



THE MIDDLE EAST AND NORTH AFRICA AND

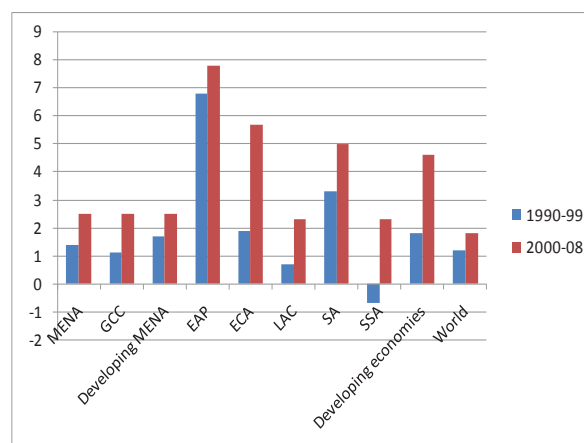
DEPENDENCE ON THE CAPITAL-INTENSIVE HYDROCARBON SECTOR

Elena Ianchovichina¹

Introduction: MENA felt the impact of the financial and economic crisis to a much lesser extent than developed economies and emerging markets outside Asia, however, the economic recovery in MENA has also lacked vigor. Before the recent uprisings, MENA was expected to return to pre-crisis growth rates of 4.8 percent by 2011-12, but growth rates in this range are not high enough to address the key challenges facing the region, including high unemployment rates – especially for young people and low labor-force participation rates, notably for women. The region also has one of the world's lowest formal employment rates as well as the highest population and labor force growth rates among middle-income economies. To address these challenges MENA's economy should be growing at rates close to those observed in East Asia and other high-performing emerging economies. It has not done so.

Economic Growth in the Last Decade: In the last ten years regional growth accelerated as compared to the 1990s as countries responded to intensified efforts to bolster their private sectors and diversify their sources of growth. Governments improved macro-economic management, simplified business regulations, reduced restrictions to trade and investment, and opened up their financial sectors. Indeed, the average number of reforms in MENA has

Figure 1 - Growth of per capita income by region (percent)²



steadily increased during the last 5 years. However, the annual per capita growth of developing MENA countries³ advanced on

¹ The Middle East and North Africa Economic Developments and Prospects report on which this Fast Brief is based on was prepared by Elena Ianchovichina (principal author) and a team comprising Lili Mottaghi, Kevin Carey, Julien Gourdon, Christina Wood, Hiau Looi Kee, Daniela Marotta, Ndiame Diop, Leonardo Garrido, Caroline Freund, Maros Ivanic, Alberto Behar, Julian Lampietti, Cosimo Pancaro, Subika Farazi, Komlan Kounetsron, Augusto Clavijo, Michelle Battat, and Yasmine Rouai. The report is available at <http://siteresources.worldbank.org/INTMENA/Resources/MENAEDPMARCH7web.pdf>. Country-specific data and information were provided by country economists and analysts working in the World Bank's Middle East and North Africa Region. The report was prepared under the guidance of Shamsad Akhtar (Vice President, Middle East and North Africa Region).

² Source: World Bank WDI.

³ For ease of analysis and exposition, the region is divided into three main groups: the GCC oil exporters, developing oil exporters and oil importers. The Gulf Cooperation Council (GCC) countries are Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and United Arab Emirates. The developing oil exporters include countries such as Algeria, Islamic Republic of Iran, Iraq, Libya, Syrian Arab Republic, and Yemen. Oil importers include countries with GCC links

average only modestly in the period between 2000 and 2008 and averaged just 2.5 percent per annum – a rate that compares poorly with the mean of 4.6 percent for the developing world (Figure 1).

The capital-intensive oil sector has been and remains the primary vehicle for revenue and wealth creation for the oil exporters in the region, while the spillover effects to the oil importing countries in the region and beyond have been significant. Oil revenues enabled governments in oil exporting countries to provide public services and infrastructure, budgetary support in times of crisis, and some – especially the GCC countries – have used their oil wealth to pursue state-led economic diversification strategies. MENA oil importers also benefitted from the oil wealth as they supplied labor to the oil-rich MENA economies and absorbed investments coming from these countries.

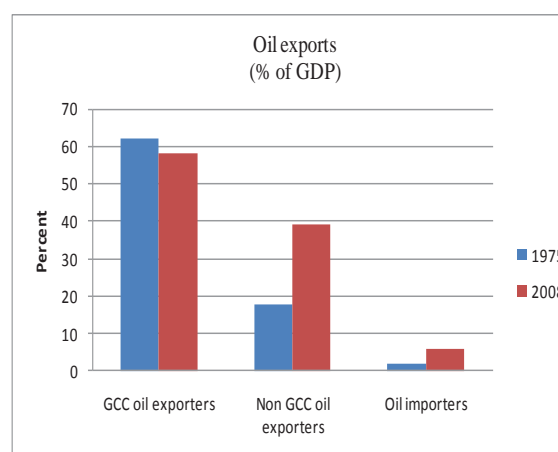
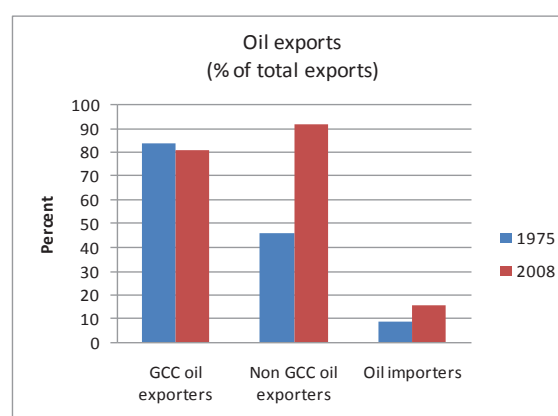
MENA's Dependence on Oil: With the benefits from oil however come serious risks as MENA remains uncomfortably dependent on the capital-intensive oil sector. In 2008, 55 percent of MENA's population lived in MENA's oil exporting countries, oil accounted for nearly 90 percent of these countries' exports (Figure 2), and more than 50 percent of these countries' GDP. In 2007 twenty-two countries in the world received at least 90 percent of their merchandise export earnings from commodities, and approximately one third of them were MENA countries.

Dependence on oil carries serious risks to growth sustainability. Some of the risks of dependence are well-understood and include volatility, Dutch disease, environmental degradation, political instability and conflict, and institutional weaknesses and corruption. Other risks are less obvious and have to do with a mismatch between the economy's endowment base and its endowment use, and in the future, the threat of viable alternatives to oil. The latter should not be discounted just because at present Asia has a tremendous appetite for commodities. Technological

advances would likely offer a low-carbon emitting alternative to fossil fuels in the future.

Dutch disease has also become a threat to those MENA oil importers receiving large remittances and finance from the GCC markets. Young people in oil importing countries, especially those with GCC links, prefer not to work in their home countries due to good prospects of finding a high-paying job in the GCC countries and elsewhere. This has increased wages for some occupations in the oil importing countries.

Figure 2 – MENA's Oil Dependence⁴



Dependence on Oil and Risk Mitigation Measures: Some MENA oil exporters have been taking steps to minimize the potential risks and enhance the potential benefits of oil-driven growth. The GCC countries, in particular, have followed prudent macroeconomic policies and management of oil

(Djibouti, Jordan, and Lebanon) and those with EU links (Egypt, Morocco and Tunisia). Developing MENA includes the developing oil exporters and the oil importers.

⁴ Source: World Bank, WDI. Note: Non-GCC oil exporters are the developing oil exporters.

revenues while accumulating large savings in the form of reserves and sovereign wealth funds. Indeed, during the period between 1997 and 2007, the group of GCC countries became the fourth largest exporter of capital after China, Germany and Japan.

Over the years, GCC oil exporters have used their sovereign oil wealth funds to finance infrastructure, technology and education in an effort to diversify their domestic and foreign sources of revenue. The UAE's service-driven model of economic diversification and Saudi Arabia's model of developing its oil-based petrochemical industry are two widely cited examples of diversification success stories. And increasingly, the oil wealth of GCC and other oil exporters is reaching other countries in the region and beyond through FDI and remittances.

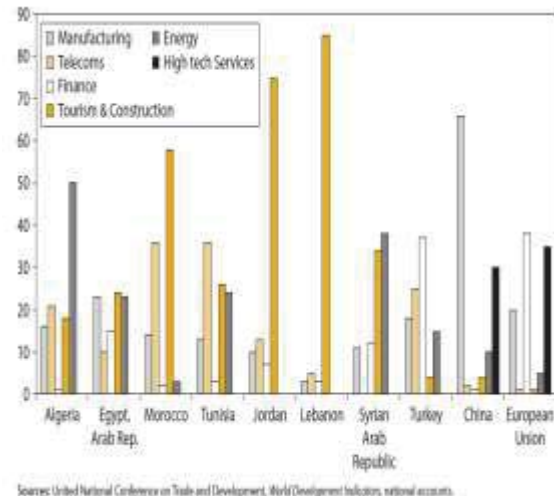
GCC oil exporters improved their competitiveness as they implemented successful prudent macroeconomic and structural reforms. Real exchange rate overvaluation became much less of a problem in most GCC countries as they opened labor and goods markets and blocked two important channels through which Dutch disease operates.

However, the labor-abundant developing oil exporters have been far less successful than the labor-importing GCC countries in dealing with some of the pitfalls of oil dependence. These countries suffer from weak institutions, conflicts, macroeconomic volatility, and Dutch disease. The latter has led to increases in the prices of non-tradables relative to tradables, making the tradable sector less competitive internationally and exacerbating the dependence on oil exports. Between 1975 and 2008 oil exports grew in importance as a source of export revenue and growth in the developing oil exporting countries (Figure 2). By contrast, during the same period oil exports declined in importance in the GCC countries.

Real exchange rate overvaluation remains a problem in most developing oil exporters. This is unfortunate because these countries are labor abundant and need rapid job growth to accommodate the second fastest growing labor force in the world after Sub-Saharan Africa. As the oil industry is not labor intensive,

continued reliance on oil will not address developing oil exporters' major issue – employment creation.

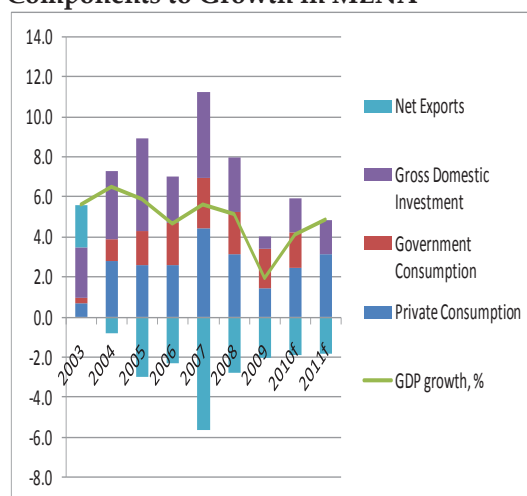
Figure 3 - Structure of FDI, cumulative 2000-07 (percent of FDI)



The Post 2001 “Home-Bias” Effect: The oil boom in 2000s also triggered an increase in investment flows from the GCC and other developing oil exporters into the oil importing countries in the region. The magnitude of these flows was boosted perhaps because of an increase in “home-bias,” or preference to retain oil wealth in the region after 2001 on concerns about potential restrictions on MENA investments in other parts of the world.⁵ Much of this investment has gone into the nontradable sectors (Figure 3), notably real estate, and has been less likely to help firms boost productivity or get access to new technologies and integrate into global production networks than investment derived from a more diverse set of countries. Indeed, net exports contributed little to growth in MENA in the past decade (Figure 4), while the contribution of gross exports was comparable in size to the contribution of the large public sector.

⁵ See for detail Noland and Pack (2008).

Figure 4 - Contribution of Demand Components to Growth in MENA⁶



Contact MNA K&L:

Emmanuel Mbi, Director, MNA Operational Core Services Unit

Regional Quick Notes Team:

Omer Karasapan, Roby Fields, and Hafed Al-Ghwell

Tel #: (202) 473 8177

MENA K&L Quick Notes:

<http://www.worldbank.org/mena-quicknotes>

The MNA Quick Notes are intended to summarize lessons learned from MNA and other Bank Knowledge and Learning activities. The Notes do not necessarily reflect the views of the World Bank, its board or its member countries.

⁶ Source: Staff estimates based on World Bank data and projections for 2010 and 2011.