Looking to the future, countries in the region will not be able to, and should not, rely on a favorable external environment to spur growth and achieve their broader social and economic objectives: oil price developments over the medium term are unlikely to be as favorable as they have been in the past two years; a comprehensive, just, and durable peace settlement remains elusive; and many countries will continue to be adversely affected by the vagaries of weather. On the other hand, there are many aspects of the global environment that offer promise for the region, particularly globalization and its impact on increasing trade opportunities, enhancing capital flows, and accelerating the transfer of technology and managerial knowhow.

It is clear that MENA countries themselves must take the measures necessary to benefit from the possibilities presented by the evolving global economy. Only by intensifying economic stabilization and market opening reforms will they be in a position to reap the potential benefits of globalization. They will also need to keep in mind that the advantages accompanying greater integration in the global economy bring added risks, for example, sudden reversals of capital flows, and certain limitations on various policy instruments. These are risks that are not only worth taking, but can also be minimized through steadfast economic policy management.

For those countries that have successfully established sound macroeconomic fundamentals, the next steps will involve creating an environment that will encourage higher domestic savings, and larger and more productive investment, which in turn will promote sustainable growth over the longer term. For the remaining countries, success in meeting the needs of the population will only be attained if action is taken now to address the financial imbalances and reduce the structural impediments to high and sustained growth.

ANNEX I

MENA at a Glance

Coverage. The MENA region is defined to encompass the economies of the Arab League (Algeria, Bahrain, Djibouti, Egypt, Iraq, Jordan, Kuwait, Lebanon, Libya, Mauritania, Morocco, Oman, Palestine, Qatar, Saudi Arabia, Somalia, Sudan, the Syrian Arab Republic, Tunisia, the United Arab Emirates, and the Republic of Yemen), as well as the Islamic Republic of Iran and Israel.[11] The region possesses abundant natural resources and, on average, enjoys a reasonable standard of living. However, individual countries exhibit a broad diversity of characteristics. They vary substantially in natural resources, economic and geographical size, population, and standards of living.

Size. The MENA region covers an area of more than 15 million square kilometers and contains more than 300 million people, roughly 6 percent of the world's population. The population of individual countries varies considerably—the smallest among them have a population of about half a million (Bahrain, Djibouti, and Qatar) and the largest have populations of some 60 million (Egypt and the Islamic Republic of Iran). The nominal GDP of the region amounted to some US$720 billion in 1996, roughly 2.5 percent of world GDP and about 14 percent of developing countries' GDP.

Population growth. Many MENA countries are experiencing rapid population growth and have a high proportion of young dependents among their population. The average increase in population in recent years has been about 3 percent, although a group of countries (Kuwait, Libya, Oman, Qatar, Saudi Arabia, and the United Arab Emirates) have registered a higher rate of growth of 3.5 percent. Bahrain, Egypt, Lebanon, Morocco, and Tunisia have recorded relatively low rates of population growth (of about 2 percent) compared with the average for developing countries as a group.

Per capita income. The region includes some of the poorest countries in the world, with per capita incomes about US$200 (Somalia and Sudan), as well as countries among the high-income group, with per capita incomes ranging between US$14,000 and US$18,000 (Israel, Kuwait, Qatar, and the United Arab Emirates).

Regional subgroupings. Many subgroupings have been used in the literature. The most common include:

- *Oil economies*. Ten MENA countries are classified as oil-exporting countries. They are Algeria, Bahrain, the Islamic Republic of Iran, Iraq, Kuwait, Libya, Oman, Qatar, Saudi Arabia, and the United Arab Emirates. Although other countries (such as Egypt, the Syrian Arab Republic, Tunisia, and the Republic of Yemen) also export oil, the role of this sector in their economies is relatively limited.
- *Cooperation Council for the Arab States of the Gulf (GCC)*. Member countries of the GCC are Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates.
- *The Arab Maghreb Union*. The member countries are Algeria, Libya, Mauritania, Morocco, and Tunisia.
- *Mashreq*. This group consists of Egypt, Israel, Jordan, Lebanon, the Syrian Arab Republic, and the West Bank and Gaza Strip.

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[11]In view of the limited availability of data for Iraq, the aggregate figures presented in this publication generally do not include information on this country.

Economic Developments in the GCC Economies

As in MENA as a whole, recent economic performance in the GCC has been favorable, reflecting not only the sharp increase in oil prices in 1996, but also the pursuit of fiscal restraint and other reforms. In many respects, the policy issues facing the countries of the GCC are similar to those facing the region as a whole, although the particular nature of the GCC economies—most notably their oil wealth, which accounts for more favorable initial conditions but greater vulnerability to international oil prices; and the segmented structure of their labor markets—present the authorities of these countries with particular nuances (Box 8). This is reflected in the medium-term plans that have been adopted, or are being discussed in these countries.

Macroeconomic performance has been favorable

Real GDP grew by 3.7 percent in 1996 and is expected to slow somewhat in 1997 to 2.4 percent (Chart 3). Taking into account terms of trade effects, real per capita *income* grew sharply in these two years as compared to the early 1990s. *Inflation has been low* in the GCC, averaging less than 1.5 percent in the past two years, reflecting prudent policies and the de facto peg of the GCC currencies to the U.S. dollar in an open economic system.

The most impressive element of economic performance among the GCC countries has been the *dramatic improvement in the fiscal balances*. Many countries were faced with substantially weaker budgetary situations following the regional crisis of 1990–91. The large expenditures associated with that crisis, together with the slowdown in economic activity in the rest of the world and a decline in oil prices, led to a deterioration in their budgetary positions, with an average fiscal deficit for the group (excluding Kuwait) of 15 percent of GDP in 1991. The drawdown in foreign assets also weakened the "built-in stabilization" role played by the region's investment income.

Recognizing the need to restore the favorable fiscal positions characteristic of the GCC in the 1970s and early 1980s, these countries have in recent years strengthened the fiscal adjustment effort initiated in the late 1980s, with the objective in most cases of achieving a balanced budget by 2000. Despite high oil prices and the consequent increase in oil-related budgetary revenues, this fiscal effort, particularly expenditure restraint, was maintained in 1996. As a result, the fiscal position improved substantially—to a deficit of 2.3 percent of GDP in 1996. Given the continuation of fiscal consolidation in 1997, the fiscal situation is expected to improve further, with a balanced fiscal position projected for the year as a whole.

The higher oil prices in 1996 were also reflected in a *strong improvement in the external current account balance* of the GCC, which registered a turnaround after five years of deficits, to a surplus of 4.4 percent of GDP in 1996, with only a slightly lower surplus expected in 1997. The external debt of the GCC countries has demonstrated a sharply declining trend in recent years, as a consequence of tighter fiscal policies, together with the repayment of borrowing incurred in the aftermath of the regional crisis.

Structural reforms are progressing

On the structural front, the GCC economies are not encumbered with structural rigidities to the same extent as other MENA countries. For example, they have more open exchange and trade regimes, and their financial systems are generally more developed. Nevertheless, and as recognized by governments, there is benefit in pursuing further structural reforms in the areas of labor markets and

Box 8. Selected Economic Characteristics of the GCC Countries

Heavy dependence on petroleum

- The hydrocarbon sector dominates the GCC economies. These countries account for 53 percent of the world's proven petroleum reserves and 24 percent of world production. They also hold 14 percent of world's proven natural gas reserves.
- This sector contributes about 35 percent of GDP in these countries.
- Oil and gas exports account for more than 60 percent of total exports, ranging from 37 percent in Bahrain to 90 percent in Oman.
- Oil and gas revenues represent on average 70 percent of total government revenues. Thus, the GCC countries' revenue base and overall fiscal position are highly vulnerable to developments in the international oil markets.

Relatively high per capita income

- The average per capita income of the GCC of US$10,718 is more than double the world average. Nevertheless, within the GCC, per capita income varies considerably, from US$5,345 in Oman, to US$18,068 in Kuwait.

Liberal exchange and trade regime

- The GCC countries have pursued exchange systems based on de facto pegs to the US dollar. Monetary policy has been aimed at maintaining stability of the exchange rate as a nominal anchor for the economy. Consequently, inflation has been low and relatively stable, a policy that has served to enhance private sector confidence.
- These countries are characterized by relatively open exchange and trade regimes, with virtually no capital controls, full currency convertibility, and fairly liberal trade policies.

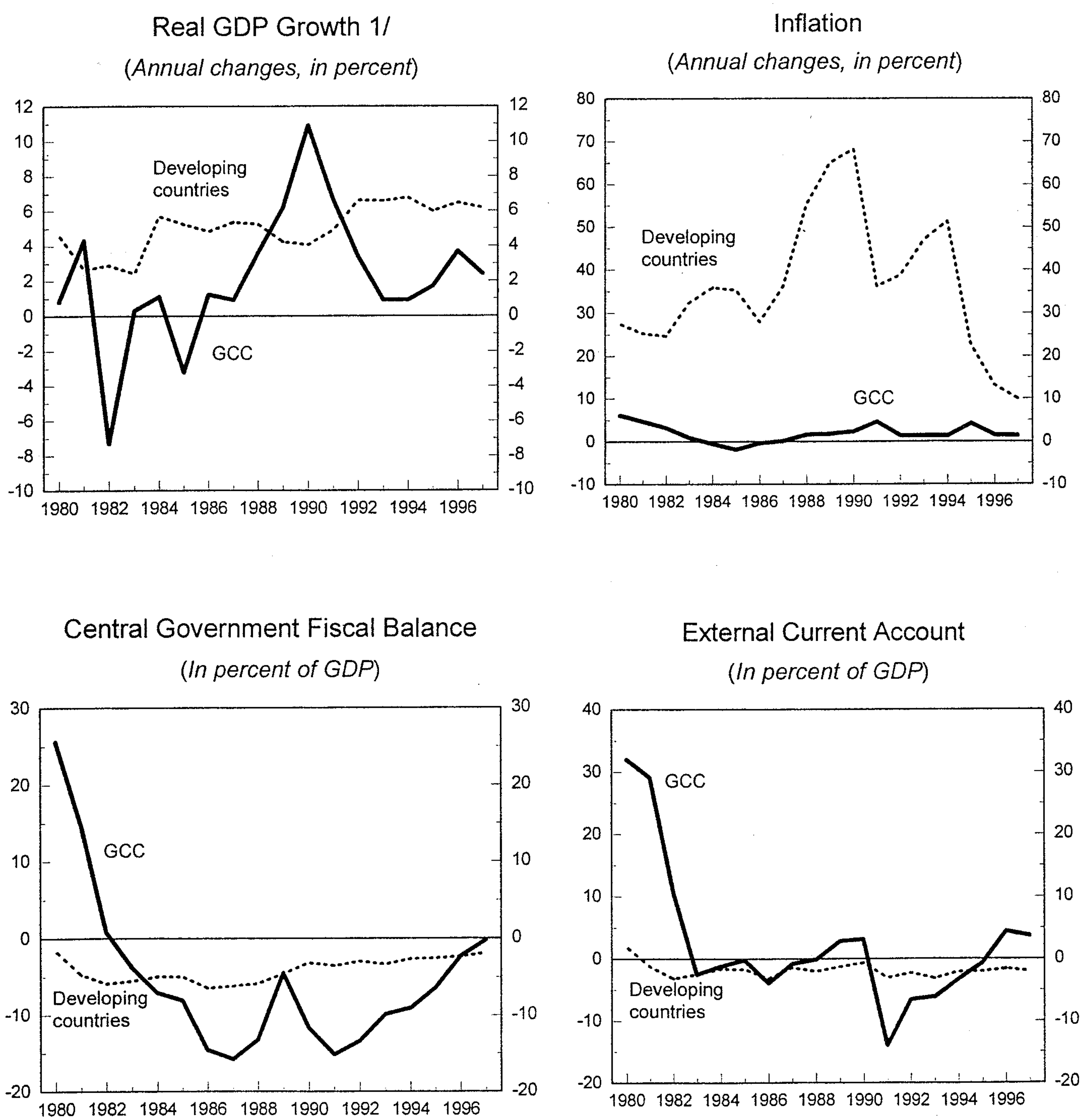
Limited economic diversification

Given the heavy dependence on the oil sector in GCC economies, a primary challenge facing these countries has been the diversification of the economic base beyond the petrochemical sector. Policies to promote diversification have included, to varying degrees, development of downstream petrochemical activities, establishment of free trade areas, liberalization of foreign participation laws, establishment of investment promotion agencies, pursuit of privatization programs.

A segmented labor market

Most GCC countries have segmented labor markets, with heavy reliance on expatriate workers hired on fixed-term contracts (representing from 40 percent to more than 80 percent of the labor force in different GCC countries). The vast majority of GCC nationals are employed in the public sector, which generally pays higher salaries and offers more benefits than the private sector. The national labor force is growing rapidly (given the high population growth rates in the region—3.5 percent a year) presenting difficult challenges for the GCC governments in terms of job creation.

Chart 3. Macroeconomic Conditions in GCC Countries are Relatively Sound...



Source: IMF, *World Economic Outlook.*

1/ Excludes Kuwait in 1990-93.

the fiscal sector. However, in other respects, their structural problems are similar to those of the broader MENA group, particularly with regards to labor market rigidities, vulnerable structural elements in the budget, and limited competition in certain sectors. The authorities recognize the challenges in these areas, and are implementing reforms.

Despite the fiscal measures taken by GCC countries, the dependence on oil-related revenues remains high, with non-oil sources contributing little to the total revenue effort. The structure of spending is also an issue. Spending on government wages and salaries represents a large proportion of total spending.

Some countries have begun to take preliminary steps to broaden the revenue base. Saudi Arabia has increased fees and charges and reduced subsidies, and Qatar has increased certain non-oil taxes, and fees for health care and education. More marked progress has been made in the GCC as a whole in restraining current spending, in part through better expenditure management and controls, although capital spending has borne the brunt of adjustment in some countries.

Privatization is on the policy agenda for all of the GCC countries, although comprehensive action plans remain to be established in most of them. Noteworthy has been Kuwait's privatization program, which has thus far involved divestiture of government shares totaling KD 760 million (some US$2.5 billion), representing between 5 percent and 99 percent of total equity in individual enterprises. The divestiture program in the United Arab Emirates has gained momentum, and private participation in new joint ventures has been successful, with projects in shipbuilding, insurance, banking, and some utility sectors.

The GCC countries are also moving toward allowing *greater foreign participation* as they endeavor to diversify their productive base, particularly into downstream petrochemical activities. Several large state infrastructure and heavy industrial projects in Saudi Arabia and Oman involve private financing, as do the Equate petrochemical complex in Kuwait and the gas facility projects in Qatar and Oman.

Financial sector enhancement has encompassed measures to diversify and deepen the market, including through the development of new products. All GCC countries have taken steps, to varying degrees, to strengthen banking supervision and regulation, and the bourses in some of the GCC countries are beginning to permit trading by non-nationals. GCC countries that are seeking to further open their financial sectors include Kuwait, Qatar, and the United Arab Emirates as well as Oman, where the government has drafted a law to increase opportunities for foreigners to participate in trading on the Muscat securities market, and Saudi Arabia, which has witnessed the launch of a mutual fund open to nonresidents.

Creating employment opportunities for their growing populations is a key policy objective in a number of GCC countries. Thus far, the focus of policy measures has been on promoting private sector development through various measures, and enhancing education and training programs, with the objective of providing new entrants to the labor market with the skills required for private sector jobs.

ANNEX III

GCC Oil and Natural Gas[12]

GCC economies are heavily dependent on oil production

The countries of the GCC are endowed with abundant reserves of hydrocarbons, particularly crude oil. Proven crude oil reserves in the GCC region (estimates of which have increased since the mid-1970s) amount to 464.5 billion barrels, or about 46 percent of global proven reserves in 1995. However, there are wide disparities in petroleum endowments among the GCC countries. Saudi Arabia has the dominant share, more than double the combined share of the next two largest producers—Kuwait and the United Arab Emirates. Oman and Qatar have markedly smaller shares, while Bahrain is a very small producer. In 1995, the average reserve to production ratio in the GCC countries was about 75 years, ranging from more than 120 years in Kuwait and the United Arab Emirates to 15 years in Oman (Table 2).

These countries account for about 21 percent of the world's oil production and about 33 percent of global crude oil exports (Tables 3 and 4). Although exports of liquid natural gas (LNG)—derived from natural gas production—from the GCC region have been small in the past, they are set to increase significantly when several export projects are completed in the medium term.

Not surprisingly, crude oil production dominates economic activity in the GCC countries. Oil contributes about 35 percent of GDP, 60 percent of export earnings, and 70 percent of revenues on average. In the last decade, petroleum exports have been supplemented by exports of petrochemicals and, more recently, exports of LNG in some countries.

Given the heavy dependence of GCC countries on oil production, *GCC economies are vulnerable to developments in the international oil market.* Since 1970, crude oil spot prices have been volatile, although the volatility has declined considerably in recent years compared with earlier periods (Chart 4).[13] These fluctuations have added an important element of uncertainty to policymaking among the GCC.

Recognizing their vulnerability to developments in the international oil market and the adverse impact of volatile oil prices on economic growth, the GCC countries initiated efforts in the 1980s to *diversify their productive base so as to reduce dependence of the domestic economy on oil exports.* Typically, crude oil producers sought to increase the value added of the petroleum sector by developing the production of petrochemicals from their abundant supplies of natural gas, propane, butane, and ethane. By 1996, a fairly broad range of petrochemicals were being produced, including basic fertilizers, industrial alcohols, fuel oxidizing agents, synthetic fibers, and plastics. More recently, diversification has also included the development of energy intensive production of metals, including aluminum and iron.

The *government plays a predominant role in the petroleum sector* of GCC economies. The role of upstream foreign investment has been limited in the major oil producing countries, owing to restrictions governing foreign participation. Typically, foreign participation has been confined to joint ventures in refining and petrochemical production. However, the smaller GCC oil producers have encouraged greater upstream foreign participation using production sharing arrangements in exploration and oil field development. These arrangements have been successful in increasing crude oil production capacity.

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[12]This section has been prepared by Thomas Enger.

[13]The standard deviation of real oil prices, a measure of volatility, declined from 14.8 in 1970–85 to 1.9 in 1986–96.

Table 2. GCC Proven Crude Oil Reserves
(In billions of barrels unless otherwise noted)

	1975	1985	1990	1995	*(Years)* 1995 R/P Ratio[1]
Qatar	5.9	3.3	3.0	3.7	21
Kuwait[2]	71.2	92.5	97.0	96.5	129
Oman	5.9	4.0	4.2	5.0	15
Saudi Arabia[2]	151.8	171.5	260.1	261.2	88
United Arab Emirates	32.2	33.0	98.0	98.1	121
Total GCC Proven Reserves	267.0	304.3	462.3	464.5	75
Memo Items:					
Global Proven Reserves	666.7	708.9	1,005.6	1,017.0	
GCC share (percent)	40.0	42.9	46.0	45.7	
OPEC Proven Reserves	463.1	535.8	771.4	785.1	
GCC share (percent)	44.1	47.2	50.6	50.2	

Source: OPEC; and British Petroleum.
[1]The Reserve/Production ratio.
[2]Includes Neutral Zone.

Table 3. Crude Oil Production, 1989–97
(In millions of barrels a day unless otherwise noted)

	1989	1990	1991	1992	1993	1994	1995	1996	Proj. 1997
Qatar	0.38	0.40	0.39	0.40	0.42	0.41	0.45	0.49	0.59
Kuwait[1]	1.47	1.72	1.12	0.31	1.06	1.89	2.14	2.05	2.09
Oman	0.64	0.68	0.71	0.75	0.79	0.82	1.87	1.92	1.97
Saudi Arabia[1]	5.07	6.41	8.23	8.40	8.14	8.10	8.16	8.16	8.27
United Arab Emirates	1.91	2.12	2.42	2.29	2.17	2.22	2.20	2.23	2.20
Total GCC	9.46	11.33	12.86	12.15	12.58	13.43	14.81	14.85	15.12
Memo Items:									
Neutral Zone Output[2]	0.37	0.30	0.13	0.36	0.36	0.39	0.43	0.48	0.54
Global Crude Supply[3]	66.06	66.92	66.79	67.09	67.45	68.56	69.94	72.00	...
GCC share (percent)	14.3	16.9	19.3	18.1	18.7	19.6	21.2	20.6	...
OPEC Crude Supply	23.80	23.00	23.30	24.40	24.70	25.00	25.10	25.80	...
GCC share (percent)	39.7	49.3	55.2	49.8	50.9	53.7	59.0	57.6	...
Crude Oil Price (In billions of U.S. dollars)[4]	17.84	22.97	19.33	19.03	16.82	15.89	17.17	20.42	19.38

Sources: IEA; and IMF staff estimates.
[1]Includes Neutral Zone Share.
[2]Shared equally by Kuwait and Saudi Arabia.
[3]Includes processing gains and OPEC Ngls.
[4]Simple average of WTI, Brent, and Dubai.

Table 4. Exports of Crude Oil
(In thousands of barrels a day unless otherwise noted)

	1989	1990	1991	1992	1993	1994	1995
Qatar	320	348	336	362	341	323	333
Kuwait	850	645	85	696	1,440	1,264	1,186
Oman	591	628	643	689	732	743	780
Saudi Arabia	3,336	4,500	6,526	6,582	6,293	6,234	6,291
United Arab Emirates	1,650	1,895	2,195	2,060	1,970	1,955	1,925
Total GCC	6,747	8,016	9,785	10,389	10,775	10,517	10,515
Memo Items:							
Global Exports	25,817	27,099	27,801	28,995	30,176	31,277	32,065
GCC share (percent)	26.1	29.6	35.2	35.8	35.7	33.6	32.8
OPEC Exports	14,880	16,060	16,960	17,410	17,900	18,020	18,070
GCC share (percent)	45.3	49.9	57.7	59.7	60.2	58.4	58.2

Sources: OPEC; IEA; and IMF staff estimates.

Factors affecting petroleum production

All GCC countries, except Oman and Bahrain, are members of OPEC and therefore have assigned quota allocations for crude oil production or oil supplied to the market. The current quota allocations are: Kuwait–2.0 mbd; Qatar–0.378 mbd; Saudi Arabia–8.0 mbd; and the United Arab Emirates–2.161 mbd.

The evolution of the overall OPEC production depends, to a large extent, on developments in the global demand for oil and non-OPEC production. Considering the expected evolution of these latter factors, together with the magnitude of their proven reserves, several GCC countries are making efforts to increase crude oil production capacity over the medium term, with the objective of increasing crude oil production capacity by about 2.0 mbd by 2002. The GCC countries thus plan to invest in the range of $4 billion to $6 billion in oil field development in the medium term.[14] The trend in the development of crude oil production capacity has been to develop fields that have light, sweet crudes that typically sell for a premium in Asia. In addition, GCC countries have been increasing the production of condensates with the development of new oil and gas fields.[15]

Current situation with regard to natural gas production

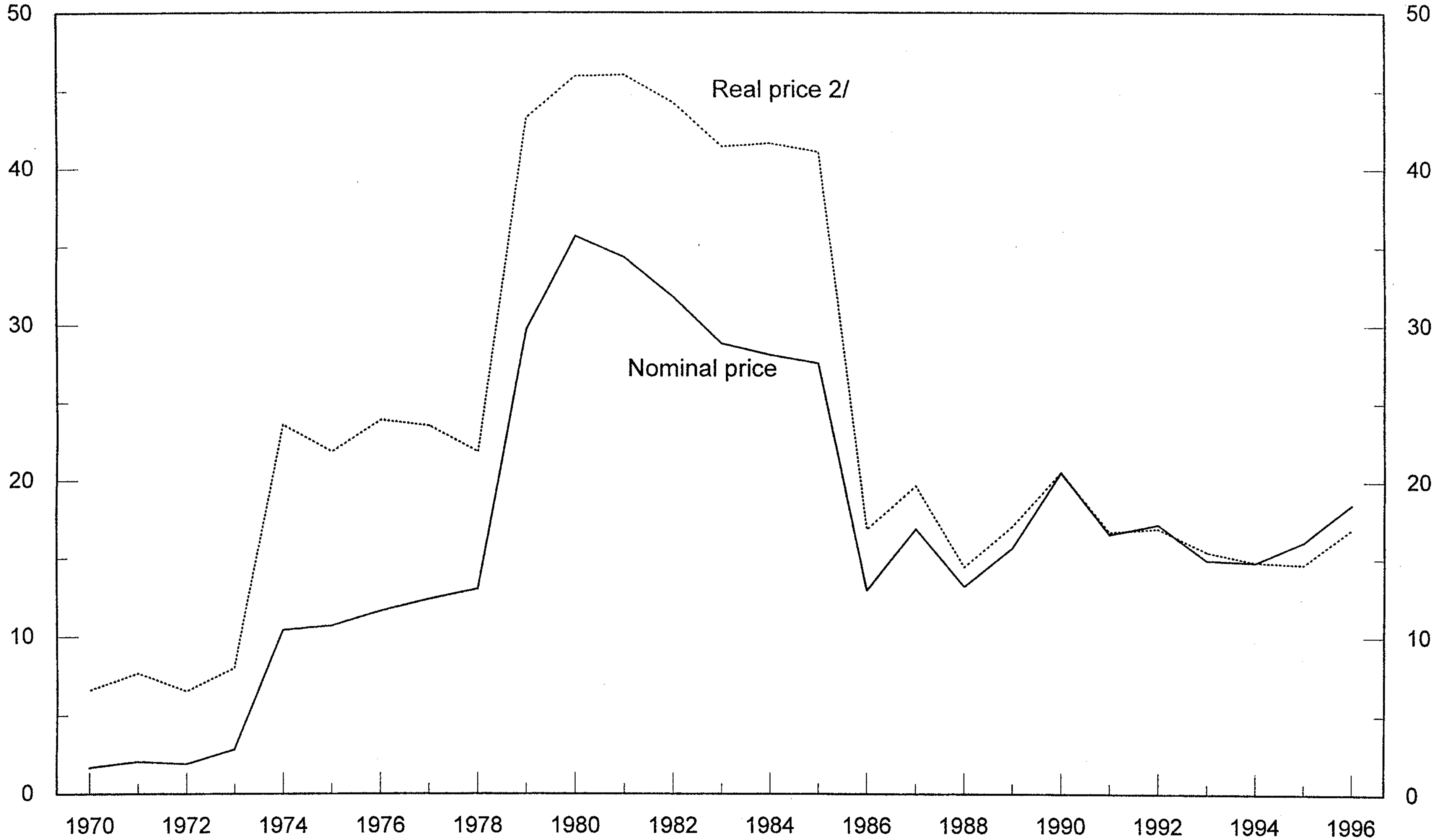
Total proven natural gas reserves (LNG) for the region quadrupled between 1975 and 1995, from 5,100 billion cubic meters (bcm) to 20,100 bcm. Proven associated and nonassociated natural gas reserves vary widely among the GCC countries (Table 5). Consequently, natural gas production has increased over this period, from 48 billion cubic meters (bcm) to 97 bcm (Table 6).

[14]This conservative estimate does not include (1) investments in planned expansions where the costs are unknown as yet; and (2) investments needed to maintain the output of existing fields, which could be large because they involve natural gas and water injection.

[15]Commonly referred to Ngls and are by-products of both crude oil and natural gas production. They include natural gasoline, naphtha, benzene, and pentane.

Chart 4. Nominal and Real Crude Oil Prices, 1970-96 1/

(In U.S. dollars per barrel)



Sources: IMF, International Financial Statistics; British Petroleum Co.; and IEA.
[1] 1970–87 Arab Light; 1988–96 Dubai.
[2] In 1990 prices.

Table 5. Proven Gas Reserves and Production in 1995
(In billions of cubic meters unless otherwise noted)

	Proven Reserves[1]	Production	*(Years)* R/P Ratio[2]
Bahrain	147	1.9	77
Kuwait	1,494	6.0	250
Oman	283	4.8	58
Qatar	7,070	13.6	520
Saudi Arabia	5,341	40.3	132
United Arab Emirates	5,831	30.1	194
GCC Total	20,166	96.8	208
World Total	150,241	2,207.0	
GCC Share (percent)	13.4	4.4	

Source: Cedigaz.
[1]Estimated at 1/1/1996.
[2]The Reserve/Production ratio.

Table 6. GCC Total Natural Gas Production
(In billions of cubic meters unless otherwise noted)

	1985	1990	1995
Bahrain	4.5	5.8	1.9
Kuwait	4.2	4.2	6.0
Oman	1.8	2.6	4.8
Qatar	5.5	6.3	13.6
Saudi Arabia	18.8	30.5	40.3
United Arab Emirates	13.2	20.1	30.1
GCC Total	48.0	69.5	96.7
World Output	1,670.1	1,988.8	2,119.6
GCC Share (percent)	2.9	3.5	4.6

Sources: BP; and Cedigaz.

Reflecting changing government strategies, the development of natural gas reserves has become a priority in recent years for several reasons. First, economic growth and population growth in the GCC countries indicate increased demand for gas to generate electricity for both business and residential use. Second, urban and agricultural development have increased the demand for water, which requires electrical power for desalination. Third, governments have recognized the important contribution to domestic budgetary revenues from exports of LNG and associated condensates, as well as from the domestic sale of natural gas for feedstock. Fourth, natural gas feedstock is the basis for the further development of the petrochemical business in the region—an important element of governments' economic diversification strategy.

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