

DOING BUSINESS IN The Arab World

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Inside

The risk of Arab-Israeli violence looms, and could be between Israel and groups such as Hamas, explains

Roula Khalaf
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More reform would underpin recovery



A view of Doha, capital of Qatar, which has snapped up assets around the world at a time of depressed prices

Getty

Andrew England says transparency, legal systems and education require particular attention

During the oil-fuelled boom years, the talk across the Arab world was of opportunity. It was, analysts agreed, a chance for a region dogged by inefficient, bureaucratic governments and stagnating economies, to modernise and tackle mounting social problems.

In the wealthy Gulf, the unprecedented influx of petrodollars between 2003 and 2008 led to a raft of vast projects in hydrocarbons, real estate and energy-intensive industries.

In the poorer states, such as Egypt and Morocco, governments moved to open their economies to attract greater foreign investment and model themselves as hubs to serve the broader region, including Europe and Africa, by taking advantage of their locations and cheap labour.

The economic crisis, however, brought an abrupt and painful end to the rapid period of growth.

Dubai, the region's business and finance hub, was particularly hard hit. This was because of its mountain of debt and the crash in real estate, which had been at the core of its expansion. But across the region projects were cancelled or delayed and governments, rich and poor, have been forced to reassess their development plans.

Now as the focus shifts to

recovery, analysts, bankers and government officials are again raising the need for states to push ahead with reforms to increase their competitiveness and develop their economies.

And in spite of the diverse nature of the region's markets, the same themes cross borders.

These include: improving transparency in a region where data either do not exist or are often old and unreliable; modernising legal systems that are cumbersome and unpredictable; and the urgent need to revamp education and improve skills, as increasing numbers of graduates enter job markets.

With more than 60 per cent of the Arab world's population aged under 25, governments like to talk up their pools of human resources and the growth of consumer markets.

But the poor state of education, a lack of skills and high unemployment from Saudi Arabia to Egypt also present governments with the challenge of creating

jobs, or they risk facing growing numbers of frustrated youngsters.

The paradox in the region is that in spite of unemployment, chief executives say one of their biggest impediments to expansion is the lack of suitable staff.

"Demographics will determine the longer growth patterns – it will be the main driver," says Marios Maratheftis, Middle East economist at Standard Chartered. "But," he adds, "just because you have a young population does not guarantee economic success. It's something that can enable success if these countries keep modernising and attracting foreign investment and creating jobs for the young population."

During the next decade, the Middle East and North Africa (Mena) region faces the daunting task of having to create 18m jobs for its growing labour forces, according to the International Monetary Fund.

That means high and sustained growth is a "precondition for such large-scale

job creation and for raising incomes," says Masood Ahmed, director of the IMF's Middle East and Central Asia department.

"This, in turn, can be achieved by strengthening trade competitiveness, so the region can better benefit from globalisation and the dynamics of today's high-growth regions."

Historically, however, Mena countries have scored poorly on most indicators of competitiveness, and since 1990 the region has managed only to maintain its share of global exports on a per-capita basis, Mr Ahmed says. This contrasts with other emerging economies that have succeeded in almost doubling theirs.

"Mena's lack of competitiveness has prevented the region from realising the full benefits of globalisation for its population in terms of income and employment gains," Mr Ahmed says.

Still, the Middle East, boasting more than half the world's proven oil reserves, is a region with significant potential.

Oil prices have been trading in a range between \$70 and \$80 a barrel and economic growth is picking up – although the pace of recovery is still being held back by lack of access to credit.

The IMF recently forecast that the Gulf states would grow at 4.5 per cent this year, compared with paltry growth of 0.4 per cent in 2009. In North Africa, the IMF is predicting growth of 5 per cent.

A number of Gulf states, particularly Saudi Arabia, Qatar and Abu Dhabi, the

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Job ideas wanted

Saudi Arabia's labour minister has used Facebook to seek ideas about ways to reduce unemployment. **Abeer Allam writes Page 2**

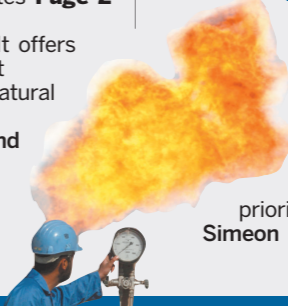
Iraq's return It offers majors their best chance to find natural resources, says **James Drummond Page 2**

Markets' recovery plan Growth, writes

Andrew England, is likely to be more subdued than during the boom years **Page 3**

Reform required

States are recognising that improving education is an important priority, reports **Simeon Kerr Page 4**



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Doing Business in the Arab World

Pressing need for ideas to create more employment

Labour force

States face the problem of growing but unskilled populations, writes **Abeer Allam**

On his Facebook page, Adel Fakieh, Saudi Arabia's new labour minister, asked for ideas for solving the country's unemployment issue.

Respondents identified the sponsorship system, under which expatriates require a local sponsor, and finding proper jobs as the biggest challenges, followed by the poor outcome of vocational training. Many suggested the minister form a team of volunteers to study the proposals.

Such moves are hardly normal practice in Saudi Arabia, where ministers typically set their agendas after receiving instructions from the senior royals and a selected council of senior business leaders.

Perhaps it is understandable for the minister to seek public

and business inputs to share the blame, given that the Ministry of Labour is in the unenviable position of being condemned by Saudis for tolerating 9m foreign workers, and by expatriates for restrictions that enable sponsors to exploit their foreign staff.

"I vowed to spend the first three months of my job just listening and studying the current situation before speaking publicly," says Mr Fakieh, who is also the chairman of the food group Savola.

Few other ministries are subject to such strident criticism. Up until his death in August, Labour Minister Ghazi al-Gosabi, the previous labour minister, was routinely derided for failing to cure the persistent problems, even as he launched initiatives to enhance vocational education, sending hundreds of Saudis to western vocational schools and encouraging others to accept lower paid jobs, in fast food restaurants for example, instead of demanding management posts upon graduation.

From Saudi Arabia to Egypt, governments in the Arab world are struggling to find private

sector jobs for their young and fast growing population. But recruiting qualified, motivated locals remains a challenge for companies moving into the region, particularly in Gulf states such as Saudi Arabia and the UAE, where governments impose quotas that force firms to hire locals.

"The basic problem in the whole region is skills," says Samir Radwan, an economist who has spent most of his career with the International Labour Organisation. "The problem in Egypt is to create enough demand for labour, while the problem of Gulf states is the supply for labour. The education system does not produce people who match the demands of the labour market."

Across the region, governments are concerned the unemployed could provide the perfect fodder for Islamic fundamentalist recruiters, or at least stir social unrest. In Saudi Arabia, unemployment is at 10.5 per cent, with 44 per cent of the 500,000 jobless educated to degree level and 43.2 per cent aged between 20-24 years

In Egypt, the most populous Arab country, labour unrest and demands for higher wages have become common. While employment is officially at 9.4 per cent, unofficially it is much higher, forcing workers to accept low salaries.

A court in April ordered the government to set a minimum wage. Workers asked for \$200 a

month, but the National Council for Wages suggested \$70, prompting Othman Mohamed Othman, minister of economic development, to say the country might as well import cheaper labour from Bangladesh.

Employers find fault with, skills, productivity and the work ethic. In the World Bank's 2010 Doing Business report,

Egypt advanced 10 ranks to 106 out of 183 nations, but dropped a rank to 120 when it comes to workers.

To tackle the skills issue, the Egyptian government set up training centres for workers, but they fail to meet demand.

In carbon-rich Gulf states, where up to 90 per cent of the labour force in the private sector are expatriates, governments face rising resentment against foreigners. In August, 200 Saudi teachers staged a rare protest demanding jobs.

In Qatar and UAE, where the locals represent less than 25 per cent of the population and demonstrations are not tolerated, nationals use internet forums to vent their anger.

Across the Gulf, officials are seeking to deploy their oil wealth to create highly paid jobs for citizens with a strong sense of entitlement, but often a poor work ethic and education.

The Saudi government pledged in August to spend \$385bn on schools, hospitals and infrastructure to halve unemployment by the end of 2014. They send thousands of stu-

dents abroad, but the impact of such policies will take years to materialise.

"Our universities contribute to unemployment because they raise expectations about salaries without imparting the skills needed," says Abdel Aziz Aluwaisheg, a Gulf economist.

To bypass the 10 per cent Saudisation quota, many employers either assign Saudi managers to positions with minimal responsibility, or create useless "work" for them to do, thus depriving them from gaining any experience.

Dozens of Saudi bankers and professionals have proved to be an asset to their companies, but many remain a burden, businessmen say.

"International companies are looking for the right talent at the right price," says John Sfakianakis, chief economist at Banque Saudi Fransi. "It is not senior talent that is the problem, it is the mid level; you have a very limited pool."

But the jobs market in Saudi Arabia is complicated by conflicting interests. While Saudis want to be favoured over for-

eigners, labour laws make it impossible and costly to fire Saudis, while the sponsorship system gives employer total control over foreign workers.

Economist say that as long as discrimination in labour rights persist, business owners will often opt for expatriates.

While Bahrain has moved to reform the sponsorship system, businessmen in Saudi Arabia and Qatar resist any change to the status quo.

Mr Aluwaisheg says governments have to force all business owners, regardless of their influence, to hire graduates and train them on workplace ethics and skills.

Young Saudis too dismiss claims that they lack discipline. A Saudi professional says he got a job that matches his skills only through connections, after trying on his own for seven months.

Nepotism and family ties dominate the hiring process, so many in the private sector are lacking in both talent and discipline, thus contributing to the myth that Saudis are not qualified, he says.

Barrage of words over reserves highlights the return of Iraq

Oil and gas

For the majors, the country represents the best chance of recent times to access natural resources, says **James Drummond**

In October, Hussain al-Shahrastani, the Iraqi oil minister, announced that his country's proven oil reserves were now 143bn barrels, the second largest in the Middle East after Saudi Arabia, the world's top producer.

Not to be outdone, Iran quickly declared its own upgrade. Its oil min-

ister said the country had 150bn barrels in reserves, up from a previous estimate of 138bn barrels.

Subsequently, Saudi Arabia, holder of the top spot, pointed to the enduring size of its reserves, while Kuwait declared that an upgrade of its reserves was on the way.

Despite the war of words and huge numbers involved, the issue of reserves is likely to be important, analysts say, only if there is a big fall in the oil price. Then, the ability to pump according to quota becomes critical because quota is partially related to reserves.

"Reserves are not really that important except in the minds of producers. Iraq is putting down a marker and issuing a declaration of intent," says Bill Farren-Price of

Petroleum Policy Intelligence, a consultancy.

Nonetheless, the reserves bidding war indicates the significance of – and perhaps the nervousness engendered by – Iraq's return to the international marketplace. The Iraqi authorities say that they want to achieve production of 12m barrels a day "within six or seven years".

While analysts say that this target is highly improbable, even an additional 3m barrels on top of its current 2.5m barrels a day may not be welcomed by other Opec members, given the fragile state of the international economy.

"Everyone is prepared to make way for the Iraqis and to allow them to build export capacity again. It's only if they start pumping above incremen-

tal demand growth that it becomes an issue," Mr Farren-Price says.

What is certain is that for the international oil companies Iraq represents the biggest opportunity to access natural resources of recent times. Nomura estimates that seven of the top 10 countries with the highest reserves shut out western oil companies and that only three – Canada, Iraq and Kazakhstan – allow them in.

Libya, for example, of which much had been hoped, is proving disappointing. In four licensing rounds between 2005 and 2007, the big oil companies competed for blocks, attracted by the largest proven oil reserves in Africa. So far, they have little to show for their huge investments.

Iraq's Rumaila oilfield, on the other hand, has 17bn barrels of oil in place – and was not included in Mr Shahrastani's upgrade figure.

The technical services agreement to develop Rumaila was won last year by BP and the Chinese National Petroleum Company. The intention is to boost production from about 1m b/d at present to 2.85m b/d. If achieved, this one field will produce more than all Algeria's fields combined.

There is though a downside to the Iraq proposition. BP and CNPC agreed to receive a fee of only \$2 a barrel for production from Rumaila. Statoil of Norway and Lukoil of Russia, which won rights to develop West Qurna, also in southern Iraq, are due to receive only \$1.15 a barrel.

As a result of these tight terms, Richard Quin of Wood Mackenzie, the Edinburgh-based consultants, estimates that Rumaila accounts for only about 1 per cent of BP's portfolio in net present value terms.

He says that even after the disaster of the spill in the Gulf of Mexico, the US still offers majors such as BP a much better value proposition than the Iraqi service contracts, which come with very tight terms.

Take, by way of a contrast, Qatar's Pearl gas-to-liquids plant, jointly owned by Qatar Petroleum and Shell. It is due to be finished by the end of the year and is to produce diesel, kerosene, naphtha and lubricant oils.

Wood Mackenzie estimates that



Iraq's oil infrastructure has held up well but there is much to do

AFF

Pearl is worth to Shell \$32bn on a net present value basis – 15 times more than the most valuable oil project for international oil companies.

Nor has development in Iraq gone smoothly, as the country is plagued by violence and a political crisis after rival parties failed to agree on a government more than eight months after inconclusive March 7 elections. The authorities have also not passed a long awaited hydrocarbons law and an Arab-Kurd dispute over oil-rich areas in the north remains unresolved.

Analysts say oil infrastructure has held up remarkably well. Even so the majors have much to do to refurbish facilities. Some areas are still in need of large-scale mine clearance.

CNPC was the first company to

enter the Iraqi oil sector after the US-led invasion of 2003. Security consultants say the depth of misunderstanding between the Chinese and Iraqis is enormous. But the majors have little choice, as they have to take a long-term view and other prospects are dwindling or inaccessible, analysts say.

An equity analyst who follows Iraq says: "The fundamental issue is that for the international companies, access to resources is limited. The Iraq bidding round shows them giving away their souls just to get access to the resource. What other opportunities have they got? Put yourselves in their place and ask where are their new projects going to be in 30 years' time? At least with Iraq you put your spade in and up comes the oil."

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Baarerstrasse 82, 6300 Zug, Switzerland
Tel: +41 41790 9909, Fax: +41 41790 9910
Email: info@westerngulfadvisory.com

Contributors

Andrew England
Chief Middle East Correspondent

Robin Wigglesworth
Gulf Correspondent

Simeon Kerr
Gulf Business Correspondent

James Drummond
Gulf News Editor

Abeer Allam
Riyadh Correspondent

Roula Khalaf
Middle East Editor

Patrick Stiles
Commissioning Editor

Steven Bird
Designer

Andy Mears
Picture Editor

For advertising, contact:
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Reform would aid recovery

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United Arab Emirates' capital, which built up significant financial reserves, continue to invest in infrastructure, boosting growth and providing opportunities for domestic and international companies.

Indeed, the downturn highlighted the spending power of the wealthier states, with investment vehicles in Abu Dhabi and Qatar able to snap up assets around the world at knock-down prices.

Saudi Arabia, the Arab world's biggest economy, is in desperate need of upgrading its infrastructure. It has announced a \$400bn, five-year domestic spending programme.

Egypt, the Middle East's most populous nation, also managed to produce healthy growth of 4.7 per cent last year, as a government economic team removes bureaucratic barriers to create a more conducive environment for local and foreign investment.

The hope is that the experiences of the economic downturn will cause governments to focus on accelerating reforms and push ahead with the more realis-

tic projects, rather than the ambitious and often unsustainable schemes drawn up during the boom years.

Simon Williams, Middle East economist at HSBC, says the underlying story of the region has not changed, given its energy resources, infrastructure needs and demographic trends.

"Much of the real estate stock is still deficient and the development of an industrial base that leverages the region's access to hydrocarbon resources, as well as an upgrade of the service sector, still holds," Mr Williams says.

"This region is at the stage of its development where it is capable of growing rapidly on a sustainable basis, but for stability to be maintained there has to be progress with reform."

The key for governments is to build on progress they have made in recent years. Countries such as Saudi Arabia and Egypt have set up "one-stop-shops" to lure foreign investment and offer improved regimes for starting businesses.

The oil boom saw the region rise in economic prominence, and FDI inflows for Mena swelled from \$11.3bn in 2002 to a

high of \$95.5bn in 2008, before declining to \$79.5bn last year, according to UN figures.

The challenge is ensuring that investment does not only flow into hydrocarbons sectors that do little to create jobs or diversify economies.

"The issue for all the states is whether the investments they do attract, will it trickle down for the people," says John Sfakianakis, chief economist at Saudi Banque Fransi. "It's still not easy to do business in the region. Given the size of these economies, they are getting some FDI, but they could be getting much more."

He says that, while FDI can play an important role in boosting economic development, it alone cannot solve the underlying challenges.

"The problem is that red tape, poor governance, as well as stereotypes about the region, inhibit non-hydrocarbon and greenfield-related FDI from entering the region.

"Governments have made progress but need to nurture a culture of service and openness, from the top to the bottom across society."

Diverse markets aim to make most of recovery

Economy

Growth without excess credit should be sustainable, says Andrew England

Arab states extend from the Atlantic coast of North Africa across the Red Sea and on to the borders of Iran, so it is not surprising they offer a range of markets with differing fortunes, drivers of growth and challenges.

There are wealthy oil exporters in the Gulf that have used petrodollars to build modern cities where there was once only desert and enjoyed a period of spectacular growth between 2003 and 2008, as the price of crude hit record highs.

In the more populated and oil-importing north African and Levant nations governments have had to rely more on agriculture and manufacturing, while fighting a battle against poverty and unemployment.

Then there are the countries such as Libya and Iraq that have substantial oil and gas reserves, but are significantly underdeveloped after being held back by years of sanctions and international isolation, and in Iraq's case, conflict.

Each in their own way has been affected by the global economic crisis and all are now seeking to strengthen recoveries that have lagged behind many other emerging markets.

Initially the Gulf states were seen as havens from the turmoil, with governments cushioned by the accumulation of significant financial reserves as they pushed ahead with ambitious development plans intended to diversify economies and modernise cities.

But the failure of Lehman Brothers in September 2008 and the collapse of oil price destroyed the myth of decoupling from the global crisis.

It also painfully turned the spotlight on unsustainable credit growth, which



Sign of the times: land for sale on Palm Jumeirah, a project by Nakheel, a Dubai World subsidiary Bloomberg

deliver a new cycle of expansion free of the boom-time excesses and bubbles we had last time."

Mr Williams says the travails of the Gulf have overshadowed positive stories elsewhere, most notably in Egypt which enjoyed growth of about 7 per cent in the three years 2006 to 2008, as the government opened up the economy and began breaking down bureaucratic barriers to investment.

This year the IMF projects Egypt will grow by 5.3 per cent. But given pressing social issues, including high unemployment and a widening gap between the wealthy elite and the poor, it needs to sustain high rates of growth for years to come.

Its advantages include the size of its domestic market, cheap labour and a strategic location that puts it on the doorstep of Europe, sub-Saharan Africa and the Middle East.

Simon Williams, Middle East economist at HSBC, says: "With just a couple of exceptions, the performance of Middle East economies during the global downturn was disappointing. But the cycle has finally turned and the recovery is on. Without another big spike in oil prices, I can't see the region getting back to the kind of growth rates it generated over 2003-08.

He adds: "Frankly, that is no bad thing and should

have been soaring at as much as 50 per cent during the boom years, and the dominance of real estate in non-oil economic activity.

The starkest example was in Dubai, which had developed into the Gulf's unrivalled trade, logistics and financial hub, in spite of only having meagre hydrocarbon resources. It shocked world markets in November 2009, when it requested a standstill for more than \$20bn of debt at Dubai World, a flagship government-owned conglomerate.

The announcement and the manner in which it was handled severely tarnished Dubai's image. But it also had a contagious effect across the Gulf and raised questions about transparency, governance, outdated financial systems as they pushed ahead with ambitious development plans intended to diversify economies and modernise cities.

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It also painfully turned the spotlight on unsustainable credit growth, which

recession swept the region.

In 2009 the six countries of the Gulf Co-operation Council – Saudi Arabia, the United Arab Emirates, Kuwait, Qatar, Bahrain and Oman – experienced real gross domestic product growth of 0.4 per cent, said the International Monetary Fund.

Together their economies dominate the Arab world, with a projected combined GDP of \$993.4bn for this year, according to the IMF.

This year Dubai, which has overall debts of more than \$100bn, has made progress dealing with its woes, and last month was able to confirm that all the creditors had agreed to its restructuring proposals for Dubai World.

Analysts also say that the city-state's core model, based on finance and trade and infrastructure, still puts it far ahead of its rivals as competition heats up to be the region's hub. Dubai is expected to emerge from recession this year with growth of 0.5 per cent.

But it still has much to do, as it seeks to emerge from its debt crisis. More government-related companies face their own difficul-

ties and the real estate sector remains in the doldrums.

Other Gulf states have been able to tap into their reserves to continue government spending to boost growth and continue improving decaying infrastructure. Even between the six GCC states there are marked differences.

Qatar, a small nation that is now the world's largest exporter of liquefied natural gas (LNG) has been leading the pack in terms of growth on the back of its gas riches. It is projected to enjoy real GDP growth of 16 per cent this year.

Saudi Arabia, the most

Qatar ... has been leading the pack in terms of growth on the back of its gas riches

populous Gulf state, faces pressing social challenges as it tackles high unemployment, a shrinking middle class and the need to create private-sector jobs for its youthful population. The kingdom, the Arab world's largest economy, is pushing ahead with a five-year \$400bn investment to cover infrastructure and hydrocarbons development.

Overall, the economies of the GCC are forecast to grow by 4.5 per cent this year. But economists say the growth will remain at a more subdued level than during the heady boom years and the subregion will remain dependent on

the volatility of oil prices, as governments talk of diversifying economies through capital and energy intensive industries, tourism and financial services.

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Lenders survive crisis but credit is still tight

Banks

Access to funds is hitting the region's businesses, writes Robin Wigglesworth

Despite some bruising blows from the financial crisis, the Arab world's banking system emerged from the downturn well-capitalised and relatively healthy.

In countries where financial stresses emerged, such as in Kuwait and the United Arab Emirates, the authorities were swift to offer support in the form of guarantees and capital injections.

As a result, although a smattering of investment companies has run into trouble and one large Kuwaiti bank needed a government bail-out after a derivatives trade went awry, no commercial bank in the Middle East and North Africa has failed over the course of the crisis.

However, in spite of the robust capital adequacy ratios and still-decent profits of banks, access to credit has emerged as one of the biggest impediments to businesses in the region.

In a recent white paper examining the credit stagnation in the Middle East and North Africa, the International Monetary Fund estimates that loan growth has decelerated by an average of almost 30 percentage points. In some countries, most notably Egypt, Saudi Arabia and Jordan, credit growth has contracted in real terms.

What lending remains is often funnelled towards government-related entities, particularly in the Gulf. The lack of credit extension is all the more noticeable after the lending spree that preceded the crisis.

The slowdown in bank lending is particularly painful in the Arab world, as other potential sources of capital, such as capital markets, remain underdeveloped in most countries.

At the end of 2007 debt

securities made up only 4.8 per cent of the region's capital markets – the total outstanding value of bank loans, bonds and equities – according to NCB Capital, the investment banking arm of one of the largest Saudi lenders.

One of the leading causes of the lending drought is the surge in investment losses and non-performing loans across the region, which has forced many banks to retain profits for provisioning.

Some banks, most notably in the Gulf, still report relatively low impaired loan ratios. However, analysts say that many are rescheduling loans to avoid booking losses – known as "ever-greening" a portfolio. This ties up capital that could otherwise be used to lend.

"Some banks are hiding things," says a senior regional investment banker. "The asset quality at some banks is so bad that

Many banks are rescheduling loans to avoid booking losses

they want to keep all their liquidity."

The increase in dud loans has hurt earnings. Overall, financial sector profitability in the Middle East and North Africa (Mena) slumped almost 44 per cent in 2008, mostly due because of bad debts, according to EFG-Hermes. Excluding Saudi Arabia, profits have fallen almost 54 per cent.

Earnings have recovered somewhat since the depths of the crisis. Mena-based financial groups reported that net profits rose 4.5 per cent last year, and 9.2 per cent in the first half of 2010 – but analysts expect provisioning to weigh on Arab banks for some time.

At the same time, funding conditions have become much trickier. Deposit growth has slowed markedly, and access to debt capital markets remains expen-

sive for all but the safest of banks.

Some bankers attribute the lending dearth to a lack of demand, arguing that borrowers – newly wary of the risks of leverage – now prefer repaying loans to taking on more debt.

However, others concede that more stringent lending standards at banks are primarily to blame.

Lenders now demand a level of transparency and safety that is rare among companies in the Arab world – where corporate governance is generally lacking.

"I don't think that demand is drying up. There's a lot of demand for credit, particularly in the small and medium-sized enterprises sector. But banks are much more conservative now," the investment banker says. "It's a shame, as it's hurting the economy."

Banks have been further put off by the near-default of Dubai World, the emirate's flagship holding company, and the default of two big family-owned groups in Saudi Arabia last year.

Sprawling family-owned conglomerates dominate the private sector in the Arab world, and have in the past been able to rely on their names to borrow large sums from banks, but the bitter \$20bn dispute between two prominent Saudi companies, Saad Group and Ahmad Hamad Algosabi & Brothers sent shockwaves across the regional financial system.

As a result of the various issues, financial stocks have eked out only an 11 per cent gain between the start of 2009 and the end of the third quarter of 2010 – compared with a 20 per cent gain for the larger S&P Pan Arab Composite index.

The IMF says that a lending revival is dependent on two interlinked factors: a macroeconomic recovery and strengthening bank balance sheets, but businesses in the Arab world should not expect a swift improvement.

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Doing Business in the Arab World

Radical reforms are required to make up lost ground

Education

More critical and creative thinking and updated curriculums are the prescription, says Simeon Kerr

Arab leaders fondly recall the Golden Age of Islam, when the Middle East under the Abbasid empire of Baghdad led the world in culture and sciences.

But education and public learning has been on the back foot ever since the Mongols ended that era with the sacking of Baghdad in 1258.

Now, Arab governments are attempting to make up for lost time, having recognised that failings in their educational sys-

tem, from universities down to kindergartens, are hampering development.

Businesses setting up in the region constantly bemoan the difficulty of recruiting skilled graduates. Education systems are failing to match curricula to the modern-day work environment, whether it is because of the overarching focus on Islamic studies in, say, Saudi Arabia, or the outdated teaching methods of state-owned schools in the Gulf.

Western universities complain that it is hard to find suitable Arab candidates for their courses, especially in mathematics and the sciences.

Across the Arab world, state-run education systems continue to focus on rote learning, crushing creative thinking across both sciences and the arts.

The influential Arab Human

Development Report of 2003 called for creation of a knowledge society by allowing freedom of expression and boosting investment in education.

Seven years, later the results are mixed, to say the least.

In the Gulf, where bloated education budgets continue to outstrip performance outcomes, governments have implemented reforms based on the advice of management consultancies, but then shifted tack within a couple of years.

"Despite potentially good reforms, little has been accomplished," says Natasha Ridge, an education specialist at the Dubai School of Government. "There is a need to let reforms see out their cycles, but the trouble is all the switch and change."

In the UAE, for example, private schools outperform the

state sector. As a result, many Dubai nationals choose to go private, deepening the divide between the few who make their way into the business elite and the less fortunate majority who cannot afford to go elsewhere.

Abu Dhabi, the oil-rich capital, has introduced an initiative to move the state sector towards a bilingual approach so school-leavers are better prepared for university.

But Qatar, which a few years ago granted independence to its schools in an attempt to improve performance, is now retreating from that bold initiative, after teachers and students complained about the pace and depth of the reform.

Unesco's Education For All initiative says the Arab World's progress in developing education has lagged behind regions, such as Africa and Asia.

The gap between the poor and rich countries of the Arab world has widened, although even the richer states are failing to boost education as much as their swelling gross domestic products would suggest.

This prognosis is confirmed by the results from the Trends in Mathematics and Science Study report of 2007, which tested fourth- and eighth-grade students from 36 countries in maths and science and saw Arab students bottom of the class.

None of the six Arab states surveyed – from Morocco through Kuwait and Yemen – had even 1 per cent of their students reach the advanced international benchmark for science or mathematics. Non-Arab Iran managed to squeeze out 2 per cent, while Singapore came top with 36 per cent in science.

In maths, results were still grim, though Egyptian and Lebanese eighth-graders managed to creep above the 1 per cent mark.

"A lot of spending has been on physical infrastructure," says Joe Sadi, chairman of the board of Booz & Company, a consultancy. "Now attention must turn to the quality of education."

Ms Ridge says: "Teaching remains very much the same as 15 years ago: teacher-centric, memorising-based learning and traditional subjects." That feeds through into an underperforming workforce.

Within the Gulf, the crisis is more severe among young males, who consistently fail to match the grades being achieved by females – many of whom will still have their careers cut short by family

demands in these conservative societies.

Ms Ridge says Gulf governments need to redirect resources into better pay for teachers, as well as teacher training, while also revamping curriculums.

Oman, for example, has extended creative arts as an elective for students above Grade 9. It is one of the few places in the Arab world to teach drama to older students.

But, overall, educationalists believe that systems across the Middle East will fail to unlock the minds of youth until broader democracy takes root and critical thinking is encouraged in the classroom.

"There is no demand for critical thinking in students, the system is there to churn out dutiful citizens who won't ask too many questions," says one teacher.

Stability hostage to regional conflict and internal dispute

Political risk

Roula Khalaf says companies have shown remarkable resilience and adaptability

The Arab world is a region of paradoxes, where great oil wealth coexists with social deprivation and regular periods of political upheaval.

If you live and work in the Middle East, the question is not "whether" but "when" the next conflict will erupt.

Stability is often hostage to an explosive combination of regional conflicts, internal political disputes, and international struggles.

Despite the perennial problems, however, the region has shown remarkable resilience, with policymakers and business communities adapting to the political and security risks.

The US-led invasion of Iraq in 2003 and the ensuing violence did not prevent a boom in the Gulf in the years that followed, as oil prices skyrocketed. Nor have recent confrontations between Israel and militant groups in the region stopped economic reforms in Egypt or infrastructure spending in the Gulf.

Today, policymakers fret most about the high-stakes stand-off between Iran and the west over a controversial nuclear programme that world powers suspect is designed to produce atomic weapons.

Given Iran's defiance of

UN resolutions demanding a halt to uranium enrichment – the most sensitive part of its nuclear activities – a looming threat is a military strike on nuclear facilities. This would probably be made by Israel, which sees Tehran's nuclear ambitions and its anti-Israeli politics as an existential threat.

Although fears of an attack are raised every few months, senior diplomats say the mix of international and US sanctions, which are squeezing the Iranian economy, have now pushed back the risk of a military confrontation for at least a year.

Iran's nuclear programme, they argue, does not appear to be progressing as fast as had been assumed, and the sanctions must be given time to bite, and perhaps persuade Iran

to curb its programme.

Even if, as many analysts and US officials predict, Iran refuses to co-operate, the US could opt for renewed negotiations that would not necessarily seek a complete halt to the nuclear programme but rather guarantees that nuclear material would not be diverted to military use.

There is, in any case, a debate already under way in Washington over whether a nuclear-armed Tehran can be deterred, and whether this is a safer option than the risk of regional confrontation.

What would be the consequences of an Israeli attack? It is difficult to predict. Tehran has warned it would retaliate in a variety of ways, including targeting US military bases in the Gulf and closing the Strait

of Hormuz, the strategic waterway through which more than a third of all exported oil passes. Such retaliation, however, is certain to spark a bigger conflict, dragging in the US and possibly other states in the region.

Escalating tensions over Iran are becoming costly in some markets in the region.

Sanctions, particularly unilateral measures imposed by the US, have discouraged business with Iran and put pressure on the economy of the regional trade hub of Dubai, at a time when the emirate has been struggling to emerge from the financial crisis.

The nuclear stand-off and Shia Iran's interest in widening its influence in the region also have heightened tensions with Tehran's Sunni Arab neighbours. This aspect of the political struggle sometimes plays itself out in Lebanon, where Iran supports the Shia militant and political group Hizbollah and pro-Western Arab states back rivals.

In the past five years, Lebanon has lurched from crisis to crisis, including a one-month war between Hizbollah and Israel in 2006. Since then, Hizbollah has restocked with missiles and Israel has repeatedly warned of a new conflict.

The risk of fresh violence in the Arab-Israeli conflict looms large over the region, but would take the form of a confrontation between Israel and militant groups – Lebanon's Hizbollah and the Palestinian Islamist group Hamas, which controls the Gaza Strip and came under Israeli assault two years ago.



Members of the armed wing of Hamas during a march against peace talks with Israel

Getty

Prospects of a peace agreement between Israel and the Palestinians, which could pave the way for a more comprehensive peace with Syria and Lebanon as well, appear remote.

The Obama administration came into office convinced that an end to the conflict was in the interest of the US, not only the Middle East.

But its awkward efforts to breathe life into the peace process have faltered, amid an Israeli refusal to freeze further construction in Jewish settlements in occupied Palestinian lands, a condition Palestinians have set to pursue peace talks.

Policymakers are increasingly anxious about Iraqi stability, after US troops depart next year. The exit has already brought heated competition for influence among regional powers.

Political risk in the Middle East cannot be assessed only in terms of regional conflicts. From a business perspective, the authoritarian systems that dominate might be seen as providing stability. Companies in Kuwait, which has a more democratic system, are frustrated by the paralysing bickering between parliament and the government.

Nonetheless, the political order does create obstacles

to business, in the form of state control of the economy or legal systems that lack transparency.

In Egypt, anxiety is growing in the business community over the successor to the ailing President Hosni Mubarak, in power since 1981. His son Gamal, an ex-banker, is being groomed, but his ambitions could face resistance from the military establishment, which will have an important say in the selection.

Businessmen and investors are convinced the military will ultimately stage a smooth transition, but more clarity would facilitate business planning.

Improvements are on their way

Legal framework

Many companies choose arbitration because the courts are unpredictable, reports Simeon Kerr

In a court in Fujairah, a small member of the United Arab Emirates, a key ruling in April brought the business-friendly Gulf state a step closer to meeting the standards of the global legal community.

A shipping-related arbitration case, that had been awarded to a foreign party in London, was enforced against a local company, the first time an overseas arbitration award has been executed in the UAE under the terms of the New York Convention.

For international observers, that might not appear so revolutionary. It is usual for international arbitration awards to be executed by the courts of signatories to the landmark convention, which includes 142 of the 192 states of the UN.

But in the UAE, which signed the convention in 2006, common practice has yet to catch up with the theory. Many judges refuse to endorse awards, arguing the nation's legal framework has not been updated to reflect the New York Convention.

Legal issues remain a serious hurdle for foreign investors across the Middle East, especially in the oil-rich Gulf, where business opportunities abound but legal frameworks lag behind economic development.

The clearest indicator of the legal landscape in Dubai over the past few years has been the rapid rise in cases heard by the Dubai International Arbitration Centre, which processed a record 100 arbitrations in 2008 and 300

in 2009. By October this year, another 300 cases had been launched, making the likely number this year 400.

The DIAC remains preferable to litigation in local courts, where proceedings are lengthy and uncertain. The centre tries to present judgments within a year.

"Arbitration is the only game in town – it gets you out of the local court system, which can be opaque, tardy and unpredictable," says Reza Mohtashami, a Dubai-based partner with Freshfields Bruckhaus Deringer, the law firm.

Lawyers say the centre remains subject to abuse by some parties, as legal trickery can delay proceedings for months longer than necessary.

Companies also have to build strate-



'Arbitration gets you out of the local court system, which can be opaque, tardy and unpredictable' - Reza Mohtashami

gies to deal with non-payment of contracts, as the recession pushes balance sheets to the limit.

Following non-payment by a Dubai government department, one international communications company provisions for a third of each contract from regional governments or companies that seem to be in distress. "You still try to get the money, but by providing for potential lost earnings, any shortfall is easier to swallow at the end of the year," an executive says.

The good news is that the legal infrastructure is slowly morphing into one that is more easily navigated by foreign investors, helping to rebuild confidence in the system.

Dubai International Financial Centre courts are getting busy, as companies in the centre open litigation at the English-language common-law jurisdiction.

These courts are also the location for the Dubai World Tribunal, which has been set up to hear disputes relating to the troubled Dubai World conglomerate, which is restructuring about \$25bn in debts.

The London Centre for International Arbitration has also set up a branch within the DIFC, which is starting to hear more cases, taking the weight off DIAC.

"Execution of awards rendered in the DIFC should be quasi-automatic in Dubai via a protocol signed by the DIFC courts and the Dubai courts," says Yasmin Mohammed, senior associate at Freshfields in Dubai. Some worry whether other emirates, for example Abu Dhabi, will recognise DIFC's jurisdiction.

Bahrain has moved all financial-related court cases valued at more than 500,000 Bahraini dinars (\$1.3m) to the Bahrain Chamber for Dispute Resolution, though some lawyers worry about the validity of the centre's jurisdiction.

Elsewhere in the region, the situation is bleaker.

Saudi Arabia, in particular, is a tough place to challenge local companies or enforce a foreign ruling. Arbitration within the kingdom remains subject to review by domestic courts, removing many of the advantages of out-of-court mediation.

One of the best ways for foreign companies to mitigate legal disaster is to team up with the right domestic partner, given that litigation often involves these partners. An adept local partner can help steer a foreign company away from areas that could spark litigation.

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