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Fiscal and Debt Profile of the MENA Region

Rola Rizk

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Abstract

During the first three years of this century, fiscal profiles of the MENA region continued to deteriorate with the overall fiscal balance converting to an average deficit of 1.7 percent of GDP in 2002. There is an overall swelling in expenditures coupled with a general drop in revenues. Fiscal policies in oil exporting countries are often determined by cyclical developments in oil prices. The decline in oil prices over 2000-2001wosened the fiscal profile of oil-producing nations. In other countries of the MENA region, were exerted to control fiscal positions. While both oil producers and non-oil producers still need to modernize their revenue structure, non-oil producing nations have a more advanced taxation system. However, for most MENA countries, a main challenges is the fast demographic evolution, high population growth and a rise in the labor force, pressuring fiscal positions through mounting personnel costs outlays. Interest payments also take up an important share of spending in some countries that have an important debt burden. Personnel cost and interest payments usually constitute the most rigid components of government spending and are difficult to scale down. Countries facing fiscal pressure usually start by curtailing capital expenditures, thereby negatively affecting economic growth. Some countries chiefly rely on their domestic markets to finance their fiscal deficits. By issuing issue treasury bills, or directly borrowing from public institutions, they thereby render the roll-over risk lower than through market access. For countries that borrow in foreign currency, the nature of their borrowings also differs amongst each other in that some are frequent issuers on international capital markets, while others mostly rely on bilateral and multilateral official funding.

مُلخص

خلال السنوات الثلاث الأولى من هذا القرن استمر التدهور في الحالة المالية في منطقة الشرق الأوسط وشمال إفريقيا (MENA) مع انقلاب الميزانية المالية الشاملة إلى متوسط عجز بلغ 1.7 % من إجمالي الناتج المحلي GDP في عام 2002. كما يوجد تضخم شامل في النفقات يصحبه انخفاض عام في الدخل. غالبًا ما يتم تحديد السياسات المالية في البلاد المصدرة للنفط من خلال التطورات الدورية في أسعار النفط، فقد أدى انخفاض أسعار النفط خلال الفترة 2000 – 2001 إلى مزيد من التدهور في الحالة المالية للبلاد المنتجة للنفط. أما في بلاد أخرى بمنطقة الشرق الأوسط وشمال إفريقيا (MENA)، فقد تم إتباع سياسات للسيطرة على الأوضاع المالية. وبينما يحتاج كلٍ من منتجي النفط وغير منتجي النفط إلى تحديث هيكل العوائد الخاص بهم، إلا إن الدول غير المنتجة للبترول تمتلك نظام ضريبي أكثر تقدمًا. مع ذلك، بالنسبة لمعظم بلاد منطقة الشرق الأوسط وشمال إفريقيا، تعد أهم التحديات هو النمو الديموجرافي السريع والنمو السكاني المرتفع وزيادة القوى العاملة التي تمارس ضغوط على الأوضاع المالية من خلال زيادة نفقات المصروفات الخاصة. كما تستحوذ مدفوعات الفوائد على نصيب كبير من نفقات بعض الدول المثقلة بأعباء الديون الكبيرة. في الغالب، تشكل كلٍ من المصروفات الخاصة ومدفوعات الفوائد أكثر المكونات غير المرنة في نفقات الحكومة والتي يصعب تقليلها. عادةً ما تبدأ البلاد التي تواجه ضغوط مالية بتقليص المصروفات الرأسمالية مما يؤثر بشكل سلبي على النمو الاقتصادي. تعتمد بعض البلاد في المقام الأول على أسواقها المحلية لتمويل حالات العجز المالي لديها. فمن خلال إصدار أذون خزانة أو الاقتراض من المؤسسات العامة مباشرةً يجعل ذلك مخاطرة إعادة الاستثمار للأرباح المتجددة القصيرة الأجل أقل تلك المخاطرة من خلال دخول الأسواق. كذلك بالنسبة للبلاد التي تقترض بالعملة الصعبة تختلف طبيعة الاقتراض فيما بينها، فبعضها مصارف مصدرة دائمة لأسواق رأس المال العالمية، بينما يعتمد البعض الاخر في الأغلب على التمويل الثنائي أو المتعدد.

1. Fiscal Profiles in the MENA Region

On average, the overall fiscal balance of the MENA region shifted from a surplus of 3.2 percent of GDP in 2000 to a deficit of 0.9 percent of GDP in 2001, and to an even larger deficit of 1.7 percent of GDP in 2002. Despite this weakening in MENA countries' fiscal positions, they remained in a better position than developing countries, which maintained fiscal deficits averaging around 4.5 percent of GDP over the past three years. MENA countries fared even better than major advanced economies, where the deficit to GDP averaged to almost 2 percent for the period 2000-2002.

At a time when Mashreq countries' fiscal positions continued their stable deficit path, Maghreb countries exerted more efforts to improve their fiscal situations. Nevertheless, the main driving force behind the fiscal movements in MENA countries remain GCC countries, whose fiscal positions, in 2000 outperformed their performance in the last three decades, largely explained by the increase in crude oil prices. During the years that followed (2001-2), fiscal positions of GCC countries deteriorated mainly on account of a decline in oil revenues in subsequent years either due to decreases in oil prices or to cuts in oil production.

1.1. GCC Countries

During the past three years, some GCC countries such as Kuwait, Bahrain, Oman, and Qatar preserved fiscal surpluses despite adverse economic conditions. Kuwait, in particular, maintained a large, albeit declining fiscal surplus. In the meantime, other GCC nations such as Saudi Arabia and the United Arab Emirates experienced a reversal of their fiscal positions from surpluses in 2000 to deficits in the subsequent two years, partly attributed to the decline in crude oil prices to under US$ 20 a barrel in late 2001, to rigid expenditure structures in those countries, and to cuts in oil production. For those countries that experienced fiscal deficits, financing was easily ensured through their vast assets portfolios.

In Saudi Arabia, lower oil prices and budgetary overspending led to a weakening in the fiscal position to levels similar to the average fiscal deficits of the past decade of 4.6 percent of GDP. In the UAE, similar fiscal behavior prevailed. Fortunately, UAE's deficits are easily financed by the income from the country's wide overseas asset portfolio[1].

In an effort to stimulate the stagnant non-oil sectors of the economy, Kuwait also adopted an expansionary fiscal policy in the past year, mainly through higher current spending. This led to a weakening of the fiscal surplus, which nevertheless remained sizeable.

1.2. Maghreb Countries

After reverting from a surplus in 2000 to a deficit in 2001, Maghreb countries' fiscal positions picked up again in 2002, largely owing to fiscal discipline and reforms in countries such as Tunisia and Morocco, which, despite revenue losses emanating from free trade agreements, adopted a prudent fiscal stance and managed to steadily decrease fiscal deficits. Meanwhile, Algeria (an oil dependent nation) maintained sound macroeconomic performance in the face of its expansionary fiscal policy.

In Morocco, notwithstanding a rising wage bill and revenue weakening mainly due to external tariff reduction, the improvement in the fiscal stance mainly occurred through lower interest spending (due to lesser debt and interest rates), as well as a lower level of capital expenditures. The reasons for the improvement were different in Tunisia. Also, in spite of the impact of trade liberalization on its fiscal position, Tunisia was able to introduce various structural reforms over the past few years. As a result, growth picked up in 2001 inducing

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[1] No disclosure is available about the amount accumulated in this fund - Moody's estimates it to be worth $100 to $ 300 billion

fiscal revenues to increase faster than expenditures thereby causing the deficit to decrease. Even when its economy weakened in 2002, Tunisia managed to maintain fiscal discipline.

1.3. Mashreq Countries and Turkey

On average, the fiscal deficit in Mashreq countries deteriorated from 3.1 of GDP in 2000 to 3.6 percent in 2002. Within this region, conflicting developments occurred: On the one hand, Lebanon pursued its fiscal adjustment effort through decreasing its deficit by 10 percentage points of GDP over the past three years. On the other, fiscal positions in Egypt and Jordan slightly weakened.

In Egypt, government finances have been following a deteriorating trend,[2] especially with the recognition and settlement of expenditure arrears beginning in 1998/99[3] and the depreciation of the pound, which led to relatively higher foreign interest payments and subsidies. The rising wages and pensions bill also exerted their toll on the country's fiscal position. In Jordan, following an improvement in 2001, regional uncertainties negatively affected the fiscal position in 2002 through higher security-related spending and a weaker revenue performance. Jordan remains highly dependent on foreign grants as a source of income and still has a fairly narrow domestic tax base, which it is trying to broaden.

In an effort to stabilize government finances, Lebanon's deficit diminished from 24.6 percent of GDP in 2000 to 14.5 percent in 2002 mainly through capital expenditure cuts, and the successful introduction of the VAT. Deficits in Lebanon have been particularly high since the war years in the 1970s. The trend continued throughout the 1990s, following the conclusion of the civil strife mainly on account of social and reconstruction spending.

Another country facing a difficult fiscal situation is Turkey. Indeed, Turkey's deficit widened in 2001 to 19.7 percent of GNP from 11.2 percent in 2000 and declined in 2002 to 13.1 percent of GNP. In both Lebanon and Turkey's cases, the primary balance is a better indicator of the country's fiscal policy and performance given the high level of debt service payments. In Turkey, the primary surplus was kept constant at 4.6 percent of GNP between 2000 and 2001 and improved to 5.1 percent in 2002. In Lebanon, the primary deficit of 7.6 percent of GDP in 2000 improved to 2.3 percent in 2001 and converted to a surplus of 2.1 percent in 2002. This clearly indicates that, excluding the heavy burden of debt service payments, the two countries are attempting to introduce order to their fiscal situations.

2. Description and Comparison of Government Expenditures in the Region

The increase in MENA countries' deficits was partly caused by the amplified government spending in some of the nations in the region. In fact, despite many of the MENA countries' endowments with natural resources, growth has been lagging behind developing countries. Perhaps for this reason, and in order to expand demand through higher government spending, some MENA countries have responded by enlarging their public sectors.

Indeed, as a share of their domestic incomes, government expenditures in the MENA region are estimated to have risen between 2000 and 2001. Expenditures ranged from a high of 47 percent of GDP in Kuwait to a low of 11 percent in Sudan. The increase in the region's spending was most likely attributable to increases in current spending, and more specifically, personnel cost. During periods of economic slowdown, governments are particularly pressured to boost wages and salaries or to employ additional public servants, ending up with a more inflated expenditure bill.

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[2] Egypt's fiscal transparency has improved with a new budget formulation, which consolidates public finances by including, in addition to the State and municipality budgets, the operations of the National Investment Bank, Social Insurance Funds, and other extra-budgetary operations

[3] All arrears were cleared by mid-2001

2.1. Current Expenditures

On average, over the past few years, current spending in the MENA region has constituted around 80 percent of total spending.

In the GCC region, some countries have recently witnessed increases in current spending; In the UAE, for instance, current spending gradually increased from 25.2 percent in 1997 to 30.2 percent of GDP in 2001 and 31.1 percent in 2002. By the same token, Kuwait experienced a rise in current spending from 37.2 percent of GDP in 1999/2000 to 42.6 percent in 2001/2002.

The Mashreq region was no different with current spending increasing in Lebanon, for example, from 31.2 percent of GDP in 1997 to 35.7 percent in 2002.

On a more positive note, most of the countries in the Maghreb region saw a decline in their current spending. In Morocco, current spending shrank from 23.6 percent of GDP in 2001 to 22.2 percent of GDP in 2002. Tunisia also had a slowing down in current spending from 25.3 percent of GDP in 1997 to 20 percent in 2002. In the same way, in Algeria, current spending declined from 23.6 percent of GDP in 1998 to 22.8 percent in 2001.

The largest share of current spending is allocated to personnel cost and interest payments. Indeed, in most of the MENA countries, governments are acting as employers of last resort for rapidly mounting labor forces (due to growing populations) as evidenced by many of those countries allocating the majority of their spending to personnel cost, including wages and salaries as well as pensions. This indicates budgetary rigidity that will need to be addressed by those countries in the future.

Governments in Morocco, Tunisia, and Lebanon allocate a large portion of their spending to personnel cost. In Morocco, the government assigns around 12 percent of GDP (in 2002) or 55 percent of current spending on personnel cost. Indeed, wage bills have been growing largely owing to the employment of 15,000 workers in one shot last year. In Tunisia, almost half of total spending (45 percent) is allocated to personnel cost, which makes up around 11 percent of GDP and uses up nearly half of total revenues. Although the wage bill has been growing at a decreasing rate, it remains a heavy burden on the budget and constrains fiscal expenditure flexibility. Tunisia and Morocco are examples of countries where unemployment pressures usually lead to rising public sector employment. Statistics in Lebanon are similar to those of Tunisia, but the background is different. Following the end of the civil war, the Lebanese public sector expanded in size as it had to absorb many new entrants; twelve years after the conclusion of the conflict, 2002 statistics denote that Lebanon apportions around 51 percent of its revenues to personnel cost (which in turn make up around 11.5 percent of GDP). Jordan also spends 11 percent of GDP on personnel cost, which absorb around 35 percent of government revenues and grants. Jordan is one of a few countries in the region that is trying to introduce changes to the government's pension scheme, which has been a growing burden on public finances and which could have worsened in the coming years if remedial action were not taken. In Egypt, even though spending on subsidies and non-interest current expenditures has declined in recent years, personnel cost has increased and now makes up around 7 percent of GDP. This is explained by the fact that Egypt was also one of the countries that have sought to compensate public workers for rises in the cost of living and to limit unemployment through public sector job creation. Should this trend continue, it is expected that personnel cost will grow even further in the near future.

In the same vein, some of the Gulf Cooperation Council countries have also witnessed a rise in personnel cost. Following years of fiscal restraint, the increase in Kuwait's total expenditures is mostly explained by a jump in real terms of more than 6 percent in expenditure on civilian wages and salaries during 2001/2. In the UAE, one of the reasons behind the fast rise in public spending (fiscal spending has jumped by nearly 50 percent since 1997) is the rapid rise in the numbers employed in civil service and the military, which will place ongoing pressure on the wage bill.

2.2. Capital Expenditures

Capital spending in the MENA region is estimated to account for the remaining 20 percent of public expenditures. Whereas interest payments and personnel cost are usually rigid components of public spending, capital spending is the first item that is cut down when pressure for fiscal containment is exerted.

Countries in the Mashreq region and Turkey have decreased capital spending to the strictest minimum in order to improve their fiscal positions. Lebanon has been steadily lowering capital expenditures from almost 9 percent (1994 to 1997) to around 2.4 percent of GDP in 2002, as the post-war reconstruction of basic infrastructure has been completed. Also at the lowest end, capital spending in Egypt and Jordan was equivalent to 4 and 6 percent of GDP respectively by the end of 2001. Likewise, in response to fiscal pressure, Turkey contained capital spending at almost 2 percent of GNP for the last three years.

Maghreb countries differed amongst each other in their approach to capital spending. Morocco for instance, kept capital spending almost stable between 2000 and 2001. It even lowered it from 5.3 percent of GDP in 2001 to 4.7 percent of GDP in 2002. Algeria and Tunisia augmented spending on investment projects due to pressures to alleviate poverty through public sector spending on infrastructure. In both countries, capital expenditures hovered around 8 percent of GDP.

Most GCC countries such as Qatar, UAE, Kuwait, and Saudi Arabia increased their capital spending in 2001 and 2002, reflecting the desire to develop their countries' infrastructure.

3. Description and Comparison of Government Revenues in the Region

Over the past few years, government revenues have been declining in the MENA region. The trend continued between 2000 and 2001, commensurate with a 1 percent of GDP decline in oil revenues, the largest component of those countries' aggregate income (around 60 percent of total revenues and grants) and the item to which all oil-producers are vulnerable. Tax revenues, the second most important revenue item for Arab countries (around 26 percent of total revenues), increased by 0.4 percent of GDP between 2000 and 2001, continuing the rising trend that has characterized the last five years in this item. However, the rise in tax revenues was not sufficient in terms of magnitude to cover for the shortfall in oil revenues. Non-tax revenues, the third main item in total Arab revenues, declined by 0.1 percent of GDP between 2000 and 2001.

In individual countries, revenues range from a high level of 70 percent of GDP in Kuwait in 2001 to a low level of 21.7 and 22.4 percent of GDP in Bahrain and Lebanon respectively.

In some countries, revenues' share of GDP declined over the last few years. This was especially true in some oil-producing nations where fluctuations in oil prices continue to largely affect countries' fiscal positions. For instance, revenues in the UAE, Bahrain, and Algeria declined by at least 4 percent of GDP between 2000 and 2001.

In contrast, in some other countries, revenues were boosted as a percentage of GDP. In Lebanon, revenues rose from 19.6 percent of GDP in 2000 to 22.4 percent of GDP in 2002, due to significant modifications in the tax structure performed through the introduction of a number of revenue measures, the latest of which being the VAT introduced in 2002. Similarly, in Turkey, revenues increased by 2.5 percentage point of GDP between 2000 and 2001 (from 26.4 percent to 28.9 percent) due to fiscal adjustment efforts and then declined to 27.9 percent by the end of 2002.

3.1. Tax Revenues

The rise in tax revenues reflects the wave of fiscal reforms that were introduced by the MENA nations and Turkey. In general, countries in the region have been trying to reform their taxation systems with a view to introducing flexibility to the sources of their earnings. The modernization of the tax system is evidenced by the overall decrease in the share of non-tax revenue over total fiscal revenue and by a corresponding increase in tax revenue over total fiscal revenue.

In Tunisia, for instance, a maturing and modernized fiscal system has resulted in a larger tax base with higher tax revenues keeping the budget deficit under control, despite the loss in revenues resulting from the implementation of the free trade area with the EU. Indeed, the decrease in the tax rate was compensated by an increase in the tax base due to a larger trade volume and the growth of the overall economy. Tax revenues rose from 21.1 percent of GDP in 1999 to 21.7 percent in 2001. In parallel, non-tax revenues declined from 3.1 percent of GDP in 1999 to 2.7 percent in 2001.

Turkey witnessed a similar change in its revenue structure; indeed, while tax revenue rose from 21.1 percent in 2000 to 22.2 percent in 2001, non-tax revenue remained constant at 4.4 percent in 2000 and 2001.

In order to alleviate fiscal pressure, Lebanon increased the shares of both its tax and non-tax revenues from 14.2 percent of GDP in 1999 to 15.3 percent in 2002 and from 5.3 percent of GDP in 1999 to 7.1 percent in 2002 respectively by introducing new taxes and modernizing existing ones.

Egypt's tax revenues are expected to improve as a result of the introduction of the VAT, the extended coverage of the GST, as well as the positive effect of the pound's depreciation on customs duties and sales tax revenue.

3.2. Income Tax

In the same vein and in their efforts to modernize their tax structures, some of the MENA countries strengthened their income tax administrations over the past few years. For instance, in Tunisia and Morocco, revenues from corporate taxes have attained 2.7 and 4.2 percent respectively, exceeding the OECD average of 2.6 percent of GDP, while in Jordan and Lebanon, they still yield around 1.5 percent of GDP, in large part due to the banking sector's profitability . In countries such as Egypt, Lebanon, Jordan, and Syria attempts are being made to broaden the tax base and to modernize the collection mechanism through computerization.

3.3. Taxes on International Trade

In some other countries, tax revenues declined due to lower taxes on international trade, which were affected by the liberalization trends that have swept the region. In Morocco, tax revenues dropped as a percentage of GDP because of the impact of trade liberalization with the EU association agreement and the erosion of the tax base due to tax exemptions granted to counteract competitiveness losses. Similarly, in Saudi Arabia, customs receipts declined significantly because of the cut in customs tariff from 12 percent to 5 percent in May 2001 in an important step to liberalize trade and to facilitate the introduction of the common external tariff among GCC countries.

3.4. Oil Revenues

In most GCC countries, the revenue base remains volatile as most revenues are generated from oil. In the large majority of countries, taxation is almost non-existent. Indeed, in Qatar and Kuwait, almost 70 percent of revenues in 2002 resulted from the sale of oil and gas and, in the UAE, the share of oil revenues was even higher at 77 percent of total revenues. This high level of dependence is of less concern for Kuwait and the UAE as their oil reserves are enough to last for well over 100 years. In Saudi Arabia, non-oil revenues are virtually non-existent as there is virtually no taxation , except for some customs duties. In Oman, despite the rapid expansion of the gas sector, the economy remains highly dependent on crude oil production and fluctuations in oil prices, which accounts for about 80 percent of government revenues.

4. Debt Profiles in the Region

Countries in the MENA region differ in their economic constitutions and in their endowment with natural resources. Their fiscal structures and therefore their debt profiles are directly affected. Few of the MENA countries such as the UAE rarely borrow due to the large pool of assets and reserve funds that are utilized for financing purposes. Other countries such as Tunisia and Morocco, for instance, have conducted privatization operations, the proceeds of which were utilized to partly finance their expanding financing requirements. Lebanon and Turkey had to mainly rely on their banking systems for financing public sector deficits through treasury bills issuance whereas countries such as Saudi Arabia and Egypt have relied on their public sector institutions.

On the international capital markets' front, an increasing number of MENA countries, such as Tunisia, Lebanon, and Turkey are becoming sophisticated borrowers. Lebanon is even preparing for the issuance of the first sovereign securitization transaction in the MENA region. Other countries, such as Qatar and Bahrain have conducted Islamic Sukuk operations while Jordan and Morocco are also conducting active debt management strategies to improve their debt profiles through debt / equity swap operations and debt buybacks.

In contrast to their worsening overall fiscal situation, domestic and external debt ratios in the MENA region declined partly due to debt repayment from privatization proceeds.

5. The Region's Domestic Debt Profile

On average, domestic debt decreased in the Maghreb, the Mashreq, and the GCC. As a result, average domestic debt declined by more than 1 percentage points of GDP between 2001 and 2002.

5.1. GCC Countries

In general, gross domestic debt dropped by 1 percent of GDP between 2001 and 2002. However, in some specific cases such as Saudi Arabia, gross domestic debt increased from around 62 percent of GDP in 2000 to 97 percent in 2002 due to fiscal deficits averaging 4.6 percent of GDP over the last decade. On the positive side, Saudi Arabia’s domestic debt has a low roll-over risk for two main reasons: (a) three-quarters of it is held by autonomous government institutions and (b) the average maturity of the outstanding debt stock is approximately 7 years.

Within the GCC region, countries that are pursuing active debt management strategies include Oman, which is pre-funding through issuing treasury bills to take advantage of low interest rates.

5.2. Mashreq Countries and Turkey

In Mashreq countries and Turkey, examples of those that rely on their domestic markets are widespread. They include Egypt, whose domestic debt rose by almost 9 percentage points between 2001 and 2002 and where the situation is similar to that of Saudi Arabia; even though the deficit is primarily financed through the publicly owned-domestic banking system, the bulk of domestic debt is held by government agencies.

Turkey and Lebanon constitute examples of countries that are facing vulnerabilities in their debt profiles. The seriousness of the situation in Lebanon is even more pronounced, yet, efforts are being exerted to control the high level of the gross domestic debt ratio. In fact, following a rise from 106 percent of GDP in 2000 to 108 percent in late 2001, gross domestic debt declined to 97 percent by December 2002 due to the replacement of relatively expensive and short-term treasury bills with longer-dated and cheaper foreign financing in the context of the Paris II conference. Prior to the Paris II conference, Lebanon chiefly relied on its domestic banking system for financing its high budget deficits. Roll-over risk on domestic debt was also high given its short maturity (average of 14 months). In Turkey, net domestic debt increased from 39 percent of GNP in 2000 to 56 percent of GNP in 2001, but declined to 48 percent in 2002. The increase in debt between 2000 and 2001 took place amidst a serious economic recession and high real interest rates environment. At the same time, domestic debt had relatively short maturities. Turkey then restructured government debt held in public institutions and state-owned banks.

In Egypt, widening fiscal deficits have resulted in an increase of the gross domestic debt by almost 9 percent of GDP between 2001 and 2002. However, Egypt's general government's net debt is significantly smaller than the gross measure, given the government's large deposits with the domestic banking system and its blocked accounts at the Central Bank held against external debt to Paris Club creditors .

Some countries such as Jordan are trying to modernize the legal framework governing their borrowing. To that effect, a new debt management law became operational in July 2001. The new law is aimed at reducing external debt, encouraging greater use of domestic debt, and limiting the overall size of public debt.

5.3. Maghreb Countries

In Algeria, excess oil receipts were used to reduce domestic public debt over the past few years. As a result, domestic debt in Algeria decreased from over 33 percent of GDP in 2000 to 22 percent at end 2002.

6. The Region's External Debt Profile

Foreign debt levels declined in the MENA region by 1.4 percentage points of GDP between 2001 and 2002. The drop was especially noticeable in the Maghreb region.

The nature of the borrowing in some MENA countries, Turkey, and Iran is changing overtime. Indeed, a few are becoming sophisticated issuers on the international capital markets. From January 2001 till June 2003, Turkey for instance issued 19 Eurobonds, followed by Lebanon and Tunisia that accessed the markets 7 and 5 times respectively during the same period of time. Moreover, Egypt, Iran, and Bahrain issued 2 Eurobonds each while Morocco issued 1 Eurobond. The US$ market was the preferred choice for those countries with an issuance size amounting to around US$ 12.4 billion (mostly from Turkey, Lebanon, and Egypt). The Euro market came second with Euro 5.6 billion worth of Eurobonds issued (mostly from Turkey, Iran, Tunisia, and Morocco). Tunisia was the only nation amongst this group to be able to access the Samurai market (twice in 2001).

6.1. Maghreb Countries

Tunisia, the region's most sophisticated borrower on international capital markets accessed the market twice in each of 2001 and 2003 and only once in 2002 through a 10-year global USD bond with an initial size of US$ 500 million that was subsequently expanded to US$ 650 million. In general, Tunisia has been able to raise capital on world markets at very favorable terms; its coupon rates on the Samurai market were specifically low, reaching 2.27 percent for a five-year Yen issue. Tunisia's external debt is estimated to have slightly risen to 61 percent of GDP by end-2002 from 60 percent of GDP by end 2001. Despite its relatively high level, the external debt burden remains manageable in view of the limited amount of short-term exposure, amounting to only 13 percent of total debt, and Tunisia's demonstrated ability to roll-over maturing credits.

Although Morocco is not as active as Tunisia on the international capital markets (only one inaugural Eurobond issued in June 2003), the level of its external debt has been declining due to the active debt management strategy; maturing foreign currency debt was replaced with local debt and debt / equity swaps were performed with each of France and Spain. Moreover, debt relief operations and privatization receipts of around 15 percent of GDP since the mid 1980's helped control the external debt burden, which peaked at 130 percent of GDP in 1985 (Morocco defaulted on its external debt in the mid 1980's). As a result, total external debt reached 45 percent by the end of 2002.

Algeria also actively pursued to reduce its external debt, which has come down significantly over the years. At around 41 percent of GDP by the end of 2002 (constant when compared to the previous year), it is currently 30 percent below its level in 1996 and is almost equivalent to Algeria's foreign exchange reserves. Meanwhile, Algeria continued negotiations with the Russian authorities to find a mutually acceptable solution to the debt owed to the Russian Federation on which debt service payments were suspended in 1998.

6.2. Mashreq Countries and Turkey

While Jordan and Egypt mostly rely on official creditors for their external financing, Turkey and Lebanon are frequent issuers on international capital markets.

In Egypt, the rise in external debt was mostly due to the pound's depreciation. However, the level of external debt is still manageable due to a large-scale 50 percent forgiveness in net present value terms back in 1991. In addition, almost 90 percent of Egypt's external debt is medium and long term.

Similar to one of its Maghreb peers (Morocco), but on a larger scale, Jordan has engaged in an active external debt management policy. In July 2002, following its agreement with the IMF on a new stand-by arrangement, Jordan concluded its 6th Paris Club rescheduling. Under the agreement, all debt maturities falling due from July 2002 to July 2004 were rescheduled. Meanwhile, Jordan continued to pursue debt swap agreements with bilateral creditors; four debt swap agreements were signed in 2001 and 2002 with Spain, Germany, UK, and France. In 2000 and 2001, Jordan bought back some of its Brady bonds. Reflecting these recent restructurings and efforts to reduce the debt burden, Jordan's total external debt fell from an average of 98 percent in 1995-2000 to around 83 percent by the end of 2002. Official creditors account for 84 percent of total external lenders.

This rise Lebanon's external debt reflects Lebanon's frequent access to financing in foreign currency, a move that has ensured financing at cheaper rates than domestic borrowing. In particular, the increase in 2002 reveals the impact of the replacement of domestic debt operations that took place following the Paris II conference whereby official creditors provided 15-year financing at 5 percent rates to help Lebanon lower its debt service bill.

In Turkey, foreign debt also increased from 18.5 percent of GNP in 2000 to 37.1 percent in 2001 and declined to 34 percent in 2002. The dramatic expansion in 2001 was mostly the result of the exchange rate depreciation that hit the Turkish economy in the same year. In addition, during the period expanding from January 2001 to June 2003, Turkey was the region's most frequent borrower with almost US$ 9 billion of Eurobonds issued.

6.3. GCC Countries

In general, GCC nations were less active on the external debt front than Maghreb or Mashreq countries. Qatar, the most active borrower amongst its peers, witnessed a slight rise of its external debt from 92 to 93.6 percent of GDP. Qatar, however, pursues an active debt management strategy in that it selectively performs debt prepayment operations. Qatar's debt is largely long-term (around 7 years' maturity) and is mostly attributable to commercial banks and private creditors.

Similarly, Oman's external debt has been dropping for the past three years mostly due to debt repayment. Most external financing is linked to major projects such as LNG and is in the syndicated loan market. Oman has not accessed the international capital markets since 1997.

7. Conclusion

At the dawn of the twenty first century, the Middle East and North Africa region is still facing crucial economic and social challenges and remains vulnerable to both exogenous and intrinsic shocks.

Political instability and security concerns continue to affect various countries' economic performance. Recently, the uncertainty caused by the war in Iraq and the consequences of this conflict have affected some countries' real economies as well as their fiscal positions partly due to their vulnerability to changes in oil prices. Indeed, for those countries to reduce such fiscal dependence, they should consider saving oil revenues when oil prices are higher than average. In this respect, the Kuwaiti experience in establishing reserve funds could be an example to follow.

Fiscal consolidation constitutes a challenge for many countries in the region. In general, in the absence of privatization proceeds, widening fiscal deficits could negatively impact debt ratios, thereby pushing up interest rates and crowding out private sector borrowing. The most striking examples of such an occurrence are the Lebanese and Turkish experiences, where real interest rates have exceeded 10 percent. Oil producing countries where deficits were also high during the last few years include Saudi Arabia and the UAE, where the reasons for rising deficits include an expanding public sector and declining revenues. Many of the MENA countries are working towards fiscal consolidation mainly through tax reform and modernization. Countries where efforts were particularly noticeable during the past few years include Tunisia, Morocco, Lebanon, and Jordan. However, MENA countries have to intensify their fiscal efforts in order to reach the industrial countries' revenue-to-GDP ratio of 44 percent from their current level of around 30 percent of GDP.

One common denominator of many MENA countries is the enlarged public sector. In the years ahead, this could be addressed through invigorating various countries' private sectors by accelerating privatization operations and reforming the state in order to raise employment opportunities and help absorb the rapidly growing labor force, stemming from the high rate of population growth. Naturally, this virtuous cycle will help rein in the increase in the size of the public sector, and will, therefore, improve various countries' fiscal ratios. The ultimate gain from invigorating the private sector will undoubtedly be higher growth for those economies that grew last year at a rate below the 4.6 percent average growth rate of developing countries and well inside the 6.2 percent growth of emerging Asian economies.

This lackluster growth might have been also caused by lower oil production as OPEC quotas were decreased, the aftereffects on tourism of the September 11 attacks, and the uncertainty associated with the war in Iraq. Within this, however, the picture varied considerably across countries. Growth in oil-producing countries was still lower than that of non-oil producers perhaps due to the reforms being introduced in some countries in the region, especially in the Maghreb.

MENA countries are also different in their re-financing risk profile. For those countries such as Saudi Arabia and Egypt that mostly rely on public domestic financial systems for funding, the re-financing risk is relatively low, even though the crowding out potential is still present given that such resources could, instead, be lent to the private sector. Countries such as Turkey and Lebanon face a higher refinancing risk mostly due to their international and domestic market access for financing.

In general, public debt in emerging market economies has risen quite steeply since the mid 1990s and currently averages around 70 percent of GDP, exceeding that of industrial countries. When compared to the debt of other emerging markets, that of the Middle East and Africa has remained broadly unchanged at uncomfortably high levels for the past few years despite the debt rescheduling undergone by countries such as Egypt, Jordan, and Morocco. Such debt levels raise the risk of a financial crisis and negatively affect the economy by keeping borrowing costs high. Overcoming this challenge requires generating large enough primary budget surpluses to ensure the sustainability of their public debt.

Whether on the foreign or domestic fronts, MENA region's debt markets call for further modernization and expansion in order to accommodate the fairly recent surge of activity in debt management and debt issuance of some countries in the region such as Turkey, Lebanon, Tunisia, Jordan, Iran, and Egypt.

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Box 1: Current Spending: A Focus on Interest Payments

Interest payment constitutes one of the largest components of current spending. It is relatively sizeable in the region's most highly indebted countries where it absorbs a high share of government revenue, reaching as much as 79 percent in Lebanon and 68 percent in Turkey in 2002 whereas they were as high as 91 percent of revenues in 2001 in both countries. In these two countries, debt service is equivalent to almost 18 percent of their national incomes – 17.7 percent of Lebanon's GDP and 18.2 percent of Turkey's GNP. These ratios are very high both in absolute and in relative terms. Indeed, interest expenditures in emerging market economies account for 5 percent of GDP, almost twice as high as in industrial countries.

In less serious cases such as Egypt and Morocco, interest payments take up around 20 percent of government revenue. In Morocco, debt service is equivalent to 5 percent of GDP and in Egypt, debt relief back in 1991 has substantially reduced the servicing burden of the government's external debt, which constitutes 0.6 percent of GDP. The domestic portion, on the other hand, is more burdensome than the foreign and represents around 5 percent of GDP. Looking forward, interest payments on Egypt's domestic debt should rise as a result of a jump in treasury-bill rates since January 2003. Debt relief has also helped Jordan address its debt servicing challenge. Indeed, in 2001, interest payments took in a mere 15 percent of revenue and represented around 4 percent of GDP. For Jordan, reducing the interest burden on the budget is one of the key components of fiscal reform. To achieve this, the government has been actively engaged in reducing external debt through debt buybacks, debt swaps, and privatization. The recent debt rescheduling in July 2002 has also reduced debt service cost.

In most GCC countries, interest payments are well within the economy's capacity and capture a lower portion of revenues. For instance, in Oman, Qatar, Saudi Arabia, and Kuwait, interest payments constitute 3.7 percent, 4.4 percent, 2.86 percent, and 2.9 percent of government revenue respectively.

Table 1: General Government Balances in the MENA Region 2000-2002

(% of GDP)	2000	2001	2002
Maghreb	**3.7**	**-0.8**	**2.2**
-Algeria	9.7	3.4	0.2
-Morocco	-6.4	-5.8	-4.6
-Tunisia	-3.3	-2.8	-2.4
Mashreq	**-3.1**	**-3.4**	**-3.6**
-Egypt	-1.2	-2.2	-2.5
-Jordan	-4.7	-3.7	-5.0
-Lebanon	-24.6	-19.4	-14.5
GCC	**7.1**	**0.1**	**-2.7**
-Bahrain	8.7	4.4	0.9
-Kuwait	32.9	32.3	20.1
-Oman	9.7	3.8	3.7
-Qatar	8.0	3.6	6.7
-Saudi Arabia	3.2	-3.9	-6.0
-UAE	6.3	-5.3	-9.3
Other	**3.6**	**-0.3**	**-2.4**
MENA	**3.2**	**-0.9**	**-1.7**
Developing Countries	-4.0	-4.7	-4.8
Major Advanced Economies	-0.3	-1.8	-3.8

Sources: Unified Arab Economic Report 2002, Arab Monetary Fund, IMF World Economic Outlook Database, September 2003, Article IV Consultation reports for selected countries, and Public Information Notices for selected countries.

Table 2: Government Expenditures in Selected MENA Countries 2000-2002

(% of GDP)	2000	2001	2002
Maghreb	**29.5**	**30.3**	**30.9**
-Algeria	28.9	31.6	35.9
-Morocco	31.8	31.1	28.8
-Tunisia	27.8	28.1	27.9
Mashreq	**35.8**	**33.7**	**34.3**
-Egypt	30.0	30.1	29.9
-Jordan	34.5	34.1	35.7
-Lebanon	42.9	36.9	37.4
GCC	**34.2***	**36.8***	
-Bahrain			
-Kuwait	40.8	40.7	46.8
-Oman	34.4	37.1	
-Qatar	30.1	32.1	
-Saudi Arabia	33.3	36.5	
-UAE	32.6	37.4	36.15
MENA	**33.2****	**33.6****	

Notes: *GCC average excludes Bahrain; ** MENA average excludes countries that are not listed in this table. (a) In general, data in this table can only be considered in relative terms and cannot be reconciled with data in table 1 due to the use of different sources of information for each country. (b) Simple averages are used for the totals.

Sources: Unified Arab Economic Report 2002, Arab Monetary Fund, IMF Article IV Consultation reports for selected countries, Moody's Investors' Services, and IMF Public Information Notices for selected countries.

Table 3: Government Revenues in Selected MENA Countries 2000-2002

(% of GDP)	2000	2001	2002
Maghreb	**30.1**	**28.2**	**28.3**
-Algeria	38.7	35.0	35.0
-Morocco	26.2	24.9	24.0
-Tunisia	25.4	24.7	25.9
Mashreq	**26.4**	**26.0**	**26.6**
-Egypt	28.8	27.9	27.4
-Jordan	30.8	31.4	29.9
-Lebanon	19.6	18.7	22.4
GCC	**41.1**	**40.5**	**37.7**
-Bahrain	34.9	32.9	21.7
-Kuwait	71.0	80.8	69.5
-Oman	29.4	33.0	33.3
-Qatar	36.2	31.0	38.7
-Saudi Arabia	36.5	32.9	35.4
-UAE	38.6	32.1	27.3
MENA	**32.5**	**31.6**	**30.9**

Notes: ** MENA average excludes countries that are not listed in this table. (a) In general, data in this table can only be considered in relative terms and cannot be reconciled with data in tables 1&2 due to the use of different sources of information for each country. (b) Simple averages are used for the totals.

Sources: Unified Arab Economic Report 2002, Arab Monetary Fund, IMF Article IV Consultation reports for selected countries, Moody's Investors' Services, and IMF Public Information Notices for selected countries.

Table 4: Gross Domestic Debt in the MENA Region

(% of GDP)	2001	2002
Maghreb	**28.0**	**25.7**
-Algeria	23.6	22.0
-Morocco	45.8	49.3
-Tunisia	23.6	22.5
Mashreq	**62.5**	**62.5**
-Egypt	56.7	65.4
-Jordan	22.3	25.1
-Lebanon	108.3	97.1
GCC	**32.5**	**31.4**
-Bahrain	25.5	26.6
-Kuwait	33.8	24.7
-Oman	8.5	7.7
-Qatar	29.5	28.0
-Saudi Arabia	93.7	97.1
-UAE	4.0	4.5
Other	**15.1**	**13.7**
MENA	**34.5**	**33.3**

Note: Simple averages are used for the aggregates.

Sources: Unified Arab Economic Report 2002, Arab Monetary Fund, IMF Article IV Consultation reports for selected countries, Moody's Investors' Services, and IMF Public Information Notices for selected countries.

Table 5. Total External Debt in the MENA Region

(% of GDP)	2001	2002
Maghreb	**74.3**	**71.8**
-Algeria	41.1	41.1
-Morocco	46.9	45.0
-Tunisia	60.2	61.0
Mashreq	**41.4**	**44.8**
-Egypt	27.6	33.5
-Jordan	80.9	82.6
-Lebanon	24.4	32.2
GCC	**39.3**	**38.1**
-Bahrain	46.9	47.6
-Kuwait	35.4	33.4
-Oman	27.1	22.2
-Qatar	92.0	93.6
-Saudi Arabia	14.5	11.7
-UAE	20.2	20.0
Other	**70.4**	**66.4**
MENA	**56.3**	**54.9**

Note: Simple averages are used for the aggregates.
Sources: Unified Arab Economic Report 2002, Arab Monetary Fund, IMF Article IV Consultation reports for selected countries, Moody's Investors' Services, and IMF Public Information Notices for selected countries.

Table 6: Eurobond Issuance in the MENA Region, January 2001- June 2003

Issuer	Size (US$ equivalent)	Original Currency	Number of issues
Republic of Turkey	3.48 bn	Euro	7
	5.95 bn	US$	12
Republic of Lebanon	3.85 bn	US$	7
Banque Centrale de Tunisie	0.46 bn	Yen	2
	0.36 bn	Euro	2
	0.65 bn	US$	1
Arab Republic of Egypt	1.50 bn	US$	2
Central Bank of the Islamic Republic of Iran	0.99 bn	Euro	2
Kingdom of Bahrain and Bahrain Monetary Agency	0.75 bn	US$	2
Kingdom of Morocco	0.47 bn	Euro	1

Source: Morgan Stanley Dean Witter

Table 7: Sovereign Rating Levels in Selected MENA Countries

	Moody's Rating
Kuwait	A2
UAE	A2
Qatar	A3
Oman	Baa2
Tunisia	Baa2
Bahrain	Baa3
Saudi Arabia	Baa3
Egypt	Ba1
Morocco	Ba1
Jordan	Ba3
Turkey	B1
Lebanon	B2

Note: The Islamic Republic of Iran is rated B+ by Fitch
Source: Moody's Statistical Handbook, Moody's Investors Services, Country Credit, April 2003

Table 8: Growth in Real GDP in the MENA Region, 2001-2002

Annual percentage changes	2001	2002
MAGHREB	3.5	3.0
MASHREQ	4.0	2.3
GCC	2.3	2.0
MENA	**3.9**	**3.7**
Developing countries	**3.9**	**4.6**

Sources: World Economic Outlook, September 2003, International Monetary Fund

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ECONOMIC RESEARCH FORUM

منتدى البحوث الاقتصادية

7 Boulos Hanna St. Dokki, Cairo, Egypt
Tel: (202) 7615071 – (202) 7615072 – (202) 7602882
Fax: (202) 7616042. Email: erf@erf.org.eg Website: http://www.erf.org.eg