Middle East: Dramatic Change and Challenges

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Good morning,

Chairman Chang Roh, Panelist members, Colleagues, Ladies and Gentlemen:

I am delighted to be with you this morning and it is good to see my old colleagues after an extended leave of absence. I would like to thank Chairman Roh for organizing the plenary session and for the invitation to speak. My thanks also extends to the program Chair for the excellent sessions organized.

What I would like to do this morning is to first give you a very brief overview of the global economy and then talk about the Middle East region, its economic outlook and the challenges ahead.

While the U.S and Europe economies are recovering very slowly from the financial crises, there still exists some risk as there are still troubled banks, possible increases in oil prices and fiscal problems that could derail the global recovery.

The emerging and developing economies continue to perform well and have been the source of strength. Based on IMF projections, the U.S is to grow at the rate of 2.1% this year and 2.4% next year, while the global economic growth is projected to be at 3.5% in 2012 and 4.1% next year.

Now I turn to the Middle East:

Major political transitions occurred in Tunisia, Egypt, Yemen and Libya in 2011 and Syria is undergoing political uncertainties at this time. While the political reforms are still taking place in the above-mentioned countries, economic situation in the region deteriorated significantly for most oil importing countries in the Middle East with the exception of oil exporting ones which grew 8% in year 2011 because of an increase in the price of oil.

Examining the oil importing countries, we can see that their growth rate declined by half (Oil importing countries in the Middle East and North Africa consist of Afghanistan, Djibouti, Egypt, Lebanon, Mauritania, Morocco, Pakistan and Tunisia), their growth rate fell from 4.3% in 2011 to 2.2% in 2012.

What factors contributed to a decline in their growth rate?

Social unrest in Egypt, Syria, and Tunisia resulted in a large decrease in tourist revenue and investment, combined with higher oil prices and slower global economic growth.

Slower economic growth in Europe especially adversely affected exports for Morocco and Tunisia in late 2011. Floods in Pakistan, drought in Afghanistan and Mauritania and sanctions on Syria all contributed to the downturn in growth.

Slower growth rate also resulted in higher unemployment. The youth unemployment rate in the oil-importing countries is over 25%, which is the highest rate than at any other region in the world. Furthermore, Governments in these countries provided food and fuel subsidies due to higher commodity prices and also offered wage and pension increases, cash transfers and tax reductions. Based on IMF estimate, the size of the national fiscal package in 2011 ranged from less than 1/2% of GDP in some MENA oil importing countries to about 22% of GDP in Saudi Arabia. While Saudi Arabia can afford this extra spending, others cannot and it has resulted in an increase in their debt level. Per capita income has also stagnated in these countries, credit conditions and rates worsened and tourism and investment suffered.

Headline inflation remained subdued as aggregate demand declined and government subsidies for many commodities increased. The only exception is Pakistan where inflation increased due to rising global food prices and accommodative monetary policy.

What economic strategies should oil importing countries employ to reverse the trend?

- These countries need to invest in education and infrastructure to create future jobs for youth in the next decade.
- They could improve the business climate in order to restore business confidence and to increase economic growth.
- Put their house in order, prioritize the budget, finance the fiscal deficit (in 2011, fiscal deficits increased to 8% of GDP and Government borrowing resulted in crowding out effect), mobilize external support to help finance fiscal deficits and stabilize reserves.
- Improve statistics in the region as they are important for good policy making decisions.
- Implement new policies on tax collection and bank supervision.
- Targeted social safety nets should replace wasteful generalized subsidies that mostly benefit the wealthy. Fiscal resources freed up by this shift could be used for investment in infrastructure, education and health. The IMF estimates subsidies cost about $210 billion, about 7% of the region GDP and only 20% of the these subsidies reach the poor while the remaining 80% benefit the non-needy. Price subsidies also result in black markets, smuggling and corruption.
- Examine the education system and to strengthen skills to prepare graduates for successful careers in the private sector.
- In order to reduce external vulnerability, central bank may exercise exchange rate flexibility.

Could these countries succeed in implementing these reforms?

Given the limited resources, this region could benefit from assistance provided by oil exporting countries toward economic stability of the region. The oil exporting countries could play an important role in supporting the transition in the oil importing countries with financing to help defray the cost of change and provide protection for the poor.

The international community could also help by improving market access for creating export opportunities and also provide access to finance financial support ($90-$100 billion in 2012 to 2013) will be critical for the region in order to move it toward the completion of economic transformation.

What lies ahead?

Social unrest is likely to continue and so will the uncertainties about the future course of action and policy. The external environment is expected to be weaker in 2012 because of higher oil prices and Europe recession. Rising energy prices are likely to increase the payments for imports for oil-importing countries. Both of these factors would have substantial impact on oil importers output and external balance. Cross border trade and migration links with Syria may also play a role.

Policy makers need to act quickly to work on reform so that the region will have an opportunity to a bright and prosperous future enjoyed by the majority of the population.

Middle East and North Africa Oil Exporting Countries:

GDP growth for Gulf Cooperation Council (GCC) reached 8%, while the growth rate for Algeria, Bahrain, Iran, Iraq, Kuwait, Libya, Oman, Qatar, Saudi Arabia, Sudan, The United Arab Emirates and Yemen stood at 4%. Non-oil GDP for most countries grew faster than oil GDP largely because of higher government spending.

Inflation remained low (less than 5%) for many of these countries with the exception of Libya, Sudan, Yemen and Iran. Depreciation of currency and nonfood commodity shortages resulted in higher inflation of about 20% in Libya, Sudan and Yemen, while in Iran it is even higher than 20%. Inflation in Iran stemmed from the temporary price effects of subsidy reform.

Non-GCC countries government increased their spending by one-third in dollar terms, giving rise to an average fiscal deficit of 1% of GDP. GCC countries increased their spending by about one-fifth in dollar terms without any adverse effect on deficit as higher oil prices and export volumes allowed fiscal position not to be affected.

What does the future hold?

GDP growth is projected to average about 5% in 2012.

Non-oil GDP growth is projected to average about 4.5% in 2012, because of construction.

Deficits are expected to rise in 2012 for these countries that are experiencing it currently, unless government expenditures are monitored and controlled. Promotion of private sector employment to diversify economic activity from government and the oil sector would also help.

European crises and global slowdown would reduce oil exporter volumes by significant amount, resulting in lower oil prices, which could affect the fiscal deficit position of those countries that are experiencing a large deficit.

Iran crisis could affect oil prices in the upward direction that would benefit other oil exporters, provided the Strait of Hormuz is not blocked or closed.

While oil supplies from Libya, Iran and Yemen remain uncertain, any shortage in oil will be provided by Saudi Arabia. Growth is expected to increase in the oil exporting countries on the back of higher oil export receipts as well as non-oil growth.

Conclusion:

Both oil exporting and importing countries need to address immediate challenges and provide strong foundation for economic development, that is, the transformation of society and b ring about fundamental changes in the structure of the economy. There are still many uncertainties about the region’s future. Nonetheless, the region has vast amount of natural resources, a large regional market, access to many markets and young population. The people of the country must themselves be major participants in the development of these resources and the beneficiary of these changes.