2. MENAP Oil Importers: Slow Recovery and Modest Prospects Call for Reform

Continued sociopolitical and security tensions, high public debt, and deep-rooted structural impediments continue to dampen the economic impetus provided by improvements in the external environment and progress in domestic political transitions—leaving growth expectations, broadly unchanged from the May 2014 Regional Economic Outlook *(REO) Update, at 3 percent in 2014 and rising to 4 percent in 2015. Intensifying regional conflicts and rising geopolitical tensions augment downside risks. Progress is being made in clawing back inefficient generalized subsidies and rechanneling them to support growth through better-targeted social safety nets for the poor and growth-generating investment. Nevertheless, continued fiscal consolidation is needed to put public debt on a sustainable path and increase buffers for dealing with adverse shocks. Greater exchange rate flexibility, in some cases, would support the recovery and improve competitiveness. Beyond the near term, improved security and deep structural reforms—especially in education, the business environment, and labor market efficiency, supported by continued stabilization efforts and stepped-up international assistance—are needed to raise the region's potential growth rates, create much-needed jobs, and improve living standards and inclusiveness.*

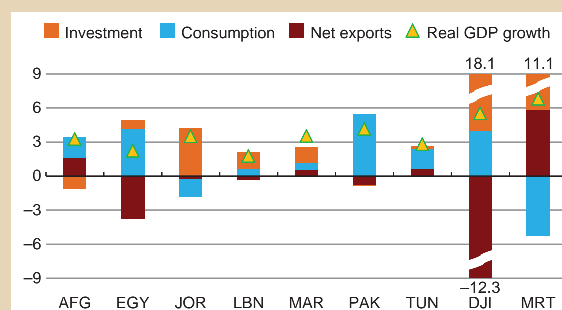
Fragile Confidence Constrains Recovery

Recently advanced political transitions are supporting a modest recovery but are overshadowed by regional conflicts. Since the Arab Spring, some countries have established new constitutions, and several have held elections. Many, though not all, governments now have the multiyear horizons needed to enact reforms for economic growth and jobs—albeit with gradual implementation, given the challenges of building strong public consensus and maintaining political stability. However, the conflict in Syria continues to take a large humanitarian toll and disrupts economic activity. It is also contributing to a political impasse in Lebanon, where the president's office has been vacant since May. More broadly, intense conflicts in the region threaten wider destabilization. Security concerns fueled by these conflicts, and social unrest on the back of still-high unemployment, social inequities (Annex IV), and limited social safety nets (Box 2.1) undermine the nascent stability the political transitions have achieved.

Figure 2.1

Consumption and Investment Drive Contributions to Real GDP Growth

(Percent, 2014)



Sources: National authorities; and IMF staff calculations.

Weak confidence weighs on domestic demand (Figure 2.1). Private investment is deterred by regional, sociopolitical, and security uncertainties. Conflicts in Syria, Iraq, and Gaza weigh on confidence in Lebanon and Jordan, where large inflows of refugees strain already limited resources (May 2014 REO Update). These uncertainties are compounded by structural and institutional weaknesses, credit risks stemming from high nonperforming loans (NPLs), high public debt, and largely unresolved structural problems, including electricity supply disruptions in Djibouti, Egypt,

Prepared by Pritha Mitra, with research assistance by Gohar Abajyan.

Box 2.1

Better Protection for the Poor in MENA

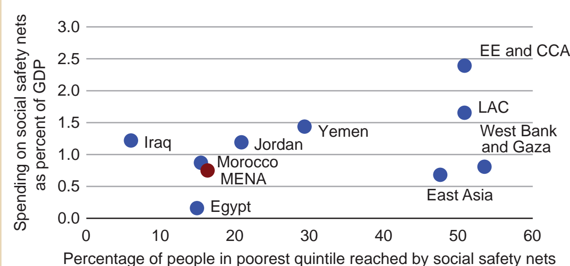
In MENA, efficiency and cost concerns over the use of generalized subsidies as a social protection tool are highlighting the urgent need to establish sustainable targeted social safety net programs that deliver for the poor and vulnerable.

Targeted social safety nets (SSNs) can reduce poverty and support inclusive growth. SSNs include cash, near-cash (for example, food stamps), and in-kind transfers (for example, food). Well-designed programs reduce poverty by providing reliable support to poor and vulnerable households. They can also help achieve social objectives when conditioned on recipients' actions (for example, children's school attendance) and can be easily scaled up during crises. Mexico expanded its temporary employment program by 900,000 people in four years in response to natural disasters.

MENA countries devote a relatively small share of their government budgets to targeted SSNs. They spend less and have lower coverage of the poor than most emerging market and developing countries (Figure 2.1.1). MENA spends on average 0.7 percent of GDP on SSNs, compared with an average of 1.6 percent of GDP in developing and emerging countries. Several MENA countries spend more on subsidies than on all other social services.

Figure 2.1.1

Social Safety Net Coverage and Cost in MENA and Other Regions



Source: Silva, Levin, and Morgandi (2012).
Note: EE = emerging Europe; LAC = Latin America and the Caribbean.

Existing SSN systems in MENA are generally not effective in reducing poverty:

- SSNs are fragmented, with a large number of small programs, each with its own targeting mechanism.
- Limited administrative capacity undermines the effectiveness of many programs and facilitates waste and corruption.
- Targeting mechanisms are mostly categorical (for example, based on geographical location), resulting in leakages and exclusion of deserving beneficiaries. Means testing (for example, in Lebanon and West Bank and Gaza) is the exception, not the rule.
- Existing programs provide limited opportunities for graduation of beneficiaries, promoting a dependency culture and limiting incentives to work.

Steps toward better systems—cross-country experiences point to two priorities for improving SSNs in MENA:

- SSNs should be better funded, drawing partly (as for other social spending) on savings generated from subsidy reform; for example, Jordan created a cash transfer program when it reduced subsidies.
- Greater effectiveness can be achieved by consolidating programs (for example, Brazil consolidated several programs into the *Bolsa Familia*); improving coverage, targeting mechanisms, administrative capacity, and service delivery (for example, payments through cash cards in Brazil, cell phones in Kenya, and biometric cards in South Africa); developing unified beneficiary registries (as in Brazil, Lebanon, and the Philippines); and establishing monitoring and evaluation mechanisms (Behrendt and Hagemejer 2009; Gentilini, Honorati, and Yemtsov 2014; Grosh and others 2008).

Prepared by Gaëlle Pierre and Carlo Sdralevich.

Box 2.1 (*concluded*)

Specific steps to improve SSNs will depend on existing systems and country priorities (Table 2.1.1). In particular, a country's income level and government objectives define the scope of its SSN systems. Support from the World Bank and other international financial institutions can play a crucial role in reaching these goals.

Table 2.1.1. Next Steps

Initial conditions →	*A few fragmented programs or no programs (e.g., Egypt, Mauritania)*	*Developed but underperforming targeted social safety nets (e.g., Jordan, Tunisia)*	*Promising flagship programs or pilots (e.g., Morocco, West Bank and Gaza, Yemen)*	*Well-developed social safety net system (e.g., Armenia, Georgia)*
Priority ↓	• Develop a safety net strategy/identify main goals of SSNs • Start with small-scale/pilot programs targeted at a subset of the poor • Use simple targeting systems focused on needs and transparent selection of beneficiaries • Start setting up infrastructure for implementing SSN programs (e.g., an implementing agency) or leverage already existing infrastructure	• Continue or start developing a safety net strategy • Carry out or continue an inventory of programs to identify overlaps and redundancy • Fine-tune existing programs to improve effectiveness • Scale up effective programs, drop redundant programs • Seek to adopt relevant international best practices (e.g., beneficiaries' registries)	• Strengthen safety net strategy • Continue developing unified registries for flagship programs • Continue developing infrastructure to monitor program performance • Link registries to improve targeting and eliminate overlaps	• Monitor program performance • Converge to international best practices, further improve coverage, control abuse and error, and improve "graduation" procedures • Strengthen evaluation of program performance

Sources: Grosh and others (2008); Silva, Lenin, and Morgandi (2012); and Isik-Dikmelic (2012).

Lebanon, and Pakistan. Despite the drag from fiscal consolidation, domestic demand is sustained by increased public investment spending, partly financed by donors. Large public sector wage bills and remittance inflows from the GCC and Europe help support consumption amid high unemployment.

The gradual global recovery, coupled with initial progress in structural reforms, supports a modest pick-up in external activity. Slowly reviving internal demand in Europe and solid GCC activity—the region's two major trading partners—are sustaining a measured but steady recovery of exports and foreign direct investment (FDI) (Figure 2.2), as well as tourism. In Morocco, structural reforms have also brought substantial FDI and export production in high-value-added industries such as cars and aeronautics. Likewise, in Pakistan, initial electricity supply improvements have

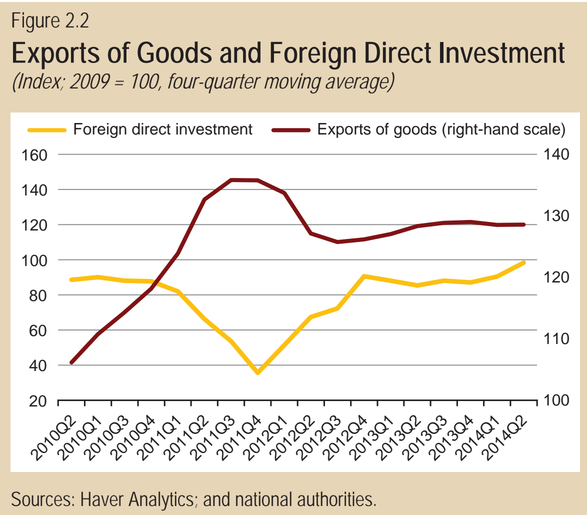


Figure 2.2
Exports of Goods and Foreign Direct Investment
(Index; 2009 = 100, four-quarter moving average)

Sources: Haver Analytics; and national authorities.

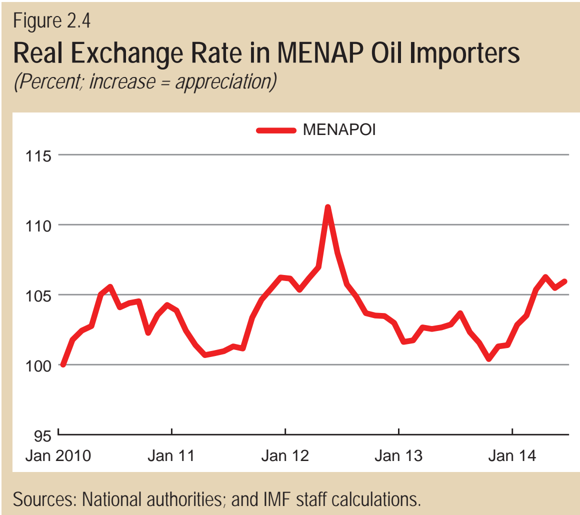


Figure 2.4
Real Exchange Rate in MENAP Oil Importers
(Percent; increase = appreciation)

Sources: National authorities; and IMF staff calculations.

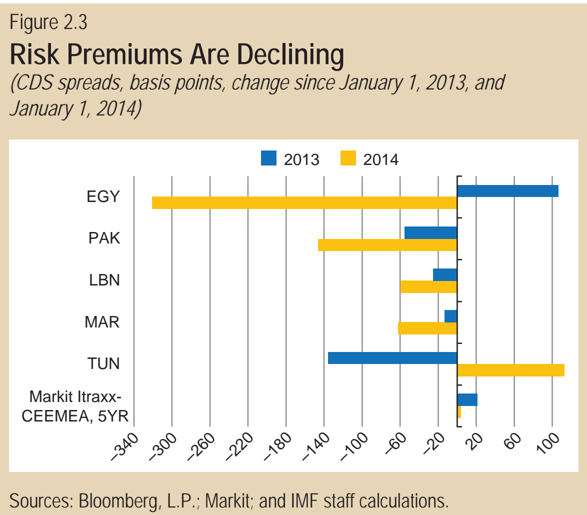


Figure 2.3
Risk Premiums Are Declining
(CDS spreads, basis points, change since January 1, 2013, and January 1, 2014)

Sources: Bloomberg, L.P.; Markit; and IMF staff calculations.

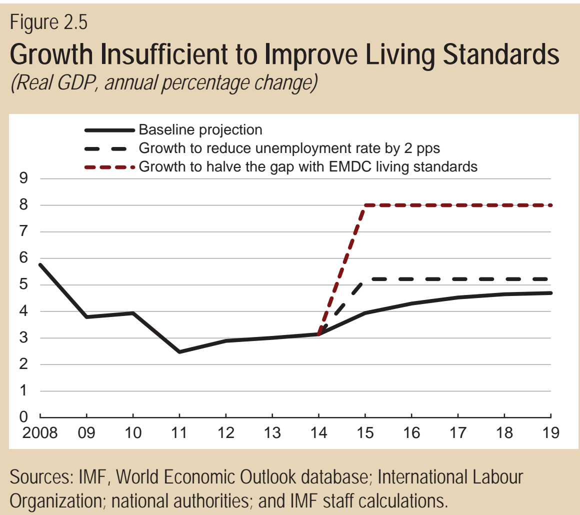


Figure 2.5
Growth Insufficient to Improve Living Standards
(Real GDP, annual percentage change)

Sources: IMF, World Economic Outlook database; International Labour Organization; national authorities; and IMF staff calculations.

helped manufacturers respond to increased export demand. Manufacturing activity and FDI also show signs of recovery in Egypt. Strengthened mining and agricultural capacity has buoyed confidence and growth in Mauritania, as have large-scale infrastructure investment and strong port activity in Djibouti. Thanks to these improvements, stock markets are strengthening and risk premiums are declining (Figure 2.3); Pakistan made its first international bond issue in seven years. Nonetheless, serious security incidents are still keeping tourism away from Egypt, Lebanon, and Tunisia, and hampering Egyptian gas exports. Large import bills, reflecting still-high levels of global food and energy prices and, also, real exchange rate appreciation (Figure 2.4), partly offset gains from higher exports.

Over the near term, growth will remain modest. Real GDP growth is forecast to remain at about 3 percent in 2014 and rise to 4 percent in 2015. A strengthening global recovery, especially in Europe, and initial structural reforms lowering production costs should continue to support export growth. Further increases in public spending on infrastructure, health care, and education will complement these reforms and bolster emerging confidence, nurturing private investment activity and jobs (Box 2.2). However, absent deeper and sustained structural reforms, these improvements will be insufficient to make a dent in the region's persistently high unemployment and raise living standards. In fact, sustained growth of about 8 percent would be needed over the medium term to halve the gap in living standards between MENAP oil importers and other emerging market and developing countries (Figure 2.5; Annex IV). On these

Box 2.2

Impact of Fiscal Measures on Jobs in MENAP Oil-Importing Economies

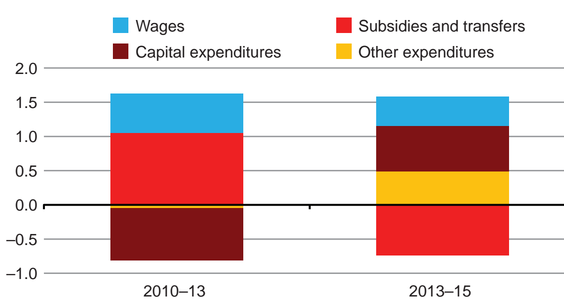
Four years after the Arab Spring, MENAP oil-importing economies are struggling to create jobs amid weak economic recovery while consolidating their fiscal positions to put debt on a sustainable path. In the near term, consolidation reduces domestic demand and thus negatively affects output and jobs. Recent work finds that during extended periods of weak growth, consolidation can prolong unemployment, resulting in skills depreciation and prompting discouraged workers to leave the labor force.[1] How can MENAP oil importers design fiscal consolidation programs to minimize the adverse impact on jobs?

Reallocation of spending from inefficient generalized energy subsidies toward growth-creating spending on infrastructure, health care, and education can mitigate adverse effects of fiscal consolidation on jobs.[2,3] Many MENAP oil importers are pursuing consolidation programs that reduce subsidy spending (Figure 2.2.1). Such programs may reduce job creation by lowering consumption and domestic demand over the near term. Yet, in Egypt, Jordan, Pakistan, and Tunisia, they have created room in the budget for increased investment in energy-efficient technologies, infrastructure, education, and health care, all of which support job creation. Such spending also improves the business environment and enhances workers' skills, leading to higher productivity and providing a further boost to job creation.

Figure 2.2.1

Change in Revenue and Expenditure[1]

(Percent of GDP)



Sources: National authorities; and IMF staff calculations.
[1]Excludes Syria.

Revenue measures, such as raising property, corporate, and personal income taxes for high-income segments of the population, and the elimination of certain tax exemptions, have little impact on jobs in the near term. This is especially true in the MENAP oil importers, where these taxes are generally low compared to other emerging and developing economies (Figure 2.2.2). Furthermore, tax reforms can create a more equitable tax environment, improve incentives for doing business, and encourage legitimization of informal businesses, causing business expansion and creation of jobs. Reducing labor tax wedges can also raise employment, but this measure tends to be less effective when informality is high, as is the case in the MENAP oil importers (October 2014 *Fiscal Monitor*).

Prepared by Pritha Mitra.

[1] The result is reduced potential growth and lower job creation over the medium term (October 2014 *Fiscal Monitor* and Dell'Erba, Koloskova, and Poplawski-Ribeiro forthcoming). These effects can be partly offset by the positive impact of fiscal consolidation on growth through lower risk premiums and greater bank financing available to firms (in cases where public debt was largely financed by domestic banks).

[2] Baunsgaard and others (2012) review the literature on advanced economies. Several studies on emerging Europe find government spending measures to have a larger medium-term impact on growth than revenue measures (Haug, Jedrzejowicz, and Aznajderska 2013; Mitra and Pogoshyan forthcoming; Šimović and Deskar-Škrbić 2013).

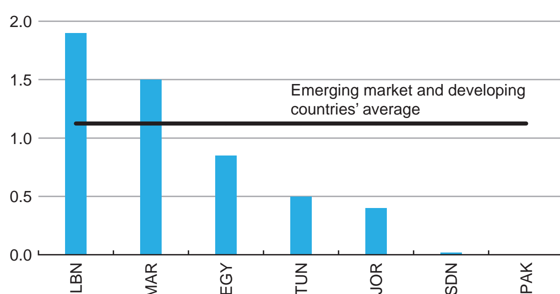
[3] In general, fiscal adjustment based on revenue mobilization efforts may be preferable to spending cuts in emerging and developing economies (October 2014 *Fiscal Monitor*)—especially when spending rigidities and low levels of public outlays imply that cuts fall disproportionally on capital and other productive public spending. However, this point is less applicable to the case of MENAP oil importers because these countries currently tend to consolidate their budgets by cutting spending on inefficient generalized subsidies.

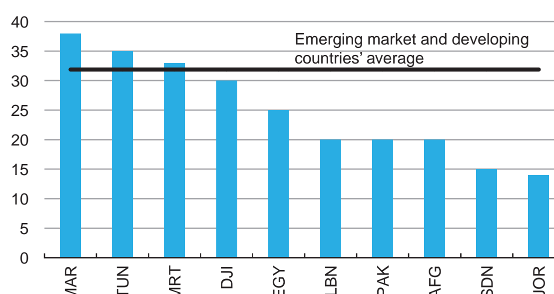
Box 2.2 (*concluded*)

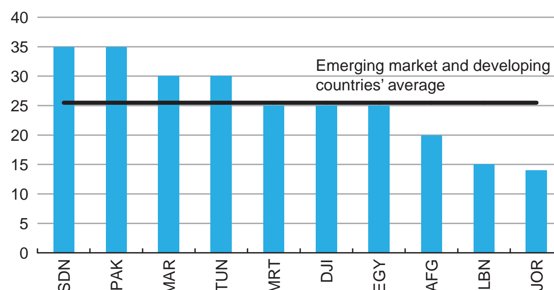
Fiscal savings can also be used to support labor market reforms, which aim to improve job placement services and reduce skills mismatches (Annex I). For example, in the MENAP oil importers, some savings from energy subsidy reforms can finance job placement services, including centralized computer matching services and apprenticeships. The mismatch between employees' skills and employers' needs, especially in vocational, language, computer, and management skills, can be addressed through targeted training programs. Governments can collaborate with the private sector in the design and financing of these programs. More broadly, public-private consultations can better align the design of tertiary and vocational education with employers' needs.

Figure 2.2.2

Property, Personal, and Income Taxes in MENAP Oil Importers





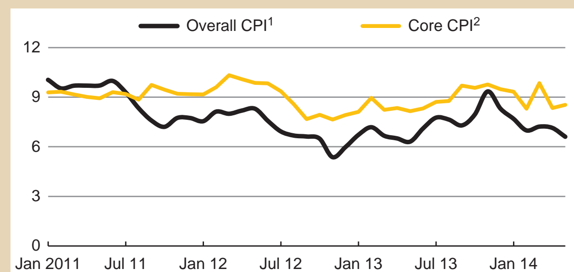


Sources: National authorities; KPMG; Deloitte; and IMF staff calculations.

indicators, which can be part of the explanation for social unrest, the MENAP oil importers fare poorly in comparison with other emerging and developing regions.

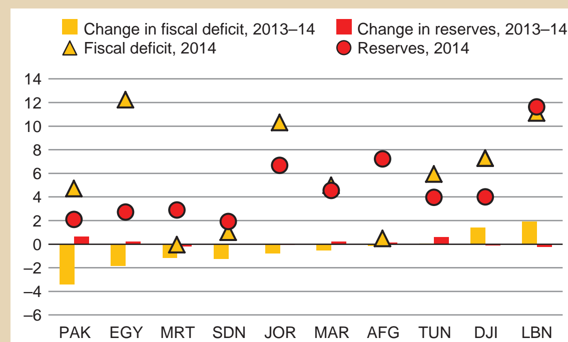
Inflation has stabilized, though at elevated levels. Over the past three years, declining global food and energy prices, weak economic activity, growth below potential, and, in some cases, monetary tightening, have reduced inflation pressures (Figure 2.6). Nevertheless, reduced energy subsidies, higher spending on public sector wages, monetization of fiscal deficits, and, in some cases, accommodative monetary policies and exchange

Figure 2.6
Inflation Pressures Persist
(Consumer price inflation; 12-month moving average, percentage)



Sources: Haver Analytics; and national authorities.
Note: CPI = consumer price index.
[1]Excluding Djibouti, Mauritania, and Sudan.
[2]Excluding Djibouti, Lebanon, Mauritania, Morocco, and Sudan.

Figure 2.7
Fiscal Deficit and Reserves
(Percent of GDP and months of imports, respectively)



Sources: National authorities; and IMF staff calculations.

rate depreciation (most recently in Egypt, Sudan, and Tunisia) as well as additional domestic demand from growing numbers of refugees (in Jordan and Lebanon) have sustained inflation. These trends are set to continue in 2015, keeping inflation at its current 9 percent level.

Downside Risks Are Elevated

The recovery is vulnerable to domestic and regional downside risks. Setbacks in political transitions, intensified social and security tensions, and larger spillovers from regional conflicts could undermine confidence, implementation of reforms, and macroeconomic stability. Spillovers from conflicts in Gaza, Iraq, Libya, and Syria could increase refugee inflows, disrupt trade, and raise oil prices—spurring inflation and raising debt. The withdrawal of international troops from Afghanistan could slow domestic demand and aggravate security tensions there as well as in Pakistan. On the upside, faster progress in reform implementation could boost domestic confidence and economic activity.

External risks are also tilted to the downside. Lower-than-expected potential growth or secular stagnation in advanced economies, particularly Europe, or slower growth in the GCC or other emerging markets could reduce growth in MENAP oil importers by slowing tourism, exports, and remittances. Countries with limited exchange rate flexibility may face higher domestic interest rates as global monetary conditions tighten further,[1] though limited international capital market exposure should generally contain risks of capital flow reversal. On the upside, stronger-than-expected trading partner growth could boost economic activity.

Gradually Declining External and Fiscal Vulnerabilities

Resilience to external shocks is improving at varied paces across the region. International reserve coverage recently increased in Egypt and Pakistan but is still low and susceptible to downside risks (Figure 2.7). Reserve coverage also improved in Jordan and remains high in Lebanon, despite import pressures to feed more refugees. In Jordan, additional pressures arise from the substitution of expensive fuel imports for lower-than-expected Egyptian gas supplies used in electricity production.

Differences in reserve coverage largely reflect variation in current account developments. The region's current account deficits are improving but the pick-up in exports, and the extent to which weak domestic investment suppresses import

[1] For more details on the impact of U.S. monetary policy normalization on MENAP oil importers, see the November 2013 *Regional Economic Outlook* (REO) and the May 2014 REO Update.

growth, varies across countries. In Djibouti and Mauritania, the current account deficit is widening owing to large investment-related imports mostly financed by FDI. Sudan's external balances remain sensitive to South Sudanese oil transit fees and gold exports. Net capital flows and grants, which also shape reserves, vary across countries because of differences in financing from foreign governments (sizable in Afghanistan, Egypt, Jordan, Morocco, and Tunisia), borrowing from international financial institutions, FDI, external debt obligations, and international sovereign bond issues.

Significant fiscal consolidation is helping to contain high deficits and debt and gradually rebuild buffers. In the aftermath of the Arab Spring, many countries raised generalized subsidies and public wage bills to calm social unrest and ease the burden of elevated international food and energy prices. Combined with weak tax revenues and sometimes large quasi-fiscal activities, fiscal deficits and vulnerabilities soared. Deficits peaked in 2013, and national policymakers are bringing them down in 2014–15. The largest reductions are expected in Egypt (2½ percent of GDP) and Pakistan (3¾ percent of GDP).[2] In most cases, however, consolidation is slowing debt accumulation, though debt ratios and their servicing are still rising.

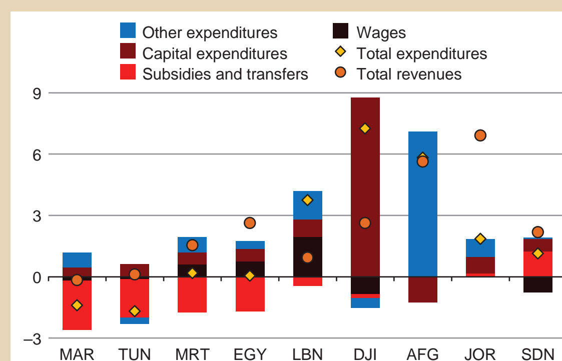
Fiscal consolidation measures largely target spending (Figure 2.8). The largest savings are from generalized energy subsidy reforms initiated in Egypt, Jordan, Mauritania, Morocco, Pakistan, Sudan, and Tunisia (Table 2.1). Wage bills are mostly being contained, but will widen in Lebanon if planned salary scale adjustments are implemented and in Mauritania if presidential campaign promises are enacted. Some savings from subsidy reforms have been channeled into better-targeted social protection for the poor (Box 2.1) and higher spending on infrastructure, health care, and education. Several revenue measures to broaden the tax base are under consideration for 2015. In the meantime, improved economic activity is expected to lift tax revenues.

[2] Pakistan's budget deficit in FY2012/2013 included a one-off clearance of power sector arrears of 1.4 percent of GDP.

Figure 2.8

Change in Revenue and Expenditure

(Percent of GDP, difference between 2013 and 2015)



Sources: National authorities; and IMF staff calculations.

Table 2.1. Spending on Energy Subsidies

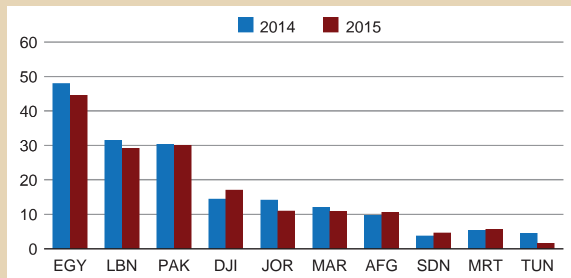
(Percent of GDP)

	Peak Spending, 2011–13	2014	Peak Year
Egypt	6.8	6.6	2012
Jordan	8.4	3.8	2012
Morocco	6.6	3.8	2012
Tunisia	3.7	2.9	2013
Pakistan	2.3	1.1	2012

Sources: National authorities; and IMF staff calculations.

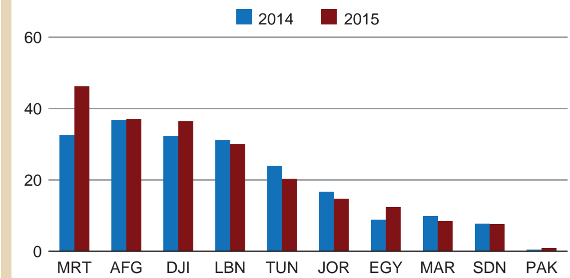
Financing needs loom large. Gross budgetary financing needs in the oil importers are large (Figure 2.9); they are particularly so in Egypt, Lebanon, and Pakistan, because of high deficits and short maturities of domestic Treasury bills. Domestic and official financing are expected to cover the bulk of these needs. Substantial bilateral donor financing, especially from the GCC to the Arab Countries in Transition (ACTs), is to continue (Box 2.3). Gross external financing needs, totaling US$100 billion in 2015, are also substantial; they have risen by US$15 billion since 2014 (Figure 2.10). They are projected to continue being financed from official sources, including IMF programs, as well as FDI and other private inflows—especially, in Lebanon, nonresident deposits. However, the previously described substantial domestic and external downside risks may endanger materialization of these inflows.

Figure 2.9
Fiscal Financing Needs[1]
(Percent of GDP)



Sources: National authorities; and IMF staff calculations.
[1]Sum of general government fiscal deficit (excluding grants) and general government external and domestic amortization.

Figure 2.10
External Financing Needs
(Percent of GDP)



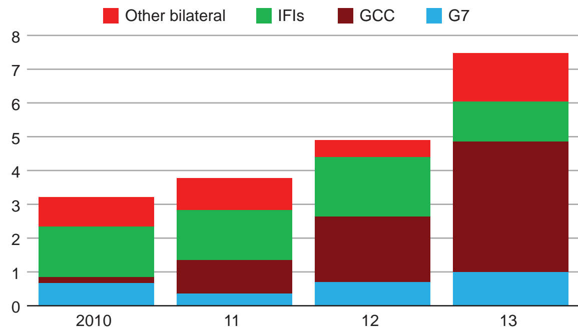
Sources: National authorities; and IMF staff calculations.
Note: Current account deficit (excluding official current transfers) plus total external amortization (excluding nonresident deposits).

Box 2.3

Shifting Patterns in Official External Financing in MENAP Oil Importers

In the wake of the global financial crisis and the Arab Spring, fiscal and external imbalances in MENAP oil importers have widened considerably, raising their dependence on external financial assistance. The overall external aid from official sources has more than doubled since 2010 to partially meet the higher financing needs of recipient countries (Figure 2.3.1).

Figure 2.3.1
Official External Financial Assistance to MENAOI
(Percent of GDP)



Source: IMF staff calculations.
Note: IFIs = international financial institutions. Data for G7 include bond guarantees.

Official external financing from the G7 countries and international financial institutions has increased in absolute terms while remaining broadly unchanged as a percent of oil importers' GDP. Financing from regional donors, particularly the GCC countries, has risen sharply. The share of these countries in total disbursements rose from 5.5 percent in 2010 to 50 percent in 2013. The GCC countries' willingness to step up their assistance is welcome, as it helps support macroeconomic stability and diversifies the MENAP oil importers' sources of financing.

Almost nonexistent in 2010, 45 percent of G7 countries' official financial support to MENAP oil importers in 2013 came in the form of bond guarantees, with Jordan and Tunisia being the main recipients. A difficult fiscal situation in donor countries could have made bond guarantees less costly than loans in the short run, while providing the same benefit for recipient countries with market access.

Project financing has increased in importance in financing flows, in line with the increased role of regional donors. Political instability in some recipient countries and their limited ability to implement economic reforms may also have reduced the willingness of donors to provide grants and unconditional support.

As the financing needs in most MENAP oil importers are projected to remain elevated, it would be important for the international community to maintain—and in some cases increase—its financial support. Tying this assistance more closely to progress in structural reforms and making it more predictable would improve the MENAP oil importers' medium-term economic prospects and resilience to shocks, while reducing their dependence on external support.

Prepared by Anja Baum, Christoph Duenwald (team lead), and Tokhir Mirzoev.

Fiscal, Monetary, and Exchange Rate Policies: Going Beyond Macroeconomic Stability

Fiscal consolidation is necessary to buttress and strengthen confidence. Lower fiscal deficits carry multiple benefits: they put public debt ratios on sustainable paths and relieve current account and external financing pressures, reducing external vulnerabilities. Policy buffers are also rebuilt, confidence fostered, high-risk premiums in international and domestic markets eased, and domestic credit made available for the private sector. These goals can be achieved by continuing the gradual fiscal consolidation path on which most MENAP oil-importing countries are already moving. Their gradual progress along this path—financing permitting—and the measures that comprise it, are successfully containing adverse effects on near-term growth. Maintaining public support for continued consolidation will require measures that limit the negative impact on the poor and reduce social inequities.

Spending reorientation is needed to sustain recent gains from fiscal consolidation and promote job creation and equity. It will be important for policymakers to resist political or social pressures to delay—or reverse, if already implemented—generalized energy subsidy reforms. It will be equally important to ensure that stepped-up, targeted social safety nets are in place to cushion the impact on the poor (Box 2.1). Reducing unsustainable subsidy bills will mitigate underlying fiscal vulnerabilities and will help preempt a larger and more painful adjustment later. In addition, channeling part of the savings to efficient spending on infrastructure, health care, and education creates jobs in the near term, boosts productivity and growth potential, and elevates equity. Similarly, enhancing active labor market policies can improve social outcomes. Gradual public sector workforce rationalization, through comprehensive civil service reforms, would also contribute to these gains.

Greater focus on tax policy is needed to improve the business environment and equity, while raising revenues. Current plans to broaden the tax base—through reduced exemptions and deductions—and tax and customs administration reforms will face challenges from vested interests. But they should be followed through, to level the playing field across sectors and firms. Raising excises on luxury goods (as some countries have already done), introducing property taxes, and raising income tax progressivity would bolster equity and raise revenues, with limited impact on growth.[3]

Changes in public sector financing can complement and support improvements in financial sector regulation. Banking systems appear generally sound, with strong capital adequacy ratios and liquidity buffers. NPL ratios are high but gradually declining. Restructuring of problem banks in Tunisia is progressing. However, across the region, vulnerabilities persist because of high state ownership and weak corporate governance of public banks. Banking and financial sector supervision should be strengthened, with tighter rules on classification of NPLs, loan restructuring, transparency, data provisioning requirements, and improved macroprudential tools. At the same time, changes in public sector financing, including regular domestic bond issuances with longer maturities, market-determined yields, and a broader investor base, would reduce rollover risks and deepen financial markets. The recently increased frequency of some MENAP oil importers' international sovereign bond issuance also enhances financial integration with the rest of the world, supports reserve accumulation, increases credit available to the private sector, and reduces banking system risks associated with high exposure to sovereign debt.

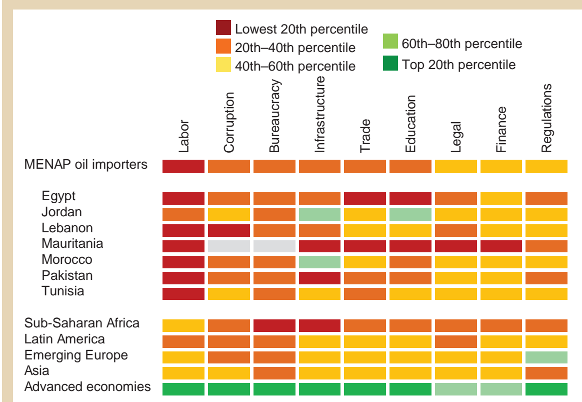
Greater exchange rate flexibility, in some countries, would enhance growth and competitiveness. As inflation declines, countries with overvalued exchange rates can raise competitiveness through greater exchange rate flexibility. Shifting the focus of monetary policy

[3] For a detailed assessment of fiscal policy options for ACTs, see IMF (2014e).

away from exchange rate stability requires the adoption of stronger monetary transmission mechanisms through expansion of interbank markets and active liquidity management, and gradual widening of exchange rate bands. In some cases, accommodative monetary policy could support growth, but poorly anchored inflation expectations and elevated, albeit declining, inflation would pose challenges. If upside inflationary risks emerged, tighter monetary policy measures—coordinated with fiscal policy—would be needed.

Figure 2.11

Raising Medium-Term Growth and Job Prospects Requires Structural Reforms[1]



Sources: World Bank; World Economic Forum; PRS Group; and IMF staff calculations.

[1]A country that performs poorly relative to its global peers in the structural areas listed at the top of the table is ranked in the lowest 20th percentile (colored red). Countries that perform a little less poorly relative to peers are ranked in the 20th to 40th percentiles (colored orange). Those that perform better than the majority of their peers are ranked in the top 20th percentile (colored green).

Lackluster Medium-Term Prospects

Absent deeper structural reforms, medium-term growth is expected to fall short of rates needed for strong job creation and improved living standards. The MENAP oil importers' medium-term growth lags behind that of other emerging and developing regions, and is declining (Annex I). Low employment and investment rates are behind this decline. High unemployment, and its discouraging effect on workers, lowers labor force participation rates over time. In some countries, especially the ACTs, discouraged workers join the informal economy. Recent low investment rates have caused deterioration of the capital stock. These developments, together with low productivity, explain the region's disappointing growth potential in comparison with faster-growing emerging and developing regions.

This lackluster growth reflects structural rigidities, institutional weaknesses, and barriers to trade and investment. Inflexible labor markets, educational deficiencies, widespread perceptions of corruption, ineffective legal systems, burdensome bureaucracy and regulations, poor physical and financial infrastructure, and a lack of trade integration within the region and with the rest of the world undermine competitiveness, productivity, and, ultimately, growth prospects (Figure 2.11). Addressing these challenges is necessary to stimulate substantial growth and bring living standards up to the level of other emerging market and developing economies (Annex I). By the same token, if reforms are not accelerated, growth, unemployment, and living standards could worsen, fueling sociopolitical tensions and resulting in further economic strife.

Structural Transformation to Boost Growth

A deep, multifaceted transformation is needed to spark economic dynamism in the private sector, leading to higher growth potential, more jobs, and less inequity.[4] At the same time, the state's economic role should focus on providing good governance, basic services, and social protection. Reaching these goals is challenging in the current environment where sociopolitical tensions and fiscal and external vulnerabilities linger amid significant downside risks.

[4] For a detailed assessment of reform needs in ACTs, see IMF (2014e) and the proceedings of the conference "Building the Future: Jobs, Growth, & Fairness in the Arab World" in Amman, Jordan, May 2014 (http://www.imf.org/external/np/seminars/eng/2014/act/index.htm).

To enable this transformation, policymakers should articulate and implement a bold and credible structural reform agenda that enjoys broad public support. As political transitions advance, setting reforms in motion is important because it signals policy direction, and because some reforms take time to affect economic outcomes. A strong package of structural reforms—supported by gradual fiscal consolidation and efficient monetary and exchange rate policies, adequate external financing, and solid communication strategies—is needed. The challenge lies in identifying and prioritizing key reforms across a multitude of areas while addressing country-specific needs. Giving priority to reforms in the business environment, education, and labor market efficiency will be critical to boosting potential growth (Annex I) and fostering equity (Annex IV).

Reducing persistently high unemployment, bringing more youth and women into the labor force, and improving the quality of education will increase potential growth. Regulatory reforms facilitating hiring and skills-building would lead to more efficient labor allocation, better compensation, and more rapid job creation. Many on the job market have attained secondary or tertiary education levels but do not have the skills demanded by firms. Governments can work with private firms to reform vocational training and align skills with job market needs. Over the longer term, expanding the size and diversity of the region's labor force by raising youth and women's participation could substantially boost economic potential. In addition, reducing large energy subsidies helps reorient production away from energy-intensive industries toward more labor-intensive production.

Tackling impediments in the business environment and financial market development could revive capital accumulation. Security tensions, poor investor protection, burdensome regulations, and low-quality infrastructure raise the cost of doing business. Dominant public sector influence in the economy leads to perceptions of corruption and deters investors. Some measures that could simultaneously address these challenges include streamlining business regulations, contract enforcement, and affirmation of investors' rights. Raising the quality and efficiency of public infrastructure (Annex II)—especially in electricity generation and distribution—and opening greater access to finance for small and medium-sized enterprises (Annex III) are also important.

Deeper international trade integration complements the structural reforms in boosting lagging productivity. Together, these factors support more robust competition and innovation, leading to competitive cost structures and opening the door for vertical integration in global manufacturing supply chains. Positive spillovers into productivity growth can be substantial, especially in countries with highly qualified technical workers and technologically sophisticated firms.

International Support

Support from the international community can facilitate economic transformation and shore up macroeconomic stability. Bilateral and multilateral official financing can help alleviate fiscal pressures, and provide an opportunity for more gradual and less painful macroeconomic adjustment while countries build consensus for implementation of structural reforms. Official financing can also catalyze additional private financing, especially where countries are already moving forward with challenging reforms. However, absent sound reforms, financing only delays the inevitable unwinding of underlying imbalances—which may be abrupt and more painful in the future. Recent IMF arrangements in MENAP oil-importing economies, committing more than US$15 billion in Jordan, Morocco (a credit line against external shocks), Pakistan, and Tunisia, aim to support countries' reform efforts and macroeconomic adjustment. The international community can also provide support through technical advice, other capacity-building initiatives, and enhanced access to export markets for the region's products and services.

MENAP Oil Importers: Selected Economic Indicators

	Average						Projections	
	2000–10	2009	2010	2011	2012	2013	2014	2015
Real GDP Growth	**5.0**	**3.8**	**3.9**	**2.5**	**2.9**	**3.0**	**3.1**	**3.9**
(Annual change; percent)								
Afghanistan, Republic of	…	20.6	8.4	6.5	14.0	3.6	3.2	4.5
Djibouti	3.5	5.0	3.5	4.5	4.8	5.0	5.5	5.5
Egypt	5.0	4.7	5.1	1.8	2.2	2.1	2.2	3.5
Jordan	6.1	5.5	2.3	2.6	2.7	2.9	3.5	4.0
Lebanon	5.1	10.3	8.0	2.0	2.5	1.5	1.8	2.5
Mauritania	3.7	–1.2	4.3	4.0	7.0	6.7	6.8	6.8
Morocco	4.6	4.8	3.6	5.0	2.7	4.4	3.5	4.7
Pakistan	4.5	0.4	2.6	3.6	3.8	3.7	4.1	4.3
Sudan[1]	7.3	4.7	3.0	–1.2	–2.7	3.3	3.0	3.7
Syrian Arab Republic[2]	4.3	5.9	3.4	…	…	…	…	…
Tunisia	4.4	3.1	2.6	–1.9	3.7	2.3	2.8	3.7
West Bank and Gaza[3]	2.6	7.4	9.3	12.4	6.3	1.9	–3.7	4.4
Consumer Price Inflation	**6.6**	**10.6**	**8.8**	**10.3**	**9.4**	**9.1**	**9.9**	**9.6**
(Year average; percent)								
Afghanistan, Republic of	…	–6.8	2.2	11.8	6.4	7.4	6.1	5.5
Djibouti	3.5	1.7	4.0	5.1	3.7	2.4	3.2	4.0
Egypt	7.9	11.8	11.2	10.1	7.1	9.5	10.9	13.4
Jordan	3.8	–0.7	5.0	4.4	4.6	5.6	3.0	2.6
Lebanon	2.7	1.2	5.1	7.2	5.9	3.2	3.5	4.0
Mauritania	6.3	2.1	6.3	5.7	4.9	4.1	3.3	4.2
Morocco	1.8	1.0	1.0	0.9	1.3	1.9	1.1	2.0
Pakistan	7.4	17.6	10.1	13.7	11.0	7.4	8.6	8.0
Sudan[1]	9.1	11.3	13.0	18.1	35.5	36.5	38.0	20.6
Syrian Arab Republic[2]	4.9	2.8	4.4	…	…	…	…	…
Tunisia	3.2	3.5	4.4	3.5	5.6	6.1	5.7	5.0
West Bank and Gaza[3]	4.0	2.8	3.7	2.9	2.8	1.7	2.6	2.8
General Government Overall Fiscal Balance	**–4.9**	**–5.3**	**–6.0**	**–7.1**	**–8.4**	**–9.5**	**–7.5**	**–6.9**
(Percent of GDP)								
Afghanistan, Republic of[4]	…	–1.8	0.9	–0.6	0.2	–0.6	–0.5	–0.8
Djibouti	–1.9	–5.2	–1.3	–1.4	–2.7	–5.9	–7.3	–10.5
Egypt	–7.3	–6.9	–8.3	–9.8	–10.5	–14.1	–12.2	–11.5
Jordan[4]	–4.2	–8.9	–5.6	–5.7	–8.9	–11.1	–10.3	–6.0
Lebanon[4]	–12.7	–8.2	–7.6	–5.9	–8.6	–9.2	–11.1	–12.0
Mauritania[4,5]	–0.7	–5.1	–2.0	–1.5	2.8	–1.1	0.1	0.2
Morocco[4]	–3.7	–1.8	–4.4	–6.7	–7.4	–5.5	–5.0	–4.3
Pakistan	–3.9	–5.0	–5.9	–6.9	–8.4	–8.1	–4.7	–4.4
Sudan[1]	–1.2	–5.1	0.3	0.2	–3.7	–2.3	–1.0	–1.2
Syrian Arab Republic[2]	–2.7	–2.9	–7.8	…	…	…	…	…
Tunisia[6]	–2.3	–2.3	–0.4	–3.0	–4.7	–5.9	–5.9	–4.1
West Bank and Gaza[3]	–28.6	–30.1	–17.8	–16.9	–16.5	–13.9	–16.5	–15.5
Current Account Balance	**–1.7**	**–4.8**	**–3.2**	**–3.5**	**–5.6**	**–4.5**	**–3.5**	**–4.4**
(Percent of GDP)								
Afghanistan, Republic of	…	1.9	3.1	3.1	3.9	4.3	4.8	0.1
Djibouti	–6.7	–9.3	–5.4	–13.7	–18.4	–23.8	–31.4	–35.0
Egypt	0.9	–2.3	–2.0	–2.6	–3.9	–2.7	–0.4	–4.0
Jordan	–4.2	–3.3	–5.3	–12.0	–15.4	–9.8	–10.0	–6.9
Lebanon	–13.3	–12.5	–13.3	–12.8	–12.7	–12.9	–12.7	–12.3
Mauritania	–15.6	–16.2	–9.4	–7.4	–32.4	–30.1	–26.8	–39.4
Morocco	0.1	–5.4	–4.1	–8.0	–9.7	–7.6	–6.8	–5.8
Pakistan	–1.3	–5.5	–2.2	0.1	–2.1	–1.1	–1.2	–1.3
Sudan[1]	–5.3	–9.6	–2.1	–0.4	–9.2	–8.6	–6.5	–6.3
Syrian Arab Republic[2]	–0.4	–2.9	–2.8	…	…	…	…	…
Tunisia	–3.0	–2.8	–4.8	–7.4	–8.2	–8.4	–7.7	–6.6
West Bank and Gaza[3]	–17.7	–12.0	–10.6	–23.6	–28.9	–18.0	–26.1	–31.4

Sources: National authorities; and IMF staff estimates and projections.

Note: Variables reported on a fiscal year basis for Afghanistan (March 21/March 20) until 2011, and December 21/December 20 thereafter, and Egypt and Pakistan (July/June), except inflation.

[1] Data for 2011 exclude South Sudan after July 9. Data for 2012 and onward pertain to the current Sudan.

[2] 2011–15 data exclude Syria due to the uncertain political situation.

[3] West Bank and Gaza is not a member of the IMF and is not included in any of the aggregates.

[4] Central government. For Jordan, includes transfers to electricity company.

[5] Includes oil revenue transferred to the oil fund.

[6] Includes bank recapitalization costs and arrears payments.