Overseas Development Institute

Briefing Paper

March 1991

THE IMPACT OF THE GULF CRISIS ON DEVELOPING COUNTRIES

The economic repercussions of the Gulf crisis have been widespread. Apart from the impact on the Gulf states themselves, the resulting economic disruptions over the past seven months have affected many countries. In response to requests for a consistent set of estimates of the impact on less developed countries, ODI undertook a study both to assess the effects and to consider the response by the international community.

This Briefing Paper, finalised on the day the war ended, draws on the findings of this study. Two conclusions stand out. First, the large number and wide range of developing countries that have been severely affected by the crisis. Second, while there has been a considerable response to the crisis, the distribution of assistance has been highly selective. Some countries have been almost over-compensated while others have received little help.

Effect on developing countries

The Gulf crisis has had both global and specific effects on developing countries. The crisis, in particular the period of higher oil prices, has adversely affected world growth and hence growth in developing countries. For the six months from August 1990 to January 1991 oil prices averaged $30 per barrel — a near doubling compared with previous levels and expectations. However, given the limited duration of this increase, World Bank estimates indicate that this has had a minimal impact on world growth and has resulted in only a 1% cut in developing countries' exports. While this is small in percentage terms it still corresponds to lost exports of some $6bn for the developing countries.

While this global effect is important it is the country-specific effects that have the greater impact overall. For most countries this is simply the effect of the increased cost of oil imports. However, there are several countries where non-oil related effects — eg loss of migrant remittances and export markets — are also important.

The estimated country-specific effects for 35 poorer (ie low and lower middle income) severely affected countries are given in Box 1. In all these countries the effects exceed 1% of their GNP — a UN criterion used in assessing the requirement for disaster relief. In total these effects are estimated to have cost these countries some $12bn.

Neither Iraq nor Kuwait is included in Box 1 as the impact of the crisis on them is of a totally different order, meriting a separate study. Also not included are any small countries with populations of less than one million. There are at least six such countries that have also been severely affected. Nor do the costings include any element of environmental damage, which now appears to be pervasive.

The estimates in Box 1 are based on the assumption that the Gulf crisis is effectively over, and in particular that oil prices have now returned to their pre-crisis levels and normal trade and migrant flows will be fully resumed by the middle of the year (see Box 2 for details). The next section considers some of the key affected countries.

Individual country examples

Egypt

The cost of the Gulf crisis to Egypt is estimated to be $1bn (corresponding to 3% of GNP). This estimate includes costs arising from the loss of remittances from some half a million workers in Iraq and Kuwait, loss in tourism receipts (winter bookings are down by 40%) and lost service contracts. As Egypt is a net oil exporter the total figure allows for the

Box 1: Impact of Gulf Crisis (where impact > 1% of GNP)

Country	*Impact of the Gulf crisis* Oil Cost / (Benefit) US$m	Non-oil Cost US$m	Total Cost US$m	% GNP
Low income				
Middle East				
Yemen	(570)	1400	830	10.4%
South Asia				
Bangladesh	130	115	245	1.4%
Pakistan	560	295	855	2.4%
Sri Lanka	140	125	265	4.0%
Sub-Saharan Africa				
Benin	40	-	40	2.2%
Chad	25	-	25	2.5%
Ethiopia	115	-	115	2.0%
Ghana	50	-	50	1.0%
Kenya	125	-	125	1.5%
Lesotho	15	-	15	2.0%
Liberia	20	-	20	2.0%
Madagascar	50	-	50	2.1%
Mali	35	-	35	1.9%
Mauritania	10	-	10	1.2%
Mozambique	20	-	20	2.0%
Rwanda	35	-	35	1.6%
Sudan	75	305	380	3.8%
Tanzania	80	-	80	2.8%
Lower middle income				
'Front line' states				
Jordan	200	1,570	1,770	31.5%
Turkey	1,210	2,150	3,360	4.9%
Egypt	(1,215)	2,200	985	2.9%
East Asia				
Papua N Guinea	60	-	60	1.8%
Philippines	470	160	630	1.6%
Thailand	980	-	980	1.7%
Latin America & Caribbean				
Costa Rica	75	-	75	1.7%
Dominican Rp.	150	-	150	3.4%
Honduras	60	-	60	1.4%
Jamaica	70	-	70	2.6%
Nicaragua	45	-	45	1.4%
Panama	60	-	60	1.4%
Paraguay	105	-	105	2.8%
North America				
Morocco	260	150	410	2.0%
Sub-Saharan Africa				
Botswana	35	-	35	2.8%
Côte d'Ivoire	110	-	110	1.1%
Mauritius	50	-	50	2.6%
Total severely affected low income countries			**3,200**	
Total severely affected low and lower middle income countries			**12,100**	

Box 2: Basis of estimated effect of crisis

The estimated costs given in Box 1 are based on a variety of sources, including information requested directly from governments and a World Bank briefing issued in September 1990. The estimate for the increased cost of **oil imports** is based on the six-month period of high oil prices (and the assumption that demand fell back to 1988 levels). It is assumed that normal **remittance flows** will start again in the second half of this year. The estimated loss is based on official remittance records. In some countries these may only account for 15% of total flows. **Resettlement costs** are estimated at $500 per returning worker. For most countries it is assumed that these costs have only been incurred for 30-50% of the total number of affected workers. Many workers are still in the Gulf while some that have returned have since been re-employed elsewhere. Losses of **export earnings** have frequently been over-stated. In this paper the assumption is that the cost has been at most 50% of one year's exports to Iraq/Kuwait. This takes into account loss of receipts for goods already dispatched and the cost of finding new customers. Loss of **tourism receipts** is estimated on the basis of World Bank and country's own figures. Figures for **loss of aid** are only included where there is strong evidence that normal aid flows have been disrupted. The effect of increased freight, insurance and fertiliser costs are not included. No attempt was made here to estimate the cost of the environmental damage that has occurred.

The implicit assumption underlying the total cost figure is that the final effects of the crisis will end by the middle of 1991. Particularly for Jordan and Yemen, whose migrant workers are unlikely to return to Kuwait and Saudi Arabia in the same kind of numbers, the estimated total costs are likely to be understated.

The list of severely affected countries was drawn from a sample of over 90 low and lower middle income countries. The sample did not include any Eastern European countries where data was not available on consistent basis. Income categories are low income (<$545/capita), lower middle income <$2,200/capita).

benefit of higher oil revenues.

While ODI's estimates are similar to those of the World Bank and the US State Department, the Egyptian government's own estimates are ten times higher. In particular, Egypt estimates the cost of providing new jobs at nearly $5bn. Such costs are not included in other countries' estimates and the Egyptian estimate would appear high as it corresponds to an amount per worker equivalent to ten times per capita income.

Egypt has already reaped the benefit of supporting the US-led coalition, through substantial debt forgiveness — a quarter of its total external debt — and the promise of new aid. The IMF and World Bank have also promised significant help. As a result, while Egypt has been severely affected by the Gulf crisis, current assistance has more than compensated for the impact.

Jordan

The same cannot be said for Jordan. Relative to its GNP, the greatest impact of the Gulf crisis — obviously excluding Kuwait and Iraq — has fallen on this country. The cost of the crisis is estimated at nearly $2bn (32% of GNP). The impact is dominated by non-oil-related factors such as loss of trade, tourism, aid and remittances.

Returning migrant workers are a particular problem for Jordan, as they represent some 10% of the labour force and prospects for re-employment are bleak. A number of the returnees are Palestinians with Jordanian citizenship and the general perception in many Gulf states is that Palestinians aided the Iraq invasion. If the Gulf states re-employ immigrant labour few of these will be Palestinians.

Jordan has also suffered from its neutral stance over the crisis. Not only has it lost the large amount of aid from Arab states but also all trade with Saudi Arabia was terminated.

Thus, for Jordan the effects of the crisis have been severe and its problems aggravated by the negative response from the international community. However, Jordan's difficulties are well known — the reverse is true for the second most severely affected poor country: Yemen.

Yemen

The cost of the crisis to Yemen has been striking. Despite being a small net oil exporter, the net cost to Yemen, is estimated at close to $1bn (10% of GNP). While the impact in relative terms is greater for Jordan, Yemen is much poorer (it is classified as a Least Developed Country by the UN) and only became an unified country in May 1990.

Yemen had few workers in Iraq and Kuwait. Most Yemenis working abroad were in Saudi Arabia, where they enjoyed a privileged status. In particular they were exempt from two laws that required foreigners to have a Saudi sponsor for a work permit and to have a Saudi partner in any business venture.

As a result of Yemen's neutral stance, these two exemptions were removed in September with only a few months notice. This has resulted in a huge exodus, as few Yemenis were able to find sponsors or partners and most businesses had to be sold at distress prices. The numbers involved are much greater than for any other country — some 800,000 are estimated to have left by end of November 1990 out of a total of close to one million. The impact of their return has been enormous as the number of migrants corresponds to some 15% of the total labour force. Also many of the migrants were not on short term contracts but were long term residents with few links back in Yemen. This compounds the resettlement problem.

Little information is readily available on how Yemen is going to cope. The only recent report of any response has been the US decision to cut its planned development aid in 1991 by over 80%.

Ethiopia

Estimating the impact of the crisis on Ethiopia is complicated by the fact that much of its oil had been supplied by the USSR at concessional rates. The estimate made here is that the crisis has cost Ethiopia over $100m (2% of GNP). This shock occurs at the same time as large numbers face famine and civil war and given the current media interest in the Gulf war, it is possible that the public response in the developed world to the famine in Ethiopia (and Sudan) will be reduced. While the risk that the Gulf crisis would result in severe transport disruptions has now abated, the past increase in oil prices has made the relief operation more expensive.

Sudan

Even before the Gulf crisis the Sudanese economy was in severe difficulties. Civil war, natural disasters and economic mismanagement have proved a devastating combination. The Gulf crisis has compounded these problems with a sharp increase in the cost of oil imports and a fall in remittances — some 35,000 workers are officially estimated to have been in Iraq and Kuwait (a recent ILO study suggests the figure could be five times higher). Altogether the cost of the crisis is estimated at nearly $400m, or 4% of GNP. This figure is also equivalent to Sudan's total export receipts and twice the amount that Sudan spent on food imports in 1990.

The impact of the crisis has been aggravated by the government's neutral stance on the Gulf conflict and only somewhat mitigated by recent offers of oil credits from Libya. Sudan's economic policies have been strongly criticised by donors recently and until there is a fundamental shift in policy it is unlikely that further assistance will be forthcoming. Sudan is in arrears with the IMF and has recently been formally declared 'non-cooperative'. No more IMF funds are being made available and World Bank lending is effectively at a standstill.

For the British government there is the additional disincentive arising from the recent release of five Palestinians convicted of killing a British family in 1988. The British government has recently decided to halt all development (but not relief) aid.

Bangladesh

The impact of higher oil prices on Bangladesh has been compounded by the loss of remittances from the 100,000 workers in Kuwait and Iraq, estimated at $100m pa. The government's own estimates of the cost of the crisis are twice ODI's figures as they take full account of the multiplier effects of the crisis on the economy.

Bangladesh's response to the crisis has included the dispatch of troops to Saudi Arabia and efforts to relocate returning migrants in other countries. Bangladesh has also set up a $400m project to help with the resettlement of returnees. Applicants have to contribute 20% equity but only limited progress has been reported to date.

India

The cost of the crisis to India is estimated at around $1.6bn. In absolute terms India is the third most affected country. However, relative to the size of the whole economy, the impact is only 0.6% of GNP. While the overall effect is relatively small, most of the 200,000 workers in Iraq and Kuwait came from just two states, Kerala and Gujurat. Remittances from the Gulf are estimated to account for some 15% of Kerala's economy. In both states the impact is likely to have exceeded 1% of their Gross State Product..

Sri Lanka

Sri Lanka is the fourth most affected country in relative terms. Nearly a third of the impact stems from non-oil costs. Some 100,000 migrants are estimated to have been working in Iraq and Kuwait and their annual remittances were around $100m.

The Gulf crisis has exacerbated an already difficult economic situation in Sri Lanka arising from the continuing civil war. Domestic unemployment was already at 20% and military expenditure was putting a severe strain on government resources.

In February 1991 Sri Lanka requested a $450m loan from the IMF to cover losses caused by the Gulf crisis.

> **Box 3**
> **Importance of remittances from migrant labourers in the Gulf**
>
> While the cost estimates made for each country reflect the impact that the loss of remittances has on the balance of payments, they do not indicate the importance that remittances play for individual families. It is difficult to generalise but the following points may help to give a picture (with the exception of Yemenis where the migration pattern is very different).
>
> Migration to the Gulf region is normally temporary, with contracts of 2-4 years typical, although renewal is often possible. Restrictions in the employing country imply that migrants often leave their families behind.
>
> The skill range of migrant workers is very wide. Migrants from Sudan are exceptionally well educated. A quarter have university qualifications and another 60% have at least high school education. At the other end over half of the migrants from Bangladesh are unskilled labourers.
>
> Remittances are a very important source of income. Migrants save or remit well over half their earnings and while some of this is spent on luxuries much goes on more basic needs. A typical breakdown of expenditure by migrants from South Asia suggests that 35% is spent on food, 25% on construction and 15% on land improvements. For the poorer migrants another important item of expenditure is the repayment of debt incurred to finance the original migration.
>
> Returning migrants often encounter problems in finding jobs on their return, even though it is often the new entrants to the labour force that lose out in the competition for jobs.
>
> Two conclusions may be drawn from these points. First, the immediate effect of the mass repatriation of workers will be mitigated by the fact that many will have homes and families to return to. However, second, the repatriation is likely to have both long term and widespread effects, affecting not only the migrants' families but also others dependent on them for finance and employment.

Forms of assistance

The initial reaction to the events in the Gulf last year was to see it in terms of the earlier oil price crises of 1973 and 1979 — a major shock to the world economy requiring permanent adjustment to the new state of the world. However, as it has become more apparent that the crisis will only be of limited duration — albeit with some very long term repercussions for some countries — the crisis has come to seem more like a widespread natural disaster having a dramatic, but essentially once-off impact. This suggests that the problem is more akin to an immediate emergency than a longer term development issue. As with natural disasters, it is the poorest countries which suffer the most as they have the smallest margin for absorbing any adverse shock.

Another parallel with natural disasters is that the assistance required is in two areas: first, general assistance to help the affected countries through the associated balance of payments problems and second, much more specific assistance to particular groups of individuals. As Box 3 illustrates, the targeting of such assistance will be difficult as it needs to reach not only the returning migrant workers, who form a relatively richer group within their country, but also those who are dependent on them for finance and employment.

Another issue of interest is the appropriate form of assistance. Many of the countries fall into the low income category, so such assistance should be at concessional rates. Strong arguments are normally made for emergency humanitarian assistance to be given on a non-discriminatory basis. These are particularly important issues for countries like Sudan and Yemen.

Finally one of the most important questions regarding the response to the Gulf crisis is whether the assistance given should be at the expense of other development aid. To the extent that the Gulf crisis has been an unexpected and unforeseeable emergency, this would suggest that any assistance should be given in addition to current programmes. On the other hand, while this study highlights those developing countries that have suffered as a result of the Gulf crisis, there are a significant number of oil exporting developing countries outside the Middle East, such as Mexico and Nigeria, that have benefitted from the period of higher oil prices. It could be argued that previously planned aid to these countries should fund at least some of the assistance given.

On the other hand, there may already be substantial diversion of aid and other lending away from the usual areas of concern — eg Sub-Saharan Africa — to the relatively richer Middle East region. The US proposal for a Middle East Bank for Reconstruction and Development and the obvious post-war tendency for donors to want to reward their allies reflect this.

International response to date

Gulf Crisis Financial Coordination Group

By far the most important response to the crisis, as far as assistance to developing countries is concerned, has been the channelling of aid through the Gulf Crisis Financial Coordination Group. The group consists of 24 countries, comprising most of the OECD countries plus some Gulf states: Saudi Arabia, United Arab Emirates, Qatar and the Kuwaiti government which was in exile to March 1991.

Members of this group have agreed to disburse some $14bn in development assistance to countries affected by the crisis. Most of the funds — $10bn — have been pledged by the Gulf states with Japan and the EC promising just over a further $2bn each. Seventy percent of this is earmarked for the three front line Gulf states (Egypt, Jordan and Turkey), while the remainder is intended for other states affected by the crisis which have joined the US-led coalition. Five countries have been explicitly mentioned: Bangladesh, Pakistan, Syria, Lebanon and Morocco. Notable absences from this list are Yemen, Sri Lanka and Sudan.

A full breakdown of how all the $14bn is to be disbursed has never been published. Similarly, details on the criteria used or the process involved in making any allocations have not been made transparent. However, there have been several reports that the Gulf states have refused to provide any funds to Jordan. While not all of the EC and Japanese funds have been allocated, those that have, have been allocated fairly evenly among the three front line Gulf states.

If this pattern continues Egypt and Turkey will end up receiving some \$10bn. This sum represents twice the estimates given in Box 1 of costs incurred by these two countries. On the other hand, Jordan is in line to receive only some \$1bn — ie around half of the estimates of costs given here. The remaining \$3bn should be more than sufficient to cover ODI's estimates of the costs incurred in the five other countries explicitly mentioned.

World Bank/IMF

In comparison with the Gulf Crisis Group the response by the World Bank and the IMF has been more limited. Both institutions have held discussions with all the countries affected by the crisis but, with the exception of one or two very small specific loans, they have concentrated on adapting existing mechanisms.

In the World Bank the main response has been the decision to speed up the disbursement of existing project and adjustment loans. While this increases the immediate flow of funds, for only half of the severely affected countries will these increases be at concessional (IDA) rates. Moreover these concessional increases are drawn from a fixed pool of funds. Without additional voluntary pledges (or earlier replenishments) by donors, these increases could be at the cost of future concessional credits.

The IMF's main response has been the adaptation of two lending facilities — the Enhanced Structural Adjustment Facility (ESAF) and the Compensatory & Contingency Financing Facility (CCFF). The first facility provides for lending at concessional rates to low income countries. Access to the funds has been increased but is still subject to a detailed adjustment programme being agreed with the IMF. These can take years to negotiate. Of the fourteen severely affected low income countries, only five have such programmes currently in place. The second facility, the CCFF, already provided for compensation for loss of remittances. This has now been extended to include several other factors including increased cost of oil imports. However, this facility still only provides non-concessional finance, and while it is useful to help with immediate balance of payments difficulties, it is too expensive for most countries. To date only India and the Philippines have taken advantage of the changes.

In October 1990 the Managing Director of the IMF addressed the issue of the Gulf crisis efforts by stating that there were

'a relatively limited number of countries for which I do not regard financing on relatively costly terms under the IMF's regular credit arrangements to be appropriate. This is why we are now working to establish a subsidy account which would be funded for the most part by voluntary contributions from the countries that are benefitting to a significant degree from the increase in fossil fuel prices'

However, this possibility does not yet appear to have materialised.

European Community

Apart from assistance with refugees, the main EC response to the crisis has been the \$2bn assistance channelled through the Gulf Crisis Group. One third of these funds has been drawn from the EC budget, while the other two thirds have come from bilateral sources, in particular Germany. It is not clear whether any of the \$2bn raised represents additional aid funds.

Bilateral donors

Many countries have made bilateral arrangements to assist countries affected by the crisis. Apart from the funds channelled through the Gulf Crisis Group, other major commitments include the US forgiving Egypt military debt worth some \$7bn. In December 1990 several donors made bilateral grants to Mozambique to fully compensate it for the increased cost of oil imports.

In the UK the government has not yet sought additional funding from Parliament to assist countries affected by the crisis. It has argued that the UK's contribution to the crisis has been on the military front (albeit with financial support promised from Kuwait and several other countries), and that it looks forward to other donors providing the extra development assistance that is needed.

However, the Overseas Development Administration has provided some aid from within its existing budget (which includes a contingency reserve). The major provision has been the UK's share of around \$100m (£50m) to the EC budget contribution to the Gulf Crisis Group of around \$100m (£50m). An example of a more specific response was the \$8m (£4m) grant given to Tanzania in January 1991 to finance oil imports over the following three months.

Conclusions

The study had five main conclusions:

- At least forty poor developing countries have been severely affected by the Gulf crisis to an extent akin to a widespread natural disaster (>1% of GNP).
- Both the IMF and the World Bank have responded to the crisis in several ways and have had discussions with the most severely affected countries, but without so far raising additional concessional funds.
- There has been a remarkable response by the countries involved in the Gulf Crisis Financial Coordination Group. The \$14bn promised so far is an enormous amount of official development assistance and corresponds to nearly a quarter of normal total aid flows. This sum is even more remarkable given that it is additional to large sums pledged to defray the military costs incurred by the Coalition forces.
- However, the distribution of this \$14bn, unlike normal responses to emergencies, has been highly selective and not always directly related to need. While in aggregate the funds raised by this Group could meet the estimated \$12bn country-specific costs of all the forty or so severely affected countries, it appears that aid to date has only been channelled to six of these, covering 60% of the total cost.
- Extending compensation to the poorest group of other severely affected countries — Yemen, Sri Lanka and fourteen Sub Saharan countries — would cost only another \$2bn, representing a small proportion of either the Coalition's war costs or Kuwait/Iraq's reconstruction costs.

For further information contact Marcus Manuel or Sheila Page at ODI.

ISSN 0140-8682

Overseas Development Institute Regent's College Inner Circle Regent's Park London NW1 4NS