

**The Economy of
the Middle East and
North Africa
in 1997**

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Middle Eastern Department

**International Monetary Fund
1997**

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November 1997

Cover Design: IMF Graphics Section

Cataloging-in-Publication Data

El-Erian, Mohamed A., 1958—

The Economy of the Middle East and North Africa in 1997 /
Mohamed A. El-Erian and Susan Fennell. —[Washington, D.C.] :
Middle Eastern Dept., International Monetary Fund, 1997.

p. cm.

ISBN 1-55775-711-9

1. Middle East—Economic conditions—1979. 2. Middle East—
Economic policy. 3. Africa, North—Economic conditions. 4. Africa,
North—Economic policy. I. Fennell, Susan. II. International
Monetary Fund. Middle Eastern Dept.

HC415.15.E43 1997

Price: \$15.00

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Acknowledgments

The authors are grateful for valuable comments from colleagues in the Middle Eastern and European I Departments. They are grateful for the contributions on country examples provided by Patricia Alonso-Gamo, Amer Bisat, Eric Clifton, Annalisa Fedelino, Thomas Helbling, Alexei Kireyev, Shahpassand Sheybani, and Sherwyn Williams. Special thanks are due to Rahul Dhumale for his contributions on investment and growth issues and to Peter Kunzel for his exceptional research assistance. Thomas Enger prepared the Annex on oil and natural gas in the GCC. Martha Bonilla, of the External Relations Department, edited the publication. Joan Wise and Anne Yee were very helpful in the final preparation of the manuscript. The views expressed in this study are the sole responsibility of the authors and do not necessarily reflect the views of the Executive Directors of the IMF or other members of the IMF staff.

Executive Summary

- After a decade of stagnating economic performance, the economic picture in the Middle East and North Africa (MENA) region improved considerably in 1996 and has remained favorable in 1997. Economic growth is estimated to be about 4 percent, and per capita income to have increased for the second consecutive year in 1997. Financial balances have also improved for the region as a whole, with a further reduction in the fiscal deficit and continued improvement in the external position.
- This performance reflects, in part, favorable external factors (the sharp increase in international oil prices in 1996 and favorable weather conditions for the Maghreb economies), but most important, particularly in 1997, the effect of appropriate domestic economic policies—including government efforts to tighten fiscal and monetary policies.
- Progress is also being made in overcoming the structural impediments in many countries. Steps have been taken to redefine the role of government; enhance financial intermediation; address inefficiencies in the labor market and introduce training schemes; deregulate domestic markets and production structures; liberalize highly protective external trade regimes; and strengthen institutions. However, MENA's implementation of structural reforms, while accelerating, continues to lag that in many emerging markets. Further efforts are needed to increase investment and saving rates so as to place the economies on a higher growth path, address the difficult employment challenge and, for some countries, deal with disappointing social indicators.
- In moving forward, MENA countries face a number of challenges. Most of all, they must move rapidly to restructure their economies in order to participate in the evolving globalization and reap the rewards, while minimizing the risks. With a less favorable outlook in this external environment, the onus of adjustment falls squarely on the MENA countries themselves.
- Those MENA countries that are more advanced in macroeconomic stabilization and structural reform will need to widen and deepen those reforms, and embark upon a second generation of reforms aimed at advancing the transformation of the role of the state in the economy and increasing economic transparency. They face the additional challenge of "managing their growing success" in the increasingly complex global economy. For those countries that have not yet begun to reap the rewards of reform, determined action is needed in the short term to set a sound foundation for growth and avoid being marginalized in the rapidly globalizing world economy.

I. Introduction

The economy of the Middle East and North Africa (MENA) has continued to strengthen in 1997, notwithstanding particularly difficult situations in certain individual economies.¹ Annual economic growth has been in the 4 percent range, resulting in a second consecutive year of much needed positive per capita income growth. Financial conditions have continued to improve as reflected in lower inflation, higher foreign exchange reserves, and a more manageable debt burden.

These short-term improvements in the macroeconomic indicators of the region are to be welcomed. They are a further illustration of the region's potential to put behind it years of foregone economic welfare gains, erosions in living standards, and undue marginalization in the rapidly globalizing world economy.

As important are the underlying changes in the structures of the economies. These changes will determine the sustainability of the region's economic improvements; the extent of beneficial linkages with the international economy; and, most fundamentally, its ability to generate employment for its growing population and to raise living standards.

The purpose of this paper is to document the recent developments in the MENA economy and the challenges that lie ahead. It complements the analyses that have been presented in a number of recent publications on the region by the International Monetary Fund (see listing at the back of this study).

The paper is organized as follows. Section II details recent macroeconomic developments, while Section III reviews the accompanying structural changes. Against this background, Section IV discusses the challenges for the period ahead as MENA economies seek to sustain higher economic growth and benefit to a greater extent from developments in the global economy. The discussion in this paper is supported by a number of boxes that provide greater details on both the experience of certain countries and key policy issues facing the region. Developments in the six member countries of the GCC² and in the oil market are discussed in Annex II and Annex III, respectively.

¹For the purpose of analysis in this paper, MENA is defined to cover the economies of members of the Arab League, the Islamic Republic of Iran, and Israel (see Annex I).

²Members of the GCC (formally known as the Cooperation Council for the Arab States of the Gulf) are Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates.

II. Recent Developments in the Macroeconomy

A. Overview

As recognized by governments throughout the region, sustaining a high rate of growth is the primary economic challenge facing the MENA economies. This is needed to enhance national prosperity, reduce unemployment in non-oil economies of the region, and generate jobs for the growing number of young people joining the labor force.

International experience, as well as a well-established body of literature, confirms that macroeconomic stability enhances economies' ability to sustain a high growth rate. Accordingly, this section discusses the extent to which the MENA economies have progressed in establishing macroeconomic stability. In the following section, another critical ingredient of the growth dynamics—the evolving structures of the economies and their relations with the international economic system—is discussed.

Available data for the MENA region *as a whole* indicate that, after over a decade of deteriorating or, at best, stagnant macroeconomic performance, the economic picture improved considerably in 1996, and remained favorable in 1997 (Table 1). This is most visible in the developments detailed below relating to the traditional set of *macroeconomic outcomes* (economic growth, inflation, and balance of payments), as well as the *intermediate macroeconomic policy targets* (such as the budgetary position, the external current account, and domestic credit developments).

The improvement in 1996 reflected the favorable impact of both domestic and external factors. *Domestic* factors included positive market reactions to government's efforts to tighten fiscal and monetary policies and, to a lesser extent—given the less advanced stage of reforms—their efforts to widen and deepen structural reforms. These factors were greatly accentuated by favorable *external* factors in the form of the sharp increase in international oil prices and favorable weather conditions for the Maghreb economies after a period of prolonged drought. Appropriately, given the volatile nature of the region's external conditions, countries, especially the oil-producing ones, used the more favorable external environment to consolidate their financial position rather than to increase spending.

In comparison to 1996, MENA's economic improvements in 1997 have been primarily the result of *domestic* policies. The economic and financial conditions of the region are responding favorably to several countries' success in further strengthening macroeconomic fundamentals and gaining greater credibility with respect to their willingness and ability to move away from the legacy of years of inward-oriented, public sector-led development strategies, particularly in the non-oil economies.

These changes have been recognized domestically, regionally, and internationally. In most, though not all, economies they have been compensating for the less favorable external factors, be it the lower international oil prices (by 5 percent up to September) or the unfavorable weather conditions. There have also been setbacks to the Arab-Israeli peace process.

Table 1. MENA: Basic Economic Indicators, 1976-97 1/

	1976-80	1981-85	1986-90 2/	1991-95 2/	1996	1997
(Percent a year)						
Real GDP Growth						
MENA	3.0	3.7	2.5	3.7	4.8	3.9
Oil exporters 3/	2.1	3.0	1.7	3.8	4.3	3.9
Others	4.5	4.8	3.6	3.6	5.5	3.8
GCC	6.8	-1.0	4.5	2.7	3.7	2.5
Real Per Capita GDP Growth						
MENA	-0.9	0.1	-0.6	-0.4	2.4	1.4
Oil exporters 3/	-2.6	-1.2	-2.2	-1.5	1.9	1.4
Others	1.8	2.1	1.4	1.0	3.0	1.5
GCC	-0.8	-5.4	-1.1	-1.5	1.3	-0.6
Inflation						
MENA	14.9	15.6	15.0	17.6	12.4	9.6
Oil exporters 3/	13.2	8.6	10.1	17.8	12.5	8.2
Others	17.6	27.7	22.0	17.5	12.3	11.5
GCC	11.7	1.3	1.1	2.6	1.4	0.9
(In percent of GDP)						
Central Government Fiscal Balance						
MENA	-3.1	-8.0	-8.8	-6.1	-2.9	-1.8
Oil exporters 3/	3.8	-2.9	-7.5	-5.9	-1.9	-0.8
Others	-15.2	-16.1	-10.6	-6.4	-4.3	-3.2
GCC	14.4	-0.7	-12.0	-10.8	-2.4	-0.2
Current Account Balance						
MENA	8.1	1.4	-1.6	-3.8	0.7	0.5
Oil exporters 3/	12.6	3.7	-1.1	-3.8	4.0	3.2
Others	-6.0	-6.3	-2.6	-3.4	-4.7	-4.0
GCC	20.6	7.2	0.2	-6.2	4.4	4.3
Overall Balance						
MENA 4/	-0.8	0.3	0.9	-0.6	-2.9	-2.1
Oil exporters 3/	-0.8	0.5	1.7	1.2	-3.3	-2.4
Others 4/	-0.4	-0.2	-1.1	-5.9	-1.7	-1.7
GCC	0.6	1.4	3.3	2.6	-4.1	-3.3
External Debt						
MENA 4/	18.5	21.4	30.2	35.1	30.9	28.5
Oil exporters 3/	10.5	9.9	13.3	17.7	14.8	12.8
Others 4/	50.4	66.0	72.9	82.6	72.4	69.1
GCC	5.9	7.3	8.4	9.2	6.9	7.1
(In percent of exports of goods and services)						
Debt Service						
MENA 4/	3.8	7.9	14.1	15.0	11.3	9.3
Oil exporters 3/	2.6	4.8	9.3	10.7	7.9	6.6
Others 4/	14.9	29.6	34.0	32.2	23.6	19.0
GCC	0.7	0.6	1.4	2.8	4.2	2.3

Source: IMF, *World Economic Outlook*.

1/ PPP weighted averages.

2/ Excluding Kuwait in 1990 and 1991.

3/ Oil exporters include Algeria, Bahrain, the Islamic Republic of Iran, Kuwait, Libya, Oman, Qatar, Saudi Arabia, and the United Arab Emirates.

4/ Excludes Israel.