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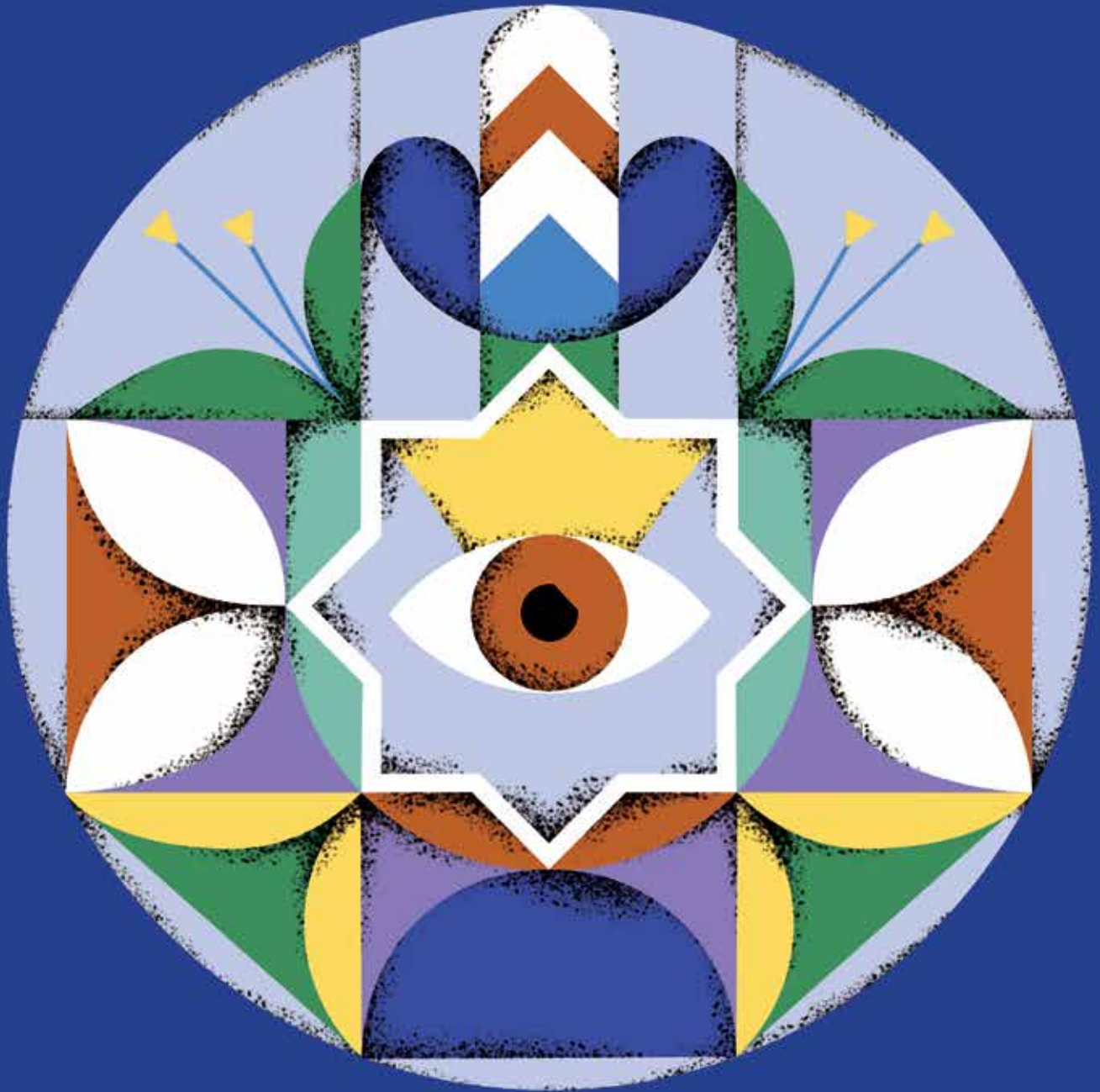
TRADE

*A Mercantile
Middle East*

GENDER

Breaking Barriers

SEPTEMBER 2023



TIME FOR TRANSFORMATION

The Middle East and North Africa



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Fall Featured Title



Over the past three decades, Morocco had a remarkable journey to economic stability and development. Still, Morocco's quest for strong, resilient, and inclusive growth is far from complete.

The chapters in this volume provide both a broad overview of Morocco's economic progress in the past few decades and its economic modernization agenda going forward.

"This book highlights the work done while recognizing the magnitude of the challenges that remain."

From the Foreword by
Aziz Akhannouch,
Head of Government, Kingdom
of Morocco



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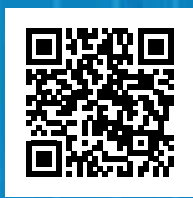
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Editor's Letter

The Arab World's Economic Destiny

FOR CENTURIES, ARAB NATIONS LED THE WORLD in the pursuit of knowledge and in scientific innovation and were among the most economically advanced places on Earth. Today, the Middle East and North Africa—nations with diverse political and economic landscapes—are at a crossroads.

Recent decades saw major changes, including the Arab Spring uprisings, and not enough change, particularly in transforming economies to fulfill citizens' demands for better lives. Several countries are mired in conflict. Debt levels in others are alarmingly high.

Stability and social cohesion are ultimately at stake. Youth unemployment in the region is among the highest in the world. More than 100 million hopeful young people will join the workforce over the next 10 years, all anxious to be included. Progress will be limited if women do not have opportunities to succeed. The economic challenge is not merely technical—it is profoundly political.

With economic leaders gathering soon in Marrakech, Morocco, for the IMF and World Bank Annual Meetings, this issue of F&D explores how the Arab world can tap growth opportunities and rebuild its economic standing.

"It's time to rethink the engines of economic growth," say the IMF's Jihad Azour and Taline Koranchelian. State-dominated activity will be hard to sustain. Some economies must secure durable and equitable growth while brightening youth job prospects and taking full advantage of the human capital women offer.

True transformation, Azour and Koranchelian say, requires a more transparent and accountable public sector, modernized economic institutions, greater private enterprise, and more responsiveness to the global energy transition. Other contributors advocate removing barriers to equality, challenging social norms, and confronting entrenched interests.

Modernizing banking and trade can play an important role. That requires lifting business and investment barriers, within the region and globally, write Nasser Saidi and Aathira Prasad. They show how the Gulf states—with their existing global links, increasingly diversified economies, and investment in trade infrastructure—can lead the way for the region.



"Though the region's challenges may be great, so are the potential and dynamism of its people and economic leaders."

Digital finance has great potential to drive financial inclusion and economic growth, says Amjad Ahmad. He lays out policy reforms to create a competitive banking sector and attract venture capital for fintech start-ups.

Clearly, global and regional forces are also at play. Changing US engagement, China's growing influence, and other regional political alignments represent a generational shift in geopolitics, writes Vali Nasr. This will, he reckons, unlock new possibilities for the region.

Elsewhere in this issue, Rania Al-Mashat calls for equitable access to climate financing. We feature three women entrepreneurs driving positive change in the region. And we profile Minouche Shafik, a leading economist whose career spans public policy and academia.

Though the region's challenges may be great, so are the potential and dynamism of its people and economic leaders. This is a historically critical time for bold action and creative thinking about the Arab world's future. And perhaps a chance to turn their legacy into their destiny.

As for the F&D team, we decided it was time for some boldness and creativity here in our own pages. With this issue, we present our redesign to enhance the reader's experience with clearer visual delineation of sections. I hope this creates a stronger and more recognizable brand for F&D as we continue to communicate thought leadership through each issue.

Thank you, as ever, for reading. **F&D**

Gita Bhatt, editor-in-chief

Kaleidoscope

A global view, in brief



THE BIG PICTURE: After 20 years, the IMF-World Bank Annual Meetings are returning to the Arab world. They will be held in October 2023 in Marrakech, Morocco—a country that bridges Africa, the Middle East and Europe. The region's growth opportunity lies in its demographic dividend, young population, digitalization, and tech innovations. Above, youth play soccer in the streets of Rabat. IMF Photo/Jake Lyell.

The Price of Fragmentation

IN AN ARTICLE IN *Foreign Affairs*, IMF Managing Director Kristalina Georgieva issues a stark warning about the decline of international cooperation. A series of shocks have exposed the fragility of the global economy. Yet, at a time when cooperation is critical, the world is witnessing increasing fragmentation, which could end with nations breaking into rival economic blocs. In a shock-prone world, economies

need to become more resilient—individually and collectively. The international community should pursue targeted progress where common ground exists and maintain collaboration in areas where inaction would be devastating. It will be crucial to shore up the global financial safety net and ensure international institutions such as the IMF are adequately resourced.

“Policymakers need to focus on the issues that matter most not only to the wealth of nations but also to the economic well-being of ordinary people,” writes Georgieva. “They must nurture the bonds of trust among countries wherever possible so they can quickly step up cooperation when the next major shock comes.”

“

Protectionism and decoupling come at a cost.”

—Kristalina Georgieva,
Foreign Affairs
September/October 2023



Overheard



“While low inflation may seem elusive, it is certainly no stranger, and central bank actions can deliver it. Unlike the characters in *Godot*, we are not waiting for a potential stranger to arrive; we are inviting an old friend to return.”

—IMF First Deputy Managing Director Gita Gopinath at the European Central Bank Forum on Central Banking 2023.



“International financial institutions must be the world’s apolitical institutional memory. They must keep reminding the global community of unresolved challenges before shifting resources to the crisis du jour. The international community should not abandon the Syrian refugees residing in Jordan just because headlines turn attention elsewhere.”

—Mohamad Al-Ississ, finance minister of Jordan (page 12, this issue of F&D).

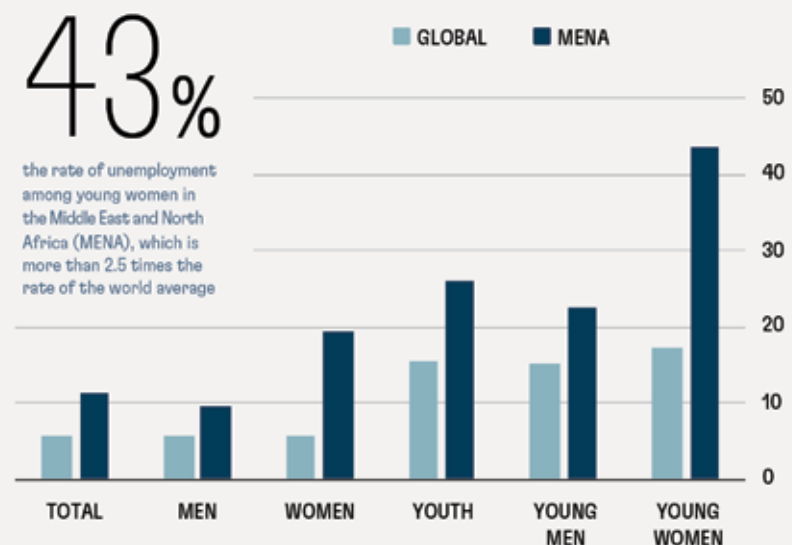


AROUND AND ABOUT: IMF Managing Director Kristalina Georgieva (at right) pays a visit to the Noor Ouarzazate Solar Power Plant in Ouarzazate, Morocco. The largest concentrated solar power farm in the world, the complex is the cornerstone of Morocco’s strategy to invest in renewable energy. Over 85 percent of the country’s electricity could be generated from renewable sources by 2050, according to the World Bank. IMF Photo/ Kim Haughton.



By the numbers

Youth unemployment, especially among women, is a long-standing and urgent challenge in the Middle East and North Africa. (unemployment rates, percent)



SOURCE: World Bank, World Development Indicators 2022 (estimates modeled by ILO).
NOTE: MENA here includes low- and middle-income countries only. YOUTH = ages 15–24.

Back to Basics



Resilient Remittances

The money that migrant workers send home provides stable income to millions of people in developing economies

Dilip Ratha

REMITTANCES SENT HOME BY migrant workers provide vital income to millions of people in developing economies. A growing income gap between richer and poorer nations, demographic pressures, and changes to the planet itself will add to the number of people who migrate in search of economic opportunity. This will, in turn, fuel the flow of remittances for decades to come.

According to official statistics, global remittances reached a record \$647 billion in 2022—three times official development assistance. In fact, remittances are worth more than that because many people send money through informal channels not captured by official statistics. Egypt's remittance receipts are greater than revenue from the Suez Canal; Sri Lanka's exceed tea exports; Morocco's are larger than tourism earnings.

India is the world's largest recipient. In 2022, it became the first country to receive more than \$100 billion

in annual remittances. Mexico, China, and the Philippines are also large recipients. For smaller countries or those caught up in conflict, these transfers are especially vital. Money from migrants is worth more than one-fifth of GDP in Tajikistan, Lebanon, Nepal, Honduras, The Gambia, and a dozen other countries.

Stable flows

At times of crisis, remittances provide a financial lifeline. Migrant workers usually increase the sums they send home in the aftermath of a natural disaster, say, so that stricken relatives can buy food or pay for shelter. Remittances are often stable even if the source country falls into crisis. During the early stages of COVID, in 2020, for instance, remittances fell by just 1.1 percent—in a year when global income shrank by 3 percent. Migrant workers played a pivotal role in the economy during the pandemic, both as highly skilled doctors and nurses and

as frontline delivery workers. The closure of money transfer operators during lockdowns disrupted remittance services, but people still sent money home through digital channels. Remittances recovered strongly and grew by almost 20 percent in 2021–22.

The United States is the largest source country for remittances, especially for Latin America and the Caribbean. Stricter border controls have trapped increasing numbers of migrants in transit countries, including in Mexico and Guatemala. A surprise result is an increase in remittance flows to transit countries as stranded migrants receive money from relatives. There's a similar story on Europe's borders, with more remittances going to trapped migrants in Morocco, Tunisia, and Türkiye for example. These flows are having a positive impact on host economies.

The Gulf Cooperation Council countries are the second-largest source of remittances in US dollar terms but by far the largest when remittances are measured as a share of their GDP. The proportion of foreign workers in the Gulf often exceeds 70 percent of the population. Saudi Arabia and the United Arab Emirates are large sources of remittances for South Asia, North Africa, and Southeast Asia. Yet growth in remittances from this region could shift. Governments in the Gulf are starting to recruit fewer foreign workers as part of a push to employ more locals and are diversifying recruitment of foreign workers, targeting those from Africa and Central Asia.

Russia is another large source of remittances. After the invasion of Ukraine in 2022, remittances to Central Asia rose sharply. This confounded expectations, especially after sanctions imposed via the SWIFT payment system. The rise stemmed from a spike in the price of oil—Russia’s principal export and the main driver of the ruble’s exchange rate. It meant that the value of ruble remittances was larger when expressed in dollars.

Expensive Africa

Sending money is often expensive. On average, customers must pay \$12.50 in costs whenever they send \$200 to a low- or middle-income country, according to World Bank data. That represents 6.3 percent of the transaction and is more than double the target set under the United Nations Sustainable Development Goals.

Africa is the most expensive place for money transfers, with remittance costs reaching 8 percent. More than two-thirds of cross-border migration in Africa takes place within the continent itself, and the flow of remittances between African countries is sizable. But the cost of multiple currency conversions, exchange controls, and a lack of interoperable payment systems all add to the expense of sending money.

Another factor that affects almost all countries is the partnership contracts between money transfer operators and national banks and post offices. It can, for instance, cost more than \$70 to send \$200 from Tanzania to Uganda—an eye-popping 35 percent of the transaction. Making it just 5 percentage points cheaper to send remittances would cut costs globally by nearly \$30 billion a year. Most of the savings would benefit poor migrants and their families in developing economies.

Digital wallets accessed via smartphones are the cheapest way to send money. Digital remittances have grown rapidly since the onset of COVID-19, but most remittance transfers still involve cash at one or both ends. The remittance market is notoriously oligopolistic—a cartel-like structure with a small number of providers exercising control through their own exclusive networks.

“Egypt’s remittance receipts are greater than revenue from the Suez Canal.”

Cumbersome regulations intended to combat money laundering and terrorism financing stifle competition. Every remittance transaction is treated with suspicion by the current rules-based approach to regulation. Many banks refuse to provide correspondent banking services to money transmitters, especially fintech start-ups, because they fear falling foul of the regulations. These “de-risking” practices have led banks to close the accounts of many money transmitters, especially those serving fragile economies, such as Somalia.

Remittance potential

When people cannot find regular channels to send money, they resort to irregular channels. This makes it more difficult to fight financial crime. A risk-based approach that reduces regulatory requirements for small sums (under \$200, say) could unlock the potential of cross-border digital remittances. Where regulations have freed fintech companies to take advantage of modern technology, the cost of sending remittances has fallen sharply.

With better regulation and lower costs, remittances have the potential to improve financial inclusion further. Remittances can be leveraged to broaden people’s access to bank accounts, as well as to saving, loan, and insurance products. Remittances can also give countries greater access to

international bond markets by improving debt sustainability and sovereign credit ratings. Future remittance revenue can be used as borrowing collateral. Commercial banks in Brazil, for instance, raised over \$1 billion at low interest rates in 2002 through bonds backed by future remittances from Japan. Remittance channels can mobilize diaspora savings, too. Nigeria raised \$300 million via diaspora bonds in 2017. India has tapped its large diaspora for almost \$10 billion this way.

Governments have, from time to time, tried to tax remittances. The revenue could, they say, be used for productive purposes. But taxes of this sort would be hard to enforce. People might simply shun formal remittance channels. Governments would do better to improve the business environment in their countries so that people choose to invest the money they receive from relatives overseas.

In many countries facing scarcity of foreign exchange, prevalence of parallel market premiums have encouraged remittance flows through informal channels. A combination of currency devaluation, higher interest rates on foreign currency deposits (and making such deposits repatriable), and elimination of surrender requirements can increase flows through formal channels.

Remittances will continue to grow. More than a billion people, most of them in Africa and South Asia, are expected to join the working-age population by 2050. By contrast, populations are aging in many advanced economies. This demographic imbalance will increase the supply of migrant workers and the demand for them. Climate change and extreme weather will add to migration pressures. As the number of migrants increases and cross-border payments become cheaper and simpler, remittances will continue to provide stable income to millions of people and play a vital part in the global economy. **F&D**

DILIP RATHA is a lead economist at the World Bank and an advisor to the Multilateral Investment Guarantee Agency.

Point of View

Shifting Sands



Vali Nasr

A generational shift in geopolitics is creating new possibilities for prosperity in the Greater Middle East



The Middle East is often seen as an arena of unending conflict: ambitious regional rivals vie for advantage as restless young people struggle against authoritarian rule and ailing economies.

And yet despite the region's many challenges—from the Islamic Republic of Iran's nuclear program to raging conflicts in Palestinian territories, Iraq, Libya, Sudan, Syria, and Yemen—recent developments suggest that the Middle East's place in the world is undergoing profound change.

The Abraham Accords between Israel and a group of Arab countries in 2020—or the recent rapprochement between Iran and Saudi Arabia—signal axial shifts in regional politics. The most salient impetus for change is the palpable shift in the US outlook on the Middle East. Since the 1979 revolution in Iran the United States has served as the mainstay of the region's security architecture. It implemented containment first of Iran and then of Iraq after the invasion of Kuwait in 1990. After the 9/11 attacks, the US "global war on terror" brought a sharper

focus on the region, leading Washington into wars in Afghanistan and Iraq and interventions in Libya and Syria. Since that high point of engagement and commitment, US attention has shifted to other global priorities, notably managing China's rise.

Despite US protestation to the contrary, Washington is no longer keen on entanglement in Middle East conflicts—as has become clear to its friends and foes in the region. Its wars in Afghanistan, Iraq, and Libya ended badly; its impact on conflicts in Syria and Yemen has been limited. Washington continues to seek containment of Iran, but not at the cost of direct confrontation.

This realization has meant that the Middle East must conceive and manage its own security to a greater extent. In the absence of ironclad American security guarantees, regional powers deem it prudent to mitigate threats and reduce tensions with adversaries through diplomacy and greater economic engagement. This approach led Saudi Arabia and the United Arab Emirates (UAE) to mend relations with Qatar and restore ties with Türkiye, Iraq, and, most recently, Iran and Syria. The same logic led to the Abraham Accords and greater engagement between Israel and Saudi Arabia. The Gulf monarchies are investing in Israel, Iraq, and Türkiye—and Iran and Syria could be next. Economic statecraft is driven by opportunities but is also the means to build and sustain new strategic relationships.

Integration, not confrontation

This thawing of relations between the walls of chasms intersecting the region since the Arab Spring of 2011 and the 2015 Iran nuclear deal will benefit countries caught in the middle—from Lebanon and Iraq in the Levant to Qatar and Oman in the Persian Gulf. Greater trade and investment are another important result. Both Saudi

Arabia and the UAE are investing in Türkiye and Iraq. The UAE's trade with Iran has grown over the past two years, and Saudi Arabia has hinted that it may invest in Iran if the two countries can normalize relations. There is now talk of major investment in a trade corridor that would connect the Persian Gulf to the Mediterranean, with roads and railways linking Oman to Saudi Arabia and on to Iraq, Jordan, Syria, and Türkiye—with lateral connections to Iran and Israel. The United States is not keen on including Iran but supports a broader Persian Gulf–Levant–India connection to limit China's role in the region and integrate the Persian Gulf into its Asia strategy.

As far-fetched as such a vision may seem—and there are significant obstacles in its path, most notably the fate of Syria—it underscores how far the region's geostrategic reality has moved. The Middle East is now imagining economic integration in lieu of confrontation. Security concerns have thus far been an obstacle to such a project, but it is now possible to contemplate a future not dissimilar to present-day Southeast Asia and to see economic integration as a solution to persistent security concerns. Even the United States recognizes strategic advantage in promoting an economic vision for the region.

The Middle East's most ambitious powers, Saudi Arabia and the UAE, aspire to be notable players in the global economy. These countries need security to build service industries and attract investment and assume the role of the economic hub for the region. This vision is more compelling because the economic boundaries of the Middle East have expanded beyond the narrower security map in the minds of many Western observers. Economic and cultural ties are weaving Central Asia and the Caucasus, the Horn of Africa, and South Asia into what has traditionally been viewed as the Middle East and North Africa region. Consider that today India is the UAE's largest trading partner. China and East Asia play an important part in this ascendant economic vision.

“In the absence of ironclad American security guarantees, regional powers deem it prudent to mitigate threats and reduce tensions through diplomacy and greater economic engagement.”

Geostrategic shift

China is now Saudi Arabia's largest energy partner, and its investments in the kingdom outpace those of all other countries. Chinese economic ties with other Gulf countries, and with Iran, Iraq, Egypt, and Pakistan, are also growing. China has invested more than \$56 billion in Pakistan as part of its Belt and Road Initiative and is discussing similar investment in trade and infrastructure in Iran. For China the Greater Middle East is a critical part of its vision for Eurasia, the landmass that would connect China's economy to Europe.

Western China borders the Greater Middle East—a region of strategic significance, especially as China's own domestic economic production moves westward from its eastern Pacific shores. China is hungry for the region's vast energy resources, but also for its potential as a transit corridor that could balance out China's current dependence on the Indian and Pacific oceans and

the increasingly contentious maritime access points in Southeast Asia and the South China Sea. The Arabian Peninsula is vital to East Asia's trade with Africa and Europe, and Iran and Pakistan are unique corridors that connect Europe on one side and the Arabian Sea on the other to China through Central Asia or overland into Xinjiang.

Just as the US has shifted its gaze away from the Middle East to Asia, China is looking west to the Middle East. This coupling of the shifting interests of the world's premier great powers constitutes the most significant change in the geopolitics of the Middle East for decades. China's deeper engagement will have an economic impact, and—as evidenced by Beijing's role in normalizing ties between Iran and Saudi Arabia—it will also contribute to a climate of greater economic interdependence within the region.

This geostrategic shift has been bolstered by Russia's war in Ukraine, too. Russia was already deeply involved in the Middle East through its intervention in Syria's civil war and its oil-production pact with Saudi Arabia and the Organization of the Petroleum Exporting Countries. The war has reduced Russian involvement in Syria but deepened its ties with Iran. Those ties are most evident in the military arena as Iranian drones and ordnance have contributed to Russia's assault on Ukraine. But Russian dependence on Iran extends beyond military supplies. Moscow is increasingly looking to the transit corridor stretching from the port of Astrakhan on the Caspian Sea through Iran to the port of Chahbahar on the Arabian Sea to trade with the world. Growing Russian trade has been important to Iran's cash-strapped economy, but it has also connected Iran with port cities on the southern shores of the Persian Gulf, which are a part of the emerging Russian trade network.

New pipelines

The same dynamic is at work in North Africa and the Levant, this time driven by Europe's reaction to Russian aggression. As Europe weans itself off Russian oil and gas, it will inevitably depend to a

greater extent on energy imports from North Africa, the Middle East, and the Caucasus and Central Asia. This will impact Algeria and Egypt, the region's gas producers, first and foremost. But its broader implications for economic integration across the Mediterranean will benefit Morocco and Tunisia, which have been at the forefront of supply chains serving European economies. The energy connectivity is translating into plans for a network of pipelines to connect oil and gas from these sources to Europe. Türkiye sees a future as the transit hub for energy pipelines coming from the south and the east and on to Europe in the west. Saudi Arabia and Qatar are contemplating pipelines that would take their own oil and gas, as well as Iraq's, to that Turkish hub.

These plans depend on resolution of conflicts in and between countries along the way. Economic interest would, in turn, foster interest in continued peace. This is perhaps a distant goal but not impossible to realize. In November 2022 Israel and Lebanon (with Hezbollah's approval) signed a historic deal setting their borders in the Mediterranean—a necessary prelude to development of their respective gas fields. The United States helped negotiate that deal and, in recognition of these emerging trends, it hopes to supplant its own old order in the region with one that connects India to the Persian Gulf and Israel through a network of ports, roads, and railways. America's vision is partly aimed at containment of Iran and China. But insofar as it relies on economic ties, it too will confirm the new geopolitical reality of the region.

As has happened so often throughout history, great power rivalries will shape the future of the Greater Middle East. Yet in this case they are working to bind countries closer together economically rather than wrenching them apart. This will open up new possibilities for the region. **F&D**

VALI NASR is Majid Khadduri Professor of International Affairs and Middle East Studies at Johns Hopkins University's School of Advanced International Studies.

Jordan's Fiscal Ownership



Mohamad Al-Ississ

Finance Minister Al-Ississ reflects on how his country spearheaded preventive and progressive fiscal policies against all odds

When I joined the Ministry of Finance in November 2019, I naively thought that our biggest challenge would be getting the budget through Parliament (it was in fact no small feat). Our relationship with the IMF, with a stagnating Extended Fund Facility (EFF) program, also left much to be desired. We believed that after these two issues were resolved, it would be smoother sailing.

Little did we know. By March 2020, we had passed the budget and had a fresh EFF program built on completely different principles. In this homegrown program, we aimed to widen the tax base instead of raising marginal tax rates. We also intended to instill discipline over our primary deficit, but not at the expense of safety nets or growth. Few people initially believed we would succeed; even fewer did when we were hit with three consecutive “black swans”: COVID-19, the Russia-Ukraine crisis, and global stagflation.

Today, Jordan's macro-fiscal and monetary stability is acknowledged by all major credit rating agencies. Moreover, Jordan's April 2023 Eurobond issuance was six times oversubscribed. We still have a long way to go, but it's worth taking a look at how we got here.

Back in academia, we debated the fiscal paths and structural frameworks proposed by the IMF. For policymakers, however, managing fiscal risk is not about neat mathematical equations or econometric models; it is about the political economy of owning reforms and tailoring them to your country's circumstances. I'll first elaborate on how we strove to do that, then examine what this process revealed about the flaws of international financial institutions and what might be done to rectify them.

Reclaiming the reform momentum

First, we stopped relying on packaged prognoses and instead did our own evidence-based analysis in 2018 and 2019. After a deep dive into the causes of our fiscal challenges, we looked at which reforms would help achieve equitable macroeconomic stability. Previous shocks from the region, which amounted to 44 percent of our GDP, drove up our deficits and debt. There was a significant fiscal impact from

“The IMF must empower countries' ownership of their reform agenda.”

these shocks, including closing our borders because of conflict in neighboring states, a disrupted energy supply, and an influx of Syrian refugees comprising 20 percent of our population essentially overnight. But when we stepped back from the pressing need for ad hoc measures, Jordan could identify the virtuous intersection of progressively widening the tax base, enacting countercyclical pro-growth reforms, expanding targeted safety nets, and managing debt service. Our new evidence-based path built credibility with the IMF and allowed us to challenge the standard approach of indirect taxation, subsidy cuts, and reduced procyclical expenditures.

Our approach was a feasible yet ambitious overhaul unique to Jordan. On the revenue side, we tapped into fighting tax evasion and avoidance rather than raising marginal rates (in fact, we cut sales tax rates on essential goods in the 2020 budget to signal a redirection, then lowered and unified our customs tariffs in 2022). We focused on improving the efficiency and equitability of revenue collection. We closed tax loopholes via legislative changes such as transfer pricing, unified the tax administration throughout the country, cracked down on tax evasion, and unified rates to limit arbitrage across multiple categories. On the expenditure side, we sharpened targeting while expanding safety nets, attempted to pay back arrears, and boosted capital expenditure for the first time in years.

The second step was to build trust by generating results. The revenue mobilization strategy is bearing fruit: in 2022, Jordan had met its income tax target for the year by August; in the first quarter of 2023, domestic revenue rose 9.1 percent year over year, driven mainly by taxes on income and profits. The country's fiscal discipline in 2022 yielded a primary deficit that outperformed the IMF program target, thanks to higher-than-expected domestic revenues. To say the plan was perfectly executed would be inaccurate, but instead of raising rates on the average citizen, we ensured that those who could afford to pay taxes paid their fair share. The revenue benefit was tangible, as was the greater social stability that followed.

It is an example of good policy being good in itself—and growing more effective the more progressive it becomes.

The third step was flexibility and focus on the big picture. Within the Ministry of Finance, macroeconomic stability remains our key goal, but context matters, and context is malleable. For example, our IMF program was one of the first with a built-in COVID adjustor and other adaptive features. As a result, Jordan achieved its EFF program targets ahead of schedule, in June 2023.

Surviving within this global system, however, is not the same as thriving—Jordan faces many ongoing challenges. For instance, rising global interest rates mean that our gains on income tax revenue go toward the rising cost of servicing debt instead of improving public services. I believe the onus is on the IMF to continue its leadership position of adapting the financial system to global changes. Here are a few suggestions.

Setting benchmarks for the IMF

Our international financial institutions rose from the ashes of World War II. Their very premise is therefore reactive, not preemptive. These institutions often mobilize resources for a country only once a shock has occurred, leading to knee-jerk firefighting, not structural measures that preventively enhance resilience. Governments tend to provide aid after the middle class has fallen into poverty rather than working to prevent it; emerging markets need tools to navigate risks preemptively, which is more cost-effective than dealing with the aftermath.

First, the IMF should add preventive tools to its roster. Jordan's recent experience shows what can happen if this practice is encouraged on a larger scale. At the onset of the pandemic, under the directives of His Majesty King Abdullah II, we avoided the post-COVID global food supply and demand shocks most countries experienced by ensuring investment in better wheat storage facilities and reserve buffers. As a result, we averted some of the expensive repercussions of the Russia-Ukraine war and other price fluctuations. Moreover, we included an adjustor for unforeseen pandemic expenditures

and were able to expand spending on vaccination and treatment. The IMF should systematically embed such adjustors in its programs.

Second, if international financial institutions stand behind globalization, they must provide buffers against globalization's challenges. We cannot assume that an unequal global system will miraculously spread the spillovers and costs of conflicts equally; we must pursue global solutions. As IMF Managing Director Kristalina Georgieva reminded us, "War in Ukraine means hunger in Africa." Yet resources are not mobilized in a way that balances need and availability.

Third, economy-wide stability is a prerequisite for household-level stability—but that alone does not guarantee it. Governments should take a more proactive approach to ensuring that the middle class has better, more affordable buffers, as opposed to expanding social safety nets following a crisis. Consider, for example, rising home mortgages, which put the squeeze on families. This must be remedied before we see widespread defaults.

Fourth, international financial institutions must be the world's apolitical institutional memory. As governments change, these institutions must keep reminding the global community of pressing, unresolved challenges before shifting resources to the crisis du jour. The international community should not abandon the Syrian refugees residing in Jordan just because headlines turn attention elsewhere. Jordan is left with a financial penalty for providing a global public good.

Last, the IMF must empower countries' ownership of their reform agenda, as it did with Jordan. In our case, equitable, progressive fiscal policies, when we were able to implement them, worked. It is not ethos, nor is it theory. The fairest policies—those that favored national interests over individual private interests—proved the most fiscally viable as well. **F&D**

MOHAMAD AL-ISSISS is minister of finance of Jordan.

I thank my advisor Afaf Asad for her intellectual contributions to this piece.

Climate Financing That Puts People First



Rania Al-Mashat

We need to find an equitable approach to financing for a climate-resilient future

As I read the daily headlines, I can't help but feel a sense of urgency and concern about our planet. An unprecedented number of calamitous climate events—floods and heat waves, superstorms, droughts, and uncontrollable forest fires, all connected to human activity—are putting people's lives in danger, disrupting economies, and causing havoc in the natural world. The need for climate action has never been more pressing, and innovative approaches to financing carbon mitigation and climate adaptation are critical to address these mounting problems. It's time to move from mere promises and pledges to concrete implementation, and resources must be allocated equitably and generously—putting people and the planet first.

Broad access to climate financing is indispensable to an effective fight against the global climate emergency. Hurricanes and heat waves know no borders. But today, global climate financing is regionally siloed and out of step with the scope and consequences of the crisis. Over 75 percent of global climate financing is spent in the countries where it is raised. As a result, many vulnerable regions—including those with a negligible impact on global warming in the first place—have limited access to climate financing.

Africa, for example, contributes less than 8 percent of global greenhouse gases but contends with a slew of climate-related maladies, including severe water scarcity, rising sea levels, and climate-sensitive diseases. Yet Africa receives less than 5.5 percent of global climate financing, even though the United Nations calls it a highly vulnerable region. Countries have a shared moral obligation to protect the global environment, as established by the principle of “common but differentiated responsibilities and respective capabilities,” which was formalized at the UN's 1992 Rio Earth Summit. But not all countries have the same financial resources, and not all countries are equally responsible for the situation we find ourselves in.

“Over 75 percent of global climate financing is spent in the countries where it is raised.”

The amount of climate investment needed to prevent catastrophic degradation of the environment is staggering, estimated to hit \$4.5 trillion a year by 2030 and rise to \$6 trillion a year by 2050. Today, by comparison, a mere \$632 billion is spent annually. These figures are sobering, especially considering that about 60 percent of developing economies' needs are not included in their Nationally Determined Contributions—pledges made under the Paris Agreement—which renders the \$100 billion pledge made in 2009 at COP15 in Copenhagen pitifully inadequate.

What's more, just 7 percent of climate financing today is earmarked for resilience and adaptation, even though the Global Commission on Adaptation 2019 estimated that investing \$1.8 trillion in initiatives such as early-warning systems and climate-smart practices over 10 years could yield \$7.1 trillion in total benefits.

Complicating matters, the COVID-19 pandemic and Russia's invasion of Ukraine have led to higher food and energy prices and tighter financial conditions. These have added to the fiscal burden on emerging market economies and have tested their socioeconomic and environmental resilience just as temperatures are rising at unprecedented rates. These cascading events have siphoned money and resources from sustainability projects and caused sharp capital retrenchment that threatens to reverse decades of hard-won development gains. The World Bank estimates that climate change could jeopardize development progress by pushing 132 million people into poverty by 2030, particularly those living in Africa and South Asia.

The cost of implementing the climate agenda—in adaptation and mitigation—far exceeds available deployed resources. A bigger pool of funds is clearly needed. It is argued that if multilateral development banks dedicated all their funds to the green transition, it would amount to about 4 percent of the financing needed (World Bank 2020). Shifting only 1–1.5 percent of global private sector assets—worth over \$450 trillion—would, however, bridge the climate financing gap

(FSB 2021). Philanthropies are also well positioned to lend a hand. In recent years, philanthropic funds targeting climate action have grown rapidly. In 2020, climate-mitigation financing ranged between \$6 billion and \$10 billion, which, put in perspective, is less than 2 percent of all philanthropic financing worldwide.

This urgent need for funds has prompted an international call for a restructured global financial architecture to step up climate action and crowd in private investment for countries most in need. Among the most ambitious are the Bridgetown Initiative and the G20 Capital Adequacy Framework.

Leveraging financial opportunities and forging synergy between climate action and sustainable development were the impetus for the *Sharm El Sheikh Guidebook for Just Financing*, launched by Egypt, which held the COP27 presidency. The goal is to help stakeholders move more efficiently from pledges to implementation by identifying key players, including climate capital providers, and clarifying opportunities, risks, and potential partnerships for a climate-resilient future.

The guidebook introduced the first definition of “just financing” to transcend the notions of climate justice and just transition. The initiative puts people first. It focuses on the equitable allocation of benefits and burdens, and it emphasizes safeguarding the social dimension of the transition to a climate-resilient future. In a nutshell, it attempts to operationalize the principle of common but differentiated responsibilities and respective capabilities by addressing country ownership, access, affordability, and resource allocation bias. It also promotes “additionality”—benefits that are attributable solely to an intervention—and good governance. Along with 12 corresponding guiding principles, just financing “accounts for historical responsibility for climate change while ensuring equitable access to quality and quantity climate financing that supports resilient development pathways, leaving no one behind.”

Accelerating the transition to a low-carbon and climate-resilient future



requires collective action and the power of multistakeholder partnerships. This means unlocking funds from public, private, and philanthropic financial actors and boosting climate financing to developing and emerging market economies. The problem is that 77 percent of developing economies’ sovereign credit ratings are “non-investment grade” and hence associated with high risk. There are also large information gaps regarding opportunities, investor appetite, and investment impact.

Closing the information gap is critical both for governments and investors and could, in turn, shed light on risk-return profiles, lower transaction costs, enable new financing mechanisms, and help generate high-impact investable projects that are Paris-aligned and contribute to country priorities.

Moving from policy to practice, Egypt is a case in point with the launch of its Country Platform for the Nexus of Water, Food and Energy (NWFE نُؤْفِي) during COP27 to emphasize country ownership and adopt a country-led, programmatic, bottom-up approach. NWFE نُؤْفِي (the Arabic means “fulfilling pledges”) introduces the missing link of investable projects and bridges the information gap. It also harmonizes efforts to ensure sustainable and productive interaction between stakeholders. Through the design, structur-

ing, and preparation of concrete and implementable mitigation and adaptation projects, NWFE was able to mobilize concessional financing and catalyze private investment. It made use of innovative financing, including blended and debt swaps for climate action (Al-Mashat and Berglöf 2023).

In the lead-up to COP28 in the United Arab Emirates later this year, it is important to take stock of successful experiences and promote knowledge sharing. The *Sharm El Sheikh Guidebook for Just Financing* provides a blueprint for countries to work together to address climate-related challenges and catalyze financing for our low-carbon future. **F&D**

LANIA AL-MASHAT is Egypt’s minister of international cooperation.

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AFRICAN CENTURY

A demographic transformation in Africa has the potential to alter the world order

LAST NOVEMBER, the global population reached a significant milestone of 8 billion. More recently, in April, India overtook China as the world's most populous country. It is Africa's booming population, however, that commands attention, with its demographic transformation set to reshape the continent and the world beyond.

Africa's population, estimated to be about 140 million in the year 1900, accounted for 9 percent of the world's population at that time; however, its share has since doubled. Fueled by a combination of falling mortality and some of the highest birth rates in the world, Africa's total population has increased tenfold and now stands at over 1.4 billion.

The United Nations projects that by 2050, Africa's population will reach close to 2.5 billion. Such a figure would mean that more than 25 percent of the world's population will be African. Its population growth will slow thereafter, but Africa will remain by far the largest source of growth globally: its share of the world's population is set to reach close to 40 percent by the end of the century.

The UN expects just eight countries to account for more than half of the increase in global population over the next three decades, and five of those countries are in Africa. The working-age population in these African countries, and in many others across the continent, will grow faster than any other age group.

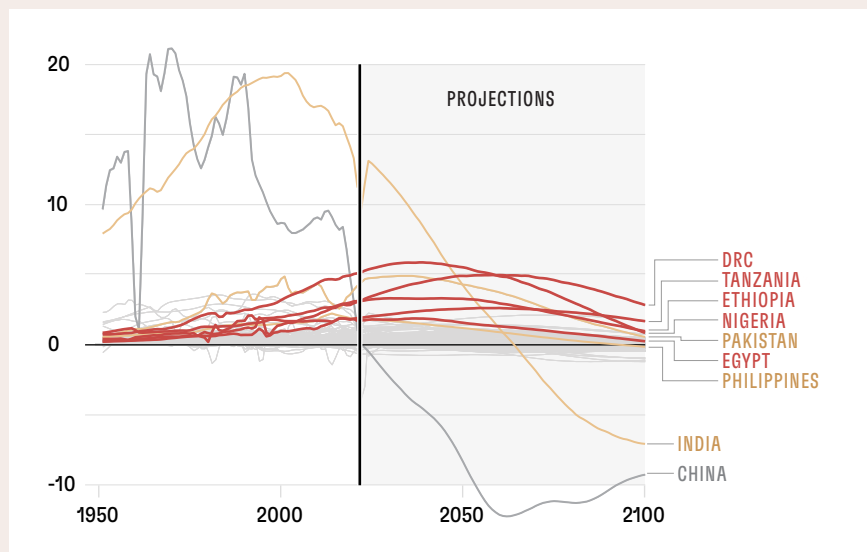
This projected shift in population and potential demographic dividend for these nations could have profound economic effects and even alter the world order, with some of these states possibly emerging as new world powers. **F&D**

ANDREW STANLEY is on the staff of Finance & Development.

Rising giants

Five of eight countries expected to account for over half of global population growth to 2050 are in Africa, with Nigeria forecast to become the world's third-most-populous country.

(annual population growth, millions)



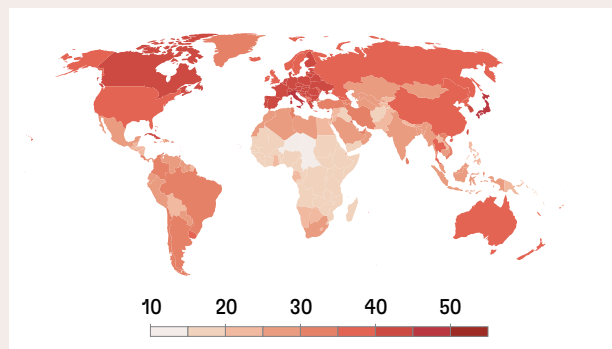
SOURCES: United Nations, World Population Prospects (2022); and Our World in Data.

NOTE: The chart shows historical estimates and projections based on the UN medium-fertility scenario. Eight countries that will account for more than 50 percent of global population growth are highlighted along with China. DRC = Democratic Republic of the Congo.

Youthful shift

Median age divides the population into two equal parts, with half older and half younger than the median age.

(median age, 2021)



18.6

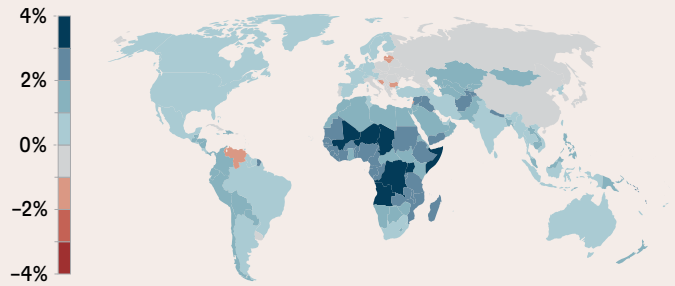
The median age in Africa as of 2021, which over time will shift upward, sparking economic opportunities and a potential demographic dividend. Investment in human capital, including education, will be critical to ensure this potential is realized.

SOURCES: United Nations, World Population Prospects (2022); and Our World in Data.

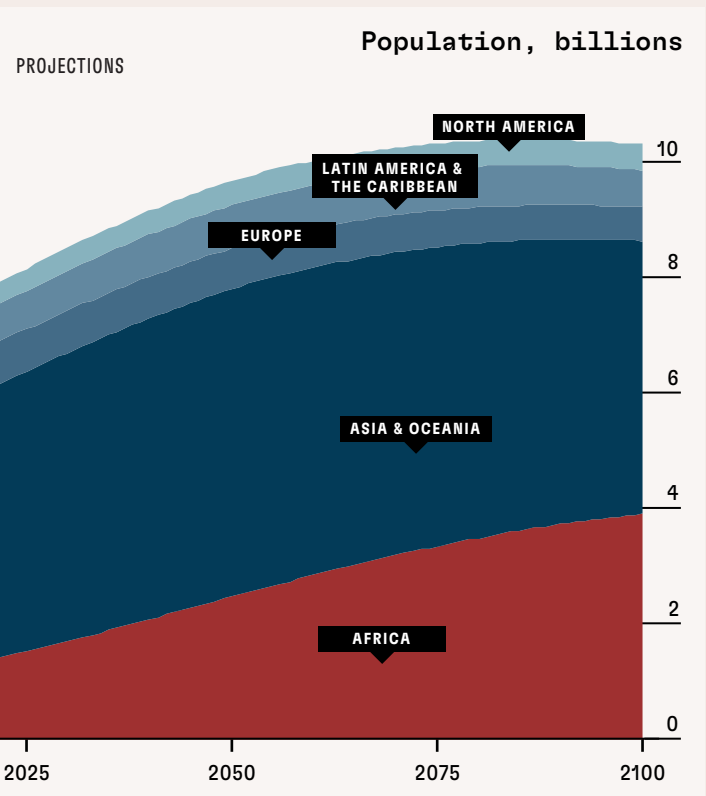
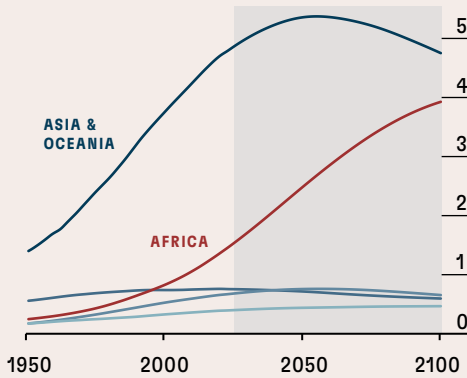
Africa's surge

Africa's population is exploding. It currently accounts for roughly half the global increase and every two years adds as many people as live in France. By 2100 two out of every five people on Earth are expected to be African.

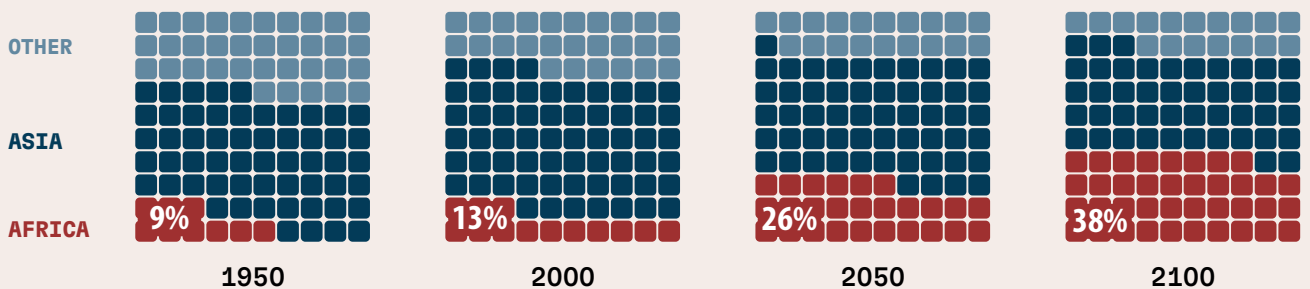
Population growth rate, 2021



Population, billions



Share of global population



SOURCES: United Nations, World Population Prospects (2022); and Our World in Data.

NOTE: The charts show historical estimates and projections based on the UN medium-fertility scenario. The boundaries, colors, denominations, and any other information shown on the maps do not imply, on the part of the IMF, any judgment on the legal status of any territory or any endorsement or acceptance of such boundaries.

OVERHAULING THE ARAB WORLD'S ECONOMIES



The Middle East and North Africa can capitalize on a changing global environment

Jihad Azour and Taline Koranchelian



It's time to rethink the engines of economic growth across the Middle East and North Africa. In a rapidly changing world, the region's two dozen nations hold unprecedented opportunities to secure inclusive growth, create high-quality jobs, and better serve the aspirations of its 600 million people.

The region spans 4,000 miles and four time zones from Morocco to the Islamic Republic of Iran. It includes some of the world's wealthiest nations—Qatar, the United Arab Emirates, Saudi Arabia—and some of the poorest—Somalia, Sudan, Yemen. While the nations of the Arab world have diverse economies and populations, they share many characteristics, including history, language, and profound cultural ties.

In the past two decades, the Middle East and North Africa have experienced both significant change, including the Arab Spring uprisings of 2010–11, and not enough forward-looking transformation—persistently lackluster growth, low female labor force participation, and high youth unemployment. Some countries face intensifying pressures related to debt, high inflation, demographics, and equity.

Nonetheless, amid these challenges lie new opportunities to secure inclusive growth and create sustainable jobs on the back of the pandemic, climate change, and the digital revolution. These include digitalization, green investment, new economic markets, the energy transition, and the changing nature of work. Already, countries including Egypt, Mauritania, Morocco, and the United Arab Emirates are moving to tap into green energy. The region could also grasp the potential to benefit from expanded intraregional trade as global supply chains undergo realignment.

The status quo of state-dominated economic activity will be hard to sustain, especially for heavily indebted countries facing high financing costs. Already swamped with high levels of youth unemployment and gender inequality, these countries won't be able to absorb the more than 100 million people who are projected to enter the workforce in the next 10 years unless they change their growth model. No-change policy will severely threaten vulnerable social cohesion—on top of the strains caused by the rapid warming of the planet and the dramatically evolving global economy.

A “new deal” for the region will be to deliver for its people on well-known and long-standing goals: more jobs, better education, greater dignity, better governance, and a broader, fairer distribution of economic opportunities and resources. How can the nations of North Africa and the Middle East achieve transformation, reduce vulnerabilities, and build resilience to future shocks? How can they drive change while promoting greater global cooperation?

Economic stability

Focusing on macroeconomic and financial stability is a start. While many governments rightly increased spending and provided social support to confront the COVID-19 pandemic and the cost-of-living crisis, such measures did not come without cost and often required borrowing. Higher debt servicing costs mean less room for fiscal maneuver as governments continue to face risks from future shocks, contingent liabilities, and worsening climate stress.

As they pay down debt, governments should mobilize revenue, withdrawing ineffective exemptions and improving tax equity; limit spending on untargeted subsidies; and control the public sector wage bill. Such outlays are rigid and constrain governments' ability to respond to shocks or finance education, health care, and social protection. For example, in Tunisia that kind of spending accounts for four-fifths of revenues.

On the monetary policy side, central banks should continue to be forward-looking, with a clear focus on price stability while maintaining financial stability as needed. Policy needs to be adjusted in line with new data, developments in global conditions, and the policy posture of major central banks.

Simply preserving macroeconomic stability, however, will not deliver the intended transformational change. Stability is the foundation, not the house. Achieving truly inclusive growth will also require structural reforms.

A strong and well-designed social safety net is essential for maintaining social cohesion. Most of

the region's social spending goes to untargeted, broad subsidies. While these help ensure affordable access to food and fuel for the poor, they entail enormous waste, as most of the benefits accrue to the wealthy, and they limit governments' ability to invest in better-targeted programs.

Replacing generalized price subsidies with targeted support would mean that those most in need could experience an immediate and visible improvement. Along these lines, Morocco removed fuel subsidies in 2016, Egypt introduced an automatic fuel price index mechanism in 2019, and Mauritania substantially reduced untargeted fuel subsidies while progressively increasing cash transfers to the most vulnerable.

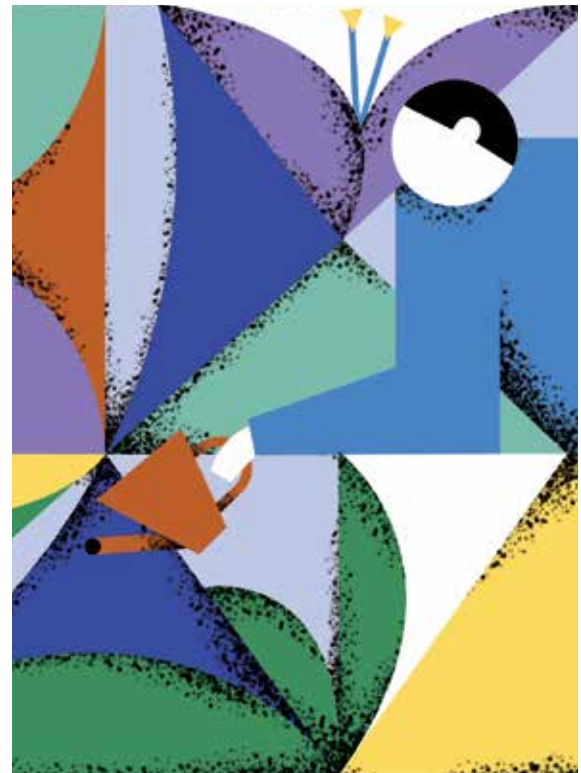
More efficient targeting mechanisms can also be implemented quickly. During the pandemic, Morocco was able to swiftly reach informal workers with a cash transfer program using digital payments. Similarly, Jordan improved the targeting of its cash transfer system, greatly broadening its reach.

Expanding the private sector

Ensuring a more inclusive role for the private sector will be key for job creation. The private sector generates more than 90 percent of jobs in developing economies. As the public sector works on delivering an enabling environment, private enterprise should take on the responsibility of increasing investment, productivity, and competitiveness while training the workforce to take advantage of a changing technological world.

Hence, the private sector needs to be in the driver's seat for expanding economic activity, supported by a strong and efficient public sector. In turn, governments' role in developing institutions, correcting market failures, and providing public goods is key. Educational improvements will be essential to ensure the formalization of the labor force—improving people's income security and access to social protections—and the development of adequate skills for people to perform

“Replacing generalized price subsidies with targeted support would mean that those most in need could experience an immediate and visible improvement.”



in the private sector. Removing legal barriers and discriminatory practices would help bolster female labor participation.

Currently, the region's state-owned enterprises are sprinkled across the economic spectrum, ranging from tobacco, textiles, foodstuffs, and furniture manufacturing to communications and electricity production. This outside presence of the public sector in commercial activities and as an employer of first resort creates inefficiencies and distortions, weighing heavily on overall productivity growth.

Stronger economic governance and decisive anti-corruption policies are key to fostering faster and more inclusive growth while ensuring that everyone has a voice. Political and economic participation safeguards accountability in the use of public resources and the provision of services. It also strengthens social cohesion and trust and ensures that the benefits of growth can be spread across society. As reforms progress, it will be important that governments provide supporting evidence for decisions and outcomes and hold themselves accountable. Transparent institutions with strong accountability ensure that the rules of the game are fair and clear.

Emphasis on resilience

The energy transition and climate resilience have become even more urgent. In a region with significant water and food needs, climate change will further

exacerbate record levels of hunger. These are likely to deepen economic upheaval, conflict, and human displacement. Tunisia's tourism and fishing sectors face the threat of beach erosion, with significant implications for activity and employment. In Mauritania, growth could fall by as much as 1 percentage point as drought intensifies, but expanding access to electricity could cut the losses in half.

Clearly, proactively bolstering resilience to climate change is an urgent priority. Some countries have already begun investing in renewable energy and climate-resilient infrastructure while enacting measures that raise the effective cost of carbon emissions, including the phaseout of subsidies. Morocco in recent years built the world's largest concentrated solar plant, which uses reflected heat to drive power generation even after the sun sets. Egypt pioneered green bonds in the region and has accelerated the integration of renewable energy over the past decade.

Governments should give priority to measures that are beneficial under all plausible climate-change scenarios and build adaptation capacity. World Bank simulations for Morocco show that investment in water infrastructure would improve resilience to drought, reducing GDP losses by almost 60 percent and capping the rise in public debt. For lower-income, fragile, and conflict-affected countries, the immediate priority should be strengthening disaster preparedness, water resource management, and climate-adapted infrastructure. These countries should also upgrade the capacity of institutions to address climate change and the ability of communities to respond to shocks.

Embracing new technologies could fuel a dramatic transformation. According to the World Bank, GDP per capita in the region could rise by more than 40 percent as digitalization elevates efficiency, inclusion, and resilience. There remains, however, much untapped potential. Smartphones are widely used, but e-commerce is still nascent. Disparities in digital adoption also remain between low-income and high-income nations.

To promote digitalization, governments need to create a strong enabling environment. This means enhancing digital infrastructure, upgrading digital literacy, and developing skills in the workforce. Such measures would alleviate adoption costs, especially for small and medium enterprises. Tunisia, for example, began this shift in 2018 with its Startup Act, which simplifies administrative procedures to encourage entrepreneurship and innovation in the digital sector.

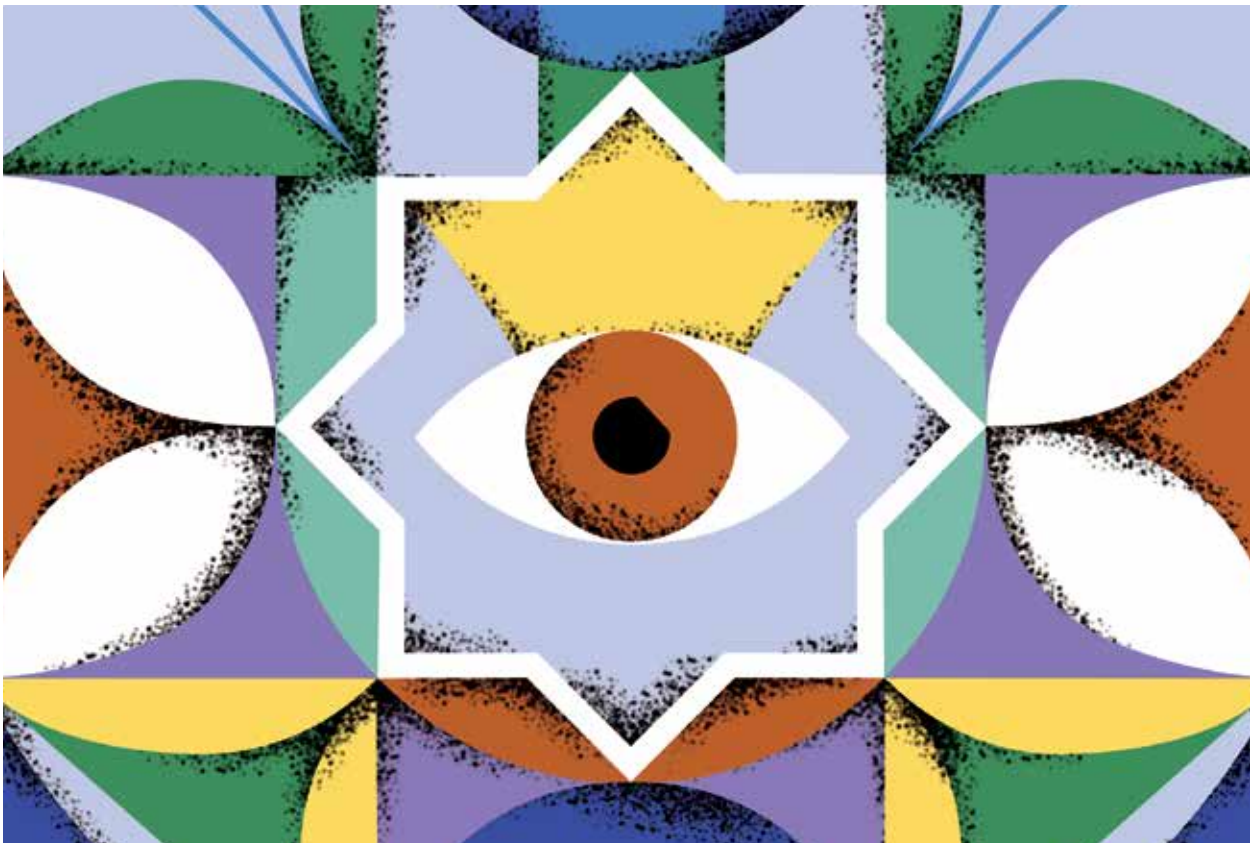
Change is a journey

Reforms will take time to bear fruit, but to ensure their success some basic yet critical ingredients must be in place. Based on past experiences across countries, governments' full ownership is key for the success and durability of reforms. Such ownership will help governments overcome resistance to change. The second ingredient is transparent communication to inform the public of the necessity of change and to build support for difficult choices. This requires a real two-way dialogue, in which governments receive and incorporate feedback from key stakeholders. People should feel that they have the power to influence outcomes and not be subject to policies that benefit only a few.

Progress in structural transformation is not linear. Many governments have attempted to deliver sustained and broad change only to be confronted with unfavorable external shocks, difficult domestic conditions, and internal and external conflicts. In addition, any perception that "reforms" are rigged to benefit a privileged few can hinder momentum. For these reasons, sequencing is key: starting with measures that deliver broad gains and capitalizing on quick wins to overcome skepticism and build a track record. There will be times of rapid progress and times when changes stall. Original plans should be ambitious and flexible enough to adjust to changing circumstances. As former US President Dwight D. Eisenhower once said, "Plans are nothing; planning is everything."

In sum, macroeconomic stability is an important outcome, but it isn't enough in itself. As the Arab upris-

"One unavoidable lesson from the past is that nothing that is forced from outside a country can work if there is no buy-in within the country."



ings and protests in Latin America have shown, stability without jobs, shared prosperity, and voice will go only so far. Stability matters because it allows governments to make structural transformations, which in turn reinforce a country's resilience and ability to preserve stability.

A renewed regional partnership

Today's fragmented global landscape calls for a reboot of regional partnerships in the Middle East and North Africa. Less trade integration would do the most harm to low-income countries in a highly fragile region, and reduced capital flows and foreign direct investment would further constrain these countries' financing, technology diffusion, and growth prospects. As global links weaken, it will be more important than ever to strengthen regional ties in trade and investment.

In this context, members of the 42-year-old Gulf Cooperation Council—Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates—have taken steps to support regional investments. But despite multiple trade agreements across the Middle East and North Africa, trade within the region remains weak.

As more advanced economies engage in “friendshoring,” it will be essential for nations in this region to diversify their economies and develop greater regional self-sufficiency. This would help improve resilience to exogenous shocks and market volatility.

As the world shifts, the international community will also need to learn from what has worked in the past and what has not. As this region undergoes a fundamental rethinking, the rest of the world should also reconsider how to address global existential threats such as climate change and pandemics and how to avoid runaway fragmentation. Multilateral institutions should upgrade rules to ensure cooperation on global public goods, fair competition, and adequate protection of the most vulnerable.

One unavoidable lesson from the past is that nothing that is forced from outside a country can work if there is no buy-in within the country. Jordanian authorities, who sought support from the IMF in 2019, have consistently shown strong ownership in the implementation of their IMF-supported program. Morocco's successful transformation over the past decade was supported by IMF credit facilities. These countries are a testimony to how a homegrown economic overhaul can be effective in transforming a country. In turn, multilateral institutions must play their role in opening dialogue, seeking consensus, and promoting careful and consistent implementation. **F&D**

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UNLEASHING MIDEAST FINTECH

Amjad Ahmad

A better regulatory environment will bring the Middle East more investment and innovation in digital finance

A young, educated, and growing population—and some of the world’s highest mobile, internet, and smartphone penetration rates—point to fertile ground for financial innovation in the Middle East and North Africa. Yet the region lags in the use of digital banking and the adoption of fintech. Seizing the massive opportunity ahead means overcoming substantial challenges, among them a protective approach to regulation. Regulatory approaches differ by country, but this region generally has the greatest potential for reform among emerging market and developing economies, especially in domestic finance, the labor market, and governance regulations. Middle Eastern countries seeking to diversify their economies by engaging the private sector and reducing the role of the public sector, providing greater access to financial services, and accelerating foreign direct investment have no choice but to embrace financial innovation.



CHRISTOPHER PIKE/BLOOMBERG VIA GETTY IMAGES

The Arab world enjoys a significant demographic advantage. A third of the population is under 30, and the massive shift to adulthood in the next decade calls for expansion of products and services that cater to new households. Many of these will be dual-income households as more women enter the workforce. This demographic shift also calls for economic diversification and growth to spur job creation. Those needs are behind the commitment of many regional governments, especially those in the Gulf region, to economic transformation. A demographic dividend in several economies, especially the large economies of Saudi Arabia and the United Arab Emirates, is increasingly possible, and the spillover could help others prosper. As we have witnessed in other emerging market economies, fintech has increased financial inclusion, a key economic growth enabler and accelerator.

The region's embrace of mobile technology gives it substantial potential as a market for digital financial products, especially among young people, who

have grown up with digital technology. One strong indication of burgeoning demand is the acceleration of noncash payments during the COVID-19 pandemic. In the United Arab Emirates noncash payments (a category that includes cardless payments) rose from 39 percent in 2018 to 73 percent in 2023.

Still, only 17 percent of consumers in the Middle East use digital banking, compared with almost 60 percent in the United States. Fintech revenues are expected to increase from \$1.5 billion in 2022 to \$3.5–\$4.5 billion by 2025 in the Middle East, North Africa, and Pakistan region as fintech in the banking sector grows from less than 1 percent to 2–2.5 percent. Some Middle Eastern countries could even achieve rates equal to those of other emerging market economies, such as Brazil's 5–7 percent and Nigeria's 12–15 percent.

Sacred ground

Among the biggest obstacles to financial innovation in the Middle East is a regional tradition of treating

the financial sector as sacred ground. In most countries, banking institutions are owned primarily by the government, quasi-government institutions, or well-connected elites. Overly protective regulatory regimes favor incumbents and lead to entrenched national champions.

Banks in the Gulf Cooperation Council (GCC) countries, with strong balance sheets supported by government largesse, have been eager to expand. But, with limited opportunities in Gulf markets, they have gone farther afield to markets such as Türkiye, which are more open to acquisitions by foreign banks. Cross-border consolidation among GCC banks will likely not happen soon. For example, it's hard to imagine Qatar National Bank obtaining regulatory approval to acquire a majority stake in a Saudi Arabian or Emirati bank. There is an uneasy tension within governments between wanting to expand financial innovation and inclusion and wanting to protect prized local banking champions.

The entrenched dynamics of the banking sector mean that many fintech start-ups in the region are service providers or customer acquisition tools for established banking institutions rather than actual competitors. Fintech opportunity must be viewed through this prism.

Competing hubs

Middle Eastern countries are increasingly interested in building an ecosystem conducive to financial innovation, with several trying to become fintech hubs, including in Abu Dhabi, Bahrain, Dubai, and Riyadh. Unlike the United States, where the government provides room for exploration and growth before stepping in, Middle Eastern governments want to be at the center of financial innovation to assert control. Hence the approach of most fintech players in the region is to play nice with the government rather than heed Mark Zuckerberg's call to "move fast and break things."

This underlying approach needs reassessment. A top-down, government-led process rather than an industry-led approach to innovation will not yield globally competitive fintech companies or attract the best fintech companies to launch locally.

While we should acknowledge that risk mitigation and consumer protection are important, these factors need not inhibit financial innovation. Policymakers in the region must build the expertise and resources needed to regulate the fintech industry effectively. Allowing fintech companies to build without being overly regulated at the early stages will unleash more innovation.

“Venture funding has fallen short of predictions, and momentum may be slowing.”

Fintech in the United Arab Emirates is built primarily around the Abu Dhabi Global Market and Dubai International Financial Centre free zones; Bahrain and Saudi Arabia, however, have taken a consolidated central bank approach. With its large market, Saudi Arabia is well positioned to scale up fintech companies through enabling regulation. But even as each ecosystem focuses primarily on developing its comparative advantage, better interconnectivity and interoperability are essential in this fragmented region.

Market scalability will continue to be the most significant challenge to building globally competitive fintech start-ups from these regional hubs. We have yet to see pan-regional players emerge in substantial numbers.

Given the importance of volume in financial services, it's hard to imagine the fintech sector thriving in a fragmented region. Can Jordan or Bahrain replicate Sweden's success with the Klarna global payment and shopping system? Highly unlikely. Scalability in the region is very costly, and regulations are prohibitive. Most founders will confess that they cannot meet their growth targets and develop a sustainably profitable business model without a regional, multimarket approach.

Investment momentum at risk

Digitalization of financial services grew out of greater access to technology at lower cost thanks to innovations in digital infrastructure, such as cloud computing, and access to venture capital. With the emergence of artificial intelligence (AI), the potential to disrupt complex industries is more realistic than ever. AI levels the playing field further for all digital start-ups, especially those in fintech, which require sophisticated analysis of complex data sets with near-perfect accuracy because of the risks involved. What was once technologically challenging and prohibitively costly for many nascent companies may now be possible, thanks to AI language models.

Fintech has been the dominant sector for venture capital investment for the past three years and is expected to stay in the lead. Venture funding in fintech in the Middle East and North Africa region rose to \$925 million in 2022 from \$587 million in 2021, an increase of 58 percent. The funding in 2022 was across 131 deals, compared with 124 deals in 2021: funding rounds are getting bigger. The sector's share of venture funding increased from 21 percent in 2021 to 29 percent in 2022.

Payment start-ups dominated the initial wave of investment, unsurprising in a region where remittances and trading account for the bulk of economic activity. More recently, a more diversi-

fied set of start-ups has been funded in the region, including buy-now-pay-later start-ups Tabby and Tamara, open banking companies Lean Technologies and Tarabut Gateway, lending platforms for small and medium enterprises Lendo and Liwwa, and wealth management players Sarwa and Thndr.

However, venture funding has fallen short of predictions, and momentum may be slowing. As of the first quarter of 2023, deals and funding in the region recorded the lowest values since the start of the COVID pandemic. A 2019 Milken Institute report predicted that by 2022, 465 fintech companies in the Middle East would raise over \$2 billion in venture capital funding, compared with only 30 start-ups that raised nearly \$80 million in 2017. Clearly, the region is not realizing its potential for all the reasons previously discussed.

Policy action is necessary

Despite the challenges, regulators in the region recognize the potential for fintech to improve financial inclusion and economic growth and are committed to creating a favorable regulatory environment. Recent announcements from Saudi Arabia regarding its open banking framework and Egypt's digital payment regulation are significant steps toward a better regulatory climate.

Several key policy actions are necessary to allow the fintech sector to achieve its full potential, keeping in mind the need for risk mitigation and customer protection:

Leveling the playing field for incumbents, international players, and start-ups will lead to more dynamic and globally competitive players. Letting incumbents compete effectively will drive higher IT spending and innovation. Incumbents will be forced to improve their products and services to retain customers. Increased competition will also drive much-needed intracountry and intercountry mergers and acquisitions, facilitating the exit of successful start-ups' venture capital and attracting capital for new venture funding in the sector.

Regulatory harmonization will allow for easier and more effective market expansion for all players. Start-ups will still need licensing and permits, but increased regulatory transparency and public engagement will smooth geographic expansion. A further positive step would be allowing licensed players in one country to operate freely in another. Agreements between regulators in the various regional hubs would allow start-ups to expand geographically with little friction. Most important is acknowledgment that regional growth is not a zero-sum game and benefits all.

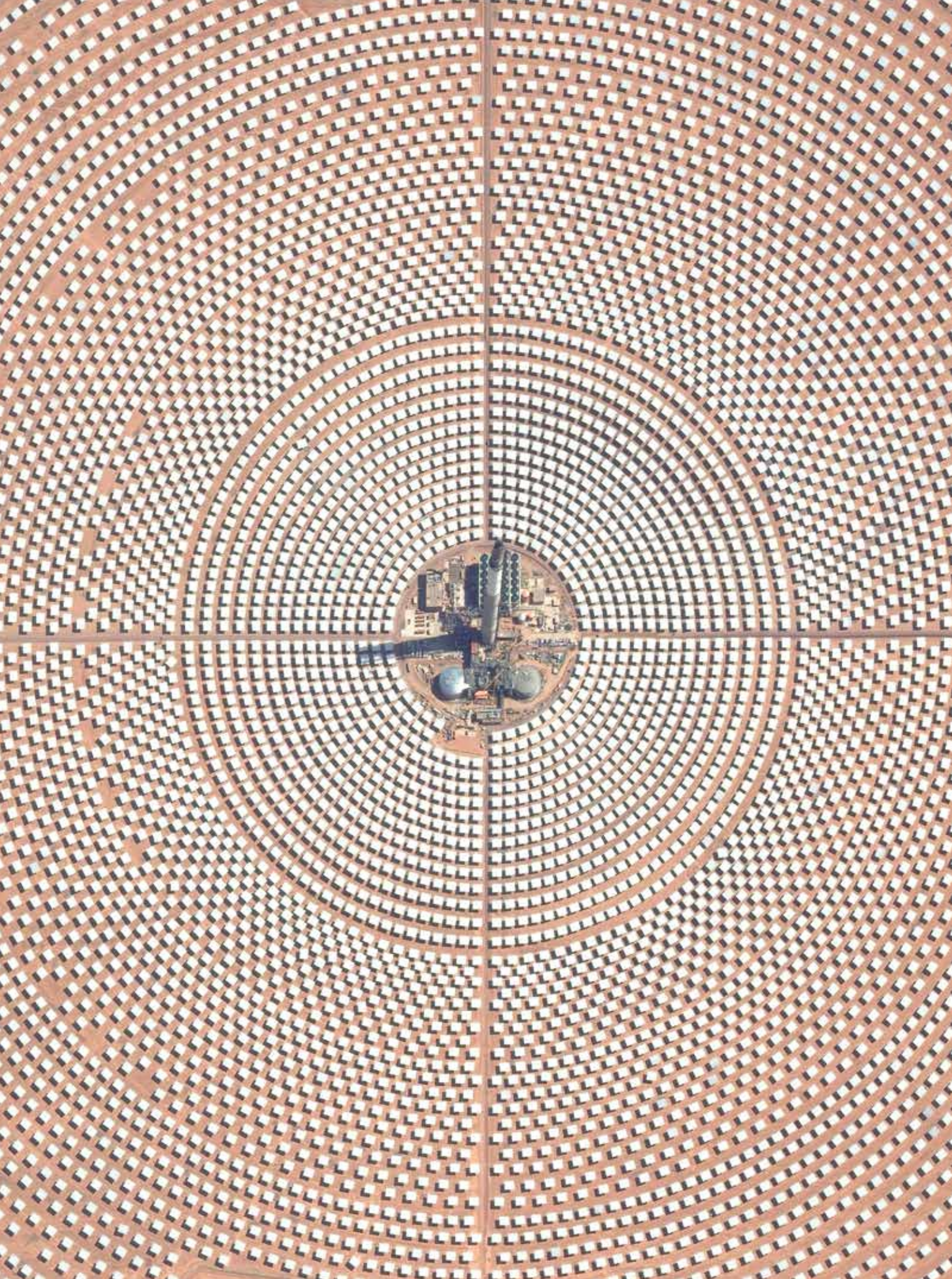
Democratizing access to information is the key to an innovative fintech sector. Open banking regulations and comprehensive credit registries of potential borrowers will lower costs and foster more competition in products and services among a larger pool of companies.

An expanded pool of investors in local venture capital is needed. In the Middle East and North Africa, venture capital financing declined 13 percent in 2023; the number of deals dropped by 55 percent. The region has tended to rely heavily on international funds to fill the gap in larger venture rounds. Excluding sovereign wealth funds and quasi-government entities, the number of local players able to fund the larger financing rounds necessary to transform and scale start-ups for regional and global competition is limited. There are just not enough international limited partners in the region to sustain the venture capital industry without government support. An active, diverse, and vast limited partner pool is essential. The ecosystem needs local and international institutional investors such as pension funds, endowments, foundations, insurance companies, and asset managers. Guarantee and incentive programs will attract these investors.

Human capital development and immigration must be a top policy agenda item. Strong financial professionals are needed to build innovative start-ups and a capable regulatory environment. Finding individuals skilled in complex finance and technology is challenging in the Middle East. The region needs a three-pronged approach: *nurture domestic talent through robust education system reform* with a focus on aligning talent to knowledge industries; *explore initiatives to improve the current workforce* through public-private partnerships, targeted programs, and incentivizing the private sector; and *launch long-term permanent visa programs and a path to citizenship*, especially for talented expatriate professionals already in the region.

The world has witnessed fintech's transformative nature and positive impact on financial inclusion, economic growth, consumer welfare, and cross-border investment and trade in developed and developing economies. Governments must seize the moment and implement the necessary reforms to ignite true fintech innovation in the region. **F&D**

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NORTH AFRICA'S HYDROGEN MIRAGE

Rabah Arezki

The prospect of billions of dollars pouring into hydrogen projects threatens to distract leaders from domestic crises

Today the rich deep blue of the Mediterranean Sea serves as the incongruous backdrop for thousands of tragic journeys by refugees and migrants heading north toward Europe. On June 14, 2023, a refugee boat capsized off the coast of Greece and left hundreds dead. In 2022, no fewer than 160,000 people attempted to cross miles of open water, often in overcrowded or makeshift boats, according to the UNHCR, the United Nations refugee agency. Almost 40 percent of them were from Tunisia or Egypt. More than 2,300 died.

The migrants were desperately seeking safety and economic opportunity, and thousands more continue to risk their lives every day for the same reason. The flow of migrants has raised tensions between the Northern Rim and the Southern Rim of the Mediterranean, a body of water that has served as the crossroads between Eastern and Western civilizations for millennia.

Even as tensions over migration run high, the Northern Rim and the Southern Rim have renewed their cooperation over energy issues. In addition to traditional oil and gas exporters such as Algeria and Libya, other nations, including Egypt, Lebanon, Israel, and Mauritania, are poised to get in on the action, thanks to several major fossil fuel discoveries.

Amid the global energy transition, investors are anxious to pour billions of dollars into many of these countries to turn the new fossil fuel finds into hydrogen. The element is the key feedstock for fuel cells, which use chemical reactions to generate electricity cleanly, with water as the main byproduct. Notwithstanding the considerable technological challenges ahead, demand for the gas in Europe and elsewhere is widely expected to surge as vehicles, factories, and other energy users seek to reduce greenhouse gas emissions.

For Southern Rim nations, however, this tantalizing opportunity for economic development

Satellite image of the Ouarzazate Solar Power Station in Morocco.

risks turning into just another Sahara mirage. That's because the hype surrounding hydrogen may continue to distract the regions' leaders from addressing the tough domestic social issues that are behind the migration crisis. If the technology does become viable, revenue from hydrogen exports to Europe could just perpetuate rent-seeking behavior by political and economic elites at the expense of their own citizens.

Certainly, the fallout from Russia's invasion of Ukraine helped cement energy cooperation between the two sides of the Mediterranean. The war put energy security at the top of the policy agenda as European nations scrambled to replace Russia's natural gas and oil. More resources from the Southern Rim flowed north, generating foreign exchange revenue.

Political leaders from Italy, France, and Germany visited their counterparts in Algeria, Egypt, Libya, and Mauritania to expand cooperation on energy issues. These high-profile contacts resulted in promises of more fossil fuel exports and new investments in extraction and transportation, including pipelines. Such investments will ensure that fossil fuels from the Southern Rim keep flowing north to Europe.

New focus on renewables

Critics have blasted Europe's advanced economies for their not-in-my-backyard policies of relying on developing economies to do the dirty work of producing fossil fuels and

extracting minerals critical for the energy transition. In addition to the climate and environmental risks, the Southern Rim and the rest of Africa face the danger of being left behind once Europe resolves its energy security issues. The economic concentration around fossil fuels and associated capital investments expose these nations to the risk of stranded assets or the threat of stringent restrictions on fossil fuel trade.

The European Union has made great strides in advancing its energy transition. Investments in renewable energy have increased rapidly, but the race to replace energy from Russia also showed how hard it is to quickly ramp up renewable and other cleaner energy sources. Still, the formidable decline in the cost of producing renewable energy has been a key driver behind these investments.

As for the Southern Rim, nations there will face greater macroeconomic and financial challenges in the energy transition, partly because of the relatively higher cost of capital. Some Southern

Rim nations have made progress toward reducing greenhouse gas emissions. Egypt and Morocco are ramping up renewable energy. Morocco built the Noor-Ouarzazate complex, the world's largest concentrated solar power plant, covering 3,000 hectares. Others, like Algeria and Mauritania, are gearing up to install large solar and wind projects.

These days hydrogen is at the center of attention in the Mediterranean region. Hydrogen is easily the most abundant element in the universe, offers a clean source of energy, and can come from a variety of sources. "Gray hydrogen" is produced from natural gas but without carbon capture and storage. When carbon capture and storage are added, the hydrogen is labeled "blue," but the costs are higher. "Green hydrogen" is produced using nuclear power, biomass, or renewable energy like solar or wind. Its costs are still relatively high.

Enthusiasm around green hydrogen is raging. Projects costing billions of dollars are under consideration in Mauritania, Algeria, Egypt, and other countries. A German developer and Mauritania signed a memorandum of understanding with a consortium for a \$34 billion project with annual capacity of 8 million tons of green hydrogen and related products.

Hydrogen projects could help keep energy flowing from the Southern Rim to the Northern Rim. The infrastructure to transport hydrogen is already under development, although projects so far focus on the intra-European market. A large chunk of the prospective hydrogen investments may end up in Europe, with Italy and Spain gearing up to become big producers. Portugal, Spain, France, and Germany signed an agreement to build a Mediterranean pipeline that would supply 10 percent of the EU's hydrogen by 2030. The energy ministries of Italy, Germany, and Austria signed a letter of support for the development of a hydrogen-ready pipeline between North Africa and Europe involving Italy's gas grid operator.

Such mega investments could have important macroeconomic implications, especially for the smaller and less diversified economies of the Southern Rim. Challenges will involve exchange rate appreciation and current account swings from deficit to surplus. Policymakers will also have to tread carefully because of contingent liabilities associated with large projects, such as failure or abandonment.

While the shift in geopolitics accelerated by Russia's war in Ukraine is furthering energy integration across the Mediterranean, the new push for industrial policy and economic sovereignty in Europe is working to limit integration. These are new risks North African countries will have to man-

“The hype surrounding hydrogen may continue to distract the region’s leaders from addressing the tough domestic social issues that are behind the migration crisis.”

age, and they suggest the need for greater attention to addressing domestic issues.

Domestic issues

Big hydrogen projects hold out the promise of generating revenues that could help address the needs of Southern Rim citizens. Access to reliable and abundant energy is surely a building block for industrializing economies. Yet, if history is any guide, the abundance of energy alone is not sufficient to achieve economic development. Countries in the Southern Rim have a lot on their plates, and social cohesion is at stake. The authorities need to regain the confidence of their youth and address long-standing domestic issues, whether social, economic, or regional. The desperation of young people from the Southern Rim drives them to risk their lives crossing the Mediterranean, signaling the pervasiveness of these issues.

There are, of course, great differences between oil-exporting and oil-importing Southern Rim nations. Importing nations such as Morocco and Egypt have overhauled or removed fuel subsidies or price controls, with accompanying mitigation measures such as cash or in-kind transfers to ease the impact on poor households. Oil-exporting countries such as Algeria and Libya have tended to stick with subsidies despite their high economic and environmental costs. In economies with little political accountability, this reflects an enduring social contract under which citizens accept subsidies and look the other way as political and economic elites capture the revenues generated by fossil fuels and now, most likely, hydrogen.

Across the Southern Rim, distrust of government and perceptions of corruption remain high. The lack of economic opportunities stems from the lack of a dynamic private sector. Unemployment is higher for individuals with more education than for those with less. In many of these countries, the legacy of a state-administered economy with large, government-owned enterprises crowds out independent businesses and creates the conditions for a parallel informal economy.

And state-owned banks have long underpinned shadowy flows of funds that support the state-owned enterprises and limit fair competition. In countries where the footprint of the state is less significant, it is a crony private sector that typically captures the wealth, distorting competition. Whether in systems where state-owned enterprises or a crony private sector dominates, millions of young people have been left behind. In both cases, the perception of corruption and rampant inequality are gravely undermining social cohesion.

The prospect of hydrogen exports may help improve external fund balances. But it may also reinforce rent-seeking activities to the detriment of other aspects of a nation's economy. To avoid repeating past mistakes, the sector must show utmost transparency to limit corruption.

Authorities should also try to maximize not only the revenues they derive from hydrogen production but also the benefits for citizens, including localization policies. An energy sector that is geared for exports will not yield the kinds of jobs that will be needed for young people, who represent the majority of the population in the Southern Rim.

It is thus important to carry out reforms that go beyond the energy sector. Restructuring must be broader and aimed at removing roadblocks to creating decent jobs for young people. That would help address their growing sense of desperation. But carrying out such changes in the context of widespread distrust isn't easy.

The sequencing of reform could build trust. In a nutshell, changes must start with the political and administrative elites and cronies "walking the talk" before introducing changes that affect the broader population. Specifically, it will help to get rid of corporate subsidies stemming from import monopolies and more generally to promote fair competition by limiting the abuse of dominant positions by state-owned enterprises or cronyism. In addition to greater transparency in the energy sector, the use of distributed solar power would blur the distinction between consumers and producers. That may make citizens more accepting of evolving market prices. Only then could labor market restructuring and exchange rate stabilization bear fruit.

Among nations on the Southern Rim, regional cooperation is at an all-time low. Rekindling cooperation would help create a larger market that would be more attractive for new investment, similarly to the development of the EU. A coming-together of North African nations could help in the renegotiation of better trade deals with EU partners and others.

Rather than grasping at the mirage of collecting prospective rents from hydrogen exports, leaders in the Southern Rim should pay more attention to building trust at home and providing opportunities to the young people who are voting with their feet at the peril of their own lives. **F&D**

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FINANCING PEACE AND STABILITY

Franck Bousquet

A course toward prosperity depends on international community support for peace as a global public good

The ongoing crises in Sudan and Niger are stark reminders of the far-reaching spillovers of violent conflict in today's integrated global economy. Beyond the suffering of vulnerable people, a full-blown conflict in Sudan would further destabilize the region. The country's neighbors, such as the Central African Republic, Chad, Ethiopia, Libya, and South Sudan, are already facing conflict, civil unrest, and food insecurity. Similar dynamics are at play in Africa's Sahelian belt, just south of the Sahara. Most recently, the military putsch in Niger has caused tensions with members of the Economic Community of West African States, elevating risks of a regional conflict.

Such dynamics have intensified across Africa and the Middle East over the past decade. The antagonists vary—including violent extremist groups, community militias, rebel movements, soldiers, and private mercenaries such as the Wagner Group. But the effects on people and economies are equally harmful. Deadly violence in



Mali and Burkina Faso peaked in 2022, forcibly displacing 2.6 million people. Conflict forced the closing of thousands of schools and health centers.

Past IMF analysis has shown that conflict and insecurity may cause an economic contraction of up to 20 percent in the Sahel. Across sub-Saharan Africa, 30 percent of countries are considered to be conflict-affected, and a study estimated that annual growth was 2.5 percentage points lower than for countries at peace. These trends typically delay or impede crucial investments in transport, electricity, and digital connectivity that regional integration efforts could unleash, such as through the African Continental Free Trade Agreement.

Sudan and Niger are just the most recent flash points in a worsening global fragility and conflict landscape aggravated by Russia's invasion of Ukraine. If this situation persists, more than 60 percent of the world's poor will live in fragile and conflict-affected states by 2030. Security, diplomatic, and humanitarian efforts will be critical to put a stop to these trends. Therefore, the international community must scale up assistance and develop financing solutions that support peace and stability as global public goods—institutions, mechanisms, and outcomes that benefit more than one group of countries and extend to current and future generations.

Global public bads

This picture gets even more complex when we factor in phenomena that may exacerbate conflict. Not all conflict-affected countries are fragile, but state fragility—a mix of weak economic performance, low-capacity institutions, poor governance, extreme poverty, and limited public services—is often a precursor to violence. Fragile states have a harder time mediating demands for security, justice, and inclusive growth. As a result, governments are perceived as not delivering impartially on the social contract and as lacking in trustworthiness and legitimacy, compared with more stable countries. These dynamics often spark social unrest and violence.

Fragile states are more vulnerable to external shocks, such as food price inflation, pandemics, and climate-related risks. An influx of refugees can mean not only short-term fiscal pressure but also long-term effects on an economy. If institutional capacity for policy coordination is ineffective, labor market misallocations persist, and nations cannot reap the benefits newcomers may bring. Young people can be a vector for creativity and private sector entrepreneurship. But in fragile states, the youth are often not employed, educated, or trained. This is especially true for young women, who are also subject to gender-based violence.

The most vulnerable countries thus must respond to overlapping crises that further strain overstretched coping capacity. Their resilience is already low, even as they face new tests. The complex effects of climate change in the absence of adaptation, for example, can further exacerbate the drivers of fragility.

When nations fail, the ripple effects reach far and wide. Conflict and state fragility amount to global public bads, or the opposite of global public goods, as they harm many groups of countries over multiple generations.

Fragility, conflict, and related spillovers can be considered “nonexcludable,” in economists' terms, meaning that everyone in an affected country suffers from direct or indirect repercussions. They can also be regarded as “nonrivalrous”: when one nation is engulfed in fragility or caught up in conflict, it does not prevent others from following suit. Such contagion is usually what happens.

This year, the United Nations estimated it would take \$51 billion in humanitarian aid to support 339 million of the world's people who are affected by conflict and natural disasters. Their fate is inextricably linked to that of people in more prosperous countries. To change course, we must draw lessons from the past and recognize that the global trends of fragility and conflict warrant humility and realism. And then we must think of the most effective ways to promote peace and stability as global public goods.

Peace and stability agenda

Resilience to pandemics, protection of the environment, and ensuring global financial stability are among global public goods. But peace and stability are at the core. When fragility and conflict prevail, governments, international organizations, the private sector, and citizens cannot make progress on common objectives. Conflicts drive fragmentation and cause reversals in trade, capital flows, and migration, and they undermine cooperation between countries.

Leaders and governments are primarily responsible for ensuring that states and societies do not succumb to fragility and conflict. Humanitarian and peace actors often play a leading role in these contexts. However, neither conflict prevention nor long-term stability are sustainable without supportive and long-term engagement by international financial institutions (IFIs). Organizations such as the World Bank, the International Monetary Fund, and other IFIs are uniquely positioned to tackle the economic dimensions of fragility and conflict. Since no country is immune to global public bads, it takes a combination of global convening

power, sharp analysis, and large-scale financing to tackle root causes, which are often about economics, political economy, and governance.

What types of interventions may contribute to peace as a global public good? Conflicts today last 30 years on average—twice as long as during the 1990s—because negotiated settlements often fail to resolve root causes. Interventions should therefore focus first on prevention programs and projects that help strengthen institutions, economies, and local communities. Traditional poverty alleviation and development programs are not enough in settings where exclusion from access to power, economic opportunities, and security is entrenched for a significant portion of the population.

Policy advice and development projects must help extend public services like health care and education to lagging regions. This will address enduring grievances that increase distrust in the state. Governance changes can help rebuild trust and mobilize domestic revenues by improving management of natural resources and ensuring that public resources benefit most of the population, not just a few members of elite groups.

When the risks of conflict are high, targeted social protection programs and the effects of economic policies on vulnerable populations can play a role in warding off social unrest. Economic gains should be shared broadly to avoid the politics of division and inequality and strengthen the credibility of policymakers. This is especially relevant for conflicts within a country, where it may take years for initial sparks to erupt into violence and where there may be a window of opportunity to act with foresight. International financial organizations have a key role to play in helping tailor programs to address the base causes of fragility and helping mitigate emerging crises.

If large-scale violence does break out, IFIs should remain engaged to prevent the collapse of the state and reduce the economic consequences of conflict. Such institutions can support basic services for the most vulnerable and deploy low-level technical capacity development to keep central banks and payment systems functioning. These systems are essential for humanitarian agencies channeling aid and for the functioning of the private sector, which can be particularly resilient during crises.

What about countries affected by the spillovers of conflict, such as refugees? Three-fourths of nations hosting large refugee populations are low- and middle-income countries. Worldwide, the United Nations High Commissioner for Refugees found that a record 108 million people had been forcibly displaced as of the end of 2022. Governments must grapple with the needs of their own people and find solutions that effectively integrate

newcomers. In so doing, they provide a global public good in another form. But this work is expensive, and the international donor community must share the costs. Lessons from recent innovations show how support can be channeled to the state and the private sector. Job creation is one of the most effective vehicles for social integration.

Catalytic funding

Potential mechanisms to support peace and stability as global public goods could build on previous innovations designed to help middle-income countries deal with refugees. A case in point is the Global Concessional Financing Facility (GCFF), created in 2016 to help Jordan and Lebanon deal with a surge of Syrian refugees with support from Canada, Denmark, Germany, Japan, The Netherlands, Norway, Sweden, the United Kingdom, the United States, and the European Union. Leveraging donor grants, the GCFF reduced the costs of borrowing for the two middle-income countries. Each \$1 in donor grants unlocked \$7 in concessional loans.

Countries are often hesitant to borrow and take on debt for refugees. Lowering the cost of loans can help decrease this hesitancy. Since the inception of the GCFF, Colombia and Ecuador have also tapped its resources in response to forced migration from Venezuela. The GCFF showed its adaptability in immediately supporting Moldova as it took in refugees from Ukraine. This mechanism has become increasingly relevant as more middle-

income countries grapple with the effects of conflicts. It could be scaled up to fund prevention activities such as development programs and policy changes that reduce fragility and conflict risks.

The GCFF has two key features: concessional financing for middle-income countries providing a global public good and a catalytic role of leveraging grants sevenfold with low-cost loans. However, three other aspects of the facility offer important lessons for encouraging global public goods.

First, the GCFF bridges the gap between humanitarian and development assistance. Second, it aims to strengthen the resilience of host countries and to support host communities, not just refugees. For instance, the participation of the United Nations High Commissioner for Refugees allows for more in-depth review of policies such as the right to work or access to services. Third, it creates a platform for development banks—such as the European Bank for Reconstruction and Development and

“Young people can be a vector for creativity and private sector entrepreneurship. But in fragile states, youth are often not employed, educated, or trained.”

the Islamic Development Bank—to enhance coordination at the country level.

In addition to innovative financing mechanisms, the scale of financing must be commensurate with affected countries' needs. In 2016, Iraq faced a dual crisis of falling oil prices and rising security costs to combat the Islamic State of Iraq and Syria (ISIS). Leveraging \$500 million in donor guarantees from the United Kingdom and Canada allowed for a World Bank loan of \$1.5 billion. Just this year, financing assurances from the Group of Seven, European Union, and other donors were used to provide IMF support for Ukraine to address balance of payments problems and restore external viability following Russia's invasion. While such guarantees are an effective way to scale up financing for countries providing a global public good, guarantees that allow private sector investment in fragile and conflict-affected states are also important. Consider, for example, the January 2023 guarantee to Somalia by the World Bank's Multilateral Investment Guarantee Agency to promote investment in renewable energy.

A way forward

The scarring effects of violence on human and economic well-being are not restricted to fragile low-income states. A recent World Bank study found that conflicts have been most intense in middle-income countries, particularly in the Middle East and North Africa. Iraq, Libya, and Syria—which all suffered large-scale civil wars—were middle-income countries before violence erupted. Beyond the loss of life, violence caused deep recessions, drove up inflation, disrupted trade, and worsened fiscal conditions. These are formidable challenges that require country leadership as well as stepped-up support from the international community, especially since many vulnerable countries are also at risk of debt distress. Promoting peace and stability as global public goods can help make such tragedies less likely.

Within their mandates, it is important for international financial organizations to put peace and stability at the heart of the global public goods agenda by catalyzing

- **Scaled-up assistance from the international community with a strong focus on prevention:** Last year, the African Development Bank updated its fragile states strategy, and the European Investment Bank adopted its first. The World Bank and the Asian Development Bank have taken similar steps since 2020. Those strategies aim to tailor the IFIs' engagement and activities in country-specific manifestations of fragility and conflict. Likewise, the IMF's strategy focuses on supporting fragile and conflict-affected states to achieve economic stability, strengthen resilience, and promote inclu-

Global Concessional Financing Facility (GCFF)

The GCFF was launched in 2016 by the World Bank, the UN, and the Islamic Development Bank to support middle-income countries receiving refugees. It provides concessional financing and improved coordination for development projects addressing the impact of refugees. The facility uses donor grants to reduce the interest rates on multilateral development bank loans to concessional levels for projects that benefit refugees and host communities. The GCFF so far has funded \$800 million in concessional credit, which in turn has leveraged almost \$5.5 billion in financing to support refugees and host communities of the Middle East for decades. China's deeper engagement will have an economic impact, and—as evidenced by Beijing's role in normalizing ties between Iran and Saudi Arabia—it will also contribute to a climate of greater economic interdependence within the region.

sive growth. These principles also inform donor approaches that aim to strengthen capabilities to engage in peacebuilding and prevent violent conflict before it erupts, such as the US Global Fragility Act. Economic reforms and development policies must be tailored to help reduce fragility and conflict risks.

- **Increased concessional financing:** The IMF has already committed \$39 billion in financing to 24 fragile and conflict-affected countries since the start of the pandemic. It is now working to ensure that the Poverty Reduction and Growth Trust is sufficiently funded to assist low-income countries, many of which are affected by fragility and conflict. Supporting such nations also requires grants with incentives for prevention. Innovative mechanisms—drawing on lessons from initiatives such as the GCFF—could be scaled up further.
- **A broad coalition of humanitarian, development, and peace actors:** Such efforts have crystallized in addressing the COVID crisis, tackling the onset of climate change, and responding to forced displacement. But they are needed now more than ever to make sure that programs are aligned for peace and stability.

Beyond diplomatic, security, and humanitarian assistance, fragile and conflict-affected countries need scaled-up support at reduced cost, with economic policy advice and programs tailored for prevention and resilience. Supporting fragile and conflict-affected states—where the majority of extremely poor people will be heavily concentrated in the future—and advancing a global public goods agenda are mutually reinforcing. An enduring foundation for poverty reduction and growth in support of fragile and conflict-affected states is the quintessential global public good. **F&D**

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DEBT CLOUDS OVER THE MIDDLE EAST

Adnan Mazarei

Parts of the Middle East and North Africa stand at the brink of a debt crisis

There is a debt storm brewing in parts of the Middle East and North Africa (MENA). Debt across the region has been climbing, reaching very high levels in several countries (Chart 1). Egypt, Jordan, and Tunisia are in a precarious situation, their economic stability teetering as they grapple with the prospects of a debt crisis. Lebanon, already reeling from one of the worst economic crises in the world, is a cautionary tale. Its plunge into default has thrown a harsh spotlight on these countries' acute debt-related challenges and their broader ramifications.

The rising tide of debt, coupled with tough global economic prospects, is stirring up a perfect storm (Chart 2). This crisis has been fueled by scarcer low-interest financing and the affluent MENA oil producers' reluctance to continue the unconditional

financial support of the past. Exacerbating this complex equation are the difficult social conditions these countries face, leaving little room for significant fiscal consolidation. Consequently, maintaining debt sustainability is a colossal challenge for these countries, and it is growing ever more daunting.

At risk are not just the prospects for economic growth but also the sociopolitical stability of these countries. The stakes are high. Amid these grim realities lies a narrow path to salvation—but that path requires bold, proactive measures to address the debt crisis head-on.

Crisis origins

The MENA region's ballooning debt problems are deeply rooted in a blend of misfortune and poor policy decisions. Each nation—Egypt, Jordan, Lebanon,



and Tunisia—faces a unique set of problems, marked by differing political and economic landscapes, as well as disparity in the composition of their outstanding debt. Yet there is a common thread in their predicaments.

These nations have been hamstrung by persistent structural issues related to governance and regulatory frameworks, state-controlled economies, bloated public sectors that stifle private sector growth, low domestic revenue mobilization, and poorly targeted subsidies. These problems are long-standing, mainly because of inadequate reforms. Their reliance on fixed exchange rates and debt financing also contributes to a crisis in the making. The situation has been exacerbated by global economic fluctuations and recent shocks—such as the pandemic and the spillovers from Russia’s invasion of Ukraine—and by higher food prices, which contribute to soaring

debt levels. Societal challenges and distrust in government that thwart the equitable distribution of economic adjustment burdens have compounded the problem. As a result, public debt has been exploited as a temporary stop-gap solution to delay dealing with economic problems—but without durable solutions.

Let us consider the specifics:

Egypt has endured years of economic stagnation, attributable in part to the military’s pervasive control over the economy. The pandemic’s toll on tourism, along with surging food import costs in the wake of Russia’s war in Ukraine, have added to Egypt’s woes. Persistent budget deficits and upholding a fixed exchange rate have resulted in substantial financing needs, met partly through short-term capital inflows. As noted in the IMF’s April 2023 *Fiscal Monitor*, Egypt’s gross financing needs in 2023 amount to a staggering 35 percent of

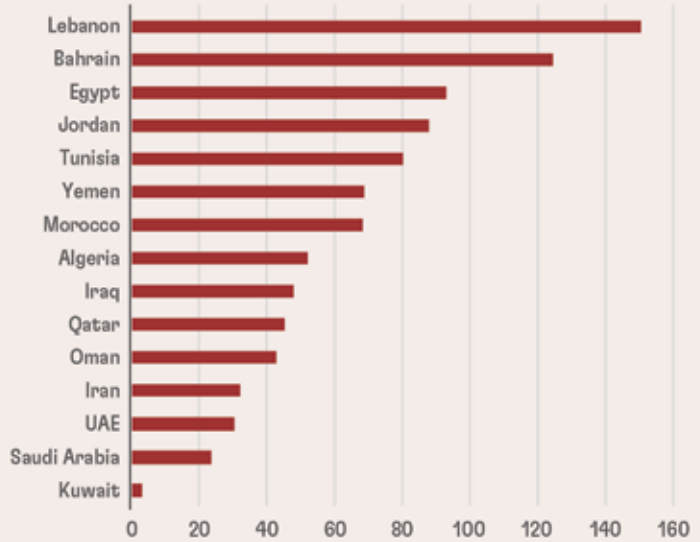


Banque du Liban, Lebanon's central bank

CHART 1

Debt at a glance

Debt levels in several MENA countries are now alarmingly high. (estimated government-debt-to-GDP ratio, 2023, percent)



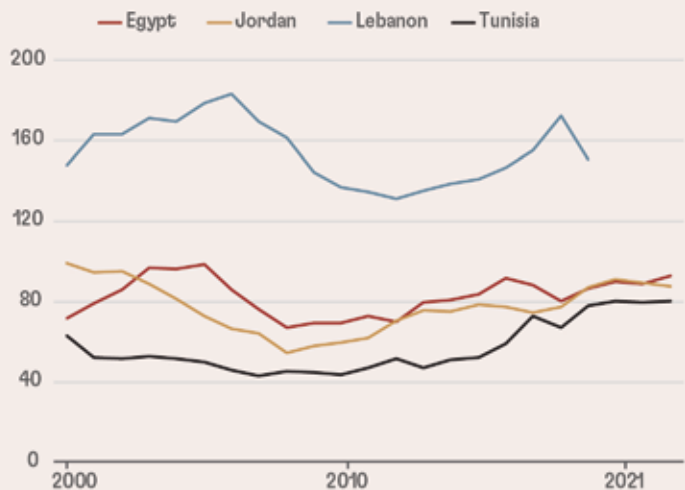
SOURCE: IMF, *World Economic Outlook*, April 2023.

NOTE: MENA = Middle East and North Africa; UAE = United Arab Emirates.

CHART 2

Perfect storm

Rising debt, compounded by tough global conditions, is creating a colossal debt sustainability challenge for some countries. (government-debt-to-GDP ratio, selected economies, percent)



SOURCE: IMF, *World Economic Outlook*, April 2023.

its GDP, leaving it highly susceptible to interest rate hikes and rollover risks.

Jordan, too, has been grappling with low growth, resulting in part from an overvalued fixed exchange rate, along with geopolitical and economic disruptions. The large influx of Syrian refugees and trade disturbances following the Syrian civil war have further strained its economy. Meanwhile, Jordan has been wrestling with control of its public finances, burdened by hefty subsidies, public enterprise transfers, and security expenditures—largely because of geopolitical factors—all while depending heavily on official aid. Fortunately, Jordan has a more effective policymaking framework than the other three countries and is performing well under its current IMF program. Nevertheless, its high debt makes it very vulnerable to adverse developments.

Lebanon's debt crisis was driven by an unsus-

tainable system built on fixed exchange rates and weak public finances, which required high interest rates to draw foreign inflows—a classic Ponzi scheme. This flawed system, along with persistent political deadlock and the banking sector's undue influence on policymaking, has precipitated a multifaceted economic and social crisis, leading to default on domestic and external sovereign debt.

Tunisia stands out as the only Arab Spring nation that appeared to take steps toward enhanced democracy and governance. However, the increasing role of the government as an employment and subsidy provider, coupled with the COVID-19 shock—which assailed the economy and budget (Mazarei and Loungani 2023)—have put Tunisia on shaky ground. The authorities insisted on maintaining exchange rate stability even when it was unaffordable. This led to dependence on external inflows, primarily from official creditors who supported Tunisia's democratic transition. But recent political upheavals that have undermined Tunisia's democratic progress, coupled with a refusal to implement necessary reforms, have eroded Tunisia's debt repayment capabilities, leading the country inexorably toward debt distress.

Previous debt crises

The MENA region's tryst with debt crises is not a recent phenomenon. The region witnessed episodes of debt distress during the 1980s and 1990s, spurred by internal and international conflicts and unfavorable global conditions, including adverse shifts in commodity prices. Poor management of fiscal and external imbalances led to multiple instances of restructuring of debt that was primarily public and publicly guaranteed (see table).

The main creditors to the MENA countries during these crises were the Paris Club and regional bilateral creditors, commercial banks, and multilateral agencies. The debt crises of the 1980s were managed through agreements within the Paris Club and private banks (known as "Brady deals"), requiring structural adjustment programs.

Another series of debt rescheduling efforts took place during the 1990s and early 2000s to address debt distress caused in part by fallout from regional conflicts, notably the first Gulf War. These debt rescheduling efforts, particularly for Egypt, Iraq, and Jordan, were carried out with substantial support from the international community and international financial institutions.

Despite these historical debt restructuring episodes, today the road to further restructuring is riddled with challenges. Given the current economic climate, it is likely to be significantly more complex and difficult.

The new debt reality

Recent years have seen significant advancements in the global debt architecture, most notably the introduction of collective action clauses in sovereign bond contracts. These changes have hastened debt restructuring of sovereign Eurobonds, a step in the right direction. However, on the whole, new developments have complicated sovereign debt restructuring—and this complexity is accentuated by flaws in the global financial architecture. The restructuring ordeal in Sri Lanka stands as a testament to the lengthy delays and potential trauma associated with such proceedings today.

Restructuring is now more difficult than in the past for several reasons. First, the ascent of China and other non-Paris Club creditors means that the official creditor base is more fragmented. Although China's claims on high-debt MENA countries are not substantial, its emergence as a leading global creditor has rendered the restructuring process in general more political, slower, and more challenging. Second, private creditors have exhibited reluctance and tardiness in providing debt relief. Third, a significant number of MENA countries—Egypt is a prominent example—have considerable domestic debt outstanding. Creditors may in the future request an expanded restructuring perimeter to include such debt. However, most of this domestic debt is held by local banks and pensions, making its inclusion particularly problematic.

Finally, the Group of Twenty Common Framework applies only to low-income countries and therefore is not applicable to most MENA countries, which are middle-income. The exceptions are Sudan, which is finally addressing its long-standing debt issues under the Heavily Indebted Poor Countries Initiative (but may have trouble proceeding because of its domestic conflict), and Yemen, a country still grappling with conflict, which will likely need time to resolve its debt problems. This new debt reality means that addressing the burgeoning MENA debt issues is a steeply uphill task.

What next?

The specter of unsustainable debt and protracted, distressing restructuring looms over high-debt MENA countries. These risks could be mitigated through a combination of growth-boosting policies, new financing, and some degree of fiscal consolidation. However, the prospects for now appear grim.

“Each high-debt nation must take urgent steps to circumvent debt distress and potential crises.”

Borrowing burdens

Poor management of fiscal and internal imbalances led to multiple debt restructurings in the 1980s and 1990s.

Country	Reschedulings
Algeria	1994, 1995
Egypt	1987, 1991
Jordan	1989, 1992, 1994, 1997, 1999, 2002
Morocco	1983, 1985, 1987, 1988, 1990, 1992
Sudan	1979, 1982, 1983, 1984, 2021 (HIPC)

SOURCE: Paris Club website.

NOTE: HIPC = Heavily Indebted Poor Countries Initiative.

First, the world economy faces a weak forecast—growth prospects are continually being downgraded amid persistently high inflation.

Second, securing external financing will pose a significant challenge and, if procured, will carry high interest rates. The Gulf Cooperation Council's oil-rich nations, which have traditionally provided substantial financing, have revamped their aid strategy. They now insist on the borrowers' concrete, credible commitment to structural reforms, including those aimed at making their economies more inviting for foreign direct investment.

Third, although fiscal consolidation could be beneficial, it is not guaranteed to reduce debt, as noted in the IMF's April 2023 *World Economic Outlook*. Moreover, given the tense social and political climate in high-debt MENA countries, public acceptance of expenditure cuts, especially to subsidies, will likely be difficult.

It may be tempting for these countries to continue muddling through, hoping that donors and multilateral agencies will come to the rescue. Some countries might even resort to inflation surprises to ease their domestic debt burden, as predicted in the IMF's May 2023 *Regional Economic Outlook for the Middle East and Central Asia*. However, the path to genuine, lasting reform calls for more substantive measures.

Each high-debt MENA nation must take urgent steps to circumvent debt distress and potential crises. The measures will vary from country to country, but all must address key governance issues broadly (ERF-FDL 2022) and credibly commit to reform. For instance, Egypt should dismantle its overbearing regulatory system and diminish the army's role in the economy to spur growth and should carry out

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35%

of GDP: Egypt's estimated gross financing needs in 2023.

solid privatization that attracts foreign investment. Jordan should implement deeper structural reforms to avert a crisis. Tunisia needs to quickly reverse the recent erosion of democracy and embark on crucial reforms. Lebanon must urgently form a government that transcends its deep-seated confessional divisions (in other words, the division of power among religious groups) and steers the country toward reform.

The chances of either the requisite reforms being implemented or the global economic climate turning favorable are slim—and both are needed. The MENA high-debt nations do have a narrow escape route from impending debt crises, but existing policies and unfavorable global developments are likely to constrict that path further. In particular, the prospects for fundamental changes in politics and economic management are dim. Consequently, some form of debt restructuring may be unavoidable. Debt restructuring, due to its inevitable economic disruption and harm, should be seen as a last resort. But if it is indeed inevitable, it is preferable to do it preemptively, as part of a broader set of corrective actions.

The highly indebted MENA nations find themselves in the path of a debt storm spawned by internal inefficiencies, poor governance, and an unforgiving global economy. Dodging this tempest will require swift, pinpointed interventions; real reform; and the readiness and ability to face up to debt restructuring. Time is of the essence; now is the moment for bold action. The question is whether these countries will undertake the needed political changes and take advantage of this critical juncture to commit to, and enact, reform—or simply continue to drift further into a sea of debt. **F&D**

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A MERCANTILE MIDDLE EAST

Nasser Saidi and Aathira Prasad

The Gulf states can catalyze trade within the Middle East and North Africa and the region's integration into the global trading system

The world has witnessed a tectonic shift in global economic geography and trade toward emerging Asia in the past two decades. However, the Middle East and North Africa (MENA) region has remained one of the least dominant, accounting for just 7.4 percent of total trade in 2022. The region's trade is characterized by a relatively high concentration of exports in a narrow range of products or trading partners, limited economic complexity, and low participation in global value chains.

Even so, commodity-dependent nations in the MENA region have made substantial gains over time, specifically in trade diversification, as shown by the Global Economic Diversification Index, which tracks the extent of economic diversification from multiple dimensions, including economic activity, international trade, and government revenues.

The MENA region's total trade in goods as a percent of GDP (an indicator of openness) was

A vendor waits for customers at a market in war-torn Yemeni capital Sana'a.





MOHAMMED HUWAIS/AFP VIA GETTY IMAGES

65.5 percent in 2021, indicating a relatively open regional economy. Yet, as shown in Chart 1, intra-regional trade is low, representing only 17.8 percent of total trade and 18.5 percent of total exports, despite a common language and culture as well as geographic proximity. The six oil-exporting Gulf Cooperation Council (GCC) nations—Saudi Arabia, Bahrain, Oman, Qatar, Kuwait, and the United Arab Emirates—account for the bulk of intra-regional trade.

Their dominance of intraregional trade suggests that the Gulf nations could become a catalyst for regional trade integration, helping lower barriers to trade, improving trade infrastructure, and diversifying the region's economies. Greater integration of non-GCC Middle East nations with the GCC will lead to more intraregional trade and greater global integration (via the GCC's existing global linkages and participation in global value chains). With the growing global economic integration of the GCC nations and their concerted effort in supporting the region's other nations (via increased trade and investment deals with Egypt and Iraq, for example), they can be a conduit for greater integration of the rest of the region into world trade.

Region's laggards

Why have non-GCC countries lagged when it comes to intraregional trade? In part it is a failure of the MENA region's multiple regional trade (and investment) agreements. The share of intragroup exports in the Arab region, excluding the GCC, has remained below 2 percent of their trade flows, partially a reflection of regional fragmentation, violence, and wars since the mid-1990s and following the Arab Spring in 2011. The region comprises a group of nations characterized by significant political differences, and this is reflected in trade patterns as well. For example, the orientation of the Maghreb nations of North Africa has been toward Europe, with the regional Euro-Med program and agreements supporting such linkages.

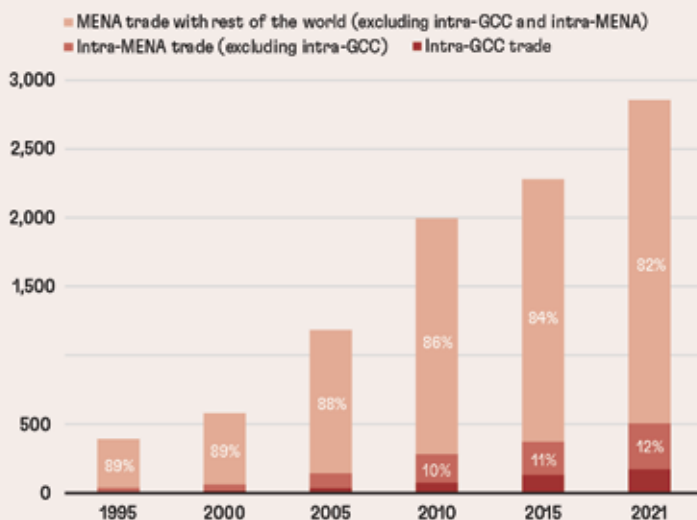
A contributing factor to the stagnation of intraregional trade is the lack of growth of trade in services. MENA services trade has ranged between 4 and 6 percent of global services trade in the past two decades. This pales in comparison with the Organisation for Economic Co-operation and Development countries, which account for more than two-thirds of global services trade. Within the MENA region, the GCC accounts for the bulk of services trade, with the largest shares in relatively low-value-added sectors like travel (and tourism) and transportation. The services trade is held back by restrictive policies that limit entry in sectors dominated by state-owned enterprises, such as telecom-

CHART 1

Neighborhood trade

MENA countries do relatively little trading within the region, in comparison with their trade with the rest of the world.

(billions of US dollars)



SOURCE: UNCTADStat.

NOTE: GCC = Gulf Cooperation Council countries; MENA = Middle East and North Africa.

CHART 2

Progress toward diversification

The mix of exports from the MENA region is changing as manufactured goods begin to replace oil exports.

The MENA region has seen a steady increase in the trade subindex over time, driven by multiple factors, including

	2000-03	2020-21
a drop in its fuel exports as a share of merchandise exports	43%	32.7%
medium- and high-tech manufactured exports as a percentage of manufactured exports	25%	36.9%
an increase in manufactured exports as a percentage of total merchandise exports	37.6%	42%

SOURCE: Global Economic Diversification Index 2023.

NOTE: MENA = Middle East and North Africa.

munications, or that impose high fees and license requirements, especially in professional and transportation services.

Such restrictive policies, along with structural deficiencies, encumber MENA nations' trade both within the region and globally.

MENA nations apply more, and more restrictive, nontariff measures than in any other region. These almost doubled between 2000 and 2020. Lack of uniform standards and harmonization, pervasive red tape, and corruption compound the effects of these barriers. Business and investment barriers include cumbersome licensing processes, complex regulations, and opaque bidding and procurement procedures.

MENA as a region underperforms on trade facilitation measures to ease the movement of goods at the border and reduce overall trade costs, though there are wide disparities across the region. The quality of trade- and transportation-related infrastructure is significantly lower in the non-GCC MENA nations. Furthermore, delays at the port result in excessive "dwell times" (delays of more than 12 days) for imported goods in some MENA countries. Algeria and Tunisia delays average about 20 days versus less than five days in the United Arab Emirates (among the top three globally).

Knocking down barriers

Overcoming these impediments to wider trade for the region requires removing barriers to trade and investment, diversifying the region's economies, and improving infrastructure.

A new generation of trade agreements, including more knowledge-intensive services, would not only support export diversification policies but would also help bridge gender gaps, improve women's economic empowerment, and subsequently result in more inclusive economic growth and integration.

The pandemic has underscored the need for trade diversification (both of products and partners) and development of new supply chains. Although the GCC's oil trade remains dominant, its members have embarked on various policies and structural reforms, such as increasing labor mobility and opening capital markets across borders, to diversify away from overdependence on fossil fuels and associated revenues. This has resulted in diversification of both the output mix (for example, increased focus on manufacturing) and the export product mix (for example, more services exports) alongside an evident shift in trade patterns toward Asia and away from the United States and Europe. More recently, the war in Ukraine further highlighted the plight of food-importing nations

in the Middle East in the context of food security. (Ukraine and Russia accounted for a third of global wheat exports; Lebanon and Tunisia were importing close to 50 percent of their wheat from Ukraine.)

The Global Economic Diversification Index trade subindex shows that the commodity-dependent nations with the most improved scores over time have either reduced dependence on fuel exports, reduced export concentration, or witnessed a massive change in the composition of exports. An example of the latter is Saudi Arabia's increased focus on medium- and high-tech exports, which rose as a share of overall manufacturing exports, to almost 60 percent right before COVID from less than 20 percent in 2000. The MENA region as a whole has already made some headway toward diversification, as shown in Chart 2.

The GCC nations have benefited from the recent rise in commodity prices, but the pandemic reinforced strategies, including the development of free zones and special economic zones, to diversify into new sectors. These policies range from attracting investment (including foreign direct investment) to higher-value-added, higher-tech manufacturing; investing in new sectors (renewable energy, fintech, artificial intelligence); and opening markets to new investors and investments (as is evident in the recent spate of initial public offerings in both the oil and non-oil sectors). These reforms help expand markets (within the MENA region and toward Africa, Europe, and South Asia), while up-and-coming sectors like renewable energy and agritech offer sustainable ways of expanding the extensive and intensive margins of trade and generating new job opportunities.

Engine for regional integration

Full achievement of the benefits of regional trade integration requires a reform of trade policies to break down barriers, including restrictive nontariff measures, complex regulation, corruption, and logistical roadblocks.

Integrating the MENA region's trade infrastructure (ports, airports, logistics) with that of the GCC would lower costs and facilitate intraregional trade, leading to greater regional integration and generating gains from trade for all parties. The GCC can lead the economic integration and transformation of the region via investments in hard infrastructure and trade-related infrastructure and logistics, in addition to developing an integrated GCC power grid. A GCC renewable-energy-powered, integrated electricity grid could extend all the way to Europe, Pakistan, and India.

The GCC nations have an opportunity to benefit from global decoupling and fragmentation with

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7.4%

is the MENA region's share of global trade.

their unfolding strategy of pursuing globalization as a regional group through new trade and investment agreements, foreign aid, and direct and portfolio investment. The ongoing disengagement from long-standing regional conflicts, in Israel, the West Bank and Gaza, Yemen, the Islamic Republic of Iran, Libya, and elsewhere, and the forging of new links (diplomatic opening such as the Abraham Accords) reduce the geopolitical risks of promoting regional trade and investment. The GCC can use this as an opportunity to shape the MENA region into an interlinked trade and investment hub. The GCC's accelerated new free trade negotiations with key partners in the MENA region, including Egypt and Jordan, and in Asia, including China and South Korea, could become the cornerstone of this transformation. The United Arab Emirates have already signed comprehensive economic partnership agreements with India, Indonesia, and Türkiye covering services, investment, and regulatory aspects of trade.

There are two complementary ways to move forward. One is to implement the GCC Common Market, invest in digital trade, lower tariff and nontariff barriers, and reduce restrictions on trade in services, along with reforms to facilitate greater mobility of labor and enhance financial and capital market linkages. Second, the GCC should develop new deep trade agreements with the other MENA countries, going beyond international trade to encompass agreement on nontariff measures, direct investment, e-commerce and services, labor standards, taxation, competition, intellectual property rights, climate, the environment, and public procurement (including mega projects). The GCC nations, which have historically used foreign aid and humanitarian aid to support MENA nations, should opt for an "aid for trade" policy to support their partners in implementing trade-boosting reforms that lower business and investment barriers, improve logistics infrastructure, and facilitate the movement of goods. **F&D**

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The authors and their team developed the Economic Diversification Index for the Mohammed Bin Rashid School of Government in Dubai to measure the comparative economic diversification of commodity producers and exporters based solely on quantitative measures. For more information, visit <https://economicdiversification.com>.

BREAKING BARRIERS

Gary A. Seidman

Women entrepreneurs are changing the dynamics of the Arab workplace

In the Arab world, women are increasingly stepping into entrepreneurial roles, asserting their influence on business and technology, and leading a quiet revolution that would have been unthinkable a generation ago. The trend marks a departure from traditional roles and gender expectations, and it could hold profound implications for the region's development and progression toward more inclusive societies.

While the Arab world has historically seen limited female participation in the labor market, the growing presence of women in business start-ups follows a global pattern that is accelerating innovation and diversifying prosperity. It is not an instantaneous or easy transition. Addressing barriers to equality frequently means challenging social norms and confronting entrenched interests. In the Middle East and North Africa, labor force participation for women is still a meager 19 percent compared with the global average of nearly 50 percent. But across the region, opportunities are expanding, and women—like the three we profile below—are challenging patriarchal attitudes.

Brewing opportunities in Yemen

Arzaq Al-najjar is trying to modernize the coffee business in one of the poorest, most war-torn, and ancient coffee producing regions on Earth. From a third-floor office overlooking Yemen's capital of Sana'a, Al-najjar, 34, runs Mocha Valley, a coffee-production and business consultancy that specializes in research, training, and development assistance for entrepreneurs, investors, coffee traders, farmers, and partners along the coffee value chain. The company takes its name from the Red Sea port of Mocha at the tip of the Arabian Peninsula—once the world's crossroads for coffee—which in turn lent its name to the popular drink. Nearly 600 years ago coffee beans procured from Ethiopia were first roasted, brewed, and sipped in Yemen's Sufi shrines. During the 16th century, ships laden with beans carried coffee from the port of Mocha to destinations throughout the Middle East and North Africa, and a century or so later to Europe. By the early 20th century, coffee had become a global commodity, and by 2021, coffee exports topped \$36 billion.



Today, Yemen exports less than 1 percent of the world's coffee, and Al-najjar is determined to change that. "What the Yemeni coffee industry needs is the development and expansion of its value chain," she says. "We want the world to know about and experience this Yemeni treasure."

Al-najjar has a unique passion for the history and importance of coffee in Yemen. She was the first female "coffee cupper," or coffee taster, in the country, and soon after completing her MBA in Lebanon, she became a consultant to local NGOs and coffee traders. An industry organized around modern standards and better data, she says, would make it easier for Yemen's producers and traders to reach global markets and help Yemen's development, which ranked near the bottom (183rd of 191 countries) of the UN's Human Development Index in 2021.

Bolstering the industry, however, is no small feat. Yemen is suffering through one of the worst humanitarian crises in the world. "Over eight years into the ongoing conflict, the Yemeni people continue to face extreme hardship. Approximately 22.5 million people, or about 75 percent of the entire popu-

Arzaq Al-najjar and her team at Mocha Valley in Sana'a, Yemen.

lation, require humanitarian assistance, with over 4.3 million civilians displaced," the World Bank reported. The IMF estimates that Yemen's GDP will fall by 0.5 percent in 2023 and that inflation will run at 17 percent.

Al-najjar, however, is identifying opportunities. "Coffee workers were unqualified and untrained, and we started by providing knowledge and free training to coffee workers to understand why we need quality standards in Yemen." When she launched Mocha Valley five years ago it wasn't easy opening doors, and it still isn't. Yemen has a traditional culture, and women are frequently discriminated against in business. "Being a woman is such a difficulty in our society," she says, "Yes, of course, I have been told, 'you are a woman and you cannot lead this company.'" Businesswomen are disproportionately burdened in seemingly banal ways. "Here in Yemen most of the deals, most of the contracts happen during qat sessions," Al-najjar explains, describing meetings in which men—and only men—negotiate transactions while chewing the leaves of the shrubby stimulant, sometimes for hours on end.



Qat also presents another set of challenges for Al-najjar and her goal of expanding coffee production. For many Yemeni farmers, qat is a more lucrative crop than coffee; as a result it siphons off farmland as well as a great deal of water in one of the world’s most water-scarce countries.

But Al-najjar is motivated to cultivate a stronger and more resilient coffee industry in Yemen and is optimistic that it can be made more efficient with greater participation from women. She is excited by the coterie of young female leaders being cultivated in Yemen’s coffee industry and at Mocha Valley. “They say they are inspired by such a journey, and they have goals,” she says. “Maybe in the future they are going to be leaders in the coffee sector.”

Empowering Egypt’s unbanked

“Khazna was built from day one to serve the underserved,” says Fatma El Shenawy, the Egyptian fintech’s cofounder and a vocal evangelist for extending financial services to low- and middle-income families throughout the Middle East.

El Shenawy helped found Khazna in 2019, before she was even 30. Her vision was to leverage a disruptive platform to connect Egypt’s unbanked and underbanked with a fast and easy digital method of accessing their money, paying their bills, and buying services from an app on their phones.

Egypt has a staggeringly high number of people who have no access to formal banking services—67 percent of the population, according to *Global Finance* magazine. But with mobile phones in more than 90 percent of the country’s households, El Shenawy and her partners saw an opportunity to connect people with a range of services. “We provide our users with an income-backed multipurpose credit line that they

can use to request a cash advance, pay their bills, purchase products from our large merchant network, and buy medical insurance for their families,” she says. The service has great scalability potential. The World Bank estimates that about 1.7 billion people around the world are currently unbanked.

Financial inclusion is a difficult problem to remedy, but Khazna is making inroads by partnering with a range of businesses that employ 1.5 million people, as well as working with Egypt Post to serve their 5 million pension customers. Beyond Egypt, Khazna has its sights on Saudi Arabia. “We believe Saudi and Egypt share key similarities for our business, mainly a progressive regulator that is open to new ideas and advancing financial service offerings driven by innovative solutions from new start-ups. Additionally, Saudi has a digitally connected population that is ready for new financial services,” says El Shenawy, who worked as an investment banker in Cairo for five years prior to starting Khazna.

Today, the firm has more than 350 employees. It raised \$38 million in equity and debt through local, regional, and global venture capital firms last March, bringing its total funding to more than \$47 million.

El Shenawy is still an anomaly in Egyptian culture, where large gender gaps remain in business and entrepreneurial activity. Labor participation is just 15.4 percent for women, compared with 67 percent for men. “One of the main challenges faced by women, in my experience, is that we do not get the same level of support that our male peers receive in [their] careers, especially in entrepreneurial endeavors, from their close communities,” she says. “I’m lucky to have always been surrounded by peers and mentors who support me on both the professional and personal level.”

At left: Fatma El Shenawy, cofounder of Khazna. At right: El Shenawy celebrates a milestone achievement with the Khazna team at their offices in downtown Cairo.



Motivating Palestinian entrepreneurs

Mona Demaidi is on a mission to accelerate high-tech female entrepreneurship in the West Bank and Gaza, and her method is intensive training and personal coaching. “Most of what I am working on in the private sector,” she says, “is upscaling youth and females in technology and providing them with mentorship.” Demaidi says that a legacy of inadequate resources, narrow opportunities, insufficient cultural support, and decades of conflict have held young Palestinian women back in the workforce, in particular in the tech sector, even though half the graduates of tech-based education programs are women. To advance economic development, history shows that trend needs to be reversed, she says, and the best way is through specialized programs in safe places that can offer tools, boost confidence, and build skills. “You know,” she sighs, “we face a lot of ups and downs here.”

Demaidi is particularly concerned that the region is falling behind in AI, an important niche where female employment lags even the full sector’s 20 percent average. “The limited availability of educational programs in AI contributes to the low number of students pursuing an education in the field,” she wrote in *This Week in Palestine*. Only 9 percent of universities in the West Bank and Gaza offer programs in artificial intelligence, and none higher than a master’s degree. Between

2016 and 2021, all of the Palestinian territories graduated just 28 students who specialized in AI, arguably one of the hottest and most talked about industries on the globe. Because of the meager number of AI start-ups in the West Bank and Gaza—less than 1 percent (and none founded by

women)—Demaidi spends significant resources cultivating AI entrepreneurship. In 2022, she developed the Palestinian National Strategy for AI, which aims to accelerate innovation and adoption.

Mona Demaidi is a bundle of energy. She splits her time between teaching at An-Najah National University, where she is an assistant professor, and running the organization Girls in Tech—Palestine, where she is the managing director. Her work has led her to develop programs that encourage women to

pursue careers in the tech industry through boot camp trainings, free online courses, private sector exchanges, and open access to job boards.

While AI start-ups are rare throughout the West Bank and Gaza, a thriving start-up ecosystem composed of tech and non-tech companies has begun to emerge in recent years. Most tech companies in that category focus on e-commerce. A driving factor has been the abundant pool of talented young tech entrepreneurs freshly minted at West Bank universities every year. That ecosystem, according to the World Bank, is at an early stage but is showing great promise, in part due to coaching programs like the ones Demaidi champions. “On average, each year, 19 more start-ups are created than in the previous year, resulting in a 34 percent compounded growth rate in start-up creation since 2009.”

Mentorship, the World Bank says, has been an accelerant in the West Bank and Gaza. Nearly 40 percent of start-up founders have been mentored, and it has proved to be an efficient mechanism for transferring know-how and enabling “entrepreneurs to acquire business acumen; understand the unspoken rules of start-up challenges; and access networks of talent, knowledge, and resources.” It is also important, Demaidi points out, for the general population and for women in particular, whose participation rate (less than 19 percent) in the workforce continue to be low. Technological change has been a disruptive force in the past, and Mona Demaidi is counting on its being a disruptive force again. **F&D**

“Nearly 40 percent of start-up founders have been mentored, and it has proved to be an efficient mechanism for transferring know-how.”

Mona Demaidi meets with students in the city of Nablus, West Bank.

LEFT PHOTO: ROGER ANIS (2X); RIGHT PHOTO: SAMAR HAZBOUN



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Industrial Policy and the Growth Strategy Trilemma

Ruchir Agarwal

IN THE DANCE BETWEEN STATE INTERVENTION AND MARKET FORCES, THE TUNE OF INDUSTRIAL POLICY MUST BE PLAYED WITH CARE

Industrial policy is gaining momentum in many countries; some economists point to China's model as a success. In the face of challenges such as the COVID-19 aftermath, vaccine nationalism, global supply-chain instability, net zero transitions, and geopolitical competition, the role of industrial policy and government support for firms and industries deemed strategic is again up for debate.

People question whether we can trust the free market and worry that countries are losing their innovation edge. National security hawks fear relying on adversaries for critical resources such as semiconductors and pharmaceuticals.

In the US, industrial policy is no longer taboo and is a central feature of "Bidenomics." There is bipartisan support for the Creating Helpful Incentives to Produce Semiconductors and Science Act (CHIPS Act), which aims to revitalize the US semiconductor industry. More than 90 percent of advanced chips, crucial for defense and artificial intelligence (AI), come from Taiwan Province of China—which raises concerns about US industry vulnerability in case of an attack. In response, the

US government is allocating \$39 billion from the \$280 billion CHIPS Act for advanced semiconductor manufacturing. The Biden administration's industrial policy is far-reaching, and at least two semiconductor manufacturing clusters are planned by 2030. Funding recipients face extensive conditions, such as a 10-year ban on expanding advanced chip capacity in China and a commitment to affordable childcare. These policies are part of a broader approach to industrial policy, which also includes \$370 billion in subsidies for clean energy in the Inflation Reduction Act.

Meanwhile, in Japan subsidies worth more than \$500 million to 57 companies are encouraging domestic investment—as part of efforts to reduce reliance on China. The European Union is scaling up its industrial policy—including by setting aside €160 billion of its COVID-19 recovery fund for digital innovations such as chips, batteries, and climate adaptation. In response to massive subsidies in the US Inflation Reduction Act, Italy's economy minister called for a common EU approach to support competitiveness and protect strategic production.



Focus on national champions

“Industrial policy” refers to government efforts to shape the economy by targeting specific industries, firms, or economic activities through subsidies, tax incentives, infrastructure development, protective regulations, and research and development support.

With industrial policy as part of their growth strategy, countries face competing objectives, such as sustainable economic growth, financial and fiscal stability, and establishing “national champions,” often a distinct objective of a growth strategy. Underpinning this objective are enhanced national security through self-sufficiency in key industries, job-rich and inclusive growth, revitalizing left-behind communities, and the voter optics of revived manufacturing. Various countries have promoted specific firms or industries as national champions—semiconductors in Taiwan Province of China, renewable energy in Germany, aerospace in France.

Industrial policy has sometimes successfully established national champions but is controversial. Economists worry that picking winners and losers can lead to market distortions and inefficient allocation of resources. Still, the revival of industrial policy shows no signs of slowing down.

Increasing economic nationalism and geopolitical tensions mean establishing national champions is likely to remain a policy objective for governments seeking to advance their national interests. In this context, the Growth Strategy Trilemma framework below can help policymakers strike a balance among economic growth, stability, and national champion objectives.

The Growth Strategy Trilemma

The framework highlights policymakers’ challenges in balancing the demands of economic growth, financial and fiscal stability, and the establishment of national champions. Pursuing any two of these objectives comes at the cost of partially sacrificing the third, making it a trilemma (see chart).

Governments that *support safe champions* (Strategy A) prioritize financial and fiscal stability along with support for safe national champions. This strategy emphasizes national security, prudence, and resilience over the potential benefits of a more aggressive strategy.

Supporting bold champions (Strategy B) emphasizes economic growth and the selection of risk-taking national champions. This approach may mean less attention to stability because of greater risk taking or less focus on efficiency and governance—with potential harm to the financial system and resulting fiscal costs. Still, governments that pursue this strategy are willing to trade a higher risk of instability for higher growth.

Promoting national champions

The Growth Strategy Trilemma has three competing objectives: fiscal/financial stability, economic growth, and the promotion of national champions.



The *fair-market capitalism* approach (Strategy C) prioritizes stability with economic growth—without a focus on national champions. Emphasis is on a dynamic market economy, free entry, businesses that operate in a fair and competitive marketplace.

Fair-market capitalism offers a different path to some national security goals than the industrial policy approach. This approach encourages a diversified global supply chain based on open and fair trade, not an economic arms race. It can lead to greater efficiency and innovation in the long run, with less risk of supply-chain disruptions.

These trade-offs are not simply about choosing one objective over another, but rather striking a balance among the three (on a continuum). The best approach depends on contextual factors, including the state of the economy, the financial system’s health, electoral pressures, and the geopolitical environment.

Efficiency gains may favor the fair-market capitalism strategy. Yet governments often succumb to the temptation of establishing national champions. Why? It could be the psychology of national leadership and the pressures on government leaders.

Why leaders embrace champions

Imagine the life of a country leader. Elected to lead your country you are now responsible for decisions affecting the well-being of millions of people. You must balance the demands of economic growth, national security, financial and fiscal stability, and

“It is hard to achieve institutional reform if there is no underlying political consensus.”

social and environmental concerns. The stakes are high, and the pressure can be overwhelming.

You face the need to deliver economic growth. Adequate growth can be essential for maintaining your political power, providing jobs, and ensuring the stability of your society. Without sustained growth, you may face mounting unemployment and social discontent, endangering your political tenure.

This pressure can manifest as *growth anxiety*. Clinical psychology studies show that anxiety causes people to fixate on immediate concerns, often at the expense of long-term goals. In the context of economic growth, leaders may experience similar anxieties causing them to prioritize short-term performance and quick wins to relieve their anxiety and demonstrate progress. This can lead to a narrow focus on particular industries or companies perceived as providing immediate growth—and disregard for potential stability risks and downsides.

Industrial policy is a key tool at your disposal—awarding contracts, providing subsidies or tax breaks, or investing in infrastructure projects to establish national champions. However, promoting national champions can have negative consequences: a concentration of economic power, misallocation of resources, and neglect of long-term considerations. It can undermine market competition and innovation, harming growth and social welfare.

You may nonetheless be compelled to promote bold champions (Strategy B) if you are under pressure to deliver quick wins, maintain political power, or provide jobs. Industrial policy can give a sense of control over economic outcomes, reducing growth anxiety and providing a sense of security.

As a leader, you may face pressure about national security and financial and fiscal stability, which can trigger a *fear of instability* driven by concerns such as dependence on other countries for critical resources or a desire to avoid failures, defaults, or scandals.

You may therefore promote safe national champions to achieve security and stability. You may think this protects the country's interests, secures critical resources, and maintains stability—which provides a sense of control over outcomes (Strategy A). However, the potential downsides of this approach, such as the risk of distorting competition and hindering innovation, cannot be ignored.

Growth anxiety and fear of instability can prompt country leaders to choose national champions. These factors often shape a country's growth strategy, even though most leaders are aware of the potential long-term economic costs.

No silver bullet

The Airbus case is often hailed as a model of successful government intervention in the economy. The cre-

ation of the Airbus consortium in Europe in the late 1960s—which challenged the dominance of Boeing in world markets—was made possible through government subsidies, commitments to absorb losses, and financing for fixed development costs. As a result, Airbus became a formidable competitor.

However, the recent Chinese experience with the COMAC C919 aircraft shows that industrial policy is no silver bullet. Convinced that a great nation should have its own airliners, China has invested heavily in developing its commercial aircraft to challenge the dominance of Boeing and Airbus. Despite investing up to \$70 billion in the Commercial Aircraft Corporation of China (COMAC), China's state-owned manufacturer, the project has been delayed by more than five years as a result of regulatory, technological, and supply-chain hurdles. The delays were compounded by special licensing requirements for technology parts exports to China imposed by the Trump administration in 2020. The C919 hasn't been certified yet by any major aviation authority outside China, partly due to safety issues. Thus, despite industrial policy success with its domestic high-speed rail network and with electric vehicles, China has not been able to replicate this achievement in the competitive global aviation industry.

The lesson here is that promoting national champions can be effective, but it's not a guaranteed recipe for success. Even in other cases of market failure, it may be hard for the government to address the problem without causing distortions or incurring high fiscal costs. And when several countries engage in industrial policy to promote their own national champions it can mean a race to the bottom in terms of subsidies and protections. Such dynamics reduce the chances of success for individual countries and can destabilize the global economic environment.

Former US Treasury Secretary Lawrence Summers recently said he liked his industrial policy advisors the same way he liked generals. "The best generals are the ones who hate war the most but are willing to fight when needed. What I worry is that people who do industrial policy love doing industrial policy." In this context, the Trilemma reminds policymakers to be cautious about industrial policy—while focusing on long-term growth, stability, and international cooperation.

Just like salt in cooking, a pinch of industrial policy can be helpful, but too much can overpower, and prolonged excess can harm. **F&D**

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Settling the Climate Debt

Benedict Clements, Sanjeev Gupta, and Jianhong Liu

PUTTING A DOLLAR FIGURE ON EMISSION DAMAGES HELPS ASSESS EACH COUNTRY'S FAIR SHARE OF THE CLIMATE BURDEN

More than 190 countries have pledged under the 2015 Paris Agreement to reduce carbon emissions, including from fossil fuel consumption, by 2030 to avoid the negative effects of rising global temperatures. However, there is a large gap between what countries have committed to do and what needs to be done. That said, countries could further reduce emissions beyond 2030.

Countries, including most Group of Twenty (G20) members, have already voluntarily pledged what they believe they can or should contribute to reducing emissions. But it may be more practical to call on the richest nations to compensate developing economies for the damage inflicted on them by climate change.

Here, the concept of “climate debt” may be useful. Climate debt represents the sum of emission damages—that is, the cumulative negative effects of carbon dioxide emissions, whose costs are imposed on the globe without compensation. We estimate climate debt for 131 countries based

on both historical and projected carbon emissions (Clements, Gupta, and Liu 2023). Such estimates are relevant for determining each country’s fair contribution toward slowing emissions and for discussion of the appropriate compensation for developing economies. Countries with large climate debt could be asked to share a proportionally higher burden, but this may be challenging for countries with high public debt and limited fiscal space. One consideration when it comes to who should pay climate debt is the ability to pay; from this perspective, less would be expected from developing economies.

Calculating climate debt

Climate debt can be estimated based on actual and projected emissions and the social cost of carbon, which measures the economic damage per ton of CO₂ emissions. We find climate debt to be extremely large—some \$59 trillion over 1959–2018 (Chart 1)—and projected to increase by another \$80 trillion during 2019–35. The size



of each country's climate debt reflects both the size of its economy (which is positively correlated with emissions) and how intensively it uses fossil fuels (thus generating emissions) for every dollar of economic output. The composition of energy use (for example, heavy use of coal) has an impact as well. As of 2018, the largest contributors were the United States (\$14 trillion), China (\$10 trillion), and Russia (\$5 trillion). Beginning in 2018, developing economies will account for a larger share of climate debt, given their relatively higher economic growth.

It can be argued that each global citizen has an equal right to an environment unaffected by climate change. This implies that countries with high climate debt because of their high emissions should compensate countries that have caused less damage to the environment.

Our data show large differences across countries in per capita climate debt (Chart 2). Climate debt per capita is highest in the United States—some 6 times higher than in China for the 1959–2018 period

and 25 times as high as in India. For 2019–35, climate debt per capita will remain highest in the United States and will rise in China, exceeding the expected level in the European Union.

Climate debt is substantial relative to government debt; in G20 countries, it is about 81 percent of GDP, compared with average general government debt of 88 percent of GDP in 2020. It is large relative to the fiscal burden expected from increases in public spending on health and pensions; in net present value terms, these outlays are projected to average 25 percent of GDP in G20 countries during 2020–35.

To assess plans to curb emissions and their likely impact on climate debt, we consider two scenarios. The 2015 Paris Agreement established a framework to limit global warming to well below 2°C and to pursue efforts to limit it to 1.5°C above the preindustrial average. The Paris Agreement works on a five-year cycle of climate action by countries. Every five years, countries submit non-binding actions planned to reduce their greenhouse

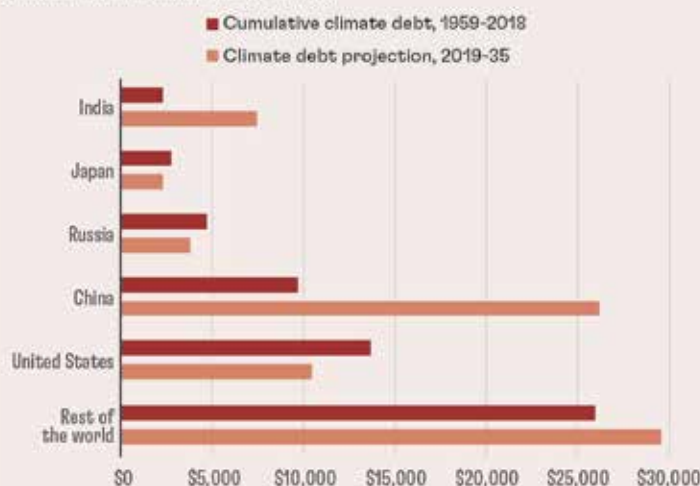
The cooling tower of a lignite-fired power plant

CHART 1

Shared burden

Advanced economies will continue to account for the majority of climate debt, but developing economies will see their share increase.

(climate debt in billions of US dollars)



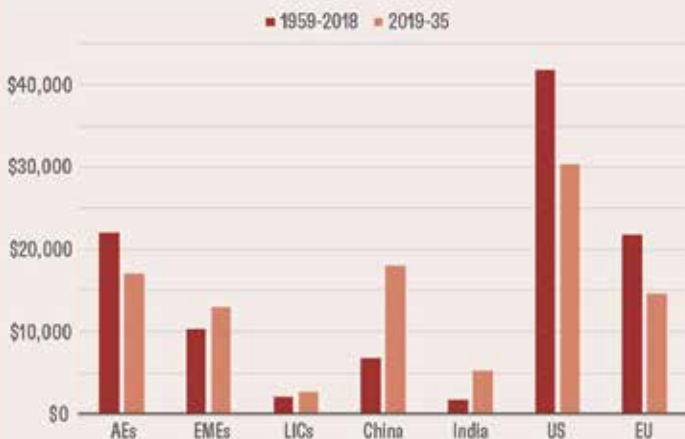
SOURCES: Authors' calculations using historical CO2 emission data from Ritchie, Rosen, and Rosado (2020). Emission projections are from the IMF Fiscal Affairs Department.

CHART 2

Dollars per person

The United States will continue to have the highest climate debt per capita, while China's will rise to exceed the European Union's.

(climate debt per capita in US dollars)



SOURCES: Authors' calculations using historical CO2 emission data from Ritchie, Rosen, and Rosado (2020). Emission projections are from the IMF Fiscal Affairs Department.

NOTE: Advanced economies (AEs) include the United States; emerging market economies (EMEs) include China and India; LIC = low-income country.

gas emissions to reach the Paris Agreement goals. These are known as Nationally Determined Contributions, or NDCs.

Debt keeps accumulating

In our first scenario, we assess the impact of full implementation of countries' NDCs on climate debt, assuming a gradual reduction in emissions for each country each year to meet the target in 2030. The net result of country NDCs is a reduction in the accumulation of climate debt by \$9.6 trillion (24 percent). While sizable, this reduction pales in comparison with our projected 2019–35 accumulation. Furthermore, countries whose emissions decline significantly (China, United States) would still contribute the most to the accumulation of climate debt (\$12.9 billion and \$5.4 billion, respectively). This suggests that NDC implementation alone is not enough for fair burden sharing across countries in reducing climate debt.

In our second scenario, we evaluate how much emissions and climate debt would need to fall, beyond what is promised in countries' NDCs, to achieve the 1.5°C goal under the Paris Agreement. Under this setup, it would seem logical to ask countries with large climate debt to make the greatest contributions to help close this gap. Many advanced economies with significant climate debt, such as the United States, Japan, and Germany, however, have already pledged in their NDCs to reduce emissions sharply by 2030. Thus, a more feasible approach might be to ask countries for additional reductions on the basis of their share of total emissions for that year. If this additional reduction were undertaken by each G20 country beyond its NDC, for example, projected climate debt would fall by an additional \$6.4 trillion. These emission reductions would still strike many as unfair, however, because climate debt per capita in the United States and other advanced economies would still far surpass that of G20 developing economies.

This exercise demonstrates that it may not be feasible, between now and 2030, to reduce emissions in a manner that is perceived as fair, given the shrinking share of advanced economies in global emissions. Instead, advanced economies may need to focus on reducing emissions over a longer time period or aggressively compensating developing economies for the damage caused by climate change, including through more generous climate financing.

The role of fiscal policy

Government taxation and spending policies are potent tools for taming the growth of climate debt.





Activists protest from the "Fridays for Future" group.

At the same time, countries face constraints in pursuing climate action because of the impact of the pandemic on their economies and the associated steep increases in public debt. The US and Europe have embraced large-scale policies to subsidize clean energy to reduce climate debt, but this option is not open to developing economies given their lack of fiscal space. That said, both country groups should pay attention to the revenue side, in particular higher taxation of energy, with carbon taxes to reduce climate debt. This would reduce emissions while helping countries fund additional spending. Carbon taxation must be accompanied by complementary fiscal policies to offset the tax's short-term adverse effects on low-income households.

There are important ethical considerations countries must address as they seek to implement tax and spending policies to reduce emissions. Which generation should bear the burden of adjusting to a lower-emissions economy? Given that the damage from emissions is rising over time, countries are better off acting as soon as possible. The current generation has already consumed large amounts of energy at prices that did not fully reflect its true social cost, including its damage to the environment. For developing economies, however, the adjustment could be phased in gradually, given these countries' greater ability to shoulder the burden as their per capita incomes rise over time.

A pragmatic approach

Climate debt from CO₂ emissions is large and unevenly spread across the world's economies. The size of the debt—and its disparity among countries—portends contentious discussions on countries' fair burden in slowing climate change and the level of assistance to developing economies to compensate for these differences.

Climate debt per capita is projected to be much higher in advanced than in developing economies, even under full implementation of NDCs by G20 countries. This implies that advanced economies may need to make additional efforts to achieve fair burden sharing in the fight against climate change. Implementing the required reductions in emissions to meet the Paris targets is problematic, given that advanced economies—which have accumulated a large share of the stock of climate debt—are already reducing their emissions sharply under their NDCs. Thus, a more pragmatic approach to fair distribution of the burden is for advanced economies to ramp up their assistance to developing economies. This means climate finance to pay for mitigation and adaptation to the impacts of climate change, through grants and concessional loans. The IMF's new Resilience and Sustainability Facility is extending concessional financing for climate transition and pandemic preparedness to developing economies. However, current climate finance has not yet reached the goal of \$100 billion a year and is clearly inadequate in light of the huge climate debt of advanced economies. **F&D**

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PHOTO: KEN BENOIT

People in Economics

The Everywhere Economist

Nicholas Owen profiles Columbia's **Minouche Shafik**, whose career spans international development, central banking, and writing on the social contract

IT'S NOT LUCK THAT ECONOMIST MINOUCHE SHAFIK played a key role in pivotal international developments of the past three decades. And she is still at it.

As a freshly minted Oxford economics PhD, she worked on Eastern Europe at the World Bank after the 1989 fall of the Berlin Wall. During the Make Poverty History campaign of the mid-2000s, she led the UK government's influential Department for International Development.

At the International Monetary Fund during the 2009–10 euro area debt crisis, she oversaw the Fund's work on several countries at the epicenter of the upheaval. During the Arab Spring pro-democracy protests of the early 2010s, Shafik ran the IMF's programs in the Middle East. She was deputy governor of the Bank of England, overseeing a \$500 billion balance sheet, during the turmoil of Britain's Brexit vote.

Now, at the age of 60, she's the first female president of New York's Columbia University, following six years at the helm of the London School of Economics and Political Science (LSE). It's an unusual economist whose career encompasses national policymaking, international financial institutions, central banking, and top academic leadership. Her honors include being named a baroness in the House of Lords and a dame for services to the world economy, as well as election to a fellowship of the British Academy.

Born in Egypt and reared in the US South, Shafik brings to the table a rare combination of tough-mindedness, high intellect, courage, and an aptitude for swaying policymakers, according to those who know her.

As a young economist, Shafik stood out for her ability to combine intellect with exceptional empathy and political intelligence, says Andrew Steer, who is now president and chief executive of the Bezos Earth Fund. In 1992 he recruited her to

Minouche Shafik

work with his World Bank development report team. “You don’t persuade governments to change policy just by doing good analysis,” he says.

“You do it by being smart politically and trying to get inside their heads and see things through their eyes,” Steer says. “Minouche is exceedingly good at that.” Shafik went on to become the World Bank’s youngest-ever vice president, at the age of 36.

Christine Lagarde, the president of the European Central Bank and a former IMF managing director, cites her attentive and inclusive leadership style. They worked together for three years in the early 2010s when Shafik was one of Lagarde’s deputy managing directors.

“Minouche is a subtle mixture of the orient and the occident; she is as Egyptian as she is European as she is British as she is American,” Lagarde says. “She supports other people, especially women, when they deserve it. She does not suffer fools gladly but will give everyone a chance.”

In her 2021 book, *What We Owe Each Other*, Shafik issues a call for a new social contract that takes into account the demographic and technological changes transforming society. She proposes a stronger “architecture of security and opportunity” by sharing risks and investing in people. “We need to get to a different place, where we’re asking more of people and investing more in them,” she says. That means constructing a floor below which income cannot fall combined with incentives to work, portable pensions linked to life expectancy, lifelong education and retraining, and intervention in early childhood to equalize opportunity.

As the leader of one of the world’s top universities, Shafik says she worries that cancel culture threatens to stifle the kind of free-thinking debate that enriches student life. “The point of university is to be intellectually challenged and confronted with difference,” Shafik says. She advocates free speech within the law. She says she is proud that at the prestigious LSE, no one was barred from speaking because of views that some might consider offensive.

“For Shafik, the Middle East’s best hope for a more prosperous future is to reverse a steady decline in the independence of parliaments, the courts, central banks, civil society, and a free press.”

At the same time, Shafik says she worries that as societies, we have lost some of our ability to disagree civilly. Universities must teach people to have difficult conversations, she says. “It’s through that process of listening that you learn, you build consensus, and you move forward as a community,” she says.

In 1966, when she was four years old, Shafik and her family fled President Gamal Abdel Nasser’s Egypt for the United States, settling first in Savannah, Georgia, deep in the American South. Only her father, a scientist whose property had been nationalized by the Egyptian general’s government, spoke any English. Her mother checked the mailbox each morning and cried, waiting for news from home.

The family soon learned the language and found their footing after a kindly neighbor advised Shafik’s mother to host paddling pool parties for local children as a way of making friends. The experience instilled in Shafik a lasting interest in social mobility and what determines where you start and end in life. “My family experienced social mobility both downwards and upwards,” she says.

Great tumult

Shafik’s childhood was a time of great social and political turmoil in America: the Vietnam War, the Civil Rights Movement, and Watergate. Shafik lost count of the number of schools she was bused to in Georgia, North Carolina, and Florida as the family moved and as the authorities tried to balance the numbers of Black and white students in the classroom.

“All of those things shaped my interest in politics, policy, international relations, and fairness,” she says. “They were big influences on what I chose to do afterward.”

After a spell back in Egypt as a teenager, she earned an undergraduate degree in economics and politics from the University of Massachusetts, Amherst. She took a master’s in economics from the LSE and a doctorate in economics from Oxford.

Nicholas Stern, chair of the LSE’s Grantham Research Institute and a noted climate economist, says he remembers meeting Shafik as a master’s student in the mid-1980s. Back then, Stern and Shafik were among a delegation of teachers and students to meet Princess Anne, chancellor of the University of London. Some 35 years later they met the princess again. Stern notes the striking contrast in mobility: “Minouche has gone from student to president, but I am still a professor, and Her Royal Highness is still a princess.”

Shafik spent much of her professional life in London and Washington. She married her husband, scientist Raffael Jovine, in 2002 in Washington, had twins, and became stepmother to his three children—all in a single sleepless year. To this day she makes frequent visits to Egypt, home to her mother and a large extended family. It’s a source of frustration for Shafik that the Middle East is less successful than it could be because of bad politics and misguided economic policies combined with internal conflicts and outside interventions.

At the World Bank in the 1990s, Shafik traveled to the Middle East often

during the Oslo peace process between Israel and Yasser Arafat's Palestine Liberation Organization. She wrote a two-volume book about the possibilities for economic cooperation. In the 2010s she was a deputy managing director of the IMF as the Arab Spring protests swept the region.

"Both times started with great optimism and ended in disappointment," Shafik says. The peace process collapsed after a right-wing extremist assassinated Israeli Prime Minister Yitzhak Rabin. The Arab Spring's democratic aspirations soured amid counterrevolutions and civil wars.

Appeals for better leaders are common in the Middle East. For Shafik, the region's best hope for a more prosperous future is to reverse a steady decline in the independence of parliaments, the courts, central banks, civil society, and a free press. "What really matters in the long run for the region's prospects are strong institutions," she says. "The institutions that make sure whatever kind of leadership you have works in the public interest."

Yet she voices confidence in the Middle East's young people, its extraordinary history, and its enormous potential, pointing out that when countries have pursued sensible policies they have prospered. "The laws of economics apply in the Middle East and North Africa just like they apply everywhere," she says.

Landmark legislation

Shafik spent seven years at the UK's Department for International Development, known as DFID. In 2008 she became permanent secretary, the department's most senior civil servant, and oversaw legislation that enshrined into law a commitment to spend at least 0.7 percent of gross national income on official development assistance. That worked out to an annual budget of about \$20 billion.

"We were incredibly proud at that time," she says, "because DFID was providing not just huge resources to development—with a strong focus on the poorest in the world. It was also providing leadership to the whole international system and mobilizing resources

from other countries and international organizations."

Suma Chakrabarti, Shafik's predecessor as the top DFID official, attributes her leadership success to her understanding of what motivates people and use of that understanding to produce ideas for much-needed reform. She used these skills to bring about change in the developing world and at every institution where she worked, he says.

Masood Ahmed, president of the Center for Global Development, worked alongside Shafik in various roles at the World Bank, the IMF, and DFID. "The most striking thing about her is her humanity and sincerity," Ahmed says. She also has the ability to deliver tough messages in an inoffensive way, he says. "Her evident empathy enables her to separate the message from the person in a way that's quite unique."

Almost a decade after Shafik's departure from DFID, Prime Minister Boris Johnson folded it into the Foreign Office and watered down the aid commitment. DFID's success, she says, stemmed from its clarity of purpose: to reduce world poverty. That's not the case under the Foreign Office, with its geopolitical, trade, and other objectives. "The presence of both the voice and the means that DFID brought to the table is sorely missed in the international system today," she says.

It's fair to say that the international system and its institutions are in a tight spot. Aid budgets have been slashed, Russia's war in Ukraine and geopolitical tensions threaten to cripple multilateral organizations, and rising interest rates are piling pressure on heavily indebted developing economies.

"The external context for international organizations has not been this tough since the Cold War," Shafik says. She stresses the importance of countries continuing to carve out a space for international cooperation, especially on global public goods like climate, pandemic preparedness, and financial stability. "Having a place where conversations are being had on these global issues is even more important when the bilateral channels are not working well," she says.

Brexit rancor

Shafik's three years at the Bank of England coincided with the UK's 2016 vote to leave the European Union. She says she remembers walking into a fully staffed trading room at 4 in the morning to watch the results and seeing the British pound slide on the screens as Asian markets opened.

The Brexit period was rancorous. The Bank of England's sober counsel of the self-harm that a leave vote could inflict on the economy led Brexit advocates to accuse the institution of being part of a "Project Fear" conspiracy. Shafik concedes that the bank's attempts to inform the debate with rigorous economic analysis had only "mixed success." In the end, she says, the vote was about something much more political.

The bank's biggest contribution, she reckons, was its contingency planning to maintain macroeconomic and financial stability whatever the political outcome. "When the markets opened in London, we were able to say that we had liquidity facilities in place should any institution need them," Shafik says. "And because we had prepared and were able to reassure the markets, no support was needed."

Shafik left the Bank of England in 2017 for academia. It was during her time as LSE president—at the height of COVID—that Shafik wrote *What We Owe Each Other*, her call for a rethinking of the social contract. Would she write the book any differently today? The only change, she says, would be to add a chapter on the international social contract and how to strengthen it.

Many were surprised that someone who spent so much of her life at international financial institutions should write a book about national social policies. But Shafik says she reckons people will support a more cooperative global system only if their national social contract is just.

"People have to believe that they're in a society in which the architecture of opportunity is fair," she says, "and that will make them more generous towards citizens of other countries." **F&D**

NICHOLAS OWEN is on the staff of Finance & Development.

Straight Talk

The Drive for Trade Integration

Jihad Azour and **Abebe Aemro Selassie** talk about the potential of unified trade across Africa

The African continent is on the threshold of a new era. African nations have collectively embarked on a path toward deeper trade integration, with the African Continental Free Trade Area (AfCFTA) as a catalyst to unlock this potential and reshape the continent's trade landscape. This ambitious initiative aims to dismantle barriers to trade and create a unified trade landscape across Africa.

We should commend policymakers for this landmark initiative. But realistically, it was in part a response to rising cross-border trade, investment, and financial flows within the region as economic activity strengthened over the years. Take trade flows within the East African Community, for example. Over the past two decades, the growth of exports within East Africa has been nothing short of extraordinary, expanding more than eightfold and significantly surpassing the growth rate of its exports to the rest of the world.



ABE SELASSIE is director of the IMF's African Department and **JIHAD AZOUR** is director of the IMF's Middle East and Central Asia Department.

Game changer

The AfCFTA, launched in January 2021, represents a historic opportunity for African nations to realize their full economic potential by dismantling barriers to trade and improving the broader trade environment. Import tariffs within Africa are higher than those of other regions, averaging 6 percent; nontariff measures amount to the equivalent of an import tariff of 18 percent. The trade environment, including the transportation and telecommunications infrastructure, access to financing, and customs and border processes, also remains challenging.

By reducing barriers to trade, the AfCFTA has the potential to fuel economic growth, generate employment, and improve living standards across the continent. The gains from greater trade integration will be amplified if the reduced tariff and nontariff barriers envisaged under the AfCFTA are accompanied by reforms to improve the trade environment. Median goods trade within Africa could increase by an impressive 53 percent, while trade with the rest of the world could rise by 15 percent over the long term when the reform measures are fully implemented. These figures translate into tangible gains, with the real per capita GDP of the median African country rising more than 10 percent and an estimated 30–50 million people lifted out of extreme poverty.

Beyond the realm of goods, the AfCFTA holds great potential for diversifying Africa's export basket and promoting services trade. A stronger trade infrastructure and better access to financing can boost services exports by some 50 percent, enabling African nations to tap into growing global demand for skill-intensive, high-value-added services. Currently, services account for a relatively low share of Africa's total exports, with traditional services dominating the market. However, the rise of digitalization and technolog-

ical advancements offer an opportunity to reshape the sector and capitalize on emerging sectors such as telecommunications. Embracing these trends can enhance Africa's competitiveness in the global services market and drive sustainable economic growth.

The AfCFTA also gives African countries access to regional and global value chains, a critical step toward economic diversification and industrialization. Africa's exports to the rest of the world remain heavily tilted toward commodities, but regional trade is much more diversified. Initiatives such as textile manufacturing offshoring by South African retailers to neighboring countries exemplify the potential for building regional value chains. By expanding these efforts and capitalizing on the opportunities presented by the AfCFTA, African nations can tap into their comparative advantage, drive innovation, and foster a more resilient and diversified economy.

In an era of rapid technological change and an evolving global economy, trade integration can enhance Africa's resilience to shocks and position the continent for long-term success. Digitalization, for instance, can significantly reduce trade costs by streamlining customs processes and facilitating cross-border payments. Electronic cargo-tracking systems and cloud-based payment systems offer a glimpse of technology's ability to improve trade efficiency. Diversification of export destinations thanks to AfCFTA implementation, moreover, means less risk from shifting global trade patterns and greater economic resilience.

Navigating the trade landscape

While this vision of trade integration in Africa sounds promising, it is important to acknowledge the challenges that lie ahead.

Africa's vast potential requires a robust infrastructure network. Inadequate transportation systems, limited access to reliable energy, and logistical deficiencies hinder the efficient movement of goods. To foster regional con-

nectivity and facilitate trade flows, significant investments in infrastructure are imperative.

Despite subregional trade agreements, nontariff barriers such as customs inefficiencies and regulatory disparities persist, impeding the smooth flow of goods and services. Simplified digital processes, standardized customs procedures and product certifications, and harmonization of regulatory frameworks are vital for seamless trade within the continent.

The digital divide poses a significant challenge to trade in both goods and services in Africa. Limited digital infrastructure and inadequate access to affordable internet services hinder cross-border trade and the growth of e-commerce. To harness the power of digital trade, investments in connectivity and digital infrastructure are paramount.

Firms—particularly small and medium enterprises—often face challenges in access to financing, which limits their participation in regional trade. For instance, the average price of a letter of credit in West African countries is 2–4 percent of the transaction value, much higher than 0.25–0.5 percent in advanced economies. Promoting financial inclusion and providing affordable credit options for firms could fuel their growth and enable their participation in intra-African trade.

For the growing workforce in Africa to fully seize the opportunities presented by trade integration, governments must invest in their education and skills development and ensure robust social protection measures to shield the most vulnerable. As digitalization permeates various sectors, targeted training programs to equip the workforce with skills in digital technologies could position Africa to tap into the expanding digital economy. Protecting those adversely affected during the transition to higher growth is essential to ensure inclusive and sustainable development. Social safety nets must be enhanced in a way that efficiently targets the most vulnerable in a fiscally sustainable way.

The continent can address these challenges through significant invest-

ment in physical and human capital—not an easy task given the current funding squeeze. African countries already face high debt, and the economic fallout from the COVID-19 pandemic and Russia's war in Ukraine—which fueled inflation and caused global monetary policy tightening—has just made things worse. African governments must strike a delicate balance between prioritizing critical infrastructure investments and adopting prudent debt management practices to ensure debt sustainability.

In addition, governments must foster a robust economy and a business environment characterized by sound policies, effective governance, and reduced bureaucracy in order to attract investment. Partnerships with the international community and the private sector would raise the revenue needed for infrastructure projects.

Looking ahead

As Africa embarks on the path of trade integration, the continent stands poised to unlock its immense economic potential. Full AfCFTA implementation, coupled with infrastructure development, human capital investment, and efforts to bridge the digital divide, would signal a turning point for trade integration in Africa. Realizing the full benefits requires a concerted effort by African governments, private sector stakeholders, and international partners to address infrastructure gaps, overcome regulatory hurdles, and foster a viable trade environment. With the right policies and collective commitment, Africa can use trade integration to drive sustainable development and create a prosperous future for its people.

As the continent positions itself to be a vibrant hub of commerce, the rewards will extend beyond its borders, benefiting global trade and invigorating economies worldwide. The journey toward trade integration in Africa is not only an opportunity for economic growth but also a testament to the continent's determination to chart its own path toward prosperity and inclusivity. **F&D**

Cafe Economics

Embracing Artificial Intelligence



Joshua Gans argues that assessing the power and pitfalls of AI requires putting it in the hands of people

In a conversation with F&D's Marjorie Henriquez, Joshua Gans, coauthor of *Power and Prediction: The Disruptive Economics of Artificial Intelligence*, assesses AI's impact on the economy, debunks overhyped concerns about the new technology, and explains the challenge of identifying an ethics enforcer. He also discusses why AI should be made accessible through competitive means and traded widely.

F&D: For years, economists have extensively studied the effects of automation, such as assembly line production, on jobs and the economy. How does this latest wave of AI differ from previous forms of automation?

JG: Previous waves of automation have focused on predominantly physical tasks, whereas AI tends to provide

the potential to automate cognitive ones. However, even this distinction can be misleading. Invariably, past automation in the form of machines that performed physical tasks was automating something a human would do that involved not only physical interactions but also a cognitive expression of intent and application. And with the information technology revolution, many of the tasks—namely, computation—were automating cognitive processes.

The main difference is more in the ability of a machine to interact in variable and non-standardized environments. Thus, while it has been possible to make a machine that can pick up a specific object in a specific location and move it to another location, AI holds the promise of picking up and moving a random object that is not in a particular location. This requires a sense of

the environment. Therefore, if there is a property AI has that moves beyond others, it is the ability to automate tasks in more varied contexts.

F&D: Looking ahead at the next five years, what do you anticipate as the most significant ways in which AI will impact productivity, employment, and income inequality?

JG: The evidence thus far shows that where AI has been employed in workplace tasks, it has often involved tools that allow people with lower skills and less experience to perform at the level of those with higher skills and more experience. For instance, demand prediction tools that indicate where there are potentially more fares available at a given time rolled out in Tokyo, allowing less experienced taxi drivers to waste less time looking for riders, whereas it did little to improve the productivity of experienced drivers.

Extrapolating from this, skill premia in certain occupations will be reduced, and employment opportunities will open up for a wider set of people. That will tend to increase productivity, raise employment, and lower income inequality—at least at certain ranges of the income distribution. Beyond the next five years, it is harder to forecast.

F&D: What key aspects of AI do you think are overhyped or overlooked in the current discussions on its impact?

JG: If only I could tell with changes happening so quickly!

That said, alongside this rise has been an unusual amount of concern and worry about the adverse consequences that might follow from the use of generative AI. That is, in some sense, a measure of its success. Large language models, or LLMs, such as ChatGPT or Bard, are able to do writing tasks faster and better than people. Generative art can produce images that may have taken days or longer with existing tools. And the boost to coding tasks has been phenomenal. As a result of all this success, some extrapolate and see that people

“The ethical issues are far from clear. Even issues of discrimination that might arise are complex.”

will be replaced in these tasks—and it will all happen too quickly.

The question we are asking ourselves right now is whether it would have been better if none of this stuff had been invented or, at least, if its adoption had been slowed down to give us time to assess the consequences. Precaution can motivate these things, but you have to balance that against the losses from slow adoption for productivity. Moreover, you cannot learn what those adverse consequences are without putting that stuff in the hands of people.

So, in general, I think the angst is overhyped in that it is more vague speculation than something involving clear or even less clear evidence. This is compared to productivity improvements that are very real and noticeable. This suggests that “letting it rip” is the right policy for the current moment.

Nonetheless, if one of the benefits of that policy is to learn what the adverse consequences might be, it behooves us to monitor for those consequences, identify their causes, and consider experimentation with policy interventions that can mitigate them. Speed has benefits but also means we have to work more intensively to ensure the best outcome.

F&D: What are the implications of AI for organizations like the IMF, which aim to facilitate growth and prosperity in countries? In what ways can AI assist these organizations in achieving their objectives and supporting countries in their economic progress?

JG: The usual playbook applies here. AI needs to be as competitively provided as possible and available as widely as possible (through trade) so that it can be deployed wherever it can increase productivity in the world. In other words, the mission would be the same as programs to encourage information technology and internet access.

F&D: Considering the complex nature of AI and its ethical considerations, which entities or stakeholders are most suitable to take on the responsibility of regulating AI and providing guidance on ethical aspects?

JG: That is a very difficult question. If the ethical issues were clear, we might identify an existing institution, whether legislative or legal, that could hold the ultimate authority on these matters. However, the ethical issues are far from clear. Even issues of discrimination that might arise are complex. I suspect that AI will be easier to reprogram to be less discriminatory than people are. But more than ever, AI does require strong policy guidance to induce the necessary changes. **F&D**

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Book Reviews

A Wide-Angle View of Inequality

Vivek Arora

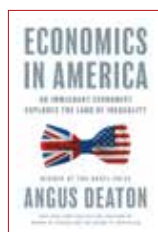
ANGUS DEATON'S NEW BOOK is based on his writings for a general audience over the years, organized around the theme of inequality in America. "With a constant eye on inequality," he says, "I write about health care, pensions, the stock market, and poverty at home and abroad." He shares his perspective as an immigrant economist who grew up in the Cambridge (England) tradition of economics before moving to the United States in the 1980s and winning the 2015 Nobel Prize, among other honors.

Deaton's central concern is rising inequality: in incomes, a gulf between "elites" and the general population, and worsening social outcomes among those left behind by globalization, policy, and technological advancement—including rising mortality among less-educated workers, which Anne Case and Deaton described as "deaths of despair" in an earlier book. Deaton sees inadequate attention to climate change as a form of inequality because it neglects the welfare of future generations.

Deaton argues that the economics profession should widen the lens through which it views welfare, as Adam Smith intended, beyond income and wealth to encompass important aspects of human well-being such as meaningful work, family, and community. Economists should balance a tendency to focus on efficiency with more attention to equity, and should pay more attention to government's potential to help address inequality.

On the appropriate role of public policy, the author emphasizes the importance of Kenneth Arrow's notion that markets must be competitive—not merely "free"—to deliver socially acceptable outcomes. Absent competition, say because monopolies or monopsonies artificially raise prices or reduce wages, market outcomes can deliver results that consistently penalize certain segments of the population.

Deaton notes that in reality the adjustment to shocks is harder than policy discourse often assumes. He highlights educational and racial inequality as stark features of the social landscape. People displaced by global forces or technology often struggle to find work because of college degree requirements and the prohibitive cost of housing in large cities. Meanwhile, the social safety net is frayed, which means greater hardship for the relatively poor and less educated.



ECONOMICS IN AMERICA

An Immigrant Economist Explores the Land of Inequality

Angus Deaton

Princeton University Press

Princeton, NJ, 2023, 280 pp., \$24.95

To address inequality, Deaton urges policymakers to focus not just on redistribution—which has conceptual and practical limits—but on “pre-distribution,” factors such as education and health that influence how markets determine the distribution of income before taxes and transfers. In some circumstances, higher minimum wages can boost low-income workers’ well-being without reducing employment.

Deaton sees a need for government intervention to reduce health care costs and poverty and to ensure more reliable retirement benefits. In the health care market, factors like asymmetric information about prices and procedures impede market competition. Overreliance on market forces in these circumstances, the author argues, leads to high health care inequality and prices and low quality compared with other rich countries.

Deaton favors communal over individual financing and provision of pensions because market risks are high, most people lack the wherewithal to manage the risks, and for those who miscalculate risks or suffer bad luck the consequences are catastrophic. Deaton argues that governments should pay attention to poverty at home—as they have a particular obligation to their own citizens who pay taxes, work, and serve—and to poverty abroad, although he does not see aid as a durable solution.

The criticisms of economics may strike some as sweeping and overlook the intellectual and policy flexibility developed during and after the global financial crisis, including by the IMF under then-economic counselor Olivier Blanchard.

Overall, the book is informative, given the wide range of subjects; compelling, given Deaton’s obvious authority and rich experience; and, given his flair for writing, enjoyable.

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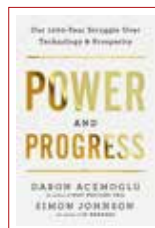
Live Long and Prosper

Prakash Loungani

IMAGINE THAT A WORKER ABOUT TO BE replaced by a robot is told: “Rejoice, your great-great-great-grandchild will benefit from these advances in technology. Sadly, you and your kids and their kids will go through rough times, but don’t be a selfish Luddite and stand in the way of future prosperity.” This is essentially what happened to textile workers in the early decades of the Industrial Revolution, according to Daron Acemoglu and Simon Johnson, in *Power and Progress*. The use of new technology and machines “did not raise worker incomes for almost a hundred years,” they write. “On the contrary, as the textile workers themselves keenly understood, work hours lengthened and conditions were horrible, both in the factory and in crowded cities.” Coal miners, including children, worked in even more deplorable conditions.

The Information Revolution is proceeding on a track similar to the early decades of the Industrial Revolution, Acemoglu and Johnson say. Since 1980, the twin forces of globalization and automation have brought us an amazing array of new products, enabled in part by the introduction of global supply chains. The two forces “have been synergistic, both driven by the same urge to cut labor costs and sideline workers.” As a result, workers—particularly low-skilled workers in advanced economies—have not shared in the prosperity, resulting in two-tiered societies. In the United States, for instance, “real wages for most workers have scarcely increased” since 1980. Only half of US children born in 1984 earned more than their parents, compared with 90 percent of children born in 1940. Work conditions may not be as deplorable as during the Industrial Revolution, but lack of opportunity has nevertheless driven many to what Anne Case and Angus Deaton call “deaths of despair.” In many countries, the share of labor in national income has fallen, with a corresponding rise in capital’s share.

Promisingly, history also offers examples of the gains from technological advances shared more broadly, a phenomenon the authors term a “productivity bandwagon.” This happens when either through accident or choice, technology raises worker productivity rather than simply displacing workers, creating ample new jobs. This bandwagon does require that workers find ways to wrest their share of the new prosperity. After a dismal start, the Industrial Revolution finally moved in this direction. This outcome came about as awareness spread that “in the name of progress, much of the population was being impoverished” and as workers organized to demand higher wages and better living conditions. As a result, in the



POWER AND PROGRESS
Our 1000-Year Struggle Over Technology and Prosperity

Daron Acemoglu and Simon Johnson

PublicAffairs

New York, NY,
2023, 560 pp.,
\$32.00

“The Information Revolution is proceeding on a track similar to the early decades of the Industrial Revolution.”

United Kingdom, for instance, from 1840 to 1900, wages increased more than 120 percent, surpassing the 90 percent growth in productivity.

The three decades following World War II were also an era of shared prosperity. New technology adopted over this period was not overwhelmingly geared toward saving money through automation and generated “plenty of new tasks, products, and opportunities.” And workers organized into labor unions to fight for their fair share of the gains. As a result, labor’s share of national income increased over this period, a sign that technology was worker-friendly and employers were sharing the gains.

Will the next decades bring shared prosperity or a further move in the direction of two-tiered societies? Acemoglu and Johnson conclude that “it is late, but perhaps not too late,” to change course, and the last chapter offers the obligatory list of steps—over a dozen in all—that societies can take to achieve this, ranging from “breaking up big tech” to “reform of academia.” The one step that matters most given the authors’ own historical evidence is “worker organization,” namely whether workers will be able to—and be allowed to—organize to improve wages and working conditions. The evidence so far is not clear: unionization has inched up in many economies, but these efforts have met with opposition from companies, and many unionization drives have failed. Acemoglu and Johnson would likely have said, “Workers of the world, unite!” if that slogan hadn’t already been taken. **F&D**

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Reaching for the Red Planet

Analisa R. Bala

The United Arab Emirates honors the visionary behind the country's ambitious space program



UAE's third 1,000 dirham note issue

IN 2020, A FEW MONTHS INTO the COVID-19 pandemic, the United Arab Emirates' space agency launched its first mission to Mars—an accomplishment depicted on the UAE's 1,000 dirham note. The spacecraft, called "*Hope*," was the first from an Arab nation to reach the red planet and is currently in orbit for one Martian year—the equivalent of 687 days on Earth—providing scientists a complete picture of the Martian atmosphere.

The country is the fifth to reach Mars, and only the second in the world (after India) to successfully launch a probe into orbit on the first attempt, just six years after forming a space agency. Omran Sharaf, the Mars mission project manager, explained the country's motivation in a 2019 TEDx Talk. "The oil age will not end because we run out of oil," he said, "it will end because of progress...It's about survival."

The UAE's goal, ultimately, is to be the first country to build a sustainable colony on the red planet in the next 100 years—a vision inspired by the UAE's founding father, the late Sheikh Zayed bin Sultan Al Nahyan. Sheikh Zayed had ambitions of making the country a hub for space research and innovation

and invested heavily in the sciences. Throughout the 1970s, he met with astronauts from several of the Apollo missions and was even gifted a sliver of moon rock by US President Richard Nixon.

The latest issue of the 1,000 dirham note depicts Sheikh Zayed looking at the UAE's *Hope* space shuttle and has a portrait of an astronaut in the security foil on the front and back. The note was recently named "Best New Banknote" at the industry's High Security Printing EMEA Conference for its design and advanced security features; it went into circulation in December 2022, in the same month the UAE again made history by launching the Arab world's first lunar rover.

The space program's success sends a message to the region's youth—a goal held by Sheikh Zayed, who wanted his love of science instilled in young people. About 90 percent of the Emirati Mars team is younger than 35, and a third are women. "If the UAE is able to reach Mars in less than 50 years," Sharaf said, "you [the youth] can do *much* more." **F&D**

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