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Monitoring and Analysis of Political, Social and Economic Development in Countries Affected by Conflict

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Part I. Introduction

The report provides a review of key political and socio-economic developments in countries afflicted by conflict and political instability in Western Asia, focusing on the period between July and December 2006. During the mentioned period, the report also provides concerned readers an analytical prism through which to view current and projected future socioeconomic and political trends in the ESCWA region. The section that follows provides a succinct analysis of the main political trends in the region, especially those exacerbating socioeconomic tensions, political instability or conflicts.

The second part of the report seeks to describe the implications of conflict on economic and social development in the short and medium terms in Iraq, Lebanon, and the occupied Palestinian territory, with special emphasis on the impact of conflict on unemployment and the impact of unemployment on conflict as well as political tensions. These three countries have been particularly affected by high unemployment rates during the reporting period. The inter-relation of political tension, conflict and unemployment is significant, particularly since 21.6 per cent of the population in the Arab world are between 15 and 24. Moreover, the working age population, which is between 25 and 64, is estimated to be 40 per cent in the Arab world¹. These significant age groups find themselves amidst a highly charged political environment and live in states which economies are increasingly unable to produce jobs. Educational systems and skills also lag behind to ensure their employability or propensity to meet market demands. In addition, political systems curtail the expression of their concerns and aspirations. Under such circumstances, the unemployed – especially the young - become susceptible to under-employment, frustration, permanent immigration, clientalism, criminal activity, religious or ideological extremism and militancy. Some political actors take advantage of such groups for their own political ends or confrontations.

The overlap between political crisis and deteriorating socioeconomic indicators, in particular unemployment, is the governing theme of this monitoring report.

Part II. Regional Political Developments

Regional developments in the past six months exacerbated both inter-state tensions and intra-state conflicts. The overlap between domestic, regional, and international factors served to heighten political tensions in the ESCWA region. Region-wide geostrategic confrontations have set the tone for conflicts and tensions at both the regional and national levels in the ESCWA region.

The implications of the aforementioned trends can be clearly seen in a number of thematic clusters that deserve special attention during this reporting period. These clusters are important not just as current trends, but also for their long-term effects on political stability and socioeconomic development in the ESCWA region.

¹ United Nations Population Division, World Population Prospects, 2004 Revision

Of particular importance in this reporting period were the July-August War in Lebanon, Israel's abandonment of its unilateral approach manifested in the disengagement strategy and political developments within the US that would affect its Middle East policies (i.e. Democrats' electoral victories in both the US Senate and Congress and the Baker-Hamilton report).

(a) The Arab Israeli Conflict: During the reporting period, the Arab-Israeli conflict witnessed two major developments: Israel's perceived defeat in the July-August War in Lebanon, and the collapse of Israel's disengagement strategy. This strategy had been a pillar of Israeli policy vis-à-vis the occupied territories during the past few years, and as such, its reconsideration is an important new development.

The saliency of the Arab-Israeli conflict as a key to regional stability was a point underscored by many Arab and European governments, as well as within the United States, by the Baker-Hamilton report. Resolving this conflict, or at least the prospects thereof, is now increasingly being perceived as a prerequisite for stabilizing Iraq as well as empowering the so-called "moderate" Arab states.

According to this view, resolution of the Palestinian question will release bent up political frustrations and restore moderation to Arab societies. It will neutralize the most important symbol deployed by radical groups and states against moderate governments, consequently shoring up the stability of the latter. Moderate Arab governments have thus pressed the US administration to launch a new peace initiative in the region, especially on the Palestinian-Israeli front. It is thus important to monitor developments in this cluster during the next reporting period.

However, prospects for the resumption of the Palestinian-Israeli peace process could no longer be sufficient for maintaining stability within the OPT. The strong links between the internal situation in the occupied territory, the Palestinian-Israeli peace process, and regional tensions have been reversed recently. Traditionally, instability in the region was attributed to the lack of peace in the occupied territory. Currently, regional disputes over other geopolitical issues serve to generate instability in the OPT.

(b) Regional Realignments: During this reporting period new regional alignments were consecrated. The once-dominant Saudi-Syrian-Egyptian axis has been replaced with a new regional configuration: the US backed Saudi-Egyptian-Jordanian alignment facing off against the Syrian-Iranian alliance. The contest between these two alliances is taking place in different areas, and is exacerbating domestic political and socioeconomic conflicts in them.

This divergence between the two alignments, notwithstanding discrepancies among members of both, has developed into a zero-sum security/political game. Loss of influence by either party in any part of the region is perceived as tantamount to an increase in the other's regional influence.

The July-August War in Lebanon exacerbated the regional divide. Syria and Iran perceived themselves to be victors in this confrontation, with a corresponding increase in their regional influence and leverage. Additionally, tensions between Syria on one hand and Saudi Arabia and Egypt on the other are perceived as having spiked during the war and in its immediate aftermath.

The increased tensions between the two alliances were translated into political/security confrontations in Lebanon, Iraq and the OPT. This was made possible by major local actors in those three countries who have seemingly aligned themselves to one of the two axes.

In Lebanon, this trend contributed to the political crisis, which exploded in November 2006, where neither alignment was willing to see its Lebanese allies weakened. Both have also been wary of a slide into civil war. As part of the contest, US involvement in Lebanon has reached new heights during this reporting period. Any solution to the current political crisis in Lebanon thus entails a regional/international consensus.

External intervention in Iraq has also intensified during this reporting period as different actors, namely the two alignments, attempt to consolidate their influence in Iraq. The dependency of local actors on the support to external powers, including the US, has transformed the country to a major arena for contention. Although a number of experts, opinion makers and politicians throughout the world, including the Baker-Hamilton Commission, assert that a regional-US consensus, or at least understanding, is vital for stabilizing the country, the opposite is taking place. The conflict in Iraq has therefore become a high-stakes game for all of the actors involved.

In the OPT, the struggle over power between President Mahmud Abbas' Fateh and Prime Minister Ismael Hannieh's Hamas also reflects the wider regional contest between the two alliances. The permeability of internal Palestinian conflict to external intervention has further complicated domestic Palestinian relations. Both Hamas and Fateh have sought political and financial support from regional and international powers. This has resulted in the polarization of the Palestinian political scene along the competing regional axes. The financial embargo on the Hamas-led Palestinian Authority is seen as a demonstration of the entanglement of domestic Palestinian affairs with international and regional dynamics.

The durability of the Iranian-Syrian alliance will be tested in the immediate future. Arab and European efforts to draw Syria away from Iran to isolate the latter may become more aggressive. But it would be wrong to underestimate the power of the Iranian-Syrian alliance, especially at a time when the latter feels that it has weathered the brunt of US engagement in the region following the invasion of Iraq.

c) The Spread of Sectarianism: The reporting period has witnessed a rise in sectarian tensions in the region.

The aforementioned geopolitical rivalry is laden with sectarian connotations: the Saudi-Egyptian-Jordanian alignment has been identified or rather packaged as serving Sunni interests, while the Iranian-Syrian alliance is seen as representing – and bent on spreading – Shiite regional interests.

Sectarianism in the ESCWA region feeds domestic political struggles but in turn is hardened by these struggles. The unabashed use of sectarian languages and symbols in what are otherwise geopolitical or domestic political struggles risks bringing sectarian tensions to new heights in the region. This, in turn, is bound to exacerbate geopolitical and domestic conflicts. However it does not seem that the sectarian wave in the ESCWA region has reached its zenith yet.

The July-August War in Lebanon led to a decrease in sectarian tensions in Lebanon and across the region. The animosity among Arab public opinion towards Israel at the time was more forceful than the Shiite-Sunni divide. Yet, as soon as the war ended, sectarian rhetoric and tensions were reenergized, particularly in countries that contain significant Shiite and Sunni communities. The most evident and violent case of sectarian tensions is that of Iraq.

Post-Saddam Iraq has steadily degenerated into sectarian civil war. Despite claims to the contrary, some parts of central Baghdad have experienced sectarian cleansing in the past six months, and sectarian militias have assumed a greater role. As sectarian violence increases in scope and intensity, local communities have resorted to self-protection. Local communities mistrust the state security apparatus, which is considered loyal to different political actors. Consequently, dissolving the militias, a precondition for achieving stability and a new political consensus, is becoming more difficult. Moreover, the Iraqi quagmire has spilled over to neighboring states, fueling Sunni-Shia tensions in a number of Gulf States, as well as Lebanon.

In Lebanon, sectarian animosity has also proved to be a ramification of the July-August War in Lebanon. The war served to intensify the internal power struggle over the post-Syria Lebanese state. Despite talk of national unity in the face of external aggression during the 33 days of the war, the political struggle resumed immediately after the ‘end of hostilities’ on 14 August 2006. The power struggle has assumed virulent Sunni-Shiite sectarian undertones. Nevertheless, sectarian skirmishes have been limited during the reporting period. Sectarian tensions are intricately linked to the ongoing contest for political power, as well as the aforementioned regional contest, and its sectarian dimension, whether real or perceived.

If this sectarian confrontation proves protracted, it risks unleashing a radical movement within Lebanon’s hitherto moderate Sunni community with unforeseen consequences. This will expose the rather fragile Lebanese society to new forms of violent radicalism. It may also allow al-Qaeda like operatives to use Lebanon as a site for a new Sunni-Shia sectarian war.

Saddam Hussein's execution in the closing days of 2006, its timing (on the first day of al-Adha holiday – the most important Muslim holiday) and its conduct has added to the surge of sectarian tensions in the region. This surge has stretched to countries where there are no Shiite communities for the first time. The outrage within the Sunni public was directed towards Iran and adopted a severe sectarian tone.

It is feared that anti-Shiite sentiment among the Sunni dominated Arab public opinion might be utilized, and indeed cultivated, by a number of regional and international actors for either local political or wider geopolitical purposes. However, it is widely recognized that such tensions, should they be allowed to erupt, could very well spiral out of control, in a manner similar to the conflict in Iraq.

Part III. Socio-Economic Development with emphasis on Unemployment

The aforementioned regional political trends of the past six months serve to intensify socioeconomic tensions and conflicts in the ESCWA region. After all, conflicts over political powers and economic resources are inseparable in the ESCWA region. More importantly, political and military conflicts have devastating and far-reaching social and economic implications, both on macro and microeconomic indicators. This monitoring report will focus on the impact of conflict on unemployment. Available information for Iraq, Lebanon, and the OPT suggests a sharp increase in unemployment rates. The following survey aims at providing a situation analysis of the impact of conflict on unemployment in each of these three countries. It also seeks to describe the implications of conflict on economic and social development in the short and medium terms.

1. Iraq

Macroeconomic Indicators

Economic growth remains below target. Overall economic growth in 2005 is estimated at around 10 percent from a low GDP base². Economic growth in 2006 is expected to slow down to 4 percent. In both 2005 and 2006, oil remained the main source of economic growth though oil production did not exceed 2.0 million barrels per day on average. Attacks against oil fields have stalled ongoing operations and the implementation of maintenance and capacity upgrading projects. Growth in non-oil economic activity is estimated to have reached 10 percent in 2006³. Recent figures issued by the Central Bank show alarmingly high inflation rates. Consumer prices have increased by 52.8 percent in October 2006 compared to October of 2005. The main factors behind the rise in inflation are the partial lifting of Government subsidies on oil products, shortages in many goods and services, as well as the high costs charged by producers as a result of insurgency attacks. It is highly unlikely that increases in salaries have matched those of consumer prices. This reflects negatively on the purchasing power of households and on political

² ESCWA, "Survey of Economic and Social Developments in the ESCWA Region 2005-2006," 5 April 2006.

³ International Monetary Fund (IMF), "IMF Country Report," no. 06/301, August 2006.

stability. Unemployment is expected to be over 25 percent in 2006. Much higher figures are registered in the Sunni areas northeast of Baghdad, however.

Unemployment

The unemployment rate in Iraq was 10.5 percent in 2004⁴. The corresponding relaxed rate was 18.4 percent. The labor force participation rate was 41 percent in 2004⁵. After all, Iraq has a young population: 39 percent of the population is less than 15 years of age. Iraq also has a low participation rate for women—13 percent in 2004⁶. The services sector was the major employer in the country and accounted for 56 percent of total employment, followed by agriculture, 15 percent, construction, 9 percent, and manufacturing, 6 percent⁷. Shifts in employment also occurred after the war. Public defense was a major employer before the war. The public sector continued to be a major employer in 2004 accounting for 30 percent of the total employed. However many individuals employed in defense shifted to other jobs or became unemployed. The wages and salaries adjusted but not to the extent to compensate for high inflation, and wages for foreign workers are many folds higher than those paid for Iraqis.

Impact of Conflict on Unemployment

Damages caused by insurgents and the lack of new investment affected adversely most productive sectors, particularly in high violence regions. The agricultural, trade, services, and industrial sectors were acutely affected, leading to an increase in unemployment. After all, these sectors account for over 98 percent of the labor force. As for agriculture, the problem remains with the lack of raw materials such as vitamins, pesticides and other essential products. Another problem is the lack of vaccination for cattle. This increases the risk of spreading contagious diseases within Iraq and in neighboring countries, leaving many farmers at low productivity or out of business. The oil industry remains the main source of national income. Nevertheless it only employs around 1 percent of the total labor force. Some sectors are less affected by the domestic crisis, such as the communication sector. The estimated number of mobile users increased from 1.4 million in 2004-2005 to 7.1 millions at the end of 2006⁸. The construction sector has similarly grown but at a lower rate.

Iraq faces serious socioeconomic problems as a result of growing unemployment. Currently the trend of continuous impoverishment of the population, from the north of the country all through the south, is alarming. Nearly 5.6 million Iraqis are currently living below the poverty line. At least 40 percent of this number is living in extremely impoverished conditions⁹. It is worth noting that this level of poverty has grown by 35 percent since 2003. A report by the World Food Program (WFP) notes a chronic poverty

⁴ Iraq, Ministry of Planning and Development Cooperation, and the United Nations Development Programme (UNDP), "Iraq Living Conditions Survey 2004," 2005.

⁵ Ibid.

⁶ Ibid.

⁷ The sectors are unknown for the remaining balance.

⁸ See *Newsweek International* at: <<http://www.msnbc.msn.com/id/16241340/site/newsweek/>>.

⁹ Iraq, Ministry of Labor and Social Affairs.

for the center and southern regions of Iraq¹⁰. It estimated that before the war, 60 percent of the Iraqi population was entirely dependent on the monthly food rations distributed by the Oil-for-Food Program. The lack of growth in productive sectors posed threats to national food security. The decline in economic activities, especially in the agricultural, industrial and commercial sectors, coupled with security risks in the transport sector, had a significant effect on the supply of basic food needs and vital medical products, leading to shortages in many areas.

The loss of jobs, low rates of investment, and internal displacement lead to instability in the Iraqi labor force. Internal displacement due to violence and unemployment rose to 1.5 million people at the end of 2006 with more than 365,000 newly displaced since February¹¹. Job seekers migrate from all around Iraq to more work-abundant regions. This leads to a surplus in the unemployed labor force in major cities, where more work opportunities could be found, and deserted or labor-free zones in other parts of the country. The excessive supply of labor unmatched by job generation has led to soaring unemployment rates. Political affiliation also affects employment trends. Supporters of the previous regime have more difficulty finding a job. A surge in frauds and unskilled labor has been noticed in some business circles. Several reports revealed that in the medical field, false doctors are working without any licenses or governmental control.

Internal displacement is coupled with the flight of Iraqi citizens to neighboring countries, mainly to Syria and Jordan. It is estimated that by the end of 2006, 1.6 million Iraqis, including those who left Iraq before 2003, were outside Iraq. Of this number 500,000 were in Jordan and 450,000 were in Syria¹². More Iraqis are heading to other countries in the region including Egypt, Lebanon, and the GCC. The number of asylum seekers in the European Union from Iraq amounted to 8,100 applicants in the first half of 2006¹³. The trend increased during the past six months with a very high demand for new passports.¹⁴ Thousands of university students and professionals stand in line in front of the Ministry of Higher Education to obtain certified copies of their records to leave Iraq.¹⁵ If this develops into a trend, a significant number of qualified Iraqis would have left the country by the end of 2007. Iraq is expected to face a brain drain and a serious loss in manpower in the future if current trends persist.

The cause-effect relationship between unemployment, poverty, and violence creates a vicious circle. Unemployment leads to delinquency, which in turn decreases investment. This leads to less demand for labor, causing more unemployment, and consequently further increase in delinquency. Such a situation has direct effect on the general psychology of the average population. A feeling of uncertainty hovers above the country, creating a growing inactive class. Most ominously, this inactive class has disregarded the

¹⁰ El Guindi, Tarik et al., "The Extent and Geographic Distribution of Chronic Poverty in Iraq's Center/South Region," May 2003.

¹¹ UNHCR, "Iraq Displacement," Briefing Notes, 11 January 2007.

¹² Ibid.

¹³ Ibid.

¹⁴ See *al-Mada*, November 8, 2006.

¹⁵ See *al-Mada*, September 30, 2006.

idea of seeking a job for three main reasons: the political-sectarian situation, the lack of security, and psychological disturbances.

Psychological disturbances have a major impact on the non-working class, especially among the youth. Many youngsters are not attending schools anymore, and adolescents are not seeking higher education. This issue is very critical since it has a major impact on the nature of the future labor force in Iraq. If this trend persists, the reduction in illiteracy rates witnessed over the past two decades would reverse. This will eventually lead to more poverty and more delinquency, leading to an economic crisis.

Another aspect that should be noted is the huge numbers of handicapped in the country. A survey showed the presence of 1.3 million handicapped, representing roughly 4.5 percent of the total population.¹⁶ This rate is highly dramatic since most handicapped are young and belong to the active population. These people face bigger chances of living in poverty, encounter integration problems, and would not have pensions, thus relying on the government to cover their living expenses.

Women employment is also affected by the current situation. The rate of participation for women in the labor force was only 13 percent compared to 69 percent for men in 2004¹⁷. One reason is the traditional status of women and their education. Women are also victims of sexual harassment and their social rights were undermined drastically during the 2003 war. Women are also victims of honor-crimes, public executions, and kidnappings. Some 5,500 women victims are reported per year.

Restoring security and political stability are the prerequisite for economic growth and social stability in Iraq. The surge in unemployment requires job generation and rehabilitation programs to integrate the growing numbers of the unemployed in economic activity. Employment is necessary to prevent more people from drifting into violence and organized crime. Iraqis need to share the profits generated from oil. The development of the productive sectors strongly relies on security in the country. For example, it would be safer and easier for peasants to sell agricultural products in the local markets, enabling the agricultural sector to prosper once again. In the trade sector, small and medium scale merchants would be able to resume their activities. The transportation and service sector would also benefit from civil peace.

2. Lebanon

Economic Costs of the July 2006 War

The economic and social costs of the July/August 2006 war on Lebanon are very high in all respects. Some 1,200 individuals were killed, 4,400 injured, and 100,000 were unable

¹⁶ See *al-Sabah*, September 13, 2006.

¹⁷ Iraq, Ministry of Planning and Development Cooperation, and the United Nations Development Programme (UNDP), "Iraq Living Conditions Survey 2004," 2005.

to return to their homes after the fighting¹⁸. According to a recent estimate by the Ministry of Finance, the direct costs of the war stand at US\$ 2.8 billion comprising damages to infrastructure, households, and productive capacity. The indirect costs emanating from the war and two months of trade blockade, including losses of livelihoods, public and private revenues, investment opportunities and following repercussions, are expected to run into several billions of dollars in the medium run. It is estimated that lost output and income in real terms was US\$ 2.2 billions in 2006¹⁹. The war also weighed heavily on present economic challenges. Boosting GDP growth and employment, encouraging investment, and enhancing public finances remain the top priorities for the economic reform agenda. The unemployment rate has increased sharply in the period during and after the war. This section provides a brief overview of the economic outcomes of the July/August war on Lebanon. It also examines the effects of the war on unemployment from both the economic and social perspectives.

The July/August war dealt a heavy blow to the positive expectations of growth in 2006. The first two quarters of 2006 witnessed signs of economic recovery with estimates for GDP growth amounting to 6 percent at the beginning of the year. After the war, GDP is expected to contract by 5 percent according to official sources.²⁰ In 2005, GDP growth declined to 1 percent reflecting the negative impact of political instability over economic activity. In addition to the direct costs, most of the productive sectors in the country, particularly, tourism, industry, agriculture, and energy suffered indirect costs in terms of lost revenues and business opportunities. The adverse effects are also expected to reach other sectors, such as trade, with weakened aggregate demand.

On the monetary side, the Central Bank was able to manage pressure on the financial sector and the Lebanese pound during the crisis because of its possession of significant level of international reserves, some US\$ 12 billion. Deposits from Saudi Arabia and Kuwait, amounting to US\$ 1.5 billion, also helped restore confidence in the sector²¹. The treasury lost two months worth of sea and airport revenues. Assistance from donor countries and the public have alleviated the problem to a certain extent. It is feared, however, that the budget deficit will worsen in 2007 following an expansionary policy to fulfill the reconstruction and rehabilitation plan. Moreover, the mounting debt burden approaching 180 percent of GDP has significant negative implications for future growth.

Unemployment

Lebanon has experienced significant unemployment rates over the past 16 years. The unemployment rate was 8 percent in 2004.²² The total labor force accounted for 32.2 percent of the population in 2004. This rate is relatively low due to Lebanon's young population – 47.1 percent of the population is below the age of 25 – and lower economic

¹⁸ Lebanese Republic, "Recovery, Reconstruction and Reform: International Conference for Support to Lebanon," 02 January 2007.

¹⁹ Ibid.

²⁰ Ibid.

²¹ Lebanon Ministry of Finance, "Impact of the July War on the Public Finances in 2006," August 30, 2006.

²² Lebanese Republic, Ministry of Social Affairs, and United Nations Development Program (UNDP), "Living Conditions of Households," 2004.

activity rates for the young²³. The participation rate of females is low and stands at less than one third of that of males.

Unemployment results from insufficient job generation and a mismatch between the supply of, and demand for, labor. This will pose a serious challenge when young people, constituting 37.1 percent of the population, join job seekers in the medium term. Moreover, a large number of foreign workers are employed in the country. In 2005, the number of work permits issued to foreign workers reached 109,400²⁴. This number does not account for the large number of unregulated or unreported foreign workers, however. Most of the foreign laborers, who come from Egypt, the Syrian Arab Republic and Asia, are involved in construction, agriculture and domestic works. Concurrently, over a quarter of Lebanese migrants hold university degrees and their exit will create a serious brain drain, let alone other social problems.²⁵ A short-term surge in unemployment will only add to the already existing consequences of unemployment in the country.

Socioeconomic Impact of War on Unemployment

The unemployment rate estimated at 9 percent in 2005 is expected to double in the direct aftermath of the July/August 2006 war²⁶. It is projected that job losses could be between 30,000 and 50,000 in the short run²⁷. Tourism, industry, and agriculture were amongst the hardest hit sectors during and after the war. Services and trade employ 68 percent of labor, followed by industry (15 percent), construction (9 percent), and agriculture (8 percent). Employment in these sectors will be adversely affected by unstable political conditions. In the areas bearing the brunt of the destruction, small entrepreneurs and employees lost their jobs as many establishments, mainly small and medium enterprises (SMEs), were destroyed totally or partially. In remaining areas, lost business activity due to the blockade, lost working days, and a contraction in aggregate demand have led to wholesale layoffs, particularly of short-term laborers. Enterprises resorted to paying reduced salaries or asking employees to take leave. It is feared that with persistent instability, this short term increase in unemployment will develop into a serious problem.

The country's tourism sector contributed around 4 percent of GDP in 2002²⁸ and currently employs 110,000 people²⁹. It was expected that about 1.6 million tourists would visit Lebanon in 2006. Restaurants and hotels rely heavily on seasonal workers especially in the peak months of July and August. It is estimated that on average 27 percent of this labor market, representing seasonal workers, lost work opportunities. As political

²³ Ibid.

²⁴ Central Administration for Statistics (CAS), "Statistical Yearbook 2000-2005," http://www.cas.gov.lb/Newsrep_en.asp.

²⁵ International Labour Organization (ILO), "An ILO Post Conflict Decent Work Programme for Lebanon," September 2006.

²⁶ The Daily Star "Analysts See High Unemployment in War's Aftermath," 31 August 2006.

²⁷ Ibid, and International Labor Organization (ILO), "An ILO Post Conflict Decent Work Programme for Lebanon," Report of the September Multidisciplinary Mission to Lebanon, 2006.

²⁸ Lebanese Republic, Ministry of Economy and Trade, "National Accounts of Lebanon 1997-2002," July 2005.

²⁹ The Daily Star "Analysts See High Unemployment in War's Aftermath," 31 August 2006.

instability continues to raise negative anticipations, some establishments are expected to close by the end of the year. This will result in more layoffs.

Around 90 industrial enterprises or large-scale factories in the South, the Bekaa, and Southern Beirut were destroyed totally or partially during the war. The Council of Reconstruction and Development (CDR) estimates the total cost of damages at US\$ 220 million. The losses of the industrial sector also include lost revenues, particularly exports, as a result of the blockade and lost working days. Earlier in the year, the industrial sector was expected to realize relatively higher levels of exports as a result of trade pacts with the EU. The total number of workers who lost their jobs is projected at 2,000 workers.

Agriculture and fishing were also severely affected by the war. Agriculture comprises 70 percent of household income in the South³⁰. The war's direct damages to the agricultural sector amounted to US\$280 million according to a FAO assessment report. Other indirect costs include loss of crops and markets, but particularly export markets. The agricultural sector relies heavily on Syrian laborers, and was consequently temporarily paralyzed after most of the workers fled to their home country during the months of July and August. Farmers in the South now face a serious unemployment problem. They have lost their source of income but must meet debt obligations. Many cultivated areas were rendered inaccessible by unexploded ordnances and will need at least two years to be cleared.

Fishermen face a similar situation. The environmental and health hazards of the oil spill left many fishermen out of business during and after the war. The average income for fishermen before the war was US\$400 per month. Their income after the war decreased to US\$150³¹. Due to the absence of alternatives, fishing activity was resumed despite lower incomes and pollution.

Other sectors, such as some trade sectors, have been affected by the slowdown in aggregate demand. The retail sector could layoff up to 2000 workers if political instability continues. On the other hand, rehabilitation and reconstruction works, expected to reach full strength in 2007, could create new demand for employment in contractual, engineering, and related support services over the coming two years. However the positive effect on unemployment will be limited given that these sectors are highly dependent on foreign labor.

The surge in short-term unemployment brought by the war has many socio-economic implications. Migration has accelerated during and after the war. So far 100,000 Lebanese have left the country. Of these around 25 percent are from the highly educated strata of society³². The effects of migration are mixed, however. Transfers from expatriates have supported private consumption and financed a huge current account

³⁰ Food and Agriculture Organization (FAO), "Lebanon: damage to agriculture, fisheries and forestry estimated at around \$280 million," 26 November 2006, Rome.

³¹ Relief Web, "Livelihoods Intervention for fishermen in Beirut, Lebanon," Press release, 18 December 2006.

³² International Labor Organization (ILO), "An ILO Post Conflict Decent Work Programme for Lebanon," Report of the September Multidisciplinary Mission to Lebanon, 2006.

deficit over the past years. However, the brain drain will reflect negatively on the job market in sectors requiring medium and high skilled labor.

Other socio-economic problems are also felt to varying degrees. The absence of unemployment security and the absence of emergency action to deal with short term unemployment will leave many families without a source of income in the coming six to nine months. The number of people below the poverty line is on the rise and living standards have deteriorated. Frustration brought in part by unemployment has led to more friction especially among the youth. There is no doubt that the distribution of humanitarian aid in the form of food and medical supplies has alleviated the suffering of many during and after the war. Job generation remains an essential second step to avoid social conflict.

Promoting a stable business climate remains one of the principal prerequisites for boosting productivity in the country. This will depend to a great extent on the restoration of political stability in the country and on the speed of the reconstruction process. Job generation also relies on direct investments. The July/August war has stopped investments from flowing to the country and disrupted many ongoing projects. International rating agencies such as Standards and Poor's and Moody's have downgraded Lebanon's sovereigns. Projects and investment flows from GCC countries amounted to US\$8 billions in the past three years³³. Some domestic and foreign investors have taken steps to shift their projects to other countries. This will result in the loss of potential job opportunities and in layoffs.

The surge in unemployment is expected to be short lived and would dissipate if economic activity regains its prewar momentum. GDP growth is expected to reach 7 percent in 2007. This is highly conditional on the resolution of the current political impasse in the country. It is also strongly dependent on compensation and financing schemes offered to the private sector. Delays of loan repayments were undertaken on a case-by-case basis by commercial banks. This measure has helped businesses retain their employees until economic conditions improve. At the macro level, donation of aid commitments in the Stockholm conference of over US\$900 coupled with an expansion in government expenditures are expected to spur consumer demand. It is hoped that the Paris III conference scheduled for January 2007 can contribute significantly to rescheduling and refinancing part of the public debt and attracting additional funds for reconstruction and compensation. Funding policies and activities aimed at generating work opportunities should be among the top priorities of Lebanon's economic relief agenda.

3. Occupied Palestinian Territory

The direct cost of damages incurred from Israel's military offensive against the OPT during this reporting period reached US\$46 millions in Gaza alone (see Table 1). The consequent reduction in GDP has amounted to around US\$120 million in the first three

³³ The Daily Star, "UAE Firms Facing Dh10 Billion in Investment Risk," 25 July 2006.

quarters of 2006 compared to the same period in 2005³⁴. The overall direct and indirect costs for the Palestinian Authority could run into hundreds of millions of dollars. High dependence on Israel and on foreign aid has contributed to the decline in Palestinian economic performance. The intensity of violence during this year coupled with growing internal and external conflicts, and more stringent restrictions by the Israeli Government over the flow of goods, capital, and persons caused a sharp deterioration in economic activity in 2006.

Table 1: Assessment of Damages Caused by the Israeli Defense Operations in the Gaza Strip, 26 June 2006 – 28 August 2006

Sector	Estimated cost in USD Million	Share of total (percentage)
Agriculture	23.5	51.3
Housing	2	4.4
Industry	0.3	0.7
Infrastructure and bridges	7.9	17.2
Power and energy	7.9	17.2
Public buildings	4.2	9.2
Total	45.8	100

Source: ESCWA calculation based on data from UNDP, “Assessment of Damages Caused by the Israeli Defense Forces Operations in the Gaza Strip,” 2006.

This deterioration in economic activity led to 8.9 percent decline in GDP growth in the 3rd quarter of 2006 compared with the second quarter, and 15.3 percent decline compared with the 3rd quarter of 2005. This amounts to the worst decline in economic growth since the beginning of the second uprising in 2001. The decline is felt mostly in the construction, agriculture, hotels, and public administration sectors, with the latter declining by over 20 percent in the 3rd quarter of 2006³⁵.

The Palestinian Authority (PA) is the major provider of services inside the OPT. Almost two thirds of the PA’s revenues come from taxes and another one third from budgetary aid. The PA’s spending was stalled by a decline in tax revenues and by Israel’s blocking of revenue transfers. Many donors have also frozen significant amounts of their pledged assistance in 2006. Between 2001 and 2004, aid flows to the OPT had grown significantly to salvage a critical humanitarian and economic situation. The aid dependency ratio increased to an average of 30 per cent of GDP for the same period. Private consumption is highly dependent on aid, transfers from the Palestinian Authority, and other private transfers, particularly from those working inside Israel. Economic activity was also negatively affected by stringent restrictions over the movement of Palestinian workers to Israel and the flow of goods. The number of closures and

³⁴ Palestinian Central Bureau of Statistics (PCBS), “Preliminary Estimates of Quarterly National Accounts, 3rd Quarter 2006,” November 2006.

³⁵ Ibid.

checkpoints impede people's movement. The flow of goods was also obstructed and the losses in terms of exports could reach US\$30 million by the end of 2006³⁶. Unemployment has further increased, reaching 24.2 percent in the 3rd quarter of 2006³⁷.

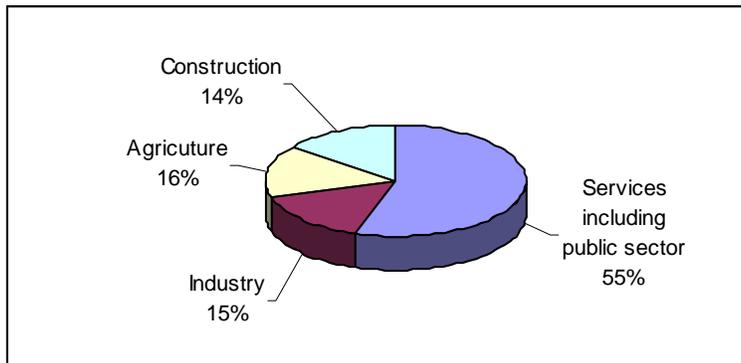
Socioeconomic Effects of Conflict on Unemployment

The latest figures by the Palestinian Central Bureau of Statistics (PCBS) show further deterioration in employment. The unemployment rate reached 30.3 percent in the 3rd quarter of 2006. It went up by 7.8 percent in the three months of June-August 2006. The effect is felt in most of the economic sectors. Most of these activities were adversely affected by the ongoing strife. The results in the services sector are mixed. Services provided the largest part of GDP (54.1 percent of GDP in the 3rd quarter of 2006) and accounted for over one half of the employees (55.1 percent in 2005 as shown in chart (1) below). Education and hotels declined by 20.5 and 37.9 percent respectively, while retail and wholesale trade, real estates, transport and financial intermediation experienced slow growth. Agriculture is the second largest employer accounting for 15.7 percent of the employed in 2005. The value added by agriculture declined by 9.3 percent in the 3rd quarter of 2006. Agriculture contributed 7.7 percent of GDP for the same period. The sector was largely hit in the Gaza Strip, with direct damages amounting to half of the total. Olive and citrus products were almost completely lost. Green houses, poultry and livestock farms, and irrigation networks suffered damages from the attacks by Israel. The industrial sector, including water and electricity, recorded 1.7 percent decline in the 3rd quarter of 2006. The sector contributed 11.8 percent of GDP in the same period and employed 14.8 percent of total work force in 2005. Many manufacturers lost their jobs during the year. Construction has a relatively small contribution of GDP (2.5 percent in 3rd quarter of 2006), but provided 14.4 percent of employment in 2005.

³⁶ Office for the Coordination of Humanitarian Affairs, "The Agreement on Movement and Access: One Year On," November 2006.

³⁷ PCBS, "Labor Force Survey Results (July-September 2006)," 7 November 2006.

Chart (1): Distribution of Labor Force by Sector in the Occupied Palestinian Territories, 2005 (percentage)



Source: ESCWA calculation based on data from the Palestinian Central Bureau of Statistics (PCBS), 2006.

As the funding crisis faced by the public sector continues, over 165,000 public sector employees are left without salaries for more than eight months. The Government of Israel is withholding tax revenue it collects on behalf of the PA. Some donor countries have abstained from paying pledged aid to the PA. Aid in 2005 funded one third of the PA budget. Many sources affirm that aid mostly from Arab donors continued to flow to the PA. Lately, Qatar pledged to pay US\$29 million per month representing the salaries of education and health workers³⁸. Similarly, Iran paid US\$120 million and pledges to pay another US\$30 million³⁹. However, internal disputes between the Presidency and the Government over many issues, including the disbursement of aid, aggravated the economic crisis. The public sector contributes almost a quarter of total employment in the West Bank and Gaza – as shown in Table 2. The estimated decline in the income of households of public employees is US\$ 330 million⁴⁰.

Table (2): Share of Public Sector Employees in Total Employment in the Occupied Palestinian Territories, 3rd Quarter 2006

Public sector employment	Q3 2006 (percentage)
Overall	22.6
West Bank	15.4
Gaza	44.0

Source: PCBS, 2006.

³⁸ BBC News, “Qatar to Pay Palestinian Wages,” 3 December 2006.

³⁹ BBC News, “Palestinian Police Storm Parliament over Unpaid Wages,” 9 December 2006.

⁴⁰ Relief Web, “Prolonged Crisis in the Occupied Palestinian Territory: Recent Socio-Economic Impacts on Refugees and Non-Refugees,” 22 November 2006.

Many additional problems have evolved from the current increase in unemployment. The overall effect of reduced aggregate consumption from lost income for the unemployed and the unpaid is expected to further plunge GDP growth and increase poverty in 2006. GDP per capita declined by one tenth in the 3rd quarter of 2006⁴¹. Consequently, food consumption declined by 8 percent. Deep poverty is expected to grow from 17.3 percent in 2005 to 27.5 percent of the population in the first half of 2006, as presented in a recent OCHA report. The problem is more acute in the Gaza Strip where 80 percent of the population lived in deep poverty by middle 2006. Another problem is the disruption of health and education services caused by the open strike of unpaid public workers. Shortages in medical staff and supplies were faced in all areas. More pressure was put on clinics run by international organizations and NGOs. The majority of public schools were totally or partially closed and an estimated 70 percent of students were affected by this closure⁴².

Addressing the 7 percent increase in unemployment brought by the current conflict in the OPT will hinge on the ability of the PA to enhance local security. It also requires an immediate action plan for humanitarian support and job generation. It is important to resolve internal conflicts and prevent more people, especially the young, from drifting into the circle of violence. Maintaining public jobs and restoring economic activity could help immensely. Measures are also needed to resolve the public finance crisis and implement the Agreement on Movement and Access signed between the PA and the Israeli Government. The US\$500 million pledged by donors in the Stockholm Conference in September 2006, and more recent donations from Arab countries and NGOs, are expected to provide much needed humanitarian assistance to alleviate the current crises in public spending. The United Nations called for a Consolidated Appeals Process (CAP) to raise US\$453.6 million. The first goal of CAP is employment generation and food assistance. It also aims to alleviate the burden faced in the areas of health, education, agriculture, and water and sanitation. All these are necessary measures for the reversal of current economic trends in the OPT.

IV. Future Trends

- The geopolitical confrontation in the Middle East will continue, with direct effects on the region's political and socioeconomic development.
- The Saudi-Iranian confrontation will shape political developments in the future.
- Riyadh's new aggressive role in Iraq is especially important in shaping the direction of future regional trends.
- Sectarian sentiments will not subside anytime soon, and sectarian violence in Iraq will continue, especially after Saddam's messy execution.
- Sectarian tensions may spread to other parts of the ESCWA region.
- The radicalizing impact of the Palestinian-Israeli crisis will continue in the future.

⁴¹ PCBS, "Preliminary Estimates of Quarterly National Accounts, 3rd Quarter 2006," November 2006.

⁴² UNICEF, "Six Months without Pay Spark Teachers' Strike in Gaza and West Bank," New York, 5 September 2006.

- The past trend of political crisis aggravating socioeconomic tensions and conflicts, which in turn intensify political challenges, is bound to continue. This vicious cycle will have devastating effects on the human security and socioeconomic development of the societies of the ESCWA region.
- The economic sources of political radicalism will grow more intense in the ESCWA region in the future. This will have grave political consequences on the young societies of the region.
- The trend of exit from select ESCWA countries in search of better economic prospects in others will continue. This will consecrate the lopsided regional economy in the making.
- Lebanon's economic crisis may spiral out of control short of a political consensus around a set of hard economic choices.
- Palestinian society is in danger of total societal and institutional collapse if present trends continue.
- Short of political stability and a massive economic reform program, future Iraqi generations are doomed to a vicious circle of unemployment, delinquency, radicalism, and exit.