has been a disruptive influence on

the sector-by-sector allocation of the resources, with sometimes negative implications for the external accounts. Consequently, Algeria was forced to pursue a policy of restraint in investments and public spending, which has had high social costs.

Aware of the impact of the situation in the world market for energy products on their respective economies, the major oil and natural gas-producing Arab countries have sought to reduce this kind of dependence by encouraging the diversification of their productive structure. Thus, apart from the development of banking and financial services carried out by the Gulf Cooperation Council countries, they all encouraged the development of manufacturing industry and, in some cases, a rise in agricultural output. However, these efforts have not yet shown significant results, for two reasons. As far as industrial production is concerned, the problem lies in the fact that these countries adopted the same model; that is, creating an industry based on the production of petroleum products, with the petro-chemical industry being an example. Consequently, although at first sight this seems to be a perfectly logical choice, these countries became competitors between themselves in a world market already saturated with these kinds of products. As for the rise in agricultural output, it has not kept up with the demographic growth, leading to an increase in food shortfalls (chart 4).

Of course, the need to diversify productive structure is much more acute in the other oil-producing Arab countries, either because oil reserves are nearing exhaustion, or because prospecting and exploring for new reserves relies heavily on foreign investment, or even due to the fact that the high domestic consumption of energy products places severe restrictions on the capacity for exporting such products. This situation is reflected in the sector-by-sector composition of GDP (chart 5), as it can be noted that the greatest contribution to GDP is made by the services sector, although this fact does not have the same economic significance for all the countries.

CHART 3

**Net transfers of international financial resources to the Arab countries, in millions of dollars**

| | Including government grants | | Without government grants | |
|---|---|---|---|---|
| | 1980 | 1992 | 1980 | 1992 |
| Algeria | – 830 | – 1959 | – 907 | – 2059 |
| Egypt | 2813 | 2092 | 2648 | – 408 |
| Jordan | 1348 | 364 | 221 | – 233 |
| Mauritania | 161 | 175 | 100 | 46 |
| Morocco | 685 | 655 | 610 | 55 |
| Oman | – 156 | – 603 | – 313 | – 618 |
| Syria | 2497 | 113 | 846 | – 217 |
| Somalia | 379 | 183 | 105 | 3 |
| Sudan | 997 | 653 | 609 | 80 |
| Tunisia | 232 | 341 | 206 | 204 |
| Yemen | 934 | 336 | 556 | 186 |

**Source:** World Bank, *World Development Report 1994.*

Bahrain, the first Gulf country to become an oil producer (1932), is currently facing the prospect of exhausted oil and natural gas reserves early in the 21st century. This situation led Bahrain to adopt a policy of economic diversification, financing the development of manufacturing industry and the service sector with oil income from the 1970s. In services, apart from port activities, there was strong growth in the banking and financial sectors, including the setting up of offshore banking enterprises, making Bahrain an important international financial centre. But, from 1983 on, Bahrain's banking and financial sector began to feel the effects of the erosion in energy prices, coupled later with the effect of stronger competition from the banks of other Gulf countries. This situation worsened with the collapse of energy prices and the evolution of the international financial system, described above, which led to a concentration of financial operations in the London, New York, Tokyo, Frankfurt and Singapore markets. In consequence, Bahrain was faced with the emergence of high budget deficits which forced the government to take out international loans that are at the root of Bahrain's recent external debt (chart 6).

CHART 4

**Food shortfall (*) in the Arab countries**

| | 1969-1971 | 1988-1990 |
|---|---|---|
| Saudi Arabia | 57.3 | 72.4 |
| Algeria | 34.2 | 76.8 |
| Djibouti | 90.9 | 87.7 |
| Egypt | 19.8 | 42.6 |
| U. A. E. | 93.2 | 136.5 |
| Iraq | 30.7 | 64.5 |
| Jordan | 61.0 | 87.2 |
| Kuwait | 110.6 | 97.3 |
| Lebanon | 80.7 | 74.9 |
| Libya | 69.1 | 77.9 |
| Morocco | 18.1 | 21.1 |
| Mauritania | 33.4 | 59.4 |
| Syria | 31.8 | 31.7 |
| Somalia | 12.7 | 17.0 |
| Sudan | 9.5 | 14.8 |
| Tunisia | 38.8 | 59.9 |
| Yemen | 29.4 | 66.0 |

(*) Proportion of imported food to food supply available for internal distribution.

**Source:** PNUB, *Human Development Report* 1994.

Of this group of countries, Egypt is the largest oil producer, with daily production almost equal to that of Kuwait in 1990 and 1992 (The Middle East and North Africa, 1994). But the high and growing domestic consumption of oil means that only a quarter of production is exported, contributing towards the increase in Egypt's trade deficit. To offset this problem, Egypt has committed itself to

encouraging the prospection for new reserves and the exploitation of natural gas deposits, seeking to attract foreign capital, namely by establishing exploration contracts with foreign oil companies. At the same time, along with its manufacturing industry, Egypt has developed its service sector, which enabled it to balance its services account at the end of the 1980s. In 1991, according to available data, the service account even showed a surplus that overtook the value of remittances from emigrants (chart 7). In services, apart from transit trade, the importance of tourism should be noted, revenue from which was estimated at 11.6 % of GDP, overtaking the 11.2 % in remittances from emigrants. Finally, it should be noted that, although the food shortfall has increased in Egypt (chart 4), there has also been a rise in agricultural production, mainly export produce in which cotton stands out.

CHART 5

**Sector-by-sector composition of GDP in small and medium-sized Arab oil-producing countries, 1992 (%)**

| | Agriculture (1) | Industry (2) | Services |
|---|---|---|---|
| Bahrain (3) | 1 | 39 | 60 |
| Egypt | 18 | 30 | 52 |
| Syria | 30 | 23 | 48 |
| Tunisia | 18 | 31 | 51 |
| Yemen | 21 | 24 | 55 |

(1) Includes agriculture, fisheries and forestry.
(2) Includes mining, manufacturing and civil construction.
(3) Figures for 1990, EMAM 1992.

**Source:** World Bank, *World Development Report* 199.

Syria and Yemen also have the potential to increase the production of energy products, but, as with Egypt, this increase depends on the strategy adopted by foreign capital regarding the energy sector, with the particularity that in the case of these two countries the strategy is subject to the influence of the level of security, given the war situations in which they have been involved, although, especially in the case of Syria, these situations appear to be on the way to being resolved. Another problem facing these countries is their extremely high external debt (chart 6), largely because of exactly those war situations, either due to the direct cost of arms purchases and other military spending (chart 8), or due to the indirect costs linked to the destruction of infrastructure or economic retaliation measures. This latter type of cost affected especially the flow of oil through pipelines crossing Syria, depriving it of important royalty profits and also having a negative effect on port activities and refining. These difficulties led to a drop in the importance of the services sector in GDP, bringing a respective rise in the percentage contribution of agriculture (chart 9), since al-

though Syria has been the only Arab country not to have seen its food dependence increase (chart 4), the level of growth of agricultural production does not justify the changes which have taken place in the sector-by-sector make-up of GDP.

CHART 6

**External debt indicators of the small and medium-sized oil-producing Arab countries, 1992**

| | Total (1) external debt | | 1992 external debt | |
|---|---|---|---|---|
| | 1980 | 1992 | (%) of GDP | (%) exp. |
| Bahrain (2) | – | 1.8 | 48 | 51 |
| Egypt | 21 | 40 | 67.7 | 147.8 |
| Syria | 3.5 | 16.5 | 96 | 255.3 |
| Tunisia | 3.5 | 8.5 | 49.6 | 112.2 |
| Yemen | 1.7 | 6.6 | 71 | 329.8 |

(1) In billions of dollars.
(2) Figures referring to 1991, according to *L'État du Monde,* 1993.

**Source:** World Bank, *World Development Report 1994.*

Contrary to Syria, in the case of Yemen the importance of the agricultural sector's contribution to GDP has fallen (chart 9). This evolution reflects, on the one hand, the development of oil exploration during the 1980s, but, on the other, results from a drop in fisheries and agricultural production, which led to the increase in food dependence (chart 4) and the current account trade deficit. This is the chief reason for the increase in the contribution of the services sector to GDP, since this sector has not shown any development worth noting. Thus, despite the growth in energy production, Yemen still shows a high deficit in its trade and services account, remaining heavily dependent on emigrant remittances, foreign aid and other foreign capital (chart 3).

CHART 7

**The evolution of Egypt's current account balance**

Unit: billions of dollars

| | 1980 | 1985 | 1988 | 1991 |
|---|---|---|---|---|
| Trade balance | –3.9 | –5.5 | –6.3 | –10.5 |
| Services balance | –0.3 | –2.7 | 0 | 5.1 |
| Emigrant remittances | 2.7 | 3.5 | 3.4 | 3.0 |
| Current account balance (1) | –1.5 | –4.7 | –2.8 | – 2.4 |

(1) Current account balance before official transfers.

**Source:** *World Bank Tables 1989-1990* and *World Development Report 1994.*

In this group of countries, excepting Bahrein, Tunisia is the least endebted and the least dependent on the export of energy products, whose value has been falling since 1984 due to the erosion of oil prices but also due to the exhaustion of reserves. Faced with this problem, to which was added the fall in world prices of phosphates (Tunisia is the fifth-largest producer of phosphates), Tunisia has sought to develop manufacturing industry and tourism, namely by seeking to attract foreign investors. Thus, from 1970 on, Tunisia began to pursue an extremely liberal policy with regard to foreign capital, through the creation of tax-free areas and granting tax exemptions to joint-venture companies. Most of the foreign companies are German, French, Belgian and Dutch, and they operate mainly in the textiles sector (65 %), but there is also foreign capital in the electronics, metalwork, electrical goods and chemical products sectors. This industrialisation policy led to a change in the import structure, increasing the weight of the value of equipment and contributing towards worsening the terms of trade. Under these conditions, Tunisia's trade deficit has worsened, with disastrous effects on its current account balance, despite the growing importance of revenue from tourism and emigrant remittances. Another fact which undermines the performance of Tunisia's external account is the high debt servicing charges (chart 10), despite the fact that 82 % of Tunisia's external debt bonds are held by public bodies which have granted special payment conditions.

CHART 8

**The weight of military spending in Arab countries**

| | As % of GDP | | In total (%) import (1990-1991) |
|---|---|---|---|
| | 1960 | 1990-1991 | |
| Iraq | 8.7 | 20.0 | 47.8 |
| Syria | 7.9 | 16.8 | 28.7 (1990) |
| Oman | – | 15.8 | 4.6 |
| Yemen | – | 14.4 | n/a |
| Saudi Arabia | 5.7 | 14.0 | 6.8 |
| Jordan | 16.7 | 10.9 | 4.6 |
| Libya | 1.2 | 8.6 | 5.5 |
| Kuwait | – | 6.5 | 4.6 |
| U. A. E. | – | 4.8 | 3.0 |
| Bahrain | – | 4.7 | 3.6 |
| Egypt | 5.5 | 4.6 | 10.6 |
| Morocco | 2.0 | 4.5 | 1.6 |
| Lebanon | – | 3.5 | 0.5 |
| Tunisia | 2.2 | 3.2 | 0.2 |
| Somalia | – | 3.0 | n/a |
| Sudan | 1.5 | 2.0 | 1.4 |
| Algeria | 2.1 | 1.7 | 2.1 |

**Source:** PNUD, *World Development Report 1993-1994.*

CHART 9

**The evolution of the sector-by-sector structure of GDP in Syria and Yemen**

| | Agriculture | | Industry | | Services | |
|---|---|---|---|---|---|---|
| | Syria | Yemen | Syria | Yemen | Syria | Yemen |
| 1970 | 20 | 39 | 26 | 1 | 54 | 60 |
| 1975 | 17 | 37 | 29 | 8 | 54 | 55 |
| 1980 | 20 | 21 | 23 | 14 | 57 | 65 |
| 1985 | 18 | 19 | 23 | 17 | 59 | 64 |
| 1992 | 30 | 21 | 23 | 24 | 48 | 65 |

**Source:** World Bank, *World Tables 1989-1990,* and *World Development Report 1994.*

CHART 10

**Ratio of external debt servicing of the Arab countries (debt servicing as % of exports of goods and services)**

| | 1970 | 1980 | 1989 | 1990 | 1991 | 1992 |
|---|---|---|---|---|---|---|
| Algeria | 4.0 | 27.4 | 68.9 | 59.4 | 73.7 | 71.3 |
| Morocco | 8.7 | 32.7 | 32.2 | 23.4 | 27.9 | 23.6 |
| Tunisia | 19.7 | 14.8 | 22.6 | 25.8 | 22.7 | 20.6 |
| Jordan | 3.6 | 8.4 | 19.6 | 23.0 | 20.9 | 20.0 |
| Syria | 11.3 | 11.4 | n/a | 26.9 | n/a | 18.2 |
| Mauritania | 3.4 | 17.3 | 20.1 | 13.9 | 16.8 | 17.2 |
| Egypt | 38.0 | 14.7 | 20.5 | 25.7 | 16.7 | 15.5 |
| Somalia | 2.1 | 4.9 | 34.1 | 11.7 | n/a | n/a |
| Oman | – | 6.4 | n/a | 13.0 | n/a | 9.0 |
| Yemen | – | – | 11.6 | 5.4 | 7.3 | 7.0 |
| Sudan | 10.6 | 25.5 | 9.2 | 5.8 | – | 5.4 |

**Source:** Figures from 1980 and 1992, World Bank, *World Development Report 1994*, other years, PNUD, *Human Development Report 1992-1993-1994.*

**2.2 — The non-oil and natural gas producing countries**

Some of these countries are currently going through periods of great politico-institutional instability, and sometimes war, which makes the study of economic aspects closely related to the topic of this paper difficult, not least because of the almost complete absence of up-to-date statistical information. Somalia, Sudan, Lebanon and Eritreia are all in this position, although the absence of information about the latter country results from the fact that it only achieved independence in 1993. As far as Djibouti is concerned, although it has been independent since 1977 and has not been directly affected by situations of instability of war, the information available is extremely limited. Despite these difficulties, we believe we can say that the fundamental characteristic of these

countries is their great dependence on foreign aid, which is clear from the high foreign debt (chart 11) and the high current deficit in its external accounts (chart 12), and is a characteristic which would certainly be worse if it were possible to take into account the Occupied Territories.

CHART 11

**Indicators of the external debt of the non-oil producing Arab countries**

| | Total (1) external debt | | 1992 external debt | |
|---|---|---|---|---|
| | 1980 | 1992 | (%) of GDP | (%) Exp. |
| Djibouti (2) | n/a | 0.2 | 41.4 | 730 |
| Lebanon (2) | n/a | 0.9 | 47.0 | 61 |
| Somalia | 0.6 | 2.4 | (3) 277 | (2) 2295.4 |
| Sudan | 5.2 | 16.2 | (4) 164 | 2961.8 |
| Jordan | 2.0 | 7.9 | 163.2 | 203.1 |
| Mauritania | 0.8 | 2.3 | 158.4 | 342.9 |
| Morocco | 9.7 | 21.5 | 71.2 | 222.1 |

(1) In billions of dollars.
(2) 1989.
(3) 1991.
(4) 1990.

**Sources:** PNUD, *World Report on Human Development 1992-1993-1994;* World Bank, *World Development Report 1994; Guide to the Third World 1993.*

Looking at the indicators in charts 11 and 12 reveals that both Somalia and Sudan are in a particularly difficult situation. Under these conditions, the indicators on debt servicing (chart 10) can only mean that Somalia and Sudan are not able to pay off the total servicing of their debt (interest and repayments), or that their creditors have granted them special payment conditions.

CHART 12

**Current account balance (CAB), international net reserves and coverage of imports in non-oil producing Arab countries in 1989-1992**

| | Millions of dollars | | Coverage of imports | |
|---|---|---|---|---|
| | CAB | Reserves | Reserves (months) | Exp. (%) |
| Djibouti (1) | n/a | n/a | n/a | 11.4 |
| Lebanon (2) | n/a | n/a | n/a | 30 |
| Somalia | – 346 | – | 0.5 | 22 |
| Sudan (4) | –1446 | 24 | 0.3 | 23 |

| | Millions of dollars | | Coverage of imports | |
|---|---|---|---|---|
| | CAB | Reserves | Reserves (months) | Exp. (%) |
| Jordan (4) | – 741 | 1030 | 2.6 | 35 |
| Morocco (4) | – 427 | 3819 | 4.8 | 62 |
| Mauritania | – 105 | 65 | 1.1 | 93 |

(1) 1990-1991.
(2) 1989.
(3) 1990.
(4) 1992.

**Sources:** PNUD, *World Report on Human Development 1992-1993-1994;* World Bank, *World Development Report 1994; Guide to the Third World 1993.*

The problem of dependency with regard to foreign aid becomes even clearer when we compare the data on public aid for development and DFI, in terms of GDP, or the percentage of that aid relative to the total value of net transfers of international financial resources to those countries (chart 13). In the case of this last indicator, we should call attention to the large increase in that percentage, from 1980 to 1992, with the added negative factor that net transfers of international financial resources to those countries have dropped sharply. As far as Djibouti and Lebanon are concerned, the only data available refers to the value of public aid for development per habitant, which stood at 250 and 28 dollars, respectively, in 1992, according to the PNUD. Thus, in terms of this indicator, Lebanon received slightly more foreign aid than Sudan (23 dollars per habitant), with Djibouti being the most favoured country (the second most favoured being Mauritania with 98 dollars per habitant).

The rest of the non-oil producing Arab countries also saw rise the importance of foreign aid for development in the total value of net transfers of international financial resources, although these transfers only showed a steep drop in the case of Jordan. On the other hand, these countries, with the exception of Mauritania, benefit from high emigrant remittances, whose contribution towards GNP has been rising, even overtaking the contribution made by foreign aid in the case of Morocco (chart 14). Despite this, Morocco still shows a current account deficit resulting from the structural deficit in its trade balance and from the onus of external debt servicing (chart 10), since revenue from tourism allows for a services account — not including payments to factor services — in surplus (chart 15). Consequently, Morocco still requires foreign capital, as do Jordan (chart 16) and Mauritania. Nevertheless, this need can be traced back to the problem of the external debt, since given the degree of endebtedness of these countries, not only has the influx of foreign private capital been curtailed, but also the onus of debt servicing has contributed towards a reduction in the transfer of international financial resources they get, with the added negative factor that a part, or even all, public aid for development is soaked up by debt servicing (charts 10 and 13).

CHART 13

**The importance of foreign development aid (FDA) for the non-oil producing Arab countries**

| | FDA/net transfers (%) | | FDA/GNP (%) 1992 | FDI/GDP (%) 1992 | Growth rate net transfers (%) 1992 |
|---|---|---|---|---|---|
| | 1980 | 1992 | | | |
| Somalia | 72 | 98 | (1) 31.3 | 0.3 | –52 |
| Sudan | 39 | 87 | 6.0 | 0 | –34.5 |
| Jordan | 84 | 163.5 | 8.4 | 1 | –73 |
| Morocco | 11 | 91.6 | 3.7 | 1.5 | – 4.4 |
| Mauritania | 38 | 74 | 19.2 | 0.2 | 8.7 |

(1) 1991.

**Source:** World Bank, *World Development Report 1994;* PNUD, *Report on Human Development 1994.*

CHART 14

**Public development aid and emigrant remittances in Arab countries, measured as a percentage of GNP (1989-92)**

| | Public development aid | | | Emigrant remittances | | |
|---|---|---|---|---|---|---|
| | 1990 | 1991 | 1992 | 1989 | 1990 | 1991 |
| Jordan | 16.7 | 17.1 | 8.4 | 10.6 | 12.7 | 9.9 |
| Morocco | 4.4 | 5.1 | 3.7 | 6.0 | 8.4 | 7.3 |
| Mauritania | 21.7 | 20.8 | 19.2 | n/s | n/s | n/s |
| Algeria | 0.4 | 0.7 | 0.8 | 0.7 | 0.6 | 0.5 |
| Egypt | 17.2 | 14.8 | 10.6 | 13.1 | 11.9 | 11.2 |
| Syria | 5.2 | 1.8 | 1.1 | 1.8 | 3.0 | 2.4 |
| Tunisia | 3.1 | 2.7 | 3.2 | 4.8 | 5.1 | 4.5 |
| Yemen | 5.4 | n/a | 4.0 | 2.6 | n/a | 12.2 |

**Source:** PNUD, *World Report on Human Development 1992-1993-1994.*

CHART 15

**Morocco's Balance of Payments (millions of dollars)**

| | 1989 | 1990 | 1991 |
|---|---|---|---|
| Merchandise exports | 3,312 | 4,210 | 4,277 |
| Merchandise imports | –4,992 | –6,282 | –6,253 |
| Trade balance | –1,679 | –2,071 | –1,976 |

| | 1989 | 1990 | 1991 |
|---|---|---|---|
| Exports of services | 1,659 | 2,024 | 1,771 |
| Imports of services | –1,190 | –1,441 | –1,313 |
| Other income received | 41 | 87 | 203 |
| Other income paid | –1,241 | –1,130 | –1,375 |
| Private unrequited transfers (net) | 1,356 | 2,012 | 2,013 |
| Official unrequited transfers (net) | 265 | 320 | 280 |
| Current balance | – 790 | – 200 | – 396 |
| Direct investment (net) | 167 | 165 | 320 |
| Other capital (net) | 644 | 1,760 | 1,137 |
| Overall balance | 9 | 1,734 | 1,149 |

**Source:** IMF, *International Financial Statistics.*

CHART 16

**Jordan's Balance of Payments (millions of dollars)**

| | 1990 | 1991 | 1992 |
|---|---|---|---|
| Merchandise exports | 1,063.8 | 1,129.5 | 1,218.9 |
| Merchandise imports | –2,300.7 | –2,302.2 | –2,998.7 |
| Trade balance | –1,236.9 | –1,172.7 | –1,779.8 |
| Exports of services | 1,447.2 | 1,351.2 | 1,449.2 |
| Imports of services | –1,267.9 | –1,122.5 | –1,324.7 |
| Other income received | 67.3 | 144.3 | 112.4 |
| Other income paid | – 281.8 | – 447.7 | – 390.0 |
| Private unrequited transfers (net) | 457.4 | 408.1 | 781.3 |
| Official unrequited transfers (net) | 587.6 | 475.7 | 386.3 |
| Current balance | – 227.1 | – 393.5 | – 765.2 |
| Direct investment (net) | 69.1 | – 25.6 | 44.1 |
| Other capital (net) | 503.6 | 2,122.9 | 951.6 |
| Overall balance | 421.0 | 2,025.2 | 392.0 |

**Source:** IMF, *International Financial Statistics.*

**2.3 — Main conclusions**

Although the financial capital held by the Arab banks is without doubt underestimated, on the level of the international financial system, as long as the working rules of the main Arab banks do not fit in with the capitalist thinking of the market, the available indicators on the external accounts of the Arab countries lead us to conclude that, as a whole, these countries went from a situation in which they exported financial surplus, during the 1970s, to a current situation of external endebtedness, in which some are net importers of capital but others are net exporters, mainly due to the high sums involved in debt servicing.

This evolution has diverse and complex causes, some of which have been noted in previous pages, but the main one, as we see it, has to do with the erosion and then collapse of the world prices for raw materials, in which the Arab countries are rich, with an accent on energy products. Indeed, the fall in prices for these products brought about a drop in the terms-of-trade of the producing countries and the drop in export revenue, forcing some countries to fall back on foreign financing. In the case of other producing countries, which had already gone into foreign debt, the drop in oil revenue prompted an increase in the onus of debt servicing, forcing them to seek new international loans, on less advantageous terms. Finally, the other Arab countries also became more dependent on the international capital market, insofar as they came to receive lower financial resources from the main oil producers.

We could add further that, in this context, the efforts to diversify exports made by the oil countries increased their international financing requirements for new investments, at the same time contributing to a deepening of the external deficit due to the increase in imports of goods and services. As for the rest of the Arab countries, efforts to increase exports have contributed towards the fall in prices of the products exported (above all in raw materials), and in the case of agricultural products have contributed towards a widening of the food shortfall, insofar as the production of products for export has been given priority.

### 3 — The «new» GATT and the Arab countries

Under the terms of the GATT Agreement signed on April 15 1994, in Marrakesh, the World Trade Organisation (WTO) will come fully into force only in 2005, with variable transition periods for different types of goods. In several articles, the Agreement acknowledges that the economic situation of the developing countries prevents measures on the opening-up of markets applied to industrialised countries from being imposed. But, in compensation, the developing countries undertook to award special rates or grant concessions, within the spirit of the Agreement, which shall be negotiated case-by-case. Thus, in principle, the developing countries will benefit from more open markets in the industrialised countries, while still being able to apply customs charges to imports, award export grants and take other measures to safeguard the equilibrium of their Balance of Payments, if the WTO General Council agrees. It should, however, be noted that under certain conditions the industrialised countries may also apply these safeguard measures.

Taking into account the principles just mentioned, evaluating the impact of the liberalisation of the trade in goods on the economies of developing countries has to begin with an analysis of the composition structure of these countries' exports and the relative importance of the industrialised countries as buyers of the exports of developing countries. This information, as far as the Arab countries are concerned, is compiled in charts 17 and 18.

CHART 17

**Composition structure (%) of the Arab countries' exports**

| | 1970 | 1992 |
|---|---|---|
| Oil, minerals and metals | 74 | 85 |
| Agricultural products | 18 | 5 |
| Manufactured products | 8 | 10 |
| Of which textiles | 3 | 4 |

**Source:** World Bank, *World Development Report 1994.*

Thus, according to the data in charts 17 and 18, the Arab countries are essentially exporters of raw materials and their main customers are in general the so-called developed capitalist countries, especially the European Union. Within this context, we can say that the direct impact of the liberalisation of trade in goods on the Arab countries will be very small, as most of the developed capitalist countries, such as the European Union, have not for a long time levied customs charges on imports of the type of raw materials exported by the Arab countries, whether it be crude oil, natural gas, phosphates or iron minerals. There may, however, be an indirect impact, through the increase in world demand for raw materials brought about by the effect of the World Trade Organisation on the growth of the economies of industrialised nations, although technological developments and the adoption of environmental protection policies may cancel out this impact.

On the other hand, despite their relatively small weight in the composition structure of Arab countries' exports, we should point out the problem of agricultural products and textiles, seeing as they represent important products in the export strategy of some Arab countries, such as Morocco, Egypt, Jordan or Tunisia.

CHART 18

**The importance of developed capitalist countries (DCC), including the European Union (EU), as buyers of Arab countries' exports**

(Percentage of the total value of Arab countries' exports, according to destination, 1990)

| | DCC | EU |
|---|---|---|
| Saudi Arabia | 65 | 21 |
| U. A. E. | 75 | 8 |
| Kuwait | 63 | 27 |
| Oman | 46 | n/a |
| Qatar | 65 | n/a |
| Algeria | 84 | 63 |
| Libya | 86 | 86 |

| | DCC | EU |
|---|---|---|
| Bahrain | 52 | 8 |
| Egypt | 65 | 54 |
| Syria | 40 | 37 |
| Tunisia | 79 | 77 |
| Yemen | 88 | 41 |
| Djibouti | 9 | n/a |
| Jordan | 6.5 | n/a |
| Lebanon | 40 | n/a |
| Morocco | 83 | 68 |
| Mauritania | 78 | n/a |
| Somalia | 43 | n/a |
| Sudan | 44 | 35 |

**Source:** *L'État du Monde,* 1993; *The Middle East and North Africa,* 1994.

As far as the Agreement on Textiles and Clothing is concerned, a transition period of 10 years, from when the World Trade Organisation comes into force, has been laid down. The transitory period embraces four stages of progressive dismantling of customs barriers, while keeping in place certain rulings in the Multifibre Agreement, in particular those which allow participating countries to take selective measures against the importation of textiles that may upset markets (that is, cause a serious loss or present a real threat of a serious loss to national producers). In this context, the application of safeguards, namely those against dumping, is foreseen. Obviously, this is one of the aspects which could impede textile exports from developing countries, as the Agreement regards low salaries and inadequate labour protection as social-dumping practises.

In reality, the Agreement implicitly recognises that anti-dumping safeguards may hurt the developing countries, since it asks the developed countries to take into consideration the difficulties of developing countries whenever they decide to have recourse to those safeguards. However, in this area there is still a certain contradiction between the rulings in the Agreement and the guidelines the IMF conveys to the developing countries regarding the adoption of policies aimed at creating a foreign trade surplus and fighting inflation.

The Agreement on Agriculture was the hardest to negotiate due to the opposing interests of the US and EU, so that the Agreement reflects above all the compromise solutions reached by the two sides. The central question underlying the negotiations lies in the differences between the agricultural policies of the US and EU but which, in both cases, have led to huge surpluses. Consequently, finding an outlet for the surplus is a priority for these countries and here, in our opinion, lies the main problem that the developing countries will have to face up to, at the risk of seeing an increase in the breakup of the distribution channels of national agricultural output aimed at domestic consumption, which would worsen food dependency. On the contrary, agricultural output for export could be encouraged by the Agreement. However, the twofold nature of agriculture for export and for domestic consumption could, also, contribute

towards an increase in food dependency, insofar as the most fertile land is given priority for export. Some recent studies point towards this fact as one of the causes of the increase in the food dependency of some Arab countries.

As far as services are concerned, the Marrakesh Agreement was limited to rulings which guarantee the current situation of deregulation and liberalisation led by the developed capitalist countries. This is, then, an area in which from the outset the developing countries hold little sway. Nevertheless, in the specific case of financial services, some Arab countries, and especially the Gulf Cooperation Council countries, have a power of intervention which should be taken into consideration as long as the Islamic banks keep their vitality.

Finally, we cannot forget that the Agreement has a serious shortcoming as far as the problem of emigration is concerned, given its importance for the current account balance for some Arab countries. Indeed, the Marrakesh Agreement refers to professional services, for which a working group was set up, but the terms for a decision to be reached point towards only services with a high degree of specialisation being considered, leaving out the services provided by little-qualified workers. In this sense, and if the philosophy underlying the decision is not changed, an Agreement may be approaching which favours a brain-drain from developing countries.

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