

# MACROECONOMIC TRENDS IN THE MIDDLE EAST AND NORTH AFRICA

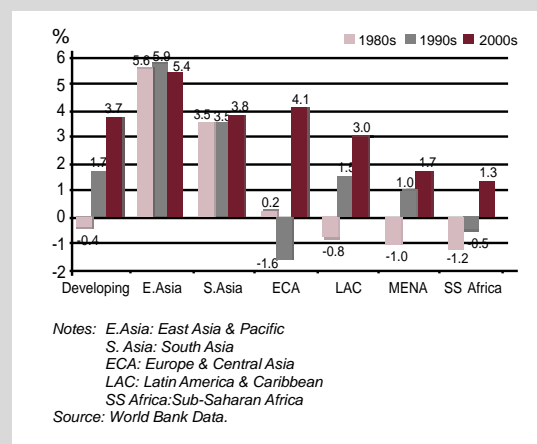
## A "Crisis of Growth"

The "performance of Middle East and North Africa (MENA) economies in the last two decades has been disappointing. Per capita GDP decreased by an average 1.0 percent per year in the 1980s, a rate worse than that of any other developing region, except Sub-Saharan Africa. Although per capita income stopped contracting in the 1990s, it still grew by a mere 1.0 percent per year. This was especially discouraging considering that growth elsewhere in the world was rapid. High-income countries in the West, especially the United States, made the most gains, while many Asian and Latin American developing economies also made impressive strides. The economies of Russia, Brazil and East Asia, which faltered during the financial crises of 1997-99, have since begun to recover. With the exception of Latin America, which was held back mainly by Brazil, the region's giant, and later by Argentina, MENA continued to grow more slowly in the late 1990s than any other region in the world (Figure 1.1).

The human consequences of low or negative growth have been serious. If the oil-rich countries of the Gulf Cooperation Council<sup>1</sup> (GCC) are not included, the unemployment rate in MENA now averages close to 25 percent—the second highest of any region of the world. In several countries, including Iran, Syria, Libya and Yemen, as many as one-third of the labor force is unemployed. Even among citizens of the GCC, where unemployment has averaged a relatively low 5 percent, joblessness has begun to grow (Figure 1.2).

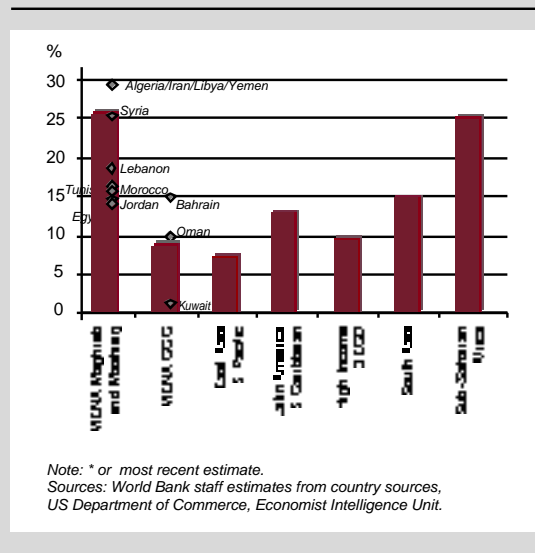
The biggest impact has mostly been on first-time job-

**Figure 1.1: GDP Per Capita Growth: Developing Regions 1980s, 1990s, and 2000s**  
(Annual Average Percentage Change)

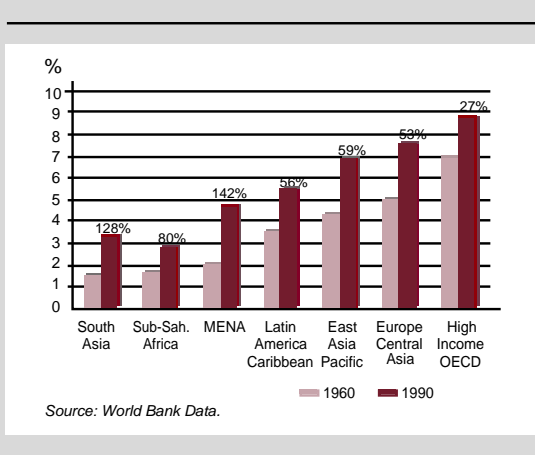


seekers and the young. Unemployment among those under 25 years in MENA is about twice as high as national averages. To its credit, the region has greatly expanded access to education. Between 1960 and 1990, the average level of education increased by 140 percent, a growth rate not matched by any other region, and illiteracy has fallen precipitously. This investment in human capital has the potential to increase productivity substantially, especially if the high unemployment among the young is reduced. However, high unemployment rates among those young deny the education payoff in the growth of the region. This is can be characterized as a "human capital crisis" in the region (Figure 1.3).

**Figure 1.2: Unemployment, 1999\***



**Figure 1.3: Growth in Average Educational Attainment of Population Over Age 15, 1960 and 1990**



## The Diversity of the MENA Region

These broad growth numbers hide a great diversity within the region. Countries such as Egypt, Jordan, Morocco and Tunisia that implemented macroeconomic reforms from an early date, liberalizing trade, reducing budget deficits, tightening monetary policies and privatizing state-owned enterprises, reaped

benefits as early as the mid-1980s. The reduction in the budget deficits reduced inflation rates, improved external performance in terms of growth of exports, reduced current account deficits and increased foreign exchange reserves.

The oil exporting states of the GCC generally achieved macroeconomic stability, but have been slow to make structural reforms. Their achievements include: encouragement of greater foreign and private investment in certain areas and the rolling back of some of their cradle-to-grave welfare benefits by increasing fees for social services.

A third group of economies in the region either has not achieved successful stabilization, such as Lebanon and Turkey, or has achieved macro-stability but has not yet significantly moved from socialist, state-dominated management of their economies, such as Algeria, Iran, Yemen and Syria. Lebanon, for example, has run a high budget deficit and borrowed heavily on local markets to finance the reconstruction of its physical and human capital after its civil war.

As a group, the early reformers performed substantially better than either the oil-exporters or the late reformers. Their economies grew by an average 4.5 percent a year (2 percent per capita) in the 1980s, compared with only 0.8 percent among GCC countries (minus 4.2 percent per capita), and 1.6 percent a year among the late reformers (minus 1.6 percent per capita).

By the 1990s, even though the performance of both the Gulf and the late reformers improved significantly, they still lagged behind the early reformers. From 1990 to 1999, GCC economies grew an average 3 percent a year (minus 0.8 percent per capita), late reformers 2 percent (1.2 percent per capita) and early reformers 6.8 percent (1.8 percent per capita).

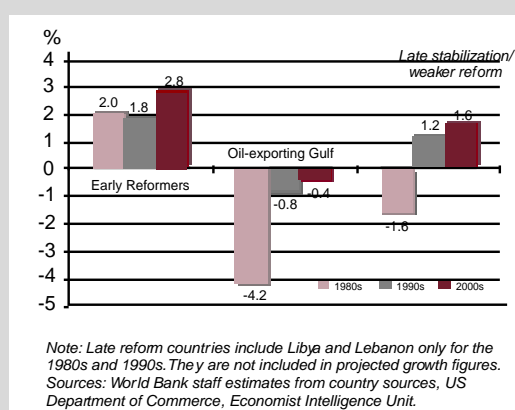
## Growth Prospects Over the Next Decade

Even before the terrorism attack on the US on the 11th of September, the world was entering a slow-down phase where less favorable economic and social conditions were unfolding. The three major economies of the world were facing a downturn. Japan had slipped back into recession, the US'

economic growth had dropped to near zero and Europe's economy was slowing sharply.

Growth forecasts figures have been revised downward but at this point, there are as yet no confirmed figures as to how the economies of the world will react to the crisis. However, initial figures of the World Bank show that the growth rate of the US and the OECD countries are expected to be lower by an average of 0.75-1.25 percentage points from the initial forecasted figures for 2002. As for developing countries, growth rate was already forecasted to fall from 5.5 percent in 2000 to 2.9 percent in 2001, mainly due to the global slowdown. However, this figure is now expected to decrease by another 0.5-0.75 percentage points for 2002.

**Figure 1.4: GDP Per Capita Growth and Growth Projections, MENA 1980-2010**



The MENA region was forecasted to grow at a rate of 3.8 and 3.6 percent in 2001 and 2002, a decreasing rate from an average of 4.0 percent in 2000. However, these figures are now likely to be even lower. Expectations of decreasing global growth have pushed prices lower, including oil prices which have fallen from \$31/b in September, 2001 to \$19/b by mid-October, 2001. It is likely that the OPEC will ensure that the price per barrel will not go lower than \$22/b. Export prices will decrease but shipping costs will increase. Tourism revenues are being hard hit in the MENA countries due to the perceived fears of using air transportation and the

increasing tensions in the region. Increased risk perceptions of the region may also hit FDI flows, which were expected to fall regardless, due to the global slowdown.

As a result of decreasing growth, the number of poor in developing countries will also increase by an estimated 10 million more people than expected for the year 2002. This will be largely a result of the decrease in commodity prices in general, and agricultural prices in particular, and will increase the burden of poverty in rural areas in particular.

There is no doubt that countries of the MENA region will be hard hit by the latest events. However, the depth of the post September shocks on MENA and the speed of recovery will depend on the nature of each market and on how policy makers will respond in order to overcome the crisis.

#### Long Term Projections for Growth

In the long term, MENA's GDP as a whole will grow by an average of 3.6 percent a year from 2000 to 2010, a rate slightly less than in the Latin America region and significantly less than in the East Asia/Pacific and Southeast Asia regions, according to the December 2000 World Bank forecasts.

Per capita GDP in the MENA region is likely to grow by less than 2 percent a year from 2000 to 2010, according to the World Bank Global Economic Prospects. This compares to 2.3 percent throughout the world, 3 percent in Latin America and 5 percent in East Asia. Only in Sub-Saharan Africa is per capita growth projected to be lower than in MENA.

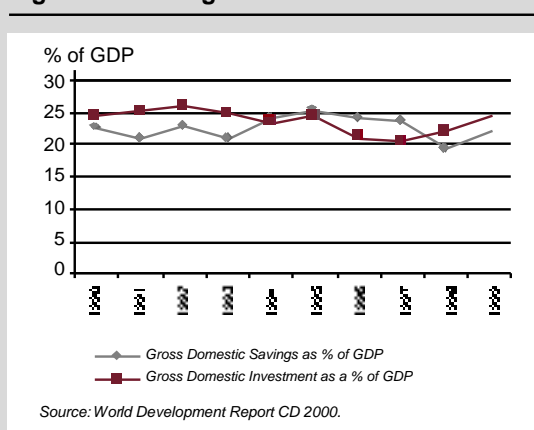
Growth prospects in the long term for the MENA economies vary, with better performance foreseen for those more advanced in their reforms. Growth among the early reformers is expected to increase to 4.6 percent a year (2.8 percent per capita) up from 3.8 percent the previous decade. That compares with annual growth of 2.6 percent (minus 0.4 percent per capita) among oil economies and about 3.6 percent (1.6 percent per capita) for the late reformers (Figure 1.4).

Despite its expanding labor force, continued macroeconomic stability and past investments in human capital, MENA's growth prospects continue to be hindered by institutional and policy constraints.

### Savings and Investment Performance

Saving rates in the MENA region are lower than in other developing regions. In MENA, Saudi Arabia has the highest saving rate (Annex Table A1.2). In general, saving in oil-exporting countries tends to be higher. The high proportion of young and dependant people throughout the region tends to limit the ability of households to shift direct income into savings. Also, a large portion of the population works for the state, whose low salaries leave little surplus for saving (Figure 1.5).

**Figure 1.5: Saving & Investment in MENA**



Saving rates are determined mainly by interest rates and the sophistication of financial markets. Savings can be increased through policies that liberalize financial markets and deepen financial intermediation by allowing more players into the market and letting them expand the types of financial products they offer. These products include new types of saving instruments in areas such as postal savings and pension funds that are designed to provide easier access to households and other small savers. Governments can increase a country's total savings by increasing their own savings. Several countries, especially in North Africa, have included financial reform in their structural adjustment programs.

In the coming decades, the ratio of the working population relative to retired persons will increase in MENA countries. This may help boost savings, especially if encouraged by the introduction of new

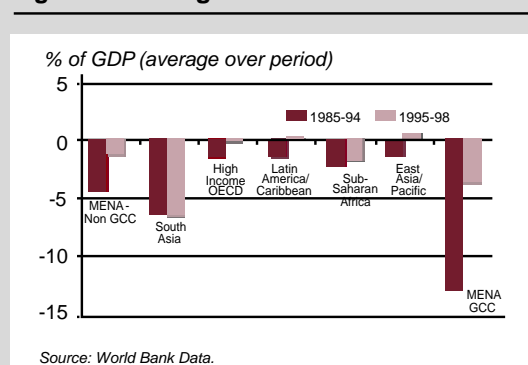
savings instruments and improvements in the overall macro environment.

The low rates of saving in MENA countries are matched by similarly low rates of investment (Figure 1.5). Investment in Arab countries increased in 1999 by a mere 1.1 percent from 1998. Algeria, Egypt, Lebanon, Mauritania, Morocco, Saudi Arabia, Tunisia and the UAE accounted for most of this growth, with the highest increase in Egypt. Much of the poor performance can be accounted for by a fall in public sector investment as governments tightened their budgets. Many MENA countries are now encouraging the private sector to take up the slack. This could be achieved by speeding up privatization and by reallocating public investment.

### Macroeconomic Stability and Better Management of Volatility

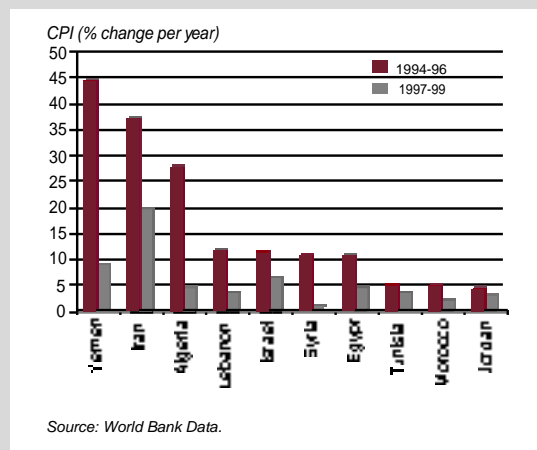
By the early 1990s, most countries had begun macroeconomic stabilization programs that focused on reducing budget deficits. Creditors helped by canceling and rescheduling large parts of government debt, reducing pressure on central banks to financial deficits by creating more money (Figure 1.6). As a result, inflation has fallen to acceptable levels throughout the region. MENA countries show no sign of abandoning this commitment to macroeconomic stability anytime soon (Figure 1.7).

**Figure 1.6: Budget Deficits 1985-1998**



Apart from Algeria, Tunisia and Yemen, and more recently Iran, most MENA countries fix their currency exchange rates as part of their macro-

**Figure 1.7: Inflation, 1994-1999**



economic programs. Usually the pegs overvalue local currencies, discouraging exports. This is contrary to the policy of encouraging exports that the East Asian Tigers have pursued for the last three decades. Some MENA countries, notably Egypt, are looking for ways to abandon the pegs to boost economic growth.

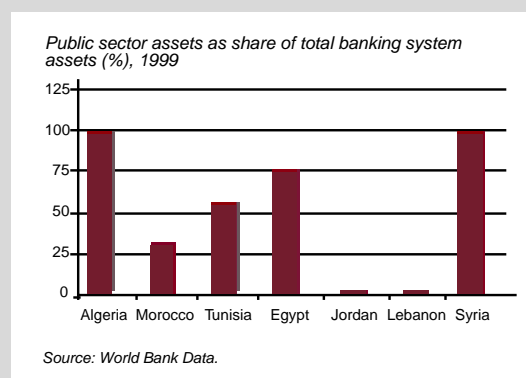
Oil remains a regional bellwether. Fluctuations in prices, revenue and related aid flows and worker remittances will continue to affect economies. The hard-won gains in macroeconomic stability of recent years in the face of lower oil prices will need to be preserved even as prices rise. Mechanisms such as higher savings during booms need to be found to deal with future volatility.

### *The Financial Sector and FDI*

With a few exceptions, the unhealthy state of the region's financial institutions continues to constrain growth and private development. The banking sector, crucial for promoting investment and savings, needs further reform, and the sale of state banks needs to be accelerated in Algeria, Egypt, Tunisia, Iran, Syria and elsewhere (Figure 1.8).

Progress has been made in privatization in general, particularly in Egypt, Morocco and Tunisia. However, only about 10 percent of the more than \$100 billion in assets that the region's governments have promised to sell has actually changed hands.

**Figure 1.8: Public Sector Share of Banking System in some MENA Countries**



GCC states have opened up their economies and are competing to attract foreign business. They offer investment incentives that include tax holidays, long-term leases, greater foreign ownership rights and simplified entry rules. The competition is particularly notable in services. Dubai and Bahrain are both trying to serve as the region's financial hub, Dubai, Bahrain and Qatar are seeking to attract tourists, while Oman has opened port services to private companies. However, despite exceptionally high returns in other developing countries, investors are still staying away from the region. MENA countries must work to make themselves more attractive.

### *The Role of Trade Liberalization*

MENA restricts trade more than almost any other region. Tariffs remain high and non-tariff barriers plentiful, slowing the region's integration into the global economy. However, a number of policy changes across the region should lead to greater openness and, it is hoped, stimulate growth.

The European Union signed trade agreements with Israel and Tunisia in 1995, followed by others with Morocco in 1996 and Jordan in 1997. After several years of negotiation, the EU finally signed a similar agreement with Egypt in May 2001, and one with Lebanon in January 2002. The EU is also seeking agreements with Algeria and Syria. The accords with Tunisia and Morocco dismantle tariffs on European

industrial exports over a twelve-year period while postponing discussion of agricultural barriers. The accord with Egypt dismantles tariffs over 16 years. In addition, Jordan recently signed a free trade agreement with the US.

A number of countries have also committed themselves to lowering tariffs, including those on telecommunications and financial services, by joining the World Trade Organization. WTO rules will further open the economies of the GCC, which are already relatively liberal, by discouraging laws stipulating that goods be imported through exclusive commercial agents. Indeed, Bahrain amended its Commercial Agency Law in 1998 to allow foreign companies to import goods and spare parts directly.

Jordan, Morocco, Tunisia, Egypt and other countries have been working to boost exports, while exporters, particularly in Jordan and Morocco, are pressing their governments to devalue their currencies to make their products cheaper abroad. Many countries have programs to modernize local industries and services.

### *Higher Industrial Productivity*

The world's economic environment in the next decade will differ dramatically from that of the 1980s and 1990s. Competition is intensifying and the basis of success changing. MENA economies have made few inroads into the new economy. With only a few exceptions, they have lagged behind in promoting technological development and have failed to invest sufficiently in research and development. There has been little technological innovation in manufacturing.

Developing countries have not yet come to grips with the notion of intellectual property rights. The MENA region's pharmaceutical industry in particular faces a tremendous challenge as countries are increasingly being forced to comply with property rights. Various government support organizations can help ease the transition. But so far many have not lived up to expectations.

### *Demographics*

Population growth in the region should help to increase production. MENA's population grew on average by 2.8 percent a year from 1980 to 1998, one

of the highest rates in the world. At the same time, the number of people of working age grew by 2.45 percent while the number of dependent people increased by only 0.25 percent. This represents a net 2.2 percent annual increase in employable people. This fall in the dependency ratio suggests that from now until 2015, MENA economies will enjoy the biggest demographic gift in the region's modern history. In other words, demographic aging of the population has the potential to induce an extra 2.2 percent percentage point rise in MENA's GDP growth, similar to the phenomenon which occurred in East and South East Asia during the 1980s.

This swelling of the working-age population makes it all the more urgent for governments to liberalize their labor markets to pave the way for more jobs. Employment in the MENA region will have to grow by more than 4 percent a year merely to absorb the new workers, let alone provide jobs for the existing unemployed. One major source of new jobs is housing construction, where a huge pent-up demand has been accumulating for years.

As governments liberalize, they must take care not to let those who are vulnerable to poverty fall through the cracks. Most social programs in MENA were put in place during the oil-rich years of the 1980s. However, most governments have set aside very little of their increased revenue from those days as a provision for the day when oil prices fell.

### *Political Development*

Cross-country evidence suggests that economic growth accelerates as political freedom expands, especially in societies that enjoy fewer political rights to begin with. Participatory political systems facilitate the conditions necessary for collecting and processing the reliable information that businesses and governments need to take decisions.<sup>2</sup>

Political development in the MENA region is progressing slowly. Although many countries held pluralistic parliamentary elections in the 1990s, the political processes have fallen well short of the criteria demanded in modern representative democracies. The executive branch of government remains generally uncontested and continues to exercise vast power. The judicial and legislative branches are partially independent, if at all. New political parties

need government permission to form, while existing opposition parties have limited access to media. Voters are often coerced to cast their ballots in favor of ruling parties.

### *Participation of Women*

Economic development is also linked to the status of women. Growth is hindered when women have less access than men to health and education. It is likewise impeded when women are denied access to jobs. In the high-growth economies of East Asia, for example, increased female participation in the labor force accounted for an increase in real per capita growth of between 0.6 percent and 1.6 percent a year from 1966 to 1990.

MENA ranks poorly in terms of gender equality. Despite great improvements over the last two decades, the number of adult females who can read and write is, on average, only two-thirds that of men. This compares to 98 percent in Latin America, 76 percent in Sub-Saharan Africa and 86 percent in East Asia. Likewise, only 31 percent of MENA women are employed, compared to 72 percent in East Asia, 41 percent in Latin America, 43 percent in South Asia and 62 percent in Sub-Saharan Africa.

### *Domestic Structural Economic Reform*

While these factors, mentioned above, played and will continue to play an important role in determining growth in the region, it is domestic economic reform that remains the most important factor. The large size of the public sector, which accounts for as much as 40-60 percent of gross domestic output and employment in some MENA countries, has been a drag on the region's growth. This is because government-run institutions tend to be far less productive than their private counterparts. The region's governments have sought to sell many of their businesses, reduce the number of employees or offer incentives to improve performance. However, the effort has been slow and half-hearted.

Private investment represents only 40 to 45 percent of the total in the region, an especially low rate compared to the 75 to 80 percent in Latin America and East Asia. Moreover, much of that private investment has flowed into fixed assets such as housing

and real estate and not into the manufacturing and services which have export potential. For private companies to become engines of growth, governments must liberalize trade faster, improve customs and other state functions, better guarantee property rights, reform and speed up their legal systems, improve mechanisms to enforce contracts and develop a more robust financial sector.

But these steps alone will not be enough. The region's private companies have often developed under government patronage, flourishing not so much by being dynamic in a competitive environment, but by selling to protected domestic markets or as state-supported monopolies. The private sector should see itself as independent; governments must allow and encourage competition throughout the economy; and society must support the change.

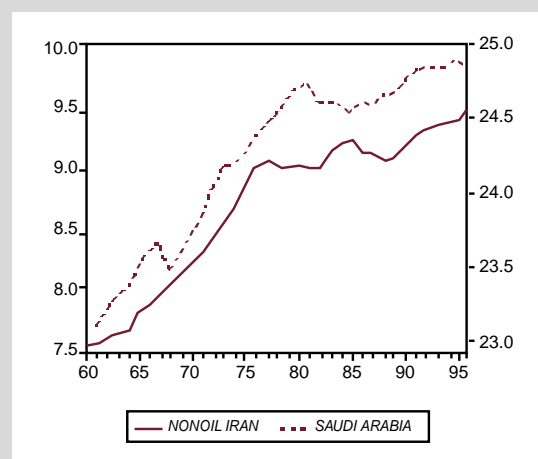
## **Macroeconomic Performance and Economic Instability**

In industrial countries, fluctuations such as those caused by monetary disturbances and productivity shocks are considered the main factors that cause an economy's business cycle to change. To what degree these fluctuations affect the economy depends on the country's structural and institutional setup. For example, unemployment and falls in output caused by negative shocks normally last longer if employment contracts are long and labor and product prices inflexible.

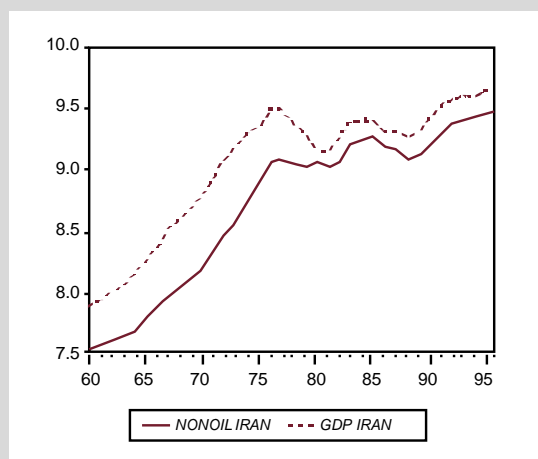
Studying business cycles<sup>3</sup> in MENA countries does not necessarily imply studying classic cycles or searching for cycles most frequently observed in the industrial countries. In modern usage, cycles mean fluctuations with no particular pattern, or a unique and universal impulse. How long these effects endure and what the short-run impact of the disturbances is on output depends on the structure and institutional setup of the economy.

There are factors specific to developing countries that are usually introduced in empirical analysis in search for sources of fluctuations. In oil-exporting MENA countries, such fluctuations are mainly caused by changes in the demand for oil. When oil demand changes, the effect on the economy tends to be much larger than fluctuations in other MENA countries. When demand for oil collapsed in the early 1980s, for

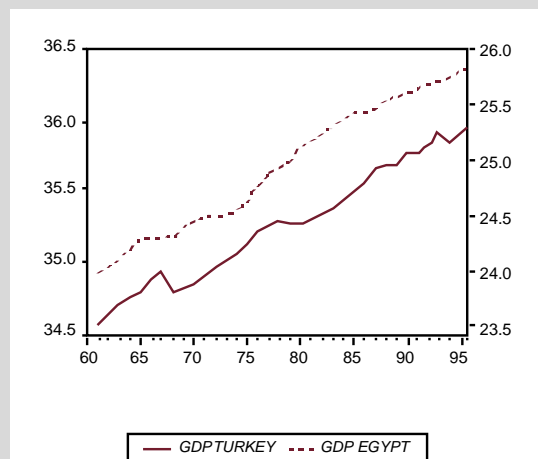
**Figure 1.9A: Log of GDP, Iran & Saudi Arabia**



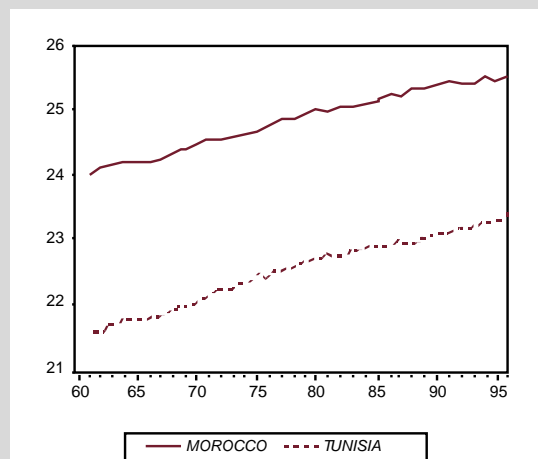
**Figure 1.9B: GDP, Non-Oil Output, Iran**



**Figure 1.9c: Log of GDP, Turkey & Egypt**



**Figure 1.9D. Log GDP, Morocco & Tunisia**



example, GDP growth in both Iran and Saudi Arabia slowed significantly during the decade. In Iran, the decline in the price of oil also had a lasting negative impact on the non-oil economy.

### Features of Aggregate Fluctuations in Selected MENA Countries

A study of the cyclical fluctuations in a small sample of MENA countries showed that these fluctuations

tend to be much larger in oil-exporting countries than in other MENA countries. Output series tend to be smoother in Egypt, Morocco, Tunisia, and Turkey (countries that do not depend much on oil exports) than in Iran and Saudi Arabia (Figures 1.9 A, C and D). The time trend for GDP in Iran and Saudi Arabia reflects a significant growth deceleration in the 1980s. In both countries, once the oil-price-boom ran out of steam, trend growth broke down. Figure 1.9B shows that non-oil GDP in Iran

has a similar trend to that of GDP (including oil), which implies that the decline in the real price of oil has had a lasting impact on the behavior of the non-oil economy.

Business cycle studies in industrial countries tend to show that consumption is significantly less volatile than GNP, and investment and foreign trade are significantly more volatile than GNP. For MENA countries we observe similar, though not identical patterns. In the case of Iran, exports are the most volatile component of real aggregate demand. Investment fluctuates more than consumption and non-oil GDP. Further inspection of aggregate data shows that oil exports are more volatile than non-oil exports, and oil exports seem to be the most important source of economic shocks.

In **Egypt**, private consumption expenditure has the lowest volatility compared to other components of real aggregate demand. Compared to consumption, investment and exports are much more volatile, and this is consistent with the experience of other countries, both developed and developing.

Output in **Turkey** exhibits less cyclical fluctuation compared to Iran and Saudi Arabia but it is less stable compared to Egypt, Morocco, and Tunis. Like the other countries in our sample, private consumption is the least volatile and exports and investments are the most volatile components of aggregate demand in Turkey. Investment is less volatile than exports but more than consumption.

In **Saudi Arabia**, private consumption exhibits less volatility compared to the other two aggregates. Consumption volatility relative to GDP is considerably less than other MENA countries studied here. Investment variability is significantly higher than both consumption and GDP, an observation consistent with the experience of other countries in our sample and consistent with the stylized facts of industrial countries. Exports are the most volatile component of GDP, even exceeding the cyclical instability of investment. Excessive instability in export earnings has always been one distinguishing characteristic of commodity or oil-producing countries. As it turns out, it is the case for Iran and Saudi Arabia.

Output in **Morocco** has the least cyclical volatility amongst our six-country sample. Consumption is the least unstable component of aggregate demand.

Investment is the most volatile component, and it is a major factor contributing to cyclical fluctuations. These observations are in line with the "stylized facts" of business cycles in industrial countries. Exports and real government expenditure show about the same degree of volatility, about twice as much as private consumption.

Amongst the components of aggregate demand in **Tunisia**, private consumption has the least degree of instability. Volatility of investment is about twice as high as that of consumption and nearly as much as that of exports. Real government expenditure in Tunis is less volatile than both.

For all the six countries in the sample, cross correlation between inflation and cyclical output and monetary shocks (defined as fluctuations in broadly defined money supply) was calculated. Positive monetary shocks do not have output effects of the same direction in Iran, Saudi Arabia, Tunis, and Turkey. For Morocco, there is a significant and positive correlation between monetary shocks and cyclical output.

## MENA Exchange Rate Policies

The crisis that exploded in Turkey at the end of November 2000 is a warning to MENA countries to adopt sound exchange rate policies and put their financial systems in order (see Box 1.2). Turkey's banking system, dominated by state banks, was weak and poorly regulated, its support of modernization and privatization was half-hearted, its currency was overvalued and its current account was in deficit (OECD figures suggest the real exchange rate appreciated by more than 20 percent in 2000 and 2001).

A country cannot simultaneously peg its exchange rate, run an independent monetary policy and keep its capital market open. This is the impossible trinity, and most currency crises result from trying to achieve it. This was the case for the Tequila crisis in Mexico in 1994 and 1995 and now the recent Turkish crisis of 2000 and 2001.

Most MENA countries have opted for exchange rate stability and monetary independence while closing their financial markets to the outside world (Annex Table A1.4). In fact, the market plays little role in determining exchange rates in the region. Out of 22

## Box 1.1. Macroeconomic Stability in Palestine

The Palestinian economy has long suffered under Israeli occupation. There has been little development of the infrastructure or the production base. As a result, Palestinians have had to find jobs in other labor markets, especially Israel, which has employed up to 40 percent of the Palestinian labor force. The gap between gross domestic product (GDP) and gross national product (GNP) is more than 30 percent. Also, the deficit in the Palestinian balance of payments with Israel has been huge.

An atmosphere of optimism followed the signing of the Palestinian Self-Rule Agreements, and in 1994 and 1995 the economy recovered. The Palestinian government set up national institutions, and many of the obstacles and barriers created by the Israeli occupation were eliminated. GDP grew by 7 percent in 1994 and 3.5 percent in 1995.<sup>4</sup> However, in 1996, restrictions on movement and economic blockades by the Israeli army reduced GDP growth to between 1.5 and 0.5 percent.<sup>5</sup> The following year was even worse. Repeated army blockades in 1997 caused growth to drop to as low as 0.5 percent. When such Israeli measures were reduced in 1998 and 1999, large numbers of Palestinians once again began working in Israel and the Palestinian economy rebounded. GDP grew by 4 percent during each of the two years and GNP by 6 percent.

Since the Aqsa Intifada broke out on 28 September 2000, the Palestinian economy has virtually collapsed. The Israeli army re-imposed an economic blockade on the Palestinian territories and restricted travel more tightly than at any point since Israel occupied the land in 1967. This paralyzed much of the economy, and from October 2000 to January 2001, GDP plunged by \$907.3 million, or \$8.6 million a day.<sup>6</sup> About 130,000 Palestinians working in Israel lost their jobs, costing the economy an estimated \$243.3 million. Israel repeatedly shut Palestinian borders with Jordan and Egypt and closed Gaza's international airport, leading to a dramatic slowdown in commerce. Exports fell by 22 percent and imports by 36.3 percent.

Unemployment soared to 39.7 percent in the fourth quarter of 2000 from 8.8 percent in June 2000.<sup>7</sup> Some 31.8 percent of the Palestinians on the West Bank now live below the poverty line, according to World Bank estimates.

*Source: Abu-Shokor, 2001.*

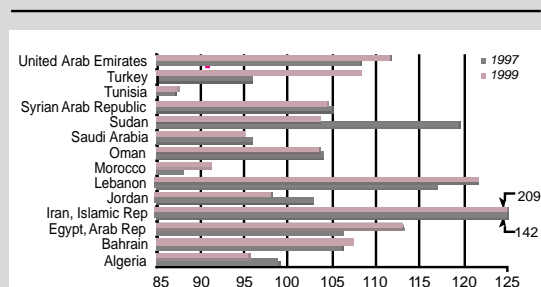
countries surveyed, only Lebanon, Sudan, Tunisia, Turkey, Yemen, and to some extent Egypt have market-determined exchange rates. Iran, Iraq, and Syria used multiple exchange rates to peg their currencies.<sup>8</sup> Fixing an exchange rate may shield an economy from currency crises, but they are likely to distort them too, while at the same time encourage black markets and corruption, force governments to ration currency and lead people to squirrel their money abroad.

Among the six countries with market-determined exchange rates, Egypt and Turkey have been oscillating between fixed and flexible exchange rate regimes. Sudan, Tunisia and Yemen have a floating (both *de jure* and *de facto*) or managed floating exchange rate regime, while Lebanon has pegged its currency. The fifth column of Annex Table A1.5 shows that most countries with a fixed exchange rate regime peg their currencies to the US dollar. While

this may be sensible for Gulf countries, whose main revenue comes from oil, which is priced in dollars, baskets that includes the euro may be more appropriate for Mediterranean countries, which have a significant share of trade with Europe. The rise of the dollar against the euro was a main reason for the recent appreciation of the region's exchange rates.

Tracking the evolution of the real exchange rate is particularly important because its behavior can help predict a currency crisis. Figure 1.10 shows large appreciations of the real exchange rates of Iran, Egypt, UAE, Turkey and Lebanon. Clearly, the data suggests that the recent crisis in Turkey will add one extra piece of evidence for the relationship between real exchange rate appreciation and currency crisis.<sup>9</sup> Countries with a flexible and market determined exchange rate (Sudan and Tunisia) do not have highly appreciated real exchange rates.

**Figure 1.10: Real Exchange Rate Index 1995=100**



Source: Panizza, 2001<sup>12</sup>.

Although, the United Arab Emirates and Iran have overvalued real exchange rates, these two countries do not have market determined exchange rates and therefore are unlikely to be the subject of a currency crisis. The remaining two countries with an overvalued real exchange rate are Egypt and Lebanon. The exchange rate management policies of these two countries are discussed in boxes 1.3 and 1.4.

One possible benefit to fixed currencies is that they minimize the risk of currency crises. With the exception of Egypt, Lebanon and, Turkey, few MENA countries seem to be vulnerable. On the other hand, pegs limit the action of market forces and generate distortions that hinder economic growth.

### External Debt in the MENA Region

Debt service remains a drain on resources despite a gradual decline in total external debt in the region to \$203.6 billion in 2000 from \$216 billion in 1995, (Annex Table A1.5). The net resource flows to the region increased to \$9.3 billion in 2000 from \$2.4 billion in 1995 (it had dropped to \$2.5 billion in 1999 after a peaking at \$14.5 billion in 1998). The increase was mainly due to an increase in net foreign direct investment to \$4.5 billion in 2000 from a negative \$0.3 billion in 1995.

The improvement can be seen by comparing the region's debts in 2000 to those in 1995. Total MENA debt decreased to 31.2 percent of GNP in 2000 from 37.3 percent in 1995 and to 94 percent of exports from 112.5 percent. Egypt's debt dropped

to \$30 billion in 2000 from \$33.3 billion in 1995, while the cost of debt service fell to 9 percent of exports from 13 percent during the same period. Morocco's debt also decreased to \$19 billion from \$22 billion within the same period. On the negative side, Lebanon's debt soared to \$8.4 billion from \$3 billion, while the cost of debt service jumped to 51 percent of GNP from 26 percent. (Annex Table A1.6). The *Global Development Finance Report* of the year 2000 rates a country's ability to service its debt by comparing the debt to GNP and exports. In MENA, it has classified Jordan, Iraq, Syria and Sudan as severely indebted.

The tendency of developing countries to focus on long-term projects can compound their debt-servicing burden. They are often forced to meet short-term repayment obligations by incurring new debt as they wait for their projects to produce a return in the distant future. To meet rising principal repayments, for example, Qatar had to borrow more in 2001, while Morocco spent privatization revenue. The burden in many MENA countries was reduced when donor countries canceled some debts. More debt may yet be canceled in the future. MENA countries might also reduce their burden by applying greater accountability to their external debt and by intensifying their debt management strategies, some of which have already proven effective.

### What Drives Successes and Failures in Fiscal Performance?

#### *Increasing Budget Revenues and Expenditures*

Even though their revenue increased by an average 9 percent between 1995 and 1999, Arab governments still face major fiscal challenges (Annex Table A1.7). Shifting to taxes as a source of public funds seems inevitable, but such moves face serious constraints. In Arab countries, tax's share of total revenue increased in the past five years by almost 10 percentage points, growing to 37 percent from 28.6 percent. This was largely at the expense of oil revenue, whose share decreased by almost 9 percentage points (Table 1.1).

Several of the region's countries have been working towards ensuring both efficiency and transparency. Administration has been organized and taxation rates unified to simplify procedures. Tariffs have

## Box 1.2. Macroeconomic Stability: The Case of Turkey

The Turkish economy has gone through a cycle of growth, crisis then reform three times in last two decades. Each cycle had different macroeconomic causes.

As a result of foreign exchange crises from 1977 to 1980, the government put a structural adjustment program in place in January 1980 under the auspices of the World Bank and the IMF. Trade in commodities was liberalized, exports were promoted and prices were reformed with the aim of reducing the state's role in the economy. As a result, the economy surged. In 1988, the economy slowed, prompting the government to open its capital market to global markets the following year. Investors could now borrow short-term money abroad, a source of finance that allowed the public sector to spend more, and the price of imports fell. Growth rebounded from 1989 to 1993.

However, the growth came at a cost. The trade deficit in 1990-93 jumped to 6 percent of GNP from 3.5 percent in 1985-88. Meanwhile, the current account began moving erratically and the budget deficit soared. The economy plunged into crisis in 1994. The government began paying higher real rates of interest on its debt instruments, and foreign capital flowed into the country. At the same time, wages, unexpectedly flexible, fell dramatically. The economy grew with renewed vigor after 1995. The growth, however, was accompanied by severe macro-economic disequilibrium. The budget and current account deficits, inflation and unemployment were growing, as was social unrest. In August 1998, the financial crisis that began in Asia spread to Turkey. The economy declined in six out of 12 quarters from 1998 to 2000. Government borrowing increased 15 percent, and by 1999 interest payments had risen to 13 percent of GDP. As its debt rose, the government was forced to borrow more money to pay interest. Inflation soared to 72 percent in January 1999.

In December 1999, the Central Bank and the Under Secretariat of Treasury began an IMF-guided program to put the economy back on track. The program aimed to stabilize the lira and reduce inflation to under 10 percent by restricting the growth of the money supply. The currency would be pegged to a basket comprised of one US dollar and 0.70 euros, against which it would be allowed to slide by about 15 percent in 2000. Other elements of the reform program included steps to reduce the government budget deficit, sell state assets, strengthen banks, increase the efficiency of the public sector and build up the central bank's foreign assets.

The program succeeded in the first 14 months: the budget deficit fell, inflation slowed to less than 40 percent and in the whole of 2000 GNP grew 6.5 percent. However, the lira's newly found strength caused the current account deficit to rise to more than 5 percent of GNP. Lower interest rates led a number of banks to use short-term funds borrowed locally and abroad to finance long-term investments. By December 2000, short-term foreign debt had risen to 152 percent the level of the central bank's net foreign reserves, up from 101 percent when the IMF program began two years earlier. The program brought down inflation, but at the cost of less stable banks.

By September 2000, political obstacles had begun blocking privatization, and negative signals emerged.<sup>10</sup> Short-term interest rates surged. By November, many banks were having problems rolling over their short-term debt. They began selling government bonds at fire-sale prices to obtain funds. To help, the central bank expanded the money supply faster than promised to the IMF, but every increase in the money supply was immediately transformed into demand for foreign currency. The central bank's foreign reserves plunged. In early December, the central bank stopped lending altogether and interest rates skyrocketed to 2000 percent. The IMF stepped in with \$10 billion, capital flight was temporarily halted, and interest rates fell. But by then the central bank had lost \$6 billion in foreign reserves.

In this vulnerable situation, the Prime Minister and the President began feuding, triggering another crisis. On February 19, investors pulled \$5 billion out of Turkey, and within three days foreign reserves plummeted by \$4.5 billion. On February 22, the central bank was forced to let the lira float, and within six weeks the currency fell against the dollar by 47.7 percent. The economy plunged into recession, with massive lay-offs and increased social unrest.<sup>11</sup>

The damage of the two crises is still being assessed, but commercial banks lost an estimated \$10 billion, and the state, which had guaranteed deposits to avoid bank runs, lost between \$15 billion and \$20 billion. Further, by abandoning the crawling currency peg, the government lost credibility. This has led to self-fulfilling inflationary expectations.

*Sources: Yeldan, 2001 and Panizza, 2001.*

**Table 1.1: Structure of Aggregate Public Budgets for Arab Countries**  
(Percentages)

	1995	1996	1997	1998	1999
<b>Revenues</b>					
Oil Revenues	57.7	55.2	56.7	48.7	49.0
Tax Revenues	28.6	31.7	30.0	36.8	37.0
Profit and Income taxes	9.0	8.2	7.8	9.7	9.7
Taxes on goods and services	7.0	6.5	6.8	8.5	8.7
Custom tariffs on trade	7.8	6.9	6.0	7.4	7.6
Non-tax revenues	10.6	10.5	10.7	11.2	11.3
Other revenues	3.1	2.5	2.6	3.4	2.6
<b>Expenditures</b>					
Current Expenditures	75.8	76.9	75.9	78.8	80.4
Capital Expenditures	22.5	21.9	22.8	20.0	19.1
Net Lending	1.8	1.2	1.3	1.2	0.5

Source: *Unified Arab Economic Report, 2000.*

been decreased to encourage trade. In 2001, Egypt expanded its sales tax to include more goods and services with the aim of compensating the imminent loss of income as it lowers its customs barriers. In 2002 it plans to reform the collection of income taxes by lowering the rates it charges on the highest income brackets, then tightening enforcement.

On the expenditure side, total spending in the region increased by almost 10.5 percent from 1995 to 1999. Most of this increase was directed to current spending, whose share grew to 80.5 percent of total expenditure from 76 percent. Capital spending share slid in the same period by almost 3.5 percentage points. Total capital spending dropped to \$34.1 billion in 1999 from \$36.4 billion in 1995. The decline was especially big in Qatar, where it fell by about 40 percent in the past two years alone; in Libya, where capital expenditure fell by 34 percent between 1995 and 1999; and in Algeria, where it fell 22 percent during the same period.

Expenditures on education, health, wages and subsidies in the MENA region have accounted for an

important share of budgetary outlays. MENA countries are not able to keep up with this sizable wage bill and employment increases. Most governments have adopted restrictive wage policies with an aim to contain the wage bill. In the area of health and education, efforts to ensure equal access to health and education in some MENA countries came at the opportunity cost of quality.

Governments have been subsidizing basic foods, energy and other goods and services to reduce poverty. Apart from burdening the budget, the subsidies have not always been effective in targeting the needy, and once in place are hard to remove. However, a number of MENA countries have succeeded in eliminating some subsidies while better targeting others. Governments are aware that new forms of social protection that are more efficient, less costly and better targeted are needed.

#### *MENA Budget Deficits still Persist*

In 1999, the combined budget deficit of Arab countries was almost \$31 billion, a slight decrease from 1998. This represented almost 5.7 percent of combined GDP, down from 6.1 percent in 1998. Kuwait's deficit soared to 14 percent of GDP in 1999 from 4.8 percent in 1998 after oil revenue plummeted by about 28 percent. Egypt's deficit as a share of GDP increased by about three percentage points after the government boosted spending on giant infrastructure schemes, such as the Toshka desert irrigation project, by 57 percent. In other Arab countries deficits decreased. Yemen's deficit dove to 0.05 percent of GDP in 1999 from 8.33 percent in 1998 after its oil revenue skyrocketed to about 7 percent of GDP. Saudi Arabia's decreased to 8 percent of GDP from 10 percent after oil income leapt by about 30 percent. (Annex Table A1.7).

#### *Mechanisms to Reduce Budget Deficits*

A premise that has proven successful in helping explain fiscal performance in a number of countries is the "common pool" problem. This problem is a fundamental dilemma in fiscal policy based on the fact that government expenditures are biased to some social groups, while the funds used for these expenditures are drawn from the pool of fiscal resources that can be used by others. The extent to which socially inefficient policies are avoided

### Box 1.3. Exchange Rate Management in Egypt

In 1991, Egypt successfully implemented an IMF-backed reform program whose centerpiece was tight monetary policy, exchange rate stability and a reduction in the budget deficit. The government on its own initiative pegged its currency, settling eventually on a rate of about 3.4 pounds to the US dollar. Since then, inflation has plummeted to 3 percent in the year that ended June 30, 2000, from 29 percent in 1989.

However, the currency peg has not been as successful. In the late 1990s, pressure increased on the government's foreign reserves, due to a drop in the tourism revenues after the Luxor event. And the government spent more than \$6 billion in reserves to support its 3.4 pound peg. Beginning mid-2000, it allowed the pound to slide, first at private money changers, then at banks, until late January 2001, when it again fixed it at around 3.85 to the dollar. It simultaneously cracked down on money changers, fining and even shutting some down for selling pounds too cheaply. Furthermore, the central bank required exchange bureaus to turn over their stock of foreign currency at the end of each day.

Besides the loss of foreign reserves (approximately US\$ 1.8 billion during the year 2000), the currency policy has chased away foreign investment and helped drag the stock market to seven-year lows. It also has a cost in terms of currency rationing, distortions and the emergence of a black market, where a dollar has fetched up to 4.88 Egyptian pounds. On the other hand, it has enabled the country to avoid a full-scale currency crisis, a major concern of the government. (In this setting, Egypt is much better positioned than Lebanon (see Box 1.4) to allow a gradual slide of the exchange rate). There have been suggestions that Egypt, instead of pegging the pound against the dollar, fix it to a basket of currencies where the euro is given a large weight. Egypt's monetary policy would be more in line with those of many of its major trading partners.

Egypt is moving towards a more flexible exchange rate, and in November 2001, the Egyptian government gave full independence to the Central Bank of Egypt, making it responsible for setting monetary and credit policy. There has been talk of moving to a currency basket and increasing the flexibility of the price of the pound. However, the fact that the public sector dominates the economy makes inflation targeting difficult to implement. In particular, the four main state-owned commercial banks control more than half of bank deposits. The Central Bank is likely to follow a gradual strategy in targeting both the exchange rate and inflation.

*Source: Panizza, 2001.*

depends on the presence of institutional mechanisms to facilitate coordination and information flows that help social groups and their representatives internalize the marginal costs of the public expenditures that they advocate.

Figure 1.11 charts the average budget deficits of eight MENA countries against the fiscal discipline index<sup>17</sup>. Data from another four countries, outside the region, have been added for comparison. As the diagram indicates, the index is well correlated with the deficits. However, because some expenditure and liabilities are kept off-budget, official data often underestimate deficits or overestimate surpluses. In the absence of better data on deficits and debts, the average rate of inflation reflects the long-term consequence of fiscal imbalances for most developing countries because of the severe constraints on borrowing. Figure 1.12 charts inflation rates against the fiscal discipline index, confirming that low capabili-

ties in fiscal institutions are associated with high macro-economic instability.

The Aggregate Discipline Index is only a starting point for identifying weaknesses in fiscal systems. Examining the constituent components of the systems shows that there are several sources of inadequacy that account for the poor macroeconomic performance among MENA countries, and these sources are discussed below.

#### *Coordination Mechanisms*

Countries generally use a combination of four different institutional mechanisms to achieve fiscal discipline. The Aggregate Discipline Index measures the strength of each mechanism and how well they are coordinated in each country. The countries that score low on this index have failed to incorporate any of the four mechanisms in significant ways.

## Box 1.4. Exchange Rate Management in Lebanon

Lebanon pegged its lira to the US dollar after an exchange rate crisis in 1992. In September 1999, the peg was 1507.5 liras to the dollar. In the last three years, this has come under increasing pressure as people lose confidence in the peg and in the government's ability to maintain it, despite its success in reducing inflation in 2000.

One barometer of confidence is the degree of dollarization. By the end of the civil war, the Lebanese kept most of their money in dollar-denominated bank deposits. But by the end of 1997, dollar deposits had fallen to 55 percent of the total. The trend was reversed in 1999-2000 as people lost confidence. Dollar deposits crept back up to 62 percent in 1999 and to 67 percent in 2000. Indeed, for much of 2000 and almost all of 2001, the Central Bank of Lebanon was about the only seller of dollars and buyer of pounds. This determination to support the pound cost Lebanon \$2.1 billion in 2000, or about one-third of its foreign reserves.

The government's huge budget deficit and growing mountain of debt is one reason for the lack of confidence. The deficit jumped to 23 percent of GDP in 2000 from an already high 14 percent. The state's debt has risen to 150 percent of one year's GDP, and interest payments comprise 40 percent of all government spending, or 17 percent of GDP.<sup>13</sup> When combined with the country's low economic growth, these figures suggest something will have to break, and people fear it will be the state's tight monetary policy.

Meanwhile, the lira itself is increasingly overvalued as it remains pegged against the dollar, which has risen against the euro, the currency of some of Lebanon's biggest trading partners. The trade deficit grew to 40 percent of GDP in 2000 as importers took advantage of cheap euros. This problem will diminish if the dollar falls, as many people expect it will.

Another reason for declining confidence is the economy's poor performance. In order to defend the peg, the government has hiked up interest rates, throwing the country into recession. This has generated political pressure for an easing of monetary policy. The peg remains highly vulnerable, and a sudden shock could easily generate a currency crisis.

Devaluing the currency would increase international competitiveness by making Lebanese products cheaper abroad. It would also reduce the dollar value of the government's total debt, since 70 percent of it is denominated by the domestic currency. A devaluation is not likely to hurt Lebanese banks either, whose assets and liabilities in dollars generally match those in domestic currency. However, businesses and households may not be so well positioned. A large share of loans to private businesses and almost all mortgages are denominated in foreign currencies. A devaluation would increase the amount of domestic currency and repayment of loans, which could lead to a series of defaults that would hurt both banks and the economy.

Further, if the government chooses to devalue gradually, people will be tempted to convert their liras into dollars as quickly as possible to avoid seeing their savings fall in value. This could lead to a run on short-term pound-denominated bank deposits. Because banks have used these deposits to buy longer-term Treasury Bills, a run on deposits would lead to a cash shortage, drive up short-term interest rates and possibly cause some banks to fail.<sup>14</sup> If the central bank decides to release its monetary brakes and pour funds into the banks, what started as a controlled devaluation could end up as a free fall, with the currency locked in a spiral of inflation and devaluations.

Another, more provocative approach would be to abandon the national currency altogether and adopt the dollar or euro as legal tender. El Salvador recently did this.<sup>15</sup> The idea may seem radical, but the short-term costs would be limited, and it would eliminate currency risk and put interest rates more in line with US levels. Furthermore, since devaluation and inflation would no longer be options, it would motivate the government to improve its finances.<sup>16</sup> Abandoning the domestic currency would also eliminate the currency mismatches that now threaten the stability of the private sector. On the negative side, the policy would prohibit an independent monetary policy.

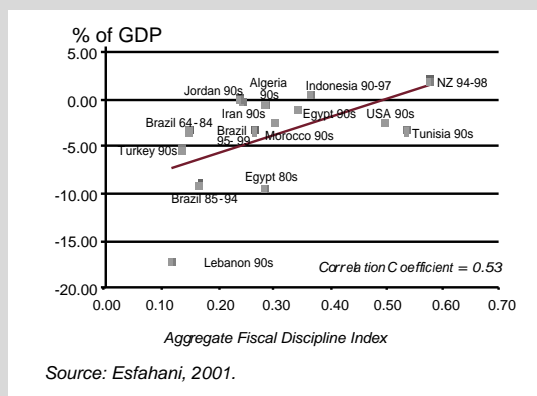
*Source: Panizza, 2001.*

The first of these coordination mechanisms is the delegation of authority from the top of the government to make budget decisions. The political systems in MENA countries are highly centralized, and one or a small handful of individuals are in charge of central budget agencies such as ministries of

finance or planning and dominate the budget process from design to implementation. Only in the region's three worst economic performers, Iran, Lebanon and Turkey, are central budget agencies relatively weak by international standards, strangely enough.

**Figure 1.11: Budget Surplus and the Aggregate Fiscal Discipline Index**

(Averaged over periods shown)

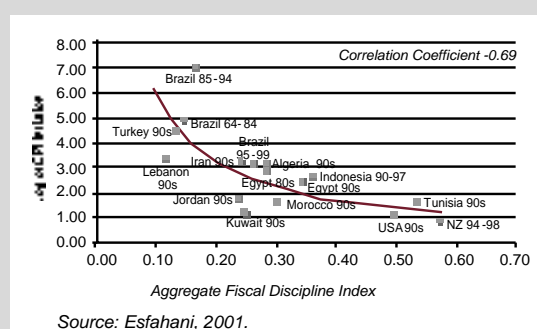


The third mechanism is the limit that laws, constitutional clauses and social norms put on spending. Examples include balanced budget requirements or rules that allow governments to borrow only for investment. These constraints are mostly used in economic unions and federal systems to control the spending of member governments. They are rare in MENA countries. This type of constraint may be undermined by creative accounting. In addition, even if loopholes are tightened, such constraints reduce flexibility and prevent governments from using spending as a stabilization mechanism when circumstances warrant.

The fourth and last mechanism is the medium-term macro-programming. This is where the budget-making authorities agree on a plan that can only be altered in a given year provided compensation is made in other years. A few MENA countries follow such plans to some degree, but the programs are relatively primitive and mostly the remnants of investment plans introduced in the 1950s and 1960s. They rarely integrate capital and operational costs into the plans or follow through with compensation when spending exceeds the plan. In the region, Tunisia and Morocco seem to use multi-year planning the most, followed by Algeria, Iran, Egypt and Jordan.

**Figure 1.12: Inflation and the Aggregate Fiscal Discipline Index**

(Averaged over periods shown)



The second mechanism is the degree to which decision makers set total deficit and spending targets before considering budget details. This is related to the first mechanism in that the powerful central budget agencies in most MENA countries draw up agreements in an early stage of the budget process. Morocco and Tunisia are the best at setting targets. Among the poor performers, only Iran employs such a mechanism to any tangible extent. However, even though its use is largely restricted to the legislative stage of the process. Lebanon is particularly weak at it, which has led to bigger deficits (Box 1.5).

### Keeping Spending Under Control

Other aspects of budget-making can affect efficiency. Discipline can be undermined by autonomous growth in parts of the budget and by off-budget spending by organizations such as the military. Many MENA governments have committed themselves to expensive subsidies that guarantee food and energy at low prices. The subsidies often grow out of control, and when governments finance the growing deficits by printing money, the resulting inflation exacerbates the problem. Food and energy subsidies are quite substantial in some MENA countries, like Iran. Generous welfare and pension plans have led to similar problems. Among MENA countries, Egypt and Jordan were able to tackle their problems through fiscal policies reforms.

Public spending outside normal budget channels can also weaken discipline. In Turkey, the legislature often lets the government create special funds with designated sources of finance. Such funds often out-

## Box 1.5. Budgetary Institutions in Lebanon: From Surpluses to Deficits

The growing budget deficits of the 1990s have thrown Lebanese government institutions into crisis. The deficits are a relatively recent phenomenon. From independence in 1943 until 1958, average yearly revenue exceeded spending by more than 30 percent. Deficits became more common from 1959 to 1970 as the state began providing more social and welfare benefits and increased spending. But average revenue nonetheless surpassed spending by more than 1.1 percent during the decade. Deficits became chronic only when the civil war broke out. Revenue fell sharply while spending on salaries, energy and subsidies remained intact.

After the civil war, the deficits persisted, even as revenue rebounded to its pre-war level. Part of the reason was the decentralization of decision-making. The new political system agreed at the Taif peace conference in Saudi Arabia transferred executive power from the president to the council of ministers, a move that undermined the government's ability to restrict spending. The problem was aggravated by the troika formula, which allowed officials to push through new spending without the prior approval of parliament, the main institution that oversees executive spending. As a result, the average deficit between 1990 and 1998 reached an unprecedented 46 percent of spending.

Another reason for recent deficits has been that parts of the budget were made autonomous. The budgets of the Council for Development and Reconstruction (CDR) as well as those of 61 public agencies were excluded from the general budget. In addition, the Court of Accounts, an autonomous financial watchdog, was rendered ineffective and in its annual reports forced to deny claims of waste. Also, the government itself rarely forecasts the operating cost of planned projects, let alone measures these against their benefit.

Budgetary institutions responsible for ensuring fiscal discipline have either deteriorated significantly or were never put in place. The large surpluses before 1970 allowed Lebanon to afford inefficiencies. Now, however, the government has the daunting task of containing the enormous deficits of the 1990s.

*Source: Atallah, 2001.*

live the purpose for which they were created, draining resources that could be used for higher priority programs within the formal budget. These funds also often run up off-budget debts that they ultimately pass on to the government.

Off-budget spending and debts are particularly a problem in Turkey, Morocco, Lebanon, Iran and to some extent Algeria. Egypt and other countries have reduced the size of the problem by privatizing or commercializing state-owned companies and banks, although they still have far to go. Throughout MENA, governments need to tackle the problem with better regulatory institutions, better assessment of the government's contingency liabilities and greater transparency in the budget.

### *Lack of Restraints in Governments Budgets*

Another problem is the ability of institutions in many MENA countries to alter their budgets during the course of the year. Governments add supplementary budgets or simply disregard allocations and

limits. Apart from driving up the deficit, the lack of restraints encourages the various agencies to devote much of their energy competing for their share of the pie throughout the year. The problem is endemic in many MENA countries.

Alarmingly, many MENA policymakers underestimate the problems that the lack of restraints cause, and even perceive it to be beneficial. They view their discretionary power to cut spending during the year as a backup in case revenue falls short or emergencies in other areas require new spending. Maintaining flexibility in the face of fiscal shocks is, of course, a valid concern, especially in countries that lack access to inexpensive finance. Kuwait has responded to the problem by creating a stabilization fund that is built upon when conditions are favorable and drawn from when they are not.

### *Making the Government Accountable*

Budget coordination mechanisms work well when the politicians using them are accountable to the

public. Unfortunately, this is seldom the case in MENA, where most governments do not release budget data to the public. Budget performance is rarely scrutinized and officials are seldom held accountable when results fall short. Audits focus mainly on financial matters, not on performance.

Accountability tends to be weakest among countries where budget decision-making power is delegated from the top. This concentration of power is likely to diminish as decision-making becomes decentralized and democracy takes root. However, if the delegation mechanism is abandoned without other strong methods replacing it, fiscal discipline may suffer, as the democratization experiences of Iran and Turkey over the past several decades demonstrate.

#### *Social Services Budgets: Public or Private?*

Many MENA governments have cut back on social services as structural reform programs impose tighter budgets. The government's involvement is being re-examined in areas that were once taken for granted: primary and higher education, health services, technology acquisition, infrastructure and utilities, environmental protection, social security and pension schemes.

Education and health services are increasingly being financed and delivered by private enterprises. In Lebanon, the private sector has dominated education for years in the absence of the central government. In Jordan, 20 percent of higher education students are enrolled in private institutions, and although previously prohibited, private universities are now being established in Egypt, while private schools at all levels have proliferated. By encouraging the private sector to provide social services, MENA governments will be able to direct more of their resources to those segments of the social sectors that are less attractive to private investor, yet help to meet the needs of the poor.

#### **Performance of the Private Sector**

Countries of the MENA region are showing increased commitment to supporting private investment and exports by implementing structural reforms and stabilization efforts aimed at improving the business environment.

In Tunisia, for example, private enterprises accounts for about 60 percent of total investment by non-financial enterprises, a figure that remained more or less steady throughout the 1990s. Total private investment was 51 percent of total investment in 1999, accounting for 14 percent of GDP. In recent years the Tunisian government has decreased tariff rates as part of its partnership agreement with the European Union, simplified customs procedures, improved its infrastructure, and offered investment and export incentives to the private sector, particularly small and medium enterprises (SMEs), which now dominate manufacturing. The government has given SMEs tax exemptions and established a fund to encourage small information technology firms. In the process, exports are moving away from raw materials to manufactured goods. But private enterprises still face problems in Tunisia. Custom clearance is much slower than in countries such as Morocco. The government still dominates telecommunications. Furthermore, SMEs have more trouble getting credit and attracting investment, suffer longer import procedures and find it hard to take advantage of export promotion programs than do large enterprises.

The *mise à niveau de l'entreprise*, begun in 1996, is a Tunisian government program designed to restructure 2000 enterprises, mainly SMEs, to make them more competitive. It favors the textile and clothing sector. As of February 2000, the restructuring plans of 645 firms had been approved and another 625 were being studied. The program has helped the increase of exports of these enterprises by 45 percent and their employment by 21 percent.

In Morocco, the government has reduced price controls, enacted a new investment code, reformed customs and taxes, worked to adapt training programs to the needs of the market and sold many of its enterprises to private buyers. As a result, the private sector's contribution to GDP increased to 73 percent in 1997, up from 64 percent in 1985. Its share in total exports increased to 75 percent in 1995, up from 60 percent in 1985. The government has a draft price and competition law in Parliament. However, the economy still suffers from slow TFP and low rates of private savings and investment. Moroccan private enterprises still face a shortage of skilled workers, poor infrastructure and an overval-

## Box 1.6. Budget Institutions and Expenditure in Tunisia

Tunisia's experience with alternating periods of growth and stability and of crisis and instability led to difficult adjustments including expenditure cuts and institutional reforms. Part of the instability can be traced to budget policy and institutions. The country has constantly faced a difficult trade off between macroeconomic stability and spending needs in all domains.

In the early 1960s, the Tunisian government expanded education and basic infrastructure while mis-stepping with regard to economic policy and institutional design. The formal stabilization plan applied in 1964/65 was a result of a number of factors, amongst them a government policy that did not allow for enough investment in consumers' goods. This policy also caused the rapid increase in money supply and aggregate demand, leading to an important increase in inflation and foreign payment imbalance, while real per capita hardly increased. At the same time, the legislature was made subordinate to the executive and the ruling party, which allowed it very little input on policy or budgets.

In the 1970s, the government allowed partial liberalization with private sector development, but the economy still remained controlled and heavily protected. The government tried to avoid increases in spending too quickly, particularly on education. It resisted borrowing from the Central Bank to finance the deficit. Nonetheless, oil revenue was rising and the government, which had expanded public projects, eventually lost its financial discipline. Private spending also rose, and GDP climbed by 6 percent a year. The government began borrowing more as its deficit soared, until eventually a crisis erupted.

By 1986/87, the government had no choice but to agree to a stabilization and adjustment program negotiated with the IMF and the World Bank. Much progress was made under the program to restore budgetary discipline. The deficit was reduced sharply to about 3 percent by the end of the 1990s. The deficit was financed mainly by selling government bonds at auctions. The budget was made more comprehensive and hidden spending was reduced.

However, the budget process still falls short. Most expenditure—food, energy and credit subsidies and government salaries—grow autonomously with little government control. Moreover, the budget still does not include all expenditure. Current and capital expenditure are hardly mentioned. In addition, there is little consultation. Business and community leaders are involved to a limited extent only when the government draws up its strategic planning priorities.

With the exception of investment expenditure, only a small part of government expenditure undergoes a systematic and objective analysis or audit. There is little supervision on spending as the budget is implemented. Furthermore, line agencies have no performance indicators. The coming challenge is to ensure that the budget becomes more efficient and a wider base is consulted when it is drawn up and implemented.

*Source: Boughzala, 2001.*

ued local currency. Bureaucracy is also a problem. Land property rights are insecure, getting information is difficult, setting up companies is cumbersome and tax administration and the judicial system are inefficient.

The private sector in Palestine is concentrated in commerce and residential construction. Industry, especially that related to technology, was growing in the two years up to the outbreak of the latest Intifada. Tourism is an area that has great potential and could help generate jobs. The SME sector also holds promise, given the right incentives, and FDI could be forthcoming from the Palestinian diaspora. Present political conditions make it highly

unlikely however, that the private sector will be able to grow or to prosper the near future.

### Institutional Reforms

The MENA region has felt the impact of globalization to different degrees reflecting the diversity of political, economic and social conditions prevalent in the area. While there has been very little reduction in the role of the state in any country, the spin-off from liberalization and privatization has prompted a rethink on the basic tenets of public administration. But changes so far introduced in governance are piecemeal and in response to specific needs. For instance, while Egypt's privatization policy should

have helped in downsizing the government bureaucracy, high unemployment, fear of social unrest as well as promises made during the parliamentary elections have pushed the government to promise more jobs and better wages in the public sector. Thus, Egypt has committed to allocate about LE32 billion in the new budget for employee remuneration and for the creation of an additional 700,000 jobs. Compelling social concerns, poverty and unemployment have also stood in the way of reform in countries like Jordan. Those reform measures taken in a number of countries have been mainly directed to capacity building, human resources development, financial management, environmental protection, technology transfer, administrative procedure and decentralization.

Under the auspices of the Technical Cooperation Programme (TCP) of the World Bank several countries in the region have improved their systems of administration. For instance, Saudi Arabia's Enhanced Financial System project has helped the computerization of its budget and accounting system. In Oman, TCP helped in conducting studies on the impact of privatization of water and electricity services. The UAE has utilized TCP to upgrade the management of its already better standards of health services, improving management of agriculture and water resources, and strengthening the delivery of services.

In the Gulf region, major efforts are now being made through legislation and regulation to indigenise the labor force in government service. Dependence on foreign labor has been high, prompting governments to adopt improved personnel policies and to create other employment incentives for natives. The impact of this policy has been to lower remittances to countries of the region that have traditionally supplied clerical and specialized personnel to Gulf administrations. The situation will become more acute when similar policies are also adopted by the private sector. A growing awareness of the need for an integrated Arab perspective on regional migration is expected to address this issue and to contribute to a policy that is less contentious.

### *Decentralization*

Decentralizing means giving people more power to make decisions at lower levels of government or out-

side of government altogether. Lower-level managers are often closer to a problem and have a better idea of what needs to be done. Distributing decision-making power releases people's energy, boosts an economy's productive forces and gives people more power to compete, both locally and internationally.

Despite general awareness of the importance of decentralization, this continues to be a slogan rather than a reality in almost all MENA countries. The state continues to be producer, provider and protector. Privatization has taken away some of the government's power in a few areas. However, much of the privatization has only been partial, with the state continuing to hold the reins of power in the background through minority stakes in companies, indirect stakes through state investment funds and heavy bureaucratic interference.

Reforms to the civil service have so far failed to allow authority to trickle down to lower echelons. On the contrary, reforms are often undertaken to counteract a problems caused by previous liberalization or privatization measures, or are mere window dressing for publicity. In most countries, civil service reform has been pushed by donors without motivation from local governments.

Any hope that elections or other schemes for more representation at the local level might decentralize decision-making has yet to be fulfilled. Where elections are held and officers chosen, dominating bureaucracies have killed the spirit of decentralization. The region's many conflicts have given governments an excuse to postpone administrative changes. Information technology and the communications revolution have given the man on the street more access to information independent of their governments. But at the same time it has given those very same governments greater means to centralize their power and authority.

Nonetheless, there have been a few successes. Iran, Turkey, Tunisia and Jordan have gone ahead with some reforms. Recent elections in Iran appear to have given rural populations more say in local decision-making, but the reform effort has not extended to urban areas, nor has it had any significant impact on power-sharing. Iranian reforms have, however, the distinction of being indigenous, rather than

sparked by external assistance and support. Decentralization of authority can take place only with the commitment of the ruling elite, and there are few signs of this happening anytime soon in most MENA countries.

### Creating an Enabling Environment

Sound macroeconomic policies, including stability of exchange rates, tight monetary policies and low budget deficits, are needed to attract investment. The lack of effective policies promoting these conditions has encouraged capital to flee MENA countries, notwithstanding that over the last ten years, more than half the region's governments have begun implementing market-based macroeconomic reforms.

On the plus side, almost all MENA countries have vastly improved their investment environment over the past decade. They have offered more incentives, streamlined procedures and allowed private participation greater scope. Countries are also opening up areas that were once a government monopoly. Egypt's new investment law opened previously banned activities to foreign investors. Jordan abolished limits on foreign ownership in the finance, insurance, telecommunications and transport sectors. Some MENA countries offer investors subsidized loans, loan guarantees and subsidies to cover part of their capital, production or marketing costs. They give export credit guarantees, subsidize certain services and offer training. However, surveys suggest incentives don't play as significant a role in attracting foreign investment, as do other factors. These include the quality of the infrastructure, the size and growth rate of the market, a conducive regulatory framework, macroeconomic stability and the cost and quality of labor. In this respect, the record in MENA countries remains uneven.

Institutional support to investors is weaker in MENA than in any other region. MENA countries still suffer from corruption, poor property rights and contract enforcement. Investment laws remain restrictive and the procedures for resolving disputes are deficient. Despite moves to privatize, the public sector still dominates the region's economies. Administration procedures are costly and burdensome, there is insufficient transparency and the judi-

cial system is slow. These weaknesses can only deter investment.

Tariffs and other import barriers are still high compared to other regions. On average, clearing an item through customs in MENA countries can take up to 30 steps and can require several weeks. Nevertheless, non-tariff-barriers remain the main problem faced by MENA economies, which in many cases are higher than those of export oriented economies in East Asia, Eastern Europe and Latin America. A new emphasis on exports and a de-emphasis of import substitution may encourage governments to re-examine their investment environment as a whole.

### Notes

- <sup>1</sup> This region includes: Bahrain, Iran, Iraq, Kuwait, Oman, Qatar, Saudi Arabia, UAE and Yemen.
- <sup>2</sup> Dani Rodrick, 2000.
- <sup>3</sup> Business cycles or fluctuations, defined as deviations of output (or a set of macroeconomic aggregates) from long-run trends, can be caused by various impulses and can be sustained in time through different propagation mechanisms.
- <sup>4</sup> Fadle El Naqeb, "The Palestinian Economy and Prospects of Regional Cooperation", UNCTAD, Geneva, July 1998.
- <sup>5</sup> The Palestinian Central Bureau of Statistics estimated direct daily losses for each day of Israeli imposed closure in the year 1996 at around \$6.1 million.
- <sup>6</sup> Before this outburst and according to the United Nations co-ordinator office, the per capita GDP was expected to rise to 2—3 percent and the amount of GDP for the year 2000 was to reach \$5,400 million.
- <sup>7</sup> About 1,265 thousand persons lost their source of income, representing 40.8 percent of the total Palestinian population of the West Bank and Gaza Strip.
- <sup>8</sup> There are often large differences between official rate and market rate. In the case of Syria, for instance, the market rate is approximately 50 Syrian pounds per US dollar and the official rate is approximately 15 Syrian pounds per US dollar.
- <sup>9</sup> The sudden devaluation of the Sudanese dinar during 1997-1998 is another example.
- <sup>10</sup> Large current account deficits are a classic outcome of exchange-rate-based stabilization policies that generate a real appreciation of the currency. Possible policies for limiting the current account deficit associated with exchange rate stabilization are: (i) a rise in consumption taxes on durables; (ii) to discourage credit booms; (iii) to tax short-term capital inflows (Rodrick, 2000).
- <sup>11</sup> By mid-January 2002 the Turkish lira had depreciated by more than 135 percent with respect to its 2001 value.

- <sup>12</sup> For all countries excluding Lebanon, Oman and UAE, the 1990-97 data are from the World Bank's Global Development Finance and World Development Indicators. For the 1997-99 period the data are based on the real effective exchange rate reported in the IFS of the IMF. In the case of Lebanon, Oman and UAE, the real exchange rate was computed using USD, DM and Euro and real exchange rates with a 50% weight assigned to each currency. The same method was used to compute real exchange rate for the 1997-99 period for Egypt, Jordan, Qatar, Syria and Turkey.
- <sup>13</sup> For over one year, the government has been attempting to reduce borrowing costs by replacing Lebanese pound debt with foreign currency denominated debt.
- <sup>14</sup> It should be said that Lebanese banks are better capitalized and positioned to face a crisis than Turkish banks.
- <sup>15</sup> In what follows, the term dollarization will be used to indicate that the country is adopting another country's currency, not necessarily the US dollar.
- <sup>16</sup> It should be pointed out that this incentive did not work in Argentina.
- <sup>17</sup> The index has been built by averaging the rankings of a variety of institutional aspects, the value of which is between zero and one, with one representing the strongest incentives and opportunities to coordinate and maintain budget discipline.

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## Annex

**Table A1.1: Income and Social Development Indicators**

	Population (mn)	ACGR* of Population (%)		GNP Per Capita		Inflation		HDI Rank	Life Expectancy at Birth	Adult Illiteracy (%)	Combined enrollment Ratio (%)
				\$	PPP (\$)	GDP Deflator (%)	CPI				
				1999	1999	1990-99	1999				
	1999	90-99	99-2015	1999	1999	1990-99	1999	1999	1999	1999	1999
Algeria	30.0	1.8	1.7	1,550	4,753	19.1	2.5	100	69.3	33.4	72
Bahrain	0.6	1.8	-	-	-	-	2.7	40	73.1	12.9	80
Comoros	0.4	0.0	-	350	1,360	-	-	124	59.4	40.8	36
Djibouti	0.6	1.8	-	790	-	-	2.0	137	51.5	37.4	45
Egypt	62.7	1.8	1.5	1,400	3,303	8.8	3.1	105	66.9	45.5	76
Iran	63.0	1.5	1.7	1,760	5,163	27.0	20.1	90	68.5	24.3	73
Iraq	22.8	2.3	2.0	976 <sup>b</sup>	-	-	135.0	-	59.01	45.0	49
Jordan	4.7	3.9	2.3	1,500	3,542	3.5	0.6	88	70.1	10.8	55
Kuwait	1.9	-1.0	2.5	18,205	-	-	3.0	43	76.0	18.1	59
Lebanon	4.3	1.8	1.2	3,700	4,129	24.0	1.0	65	72.9	14.6	78
Libya	5.4	2.1	2.0	5,859 <sup>b</sup>	-	-	18.0	59	70.3	20.9	92
Mauritania	2.6	2.7	2.2	360 <sup>b</sup>	-	6.1	4.1	139	51.1	58.4	41
Morocco	28.2	1.6	1.4	1,200	3,190	3.2	0.7	112	67.2	52.0	52
Oman	2.3	3.7	2.2	6,701 <sup>b</sup>	-	-2.9	0.4	71	70.8	29.7	58
Qatar	0.8	2.9	-	23,500 <sup>b</sup>	-	-	2.2	48	69.3	19.4	75
Saudi Arabia	20.2	2.5	2.9	6,874 <sup>b</sup>	-	1.2	-1.4	68	71.3	23.9	61
Somalia	9.4	0.9	-	-	-	-	-	-	46.93	76.02	7
Sudan	29.0	2.2	2.1	330	1,298	66.6	16.0	138	55.6	43.1	34
Syria	15.7	2.6	2.1	970	2,761	8.7	-0.5	97	70.9	26.4	63
Tunisia	9.5	1.5	1.2	2,100	5,478	4.6	2.7	89	69.9	30.1	74
Turkey	64.4	1.4	1.2	2,900	6,126	78.3	64.9	82	69.5	15.4	62
UAE	2.8	4.5	1.9	17,649 <sup>b</sup>	-	2.4	2.0	45	74.8	24.9	68
West Bank and Gaza	2.8	3.4	-	1,610	-	9.1	5.5	-	71.0	14.01	-
Yemen	17.0	3.6	2.8	370	1,755	26.1	-1.2	133	60.1	54.8	51
Comparator Countries:											
Israel	6.1	2.6	1.6	16,240 <sup>b</sup>	-	10.7	5.2	22	78.6	4.2	83
Malaysia	22.7	2.2	1.6	3,400	7,963	3.9	2.7	56	72.2	13.0	66
Mexico	96.6	1.5	1.3	4,440	7,719	19.5	16.6	51	72.4	8.9	71
Comparator Regions:											
Low & Middle- Income	5,081.6	1.4	1.2	1,240	3,410	-	-	-	-	-	-
East Asia & Pacific	1,836.6	1.1	0.8	1,000	3,500	-	-	-	69.2	14.7	71
L. America & Carib.	508.2	1.5	1.3	3,840	6,280	-	-	-	69.6	12.2	74
MENA	290.3	2.0	1.8	2,060	4,600	-	-	-	66.4 <sup>a</sup>	38.7 <sup>a</sup>	63 <sup>a</sup>
South Asia	1,329.3	1.7	1.4	440	2,030	-	-	-	62.5	44.9	53
Sub-Saharan Africa	642.8	2.4	1.9	500	1,450	-	-	-	48.8	40.4	42
World	5,978.0	1.3	1.1	4,890	6,490	-	-	-	66.7	-	65

\* ACGR: Annual Compound Growth Rate.

Sources: World Bank: World Development Indicators, 2001; World Development Report, 2001; IMF: World Economic Outlook, 2000; International Financial Statistics, 2000; UNCAD: Human Development Report, 2001; The Least Developed Countries 2000 Report.

Arab Fund: Unified Arab Economic Report, 2000; Economist Intelligence Unit: several country reports, 2001.

Notes: a: figures are for the Arab States only; b: figures are for Gross Domestic Product per capita. 1: figures for 1998; 2: figures for 1997; 3: figures for 1995-2000.

**Table A1.2: GDP, Growth and Structure**

	GDP 1999		Structure of GDP by Sector (%) 1999							Structure of GDP by Expenditure (%) 1999				
	Current Prices (\$ bn)	Av. Growth (%) 1990-99	Agriculture & Fishing Industry	Extractive	Manufacturing	Construction, Energy & Water	Trade & Tourism	Transport & Communication	Financial Services	Public Services	Private Consumption	Public Consumption	Total Investment	Domestic Saving
Algeria	47.9	-2.8	10.5	28.2	9.0	9.9	11.1	6.8	4.6	12.6	51.2	17.0	27.5	31.7
Bahrain	6.6	4.3	0.9	18.1	12.0	6.5	8.0	7.7	8.7	34.8	55.4	20.8	87.3	-
Comoros <sup>2</sup>	0.2	-	39.0	-	13.0 <sup>a</sup>	-	-	-	-	49.0	14.0	89.0	21.0	-
Djibouti	0.5	2.5	0.8	0.2	2.5	10.6	14.3	21.5	11.6	25.5	63.5	31.9	22.2	-
Egypt	89.0	10.8	16.3	4.2	18.3	7.0	1.2	8.7	20.9	17.0	74.2	10.1	24.1	14.4
Iran	138.9	1.6	21.0	-	31.0 <sup>a</sup>	-	-	-	-	48.0	64.0	14.0	18.0	22.9
Iraq	81.9	1.0	32.7	4.7	7.7	3.8	23.8	11.1	7.0	19.8	19.2	61.9	16.7	-
Jordan	7.5	7.2	2.1	3.4	11.8	6.1	9.8	14.6	16.2	21.2	70.7	26.6	22.5	2.6
Kuwait	29.7	5.5	0.4	37.1	12.2	0.0	7.2	5.6	9.3	25.2	50.1	27.3	12.6	22.3
Lebanon	16.5	21.8	7.8	0.0	9.1	10.2	28.8	3.1	6.2	34.9	78.3	30.8	29.1	-12.8
Libya	31.1	-0.6	10.8	24.3	6.6	7.0	13.8	8.9	3.3	25.2	67.0	15.9	18.6	-
Mauritania	0.9	-2.2	22.4	12.0	8.8	5.4	17.5	7.2	5.4	10.4	79.4	12.5	14.4	7.2
Morocco	35.1	3.5	11.5	2.0	17.7	13.3	20.1	5.6	0.0	29.9	66.0	18.8	23.6	20.1
Oman	15.6	3.2	2.6	38.9	4.3	3.8	13.5	7.4	1.3	26.9	48.4	23.8	15.8	-
Qatar	12.2	5.7	0.6	45.0	7.3	6.4	7.2	4.4	10.4	18.0	21.4	26.6	21.4	-
Saudi Arabia	139.2	3.2	6.6	31.3	9.6	9.5	7.2	6.6	4.2	23.2	38.9	29.8	20.3	31.3
Sudan	11.6	-7.1	37.4	1.0	7.4	1.0	7.1	24.0	6.1	16.1	85.7	4.7	16.7	-
Syria	16.8	2.1	24.0	14.6	11.4	4.3	18.6	12.7	4.3	10.2	69.5	11.4	18.8	18.2
Tunisia	20.8	5.7	12.9	3.4	18.2	6.5	14.9	8.0	3.7	19.5	59.4	15.6	27.8	24.4
Turkey	185.7	2.3	16.0	-	24.0 <sup>a</sup>	-	-	-	-	60.0	65.0	15.0	23.0	19.6
UAE	52.1	5.0	3.4	25.8	12.5	10.6	13.2	7.2	4.1	22.6	49.7	18.4	28.8	0.0
West Bank & Gaza	4.8	-	6.9 <sup>1</sup>	-	16.8 <sup>1</sup>	10.6 <sup>1</sup>	-	-	-	58.1 <sup>1</sup>	18.8 <sup>1</sup>	97.7 <sup>1</sup>	26.8 <sup>1</sup>	-18.7
Yemen	6.8	-2.8	16.1	31.4	10.4	4.5	8.0	10.9	0.3	15.9	72.4	14.8	20.9	11.8
Comparator Countries														
Israel	100.8	7.5	3.9	-	36.6 <sup>a</sup>	-	-	-	-	59.5	60.0	29.0	21.0	11.4
Malaysia	79.0	6.7	11.0	-	46.0 <sup>a</sup>	-	-	-	-	43.0	42.0	11.0	22.0	47.3
Mexico	483.7	7.0	5.0	-	28.0 <sup>a</sup>	-	-	-	-	67.0	68.0	10.0	23.0	21.9
Comparator Regions														
Low & Middle-Income	6,551.5	4.5	12.0	-	35.0 <sup>a</sup>	-	-	-	-	53.0	61.0	14.0	23.0	25.0
East Asia & Pacific	1,894.9	8.3	14.0	-	45.0 <sup>a</sup>	-	-	-	-	41.0	53.0	11.0	30.0	36.0
L. America & Carib.	2,052.7	6.8	8.0	-	30.0 <sup>a</sup>	-	-	-	-	62.0	66.0	15.0	20.0	19.0
MENA	613.7	4.8	14.0	-	38.0 <sup>a</sup>	-	-	-	-	48.0	56.0	20.0	22.0	24.0
South Asia	581.2	4.1	27.0	-	26.0 <sup>a</sup>	-	-	-	-	47.0	70.0	11.0	22.0	18.0
Sub-Saharan Africa	324.1	1.0	15.0	-	29.0 <sup>a</sup>	-	-	-	-	16.0	68.0	17.0	18.0	15.0
World	30,876.2	4.0	5.0	-	31.0 <sup>a</sup>	-	-	-	-	63.0	62.0	15.0	23.0	25.0

Sources: World Bank: World Development Indicators, 2001; World Development Report, 2001.

IMF: World Economic Outlook, 2000; International Financial Statistics, 2000.

UNCAD: Human Development Report, 2001; The Least Developed Countries 2000 Report.

Arab Fund: Unified Arab Economic Report, 2000.

Economist Intelligence Unit: Several country reports, 2001.

Notes: a: whole industrial sector including mining, manufacturing, construction, electricity, gas and water supply. 1: figures for 1998; 2: figures for 1997.

**Table A1.3: Fiscal and External Balances**

	Fiscal Balance Deficit/Surplus (% GDP)	External Debt		Balance of Payment			Net Private Capital Flows (\$ mn)	Official Development Assistance (% GNP)
		(\$ mn)	NPV <sup>a</sup> (% GNP)	Trade Balance <sup>b</sup> (\$ mn)	CA Balance <sup>c</sup> (\$ mn)	Overall Balance (\$ mn)		
		1999	1998	1999	1999	1999		
Algeria	-0.5	37,597	66.0	3,360	20	-2,420	-1,321	0.9
Bahrain	-2.1	na	-	719	-421	26	-	-
Comoros		201 <sup>1</sup>	-	-	-	-	-	-
Djibouti	-1.3	280 <sup>1</sup>	-	-195	-17	-7	-	-
Egypt	-4.2	28,761	29.0	-9,928	-1,482	-4,027	1,385	2.3
Iran	-5.7	10,357 <sup>1</sup>	12.0	300	-1,897	-1,5691	588	0.1
Jordan	-4.2	7,315	110.0	-1,460	405	926	207	5.7
Kuwait	-13.8	na	-	5,568	5,059	925	-	0.0
Lebanon	-14.4	5,410	41.0	-5,083	-3,462	266	1,740	1.5
Libya	0.0	..	-	2,062	800	753	-	-
Mauritania	2.5	1,533	148	23	10.4	-43	3	17.8
Morocco	-2.5	17,548	54.0	-2,555	-269	1,639	965	1.5
Oman	-7.8	3,106	-	2,416	-182	-172	-	-
Qatar	-1.1	na	-	4,962	2,171	2,458	-	-
Saudi Arabia	-7.0	na	-	22,639	-1,701	-8,897	-	0.0
Sudan	-0.7	16,918	-	-476	-465	115	-	-
Syria	-4.2	18,334	136.0	216	201	259	76	1.0
Tunisia	-1.9	11,652	54.0	-2,145	-436	693	694	0.8
Turkey	-8.4 <sup>1</sup>	101,796 <sup>1</sup>	49.0	-14,376	-1,364	-	1,641	0.0
UAE	-13.4	na	-	6,335	1,749	1,531	-	-
West Bank and Gaza	6.2	607	-	-	2,864	-	-	-
Yemen	-0.1	5,137	56.0	26	104	320	-210	5.5
Comparator Countries								
Israel	-2.2	-	-	-7,366	-1,881	318	-	-
Malaysia	2.9 <sup>1</sup>	45.9	69.0	-64,286	12,606	4,712	-	0.9
Mexico	-1.4 <sup>1</sup>	167.0	39.0	-285,444	-14,166	4,278	23,188	0.0
Comparator Regions								
Low & Middle- Income	-3.1 <sup>1</sup>	2,563.6	-	38,895	-	-	267,700	0.7
East Asia & Pacific	-3.0 <sup>1</sup>	674.7	-	108,578	-	-	67,249	0.5
L. America & Carib.	-4.2 <sup>1</sup>	813.4	-	-34,361	-	-	126,854	0.2
MENA	-	208.5	-	9,570	-	-	9,223	0.9
South Asia	-5.1 <sup>1</sup>	164.6	-	-15,238	-	-	7,581	0.9
Sub-Saharan Africa	-	216.4	-	-7,586	-	-	3,452	4.1
World	-1.5 <sup>1</sup>	-	-	175,177	-	-	-	0.6

Notes: na: not applicable; a. NPV: net present value; b. CA: current account; CA balance excludes official transfers; c: trade balance includes merchandise trade only.

1: figures for 1998.

Sources: World Bank: World Development Indicators, 2001; World Development Report, 2001.

IMF: World Economic Outlook, 2000; International Financial Statistics, 2000; Balance of Payments Statistics; Arab Fund: Unified Arab Economic Report, 2000.

Economist Intelligence Unit: Several country reports, 2001.

**Table A1.4: Exchange Rate Arrangements in the MENA Region**

	Market Versus Official	Multiple Exchange Rates	Type of Exchange Rate (IMF)	Fixed to	Type of Exchange Rate (de facto from LYS)		
					1997	1998	1999
Algeria	Official	NO	Managed float		NA	NA	Float
Bahrain	Official	NO	Fixed	USD	Fixed	Fixed	Fixed
Comoros	Official	NO	Fixed	EURO	Inconclusive	Fixed	Fixed
Djibouti	Official	NO	Super Fixed (Currency Board)	USD	Inconclusive	Inconclusive	Inconclusive
Egypt	Market/Official	NO	Fixed until mid-2000, managed float from mid 2000 to January 2001, managed peg from January 2001	USD	Inconclusive	Inconclusive	Inconclusive
Iran	Official	YES	Fixed	NA	Inconclusive	Inconclusive	Inconclusive
Iraq	Official	YES	Fixed	NA	NA	NA	NA
Jordan	Official	NO	Fixed	USD	Inconclusive	Inconclusive	Inconclusive
Kuwait	Official	NO	Fixed	Basket of currencies	NA	NA	NA
Lebanon	Market	NO	Fixed	USD	Fixed	Fixed	Fixed
Libya	Official	NO	Peg with band	SDR	Fixed	Float	Float
Mauritania	Official	NO	Managed float		Dirty Float	Float	NA
Morocco	Official	NO	Fixed	Basket of currencies	Float	Float	Float
Oman	Official	NO	Fixed	USD	Fixed	Fixed	Fixed
Qatar	Official	NO	Fixed	USD	Fixed	Fixed	Fixed
Saudi Arabia	Official	NO	Fixed	USD	Fixed	Fixed	Inconclusive
Sudan	Market	NO	Managed float		Crawling Peg	Dirty Float	Float
Syria	Official	YES	Fixed	NA	Inconclusive	Inconclusive	Inconclusive
Tunisia	Market	NO	Monetary targeting		Float	Float	Crawling Peg
Turkey	Market	NO	Crawling peg until February 2001, then floating	USD and EURO	Float	Float	Fixed
UAE	Official	NO		USD/SDR	Inconclusive	UAE	Official
Yemen	Market	NO	Fixed Floating		Dirty Float	Float	Inconclusive

Source: IMF International Financial Statistics and Levy Yeyati and Sturzenegger (2000). No information available for Somalia and West Bank and Gaza. Inconclusive means that Levy Yeyati and Sturzenegger were not able to classify these countries.

Notes: The first five columns of the table were built using information from the International Financial Statistics of the IMF and report the various countries' official exchange rate arrangements as of January 2001. The last three columns report the countries' de facto exchange rate arrangements derived by Levy Yeyati and Sturzenegger: "Classifying Exchange Rate Regimes: Deeds vs Words," mimeo, Universidad Torquato di Tella, Buenos Aires.

**Table A1.5: Summary Debt Data for the Middle East and North Africa**  
(\$ billion)

	1990	1995	1997	1998	1999	2000
TOTAL DEBT STOCKS (EDT)	183.8	216.0	216.5	217.0	208.5	203.6
Long-term debt (LDOD)	137.6	165.1	166.5	173.4	155.0	151.6
Public and publicly guaranteed	136.1	161.8	157.4	167.5	151.1	146.8
Official creditors	81.0	117.7	113.2	117.0	105.0	99.5
Private creditors	55.1	44.1	44.1	50.5	46.1	47.3
Private nonguaranteed	1.5	2.3	9.1	5.9	3.9	4.8
Use of IMF credit	1.8	2.2	2.9	3.0	2.9	2.5
Short-term debt	44.4	48.8	47.1	40.6	50.6	49.4
<b>NET RESOURCE FLOWS</b>	<b>10.1</b>	<b>2.4</b>	<b>17.4</b>	<b>14.5</b>	<b>2.5</b>	<b>9.3</b>
Net flow of long-term debt	(0.7)	(0.6)	10.5	2.8	(3.0)	0.5
Public and publicly guaranteed	(0.7)	(1.6)	4.9	1.6	(2.2)	(0.1)
Official creditors	1.4	(2.2)	0.7	(1.9)	(1.9)	(1.9)
Private creditors	(2.1)	0.6	4.2	3.5	(0.3)	1.8
Private nonguaranteed	0.0	1.0	5.7	1.2	(0.8)	0.7
Foreign direct investment (net)	2.5	(0.3)	2.6	6.6	1.5	4.5
Portfolio equity flows	0.0	0.2	1.5	0.9	0.7	0.9
Grants	8.3	3.2	2.8	4.2	3.3	3.4
<b>NET TRANSFERS</b>	<b>3.6</b>	<b>(5.6)</b>	<b>9.1</b>	<b>5.8</b>	<b>(6.3)</b>	<b>(0.2)</b>
Interest on long-term debt	5.2	6.8	7.0	7.2	7.2	7.2
Profit remittances on FDI	1.3	1.3	1.4	1.5	1.6	2.3
<b>NET TRANSFERS ON L-T DEBT</b>	<b>(6.0)</b>	<b>(7.4)</b>	<b>(10.1)</b>	<b>(4.4)</b>	<b>(10.2)</b>	-
Public and publicly guaranteed	(5.7)	(8.2)	(10.8)	(5.3)	(9.2)	-
Official creditors	(1.0)	(6.1)	(8.4)	(6.3)	(6.2)	-
Private creditors	(4.7)	(2.1)	(2.4)	1.0	(3.0)	-
Private nonguaranteed	(0.1)	0.9	0.7	1.0	(1.0)	-
Debt indicators						
<b>Debt/GNP (%)</b>	45.7	37.3	29.4	37.7	34.9	31.2
<b>Debt/Exports of G&amp;S (%)</b>	112.5	133.4	114.6	134.6	111.5	93.8
<b>Debt service/Exports of G&amp;S (%)</b>	14.9	15.0	10.5	14.5	13.7	10.9
<b>Interest/Exports of G&amp;S (%)</b>	5.3	6.0	5.1	5.9	5.1	4.7
<b>Short-term/Total debt (%)</b>	11.5	22.6	21.8	18.7	24.3	24.3
<b>Concessional/Total debt (%)</b>	24.2	26.0	27.1	27.5	28.2	29.3

Source: Global Development Finance, World Bank, 2001.

**Table A1.6: Debt Data for Selected MENA Countries, 1999**  
(\$ billion)

	Algeria	Egypt	Jordan	Lebanon	Morocco	Oman	Syria	Tunisia	Yemen
TOTAL DEBT STOCKS	28,015	30,404	8,947	8,441	19,060	3,603	22,369	11,872	4,610
Public and publicly guaranteed	25,913	25,998	7,546	5,568	17,284	1,768	16,142	9,487	3,729
Private nonguaranteed debt	0	112	28	671	1,593	0	0	772	0
Use of IMF credit	1,906	0	498	0	0	0	0	76	409
Short-term debt	195	4,294	875	2,202	183	1,835	6,227	1,538	473
NET RESOURCE FLOWS	-1,797	1,814	501	1,965	-26	-390	55	968	297
Net flow of long-term debt	-1,855	-564	97	1,630	-438	-475	-93	510	148
Net foreign direct investment	7	1,065	158	250	3	60	91	350	-8
Portfolio equity flows	3	550	11	3	91	11	0	0	0
Grants	48	763	234	82	317	14	57	108	157
NET TRANSFERS	-3,710	-1,401	90	1,320	-1,403	-173	-362	374	400
DEBT INDICATORS									
Debt/Exports of G&S (%)	199	158	163	...	150	49	385	123	118
Debt/GNP (%)	61	34	113	51	56	...	149	59	75
Debt service/Exports of G&S (%)	38	9	12	...	24	10	6	16	4
Interest/Exports of G&S (%)	13	5	6	...	9	2	4	6	2
Short-term debt/Total debt (%)	1	14	10	26	1	51	28	13	10
Concessional/Total debt (%)	12	74	45	7	32	16	67	22	74
Memo:									
Gross National Product (GNP)	45,739	90,144	7,918	16,486	34,024	...	15,019	20,040	6,171

Source: *Global Development Finance, World Bank, 2001.*

**Table A1.7: Fiscal Position of MENA Budgets**

(\$ billion)

	Revenues			Expenditures			Deficit or Surplus (% of GDP)		
	1997	1998	1999	1997	1998	1999	1997	1998	1999
Arab Countries	171,797	146,228	147,789	184,043	177,357	178,787	-12,246	-31,129	-30,999
							(-2.32)	(-6.13)	(-5.74)
Algeria	16,057	13,186	14,277	14,912	15,027	14,525	1,145	-1,841	-248
							(2.39)	(-3.89)	(-0.52)
Bahrain	1,809	1,474	1,770	2,142	1,784	1,909	-333	-310	-139
							(-5.24)	(-5.01)	(-2.09)
Djibouti	156	155	169	178	162	175	-22	-6	-7
							(-4.35)	(-1.18)	(-1.25)
Egypt	19,033	20,071	21,553	19,720	20,897	25,296	-687	-826	-3,743
							(-0.91)	(-1.00)	(-4.19)
Jordan	2,284	2,396	2,516	2,503	2,898	2,831	-219	-501	-315
							(-3.13)	(-6.86)	(-4.22)
Kuwait	14,584	11,837	9,197	12,915	13,051	13,281	1,669	-1,214	-4,084
							(5.56)	(-4.79)	(-13.76)
Lebanon	2,438	2,935	3,228	6,320	5,215	5,607	-3,882	-2,281	-2,379
							(-26.11)	(-14.11)	(-14.43)
Libya	14,097	13,837	10,653	14,097	13,827	10,653	0	0	0
							(0.00)	(0.00)	(0.00)
Mauritania	303	290	261	247	250	238	56	41	23
							(5.22)	(4.14)	(2.45)
Morocco	8,601	8,736	10,347	9,616	9,359	11,223	-1,015	-623	-876
							(-3.04)	(-1.75)	(-2.49)
Oman	5,896	4,801	4,674	6,001	5,778	5,885	-104	-977	-1,211
							(-0.66)	(-6.90)	(-7.75)
Qatar	4,050	4,181	3,873	4,972	4,678	4,009	-922	-497	-136
							(-8.16)	(-4.84)	(-1.11)
Saudi Arabia	54,873	37,762	39,321	59,085	50,682	49,024	-4,211	-12,920	-9,703
							(-2.87)	(-10.06)	(-6.97)
Sudan	689	822	856	826	880	939	-138	-58	-83
							(-1.30)	(-0.46)	(-0.71)
Syria	4,150	4,120	4,157	4,704	4,816	4,860	-555	-696	-703
							(-3.34)	(-4.34)	(-4.18)
Tunisia	5,500	6,328	6,130	6,225	6,419	6,525	-726	-91	-395
							(-3.83)	(-0.45)	(-1.88)
UAE	15,307	11,630	12,609	17,540	19,461	19,608	-2,233	-7,830	-6,999
							(-4.43)	(-16.53)	(-13.42)
Yemen	1,970	1,676	2,196	2,040	2,175	2,199	-70	-499	-3
							(-1.05)	(-8.33)	(-0.05)

Source: Unified Arab Economic Report, 2000.