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MENA ECONOMIC MONITOR

The Economics of Post-Conflict Reconstruction in MENA

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Abbreviations

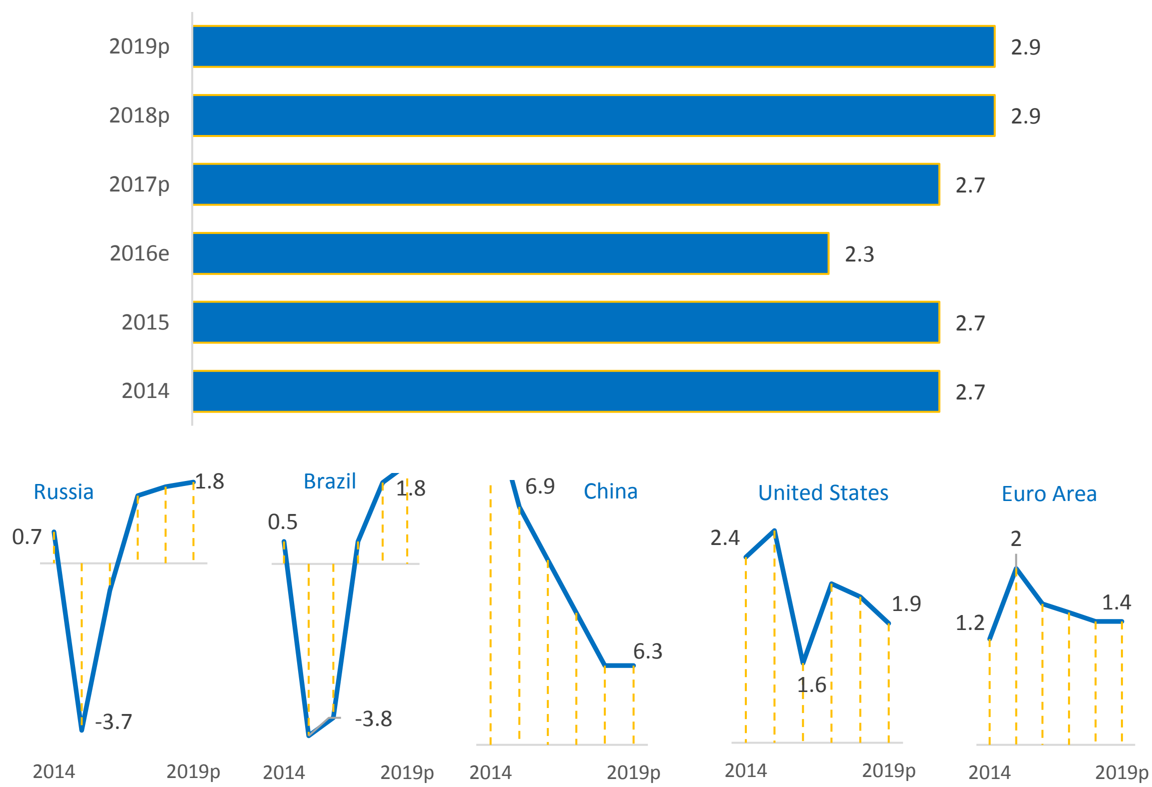
CARE	Humanitarian Organization Fighting Global Poverty
CNETAC	Closer Neighbors Economic and Trade Association
DEA	Data Envelopment Analysis
DNA	Damage and Needs Assessment report
EIA	Energy Information Administration
ESCWA	United Nations Economic and Social Commission for Western Asia
FAO	Food and Agriculture Organization of the United Nations
FDI	Foreign Direct Investment
GCC	Gulf Cooperation Council
GDP	Gross Domestic Product
IBRD	International Bank for Reconstruction and Development
ICE	Intercontinental Exchange
IDPs	Internally Displaced Persons
IMF	International Monetary Fund
ISIL	Islamic State of Iraq and the Levant
mbd	Million Barrels per Day
MDG	Millennium Development Goals
MENA	Middle East and North Africa region
MW	Megawatts
OPEC	Organization of the Petroleum Exporting Countries
PPP	Purchasing Power Parity
SAR	Saudi Riyal
SCPR	Syrian Center for Policy Research
SYP	Syrian Pound
TIMSS	Trends in International Mathematics and Science Study
UAE	United Arab Emirates
UK	United Kingdom
UN	United Nations
UNDP	United Nations Development Programme
UNHCR	United Nations High Commissioner for Refugees
UNICEF	United Nations International Children's Emergency Fund
UNOCHA	United Nations Office for the Coordination of Humanitarian Affairs
UNOSAT	United Nations Institute for Training and Research (UNITAR)
U.S.	United States
$	US Dollars
VAT	Value Added Tax
WATSAN	Water and Sanitation

Recent Economic Developments and Prospects

Global Outlook

Despite disappointing growth in 2016, global economic activity is expected to improve slightly in 2017 and beyond, led by a growth recovery in emerging-market and developing economies (Figure 1.1). Global growth in 2016 was estimated at 2.3 percent, much lower than before, mostly as a result of slower growth in commodity exporters in Sub-Saharan Africa, Latin America and the Middle East. Low oil prices in particular have badly hurt economic activity in these countries. Growth in the U.S., Eurozone, China and Japan also remained subdued due to increased policy uncertainty and slow investment. Global growth is projected to recover modestly to 2.7 percent in 2017 and reach 2.9 percent in 2019 due to slight improvement in economic activity in major commodity exporters. Oil prices are still low but have shown some stability around $50 a barrel. Recessions in Russia and Brazil are expected to bottom out with growth turning positive during the period of 2017-19. Low commodity prices and accommodating monetary policies are expected to help growth in commodity importers remain solid.

Figure 1.1 Global Growth Outlook, percent



Source: World Bank. Note: p stands for projection and e for estimate. Growth projection does not include the effects of the new U.S. administration's policies.

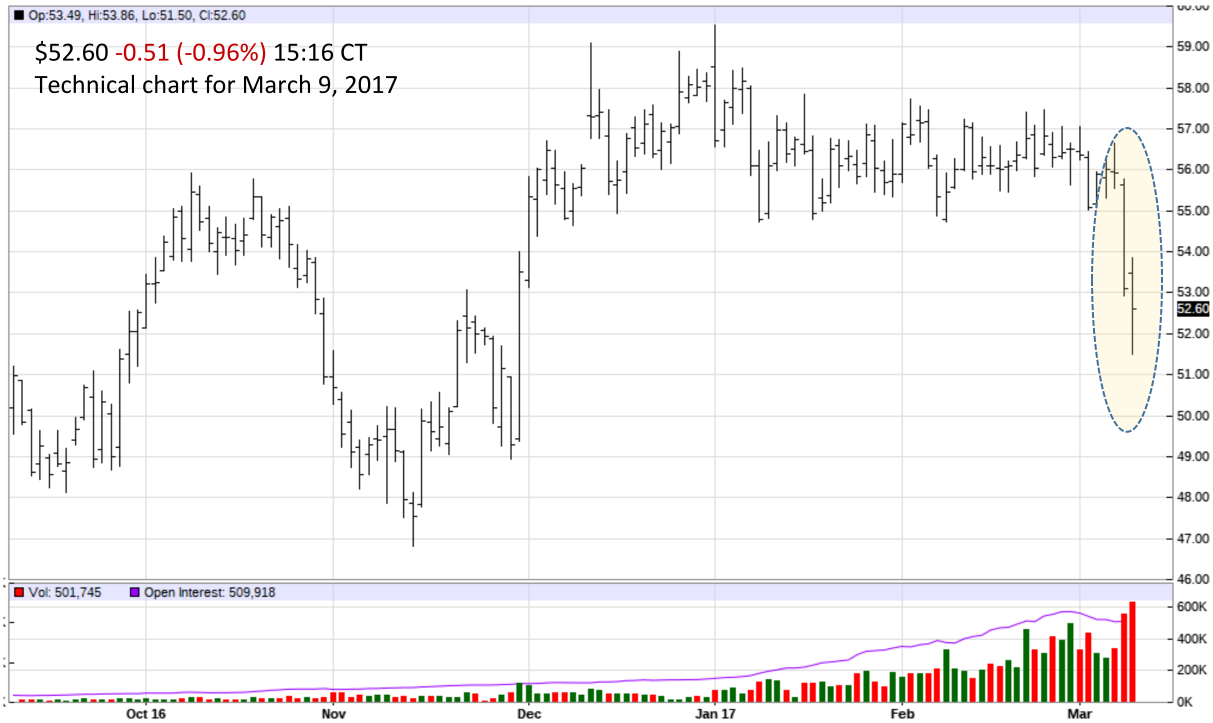
These growth projections are subject to various risks. Growing policy uncertainty following the Brexit vote in the UK, a new administration in the U.S., the prospects of rising interest rates and the upcoming elections in France and elsewhere could cloud the prospects of a rebound in global growth. Conversely, fiscal stimulus or other growth-enhancing policies in major economies, particularly the United States, could lead to a better-than-expected global recovery going forward. Developments in the U.S. economy have significant impacts on the rest of the world directly, through import demand, and, indirectly through productivity spillovers embedded in trade. Estimates by the World Bank show that a 1 percentage point increase in U.S. growth could lift growth in advanced economies by 0.8 percentage points and in the emerging market and developing countries by 0.6 percentage points after one year. Global growth could increase by 0.7 percentage points. Taking into account these risks, there is a 50 percent probability that actual global growth in 2017 will be between 2 and 3.2 percent.

Developments in the Oil Market

Oil prices respond to demand, supply and oil inventories, where the latter depend directly on volatility in the oil market (Devarajan and Mottaghi, 2016a). High levels of inventories will put downward pressure on oil prices, and unless oil stocks are drawn-down, any potential price recovery will be capped. This has been the situation in the oil market since June 2014 when prices dropped by two-thirds, from $140 a barrel to less than $50 currently. In a move to bring demand and supply into balance, the Organization of the Petroleum Exporting Countries (OPEC) agreed to its first sharp cut in eight years, reducing output by some 1.25 million barrels per day (mbd) bringing its ceiling to 32.5 mbd, with Saudi Arabia carrying the bulk of the reduction, cutting 680 thousand barrels per day. The production cut was also supported by non-OPEC oil producers notably Russia bringing total production down by 1.8 mbd from January 1, 2017. While the move was successful in raising prices for a short time after the announcement, it failed to keep the momentum. Since late February, prices have struggled to rise above $52 a barrel despite near full compliance among OPEC and non-OPEC members with their reduced quotas. The main reason is that the market is going through a fundamental change where US shale producers, and not OPEC, are the swing producers.

Since early 2017, US shale oil production has been growing at an unprecedented pace, offsetting the loss of OPEC output in the market. Oil prices above $50 a barrel (breakeven cost) incentivise US shale oil producers to increase rigs, a proxy for oil activity, and boost output. For example, oil output from Permian Basin, covering parts of western Texas and southestern New Mexico, expanded to 53,000 barrels per day in February 2017 and is expected to climb to 70,000 in March. Moreover, production of Eagle Ford shale is expected to rise significantly by 14,000 barrels in March bringing total production to 1 million barrels per day. Recent developments in the oil market have spilled over into the futures market where oil contracts are traded at below $50 a barrel - $49.25, $49.77 and $50.20 for delivery in April, May and June respectively - suggesting that a recovery in oil prices beyond $50 a barrel is not expected soon (Figure 1.2). Under these circumstances and in the absence of a demand shock or drawdown of stocks, the market will remain supply driven and any attempt to revive prices will be capped, at least until the end of the decade.

Figure 1.2 Brent Crude Futures for Delivery in May 2017, US Dollar

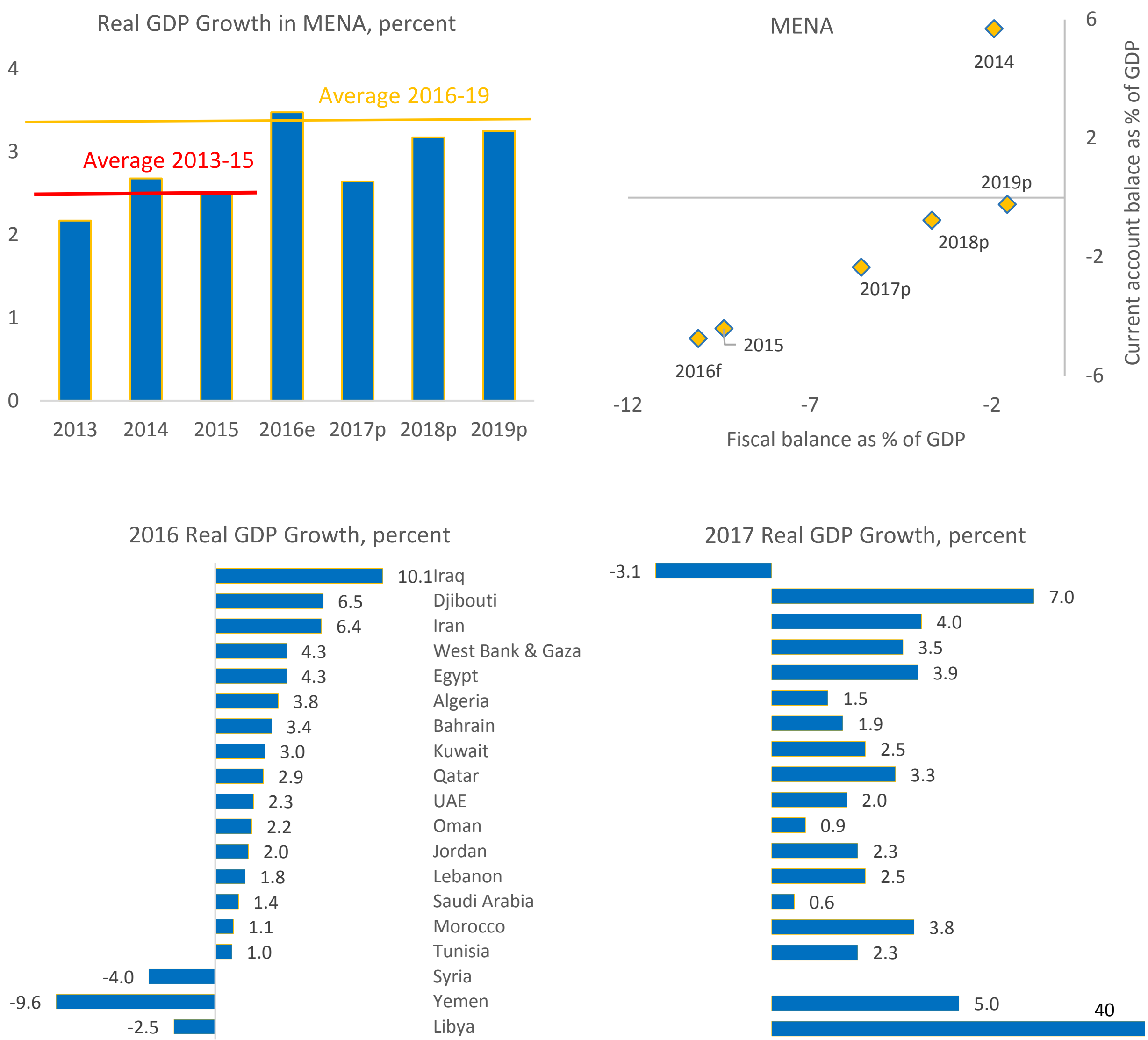


Source: Interconintental Exchange (ICE)

Recent Economic Developments and Outlook for MENA

Plagued by war, violence and low oil prices, economic activity in the Middle East and North Africa (MENA) region remained subdued between 2013 and 2015 at around 2.4 percent on average, half of the annual growth seen during the 2000s. After 2017, the situation is expected to improve slightly and growth to surge above 3 percent over the forecast period (Figure 1.3). Though still below potential, the improvement in growth offers hope. Signs of "green shoots" are observed in some countries in the region, particularly Egypt and Iran; a sense of stability in the oil market, albeit at low prices; and the positive impacts of ongoing peace talks in Syria, Yemen and Libya could together prompt higher growth in the region going forward. In this environment, the regional average growth in MENA is estimated to have reached 3.5 percent in 2016. This is about one percentage point higher than the average growth observed in previous years. Among groups of countries, we expect growth in developing MENA countries - the main driver of regional growth - to have quadrupled in 2016 reaching 4.9 percent, from its 2015 level of 1.1 percent and to stay around 4 percent by 2019.

Figure 1.3 MENA's Macroeconomic Situation



Source: World Bank. Note: p stands for projection and e for estimate.

Growth in oil exporters is also estimated to have picked up in 2016 from its low level in the previous years (See Table 1.1). GCC countries are the only subgroup where growth slid from 3.8 percent in 2015 to 2 percent in 2016 due to austerity measures and oil production cuts undertaken as part of the reforms to combat low oil prices and the sharp fall in oil revenues (Box 1.1). In 2017, growth in MENA is expected to decline to 2.6 percent as a result of a slowdown in the economies of oil exporters to 2.4 percent growth, down by 1.1 percentage points from 2016. The main reason is a likely short-term contraction in Iraq as the country complies with the agreed

OPEC cut of about 180,000 barrels a day. At the same time, growth in Yemen and Libya is expected to turn positive due to an increase in production in the hydrocarbon sector. Growth in oil importers is expected to pick up to 3.5 percent in 2017 from 2.9 percent in a year before; almost all countries in this subgroup will perform better than last year.

Fiscal and current account balances for MENA as a whole are expected to improve significantly throughout the forecast period (See Figure 1.3, top right panel). MENA countries on average enjoyed years of fiscal surplus prior to the 2011 Arab Spring and the 2014 sharp drop in oil prices. In 2010, the total surplus amounted to $110 billion, about the same size as Kuwait's GDP and larger than the GDP of Lebanon, Libya and Morocco. This huge amount of savings was spent mostly on food and fuel subsidies (almost 10 percent of GDP), large public sector wage bill (more than half of total expenditure in Yemen and Libya); much less was used for capital investment.

The result has been high unemployment particularly among youth and females, a weak private-sector and business environment, which were factors that led to the 2011 Arab Spring uprising (Devarajan and Mottaghi, 2015a). The huge fiscal surplus in MENA in 2010 turned into a $285 billion deficit in 2016 which was mainly financed through issuing debt and drawing down reserves. As countries such as Egypt and several oil exporters are taking necessary reforms (See Box 1.1), the fiscal deficit is expected to narrow considerably in MENA reaching 1.5 percent of total GDP in MENA or $52 billion in 2019.

Green shoots are observed in Egypt and Iran. Egypt is implementing key reforms both on the revenue and expenditure side of the budget, most notably the introduction of the VAT law and civil service reform law last year; floating the exchange rate; and increasing fuel prices close to the world price. As a result, foreign direct investment is expected to double in 2017 reaching $5 billion. Growth is expected to remain strong at about 5 percent in 2019. Both fiscal and current account deficits will improve throughout the forecast period. The large debt to GDP ratio and high inflation, particularly after floating the exchange rate, remain a concern going forward. Iran is back in the spotlight after the implementation of the Joint Comprehensive Plan of Action last year, attracting more foreign direct investment (FDI) mostly in the oil sector. Growth in 2016 is estimated to have reached 6.4 percent, following a 1.8 percent contraction in the previous year, resulting from higher growth in the mining and manufacturing, services and agriculture sectors. Oil exports have increased significantly due to an increase in oil production from 3.2 million barrels per day in 2015 to 3.7 million in 2016 and an expected 4.2 million in 2017. This is expected to result in a huge increase in the current account surplus from 2.7 percent of GDP in 2015 to 6.5 percent of GDP in 2017. Iran is one of two countries that are expected to register a high current account surplus in 2017 and the only country with a fiscal deficit of less than 1 percent of GDP in that year (See Table 1.1). The fiscal deficit is expected to turn into surplus in 2018. Putting all this together, we expect growth to stay above 4 percent by 2019, higher than other oil exporters in the region.

Box 1.1 Recent Reforms in GCC Countries

The pace of reforms in GCC countries intensified in 2016 as governments across the sub-region are treating low oil prices as permanent. Despite the recent agreement among OPEC and non-OPEC members to cut production and revive prices, oil futures prices for delivery in March point to $53.44 per barrel, suggesting that oil prices are not expected to rebound any time soon or at least by the end the decade. The main reason is continued acceleration in U.S. oil drilling which offsets bullish news that OPEC is complying with the promised cut (See Devarajan and Mottaghi, 2016a).

Recent measures include raising utility rates, fuel prices, and taxes on expatriates, amending labor market laws, and issuing debt to finance high fiscal deficits. These include:

Financing: ***Saudi Arabia*** raised $17.5 billion in an international bond sale and ***Qatar*** sold 15 billion QAR ($4.1 billion) in bonds to local debt markets. ***Bahrain*** issued $2 billion in international bonds, half in a sukuk. ***Oman*** issued debt in the amount of $5 billion in international bonds. ***Kuwait*** expects to raise $8 billion with its first international bond issue.

Taxes: ***Saudi Arabia*** removed subsidies and increased fees for government services to issue passports, driving licenses, car transfers, traffic violations, residence permit renewals for domestic workers; increased customs duties on 193 commodity products; and plans sugar drink and tobacco taxes for April 2017. New visa fees includes SAR 8,000 (about $2,133) for a two-year multiple entry permit, as well as reducing the benefits of a SAR 500 (about $1,334) multiple exit/entry visa from 6 to 3 months. The cabinet approved 5 percent VAT to begin in early 2018. ***Abu Dhabi*** introduced a new 3 percent municipality fee on expat rental contracts. ***Oman*** increased the income tax with significant changes applied to small businesses and visa fees by 50 percent and introduced extra fees for airport departures of about 2 Omani rials ($5.18). ***Bahrain*** increased visa fees and ***Qatar*** introduced new fees for alcohol licenses for expats. In ***Kuwait***, work permit fees were raised from about $6.63 (2 Kuwait dinars) to $165.78 (50 Kuwait dinars) and its renewal from about $6.63 (2 Kuwait dinars) to $33.16 (10 Kuwait dinars).

Subsidies: ***Kuwait's*** Cabinet approved increasing petrol prices by 41 percent for low-octane petrol and 83 percent for low emission petrol starting in September. ***Qatar*** increased gasoline prices by 30 percent, causing a liter of unleaded gas to reach $0.36. Gas prices rose by up to 60 percent in ***Bahrain***, to $1.25 per gallon for regular petrol and $1.60 per gallon for premium fuel. ***Oman*** reduced subsidies through increased gasoline prices by 33 percent for premium fuel and 23 percent for regular fuel. ***Saudi Arabia*** increased prices between 50 percent and 66 percent to SAR 0.75 per liter of octane 91 and SAR 0.90 per liter of octane 95. The ***UAE*** government has taken a different approach from other GCC countries and floated petrol prices based on global oil prices.

Doing business: ***UAE's*** Cabinet approved a Bankruptcy Law (expected to come into effect Q1, 2017) pending presidential signature. The law is aimed at safeguarding the rights of creditors and debtors in insolvency situations, including measures that prioritize secured creditor rights, and enable companies to restructure without unanimous creditor approval.

Source: The Arab Gulf State Institute in Washington, Gulf Economic Barometer, March 20, 2017.

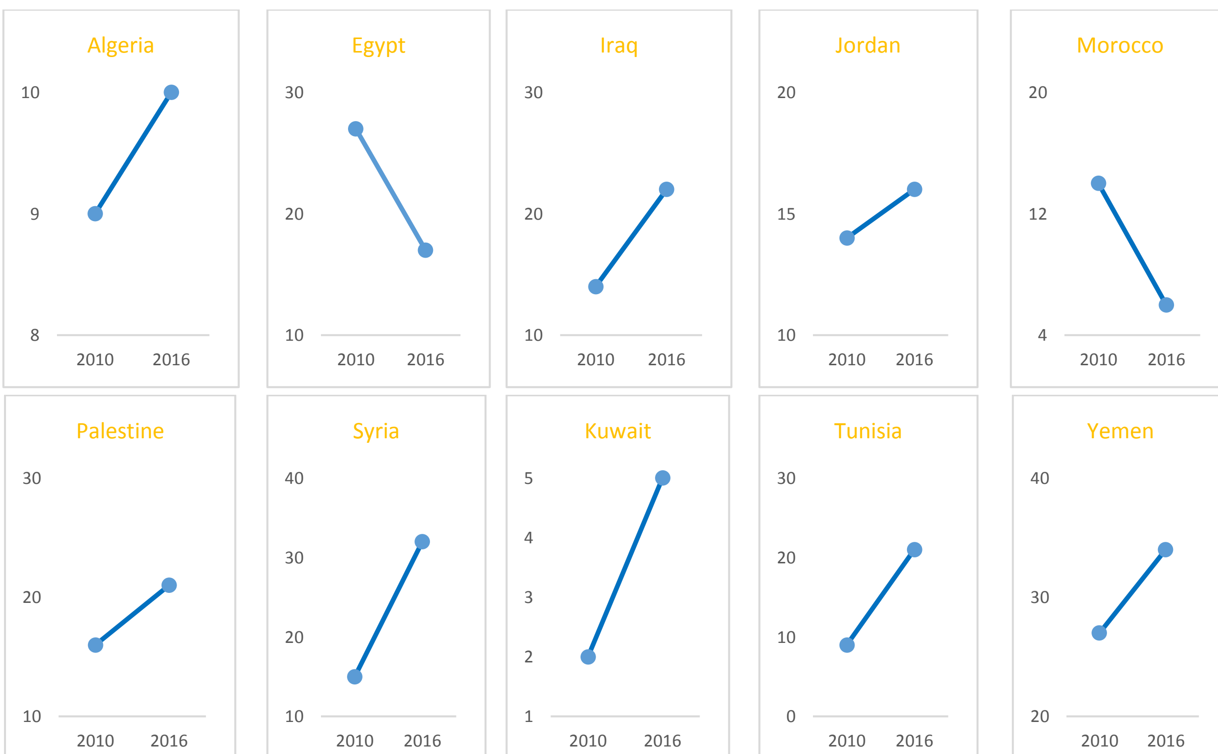
Table 1.1 MENA's Macroeconomic Outlook

	Real GDP Growth, percent						Fiscal Balance as percentage of GDP						Current Account Balance as percentage of GDP					
	2014	**2015**	**2016e**	**2017p**	**2018p**	**2019p**	**2014**	**2015**	**2016e**	**2017p**	**2018p**	**2019p**	**2014**	**2015**	**2016e**	**2017p**	**2018p**	**2019p**
MENA	**2.7**	**2.5**	**3.5**	**2.6**	**3.2**	**3.2**	**-2.1**	**-9.4**	**-10.1**	**-5.6**	**-3.6**	**-1.5**	**5.7**	**-4.4**	**-4.8**	**-2.4**	**-0.7**	**-0.1**
Developing MENA	**2.0**	**1.1**	**4.9**	**3.7**	**4.0**	**3.8**	**-7.3**	**-10.4**	**-8.9**	**-5.0**	**-3.4**	**-2.2**	**-2.9**	**-6.5**	**-6.1**	**-3.5**	**-2.8**	**-2.4**
Oil Exporters	**2.6**	**2.2**	**3.5**	**2.4**	**2.9**	**2.9**	**-0.5**	**-9.6**	**-10.3**	**-5.3**	**-2.9**	**-0.5**	**8.1**	**-4.1**	**-4.1**	**-1.4**	**0.5**	**1.2**
GCC Countries	**3.2**	**3.8**	**2.0**	**1.5**	**2.3**	**2.6**	**2.8**	**-8.5**	**-11.3**	**-6.2**	**-3.7**	**-0.9**	**13.6**	**-2.3**	**-3.6**	**-1.4**	**1.2**	**2.0**
Bahrain	4.4	2.9	3.4	1.9	1.9	2.3	-3.4	-12.8	-12.6	-9.8	-8.9	-7.6	4.6	-2.4	-4.6	-3.8	-3.5	3.5
Kuwait	0.5	1.8	3.0	2.5	2.6	3.2	18.0	-0.4	0.5	4.6	4.8	4.7	33.2	7.5	1.9	5.0	5.5	6.1
Oman	2.5	5.7	2.2	0.9	2.4	2.9	-3.6	-16.5	-20.3	-13.9	-9.2	-7.4	5.2	-15.5	-16.2	-14.4	-9.8	-6.7
Qatar	4.0	3.5	2.9	3.3	2.6	2.5	12.6	1.4	-8.2	-2.3	0.7	2.4	24.0	8.3	-2.3	-0.8	1.2	2.8
Saudi Arabia	3.7	4.1	1.4	0.6	2.0	2.1	-3.4	-15.1	-18.1	-10.6	-6.7	-1.7	9.7	-8.6	-6.5	-4.0	0.5	0.9
UAE	3.1	3.8	2.3	2.0	2.5	3.2	5.0	-2.1	-3.5	-2.2	-1.9	-1.0	10.1	3.3	1.3	3.0	3.2	3.4
Developing Oil Exporters	**1.7**	**-0.3**	**5.9**	**3.8**	**4.0**	**3.5**	**-6.2**	**-11.4**	**-8.5**	**-3.7**	**-1.5**	**0.0**	**-1.4**	**-7.1**	**-5.0**	**-1.3**	**-0.6**	**-0.1**
Algeria	3.8	3.9	3.8	1.5	0.6	1.5	-7.3	-16.2	-12.2	-4.7	-2.4	-1.0	-4.4	-16.5	-15.6	-12.6	-10.6	-9.5
Iran, Islamic Rep.	4.3	-1.8	6.4	4.0	4.1	4.2	-1.2	-1.9	-1.5	-0.6	0.2	1.1	3.8	2.7	6.5	6.5	5.5	4.6
Iraq	0.7	4.8	10.1	-3.1	2.6	1.1	-5.3	-12.3	-8.2	-4.4	-3.6	-1.0	2.6	-6.5	-7.2	-4.5	-4.7	-2.5
Libya	-24.0	-8.9	-2.5	40.1	19.7	11.4	-43.3	-76.9	-52.7	-18.8	-6.1	-1.9	-46.1	-67.1	-50.8	-15.3	-5.1	-2.5
Syrian Arab Republic	-18.0	-15.8	-4.0	...	...	...	-19.3	-20.2	-18.2	...	...	...	-19.0	-8.4	-9.9	...	...	...
Yemen, Rep	-0.2	-28.1	-9.6	5.0	...	...	-6.8	-11.1	-9.0	-10.3	...	...	-1.7	-5.5	-5.6	-4.2	...	...
Developing Oil Importers	**2.6**	**3.7**	**2.9**	**3.5**	**3.9**	**4.3**	**-9.4**	**-9.0**	**-9.5**	**-7.5**	**-6.9**	**-6.0**	**-5.3**	**-5.7**	**-7.7**	**-7.9**	**-6.9**	**-6.3**
Djibouti	6.0	6.5	6.5	7.0	7.0	7.2	-10.8	-21.7	-15.5	-1.9	-1.5	-1.2	-24.7	-33.0	-31.1	-22.2	-17.7	-14.4
Egypt, Arab Rep	2.9	4.4	4.3	3.9	4.6	5.3	-11.5	-11.0	-12.1	-10.5	-9.2	-7.3	-0.9	-3.8	-6.1	-5.5	-4.4	-3.8
Jordan	3.1	2.4	2.0	2.3	2.6	3.0	-14.2	-6.9	-6.2	-5.0	-3.1	-2.2	-7.3	-9.1	-7.3	-8.5	-7.4	-5.9
Lebanon	1.8	1.3	1.8	2.5	2.6	2.6	-6.6	-8.2	-10.0	-9.5	-9.8	-9.4	-25.4	-17.1	-20.9	-20.2	-19.2	-19.2
Morocco	2.6	4.5	1.1	3.8	3.7	3.6	-4.7	-4.3	-3.9	-3.0	-3.0	-3.0	-5.7	-1.9	-4.0	-4.2	-4.0	-4.0
Tunisia	2.3	1.1	1.0	2.3	2.8	3.2	-5.0	-5.6	-6.0	-5.9	-5.5	-5.0	-9.1	-8.9	-9.0	-8.4	-7.6	-7.1
West Bank & Gaza	-0.2	3.4	4.3	3.5	3.4	3.4	-12.5	-11.4	-8.1	-9.7	-9.4	-9.2	-6.7	-15.9	-16.3	-15.5	-15.4	-15.8

Source: World Bank. Note: e stands for estimate and p for projections. Fiscal balances for Jordan, Tunisia, West Bank and Gaza, and Yemen exclude grants. Data for Egypt correspond to fiscal year (July to June). Due to lack of data for Syria and Yemen, regional and sub regional averages may not be comparable over time.

While most macroeconomic indicators are expected to improve in the region, people in MENA have a different perception of their lives. Figure 1.4 depicts responses of people from selected countries in MENA to the question about how satisfied they are with their lives. The results of the 2017 Gallup survey show that compared to the pre Arab Spring years, people in Iraq, Yemen and Syria are suffering most: the dissatisfaction index has increased by 15 percentage points on average in 2016 compared to 2010. Similarly, in Algeria, Kuwait, UAE, Tunisia, Palestine and Jordan people feel their quality of life has deteriorated but by a lesser amount than the first group as they constantly feel the pain of the negative spillovers of war, terrorism and falling government revenues resulting from low oil prices, on their daily lives. This is reminiscent of the situation before the Arab Spring, when MENA as a whole was growing rapidly at 5 percent on average - with growth in Egypt, Tunisia, Yemen and Syria even faster - but life satisfaction indicators were declining, especially in the Arab Spring countries (Devarajan and Ianchovichina, 2017). In the event, people stood up and demonstrated their widespread discontent over exclusion, lack of voice and freedom, unemployment and poor service quality in a chain of revolutions during 2010-11. Conversely, dissatisfaction rates have improved slightly among people in Egypt and Morocco as reforms are taking place.

Figure 1.4 Gallup Dissatisfaction Index



Source: Gallup Survey 2017. Note: Life satisfaction index measures perception of respondents of where they stand now and in the future. Specifically the people are asked to evaluate their lives by imagining a "ladder" with steps numbered from 0 to 10, where "0" represents the worst possible life and "10" represents the best possible life. Dissatisfaction rates are calculated for life satisfaction scores of 4 and below.

Risks and Challenges

Risks to the short-term outlook include excess volatility in oil prices, escalation of war and violence in the region, and uncertainty about the new U.S. administration's policies towards the countries in the region. Conversely, positive outcomes of the ongoing peace talks in Syria and to some extent in Yemen and Libya, and reduction of insurgencies in Iraq could improve short-term prospects in the region.

Risks to long- term growth in the region are manifold. Conflict and proxy wars, political instability, corruption and poor governance can have devastating impacts on growth potential. The key challenges in sustaining high and inclusive growth in the region include ending the armed conflicts, improving macroeconomic conditions, and undertaking microeconomic reforms to create a better business climate for the private sector. But more important is maintaining the political momentum for reforms.

At the same time, the prospects for a growth recovery and even moving to a higher and sustainable growth path in MENA are significant. First, reforms are a must in both oil exporters and oil importers. Many governments have already implemented subsidy reforms and taken austerity measures (See Box 1.1), but additional measures to raise revenue are needed to preserve macroeconomic stability and strengthen growth. Better policies are needed to foster private sector investment to complement public sector investment. Reforms oriented to reducing public-sector employment and narrowing the wage differential between the public and private sectors would be essential components of the growth strategy. Finally, macroeconomic stability should be maintained supported by strong fiscal frameworks and clear communication strategies.

Second, there is a need to revolutionize the education system for better quality and relevant skills. A reorientation of the region's education system towards learning skills through vocational training that are relevant for today's high-tech industry is essential for boosting entrepreneurship and jobs. For example, technology companies are the most popular private-sector employers for young nationals, topping the list in Saudi Arabia, the UAE, Qatar and Kuwait. Increasing women's participation rate for instance through promoting the formal, private sector is important. For example the Saudi retail sector has been a major focus of jobs for national women.

Third, oil exporters have been growing with oil and slowing with oil. There is a need to boost growth in the non-oil tradable sector that could help reduce exposure to price volatility and generate productive, private-sector jobs. Improving the business environment and reducing trade barriers in the GCC (including in the services sector) is likely to help boost competition. Privatization may also be important as a way to boost competition given the large role of the public sector in oil exporters including GCC economies, but it will need to be designed to ensure adequate post-reform regulation. And finally improving intra-regional trade will be one key to improving growth prospects as regional integration could open up trade with large, global markets, such as Europe and Asia, exploit economies of scale in infrastructure, and possibly build trust among countries in the region, some of whom are engaged in proxy wars.

Just as violence and conflict have contributed to the slow growth in MENA over the past six years, the prospects of peace in Syria, Yemen and Libya remain one of the keys to resuming growth over the next decade. But realizing that potential depends crucially on how the post-conflict reconstruction is conducted. On the one hand, a well-managed process could help these war-torn countries rebuild their shattered economies and re-integrate their people so that the region as a whole, and possibly the rest of the world, benefits. On the other hand, a badly managed process can risk a recurrence of conflict, continued stagnation and suffering, and perpetual fragility. The economics of post-conflict reconstruction, therefore, is critical to the future of MENA's economies, which is why it is the subject of the next chapter.

The Economics of Post-Conflict Reconstruction in MENA

Introduction

The Middle East and North Africa (MENA) has known war for centuries. In recent times, the Iran-Iraq war (1980-88) and the Yemen civil war (1962-70) both lasted eight years; the Lebanese civil war (1975-90) took longer to subside; and the Palestinian-Israeli conflict has flared up, especially in Gaza, several times. All resulted in a large number of deaths and casualties, and massive physical damage. Yet, the region's current civil wars in Syria, Libya, and Yemen[1] stand out on a number of dimensions. First, the wars have had destructive effects on almost all aspects of these economies. In particular, the oil sector – lifeline of the governments – has seen its infrastructure destroyed, bringing production down significantly. Violence has created newly vulnerable groups, such as the unemployed, households headed by women, children born into conflict, and the disabled. In particular:

- Civil war in Syria has killed about 500,000 people, displaced half the population - one-third of them outside the country - and pushed more than two-third of Syrians into poverty. The refugee tide, initially contained within the neighboring countries of Jordan, Lebanon, Turkey, and Iraq, has washed up on European shores, turning into a global displacement crisis.
- The conflict in Yemen has touched every aspect of Yemenis' lives, limited their access to food, water, and health care, deepened poverty, and forced millions of children out of school. More than 7,000 people have been killed, and over 31,000 wounded. So far, more than 15 percent of Yemenis have been displaced or have fled the country.
- Violence in Libya has displaced one tenth of its 6 million people internally, and about 125,000 externally, particularly to Europe because of its close proximity.

Secondly, three civil wars are underway simultaneously, directly affecting the lives of more than 60 million people, about one-fifth of the population of the MENA region. They are having spillover effects on neighboring countries such as Jordan, Lebanon, Tunisia and Turkey, who are hosting an unprecedented number of refugees while seeing their trade, tourism, and security undermined. Terrorist attacks have spread around the globe.

Third, all three civil wars originated with the Arab Spring protests, but have since turned into sectarian conflict.

[1] The ongoing conflict in Iraq shares many similar characteristics to these wars, but since it is concentrated in parts of the country, we do not include it in this list of civil wars.

Fourth, the civil wars in Syria, Libya and Yemen have become “proxy wars” where various factions receive substantial financial and arms assistance from foreign actors and countries. Historically, proxy wars tend to last longer than other wars, as continued funding stymies efforts at a negotiated peace settlement.

These differences from previous wars in the region imply that, in addition to being a political and military challenge, peace and reconstruction in MENA is a huge economic challenge. The scale of destruction and forgone economic growth - the loss in GDP relative to the “no-war” counterfactual in Syria alone is estimated at $200-300 billion - means that substantial resources will be needed for post-conflict reconstruction. The pace and rhythm of these resources will need to be calibrated with the absorptive capacity of the post-conflict economies. Furthermore, given that all three countries experienced Arab Spring protests, any post-conflict reconstruction effort will need to rebuild not just infrastructure but institutions. In particular, the new institutions should address the sense of exclusion that led to people’s protesting in the first place.

Inasmuch as all three wars have become sectarian conflicts, a post-conflict settlement will probably involve some autonomy to sub-national regions along sectarian lines. Here, the distribution of oil revenues across different entities will be critical. Finally, the fact that the wars have had harmful spillover effects not just on neighboring countries but across the MENA region and beyond implies that the whole world stands to benefit from a cessation of hostilities in Libya, Syria and Yemen. Peace in MENA is a global public good. It follows that the global community needs to come together to help finance, and more importantly to help implement, the post-conflict reconstruction programs in MENA.

This chapter provides this economic perspective on post-conflict reconstruction in MENA. For each country, we first describe the pre-conflict economy. Next, drawing on various sources, we provide estimates of the costs of the war. We start with the human costs, proceed to estimates of the damage to infrastructure and physical capital (drawing on the United Nations and World Bank damage and needs assessments), and end with the macroeconomic and sectoral costs. This synthesis of the damages from the war provide a backdrop to an exposition of the post-conflict reconstruction strategies. Rather than providing a single number for the financing needed, we focus on priority areas for reconstruction, instruments, and some principles of a reconstruction strategy. These principles are important because for the three countries, we will need to rebuild not just physical capital, but human capital, which has suffered greatly in the conflict; and social capital or trust among various groups. While the details will be country-specific, the chapter suggests principles that can guide post-conflict reconstruction in all three countries. In describing principles governing the role of the international community, the chapter draws on the experience with other reconstruction efforts, notably that of Iraq after 2003.

Syria

Pre-Conflict (1970-2010)

Syria depicts the characteristics of an oil-based economy, albeit at a smaller GDP than most of the region's oil producers. For the four decades before 2011, the economy relied on oil for more than 50 percent of exports and 35 percent of government revenues. With its oil wealth, the Syrian government supported the "Arab social contract", providing citizens with universal subsidies, public-sector jobs, and free health and education in return for limited voice and accountability. Periods of oil windfalls brought increases in income, expansion of public-sector jobs, investment in infrastructure, and improvements in living standards together with advances in health and education.

Economic growth was strong during this period, averaging around 5.6 percent, with several years of double-digit rates. Between 2000 and 2008, GDP per capita doubled, reaching $2,806, lower than other oil-exporting countries except Yemen, but comparable to Morocco and Egypt. The high growth was accompanied by fiscal stability, low debt (around 20 percent of GDP) and reasonable levels of foreign reserves. Syria's fiscal deficit was contained at around 4 percent of GDP for years prior to 2010. Remittance inflows were on the rise, reaching $2 billion in 2010 from $135 million in 2002.[2]

Years of oil boom made it possible to invest significantly in human capital (Figure 2.1). By 2010, about 92 percent of the population had access to electricity, with 100 percent in urban areas. About 95 percent of households had access to improved sanitation facilities and life expectancy stood at 72 years, higher than most countries at this level of per capita income. Health indicators improved significantly. Immunization coverage reached 84 percent of the population in 2010, and child mortality was down from 38 per 1,000 births in 1990 to 13 in 2010. Education was accessible to all school-aged children with the gross enrollment rate in primary education at 126 percent in 2007. Still, the enrollment rate for females was significantly less than for males. Only 58 percent of the female population over 25 years had completed primary education in 2009 compared with 76 percent of males, according to World Bank data. The gap between male and female educational attainment narrowed for those who completed secondary education.

In addition, Syria is one of the MENA countries that appears to have used public spending efficiently (Box 2.1). However, the education system in Syria, like those of other MENA countries, fell short on quality. The results of the 2007 Trends in International Mathematics and Science Study (TIMSS) show that about half the Syrian students who appeared in the international exam performed below the lowest international benchmark.

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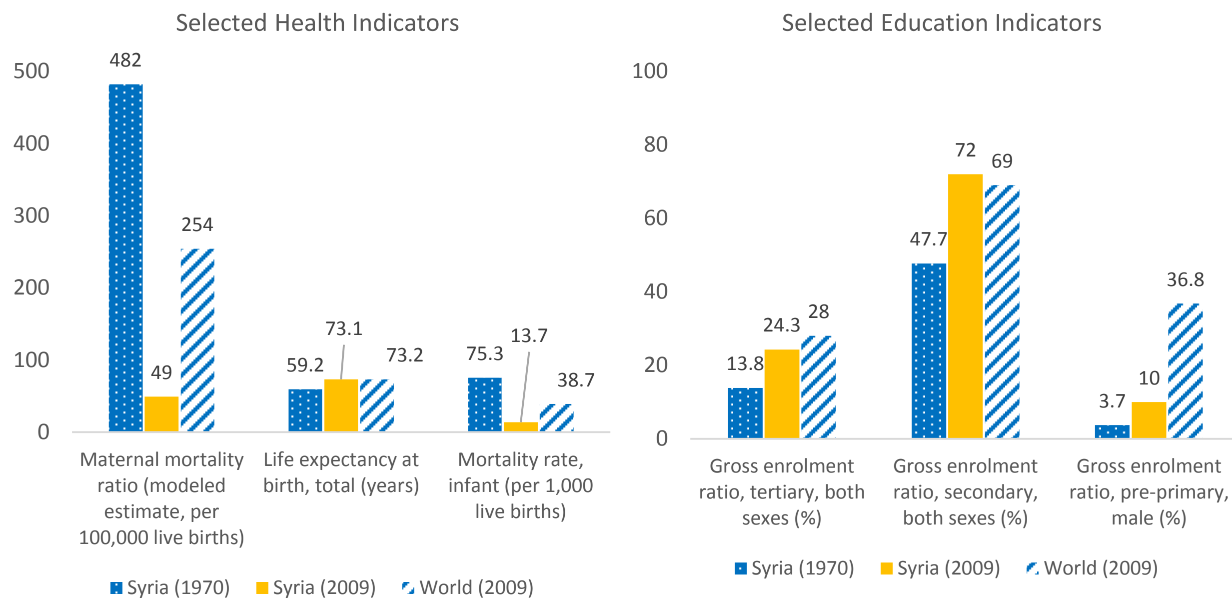
[2] See World Bank migration data.

Though high, the oil-driven economic growth of 1970-2010 was extremely volatile, thanks to the cycles of oil boom and bust during this period (Figure 2.3). Volatility in oil prices led capital expenditures to rely heavily on oil wealth and in sectors that were not conducive to job creation. The public sector wage bill and fuel subsidies increased throughout this period in a move to improve standards of living and reduce the high rates of unemployment resulting from years of investing in the capital-intensive oil sector.

Figure 2.1 Syria's Health and Education Indicators



Source: World Bank.

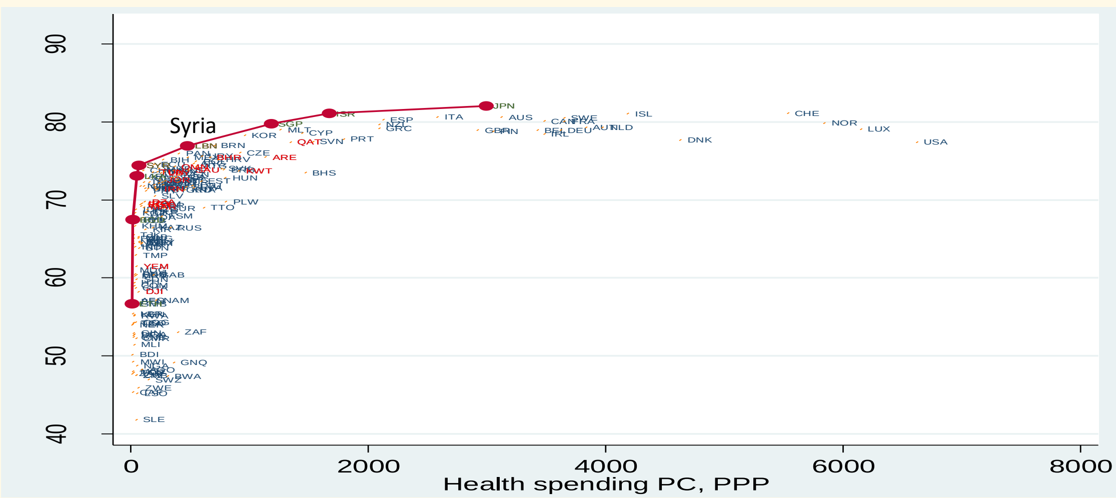
But the higher standards of living and public-sector jobs raised expectations, leading to a wide gap between actual market wage rates and expected wages. Those in the labor market queuing for public sector jobs were faced with a limited number of alternatives and were pushed into the informal sector. Together with a weak private sector that was not able to create private employment, this contributed to an official unemployment rate of about 9 percent in 2010, and unofficially 20 percent, with female rates exceeding 23 percent and the youth unemployment rate at around 19 percent.

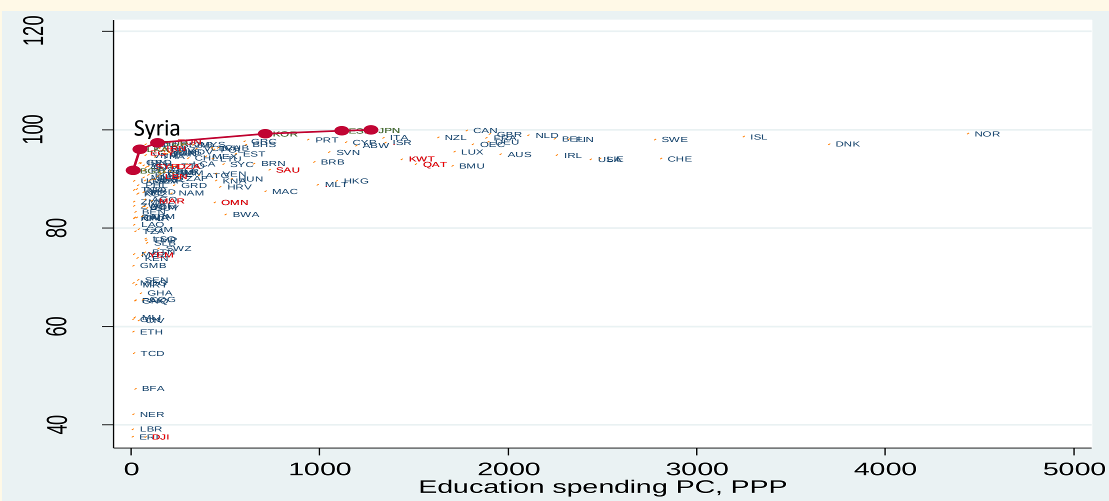
Inflated public sector wages undermined competitiveness in the non-oil sectors. Among them, agriculture played an important role in terms of contributing to growth—oil and agriculture accounted for 50 percent of GDP in 2010—and creating jobs especially for rural workers. But due to the geographical situation of the country which made it prone to droughts, production and employment in this sector remained low and vulnerable.

Box 2.1 Syria an Outlier in Efficiency of Public Spending

Studies have shown that only two MENA governments have used their resource efficiently to provide public health and education services to their citizens. A study by Mottaghi (2016) uses non-parametric methods of Data Envelopment Analysis (DEA) to estimate the efficiency of public spending in health and education in a panel of 170 countries including MENA countries for two periods, 1990-99 and 2000-10. Health output is measured by life expectancy at birth and education attainment by net primary enrollment, and total public spending is considered as the input. The study shows that during the period of 2000-10, Syria was one of only two MENA countries (the other was Lebanon) achieving high efficiency scores in public spending in health and education spending. Figure 2.2 shows Syria's estimated efficiency scores in health and education for life expectancy at birth and net primary enrollment respectively. The estimated efficiency score for public spending on the health indicator for Syria is on the frontier (red line) and for the education indicator is very close to the frontier. The results are consistent with high achievement in both educational attainment and health indicators for Syria during the 2000s.

Figure 2.2 Syria: Spending Efficiency Frontier Estimate, 2000-2010

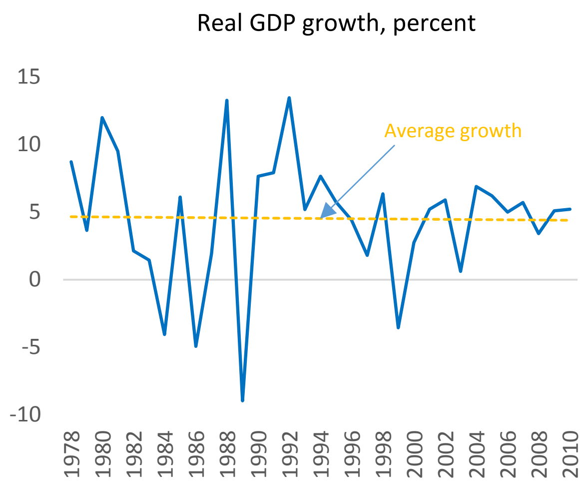


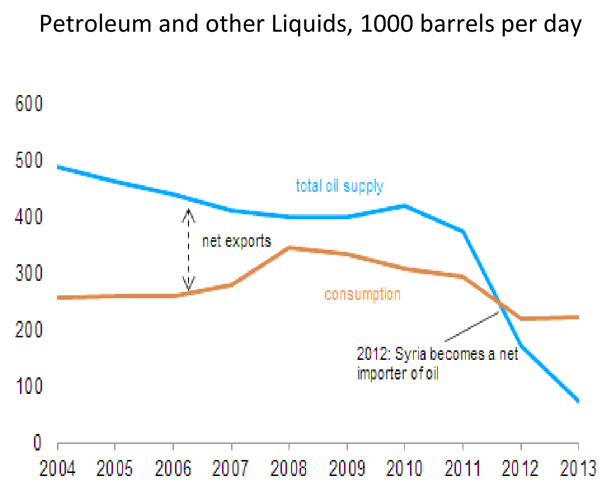


Source: Mottaghi, Lili, 2016. "Spending Efficiency in MENA, an Efficiency Frontier DEA Approach". Note: PC and PPP stand for per capita and purchasing power parity.

Domestic economic shocks including the real estate boom and the removal of some subsidies in 2008 led to a sharp increase in the cost of living. House prices soared following speculative land deals, making it harder for families and young people to afford a house.

Figure 2.3 Syria's Economic Situation





Source: World Bank and EIA.

Skills mismatch and the disconnect between the labor market and the education system gave rise to young people looking for jobs elsewhere including street trading, which was considered illegal. The result was the exclusion of many young Syrians from social and financial services. The distribution of income widened as individuals above the third decile in the expenditure distribution benefited proportionally more than the poor from economic growth.[3]

Between 1997 and 2004, inequality in Syria as measured by the Gini index rose from 0.33 to 0.37. A UNDP report (2005) showed that the proportion of people whose expenditure was below the lower national poverty line rose from 30.1 percent to 33 percent between 2004 and 2007, representing about 6 million people.[4] The three-year-long drought devastated agricultural yields and livelihoods in the northeastern and southern parts of the country, further increasing food prices and plunging rural workers and their families into hardship. A series of economic reforms during the 2000s disproportionately empowered those who were close to power including a number of Alawis, which fueled anger among the Sunni Arab poor (Phillips, 2011).

Syrians, particularly the youth, became increasingly dissatisfied with the quality of their lives. The average life evaluation index for Syria compiled by Gallup, which measures the quality of life as perceived by citizens, declined from 5.4 in 2008 to 4.4 (for WP16 index) in 2010 and from 6.4 to

[3] Khalid Abu-Ismail, Ali Abdel-Gadir and Heba El-Laithy, Poverty and Inequality in Syria (1997-2007), UNDP.
[4] Poverty in 2004 was more prevalent in rural than in urban areas of Syria (62% in rural areas). The North-Eastern region (Idleb, Aleppo, Al Raqqa, Deir Ezzor and Hassakeh), had the greatest incidence, depth and severity of poverty.

5.7 during the same period (for WP18 index).[5] By 2011, both indices declined sharply to 4 and 5 respectively and continued falling, suggesting deep deterioration in life satisfaction among Syrians. A combination of the economic and social weaknesses described above including the erosion of prospects for youth represented by high unemployment rates, and lack of voice resulting from the exclusion of certain sects, triggered an outbreak of riots in Daraa in early 2011, which escalated into a widespread civil war.

Civil War (2011-Present)

Six years of war and violence in Syria have torn the social fabric[6] of a society that once coexisted with multiple ethnicities, religions, races, and political orientations.[7] Historically, Syria has not been directly involved in armed conflict except for the Franco-Syrian war in 1920 and the Great Syrian Revolt of 1925-27. The current war grew out of the unrest of the 2011 Arab Spring.[8] Whether Syria's multiethnic social fabric triggered the current war or the war itself is responsible for the current sectarian divide (or both) is not clear. But clearly the war is among several factions: the Syrian Government and its various supporters, a loose alliance of Syrian Arab rebel groups, the Syrian Democratic Forces, Salafi jihadist groups (including al-Nusra Front) who often co-operate with the rebels, and the Islamic State of Iraq and the Levant (ISIL or Daesh). Among opposition groups, Daesh has turned into a major force in the country's sectarian insurgency, capturing and controlling swaths of Syria and Iraq – squeezing some of the crude oil production in both countries. Scarcity of weapons and funds have been fueling additional conflict between different rebel factions.

[5] Subjective well-being indicators such as "life satisfaction index" explains the quality of life as expressed by the citizens. Specifically they answer the following two questions: Please imagine a ladder, with steps numbered from 0 at the bottom to 10 at the top. The top of the ladder represents the best possible life for you and the bottom of the ladder represents the worst possible life for you. On which step of the ladder would you say you personally feel you stand at this time (WP16)? Please imagine a ladder, with steps numbered from 0 at the bottom to 10 at the top. The top of the ladder represents the best possible life for you and the bottom of the ladder represents the worst possible life for you. Just your best guess, on which step do you think you will stand in the future, say about five years from now (WP18)?

[6] Social fabric refers to how well the members of a society interact with each other. A loose interaction and lack of trust in state lead to conflicts that pit one group against another.

[7] Alawi (a sect of Shia Islam, 12 percent of population) government, and the Sunni Muslim majority (64 percent of population) with opposition groups (rebels) which may partially consist of other religious groups. Non Muslim groups consist of the Christians (9 percent of population), Druze (3 percent of population), Shia (1 percent of population) and various others (1 percent of population) and the 10 percent of Syrians who are ethnically Kurdish, though mostly Sunni, identify primarily with their own ethnic.

[8] There are perceptions that the Syrian war has turned into a "Proxy war" where the factions receive substantial support from foreign actors and countries. These factions include Shia Muslim backed by Iran against Sunni's Syrians backed by Saudi Arabia. As a result, escalating level of sectarian violence in Syria is linked with the proxy war between these countries. For example, there are speculations that the rebels continue to be backed by Sunni Arab states such as Saudi Arabia, and the Alawite dominated government forces are backed by Shia Iran.

Human Costs

Regardless of the nature of the war, the outcome has been one of the worst humanitarian and economic disasters with large spillovers to the rest of the world. Estimates by the Syrian Observatory for Human Rights puts the number of deaths in Syria as of December 2016, at more than 310,000 people since the conflict began in March 2011. This is twice as much as the casualties in the Yemen civil war of 1962-70 and the 15-year civil war in Lebanon. The Syrian Center for Policy Research (SCPR) puts the death toll at 470,000 with 1.1 million being injured. The war between Iraq and Iran produced three to five times more deaths over a period of eight years, but both the Syrian and the Iran-Iraq wars produced the same amount of deaths per capita (Iran has about 4 times the population of Syria).

2014 Compared to 2010

Life expectancy at birth	21.5% decline
Immunization coverage	33% decline
Average monthly income	83% decline
Unemployment rate	Increased by 3.7 million
Poverty rate .	14% increase

Source: SCPR.

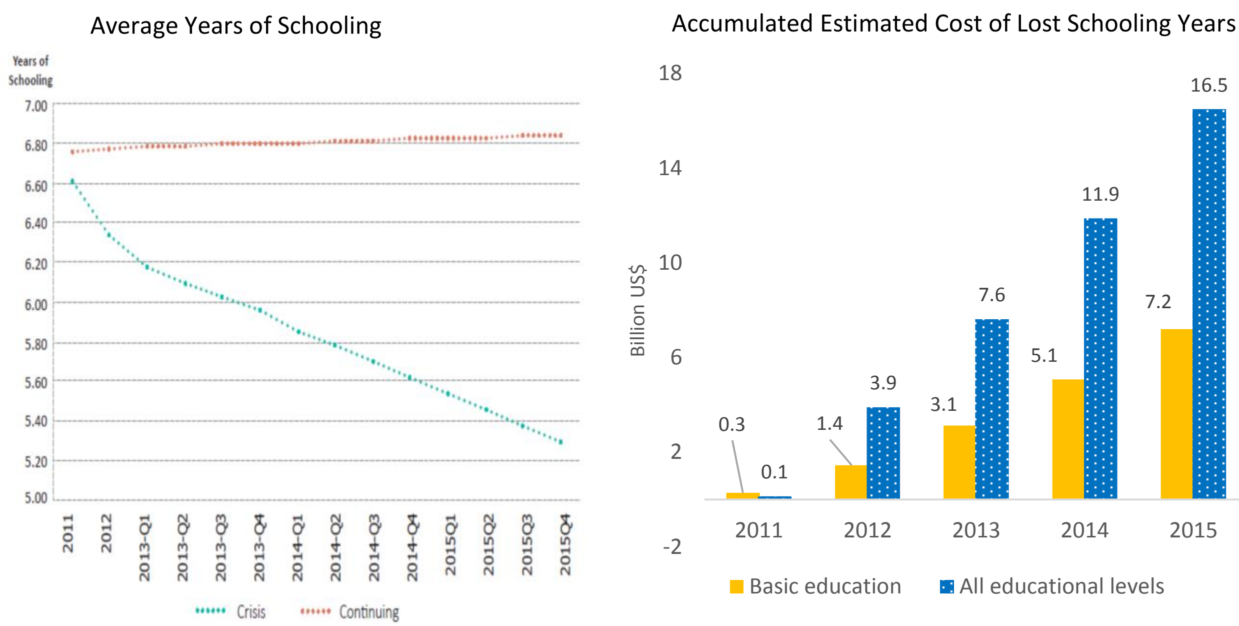
Population. The Syrian population has fallen from 21.8 million in 2010 to 18.5 million in 2015 (a decline of 15 percent), whereas it was expected to reach 25.6 million in 2015 in the absence of conflict. Relative to the counterfactual, the population has decreased by almost 28 percent. The unemployment rate is estimated to have risen to 56 percent in 2014, increasing the number of unemployed to 3.7 million. About 3 million lost their job due to conflict and more are going jobless as conflict continues. ESCWA forecasts that unemployment increased to 66 percent in 2015 with more people pushed into informal, low-productivity jobs.

The Human Development Index (a composite statistic of life expectancy, education, and per capita income indicators, used to rank countries by their level of development) for Syria fell by 2 percent every year during 2010-15, resulting in Syria's position in the global ranking going from mid-ranking in 2010 to 134th out of 187 countries in 2015, comparable to Congo, Timor-Leste, Zambia and Ghana.

Forcibly Displaced. Compared to three million people displaced in Iraq, 2.5 million in Yemen and 1.3 million in Ukraine, Syrian forced displacement stands out. Over 11.5 million (half of the pre-conflict Syrian population) have left their homes. Over half of them - about 6.6 million people - have been displaced within Syria. Globally, Syria stands after Colombia with the largest number of internally displaced persons (IDPs). The remaining 4.9 million have fled the country as refugees mostly to nearby countries such as Lebanon, Turkey, Iraq, Jordan and Egypt; about one million have gone to European countries. To keep these figures in perspective, fighting in Afghanistan has produced 2.7 million refugees, Somalia about 1.1 million, the Lebanese civil war one million, and the Iran-Iraq war a negligible number.

Children and Education. Syrian children are affected in multiple ways with more than 8 million witnessing violence, loss of parents, displacement, child labor, forced child marriage and shortages of schools. The latest official data show that more than 10 percent of girls in Syria are married before the age of 18 and the conflict has led to a dramatic increase in child marriage within the Syrian refugees.[9] UNICEF estimates that 2.8 million children are out of school with 2.1 million inside Syria and the rest outside of the country. This amounts to half of the school-age children in Syria. The SCPR projected that the 2015-16 school year will follow suit with half the children not attending school (Figure 2.4). Among them, one-third did not attend school due to fear of safety and the difficult security situation. The rest did not attend school due to financial hardship as a result of child labor and destruction of the educational infrastructure. SCPR estimated the accumulated cost of loss of years of schooling by children at about $16.5 billion in 2015. The United Nations International Children's Fund (UNICEF, 2015) reports a loss in human capital of about $10.5 billion due to loss of education among Syrian children and youth.

Figure 2.4 Syria: Cost of Lost Schooling Years



Source: SCPR.

SCPR estimates that by 2014, more than 25 percent of all schools in the country (around 5,200 schools) were not operational, 90 percent of which were partially or completely destroyed and the remainder serving as shelters for IDPs. Official data show that the education sector losses from the beginning of the crisis until end-2014 amounted to SYP 170 billion, or about $809 million

[9] UN Women, Gender-based violence and child protection among Syrian refugees in Jordan, with a focus on early marriage, *2013.*

at the current exchange rate.[10] Lack of staff due to staff flight, displacement and migration besides other violent incidents have adversely contributed to the situation.

A survey by SCPR shows a wide gap in attendance rates between regions. During the 2014-2015 school year, the school-age non-attendance rate was highest in Raqqa and Deir Ezzor where it reached 95 per cent. This dramatic decrease in school attendance in both cities was a result of a decision taken by Daesh to close schools in regions under their control. School non-attendance in Aleppo was around 74 percent, followed by Rural Damascus at 49 percent, and Idleb at 48 percent. The school-age nonattendance rate was relatively low at about zero percent in Tartous, 16 per cent in Damascus.

Health. The health system is completely dysfunctional, with demolition of infrastructure and medical centers, lack of medical equipment and vaccines, and professional staff fleeing the country. Vaccination rates for most types of illnesses have dropped to less than 70 percent while reaching zero percent in some regions (compared with pre-crisis rates of 99-100 percent). Diseases that were eradicated are coming back. Infant and maternal mortality, which were on a declining trend pre-crisis (See Figure 2.1), have started to rise, reaching around 23 deaths per thousand and 63 deaths per hundred thousand births in 2013, from 18 and 52 deaths in 2011 respectively. Provision of health services has taken a significant hit, with 35 percent of public hospitals functioning partially, while another 22 percent being completely out of service according to the UNICEF. The collapse of the pharmaceuticals industry has resulted in a scarcity of medication and the development of a black market, preventing access for treatable and chronic diseases, especially among the poor.

Women. Women's role in Syria has shifted dramatically during the war. Data show that 12-17 percent of households in Syria[11] and up to one-third of households in refugee-hosting countries[12] are now female-headed. This has contributed to deterioration in the living conditions for women inside and outside of Syria. Data from UNHCR show that half of the registered Syrian refugees are females of working age. With the scarcity of jobs in the hosting communities particularly acute for women, the income of the female headed households tends to be below that of male-headed households.[13] Women, in particular poor women and those with disabilities and social

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[10] Actual losses are likely much higher when converting the local currency losses of the early years of the crisis, given the significant depreciation of the exchange rate of the Syrian pound to the US dollar over the past 5 years.

[11] Livelihoods Assessment in Southern Syria: Dar'a and Quneitra governorates. Joint report published by NRC, RFSAN, IMMAP, United Muslim Relief, FAO, Humanitarian Monitoring Group, and CARE. November 2015, p. 24; *Livelihoods assessment in Eastern Ghouta.* CARE. 2016 (forthcoming), p. 8; *Livelihoods and Agriculture Needs Assessment in Idleb and Aleppo.* CARE International. 2015 (not published), p. 9.

[12] One quarter according to the UNHCR data for the region: *Women alone.* UNHCR, 2014; 28 percent according to CARE data for Jordan: *Five Years into Exile.* CARE International in Jordan. June 2015; and 34.6 percent for Jordan according to UNHCR: *Living in the Shadow*. Jordan Home visit report. UNHCR, January 2015.

[13] Livelihoods Assessment in Southern Syria: Dar'a and Quneitra governorates. Joint report published by NRC, RFSAN, IMMAP, United Muslim Relief, FAO, Humanitarian Monitoring Group, and CARE. November 2015, p. 26.

needs are extremely vulnerable; many have experienced physiological and mental problems. Access to medical, education and others services is difficult for women given the cultural context for many Syrian refugees. A study has shown that more than one-third of refugee women are dealing with disability. They also face various types of legal problems such as family law issues, accounting for 65 percent of all cases in Jordan, for example. Criminal legal problems accounted for 15 percent of cases, refugee-related issues 13 percent, and civil issues 7 percent. Marriages in Syria are not certified by a court, whereas in the host communities such as Jordan, the rule is different. Syrian females have difficulty proving family relations, which is often a necessary step to obtain certain kinds of humanitarian relief, causing many to file cases in the host community family courts. In the case where alimony and child support payments are not made, female-headed households are more likely to fall into poverty.

Poverty. Unavailability of water supply, poor quality when available, limited access to food, sanitation, and health care have pushed the majority of people into poverty. Estimates by SCPR show that the number of people living in poverty has increased to 85.2 percent in 2015 relative to 83.2 percent in 2014 and 64.8 percent in 2013.[14] About 35 percent are living in extreme poverty (limited access to basic food) though the levels of poverty differs significantly among governorates and has increased dramatically in conflict zones and besieged areas. As shown in the poverty map, in 2015 Al-Raqqa was considered the poorest region in Syria with 91.6 percent of residents living below the overall poverty line. In addition, the highest overall poverty levels among the population were registered in Idleb, Deir Ezzor, Homs, and rural Damascus (See Map 2.1).

Physical Costs

Assessments of the physical damages to key public and private assets in Syria have been conducted by the World Bank, SCPR and REACH (IMPACT). The analysis in this section relies on these assessments.

The World Bank Damage and Needs Assessment (DNA) report in 2014, with a subsequent update in March 2016, conducted a remote data collecting exercise that combines satellite imagery with social media to assess damages to the six war-ravaged cities; Aleppo, Dar'a, Hama, Homs, Idlib, and Latakia and in selected sectors: housing; education; health; water and sanitation; energy; transportation; and agriculture.[15] Damages caused during 2015 and early 2016 were more severe

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[14] Poverty estimates are based on national poverty lines and data from the official Household Income and Expenditure Survey (2009). SCPR projects real private per capita consumption growth in 2010-14 using micro-simulation, assuming no change in expenditure distribution within each governorate, and taking into consideration the change in the structure of prices between governorates.

[15] It is worth noting that the assessment is not considered the recovery and reconstruction needs. Since the historical replacement costs do not take into account inflation, security, insurance premiums, and other market imperfections

than previous years and the latest update of the damage assessment has increased relative to estimates at end of 2014, suggesting that the war intensified in these cities (See Table 2.1 for breakdown of the damage costs).

Estimates by the World Bank put the cost of damages - at 2007 constant prices - between $5.9 and 7.2 billion as of March 2016. This is a lower-bound estimate since data gathered remotely do not capture the total physical damages to these cities and the prices used to calculate the damages are pre-crisis levels that do not take into account inflation, and insurance premiums. If adjusted by the inflation rate only, damages for six cities over seven sectors for 2016 are estimated at $33.7 to $41.1 billion for 2016 (Table 2.1). Estimates by the Syrian Ministry of Petroleum and Mineral Resources put the cost to the oil industry alone at $27 billion from the destruction of wells, pipelines, and refineries. Putting these all together, damages from war in six cities among eight sectors including oil, will amount to close to $68 billion as of March 2016. This figure is close to that of SCPR, who estimate the destruction of physical infrastructure to be about $67.3 billion including loss of residential and non-residential buildings. Their estimates also include damages to equipment and tools.

Table 2.1 Syria: Estimated Damages in Constant and Current Prices

	Cost in 2007 Prices Million US$	Nominal Cost in 2016 Prices Million US$
Agriculture	74-91	422-530
Energy	1,100-1,500	6,100-8,500
Housing	4,100-4,900	22,800-28,000
Transport	127-156	752-891
Water and Sanitation	56-69	320-394
Health Infrastructure	320-390	1,800-2,200
Education Infrastructure	195-215	1,100-1,200

Source: World Bank staff estimates, DNA report 2014 and subsequent update in March 2016.

Next, we will look at the World Bank damage assessment calculated at unit cost using pre-crisis prices, broken down by major cities and sectors in Syria (See Table 2.2). In this report, we have adjusted the estimates of sectoral damages by inflation rates to provide the current value of the damages in six cities over seven sectors (See above).

that affect the reconstruction costs in post conflict recovery, the reconstruction needs would be much higher than the damage costs.

Table 2.2 Syria: Estimate of Damages for Six Cities and Selected Sectors, March 2016

	Completely Destroyed Units	Partially Damaged Units
Education		
Pre-K/Kindergarten	1	19
Primary School	10	70
Secondary School	8	38
Primary and Secondary School	3	15
Vocational School	7	11
College/University	1	6
Education Office	0	0
*Unknown**	17	167
Housing		
Apartment Building	39,607	141,104
Popular Housing (Sha'bi)	9,144	21,856
Villa	32	98
Traditional Arab Home (Dar' Arabi)	551	1,843
Country House	38	86
Agriculture House	9	18
Tents	0	0
Refugee Camp	0	0
Hotel	2	7
Institution	0	0
Health		
Private Hospital	7	56
Public Hospital	4	8
Hospital (Unknown)	1	11
Medical Center (Public)	0	8
Medical Center (Private)	4	115
Medical Center (Unknown)	0	0
Specialized Medical Center	1	5
Medical Point	0	3
Polyclinic	1	2
Rehabilitation Center	0	0
Teaching Hospital	0	0
Medical Training Center	0	0
Pharmacy/Dispensary	24	50

Source: World Bank DNA, March 2016.

Estimates by the DNA report show that Aleppo appears to be the most affected among the six cities, accounting for roughly 57 percent of the estimated damages in 2016. Damages have been increasing since December 2014 (initial estimate) due to considerable increase in housing destruction.[16] Following Aleppo, Homs and Hama are the most affected cities. Housing is the most affected sector in Homs accounting for almost 83 percent of the damage estimates.

Almost 80 percent of the damages in Hama are in the energy sector. Dar'a and Idlib's share in overall estimated damages is low partly due to their smaller size compared to the other cities. Overall, the two cities account for 2 percent and 6 percent of the total estimated damage cost respectively. By contrast, Latakia has been a relatively secure area since the beginning of the conflict, experiencing only very limited destruction.

Agriculture. Agricultural production has dropped significantly during the war, contributing to rising food prices. Together with the depreciating Syrian Pound, this has made living conditions hard for those inside the country. Data collected between January and August 2016 by REACH in Northern Syria show that the median cost of a Survival Minimum Expenditure Basket (SMEB), which represents the minimum amount of food and nonfood items needed for a Syrian household to survive, rose by 37 percent in May. This was largely driven by rising food prices with the median price of bread in Syrian pounds rising by 38 percent, bulgur by 82 percent, and sugar by 121 percent over eight months. Cereal production levels have remained low, with an estimated 2-2.5 million tons of wheat, far below the historical average of about 3.5-4 million tons. The DNA analysis puts the damages to the agriculture sector in all six cities to around $74 to $91 million. Applying the inflation rate to these estimates will give us a rough estimate of between $422 and $530 million in damage costs for 2016.

Energy. The destruction or damage to assets have created a severe disruption to the power sector, which was already inadequate for the peak demand needs of the country. Syria had 7,500 MW of capacity nationwide. The assessment covered energy infrastructure providing approximately 70 percent of the grid electricity to the six cities. Damages in the energy sector in the six cities are estimated to be between $1.1 and $1.5 billion in real terms as of March 2016. Adjusted by inflation, the damage amounts to $6.1 to $8.5 billion. The damage assessment for the energy sector covers Power Plant, Substation, and Transmission Tower and assesses roughly 60 percent of the installed power generation capacity in the country. Hama is the most affected city with the largest power plant capacity (1,730MW split between two large plants) of the six cities.

Housing. The housing sector is the most damaged sector in these six cities. As of March 2016, an estimated 20 percent of total housing in Aleppo, Dar'a, Hama, Homs, Idlib, has been completely destroyed. Homs and Idlib have incurred the vast majority of the destroyed units.

[16] In December 2014, accounted for roughly 40 percent of total damages.

About 34 percent of housing units were partially damaged with Aleppo accounting for the largest number of partially destroyed housing units. Total damages in the Housing sector in the six cities are estimated to be around $5 billion, though this may be an underestimate because of the price quote that has been used for estimation. Adjusting for inflation, in 2016 prices, the damage cost amounts to $28 billion. The estimated cost only covers physical damage to the core housing structures and does not include destruction of amenities inside the house and losses resulting from looting.

Transport. About 2.2 percent of the total length of intra-city roads in the cities of Aleppo, Dar'a, Hama, Homs, Idlib, and Latakia have been directly damaged. Among them, primary roads and Trunk roads have been damaged the most. Though the impact on road functionality extends beyond direct damage to the road itself. Aleppo accounts for the vast majority of the damage assessed (49.4 percent of the total), and Homs the second largest accounting for 18 percent of the total. The total damages to roads in the six cities is estimated to be ranging from $127 to $156 million, covering only physical damage to roads and bridges, and does not include additional urban infrastructure such as traffic lights, culverts, and road signs. The damage cost would be much higher adjusting for inflation, leading to an estimate of $725 to $891 million in 2016 prices.

Water and Sanitation (WATSAN). The sector has incurred significant damage. There were 260 WATSAN assets ranging from water tanks, treatment facilities, and dams in the cities of Aleppo, Dar'a, Hama, Homs, Idlib, and Latakia (the assessment does not cover the damages to the water pipe network). Of that total, 23.8 percent, mainly the water towers, have suffered damage. Aleppo and Dar'a suffered the most damage, accounting for 49 percent and 27 percent of the total damages assessed respectively. Although much of the infrastructure was undamaged, reduced functionality is a significant problem. Water infrastructure's dependence on electricity infrastructure has also affected service delivery, particularly in the case of Aleppo where the Tishreen Dam, which provided 60 percent of Aleppo's power, has reduced the operational times of pumping stations, and limited household access to both clean water and electricity. The total cost to the infrastructure element of the WATSAN sector, for all six cities, is estimated to be between $56 and $69 million. Adjusting for inflation, the damage cost amounts to $320 to $394 million in 2016 prices.

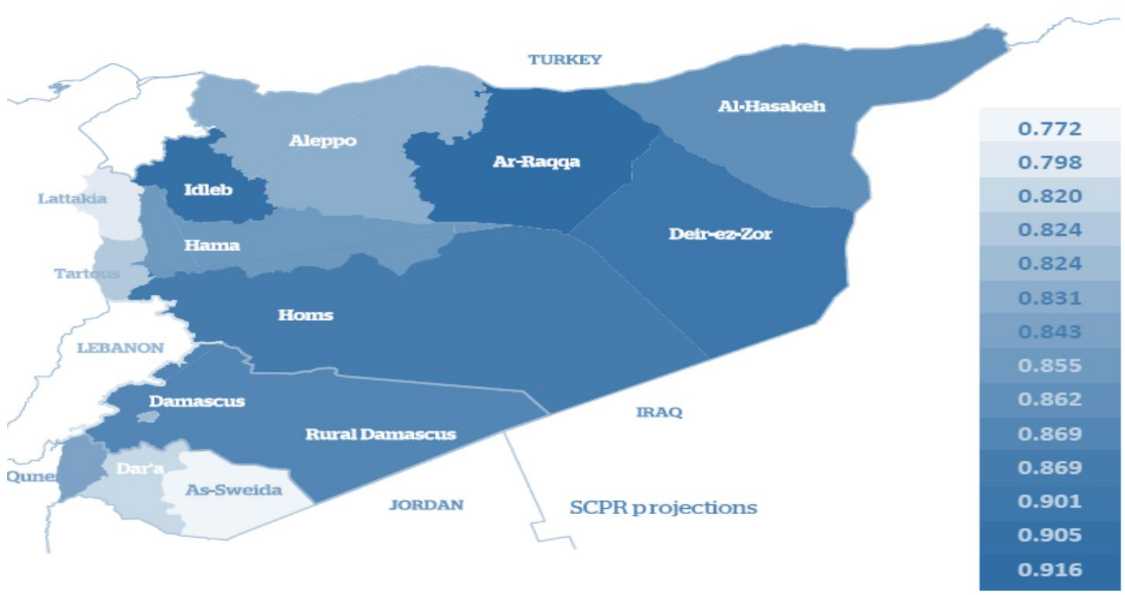
Health and Education Infrastructure. Damages to the health sector include damaged medical infrastructure, shortage of supplies and medicine, and lack of health professionals. There were 780 health facilities in the cities of Aleppo, Dar'a, Hama, Homs, Idlib, and Latakia, ranging from hospitals to pharmacies. About 302 or 40 percent have suffered damages or been completely destroyed. Aleppo suffered the most damage, accounting for 48.4 percent of the total damages assessed. The total cost to the infrastructure element of the health sector, for all six cities, is estimated in real terms in the range of $320 to $390 million at pre-crisis prices. Adjusted by inflation, the damage cost amounts to $1.8 to $2.2 billion.

The education sector has suffered a major setback and lost much of the remarkable progress it had made towards almost meeting the 2015 Millennium Development Goal (MDG). There were 1,417 institutions ranging from Pre-K to Universities in the cities of Aleppo, Dar'a, Hama, Homs, Idlib, and Latakia. About 14.8 percent, particularly the primary and secondary schools, have suffered damages. Aleppo and Dar'a suffered the most damage, accounting for 46 percent and 45 percent of the total damages assessed respectively. The total cost to the infrastructure element of the education sector, for all six cities, is estimated to be between $195 to $215 million, as of March 2016 estimated at pre-crisis 2007 prices and do not take into account the rising inflation in the aftermath of the war. At current 2016 prices, the World Bank estimates the damage cost to the infrastructure of the education sector to be in the range of $1.1 to $1.2 billion.

Economic Costs

Economic activity in all sectors of the economy (except the military) have slowed down or stalled as a result of war and violence. For ease of analysis, we will first discuss the macroeconomic impact of the war on the Syrian economy over the past 6 years. Next, we will provide estimates of sectoral damages from the World Bank, UNOSAT and SCPR to show the severity of damages.

MAP 2.1 Overall Poverty in Syria, 2015



Source: Syrian Center for Policy Research (SCPR).

Macroeconomic. The protracted Syrian war has damaged the structure of the economy, diverting resources from productive sectors to fighting conflict across the country. Economic instability, violence and lack of security have created multiple groups, each governing a region or sub-region. Job opportunities are available only in conflict-related areas. Trade has been disrupted and is mostly informal. Under these circumstances, economic activity has fallen. Compared to the GDP levels in 2010 (prior to conflict), Syria's GDP fell by 16 percentage points on average each year during the period of 2011-14. The World Bank estimated that growth was expected to contract by another 16 percent in 2015 and 4 percent in 2016. Collier (1999) estimates that countries annual real GDP growth tends to slow down by more than two percentage points on average during civil conflict; Syria's growth fell by over five times that amount. The decline in average annual per-capita income in Syria has been about two percentage points larger than those for a sample of more than a dozen fragile countries (Stewart et al., 2001).

The dramatic decline in the size and skills of the labor force due to loss of life, disability and displacement has been a major source of output loss. According to Ianchovichina and Ivanic (2016), death and forced displacement accounted for one-fifth of the decline in Syrian economic output during the first three years of the war, while capital destruction contributed close to a quarter.

Syria's non-oil GDP declined by an annual rate of 15.5 percent for 2011-14 and was estimated to decline further by 4.9 and 4.3 percent over 2015-16 respectively. Cumulative output in constant prices is estimated to have declined by two-thirds between 2010 and 2016. The estimated foregone output (output if there were no conflict and the economy grew by 5 percent annually, on average) amounts to 300 percent of 2010 GDP in constant prices (Figure 2.5). Oil production, the main source of government revenue and exports, has come to a virtual halt due to conflict and Daesh control. Prior to the conflict, the country produced 368,000 barrels of oil per day and exported half of this amount, mainly to Europe. Oil production has dipped to less than 40,000 barrels in 2016 due to damages to facilities and pipelines, and international sanctions imposed on Syria in late 2011 (See Figure 2.5).

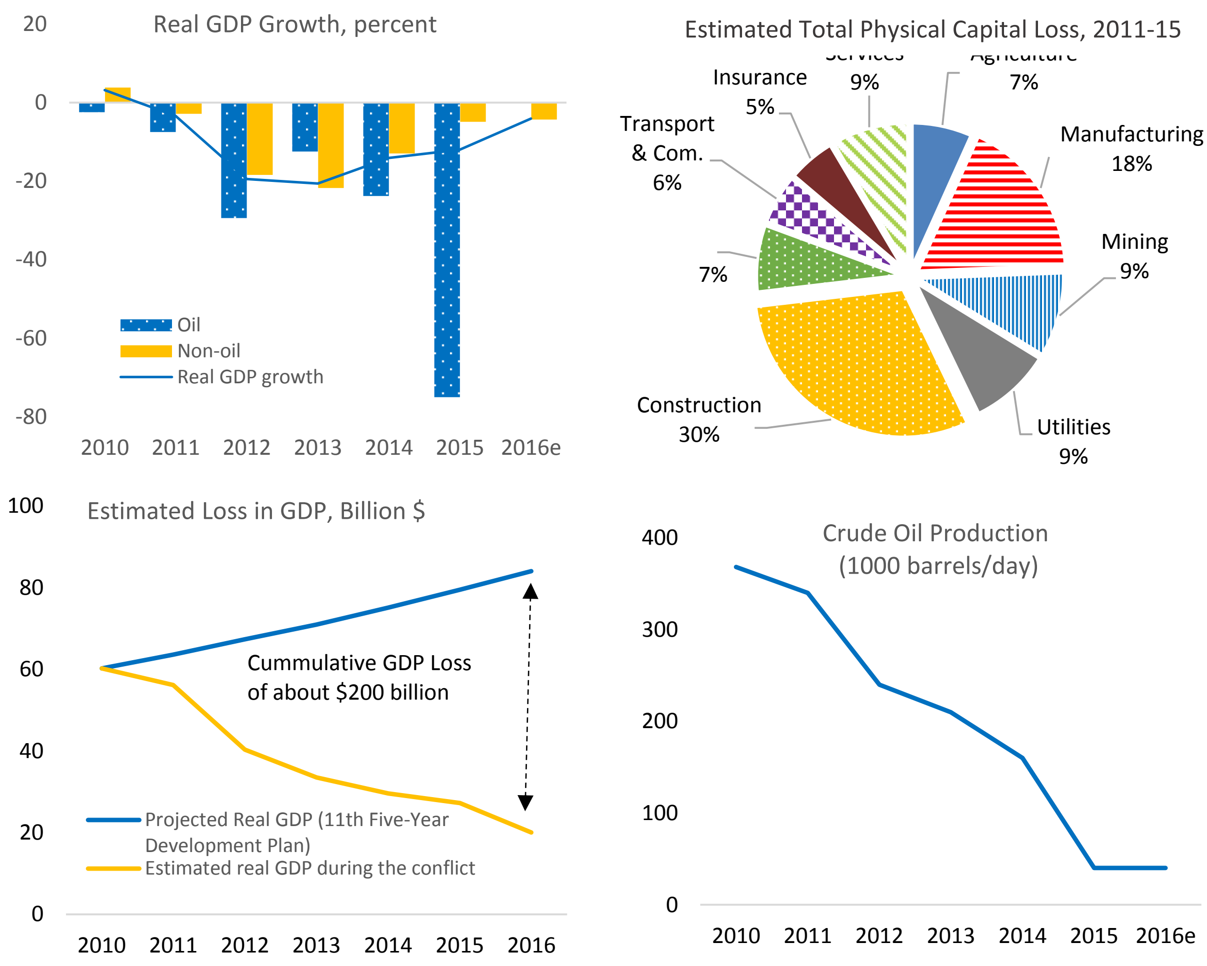
The 2011 international sanctions imposed by the United States, the European Union, the League of Arab States and some other countries banning oil imports from Syria, freezing government and individual assets and termination of investment by Arab governments have contributed to the massive loss in output. Qatar, for example is estimated to have halted $6 billion in investment in the country. The banning of Syrian oil imports has forced the State Oil Company to find new markets elsewhere but with no success. Some of its oil buyers including Indian refineries were not been able to secure private or public insurance for shipments. Sanctions on Syrian oil are estimated to have cost the government $4 billion in lost revenues, leading to a severe foreign currency crisis.[17] To counter the impact of the trade losses on the economy, Syria has largely

[17] http://carnegie-mec.org/publications/?fa=48598

relied on Iran, Iraq, and Russia and to some extent Turkey and Jordan. Iraq, ignoring the Arab League sanctions, increased its imports from Syria by 40 percent, and Iran increased its imports by 100 percent.

Moreover, the total costs of war in terms of economic output would nearly double if the opportunity cost of the forgone deep trade integration reforms within the "Levant Quartet"[18] were included in the estimation (Ianchovichina and Ivanic, 2016). These reforms would have allowed Syria to modernize its economy by improving firms' competitiveness and diversifying production. Although Syria continued to trade with its neighbors after 2011, the composition of trade changed considerably, from capital goods such as machinery and equipment to necessities and other goods in short supply.

Figure 2.5 The War Economy of Syria



Source: World Bank and UN ESCWA. Note: e stands for estimate.

[18] The negotiations of a regional trade agreement among Turkey, Syria, Jordan and Lebanon (the "Levant Quartet") were advanced in 2010, as reflected in the Joint Declaration on Establishing Closer Neighbors Economic and Trade Association (CNETAC) signed in July 2010 (World Bank, 2014, Aydin and Yanar, 2011).

Due to violence and the government's large military expenses, capital expenditures have fallen rapidly, to about half a percentage point of GDP in 2016, compared to 9 percent of GDP in 2010, while current expenditure has increased by 6 percentage points of GDP in 2016 compared to 2010. With almost zero oil revenues, the huge fiscal and current account deficits have been financed by printing money and using foreign reserves. Total foreign reserves are estimated to have reached below $1 billion in 2016 from $20 billion in 2010. The Syrian Pound has depreciated by 400 percent, with the official rate at 514.43 per US dollar on March 10, 2017. The current account balance has deteriorated mainly due to a sharp decline in tourism and oil exports. Lines of credit from Iran and assistance from Russia have helped government finances, but aggravated the already high public debt, which doubled during 2011-14. The IMF estimates that public debt stands at 100 percent of GDP in 2015, up from 31 percent of GDP in 2009.

Infrastructure. Sectoral output losses and infrastructure destruction are significant. They are mainly in the construction (housing) sector followed by manufacturing, and mining especially oil (See next section). A large number of housing units have been destroyed or damaged, putting pressure on the existing houses in the cities not directly involved in war.

The manufacturing hubs of Aleppo, Homs, and the suburbs of Damascus have been destroyed by intense fighting. Furthermore, this sector has been suffering from shortages in fuel, electricity and raw materials due to lower imports. Since 2010, pharmaceutical production has declined by 90 percent according to the UN. The agriculture sector has been affected largely by shortages of inputs, equipment and storage problems and this has been exacerbated by low precipitation rates recorded in 2014. According to the Food and Agriculture Organization of the United Nations (FAO), wheat production has been halved in 2014 compared to mid-2000. The damage to irrigation infrastructure has led to increased reliance on rain-fed crops.

Costs of Rebuilding the Syrian Economy

Estimates of output and growth for 2017 and beyond are difficult due to lack of reliable data particularly on damages to the infrastructure, currency depreciation and fiscal-deficit financing in the face of dwindling reserves. The destruction of health and education services, and displacement of highly skilled workers and entrepreneurs fleeing the country have also affected the labor market. Moreover, the current low school enrollment rate of children and their deteriorating health conditions will negatively impact the country's potential output for years to come. Estimates by the World Bank show that if a political solution is reached today and reconstruction begins, it will take 10 years for the Syrian GDP to get close to its pre-war (2010) real GDP level, if the economy grows by 5 percent on average. Growing at lower than this rate i.e. at 3 percent growth rate, will delay the recovery by another 10 years.

Recovery and faster growth will also depend on the reconstruction strategy, implementation and the resources available from the international community. Furthermore, studies have shown that the pace of economic recovery in the medium term depends to some extent on whether a country is rich in natural resources (Devarajan and Mottaghi, 2016b). This is because oil output could recover faster than others sectors in oil rich countries compared to other sectors of the economy. A peace settlement in Syria could lead to a swift rebound in oil output and exports, allowing the economy to recover more quickly.

Rebuilding Human Capital

The post-conflict Syrian economy will inherit a weak labor market, disrupted education system and patchy human capital characterized by shortages of skilled workers, teachers, professionals, physicians, etc. that have either fled the country or been displaced internally. Motivating the displaced and refugees to return and, more important, creating jobs for those that have been out of the labor market for several years is a daunting task. Vast amount of resources and sustainable policies are needed to encourage displaced people to return and to help them reintegrate into the society. This is challenging both for the post-conflict government and the international community as some of the refugees particularly the skilled workers, may choose to stay in hosting communities due to insecurity and lack of access to basic services and jobs in their homeland.[19] For example, in post-war Bosnia, many refugees did not return to their home community due to lack of employment opportunities. Contrary to the refugees who have fled the country, IDPs are more likely to return, providing appropriate reintegration support for their smooth transition.

There are many obstacles that stand in the way of reintegrating of returnees into the society. Returnees often choose not to return to their pre-war living communities for fear of discrimination, violence or lack of economic opportunities. This could also apply to those IDPs who select not to go back to their former communities in their homeland and choose different areas to live. This could increase competition in finding jobs, schooling and health care services in the areas that are overly demanded. A recent study by the World Bank examines what can be learned from the available literature and the case studies about the when, who, and why of return, and the role of international assistance in the eight case studies. The study finds that most returnees to their home countries will not go back to their original villages and hometowns. Instead, they settle in the capital where they can find more economic and educational opportunities. For example, during the civil war in southern Sudan between 1983 and 2005, more than two million people predominantly from rural areas fled to Khartoum. While half have remained in Khartoum, many of those that returned (along with IDPs) have moved to Juba and

[19] Studies have shown that average number of years for refugees in exile to return after a peace deal is about 17 years.

other towns in what is now South Sudan rather than to their rural areas of origin, due to better security, services, and economic opportunities.

What can be done for a smooth reintegration of the Syrian returnees into the labor market? The answer depends on two factors; how fast the education system can respond to the need for rebuilding human capital in Syria, and how to fill the skill gap between schooling and the labor market? First, due to the mass destruction of the education system, there is an urgent need to form medium-term programs to support educational services for Syrians. Returnees and displaced people need to acquire new skills that are needed to land a job and this could be done through re-evaluating and revitalizing the education and training system. Studies have shown that in countries affected by violence, local education institutions are not capable of providing quality education to the population immediately after a peace settlement. So it is crucial to focus on short-term interventions perhaps through private or international development partners including universities to help restore the education system. This could start now while peace talks are underway. In the medium to long term, however, it is imperative to move from short term interventions to re-build physical infrastructure and institutional capacity aimed at re-orienting the education system towards learning skills and vocational training.

Second, social capital and relationships of trust play an important role in the reintegration process. Studies have shown that communities with a good stock of social capital have less crime, better health and higher educational achievement (Halpern 2009). There is, however, a downside to this and that is when groups and organizations with high social capital have the means to exclude others. A survey conducted by UNHCR in the Afghan labor market in 2006 showed that networking played a strong role in integration of returnees into the labor market through personal networks of friends and relatives as well as professional networks in their field to get information about jobs or to get a job directly. The results also show that attractive sectors for job creation were those that needed less skills such as construction, wholesale, retail and manufacturing where they could easily find a job.

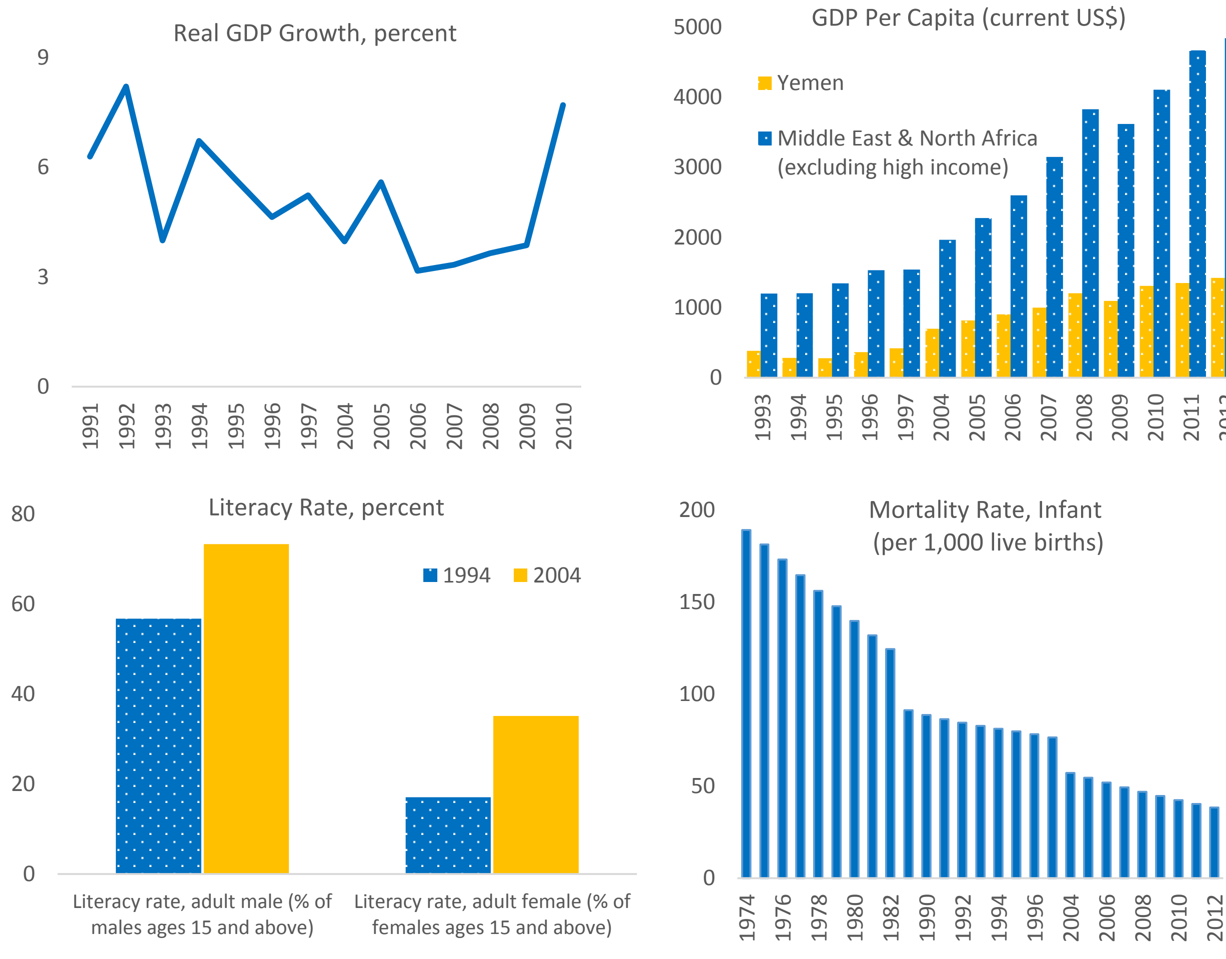
Yemen

Pre-Conflict (1970-2010)

Yemen, an oil-based economy, supported the same "Arab social contract" as the rest of the countries in the MENA region. For the past three decades, Yemen has relied on oil for more than one third of its GDP ($31 billion in 2010), half of government revenues and 90 percent of its exports. For years, particularly during the high oil prices of the 2000s, the government enjoyed more than $3 billion oil revenues annually, allowing it to support a large public sector and investment in infrastructure. Oil resources remained the main driver of growth, shaping the long term economic trajectory of the country. Growth was high but volatile, reaching 7.7 percent in 2010 (due to the gas liquefaction investment). Average growth for the period of 1970 – 2010 was a reasonable 3.8 percent (Figure 2.6). Despite such high growth, GDP per capita in Yemen remained the lowest among all countries in MENA, due to a high fertility rate of about 5.4 children born per woman and population growth rate above 3 percent.

Despite improvements in education and health indicators, poverty remained high. The percentage of people living below the poverty line of $1.9 per day (PPP) increased from 44.9 percent in 1990 to 46 percent in 2010. At $4 a day (PPP) more than 85 percent of people lived below the poverty line in 2010. Yemen also had one of the highest malnutrition rates in the world, with almost 60 percent of children under the age of five having chronic malnutrition, 35 percent underweight, and 13 percent having acute malnutrition in 2012.

Figure 2.6 The Economy of Pre-Conflict Yemen



Source: World Bank.

There are multiple reasons for the high poverty rate including water shortages that reduced availability of agricultural products, the inflated public sector that has reduced job opportunities elsewhere, and mismanagement of economic policy. For example, Qat plantation represents about 30 percent of the agricultural production but half of the employed adult males working in the sector grow Qat, a low level drug-like leaf that consumes water and is estimated to be six times more profitable than other food crops, while the country imported over 90 percent of its food. Studies have shown that Yemenis spend one-quarter of their income on Qat, more than they do on food. Spikes in food prices during this period exacerbated the situation, throwing large numbers of Yemenis into poverty. About one million were hired in the public sector and between 8 to 10 percent of them worked mostly as “ghost employees” who were salary earners but either did not exist or were listed on the payroll of other services, cashing in two or three salaries plus benefits. Government wages and salaries remained a burden on expenses, reaching 11 percent of GDP in 2009. Subsidies also constituted a big share of government expenses, standing at 14 percent of GDP in 2008.

A number of factors led to the 2011 uprising in Yemen, alongside other Arab Spring countries. A broken social contract, low levels of education, with approximately half of the youth illiterate and even those with university degrees lacking skills to be absorbed in the labor market, resulted in an ongoing youth unemployment crisis (standing at an estimated 60 percent). The drop in oil prices after 2009 that led the government to rethink its obligations towards expanding public-sector jobs; lack of voice and accountability; low quality of social services; high rates of poverty and malnourished people; all in a multi-sect, tribal society, triggered the protests in 2011. The long-serving President, Ali Abdallah Saleh, was removed from office. A process of national dialogue to write a new constitution was established. A few months after the national dialogue concluded, a group led by the Houthis, who were not part of the national dialogue, rebelled. The civil war that started in March 2015 is sometimes called a proxy war because it consists of military operations by a coalition led by Saudi Arabia battling the Houthis, who are thought to be supported by Iran. Now in its second year, the civil war has produced the worst humanitarian crisis in the history of Yemen.

Civil War (2015-Present)

Human Costs

Social indicators in Yemen were weak before 2015, but the escalation of conflict has destroyed progress made in the past two decades. The 2015 Human Development report ranks Yemen 160th among 188 countries, a setback from 154th rank in 2014. The effect of the conflict has been catastrophic to the Yemeni people. The civilian death toll is estimated to have exceeded 6,000, with about 28,500 wounded. As of end 2015, 2.5 million people were estimated to be internally displaced in Yemen. The poor are suffering the most: 21.2 million Yemenis or more than 80 percent of the population are in need of emergency humanitarian assistance; 14.4 million Yemenis are facing chronic food insecurity, an increase of 35 percent since the conflict began; and 19.3 million Yemenis are without safe drinking water or sanitation. According to UNOCHA, this has led to a sharp increase in malnutrition and disease burden as reliance on water from unprotected sources makes people, particularly the young, vulnerable to diseases.

Children. Continued violence has taken a toll on Yemeni children. Data gathered by UNICEF show that six children have been killed or injured every day since March 2015, a sevenfold increase compared with 2014. Combatant parties have also recruited children to join the fighting. In 2015, the United Nations documented 848 cases of child recruitment, with reports suggesting that children as young as 10 were pulled into battle. There are estimates that about 3,600 schools have closed, bringing the total school-age population that is out of school to more than 3.4 million, or half of all school-aged children in the country. At least 51 attacks on education facilities in Yemen have also been verified.

Physical Costs

The civil war in Yemen is still ongoing and therefore estimates of the costs of damage to infrastructure, physical capital and human capital are incomplete. A joint study by the World Bank, United Nations, Islamic Development Bank and European Union put an early estimate of damage costs (still partial and incomplete) of $15 billion, consisting of almost $7 billion in economic losses (in nominal terms) and over $7.3 billion in production and service delivery. The cost estimates assess residential damage only in the cities of Sanaa, Aden, Taiz and Zinjibar, to be about $3.6 billion but data collection was cut off in October 2015 -- about seven months into the conflict. The cost to reconstruct damaged energy facilities in the four cities was an estimated $139 million, most going to repairing damaged or destroyed power plants. A survey by Yemen's education ministry showed that of 1,671 schools in 20 governorates that suffered damage, 287 need major reconstruction, 544 were serving as shelters for internally displaced persons, and 33 were occupied by armed groups. Based on a sample of 143 schools, the estimated cost of the damage was $269 million. Estimates by the Ministry of Public Health and Population, show that 900 of 3,652 facilities providing vaccination services were not operating in early 2016, leaving 2.6 million children under 15 at risk of contracting communicable diseases.

Economic Costs

Yemen has a history of instability but the recent war has pushed the country into a humanitarian crisis. Economic activity has collapsed in almost all sectors of the economy, particularly oil; access to social services including health and education has dropped significantly; and imports have contracted substantially. Oil production, the main source of government revenue, declined sharply following the uprising in 2011 due to increased insurgencies in oil fields and later on as a result of the ongoing proxy war that started in March 2015. The economy contracted sharply in 2015 and 2016 by 28.1 percent and 4.2 percent respectively. The UNDP Business Survey Report estimates several firms suspended their operations, including 35 percent in the service sector, 29 percent of the industrial enterprises and 20 percent of trading companies. This swelled further the already critical unemployment rate in the country. Combined with the effects of conflicts on other sectors (social, agriculture, fishery and livestock, trade and industry, banking system, etc.), this worsened the living condition of Yemenis. Inflation reached 39 percent in 2015, and is expected to increase further as fiscal performance is continuously weakening. The fiscal deficit has widened and foreign financing of the budget has largely come to a halt, as many development partners suspended their engagement. On current expenditure, the premium on wages and salaries were cut as a response to lower oil prices and government's shrinking finances as well as a large cut in subsidies from 8 percent of GDP in 2011 to less than 1 percent in 2015. Public investment was low prior to 2011 but effectively halted afterwards to less than 0.2 percent of GDP in 2016. The Yemeni exchange rate has come under stress due to the loss in oil revenues and lack of foreign financing. International reserves declined to less than $2 billion in late 2015 (2 months of imports). Consequently, in February 2016, the central bank stopped supporting imports at the official exchange rate except for wheat and rice. The government's reliance on central bank financing of the fiscal deficit led to inflation and an increase in domestic debt stock by about 18 percent of GDP to an estimated 53 percent of GDP in 2016.

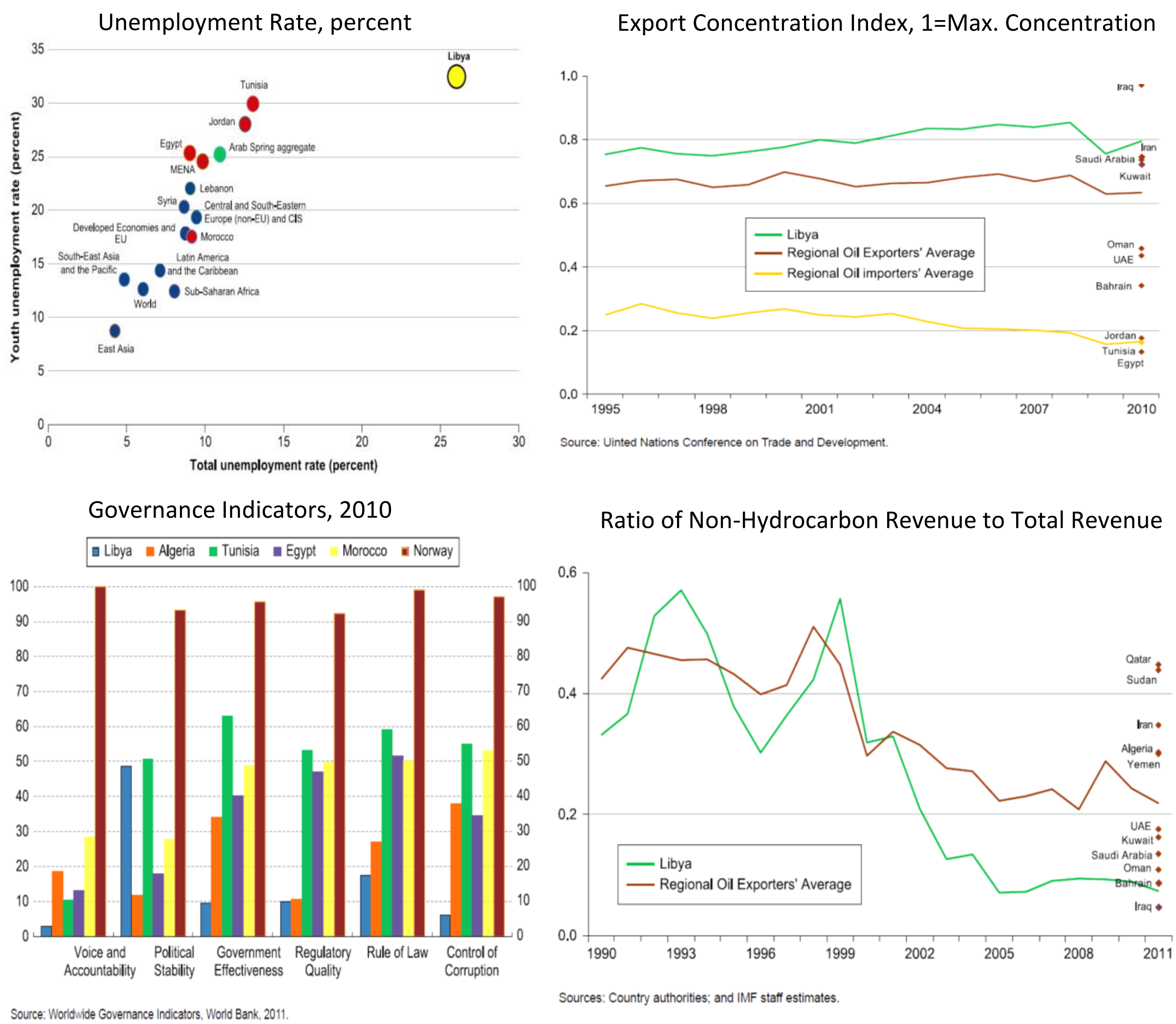
Libya

Pre-Conflict (1970-2010)

The economy of Libya depends on oil for almost all exports earnings, 80 percent of government revenue and half of GDP. As a result, per capita income in Libya calculated by the World Bank was $11,934 in 2010, higher than the MENA average and close to the highest per capita income in Africa. The government supported the same Arab social contract as the rest of the Arab countries, providing citizens free health and education, public sector jobs and food and fuel subsidies in return for limited voice and freedom. Following the lifting of UN sanctions in 2003, economic activity increased steadily for seven years. During 2004–10, average real GDP growth was approximately 5 percent, annual consumer price inflation averaged less than 4 percent, and official foreign assets increased from $20 billion at end-2003 to $170 billion at end-2010. More than 80 percent of the formal labor force worked in the public sector. The limited private sector that existed was handicapped by the dominance of the state and crippling institutions. Consequently, governance indicators remained poor, job creation was lackluster as it was heavily reliant on public sector while dependence on expatriate workers increased (Figure 2.7). A combination of these factors led to the 2011 Arab Spring uprising.

Similar to other Arab countries, Libya made good progress in education and health. Life expectancy increased from 46.9 in 1970 to 75.1 in 2010 and the rate of literacy among the adults rose to 89.5 percent with 99.5 percent of youth between 15-24 years were literate in 2010. The under-five mortality rate also fell from 139 in 1970 to 28 in 2010. Years of investment in primary education led to an increase in the literacy rate among people aged 15 years and older from 60 percent of population to over 85 percent of population in 2010. While the gender gap in literacy narrowed in 2010, literacy rates were still higher among males than females. The literacy rate for males in 2010 stood at 96 percent and for female at 83 percent.

Figure 2.7 The Economy of Pre-Conflict Libya



Civil War (2011-Present)

Human Costs

The war, insecurity and violence have impacted more than 3 million people across Libya (half the population) of which an estimated 2.4 million people are in need of protection and humanitarian assistance. These include about 241,000 internally displaced persons, about 437,000 non-displaced with special needs and another 125,000 refugees fleeing the country to Europe and Italy in particular. Of these, half are women and one third are children and mostly located in the western part of the country. In addition to the ongoing civil conflict, Daesh is still present on the ground. The battle has led to a large number of deaths and injuries among civilians. In 2016 alone, between January and October, about 498 civilians were reported dead or injured. A survey by UNOCHA (United Nations Office for the Coordination of Humanitarian Affairs) shows that only four hospitals were found to be performing above 75 percent functionality out of the total 98 hospitals surveyed. People lack clean water and sanitation facilities (54 percent of people report reduction in the quantity of safe water), proper housing (due to significant damages to housing and infrastructure, see next section), education services (over 558 schools are either no longer functional or partially functional) and food (17 percent of IDPs are food insecure). In addition, IDPs, returnees and non-displaced are easy targets of violations of their rights and are exposed to high security and safety risks (Table 2.3).

Table 2.3. Libya: Vulnerable People by Sector

	People in Need (million)	IDPs (1000 people)	Refugees (1000 people)	Non-displaced (1000 people)	% Female	% of Children
Health	1.3	178	47	338	45	34
Protection	1.3	127	47	230	44	33
Shelter	0.6	97	47	8	40	30
Water and Sanitation	0.5	30	19	45	40	30
Food security	0.4	65	20	36	48	37
Education	0.3	31	2	62	49	100

Total of 1.3 million people in need

Source: Humanitarian Response Plan, 2017 at http://www.humanitarianresponse.info/en/operations/libya.

Children. Armed conflict has severely affected children, depriving them of access to basic social services. UNICEF reported that 1,060,000 children are estimated to be suffering from acute malnutrition, of whom 279,146 suffer from severe malnutrition. Thousands of children, especially girls, are out of school in different parts of the country, as schools are not functional, having been damaged by armed conflict or used as shelters for IDPs. Children are recruited into armed and extremist groups and a target for human traffickers, exposing them to life threats. There are estimates that about 439,000 children out of a total children of 2.4 million are in need of protection services, such as psychosocial support, community-based child protection services, and community reintegration to overcome the trauma caused by violence. Displacement and lack of security have led parents to pull girls out of school while many are pushed into early marriage.

Physical Costs

Libya is fully dependent on oil and the six-year conflict has blockaded the oil terminals and ports, with some tribes shutting down the fields of the government. In this report, we will provide estimates of the damages to oil fields in terms of lost revenues due to insurgency, and the damage assessment to civilian infrastructure prepared by the REACH Initiative for Benghazi, the most damaged city in Libya during the war. Due to several attacks to oil terminals over the past four years, the Libyan oil fields have encountered major infrastructure damage, blocking oil exports. Estimates by the EU show that militia control of major oil terminals (Ras, Lanuf, Sidra, Zueitina and Brega) for almost three years has cost Libya over $100 billion in lost revenue.

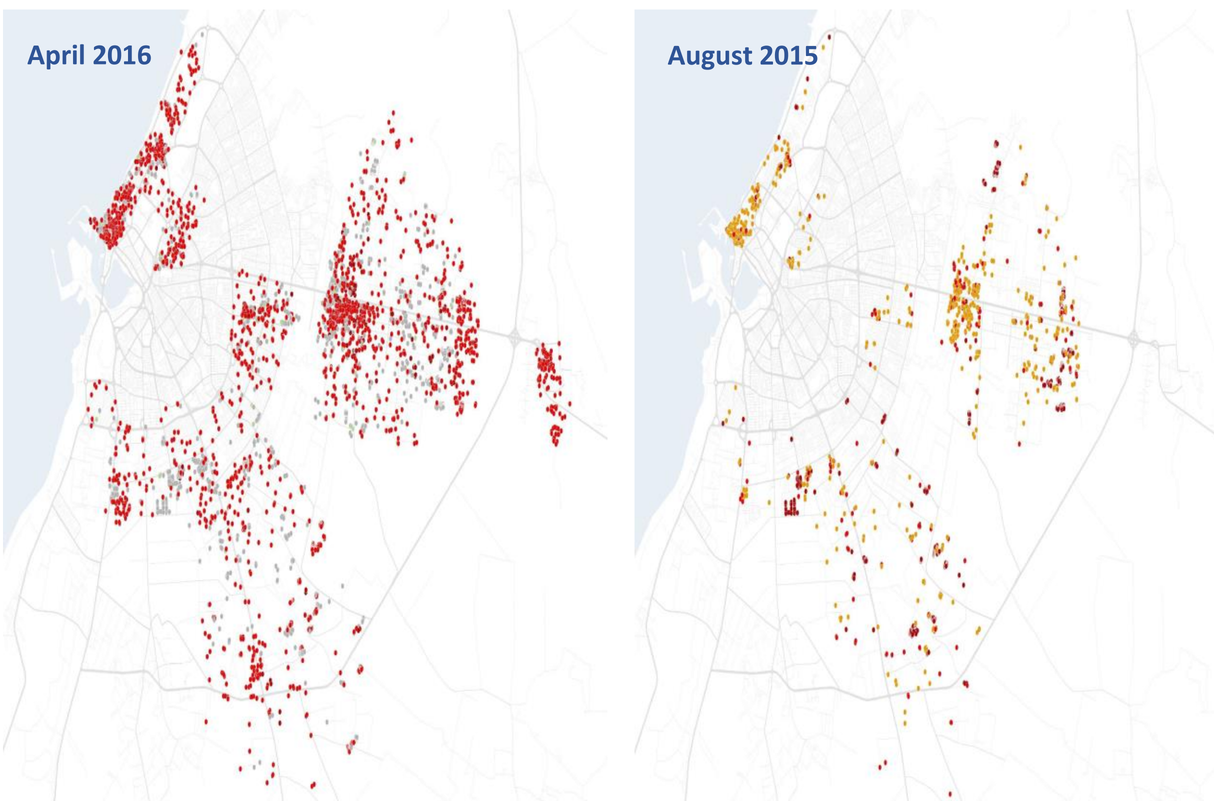
Among cities in Libya, Benghazi has the highest rate of damages to buildings due to the war and militia attacks. The IMPACT damage assessment covers 13 areas in Benghazi through satellite imagery over two periods of August 2015 and subsequent analysis in April 2016. The analysis identifies three types of building damages: destroyed (between 75-100% of structure destroyed), severely damaged (between 30-75% of structure destroyed), and moderately damaged (between 5-30% of structure damaged). The damage assessment shows that in August 2015, of the 1,620 damaged structures, 658 structures were destroyed, 276 structures were severely damaged and 686 were moderately damaged with an additional 537 identified as possibly damaged. Analysis of April 2016 with satellite imagery reveals a significant increase in damage. An additional 1,791 structures were identified including 455 destroyed, 580 severely damaged and 756 moderately damaged with an additional 706 identified as possibly damaged. Overall, between August 2015 and April 2016, about 3,344 structures were identified as destroyed, severely damaged or moderately damaged, with an additional 1,152 identified as possibly damaged (See Map 2.2).

Economic Costs

Six years of war in Libya has significantly undermined the achievements made in health and education. Moreover, economic activity has been disrupted and the social fabric torn by increased violence. The economy has remained in recession for the fourth consecutive year in 2016. Libya produced more than 1.6 million barrels per day of crude oil prior to the uprising in 2011; that has fallen to around 380,000 barrels per day. The non-hydrocarbon output remains weak due to disruptions in the supply chain and insecurity as well as lack of adequate investment. Real GDP is estimated to have declined by 8.9 percent in 2015 and it shrank further by 2.5 percent in 2016. Per capita income has fallen to less than $5,000 in 2016 compared to almost $13,000 in 2012. Inflation reached unprecedented levels in 2016 at 26 percent, up from 10 percent in 2015 driven by high food prices. Lack of funding to finance imports, especially food, led to shortages in basic commodities and expansion of black markets activities. The situation was exacerbated by households' attempting to store food.

Few Libyans work outside the government and the public sector has not been able to provide jobs for new entrants in the labor market. Libya has recorded high unemployment rates for the past two decades. The official unemployment rate stood at 13.5 percent in 2010 with youth unemployment estimated at double that rate. Oil revenues (the lifeline of the government) have fallen sharply to only a fifth of their pre-revolution levels, while spending has remained high. The share of the public wage bill in GDP is about 53 percent in 2016. Investments have been insufficient for sustaining adequate public provision of health, education, electricity, water and sanitation services. Being highly dependent on hydrocarbon exports and food imports, Libya's balance of payments and fiscal space suffered in 2016. Foreign reserves have remained the main source of financing of the budget deficit.

Map 2.2 Overall Damages to Structures in Benghazi (August 2015 – April 2016)



Source: IMPACT.

Principles in Rebuilding Post-Conflict MENA

The description of the pre-conflict economies of these three countries as well as of the devastating effects of the wars points to a fundamental principle: Reconstruction has to be a *nation-building* exercise. It has to go beyond repairing the physical damage of the war to addressing the root causes of the conflict. Relatedly, reconstruction has to be a *peace-building* exercise, if nothing else to prevent a recurrence of conflict. It should be designed to influence the conflict dynamics towards peace by changing the calculus of the belligerents.

With these overarching principles, the assessments of the damage and economic costs of the three civil wars in MENA - estimated in the order of $300 billion - as well as the review of previous experience with post-war reconstruction programs such as Iraq after 2003 (Box 2.2), suggest certain specific principles that could guide a post-conflict reconstruction strategy in the region.

1. Massive but Modulated Financing Supported by the International Community

The scale of damage is such that just bringing the economies of Syria, Yemen and Libya back to their pre-war levels will require a colossal amount of resources. Estimates of the order of two to three times the country's 2010 GDP would not be unreasonable. However, any recovery program should strive for going beyond reproducing 2010 GDP since, as shown above, the economies would have grown significantly in the absence of a civil war. Syria, for instance, had an historic opportunity to break the lower-middle-income barrier and become an upper middle-income country by 2025. Catching up to this long-term trajectory could take several years and trillions of dollars. Yet it is only fair to the people of these countries that any reconstruction plan keep its eyes on this seemingly unattainable trajectory and seek to achieve as much of its promises as possible.

In addition, much of the damage to human capital - children pulled out of school, re-emergence of communicable diseases, psychological trauma - will have long-term, possibly intergenerational consequences. Hence the focus of reconstruction should go beyond restoring the current lost output to preventing a long-term and possibly permanent stagnation in the economy.

Arriving at an estimate of the resources needed is only the first step. The next one is identifying how the funds will be raised. In the cases of Syria, Yemen and especially Libya, the oil sector—when it is back in production—could represent an important source of financing, just as it did for Iraq. To be sure, oil prices are unlikely to go above $60 per barrel (Devarajan and Mottaghi, 2016a) and restoring oil production will itself require financing. But the experience of other post-war recoveries shows that countries with significant natural resources are able to revive their economies faster than those without (Devarajan and Mottaghi, 2016b). So prioritizing the resumption of oil production could both help revive the economy and finance further reconstruction.

That said, even a fully functional oil sector would not generate enough resources to finance the post-conflict reconstruction in any of these countries. This is where the international community needs to step in. Given the sizable spillovers of these wars to neighboring countries and places further away such as Europe, it is in the international community's interest that peace, once achieved, should be sustained. And this requires that the post-war reconstruction program be adequately financed. Indeed, agreement around a reconstruction program could be the point of convergence among different regional and international players in the current conflicts.

Box 2.2 Lessons from Post-2003 Reconstruction of Iraq

In the aftermath of the U.S.-led invasion of Iraq in 2003, the international community, led by the United States, embarked on an ambitious program of recovery and reconstruction of the country. Today, Iraq is beset with sectarian conflict, including a protracted struggle against Daesh, a fragile economy (thanks to low oil prices), infrastructure deficits, and multiple governance challenges such as widespread corruption and lawlessness in parts of the country. What lessons can be drawn from the reconstruction experience for the other conflict countries in MENA?

- The reconstruction was well-funded (to the tune of $60 billion), complemented by about $126 billion from the Iraqi capital fund (from the era of high oil prices). Yet these funds were not well-used to strengthen, or even work with, Iraqi institutions. By contrast, an international trust fund to support institution-building had only $1.8 billion.
- The large allocation by the U.S. often created pressure to disburse within a fiscal year, leading to some unproductive expenditures. For instance, large sums were spent on increasing electricity generation by buying gas turbines or restarting generation plants without much repair. Eventually, electricity generation fell.
- Several departments of the U.S. government had reconstruction plans ready before the end of the war. Unfortunately, most of these plans were not used, partly because of poor coordination among the different departments.
- The reconstruction effort had limited results because it was largely "supply-driven" with little consultation with Iraqi counterparts on planning and implementation.
- The large sums of money involved also contributed to significant fraud, waste and abuse of reconstruction funds.
- Decentralization was part of the post-war agenda, aimed at preventing a return to dictatorship. Despite resources spent and a new constitution that stipulates a federal political system, not much progress has been made.

In sum, the experience with post-2003 reconstruction of Iraq provides some sharp lessons, mostly of "what not to do", for post-conflict reconstruction in MENA. In particular, the corrosive effects of large amounts of funding that are used for "supply-driven" projects without even minimal consultations with the recipient is a wake-up call. In the rush to help these war-torn economies, external actors may need to suppress their usual instincts and seek different approaches.

Source: Matsunaga, Hideki, 2017. "Successes and Failures of Post-2003 Iraq Reconstruction".

Peace and stability in MENA is a global public good. Like all global public goods, it will be under-supplied if individual countries only act in their own self-interest. Post-war reconstruction in

MENA, therefore, needs the global community to come together and deliver a joint program, just as they did in the final days of the Second World War at Bretton Woods in July 1944 (Box 2.3).

Box 2.3 Successful Post-Conflict Nation-Building: Germany and Japan

Germany and Japan set a standard for post-conflict nation-building and their success proves that post-conflict societies could transform themselves; and that major transformation could endure (Neeson, 2008). The Marshall Plan which was officially launched in 1948 and ended in 1951 was critical in rebuilding Western Europe and Germany, in particular. However, the plan was preceded by series of conferences starting in 1944 (during the war time) at the Bretton Woods Monetary Conference at which large amount of funds were pledged for rebuilding these countries. The International Monetary Fund (IMF), International Bank for Reconstruction and Development (IBRD)- which were conceived at the Bretton Woods conference - and the UN Relief and Rehabilitation Administration, provided $1.2 billion and $1.1 billion in 1946 and 1947 respectively. The United States provided large funds and aid to a number of European countries, amounting $3.4 billion in 1946 and $4.7 billion in 1947, enabling Germany and the rest of Europe to pay for the large flow of imports that were instrumental for the post-war recovery (Dubbins et al., 2003).

The Bretton Woods arrangements did not only provide funds but achieved clarity on what was called an "international economic order", or the "(institutional) rules of the game". Policies or politics and access to financial resources went together. "Consensus" (except for the 'Eastern Bloc" countries and the emerging developing countries) on these rules established the quasi-public good, the "international economic order".

Both Germany and Japan showed similarities in their approach to post-war reconstruction. They enacted political, economic and social reconstruction aimed at rebuilding the country. First, they amended and ratified their Constitutions by empowering women, guaranteeing fundamental human rights, strengthened the powers of Parliament and the Cabinet, and decentralized the police and local government. Priorities were given to reforming the educational system, and the national budget system along with media which was considered a major vehicle for accomplishing reform and democratization.

In translating this "mechanism" to the MENA region, the quest should not only be for resources to rebuild countries and economies, but also about policies as the past was not sustainable, judging by the Arab Spring events.

[1] See Friedrich, C.J, and Spiro, H.J, The constitution of the German Federal Republic, in Litchfield, E.H, 1953, Governing postwar Germany, Cornell University Press, p.117-151.

While the financial and technical support of regional and international partners is critical, the reconstruction program should be a national-driven and not a donor exercise. It should be based on national visions and agendas developed through inclusive forums of debate. Donors can reinforce this process by working through national institutions, even if they are nascent, rather than impose a foreign entity in an already fragile situation (See Box 2.2).

While raising the necessary financing is important, the pace and rhythm by which the money is spent is just as important. The experience of Iraq (and possibly Afghanistan), as well as other high-aid developing countries, teaches us that spending beyond the absorptive capacity of the recipient can create huge distortions, rent-seeking behavior, and possibly make the situation worse (See Box 2.2). If complementary inputs such as technical knowledge and incentives are not in place, large amounts of financing will serve to raise prices beyond reasonable levels. It can also lead people to favor expedient, short-term investments (to show that the money was spent) at the expense of longer-term, institution-building measures. Rather than focusing on just raising the total amount of money estimated as needed, the principle should be that no sensible and realistic post-conflict reconstruction activity should be financially constrained.

2. Rebuild Institutions not just Infrastructure

Any reconstruction program will require prioritizing and sequencing of interventions. In Syria, for example, should they first rebuild Aleppo or Homs? Should electricity be restored before restarting children's schools? Given that all three countries followed an autocratic, state-led development model in the past—a model whose breakdown led to the Arab Spring protests that, in turn, led to civil war—it is essential that the reconstruction strategy not reproduce the old social contract (Devarajan and Mottaghi, 2015b). Rather, it should be people-led, -driven, and –controlled. Decisions on resource allocation, even for large-scale infrastructure projects, should not be taken exclusively at the central-government level. There should be mechanisms by which the public is consulted and their voice has an impact on the decisions.

Giving citizens voice in decision-making is important for two reasons. First, as just noted, it would be a departure from the old social contract, which has clearly broken down. Fuel subsidies, for instance, are not only inefficient and regressive, but they serve to disempower people, especially poor people. For the only way they can get a benefit from the state is to consume fuel (Devarajan and Mottaghi, 2014). Replacing these fuel subsidies with cash transfers not only reduces inefficiencies such as pollution and congestion associated with excess fuel consumption, but it gives people a choice of what to consume out of the benefit they receive. In this spirit, the post-conflict reconstruction program should try to give people a choice over what types of benefits they wish to receive.

The second reason for consulting with the public before, say, building infrastructure is that the three civil wars have become sectarian conflicts with a large number of displaced people. In Syria, over half the population has left their homes. Inasmuch as they were fleeing violence perpetrated by groups different from themselves, some of these people may not wish to return to whence they came. They may not even wish to live with people of their own sect.

In a study of rebuilding post-war Bosnia, Whitt (2010) finds that people do not unconditionally trust their co-ethnics and universally distrust other groups. He suggests that factors other than ethnicity could create trust among different sects in society. Institutions that cut across ethnic or sectarian lines, but build trust, can be critical in rebuilding post-war economies. While helping these institutions emerge, one concrete measure of post-conflict reconstruction could be to give citizens cash transfers and let them decide where to move before rebuilding infrastructure. Not only will this avoid wasteful infrastructure spending, but it would empower citizens and possibly incentivize local governments to attract citizens, both of which would help build trust in the state.

A particular way for the reconstruction program to be people-led is to crowd in the private sector. A post-conflict government will have neither the resources nor capacity to rebuild the economy. But the private sector can - and will - be the engine of growth in the aftermath of the war. The government should promote a dynamic business environment and institutional reforms, based on a consensus emerging from an inclusive dialogue on reconstruction, so that the power of the private sector can be unleashed. Privileging the private sector will also be important in facilitating the return of refugees, many of whom abandoned their businesses during the war. Finally, a dynamic private sector is the strongest antidote to a resumption of conflict.

3. Local Autonomy with Fair Distribution of Oil Revenues

All three civil-war countries are oil economies that, before the war started, earned between 35 and 90 percent of government revenues from oil. Indeed, oil may have been a reason for the conflict. Many oil countries suffer from poor public expenditure outcomes at least partly because oil revenues, unlike tax revenues, go directly from the oil company to the state without passing through the hands of the citizens. As a result, citizens may not know the extent of oil revenues. And even if they knew, they may not have as much incentive to scrutinize how government spends the money, because they do not think of it as "their money" (even though it is). This syndrome often results in inefficient and ineffective public expenditures, eventually leading to citizen dissatisfaction and protest at the government, as happened in the Arab Spring. In short, any post-conflict reconstruction strategy, especially if it is financed by revenues from a revived oil sector, has to pay close attention to how those revenues are spent and—equally importantly—how citizens perceive how those revenues are spent.

Moreover, as noted earlier, these wars have evolved into sectarian conflicts, often with the warring parties controlling particular parts of the country. In order to maintain the integrity of the country after a peace settlement—to avoid various groups seceding and forming their own country—the central government may devolve some fiscal authority to sub-national entities.

Since they are all oil economies, how oil revenues are shared among the sub-national units then becomes crucial to the success of a post-conflict reconstruction program. On the one hand, it may be efficient to distribute oil revenues to where they can be most productive. On the other hand, to the extent that some part of the conflict was due to grievance by one group's not getting their “share” of the nation’s resources, an allocation that does not take this factor into account may lead to a resumption of conflict. There is also the particular issue of people living near the oil fields who often feel shortchanged when oil revenues are distributed to other parts of the country but they bear the pollution and other costs of oil production. Finally, with the large number of displaced people, there will be large population movements post-conflict, to which any particular allocation of oil revenues needs to be calibrated.

Taking all these considerations into account, perhaps the equal distribution of oil revenues to every citizen (including possibly citizens who are currently refugees) should be considered. Such a policy cannot be considered “unfair” by one group or another (since everybody gets the same amount). Furthermore, as with distributing reconstruction resources to individuals and letting them move where they like, this distribution of oil revenues will accommodate the movement of people after the conflict. Indeed, subnational governments may try to entice people to move to their jurisdiction because every person comes with his or her money. Most importantly, this distribution of oil revenues means that government will need to tax citizens to finance public goods, thereby increasing the chances that citizens will hold government accountable for spending decisions.

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Country Notes

ALGERIA

A strong recovery in hydrocarbon production and higher-than-expected public spending kept growth relatively buoyant in 2016 at 3.8 percent, despite low global oil prices. However, non-hydrocarbon growth decelerated, while inflation rose. Double-digit twin deficits remained, depleting fiscal savings. In the medium term, growth and the twin deficits are expected to decline sharply as the government implements fiscal consolidation. The resulting contraction in GDP per capita growth may negatively impact households' welfare.

Recent developments

In 2016, Algeria sustained its fairly strong growth, mainly driven by recovery in hydrocarbon production, which dominated the slowdown of non-hydrocarbon growth. During this period, GDP is estimated to have grown by 3.8 percent, almost unchanged from 2015. The sustained growth was driven by a recovery in hydrocarbon production, which grew at 3.6 percent, up from 0.4 percent in 2015. The non-hydrocarbon sector growth slowed to 3.9 percent from 5.0 percent in 2015, mainly due to a slowdown in agriculture (due to unfavorable weather), water and energy, and other industries. Yet, this slowdown remained modest despite the impact of a sharp fall in oil prices, from US$100 p.b. in 2014 to US$46 p.b. in 2016. Exports increased their contribution to growth in 2016, while imports and government consumption contributed negatively, see figure 1.

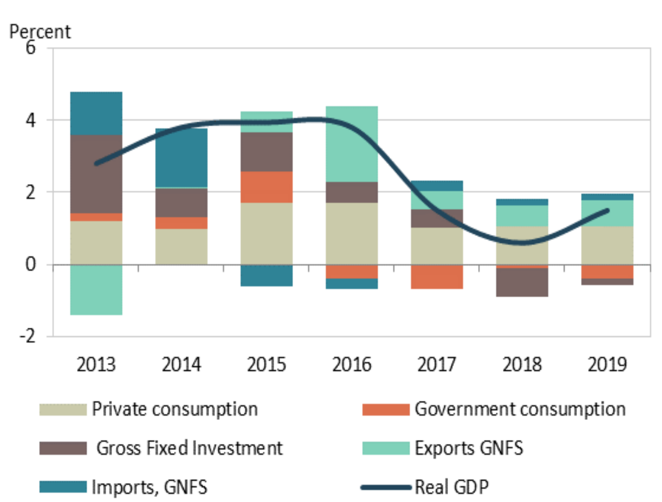
This sustained growth has been achieved in part due to a smooth pace of fiscal consolidation, which cut the fiscal deficit to 12.2 percent of GDP in 2016, from 16.2 percent in 2015 (Table 1 and Figure 2). The government implemented with some success the set of austerity policies adopted in the 2016 budget. The budget called for a 9 percent cut in expenditure (mostly investment) and a 4 percent increase in tax revenues based on a 36 percent hike in gasoline prices and higher taxes on electricity VAT rates and on car registrations. The budget also empowered finance authorities to approve further expenditure cuts if oil prices fall below the oil price assumption, and to engage in external borrowing if needed. However, government spending is estimated to have decreased only by 6.0 percent, primarily driven by a capital-expenditure cut of 11.2 percent.

The current account deficit declined slightly to 15.6 percent in 2016, from 16.5 percent in 2015. Imports decreased by 5.9 percent in 2016, falling significantly short of the sharp decline in exports of 16.8 percent. The former was partly driven by the new Government policy of import licenses to curb the current account deficit.

In 2016, monetary authorities allowed the dinar to further depreciate with respect to the U.S. dollar by 8.6 percent to prevent its misalignment, which increased inflationary pressures. Inflation stood at 6.4 percent in 2016, up from 4.8 percent in 2015, partly due to the pass-through from dinar depreciation.

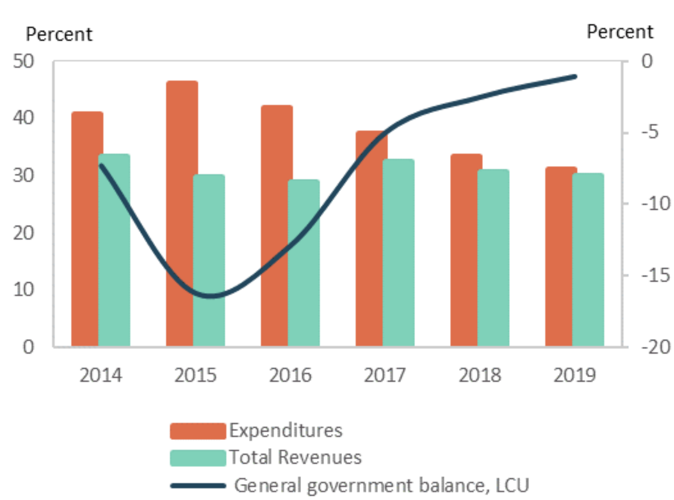
Enduring high youth unemployment rates reflect limited economic opportunities for the improvement of households' living conditions. In September 2016, unemployment rose to 10.5 percent, from 9.9 percent in April 2016, the two latest available data. Unemployment is acute among women, at 20 percent, among youth at 26.7 percent, and among those with a university degree at 17.7 percent. Labor force participation remains low at 41.8 percent plagued by an extremely low rate of women's participation (16.6 percent). The persistent lack of jobs, combined with the slowdown of the economy, and inflationary pressure raise concerns of a possible increase in the

FIGURE 1 Algeria / Contributions to GDP growth



Sources: World Bank, Macroeconomics and Fiscal Management Global Practice.

FIGURE 2 Algeria / Fiscal position



Sources: World Bank, Macroeconomics and Fiscal Management Global Practice.

country's poverty rate and the number of households in a vulnerable situation.

Outlook

The Algerian economy is expected to slow down in the medium term. Real GDP growth is expected to average 1.2 percent in 2017-2019. The downward revision of growth projections compared to the Fall 2016 projections is due to the announced fiscal consolidation and a moderation of hydrocarbon production growth. In 2017-19, a modest 2.5 percent increase in hydrocarbon production resulting from the start of production in new oil wells and a positive correction in oil prices will mitigate the negative effect of fiscal and current account consolidation on the real non-oil sectors. Continued lower levels of oil prices (albeit with some positive correction) and sluggish household demand due to high levels of unemployment and/or inactivity will help keep a lid on inflation. The fiscal deficit is estimated to further decline to below 5 percent in 2017 and one percent by 2019, if the government maintains tight control over spending. This deficit is expected to be financed by the issuance of new debt, given that fiscal saving has been depleted, increasing the debt-to-GDP ratio to 14.6 percent in 2018 and over 20 percent in 2019. The current account deficit is projected to progressively decline to below 10 percent in 2019.

Risks and challenges

This outlook is exposed to at least two downside risks: a lower than expected oil price and social discontent. The current outlook assumes a strong recovery of oil prices (27 percent in 2017). Given that oil represent about 25 percent of the Algerian economy during the last 3 years, a lower than projected price will pose a challenge to growth. Because the prospective increase in hydrocarbon production might also depend on the price level, Algeria would be especially vulnerable to a continued decline in oil prices. Moreover, mounting social discontent from government spending cuts, tax hikes and high youth unemployment levels constitute substantial risks to this outlook. For example in January 2017, significant riots took place in Béjaia and its surrounding towns in protest of the announced increase of the VAT from 17 percent to 19 percent. While political will and national consensus to rationalize inefficient, inequitable and generous subsidies is emerging, such reform requires improved safety nets such as a well-targeted cash transfer system and a comprehensive media campaign. Some of these accompanying measures are currently under design for implementation in the medium term.

TABLE 1 **Algeria** / Macro outlook indicators (annual percent change unless indicated otherwise)

	2014	2015	2016 f	2017 f	2018 f	2019 f
Real GDP growth, at constant market prices	3.8	3.9	3.8	1.5	0.6	1.5
Private Consumption	4.4	3.3	3.9	3.5	3.5	3.4
Government Consumption	1.1	2.6	-2.2	-4.6	-0.4	-1.3
Gross Fixed Capital Investment	6.4	3.0	0.8	0.3	-5.3	-1.3
Exports, Goods and Services	0.2	0.5	3.6	2.0	2.5	2.6
Imports, Goods and Services	8.6	-3.3	-3.7	1.6	1.0	1.0
Real GDP growth, at constant factor prices	4.0	4.5	3.8	1.5	0.6	1.5
Agriculture	2.5	7.6	3.9	3.8	3.8	3.9
Industry	3.4	4.1	4.1	3.2	3.1	3.2
Services	5.6	3.7	3.2	-2.2	-5.0	-2.8
Inflation (Consumer Price Index)	2.9	4.8	6.4	4.8	4.3	4.0
Current Account Balance (% of GDP)	-4.4	-16.5	-15.6	-12.6	-10.6	-9.5
Fiscal Balance (% of GDP)	-7.3	-16.2	-12.2	-4.7	-2.4	-1.0
Debt (% of GDP)	8.0	9.2	12.6	12.3	14.6	20.4
Primary Balance (% of GDP)	-7.0	-15.9	-11.8	-4.2	-1.9	-0.7

Sources: World Bank. Macroeconomics and Fiscal Management Global Practice.
Note: f = forecast.

BAHRAIN

Growth continues to slow and the fiscal deficit remains wide. The BOP current account has moved into deficit and international reserves have declined, with significant pressure on the exchange rate peg. Despite the recent fiscal consolidation efforts, Bahrain is the most vulnerable GCC country in the face of low oil and bauxite prices due to its limited savings and high debt levels, leaving it exposed to financing risks.

Recent developments

Cheap oil continues to test Bahrain's economic resilience. Bahrain maintained an expansionary fiscal stance since 2009 resulting in general government deficits. The situation worsened in 2015 with a decline in oil revenues by about 10 percent of GDP and a general fiscal deficit estimated at 12.8 percent of GDP (from 3.4 percent in 2014). The deficit spending helped maintain economic growth at 2.9 percent, but brought reserves down to a low level at 2.6 months of imports and increased public debt to 62 percent of GDP.

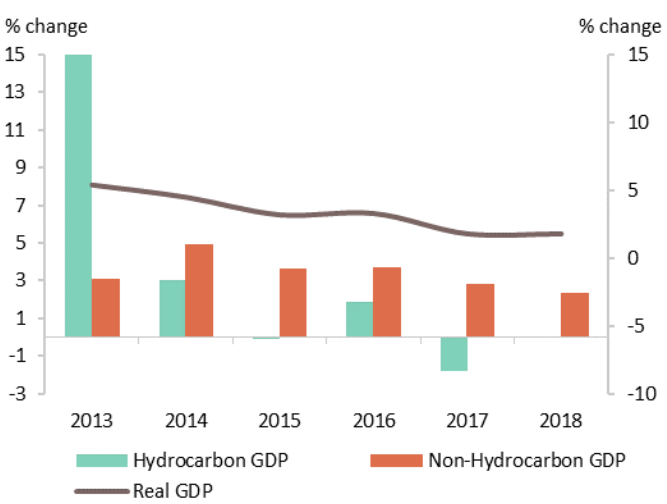
Bahrain has introduced some initiatives for fiscal consolidation. Revenue enhancing measures such as higher tobacco and alcohol taxes and government services fees were introduced over the past year. A cost-cutting program entailed the raising of petrol prices by up to 60 percent in January 2016 (likely to create savings worth US$148.4 million), the gradual phasing-in of price increases for electricity, water, diesel, and kerosene by 2019, an increase and unification of natural gas prices for industrial users, and the removal of meat subsidies. Inflation has gradually picked up in 2016 mainly as a result of the subsidy reform: the headline CPI rose by 3 percent, but it will remain subdued in 2017 as one-off measures affect the current year only.

2016 outcomes demonstrate, however, that the authorities' emphasis on growth comes at the expense of fiscal deterioration. The Bahraini economy grew by an estimated 3.4 percent in 2016. While the hydrocarbon sector grew by an estimated 2 percent, the non-hydrocarbon sectors grew by an average estimated rate of 3.7 percent, a figure that reflects the continued emphasis on public investments, some of which were funded by the GCC. The downside of this approach, however, has been manifested in persistently high fiscal deficits, estimated at 12.6 percent of GDP in 2016. A large portion of the 2016 deficit was covered by debt issuances, despite the sovereign downgrade reflecting increasing pressures on government finances. Bahrain issued a US$600 million bond just before the downgrade and the authorities raised the public debt ceiling to BD 10 billion (around 80 percent of GDP) to enable additional borrowing.

Bahrain's external position faces growing vulnerabilities. The current account surplus of the past 12 years turned into a deficit in 2015, following the drop in oil prices and further deteriorated in 2016 to 4.6 percent of GDP. Reserve adjustments reflect the growing external imbalances. The exchange rate peg has come under significant pressure: external imbalances were reflected in a decline in reserves to 2.6 months of imports in the same time frame. The real effective exchange rate has also appreciated by 17 percent since mid-2014, complicating adjustments to the adverse terms of trade shock that Bahrain is facing.

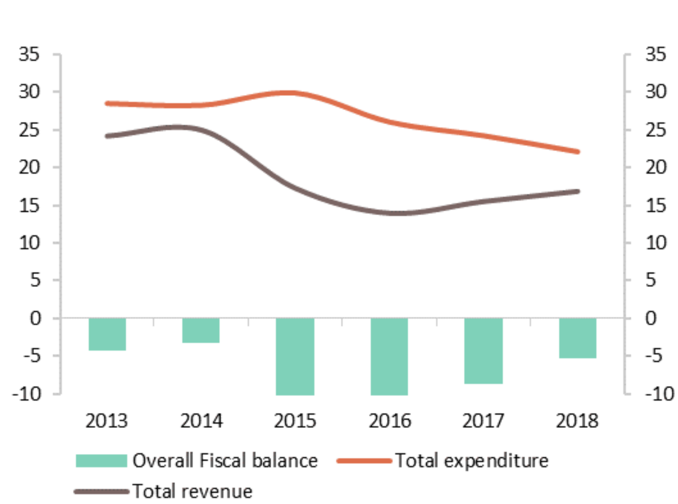
Little comprehensive welfare analysis is available due to restricted access to household survey data, limited capacity, and the sensitivities involved. Among Bahraini nationals', labor force participation is

FIGURE 1 Bahrain / Growth in GDP and its components



Sources: Bahraini Authorities, World Bank and IMF staff estimates.

FIGURE 2 Bahrain / General Government Operations (in percent of GDP)



Sources: Bahraini Authorities, World Bank and IMF staff estimates.

low, and people work predominantly in the public sector, where wages are high and productivity low. Immigrant workers constitute about a half of the resident population and command much lower incomes. Key elements of the social contract—public employment and subsidies—are becoming less affordable in the context of subdued oil prices. Bahrain aims to gain from upgrading its capacity for welfare measurement that would support the design of policies aimed at mitigating the impact of the necessary adjustment. Results from a new household survey in 2015 have not yet been published.

Outlook

Economic growth is expected to decline in the forecast period. Real GDP growth projections have been revised downwards to 1.9 percent in 2017 and 2018, as continuing low oil prices depress private and government consumption. Some infrastructure investments are also likely to be put on hold. In the absence of significant upfront fiscal adjustments, Bahrain will remain vulnerable to fiscal risks.

Average inflation is expected to decrease to 2.1 percent in 2017 reflecting the cooling off in economic activity and phasing out of temporary price-boosting effects of subsidy reforms. The current account deficit will partially narrow to 3.8 percent of GDP in 2017 and remain about there for the years to come, with the exception of small adjustments. International reserves are expected to follow a declining trend, and reach 1.5 months of imports in 2018. Public debt is projected to exceed 90 percent of GDP in 2017, and reach about 100 percent in 2018.

Risks and challenges

Ensuring fiscal sustainability while preserving a healthy growth rate has become an important challenge in Bahrain. Real GDP growth is expected to slow and fiscal and external balances are expected to remain under pressure in 2017 due to oil prices remaining well below fiscal breakeven levels. Despite efforts to diversify and boost non-oil fiscal revenues, hydrocarbons account for about 80 percent of government revenues in Bahrain. In addition, subsidies still absorb more than 20 percent of the fiscal budget. The fiscal break-even price for Bahrain was estimated at US$110 per barrel in 2016, the highest amongst the GCC. Thus, Bahrain is expected to continue to run significant general fiscal deficits in the forecast period -9.8 percent of GDP in 2017. Delays in implementing fiscal consolidation or a further decline in oil prices could trigger additional sovereign rating downgrades making access to external financing harder, and intensifying pressure on reserves and the peg. Fiscal solvency and liquidity risks are high, and outcomes remain vulnerable to shocks to growth, commodity prices, and interest rates.

TABLE 1 Bahrain / Macro outlook indicators (annual percent change unless indicated otherwise)

	2014	2015	2016 e	2017 f	2018 f	2019 f
Real GDP growth, at constant market prices	4.4	2.9	3.4	1.9	1.9	2.3
Private Consumption	-0.7	1.9	2.1	1.6	1.5	1.5
Government Consumption	4.0	0.3	-1.2	-2.3	-2.0	11.1
Gross Fixed Capital Investment	5.9	-12.1	5.8	3.2	2.6	2.2
Exports, Goods and Services	-4.1	1.3	2.7	2.6	3.1	2.0
Imports, Goods and Services	-7.4	-5.6	0.2	2.2	2.6	3.2
Inflation (Consumer Price Index)	2.7	1.8	3.0	2.1	2.0	2.0
Current Account Balance (% of GDP)	4.6	-2.4	-4.6	-3.8	-3.5	3.5
Fiscal Balance (% of GDP)	-3.4	-12.8	-12.6	-9.8	-8.9	-7.6
Primary Balance (% of GDP)	-1.6	-10.5	-10.2	-7.0	-5.9	-5.5

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice.
Note: e = estimate, f = forecast.

DJIBOUTI

Growth is estimated at 6.5 percent in 2016 and expected to remain strong in 2017. Growth in 2017 will be supported by improved net exports, compensating for a decline in investment, and pick-up in private and government consumption. Although fiscal and external positions are improving, debt and fiscal sustainability risks remain. Unemployment, at almost 40 percent of the labor force, continues to cripple the country.

Recent developments

GDP growth is estimated at 6.5 percent in 2016 as in 2015. The growth pace in 2016 was mainly driven by continued capital-intensive activities in port development, construction of a new free zone, and a railway to link from Addis-Ababa (Ethiopia) to the Djiboutian ports of Tadjoura and Doraleh. Inflation accelerated to 3.5 percent in 2016 from 2.2 percent in 2015, spurred mainly by demand for housing and services.

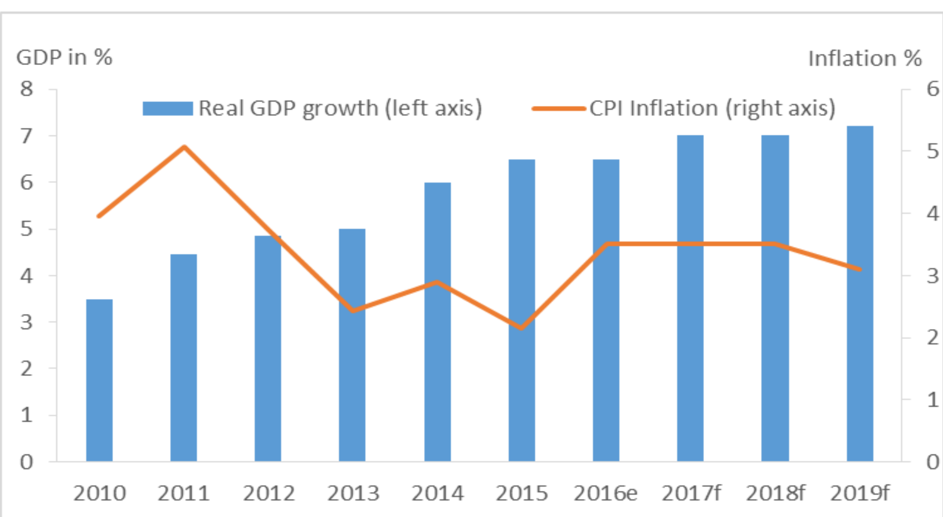
The fiscal deficit is estimated to have declined to 15.5 percent of GDP in 2016, from 21.7 percent in 2015, given the softening of infrastructure projects for port development and construction of a new free zone and the railways, which had triggered large capital expenditure. The external deficit also improved slightly to an estimated 31.1 percent of GDP in 2016, from 33.0 percent in 2015, as capital imports wind down with the ending of infrastructure projects. FDI remained strong in 2016, estimated at 9.1 percent of GDP, compared to 7.2 percent in 2015, stimulated by industrial development in the new free zone and operations of the newly constructed railway. Foreign exchange reserves remained strong in 2016, sufficient for coverage of broad money and currency board, at 3.4 months of imports in 2016. The REER appreciated by an estimated 1.1 percent in 2016, reflecting the combined effects of the supply side constraints and high consumer prices. The banking sector remains weak with a deteriorating loan portfolio of commercial banks and rising nonperforming loans (NPLs). The ratio of NPLs to total loans increased from 14 percent in 2013 to 23 percent in 2016. The authorities attribute this increase to the introduction of stricter loan classification requirements.

The statistical system in the country has faced important limitations in terms of welfare and poverty monitoring. There have been only two, non-comparable household surveys collected in the last ten years, with both missing the nomadic population – a group that represented 20 percent of the population in 2009 and are highly vulnerable due to the recent extended drought period. Unemployment remains widespread with the rate reaching 39 percent in 2015 according to official estimates. The rate is higher among women (49 percent) and in rural areas (59 percent). Meanwhile, the labor force participation rate is less than 25 percent.

Outlook

Growth is expected to reach 7 percent in 2017 as the sharp drop in investments due to the end of the infrastructure projects is expected to be more than offset by the sharp decline in capital goods imports leading to an improvement in net exports. Growth will also be supported by an expected pick up in private and government consumption. The medium-term outlook for 2018-2019 remains favorable, with the expectation that the recent capital investments will generate revenues to service

FIGURE 1 Djibouti / Growth and Inflation



Sources: Government of Djibouti, World Bank MFM GP the debt. The fiscal position should gradually improve, narrowing to low single digits in 2017-19, under the assumption that current investments will create new production and export capacity, spending is rationalized, and fiscal policies to improve the business environment for SMEs and increase revenues as well as fuel subsidies reform are implemented effectively. The current account deficit is projected to decline to 22.2 percent of GDP in 2017 and further down to 14.4 percent by 2019, with a gradual pick up in exports over imports. FDI inflows and capital transfers should continue to finance the deficit. Reserves are expected to continue to guarantee adequate currency board and import coverage (of well over 3.7 and 3.6 months of imports, respectively in 2018 and 2019), thus allowing the peg of the Djibouti Franc to the US$ at 177.72 to be sustained. Inflation is projected to remain at 3.5 percent in 2017-2018 as demand in the housing and services sectors remains strong.

As growth is mainly driven by infrastructure investments, its impact on job creation is expected to be limited.

Djibouti has embarked on a program to update its statistical system. A new National Strategy for Development of Statistics is being developed, and a nationally representative household survey is expected to be rolled out during the first half of 2017. These are expected to substantially improve the monitoring of vulnerable populations in the country.

Risks and challenges

Economic diversification, strengthening institutional capacity and accountability, and improving public services delivery remain key challenges to overcome Djibouti's entrenched macro-economic problems. Addressing the skills mismatch through active labor markets programs will also be instrumental in reducing unemployment. Macroeconomic stability remains subject to high risks, considering Djibouti's own internal macro-imbalances and its vulnerability to global economic conditions, due to its heavy reliance on transit trade and transshipments. To ensure macro-economic stability, the government needs to engage in reforms to rationalize spending and effectively implement fiscal reforms, to improve the business environment for private sector development, and promote domestic resource mobilization. Social instability and discontent as well as security issues on the Red Sea could also pose a risk to growth prospects.

TABLE 1 **Djibouti** / Macro outlook indicators (annual percent change unless indicated otherwise)

	2014	2015	2016 e	2017 f	2018 f	2019 f
Real GDP growth, at constant market prices	6.0	6.5	6.5	7.0	7.0	7.2
Private Consumption	6.4	6.3	6.0	6.1	6.2	6.3
Government Consumption	4.4	4.5	3.5	3.6	3.6	3.4
Gross Fixed Capital Investment	13.1	27.7	11.7	-4.2	2.3	3.8
Exports, Goods and Services	2.1	13.9	13.1	7.1	7.6	7.8
Imports, Goods and Services	8.6	23.7	11.4	-2.1	2.3	3.0
Real GDP growth, at constant factor prices	3.1	3.1	6.5	7.0	7.0	7.2
Agriculture	3.0	3.0	2.1	2.5	3.0	3.0
Industry	5.4	5.4	5.5	5.8	6.0	6.1
Services	2.5	2.5	6.9	7.5	7.4	7.7
Inflation (Consumer Price Index)	2.9	2.2	3.5	3.5	3.5	3.1
Current Account Balance (% of GDP)	-24.7	-33.0	-31.1	-22.2	-17.7	-14.4
Fiscal Balance (% of GDP)	-10.8	-21.7	-15.5	-2.1	-1.5	-1.2
Debt (% of GDP)	48.4	70.4	84.9	84.5	83.5	82.4
Primary Balance (% of GDP)	-10.6	-20.1	-13.8	-0.1	0.7	1.1

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice

Notes: e = estimate, f = forecast.

ARAB REPUBLIC OF EGYPT

Egypt has embarked on a major economic reform program, including the liberalization of the exchange rate regime, fiscal consolidation measures and reforms to the business environment. The liberalization of the exchange rate regime is a key step towards restoring the competitiveness of the economy and boosting private sector activity, which had been severely impeded by shortages of foreign currency. Yet, the reforms are exacerbating social pressures in the short term, with inflation reaching some of the highest recorded rates.

Recent developments

The first quarter of FY17 (July to June) marked a slowdown in growth recording 3.4 percent compared to 5.1 percent in the same quarter last year, with annual growth in FY16 registering 4.3 percent. Growth was constrained by severe shortages in hard currency, an overvalued exchange rate and sluggish growth in Europe, Egypt's main trading partner. Key sectors continue to experience negative growth, particularly tourism and the oil and gas extractives sector that has been suffering from underinvestment and arrears.

The annual fiscal deficit in FY16 increased to 12.1 percent of GDP, up from 11 percent the year before. However, in the first half of FY17 the deficit declined to 5.4 percent of GDP, down from 6.4 percent in the same period last year. The improvement in the first half is solely driven by a decline in total expenditures, which compensates for a drop in total revenues. Lower expenditures were driven by a decrease in subsidies and public wages as a percentage of GDP.

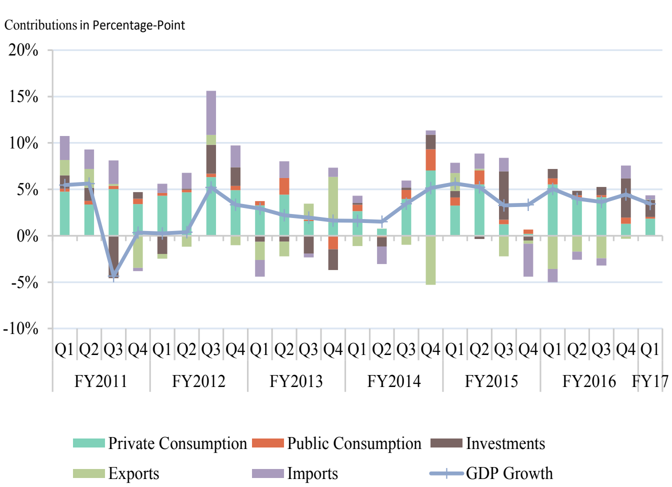
The most recent data for the first quarter of FY17 show an overall surplus in the balance of payments of 0.5 percent of projected GDP, compared to a deficit of 1 percent during the same period of the previous year. The improvement in external accounts was mainly due to the narrowing trade deficit induced by an increase in merchandise exports (by 11.2 percent) and a decline in merchandise imports (by 4.8 percent). Meanwhile, Suez Canal receipts further deteriorated by 4.8 percent and net private transfers also declined by 21.8 percent. As a result, the current account deficit widened to 1.4 percent of GDP compared to 1.1 percent in the same quarter of the previous year. More positively, FDI inflows increased to US$1.9 billion over the same period, up from US$1.4 billion the previous year.

To stimulate growth and address major macroeconomic imbalances, the government embarked on a major economic reform program. The key features include (i) the liberalization of the exchange rate regime; (ii) fiscal consolidation through a combination of expenditure and revenue measures, notably cuts in fuel subsidies, containment of the wage bill and introduction of VAT; and (iii) reforms to the business environment and addressing impediments to industrial activity.

The reform program was supported by an IMF Extended Fund Facility of US$12 billion which contributes to cover Egypt's financing needs, the rest of which has been covered through disbursements under the World Bank, the African Development Bank and a number of bilateral loans, in addition to a recent issuance of Eurobonds in the amount of US$4 billion.

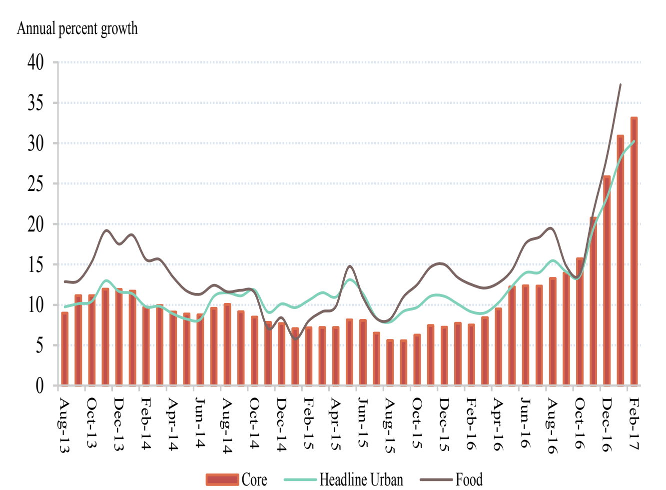
Following the floatation, the exchange rate displayed strong overshooting (hitting its lowest rate of 19.5 in December compared to a pre-float fixed rate of 8.8), but has subsequently strengthened as foreign investor confidence picked up and backlogs of USD orders to finance imports eased. Net international reserves reached US$26.4 billion at-end January (6 months'

FIGURE 1 Arab Republic of Egypt /Real GDP growth, demand-side, FY2011-FY2017



Sources: Authors' calculations based on Ministry of Planning data.

FIGURE 2 Arab Republic of Egypt / Inflation rates, August 2013 – February 2017



Sources: Central Bank of Egypt.

imports), up from a pre-floatation level of US$19 billion.

Currency weakening has led to a sharp rise in inflation, which reached its highest recorded level of 30.2 percent in February 2017. Following the currency floatation, the CBE increased interest rates by 300 basis points (bringing the cumulative increase to 550 basis points since March 2016) to absorb excess liquidity and curb inflation. High inflation has contributed to the aggravation of social conditions, given the persistently high unemployment (12.6 percent in 2016). The recently adopted reform program involves efforts to improve social safety nets, notably through the partial reallocation of freed up resources from reduced energy and food subsidies; the expansion of cash transfer programs; and an increase in the general pension budget by 15 percent. Nonetheless, the mitigation of recent adverse shocks will continue to depend on an effective targeting mechanism.

Outlook

GDP is expected to grow by 3.9 percent in FY17, and will be largely driven by public investment and to some extent net exports. Private investment is expected to pick up only in the second half of FY17, supported by enhanced competitiveness following the depreciation of the currency and the gradual implementation of business climate reforms. Tourism is also expected to steadily recover on the back of a weaker currency. Yet, growth will likely be undermined by slower growth of private consumption, which is expected to be negatively affected by record high inflation rates. Prudent monetary policy is projected to bring inflation down over the forecast horizon after the one-off effects of depreciation, subsidy reforms, and the introduction of VAT dissipate.

The fiscal deficit is projected to narrow to 10.5 percent in FY17, contingent on the government's commitment and ability to sustain its fiscal consolidation plan. With the implementation of the VAT, the expected increase in the VAT rate to 14 percent from the current 13 percent, and efforts to improve tax collection, revenues are expected to improve, while expenditures will continue to be contained.

The current account deficit is expected to start improving in FY17, supported by a positive exchange rate effect and an increase in remittances transferred through formal channels.

In the near term high inflation is likely to have negative short-term effects on households. Current efforts to improve targeting in the food smart-card program, currently used to protect the vulnerable population from food price shocks and ensure a minimum level of food security, could provide additional resources for an improved safety net.

Risks and challenges

Policy slippage and absence of real-sector reforms may negatively impact the anticipated economic recovery. Deteriorating security risks can adversely affect the recovery of the tourism sector, traditionally a main source of revenue and foreign currency.

On the social front, resources from fuel subsidy reform to be allocated to social programs may be lower than expected due to currency depreciation, but efforts should continue to improve the efficiency of the safety net system. Sustained high unemployment may lower households' ability to improve their living conditions.

TABLE 1 Arab Republic of Egypt / Macro outlook indicators (annual percent change unless indicated otherwise)

	2014	2015	2016 e	2017 f	2018 f	2019 f
Real GDP growth, at constant market prices	2.9	4.4	4.3	3.9	4.6	5.3
Private Consumption	4.4	3.1	4.6	1.8	2.8	3.5
Government Consumption	8.4	7.0	3.9	0.9	1.8	2.2
Gross Fixed Capital Investment	1.7	8.6	11.2	13.7	7.6	11.0
Exports, Goods and Services	-11.9	-0.6	-14.5	7.0	7.0	6.5
Imports, Goods and Services	0.2	0.6	-1.9	-1.5	2.0	2.2
Real GDP growth, at constant factor prices	2.9	3.3	2.3	3.1	4.0	4.8
Agriculture	3.0	3.1	3.1	2.9	3.0	3.0
Industry	1.5	1.1	0.2	2.0	4.0	4.5
Services	3.9	4.9	3.6	3.9	4.2	5.4
Inflation (Consumer Price Index)	10.1	10.4	10.2	20.1	14.2	11.3
Current Account Balance (% of GDP)	-0.9	-3.8	-6.1	-5.5	-4.4	-3.8
Financial and Capital Account (% of GDP)	1.7	5.6	7.4	6.2	4.9	3.9
Fiscal Balance (% of GDP)	-11.5	-11.0	-12.1	-10.5	-9.2	-7.3

Sources: World Bank. Macroeconomics and Fiscal Management Global Practice.
Notes: e = estimate, f = forecast.

IRAN, ISLAMIC REPUBLIC

The Iranian economy experienced a strong recovery in 2016 as a result of sanctions relief, following a 1.8 percent contraction in 2015. However, growth prospects in the medium term are expected to be modest due to near capacity oil production and weak non-oil sector activity. The latter will not pick up unless FDI recovers, the economy reconnects with the international banking system, and more progress is made in implementing domestic reforms. Unemployment has ratcheted up and inflationary pressures have started to increase.

Recent developments

GDP growth in the first half of the Iranian calendar year (ending on March 20), reached 7.4 percent yoy. The boost in growth was largely a result of the oil sector's bounce back, both in production and exports, following the removal of sanctions in January 2016 through the JCPOA. However, economic activity seems muted in non-oil sectors (0.9 percent yoy growth in the first half of 2016) as the delay in the Iranian banking sectors' integration with the global banking system continued to impede FDI and trade. Gross capital formation continued to contract in the first half of 2016, raising concerns for the medium-term outlook. Higher frequency economic activity data suggest some signs of growth in the non-oil sectors, albeit not widespread. Contraction in the construction sector slowed down as private investment in new construction projects grew rapidly after five consecutive quarters of decline.

Inflation appears to be stabilizing at around 10 percent after a declining trend over the past three years. This signals that the output gap is closing. The CBI has actively pursued tight controls on keeping the nominal exchange rate stable and resisted depreciation primarily relying on oil-based foreign exchange reserves. As a result, the real exchange rate has appreciated, which undermines the competitiveness of non-oil exports. By allowing a higher number of transactions to take place at the market rate, the government managed to reduce the gap between the official and market exchange rates from 112 percent in 2012 to 14 percent in September 2016 – which more recently increased to 20 percent in December. Yet, the planned unification of the two rates is delayed to next fiscal year.

The unemployment rate increased significantly to 12.7 percent in the second quarter of 2016 and remains particularly high among women and youth.

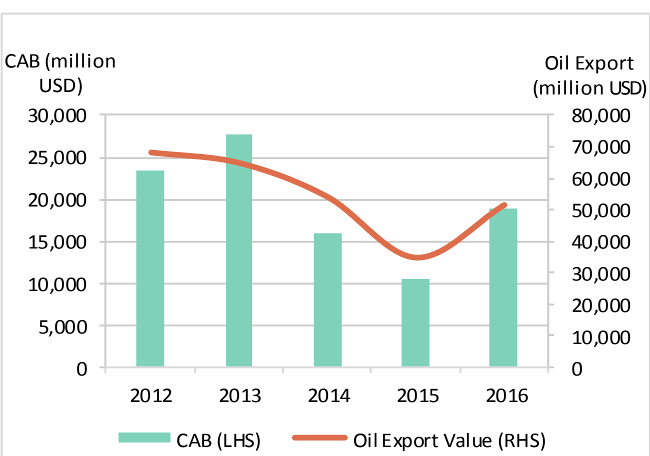
The current account surplus improved in 2016 to around 6.5 percent of GDP due to significantly higher exports to Iran's main trading partners such as the EU as a result of the removal of economic sanctions and a pick-up in oil shipments to Europe.

The fiscal deficit improved slightly to 1.5 percent of GDP in 2016, from 1.9 percent in 2015, even as oil revenues remained suppressed during the early part of the year. Government debt increased to 2 percent of GDP in 2016.

Outlook

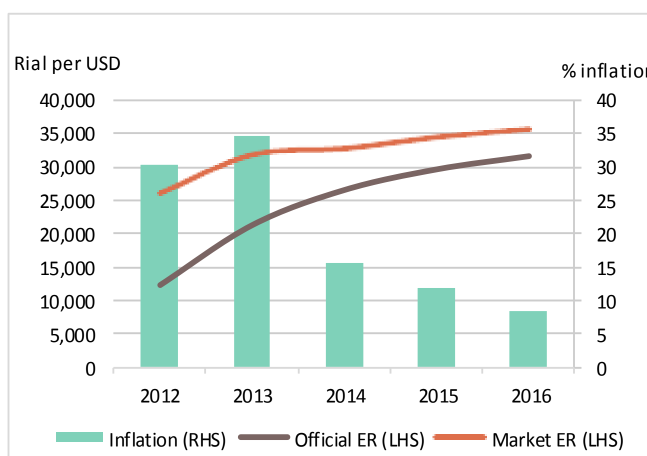
In the medium term, with some recovery in investment growth, Iran's economy is expected to experience moderate growth rates, at slightly over 4 percent. The contribution of exports will diminish, as spare capacity in the oil sector is utilized and the increase in oil production decelerates. On the production side, the revival of non-oil

FIGURE 1 Islamic Republic of Iran / Current account balance and oil exports



Sources: World Bank data and calculations, CBI and IMF.

FIGURE 2 Islamic Republic of Iran / Exchange rates (Rial per USD) and CPI inflation



Sources: World Bank calculations and CBI data.

industrial production is expected to be the main contributor to overall growth; agriculture and service sectors are projected to grow by around 4 and 3 percent, respectively. The gradual change in the composition of growth could also help increase employment due to higher job elasticity in these sectors.

While fiscal balances in the last few years suffered from low oil revenues, in the medium term spending pressures will dominate, given the expected rise in interest payments from securitization of government arears and the continued pressures from the pension system. Improved tax collection and prudent management of spending will help achieve a budget surplus in 2018-19.

Risks and challenges

The major risk in the near future is the political uncertainty around the full implementation of JCPOA. In addition, the Iranian presidential elections are scheduled for May 2017. These are likely to continue influencing consumer/investor confidence and may lead to a further weakening in private consumption and investment. Under this scenario, GDP growth will remain below 3 percent. Furthermore, lower than projected oil prices will put pressure on government revenues and undermine growth.

Going forward, the main challenge still facing the economy is channeling the 'oil boom' in a direction that will benefit the broader population. This would require not only tackling the structural reform agenda that will boost non-oil sector growth, connecting the Iranian banking sector with the rest of the world, and improved trade linkages, but also and most importantly, facilitating much needed job creation especially for the country's young and highly educated population.

TABLE 1 **Islamic Republic of Iran** / Macro outlook indicators (annual percent change unless indicated otherwise)

	2014	2015	2016 f	2017 f	2018 f	2019 f
Real GDP growth, at constant market prices	4.3	-1.8	6.4	4.0	4.1	4.2
Private Consumption	3.1	0.8	2.0	3.4	3.8	3.7
Government Consumption	2.7	-8.3	1.7	2.4	2.8	2.5
Gross Fixed Capital Investment	3.5	-9.8	-7.3	5.8	6.9	7.1
Exports, Goods and Services	12.0	7.1	35.0	7.0	5.0	4.8
Imports, Goods and Services	-5.7	-5.2	6.4	7.1	5.8	4.3
Real GDP growth, at constant factor prices	3.0	-1.8	6.4	4.0	4.1	4.2
Agriculture	3.8	3.9	4.6	4.2	4.1	4.1
Industry	4.9	4.2	8.1	6.8	5.9	5.8
Services	1.7	-6.3	5.4	1.9	2.7	3.0
Inflation (Consumer Price Index)	15.6	11.9	8.4	10.9	10.2	9.6
Current Account Balance (% of GDP)	3.8	2.7	6.5	6.5	5.5	4.6
Fiscal Balance (% of GDP)	-1.2	-1.9	-1.5	-0.6	0.2	1.1
Debt (% of GDP)	1.3	1.1	2.0	2.5	2.2	1.0
Primary Balance (% of GDP)	-1.1	-1.8	-1.4	-0.5	0.3	1.2

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice.
Note: f = forecast.

IRAQ

Iraq has faced the ISIS war and a protracted reduction in oil prices since mid-2014. Strong oil production sustained growth, but the non-oil economy has contracted sharply. Ten percent of Iraqis remain displaced due to continuous unrest. A large international financing package supports the government's reform effort. Following an OPEC agreement, oil production would decrease in 2017, but higher oil prices would improve fiscal and external balances. Non-oil activity would return to positive growth. Risks remain high.

Recent developments

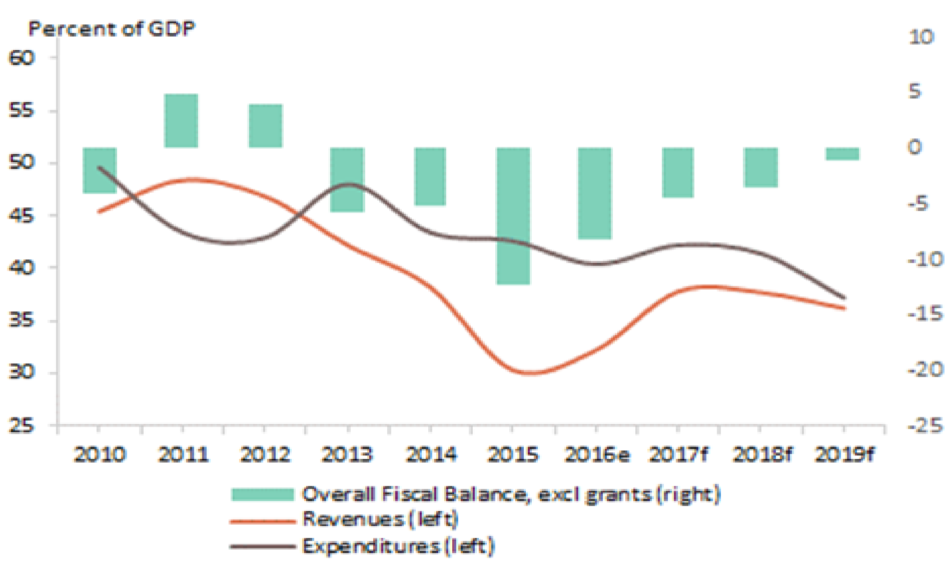
The ISIS insurgency and the protracted reduction in oil prices since mid-2014 have severely impacted Iraq's heavily oil-dependent and non-diversified economy. The economy sharply decelerated in 2014, before recovering in both 2015 and 2016. GDP grew at 4.8 percent in 2015 on the back of a 19.4 percent increase in oil production, following a slowdown to 0.7 percent in 2014. In 2016, overall growth is estimated to have reached 10 percent thanks to strong oil production. The security and oil shocks forced the government to rapidly reduce expenditure which negatively affected private sector consumption and investment. The non-oil economy contracted by 10 percent a year in 2015 and 2016. Inflation averaged 0.4 percent in 2016.

Lower oil receipts and higher humanitarian and security-related expenditure worsened the fiscal and external balances. The fiscal deficit reached 12.3 and 8.2 percent of GDP in 2015 and 2016, respectively, despite rapid fiscal consolidation. The fiscal deficits have been mainly financed through domestic bank financing. Domestic and external arrears also accumulated to US$11 billion. The current account balance turned into a deficit of 6.5 percent of GDP in 2015, reflecting a 41 percent drop in oil export revenues, and has further worsened to 7.2 percent of GDP in 2016. To partly finance this deficit, total international reserves have declined from about US$54 billion by end-2015 to US$47 billion at end-2016.

A large international financing package supports the government's efforts to implement reforms to control expenditure and lay the ground for structural reforms. In 2016, the World Bank provided US$1.44 billion (Including US$443.8 million guaranteed by the UK and Canada) Development Policy Financing (DPF) loans and the IMF provided US$1.2 billion financing as part of a three-year program supported by a Stand-By Agreement. In January 2017, the government issued a US$1 billion bond guaranteed by the U.S. government. JICA, and France are expected to provide additional budget support. In addition to measures to increase non-oil revenue, control the wage bill and non-contributory pension expenditure, the government has started piloting a new electronic salary payment system. It has sent to Parliament a new Social Insurance Law to improve the financial sustainability of the public pension fund, and adopted and operationalized a new proxy-means testing system to better target cash-based social transfers to the poor. It committed to reduce gas flaring associated with oil extraction and increased gas capturing. In January 2016, the government increased four-fold the electricity tariffs to reduce subsidies and later adopted a strategy to increase tariff collection. Long-standing structural vulnerabilities have been exacerbated by the ongoing violence and economic disruption. The security crisis is estimated to have created more than 3.4 million internally displaced persons.

Iraq has one of the lowest employment-to-

FIGURE 1 **Iraq** / Fiscal Accounts (percent of GDP)



Sources: Ministry of Finance; IMF; and World Bank staff projections population ratios in the region, even among men, and the 2014 crisis has led to an estimated reduction in employment by 800,000 jobs. The Public Distribution System provides the only safety net for the vast majority of the poor, and is currently stretched to its limits.

Outlook

Iraq's economic outlook is expected to improve under the assumption of a more favorable security environment, and continued fiscal consolidation. The non-oil economy after three years of contraction is expected to rebound in 2017 due to improved security and higher non-oil investment spending. However, real GDP is expected to contract by 3 percent in 2017 due to a projected 6 percent reduction of oil production, as a result of the agreement to reduce oil production by 1.2 million barrels per day reached among OPEC members in November 2016. Lower production is expected to reduce oil export volume by 5 percent in 2017. Oil production and exports are projected to return to their 2016 level in 2018 and 2019. Iraq's oil export prices are projected to average US$47.4 per barrel in 2017, compared to an average of US$35.6 in 2016. Higher oil prices would reduce the overall fiscal and current account deficits to 4.4 percent of GDP and 4.5 percent of GDP in 2017. The public debt is expected to remain sustainable over the medium term, given the projected fiscal consolidation and improved growth prospects. The 2017 budget re-instated the budget sharing agreement by which the Federal Government transfers 17 percent of budget expenditure, equivalent to ID11.6 trillion (US$9.8 billion) to KRG in exchange for KRG delivering 550,000 bpd to SOMO, the national oil company. While evidence of resumption of the transfers is not yet available, both parties have included the federal transfers in their 2017 budgets.

Risks and challenges

Weaker than projected global growth or higher than-expected supply of oil into the global markets could put downward pressure on oil prices and renew pressures on Iraq's twin deficits. The external debt remains highly vulnerable to a current account shock, such as a further reduction in oil prices or a real exchange rate depreciation. Refinancing risks due to large gross financing needs are partly mitigated since about one third of domestic debt consists of short-term debt held by the central bank. Any worsening of the ISIS insurgency and political tensions would materially and negatively impact Iraq's economy, require higher security expenditure and undermine the reform effort. Risks are also related to the capacity of the government to provide public services and start reconstruction. Tensions could also be related to the revenue sharing agreement between Baghdad and Erbil. As in the past, its implementation could be undermined by spending pressures in Baghdad and changes in oil prices.

TABLE 1 Iraq / Macro outlook indicators (annual percent change unless indicated otherwise)

	2014	2015	2016 f	2017 f	2018 f	2019 f
Real GDP growth, at constant market prices	0.7	4.8	10.1	-3.1	2.6	1.1
Private Consumption	7.6	20.0	16.4	-6.0	3.1	3.7
Government Consumption	-13.2	29.1	31.0	-13.0	-4.3	-4.4
Gross Fixed Capital Investment	22.3	-2.1	-13.0	2.0	-2.7	-0.8
Exports, Goods and Services	-4.7	49.1	13.6	-4.9	4.6	0.1
Imports, Goods and Services	-7.2	11.2	-0.1	4.9	-4.0	-3.6
Real GDP growth, at constant factor prices	0.7	4.8	10.1	-3.1	2.6	1.1
Agriculture	-2.0	-49.3	59.6	0.0	7.0	7.0
Industry	2.1	5.1	8.0	-2.5	2.0	0.6
Services	-1.7	10.5	11.3	-4.5	3.3	1.6
Inflation (Consumer Price Index)	2.2	1.4	0.4	2.0	2.0	2.0
Current Account Balance (% of GDP)	2.6	-6.5	-7.2	-4.5	-4.7	-2.5
Fiscal Balance (% of GDP)	-5.3	-12.3	-8.2	-4.4	-3.6	-1.0
Debt (% of GDP)	31.8	55.0	63.1	59.8	60.0	58.5
Primary Balance (% of GDP)	-5.0	-11.7	-7.0	-3.1	-2.5	0.1

Sources: World Bank. Macroeconomics and Fiscal Management Global Practice.
Note: f = forecast.

JORDAN

With record high unemployment and sluggish growth, Jordan's economy continues to be impacted by repercussions from the Syrian crisis, including the presence of more than 655,000 registered Syrian refugees. Jordan's main challenge is to stimulate job-generating growth. Tight fiscal and monetary policies are expected to continue as Jordan works towards fiscal sustainability and a lower debt-to-GDP ratio.

Recent developments

Jordan's economy remains sluggish as growth slowed down in 2016 for the second year in a row—to an estimated 2 percent from 2.4 percent in 2015—further diverging from its potential. This is largely due to a weaker mining and quarrying sector, partly related to downward pressures on global potash prices, and to a confluence of factors related to spillovers from the Syria crisis, notably the closure of export routes to Iraq and Syria and lower tourism amid security incidents (Figure 1).

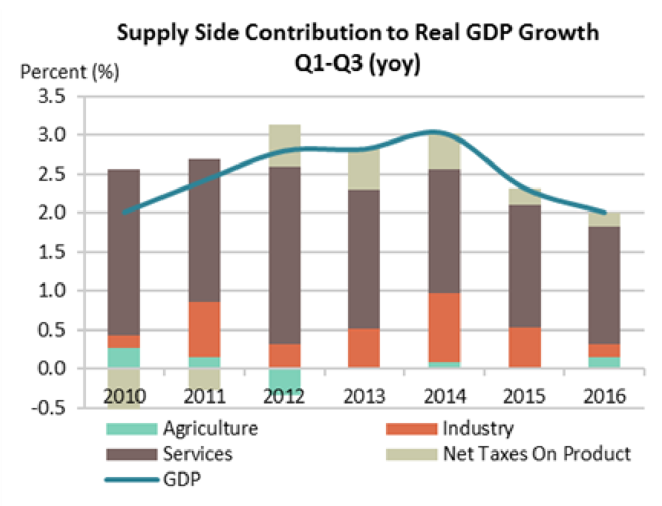
Unemployment reached an historical high of 15.3 percent in 2016. The labor force participation rate and employment rate continued their trend decline, worsening to 36.0 and 30.5 percent (compared to 36.7 and 31.9 percent in 2015, respectively) (Figure 2). Declining labor force participation rates could stem from discouraged workers given perceived competition from refugees and weak job creation.

In 2016, Jordan witnessed deflation for the second year in a row; Consumer price inflation averaged -0.8 percent (period average) largely due to an average decline in international oil prices and lower food prices, while core inflation averaged 2.2 percent. However, inflation picked up in November 2016, and is expected to accelerate into 2017, due to higher oil prices' impact on transportation and fuel prices, and higher prices of tobacco and cigarettes, education, and personal care.

Fiscal and external current account deficits narrowed in 2016. The fiscal deficit (before grants) reached an estimated 6.2 percent of GDP following a number of measures introduced in 2016 including the removal of 2015 Goods and Sales Tax exemptions, reducing tax exemptions on imported used cars, increasing taxes on cigarettes and alcohol, and raising the transfer fees on car sales. Debt however remains elevated at about 95 percent of GDP with further pressures stemming from larger financing needs of the Water Authority of Jordan whose debt is government-guaranteed. Despite the contraction of remittances by 2.4 percent, the current account deficit is estimated to have improved in 2016 over 2015 thanks to lower trade and primary income deficits. While exports of goods deteriorated by 4.1 percent and tourism receipts slowed, the trade deficit is expected to have improved led by a 6.2 percent contraction in imports due to declining energy imports.

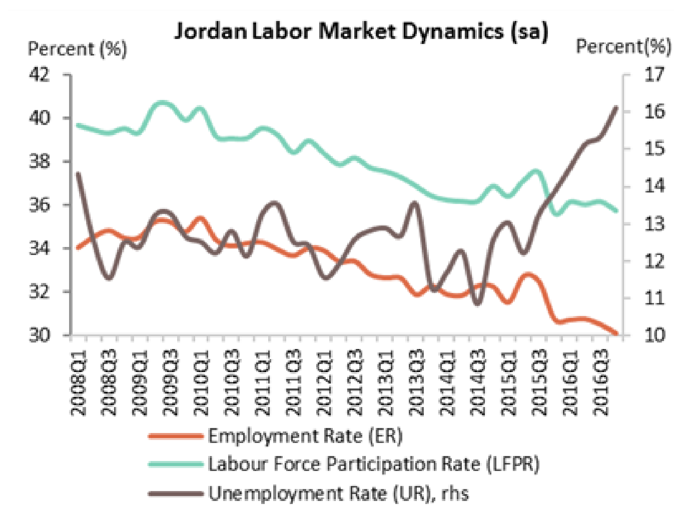
Monetary policy has tightened as of December 2016 following the Fed's lead and in support of the exchange rate peg. The Central Bank of Jordan raised policy rates in December 2016 and again in February 2017 by 25 bps and 50 bps respectively to maintain the JD-USD deposit rate spread and tackle rising dollarization. Dollarization of deposits reached 18.9 percent end-2016, its highest rate since March 2014. The stock of foreign reserves held at the central bank declined to reach US$12.9 billion (7.7 months of imported goods, excluding re-exports) by end-2016, 9 percent lower than end-2015.

FIGURE 1 Jordan / Contribution to Change of Real GDP by Production (y-o-y)



Sources: DOS and staff calculations.

FIGURE 2 Jordan / Labor Market Trends 2008-2016



Sources: DOS and staff calculations.

Outlook

Jordan's economy is expected to pick-up marginally to 2.3 percent growth in 2017; a slightly higher uptick is forecasted in the medium-term to average 2.6 percent over 2017-2019. THe impact of reforms related to stimulating private-sector investments (such as through improving predictability of regulations, improving access to finance for small and medium enterprises, and trade facilitation) and higher exports due to the European Union's relaxation of Rules of Origin should kick-in, and sectors such as tourism and construction are expected to improve.

The current account deficit is expected to narrow over the medium-term but not before widening in 2017 on account of higher energy imports related to higher oil prices. In the medium term, higher exports of garments, phosphate and potash, and a turnaround in exports of services, notably positive inflows of remittances from the GCC given higher oil prices and positive growth in tourism receipts, are anticipated.

Fiscal consolidation will continue along with revenue-enhancing measures. While financial viability of the energy sector has improved, financing needs in the water sector continue to pressure the debt situation. Given Jordan's peg to the USD, monetary policy is also expected to continue tightening in line with the Fed's expected rate hikes. Rising interest rates will contribute to raise Jordan's borrowing costs.

Risks and challenges

One of Jordan's challenges is to navigate the storm of spillovers from the Syrian crisis including hosting more than 655,000 registered Syrian refugees, a situation that is becoming more protracted.

But the major challenge for the Jordanian authorities remains stimulating growth and job creation while reigning in the fiscal deficit – even more imperative as labor market indicators deteriorate and living conditions become more expensive as inflationary pressures appear. However, short of a positive shock such as the reopening of trade routes with Iraq or a peaceful conclusion to the Syria conflict, it is difficult to foresee a significant jumpstart to growth unless structural reforms are implemented at a quicker pace.

Given this difficult social environment, the introduction of fiscal adjustment measures to contain the deficit and ease reliance on grants from donors will continue to prove difficult..

TABLE 1 Jordan / Macro outlook indicators (annual percent change unless indicated otherwise)

	2014	2015	2016 e	2017 f	2018 f	2019 f
Real GDP growth, at constant market prices	3.1	2.4	2.0	2.3	2.6	3.0
Private Consumption	-2.6	8.5	4.7	1.4	0.2	0.0
Government Consumption	6.5	3.6	6.5	4.2	1.5	2.3
Gross Fixed Capital Investment	2.1	-8.0	-10.6	3.4	4.7	9.5
Exports, Goods and Services	7.5	-9.0	-5.0	5.2	9.2	9.7
Imports, Goods and Services	-0.9	-3.0	-2.5	3.8	3.7	5.3
Real GDP growth, at constant factor prices	3.2	2.6	1.6	2.4	2.6	3.2
Agriculture	7.6	5.0	-2.2	1.0	1.2	1.8
Industry	3.9	2.2	1.4	2.3	2.8	3.4
Services	2.7	2.6	1.9	2.6	2.5	3.1
Inflation (Consumer Price Index)	2.9	-0.9	-0.8	3.2	2.2	1.9
Current Account Balance (% of GDP)	-7.3	-9.1	-7.3	-8.5	-7.4	-5.9
Financial and Capital Account (% of GDP)	4.3	7.1	3.1	4.1	4.2	2.4
Net Foreign Direct Investment (% of GDP)	5.8	4.3	4.0	4.1	4.4	4.7
Fiscal Balance (% of GDP)[a]	-14.2	-6.9	-6.2	-5.0	-3.1	-2.2
Debt (% of GDP)[b]	89.0	93.4	94.8	94.5	90.1	86.1
Primary Balance (% of GDP)[a]	-10.5	-3.4	-3.0	-1.6	0.4	1.3

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice.
Note: e = estimate, f = forecast.
[a] Includes fiscal gap of 0.3% of GDP in 2017, 2.0% of GDP in 2018 and 2.5% of GDP in 2019.
[b] Governement and guaranteed gross debt. Includes WAJ estimated borrowing for 2017-2019.

KUWAIT

The economy grew by an estimated 3 percent in 2016, supported by higher oil production and implementation of the Development Plan. A partial recovery in oil prices over the past year has eased pressure on fiscal balances somewhat. Banking sector liquidity continues to improve. Major infrastructure projects will continue to support growth in the near to medium term. Key challenges include hydrocarbon dependence and parliamentary opposition to deep structural reforms.

Recent developments

GDP growth in 2016 accelerated to an estimated 3 percent (market prices) from 1.8 percent the previous year. Output in the non-oil sector expanded by an estimated 2 percent, better than in 2015 (1.3 percent) but less than half the pace before global energy prices began to fall in 2014. Despite uncertainty related to the dissolution of parliament and subsequent elections in November, activity has been supported by public infrastructure spending related to the Development Plan.

In January, the government released the New Kuwait 2035 Strategic Plan, which aims to transform the country into a regional, financial and commercial hub. This should renew focus on the country's efforts for economic diversification. Rising oil production also provided a boost to growth, averaging roughly 2.95mn bbl/day during 2016, up by 3.5 percent from 2015 levels.

Incoming data suggest the economy is mending. Investor sentiment and stock prices have risen as oil prices recovered to the mid-50-dollars range following the December OPEC agreement to manage supply. After surging to 3.8 percent yoy in September due to the removal of fuel subsidies, inflation eased to 3.5 percent yoy in December on the back of a sharp moderation in food prices. Although the property market continues to cool, there has been some recovery in commercial property prices.

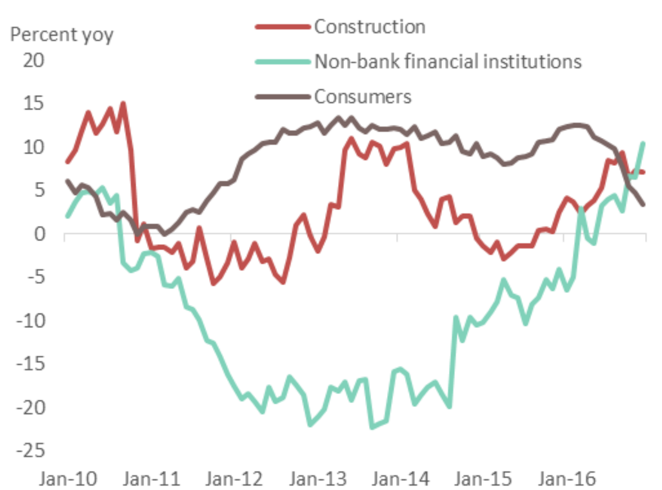
Corporate sector credit growth slowed toward end-2016, but this mainly reflected the repayment of a single KD 688 million loan. Lending to the construction sector grew by 7 percent yoy in December, and by 10.5 percent to the non-bank financial sector, which had experienced severe deleveraging over the past 5 years. Bank deposits continue to grow at a healthy pace, bolstering liquidity.

External positions remain strong and supportive of Kuwait's currency peg, backed by a Sovereign Wealth Fund (SWF) estimated at around US$600 billion and supported by improving oil prices. After turning negative in the first half of 2016, the balance of trade in goods and services shifted into surplus in the second half as oil receipts recovered. Import growth remained muted, although capital goods imports were robust, rising by 20 percent yoy in Q3 2016.

The government posted a budget deficit of 17 percent of GDP (after transfers to the SWF and excluding investment income) in FY 2015/16, about the same as in the previous year. These are the first shortfalls in more than a decade, and compare with a surplus of about 5 percent in FY2013/14. Total spending fell 15 percent mainly due to the declining cost of electricity and fuel subsidies. Strong implementation of capital spending plans – reflected in the highest execution rate in a decade – are supporting private sector activity.

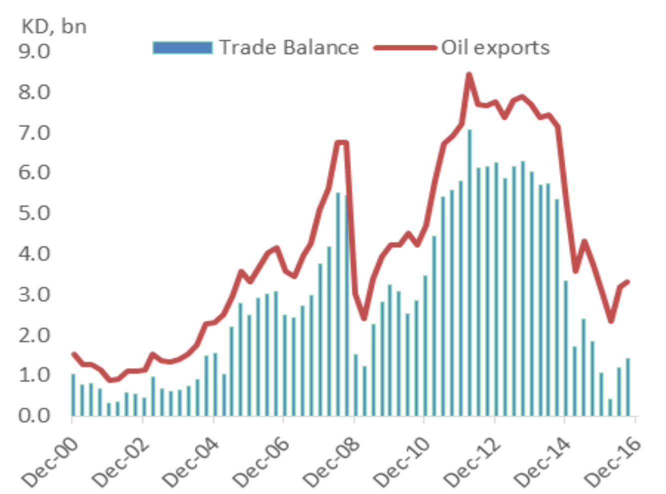
The 2016/17 budget projects a near doubling of the deficit but conservative oil price assumptions (US$35/bbl) and anticipated savings worth 1.7 percent of GDP from fuel subsidy reforms implemented in

FIGURE 1 **Kuwait** / Bank lending



Sources: Central Bank of Kuwait, Haver, World Bank.

FIGURE 2 **Kuwait** / Trade balance and oil exports



Sources: Central Bank of Kuwait, Haver, World Bank.

September 2016 suggest that actual outturns should be closer to 12 percent. Low public debt levels provide scope for borrowing, with the government indicating plans to issue US$10 billion in international bonds during 2017.
Kuwait is an oil-rich country, where involuntary unemployment is virtually nonexistent. Eighty percent of employed Kuwaiti nationals work in the public sector. In contrast, immigrants, who make up two-thirds of the population, constitute the bulk of lower-income residents. Additional concerns of immigrant workers include unpaid or delayed wages, difficult working conditions and fear of a crackdown.

Outlook

OPEC-related oil production cuts should slow GDP growth to 2.5 percent in 2017. In the medium term, however, oil output should rebound unless another OPEC deal is negotiated. In addition, the government plans to invest US$115 billion in the oil sector over the next five years, which should also boost oil production starting around 2018. With additional support coming from public-investment spending, growth should rise to about 3.2 percent over the medium term. Both current account and budgetary pressures should ease on the back of a partial recovery in oil prices and rising output. The baseline assumes gradual implementation of spending and revenue reforms including the introduction of a VAT in 2018, which Kuwait looks on track to implement.

Risks and challenges

Key external risks include spillovers from geo-political tensions and conflict. A strong resurgence of US hydrocarbon output, as business regulations are loosened under a new US presidency, could weigh on global oil prices, particularly if the US emerges as a major energy exporter. On the upside, global rebalancing in energy markets has progressed significantly, and excess supply in oil markets has largely dissipated, which could generate upside price risks.
Longer-term challenges relate to Kuwait's dependence on the hydro-carbon sector. A poor business environment and the large size of the public sector have hampered the development of the private non-oil sector, although the government is attempting to increase private sector investment through major Public Private Partnership (PPP) projects under the Development Plan. Comprehensive reforms are needed to rebalance the economy away from hydrocarbon dependence to a more diversified growth path underpinned by innovation, private sector entrepreneurship and job creation, and an improvement in the skills-mix of its labor force. However, reform slowdown is a risk given substantial financial buffers and parliamentary opposition to reforms.

TABLE 1 Kuwait / Macro outlook indicators (annual percent change unless indicated otherwise)

	2014	2015	2016 f	2017 f	2018 f	2019 f
Real GDP growth, at constant market prices	0.5	1.8	3.0	2.5	2.6	3.2
Private Consumption	4.9	2.4	4.0	4.0	2.9	2.9
Government Consumption	-0.8	-0.5	-14.5	4.8	2.9	1.9
Gross Fixed Capital Investment	4.6	13.0	10.4	6.3	4.0	5.0
Exports, Goods and Services	1.4	1.0	4.8	1.0	2.7	3.4
Imports, Goods and Services	8.0	5.1	3.5	4.3	4.1	4.1
Real GDP growth, at constant factor prices	1.0	-0.3	3.0	2.5	2.6	3.0
Agriculture	7.5	4.2	2.0	2.0	2.0	2.0
Industry	-0.5	-1.7	2.4	1.8	1.7	2.4
Services	3.3	1.9	3.8	3.4	4.0	3.9
Inflation (Consumer Price Index)	2.9	3.3	3.2	3.5	3.0	3.0
Current Account Balance (% of GDP)	33.2	7.5	1.9	5.0	5.5	6.1
Financial and Capital Account (% of GDP)	-36.8	-11.2	-5.7	-8.6	-9.1	-9.8
Net Foreign Direct Investment (% of GDP)	-8.4	-8.4	-5.0	-3.0	-2.0	-2.0
Fiscal Balance (% of GDP)[a]	18.0	-0.4	0.5	4.6	4.8	4.7
Ex. inv. Income and after transfers to SWF	4.6	-17.6	-17.1	-11.9	-10.6	-11.1
Debt (% of GDP)	16.3	7.2	11.8	17.2	20.0	20.0
Primary Balance (% of GDP)	18.1	0.0	0.6	4.7	5.1	5.0

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice.
Note: f = forecast.
[a] Fiscal balance data is reported on a general government basis i.e. before transfers to the sovereign wealth fund and including investment income.

LEBANON

The election of President Michel Aoun in October 2016 after almost two and a half years of a presidential vacancy, and the subsequent formation of a unity government, have resuscitated the political process in Lebanon. Nonetheless, the protracted Syrian conflict is exacerbating the country's vulnerabilities and remains an impediment to the return to potential growth. For the fifth year, Lebanon remains the largest host (on a per capita basis) for displaced Syrians, which has significantly strained already weak public finances in a situation of limited international assistance.

Recent developments

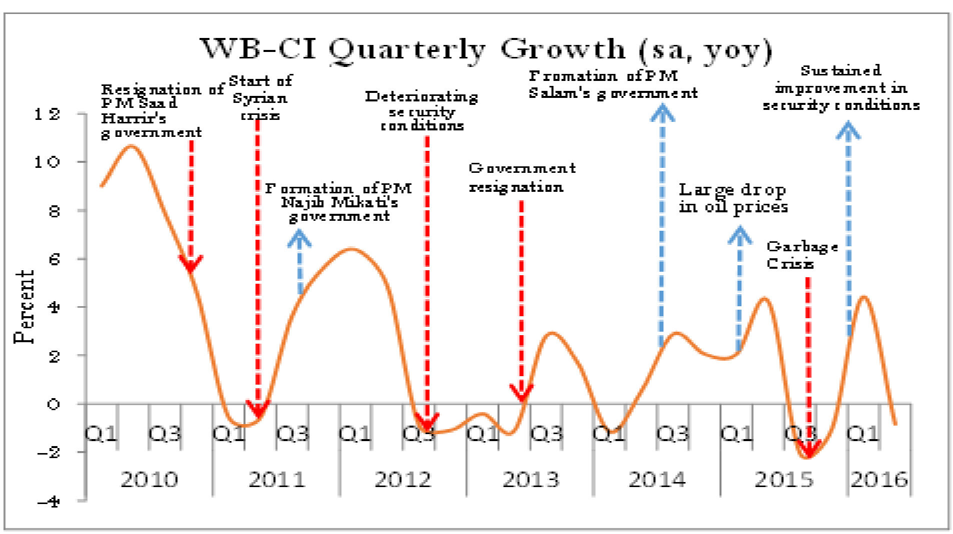
In 2016, Lebanon's real GDP growth accelerated slightly to reach an estimated 1.8 percent, compared to 1.3 percent in 2015. This was driven by an improvement in the real estate sector—cement deliveries expanded by 4.4 percent in 2016 compared to a contraction of 8.6 percent in 2015—as well as continued increase in tourist arrivals. From the demand side, private consumption continues to be a principal driver, helped by improved security conditions and low oil prices.

In the absence of any fiscal reforms, an increase in tax revenues in 2016 from a marginally improving economy was not able to offset higher expenditures, leading to an increase in the overall fiscal deficit to an estimated 10 percent of GDP and a small primary surplus at 0.1 percent of GDP. With subdued GDP growth and high interest rates, such a surplus remains insufficient to prevent the debt-to-GDP ratio from continuing on its unsustainable path, reaching an elevated 157.5 percent by end-2016. On the external front, a pickup in imports of merchandize goods combined with deteriorating exports led to a worsening of the goods trade balance. Furthermore, after being largely unaffected by lower oil prices in the past two years, remittances declined by 0.5 percentage points (pp) to 5.5 percent of GDP in 2016 due to spending cuts in the GCC countries. As a result, the already sizable current account deficit is estimated to have widened to an estimated 21 percent of GDP, which is among the largest in the world, exposing the country to significant financing risks. As such, the economy is structurally and heavily dependent on capital inflows to finance its current account deficit. In 2016, faced with weaker capital inflows, Banque du Liban (BdL) financially engineered a swap that was able to boost its foreign exchange reserves and capitalization in local currency at commercial banks. As a result, gross foreign exchange reserves at BdL rose by 11.1 percent by end-2016 to reach US$34 billion after registering a decline of 5.4 percent in 2015.

Outlook

The boost to confidence generated from the resumption of the political process in combination with easing of tensions with the GCC following President Aoun's visit to the region in January 2017, are likely to translate into a pick-up in GDP growth in 2017, which we project at 2.5 percent. Specifically, a stronger real estate sector as well as a continued increase in tourist arrivals are expected to lead to a pickup in economic activity in 2017. Lebanon's economic prospects over the medium term are highly affected by geopolitical and security conditions, and those remain volatile. Projections assume that the Syrian war persists and that spillovers into Lebanon, while significant, remain contained. Based on this, we forecast growth over the medium term to remain around 2.5 percent annually. Potential growth is contin-

FIGURE 1 Lebanon / Volatile economic activity reflects frequent shocks



Sources: Lebanese authorities and WB staff calculations.

gent on the resolution of the Syrian conflict in a manner that does not compromise the structure and stability of Lebanon, as well as on the resumption of the domestic political process.

Also in 2017, higher oil prices will lead to an increase in government transfers to the loss-making public electricity company, likely inducing a small widening in the fiscal deficit. More expensive fuel imports will in addition further enlarge Lebanon's import bill. Despite this, and continued deceleration in remittances, the current account deficit, boosted by the tourism sector, will for the most part remain unvaried as a percentage of GDP.

Risks and challenges

Security and political challenges continue to be Lebanon's primary concerns. Tense discussions on the forthcoming parliamentary election law, if unresolved, could revert the political process back to stalemate conditions, reintroducing the pre-presidential elections' negative atmosphere.

Assuming no further financial engineering by the central bank in order to boost capital inflows, Lebanon can once again be vulnerable to a slowdown in net foreign asset accumulation in the face of persistent and sizable fiscal and current account deficits. If financial engineering persists, then it will be subject to a combination of declining positive returns and increasing associated risks. As such, unless foreign currency financing needs are reduced, balance of payment pressures will reemerge. More generally, a frail macro-fiscal framework, underpinned by unsustainable debt ratios and persistent and sizable fiscal and current account deficits, exposes the country to significant refinancing risks. Attracting sufficient capital, and in particular deposits, to finance larger budgetary and current account deficits could prove challenging based on recent commercial banks' deposit growth data.

One of the key challenges to improving empirically informed policy is to strengthen the data and analytical base of the government. An improved data system would better inform understanding of the micro-implications of the crisis and build capacity in the Central Administration of Statistics for poverty measurement and monitoring.

TABLE 1 Lebanon / Macro outlook indicators (annual percent change unless indicated otherwise)

	2014	2015	2016 e	2017 f	2018 f	2019 f
Real GDP growth, at constant market prices	1.8	1.3	1.8	2.5	2.6	2.6
Private Consumption	-1.9	7.1	4.0	-3.0	0.1	3.1
Government Consumption	2.0	-0.3	7.1	-2.5	0.9	-0.6
Gross Fixed Capital Investment	5.5	-8.6	5.8	1.4	2.2	3.8
Exports, Goods and Services	3.2	-2.3	6.7	4.9	4.6	5.1
Imports, Goods and Services	-1.5	1.2	9.7	-3.1	0.4	4.4
Real GDP growth, at constant factor prices	1.4	2.6	3.2	2.4	2.6	2.6
Agriculture	4.5	0.6	-19.0	2.5	0.0	-0.7
Industry	11.0	0.7	-22.9	3.4	2.5	2.6
Services	-0.7	3.2	10.2	2.3	2.7	2.8
Inflation (Consumer Price Index)	1.2	-3.7	-0.8	3.8	2.7	2.0
Current Account Balance (% of GDP)	-25.4	-17.1	-20.9	-20.2	-19.2	-19.2
Financial and Capital Account (% of GDP)	27.9	23.5	16.7	8.1	11.8	9.6
Net Foreign Direct Investment (% of GDP)	3.6	3.6	3.7	3.8	3.8	3.9
Fiscal Balance (% of GDP)	-6.6	-8.2	-10.0	-9.5	-9.8	-9.4
Debt (% of GDP)	145.6	149.4	157.5	166.2	170.4	173.6
Primary Balance (% of GDP)	2.6	1.3	0.1	0.9	1.2	1.5

Sources: World Bank. Macroeconomics and Fiscal Management Global Practice.
Notes: e = estimate, f = forecast.

LIBYA

Hit by the ongoing conflict, the Libyan economy continued to suffer from recession in 2016. It is estimated that GDP lost half of its pre-revolution level. Budget revenues and exports proceeds reached the lowest amounts on record because of low oil production and prices. Consequently, the twin deficits remained high. Real incomes eroded, exacerbated by unparalleled high inflation. In addition to near-term challenges of macroeconomic and social/political stability, medium-term challenges include rebuilding infrastructure and diversifying the economy for job creation and inclusive growth.

Recent developments

The lengthy conflict is taking a heavy toll on the Libyan economy and the well-being of the population. Obstructed by the conflict, production of oil, the main source of income in Libya, has been steadily declining over the last 4 years to reach around 0.38 million barrel per day (bpd) in 2016, which is less than one-fourth of pre-revolution levels. As a result, the Libyan economy shrank by an estimated 2.5 percent in 2016, with estimated real GDP falling to less than half of its pre-revolution level.

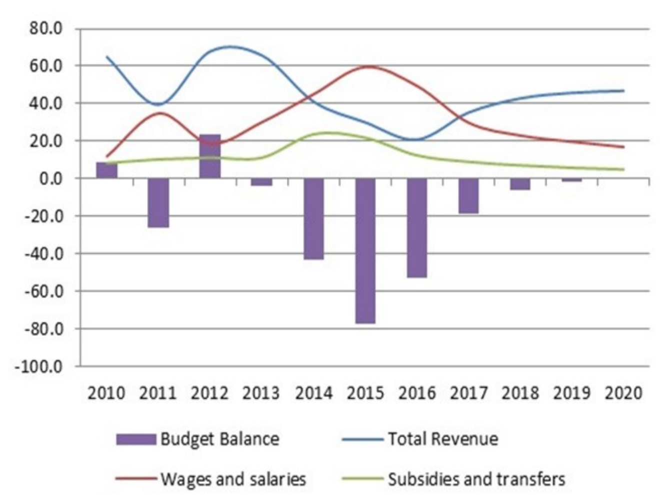
The conflict has also hit the population hard. The World Health Organization reports that insecurity and violence across the country have created unsafe living conditions and damaged critical infrastructure, placing people at high risk of injury and death, disrupting access to public utilities and services, and driving displacement. Public services and utilities have been heavily disrupted or shut down. Around 1.3 million people have no access to life-saving health care services and resources. In addition, the latest round of the International Organization of Migration Displacement Tracking Matrix in November 2016 reported 313,236 displaced persons, 462,957 returnees, and 256,690 migrants.

Inflation reached unprecedented levels in 2016 leading to substantial loss in real purchasing power of the population. Higher prices have been driven by acute disruptions in the supply chains of basic commodities and the expansion of black markets. This has been further aggravated by the de facto removal of food subsidies due to lack of funds and the strong devaluation of the Libyan currency in the parallel market. As a result, overall inflation averaged 26 percent in 2016.

The budget of the Government of National Accord continued to suffer from the conflict. Hydrocarbon revenues fell to LYD 7.5 billion in 2016, less than a fifteenth of pre-revolution levels. Non-hydrocarbon revenues remained low due to tax evasion and weak enforcement of tax regulations. However, Libya managed to make some savings on subsidies (down 37 percent compared to 2015) thanks to lower imported fuel prices and the de-facto removal of food subsidies. Wages also declined (down 8 percent) following the removal of more than 100,000 duplicate payments from government payrolls. Nevertheless, spending on wages and subsidies are still very high (49.5 and 12.5 percent of GDP respectively). Overall, the budget deficit remained high at 52.7 percent of GDP. The deficit was financed mainly through borrowing from the Central Bank of Libya. Consequently, domestic debt has increased to around 100 percent of GDP in 2016.

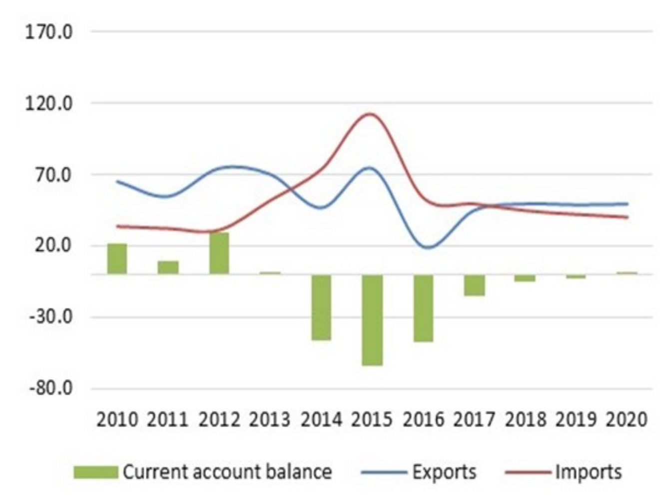
The balance of payments is also suffering from the lengthy conflict, exacerbated by low global oil prices. Libya exported an average of 0.22 million bpd of oil last year, which is less than a sixth of the pre-conflict level. Hit further by declining oil prices, revenues from hydrocarbon exports are estimated to have fallen by half in 2016, representing only 11 percent of

FIGURE 1 **Libya** / Public finances, in % of GDP



Sources: Government of Libya and World Bank staff estimates.

FIGURE 2 **Libya** / Balance of payments indicators, in % of GDP



Sources: Government of Libya and World Bank staff estimates.

pre-revolution export revenues. Imports remained contained due to lack of foreign exchange. Against this backdrop, although improving, the current account deficit is still high at an estimated 51 percent of GDP. To finance these deficits, net foreign reserves are rapidly being depleted, reaching an estimated US$53.5 billion by end 2016. The Libyan Dinar lost 70 percent of its value in the parallel market due to weak macroeconomic fundamentals and foreign exchange restrictions.

A cash shortage in the banking system has been a concern in Libya. Households have been facing increasing difficulties to convert their liquid bank deposits into currency. This phenomenon reflects an excess demand for cash by households—mainly because of a generalized lack of trust in the banking system—and shortages in the banking system to meet government's high financing needs.

Outlook

The economic outlook assumes that a new functioning government is endorsed this year. In this context, the dynamics in the hydrocarbon sector triggered during the last quarter of 2016 is expected to continue, translating into higher production of oil, which is projected to progressively reach 1 million bpd by end-2017, still representing only two thirds of potential. On this basis, GDP is projected to increase by 40 percent. Although improving, the twin deficits will remain, as revenues from oil will not be sufficient to cover high budget expenditures and consumption-driven imports. This should keep the budget deficit at about 18.8 percent of GDP and the current account deficit at 15.3 percent of GDP in 2017.

Over the medium term, it is expected that oil production will progressively increase until 2020—albeit staying below full capacity due to the time necessary to restore the heavily damaged oil infrastructure. In this context, growth is projected to rebound at around 19.7 percent in 2018 and 11.4 percent in 2019, which will take GDP to 84.5 percent of its pre-conflict level. Both the fiscal and current account balances will significantly improve, with the budget and the current account running surpluses expected from 2020 onwards. Foreign reserves will average around US$ 41 billion during 2017-2019, representing the equivalent of 16.5 months of imports.

Risks and challenges

Immediate challenges are to achieve peace that would lead to improved macro-stability and the restoration of basic public services. Current expenditures, especially the wage bill and subsidies, need to be brought under control. Given existing political uncertainties, there are significant downside risks to the improved macroeconomic scenario presented above. An improved macro outlook is unlikely to be sustained, and not sufficient to bring about significant change, unless immediate and targeted actions are taken to address the humanitarian crisis, through aid and specific programs to address the destruction and lack of basic services. In the medium term, the country also needs broader and deeper structural reforms, inter alia by improving tax revenues, enhancing the management of public financial and human resources, launching civil service reform, and promoting the development and diversification of the private sector for job creation. Inclusive growth will require not only substantial increases in investments on key basic services to rebuild human capital, but also interventions targeted to the poor and the middle class to restore the well-being of the population.

TABLE 1 Libya / Macro outlook indicators (annual percent change unless indicated otherwise)

	2014	2015e	2016f	2017f	2018f	2019f
GDP, at constant market prices	-24.0	-8.9	-2.5	40.1	19.7	11.4
Private consumption	-1.4	-9.3	-9.7	17.4	7.9	4.1
Government consumption	6.6	-19.5	-31.6	21.9	6.3	6.0
Gross fixed capital investment	-16.7	-3.4	-5.6	14.3	25.2	16.3
Exports, goods & services	-54.6	13.5	-26.9	152.3	26.8	9.8
Imports, goods & services	-8.8	-3.8	-24.2	28.1	13.0	5.9
GDP, at constant market prices	-24.0	-8.9	-2.5	40.1	19.7	11.4
Hydrocarbon	-53.7	-15.8	-4.3	124.0	36.3	16.0
Non-hydrocarbon	-1.0	-6.5	-2.0	15.0	10.0	8.0
Inflation (Consumer Price Index)	2.4	9.8	26.0	3.0	2.7	2.5
Current account balance (% of GDP)	-46.1	-67.1	-50.8	-15.3	-5.1	-2.5
Fiscal balance (% of GDP)	-43.3	-76.9	-52.7	-18.8	-6.1	-1.9

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice.
Note: e = estimate; f = forecast.

MOROCCO

After a poor agricultural season in 2016, the primary sector is expected to rebound in 2017, pushing GDP growth to 3.8 percent. Meanwhile, non-agriculture activity and inflation remain subdued. Morocco's already low labor participation rate keeps declining. Sustained fiscal consolidation efforts and the fall in international oil prices helped cut the twin deficits in recent years. Looking forward, Morocco continues to face the paramount challenges of promoting stronger private-sector-led growth and job creation, and increasing shared prosperity.

Recent developments

The vagaries of the weather continue to drive Morocco's economic growth. After a record cereal production in 2015, Morocco was affected by a severe drought in 2016. Agricultural production, which still represents almost 15 percent of Morocco's GDP, contracted by around 10 percent and dragged overall GDP growth down to 1.1 percent in 2016. Despite large public-investment efforts in recent years, nonagricultural growth remained sluggish around 3 percent. While the unemployment rate decreased slightly to 9.4 percent, it masked a protracted decline in the labor force participation rate, which is now well below 50 percent. The number of youth aged 15-24 not in education, employment or training reached and estimated 1.7 million in 2016. With an exchange rate pegged to a basket of the Euro and U.S. dollar, inflation has remained below 2 percent.

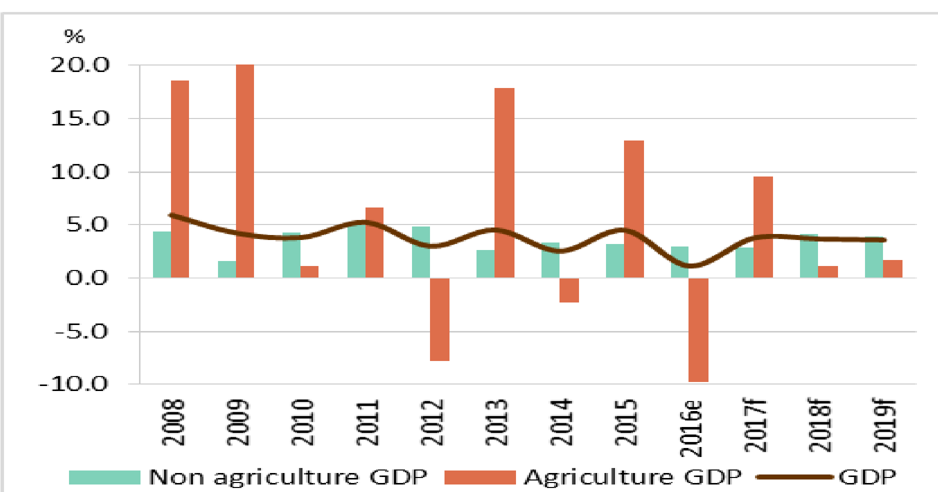
Prudent macroeconomic policies has helped reduce external and fiscal imbalances in recent years. The completion of the subsidy reforms initiated in 2014 coupled with a solid fiscal management and financial oversight contributed to further reducing the fiscal deficit to an estimated 3.9 percent of GDP in 2016 and to stabilizing the public debt at around 66 percent of GDP. Improvements in the government investment-saving balance and the fall in international oil prices led to a significant reduction in the external current account in recent years; which was only reversed in 2016 as a result of the effects of an accommodative monetary policy and a recovery in investment lending to the private sector. With continued sizeable FDI inflows, Morocco's foreign exchange reserves strengthened further to reach 6.4 months of imports of goods and services at end-2016.

Outlook

With good rainfall since the fall of 2016, GDP growth is projected to bounce back to 3.8 percent in 2017. The cereal crop is expected to be above its historical average and agricultural GDP to grow by close to 10 percent. Nonagricultural GDP is also projected to rise slightly above its recent trend due to the agriculture spillover effect and rising confidence of both consumers and producers. However, the positive cyclical developments are unlikely to translate into major structural improvements in labor market outcomes. Since inflationary expectations are well-anchored, the rate of inflation should remain around 2 percent.

The ongoing delays in forming the new government following the October 2016 legislative elections are slowing reform momentum. A draft 2017 budget law that contemplates a further reduction in the fiscal deficit to 3 percent of GDP is nevertheless being implemented. The projected increase in international oil prices will contribute to worsening the current account but the external financing requirements will remain a moderate concern

FIGURE 1 **Morocco** / Volatility of growth rate



Source: World Bank.

given Morocco's relatively low external debt and access to international markets. Furthermore, the second two-year PLL arrangement from the IMF will continue to serve as insurance against external risks.

Over the medium term, Morocco's economic outlook is expected to improve, provided the forthcoming government remains committed to pursuing prudent macroeconomic policies and implementing structural reforms to, inter alia, reinforce the business environment, modernize the public administration, and improve access to quality public services. The gradual move to a more flexible exchange rate regime announced by Bank Al-Maghrib should also help strengthen Morocco's competitiveness. The planned implementation of the organic budget law and decentralization process are opportunities to strengthen the governance and efficiency of the public sector. Overall, annual GDP growth is projected to reach its current potential of 4 percent on average.

Risks and challenges

Given Morocco's agriculture output volatility, weak economic prospects in the euro area and the continued possibility of adverse geopolitical developments in the region, the risks to the outlook are tilted to the downside. Modernizing the agricultural sector, diversifying the industrial sector, and scaling-up the services sectors would help mitigate the risks that are under the government control. This would require major efforts at strengthening Morocco's market institutions, especially those governing the efficient allocation of labor and capital and the further integration into global value chains. Following the successful liberalization of petroleum prices at the pump, the projected 30 percent rise in international oil prices will also test the acceptability and robustness of the new pricing system.

Morocco remains confronted by the challenge of a relatively slow structural transformation. The country has remained structurally oriented toward non-tradable activities (such as construction). Given this orientation, the country has made little productivity gains over the past two decades despite high levels of investment. Investment efforts–dominated by publicly funded large infrastructure projects–have not yet triggered a growth takeoff.

To secure higher gains in productivity and competitiveness over the medium term, major efforts are needed to strengthen public governance, modernize the public administration, strengthen connectivity across regions, and improve the education system outcomes. Ultimately, Morocco's future prosperity is fundamentally linked to its capacity to accumulate human capital. The low labor force participation rates of youth and women also highlight the need to enhance inclusion.

TABLE 1 Morocco / Macro outlook indicators (annual percent change unless indicated otherwise)

	2014	2015	2016 e	2017 f	2018 f	2019 f
Real GDP growth, at constant market prices	2.6	4.5	1.1	3.8	3.7	3.6
Private Consumption	3.6	2.4	2.6	4.0	2.9	2.9
Government Consumption	1.8	1.9	1.3	1.5	1.7	1.9
Gross Fixed Capital Investment	-2.1	1.5	3.9	3.8	4.0	4.1
Exports, Goods and Services	8.4	6.0	4.5	5.9	7.3	7.1
Imports, Goods and Services	3.3	-3.1	7.9	4.5	4.6	4.9
Real GDP growth, at constant factor prices	1.7	3.5	0.4	4.0	2.8	3.0
Agriculture	-2.3	13.0	-9.8	9.6	1.1	1.7
Industry	2.9	2.8	1.9	2.1	2.5	2.7
Services	2.3	1.3	2.6	3.4	3.3	3.5
Inflation (Consumer Price Index)	0.4	1.6	1.6	2.0	2.0	2.0
Current Account Balance (% of GDP)	-5.7	-1.9	-4.0	-4.2	-4.0	-4.0
Fiscal Balance (% of GDP)	-4.7	-4.3	-3.9	-3.0	-3.0	-3.0
Debt (% of GDP)	63.5	64.1	66.2	66.3	66.0	65.5
Primary Balance (% of GDP)	-2.0	-1.6	-0.9	0.1	0.2	-1.0

Sources: World Bank. Macroeconomics and Fiscal Management Global Practice.
Notes: e = estimate, f = forecast.

OMAN

Protracted low oil prices continue to weigh on Oman's economy. The OPEC agreement to cut oil production in 2017 and the government's ongoing commitment to austerity are likely to further depress growth. Fiscal and current account deficits remain large, and Oman is increasingly resorting to external borrowing to finance its deficits. However, growth is expected to pick up in 2018 as Oman pins hopes for its economic diversification plan on the fisheries and tourism sectors.

Recent developments

Real GDP growth in Oman is estimated to have slowed down to 2.2 percent in 2016 from 5.7 percent in 2015, according to official Omani estimates. Non-hydrocarbon GDP growth is estimated to have dropped to 2 percent in 2016 from 7 percent in 2015 as public spending declined with knock-on effects on investment and consumption. Investment in oil recovery techniques led to record high oil production levels in 2015 and 2016. Hydrocarbon GDP growth nearly halved in 2016, falling from 4.2 percent in 2015 to 2.4 percent in 2016. The current account deficit worsened to an estimated 16.2 percent of GDP in 2016 from 15.5 percent in 2015. Oman did not follow the US policy rate hike in December as did four other GCC states, but given its peg to the dollar Oman is expected to mirror future Fed rate movements. Inflation is estimated to have increased from 0.1 percent in 2015 to 1.1 percent in 2016 reflecting the fuel price reform.

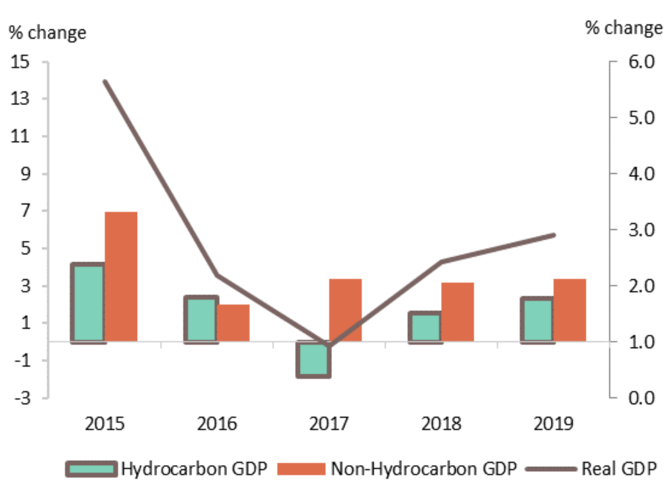
Oil receipts constitute 70 percent of government revenues and low oil prices have widened the fiscal deficit to 20.3 percent of GDP in 2016 from 16.5 percent in 2015 despite fiscal consolidation efforts. This deficit was 60 percent larger than budgeted, and was financed mainly by foreign borrowing (around 67 percent of the deficit) and reserves (28 percent). Fuel subsidy reform, cuts in defense and capital spending and wages and benefits were the main levers of consolidation. While oil and gas revenue fell by 29 percent in 2016, non-hydrocarbon revenue is estimated to have increased by 20 percent due to higher customs and investment income.

A National Diversification Program (Tanfeedh) that uses Malaysia's economic transformation model, kicked off in September 2016. Through a series of "labs" the public and private sectors worked to create a road map for Oman's future in the logistics, manufacturing and tourism sectors. The government has also begun working towards Oman's Vision 2040.

The main social concern for Oman is the lack of jobs for the growing population. ILO estimates youth unemployment in Oman at 20 percent, a pressing problem in a country where almost 40 percent of the population is less than 25 years old. Young Omanis typically wait three years to find a job—partly reflecting their strong preference for public-sector jobs, where pay is higher and working hours shorter. Oman will have to generate 45,000 jobs annually to address the problem, and the ongoing effort to replace expatriates with Omanis ('Omanization') is insufficient without an improvement in the environment for private sector job creation. The private sector continues to rely on expatriate labor, reflected in their average population growth of over 4 percent in 2010-15.

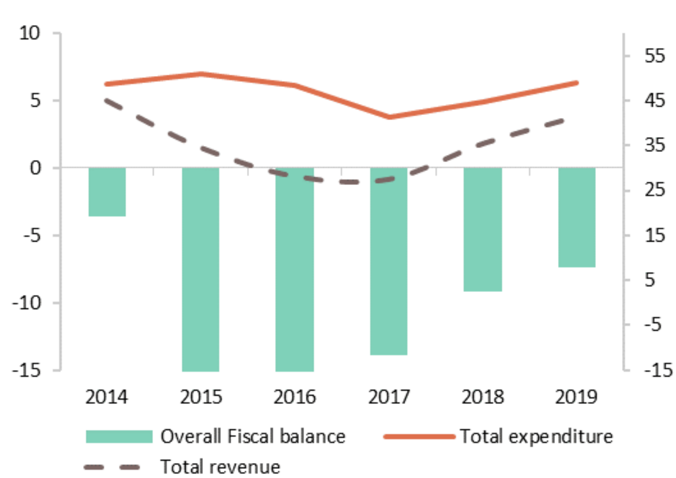
The diversification reforms sought by the government would have short-term negative effects on the population, and the government thus faces the challenge of ensuring that adequate social protection and mitigation policies are in place. Existing beneficiary identification, welfare measurement and analysis methods and

FIGURE 1 Oman / Real Annual GDP growth



Sources: Omani Authorities, World Bank Staff estimates.

FIGURE 2 Oman / General Government Operations (in percent of GDP)



Sources: Omani Authorities, World Bank Staff estimates.

institutions may need to be updated and revalidated.

Outlook

Overall real GDP growth is projected to slow down further in 2017 to just under 1 percent owing to the agreement reached with OPEC producers to cut oil production until June 2017 and the dampening effects of government spending cuts on business sentiment and private consumption. The 2017 planned budget has cut spending by 8 percent leading to a budgeted deficit of 10.6 percent of GDP. However, with further delays in consolidation efforts, the budget deficit could reach 13.9 percent in 2017. Monetary policy will remain tight as interest rates continue to rise. Owing to the hike in electricity tariffs and higher global food prices, inflation is expected to inch up to 1.4 percent.

Over the medium-term, however, growth is expected to recover gradually reaching around 3 percent by 2019, as a recovery of oil prices improves confidence and encourages private sector investment. The government's policy reform agenda remains focused on economic diversification and fiscal consolidation. Pro-business reforms such as the foreign ownership law and the FDI law, and the lifting of sanctions on Iran are expected to increase trade and investment opportunities.

In January 2017 electricity subsidies were removed for industrial, commercial and government users, who collectively consume over 30 percent of the total energy supply. Moreover, the adoption of a 5 percent VAT expected in 2018, higher corporate income tax and increasing excises and fees for government services are expected to narrow the fiscal deficit to 7.4 percent in 2019. Oman's sovereign wealth fund, estimated at US$34 bn, has been used to partially finance the fiscal deficit. However, greater reliance on foreign borrowing will likely raise debt dramatically over the forecast period, estimated to reach 31.5 percent of GDP by 2020 from 5 percent in 2013. The current account deficit is projected to improve to 14.4 percent in 2017 and continue to narrow as oil prices rise, non-oil exports grow, and the gas pipeline with Iran (expected in 2020) increases LNG exports. Inflation is expected to ease to 1.1 percent by 2019 despite the introduction of the VAT, due to the stagnation in food prices and the dissipation of cost-push pressures from subsidy reform.

Risks and challenges

The successful recovery of economic growth, necessary for securing employment opportunities, hinges on the timely implementation of diversification reforms. The massive infrastructure spending program under the 9th development plan is likely to encounter delays as the government continues to be fiscally constrained. The industrialization plan is set to grow power demand which would require a prioritization of natural gas projects. The government will look towards increasing public-private partnerships which might prove difficult in the short term due to falling investor confidence in the region. The government is also likely to continue to face social unrest in response to subsidy reform.

The overall economic outlook is vulnerable to several external risks. Further oil price shocks combined with delays in fiscal consolidation could lead to a further downgrade of credit risk. A continued slowdown in China, Oman's main trading partner, would add to downside risks.

TABLE 1 **Oman** / Macro outlook indicators (annual percent change unless indicated otherwise)

	2014	2015	2016 f	2017 f	2018 f	2019 f
Real GDP growth, at constant market prices	2.5	5.7	2.2	0.9	2.4	2.9
Private Consumption	5.6	2.9	1.9	1.5	2.5	3.0
Government Consumption	9.6	0.8	-4.3	-1.0	2.8	4.1
Gross Fixed Capital Investment	0.8	2.5	1.8	2.5	2.1	2.6
Exports, Goods and Services	-2.1	-9.4	2.3	-1.6	2.5	4.1
Imports, Goods and Services	-9.8	-3.2	-1.5	-1.1	2.3	3.5
Inflation (Consumer Price Index)	1.0	0.1	1.1	1.4	1.3	1.1
Current Account Balance (% of GDP)	5.2	-15.5	-16.2	-14.4	-9.8	-6.7
Fiscal Balance (% of GDP)	-3.6	-16.5	-20.3	-13.9	-9.2	-7.4

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice.

Note: f = forecast.

PALESTINIAN TERRITORIES

Recovering from the 2014 recession, the Palestinian economy expanded by about 4 percent in 2016 due to transitory factors, mainly an uptick in Gaza reconstruction. At 27 percent, unemployment continues to be stubbornly high. Given the ongoing constraints to economic competitiveness, medium-term growth is projected at 3.5 percent. Lower than expected aid and the possibility of further conflict pose downside risks to growth and employment.

Recent developments

Since the 2014 Gaza war, the Palestinian economy has been on a recovering trend, albeit driven by unsustainable factors. The severe economic impact of the Gaza war pushed the Palestinian economy into recession in 2014. Since then, the economy has rebounded with the real GDP growth rate reaching 3.4 percent in 2015 and an estimated 4.3 percent in 2016. Drivers of the recent growth, however, are not sustainable. Growth in the Gaza Strip is estimated to have reached 7.4 percent in 2016 driven by a surge in construction activity, while the West Bank economy expanded by 3.4 percent mainly due to an increase in household consumption financed by bank loans.

At 27 percent, the unemployment rate in the Palestinian territories remains stubbornly high. The overall figure masks wide regional differences with unemployment in Gaza, at 42 percent, more than twice as high as that in the West Bank. Youth unemployment continues to be a major concern in the Palestinian territories, particularly in Gaza where more than half of those aged between 15 and 29 are out of work.

2016 witnessed a slight deflation in Palestine with the Consumer Price Index declining by 0.2 percent. The Israeli Shekel is the main currency in circulation in the Palestinian territories, and hence low inflation has been affected by deflation in Israel, in addition to a fall in global fuel and food prices.

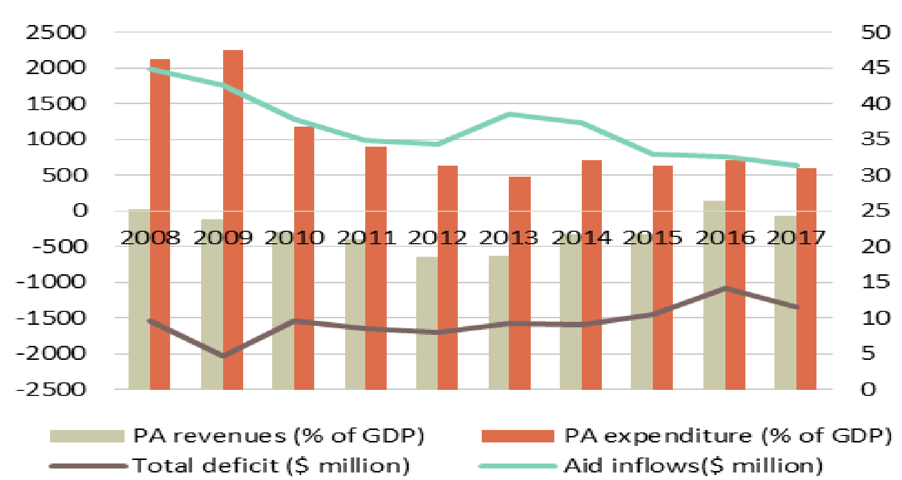
The Palestinian Authority's (PA) fiscal situation remained difficult in 2016 despite a strong revenue performance. Public revenues grew by about 5 percentage points of GDP reaching 26 percent in 2016, on account of one-off revenue transfers by the Government of Israel (GoI) and advance receipts of telecom license fees. This offset the higher than budgeted increase in public expenditures which reached 32 percent of GDP in 2016, mainly driven by wage increases for teachers and engineers, and led to a decline in the total deficit (before grants) to 8 percent of GDP. In parallel, aid to the PA continued its declining trend in 2016, resulting in a US$330 million financing gap (2.5 percent of GDP) and further arrears accumulation to the private sector and the public pension fund.

The external current account deficit (including official transfers) is estimated to have slightly widened in 2016 and reached 16.3 percent of GDP mainly due to a fall in aid inflows. On the other hand, the trade deficit witnessed a slight decline in 2016 to 41 percent of GDP following a drop in imports from Israel—the Palestinian territories' main trading partner—due to lower fuel prices and a trend among Palestinian consumers to boycott Israeli products. Exports continue to be constrained by the ongoing trade restrictions, and have remained low and stagnant at around 19 percent of GDP.

Outlook

The recent pickup in growth was driven by Gaza reconstruction and is not sustain-

FIGURE 1 Palestinian territories / Estimates and outlook: Public finances



Sources: MoF and staff estimates.

able without an easing of external restrictions and efforts to improve the domestic business environment. Therefore, the economic outlook for the Palestinian territories remains unfavorable, with projected growth levels insufficient to improve living standards. Assuming that the current restrictions remain in place and that the security situation stays relatively calm, the real GDP growth rate of the Palestinian economy in 2017 is projected at 3.5 percent: 2.7 percent in the West Bank and 5.5 percent in Gaza. In the medium term, real GDP growth could hover around 3.5 percent. This sluggish growth implies near stagnation in real per capita income and an increase in unemployment. The fiscal deficit (before grants) is projected to increase to 10 percent of GDP (US$1.35 billion) in 2017. At the same time, foreign aid in 2017 could fall to about US$640 million, leaving a financing gap in excess of US$0.7 billion (5 percent of GDP). PA actions alone will not be enough to fully close the gap. Unless donor aid is significantly stepped up, the gap will mostly be financed through arrears to the private sector and borrowing from local banks.

Due to the persistently large trade deficit, the 2017 current account deficit - including official transfers - is projected to stay high. Constrained by the restrictions system, Palestinian export growth is expected to remain sluggish and the Palestinian territories will continue to heavily depend on imports to meet even some of their basic needs. Consequently, the current account deficit is expected to remain high in 2017, at about 15.5 percent of GDP.

Risks and challenges

Lack of progress in the peace process and the Israeli constraints on trade, movement, and access to resources, alongside the internal political divide between the West Bank and Gaza and a challenging business environment continue to stand in the way of a sustainable economic recovery in Palestine. Therefore, downside risks to growth and employment remain significant. First, despite some progress in recent months, setbacks to the reconstruction process in Gaza are possible. The resumption of armed conflict cannot be ruled out and if this happens, the Gaza economy is expected to slip back into recession. Also, if tensions erupt again throughout the West Bank, they will result in elevated security risks that may negatively impact economic activity. Finally, growth in the West Bank may be worse than expected if the decline in donor support is sharper than current projections.

TABLE 1 Palestinian territories / Macro outlook indicators (annual percent change unless indicated otherwise)

	2014	2015	2016 e	2017 f	2018 f	2019 f
Real GDP growth, at constant market prices	-0.2	3.4	4.3	3.5	3.4	3.4
Private Consumption	3.5	6.2	4.5	4.5	5.0	5.0
Government Consumption	3.7	5.8	2.9	4.0	4.0	4.0
Gross Fixed Capital Investment	-10.1	8.1	-4.3	-8.3	-10.5	-12.2
Exports, Goods and Services	9.6	2.6	0.0	4.5	4.0	4.0
Imports, Goods and Services	4.1	9.5	-0.5	1.5	2.1	2.1
Real GDP growth, at constant factor prices	-2.3	1.6	3.5	4.2	4.0	4.0
Agriculture	-7.6	-7.2	-10.9	0.5	1.4	1.6
Industry	-13.8	-2.6	5.2	4.0	4.0	4.0
Services	3.1	3.8	3.7	4.4	4.1	4.1
Inflation (Consumer Price Index)	1.7	1.4	-0.2	1.1	1.5	1.2
Current Account Balance (% of GDP)	-6.7	-15.9	-16.3	-15.5	-15.4	-15.8
Financial and Capital Account (% of GDP)	2.4	12.1	13.9	13.1	13.2	13.7
Net Foreign Direct Investment (% of GDP)	-0.2	-0.5	1.2	0.1	0.1	0.1
Fiscal Balance (% of GDP)	-12.5	-11.4	-8.1	-9.7	-9.4	-9.2

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice.
Notes: e = estimate, f = forecast.

QATAR

As low global energy prices have persisted, fiscal and current account balances have shifted into deficit. The government has pared back current spending and undertaken subsidy reform. However, continued spending on 2022 FIFA World Cup capital projects is shoring up growth. Financial buffers also remain large. Given the uncertain medium-term outlook for the hydrocarbon sector, economic diversification is critical.

Recent developments

GDP growth slowed to (an estimated) 2.9 percent in 2016 from 3.5 percent the year before. As in previous years, output in the hydrocarbon sector remained broadly flat, reflecting in large measure the effects of a self-imposed moratorium on additional output from the giant North Field (source of the gas that transformed Qatar into the world's largest LNG exporter). Crude oil production had peaked in 2008 at 880,000 b/d and has since gradually declined to about 650,000 b/d in 2016. Since then output has fallen by 40,000 b/d in the first half of 2017 as part of cuts agreed with OPEC.

Fiscal adjustment and tighter banking liquidity took a toll on non-hydrocarbon activity in 2016, which expanded at its slowest pace in several years (Figure 1). There was a particularly sharp slowdown in manufacturing and transport, offset by strong outturns in construction, wholesale and retail trade and financial services. Banking sector solvency indicators and capital buffers remain healthy, but credit growth to the private sector has fallen to 6.5 percent yoy in December, down from over 20 percent a year earlier and close to a six-year low. Public sector deposit growth has remained in negative territory over the past two years, shrinking by 11 percent in 2016. The boom in the real estate sector has ended: following three years of double digit increases, real estate prices began falling in the second half of 2016, posting a decline of 9.5 percent yoy in Q4.

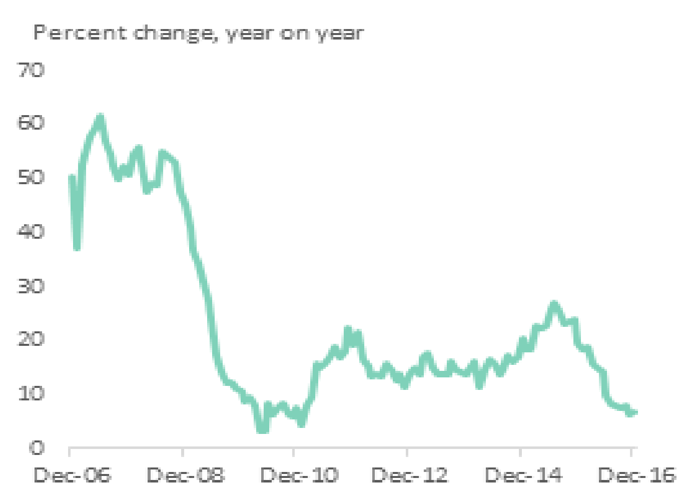
Although large fiscal and current account surpluses have vanished with the downshift in global oil prices, a sovereign wealth fund (SWF) with some US$335 billion in assets is helping to anchor confidence in financial markets and the currency peg. The country recorded its first fiscal deficit since 2000 in 2016 of about 8 percent of GDP (calendar year basis). With no drawdowns permitted from the SWF for budget support purposes, the government issued US$9 billion in international debt markets to help finance the deficit, and indications are that it will likely issue a mix of domestic and international debt in 2017 as well. Since 2014, the government has been engaged in sustained efforts to control and rationalize spending, reflected in the prioritization of capital projects deemed critical to economic diversification and the World Cup and shelving of other "non-essential" projects. In addition, water and electricity tariffs were raised in October 2015 and in May 2016 gasoline prices were deregulated to track global prices more closely. The current account, meanwhile, has sharply deteriorated, from a surplus of over 30 percent of GDP in 2011-12 to an estimated deficit of 2.3 percent in 2016, the first in 17 years.

In the labor market, expatriate workers face several challenges, complaining about delays or withholding of wages, poor working conditions, substandard employer-provided accommodation, irregular recruitment practices and lack of information on how to enforce their rights.

FIGURE 1 Qatar / Non-Hydrocarbon GDP

Sources: Haver, World Bank Staff.

FIGURE 2 Qatar / Commercial Bank Claims on the Private Sector



Sources: Haver, World Bank Staff.

Outlook

Qatar is currently in the midst of a multi-year US$200 billion infrastructure upgrade ahead of hosting the World Cup, which should support activity, particularly in construction, transport and services. The 1.4 billion cubic feet per day Barzan gas project—the last project approved before the North Field moratorium—is set to start production in 2017. This should boost growth to 3.3 percent in 2017, and help offset some of the anticipated production decline in natural gas output over the next few years. With FIFA-related investment beginning to plateau, growth is expected to gradually stabilize around 2.5 percent in 2019. Qatar's peg to the US Dollar means that monetary policy will gradually tighten in tandem with the US, at a time of slow domestic GDP growth. Fiscal and current account balances should gradually improve. As gas production increases and oil prices recover, export earnings should recover. The fiscal deficit will narrow, helped by savings in current expenditures and subsidy reforms and the introduction of a VAT in 2018.

Risks and challenges

Over the medium term, the emergence of new suppliers in the United States, East Asia and Africa implies an erosion of Qatar's bargaining power vis-à-vis long-term LNG contract terms, which have historically provided some protection against volatility in spot and short-term markets. New producers could also threaten Qatar's domination as the world's largest LNG exporter. Other external risks include regional instability and global financial volatility that affects capital flows and cost of funding at a time when the region as a whole is tapping international investors for funds to finance fiscal shortfalls.

Qatar's investment-driven growth strategy over the past decade has helped to transform standards of living for citizens, but has also contributed to concerns regarding fiscal sustainability in an environment of persistently low energy prices, excess capacity in the real estate sector, and demographic imbalances. On the fiscal front, Qatar's fiscal policy lacks fiscal anchors that could help shield the budget from volatility in commodity prices. Given the uncertain outlook for the gas sector later this decade and beyond, the development of the non-hydrocarbon sector is critical. To diversify and achieve its aspirations for a "knowledge-driven economy" as per the Qatar National Vision (2030), Qatar will have to raise the productivity of its investments, in both human and physical capital, and undertake structural reforms to improve the business environment. Efforts are being made to strengthen coordination, planning and executions systems at the center of government.

TABLE 1 **Qatar** / Macro outlook indicators (annual percent change unless indicated otherwise)

	2014	2015	2016 e	2017 f	2018 f	2019 f
Real GDP growth, at constant market prices	4.0	3.5	2.9	3.3	2.6	2.5
Private Consumption	8.0	7.9	5.6	3.5	3.3	3.6
Government Consumption	8.9	1.1	-21.0	-2.5	-0.7	-3.4
Gross Fixed Capital Investment	11.3	1.3	8.0	10.3	4.0	4.0
Exports, Goods and Services	0.4	-1.4	2.1	1.5	2.0	2.2
Imports, Goods and Services	6.4	-9.1	-4.0	4.5	2.0	2.0
Real GDP growth, at constant factor prices	4.0	3.5	2.7	3.2	2.6	2.6
Agriculture	25.0	8.5	4.0	4.0	4.0	4.0
Industry	1.9	1.7	2.0	4.0	2.5	2.5
Services	9.3	7.8	4.4	1.5	2.7	2.7
Inflation (Consumer Price Index)	3.1	1.9	2.7	3.0	2.5	2.5
Current Account Balance (% of GDP)	24.0	8.3	-2.3	-0.8	1.2	2.8
Financial and Capital Account (% of GDP)	-23.1	-7.5	3.2	1.6	-0.3	-1.9
Net Foreign Direct Investment (% of GDP)	-2.8	-2.8	-3.0	-2.8	-3.0	-3.1
Fiscal Balance (% of GDP)	12.6	1.4	-8.2	-2.3	0.7	2.4
Primary Balance (% of GDP)	13.8	3.2	-6.0	0.3	3.2	5.0

Sources: World Bank. Macroeconomics and Fiscal Management Global Practice.
Notes: e = estimate, f = forecast.

SAUDI ARABIA

Cheap oil continues to test the economic resilience of the Kingdom of Saudi Arabia. In 2016, the authorities deepened fiscal consolidation measures and introduced major reform initiatives to counter the growing challenges posed by the new reality of oil markets. With unfolding fiscal consolidation efforts, improvements in medium fiscal outlook were achieved at the expense of growth, which closely relies on public spending.

Recent developments

Low oil prices continue to challenge growth and fiscal sustainability in the Kingdom of Saudi Arabia (KSA). While recovering from a monthly average of US$30 per barrel earlier in 2016, at US$54 a barrel, the prices remained well below half of their 2014-peak in January 2017. As hydrocarbons account for about 80 percent of fiscal revenues and more than 40 percent of GDP (Figure 1), the KSA remains vulnerable to subdued prices.

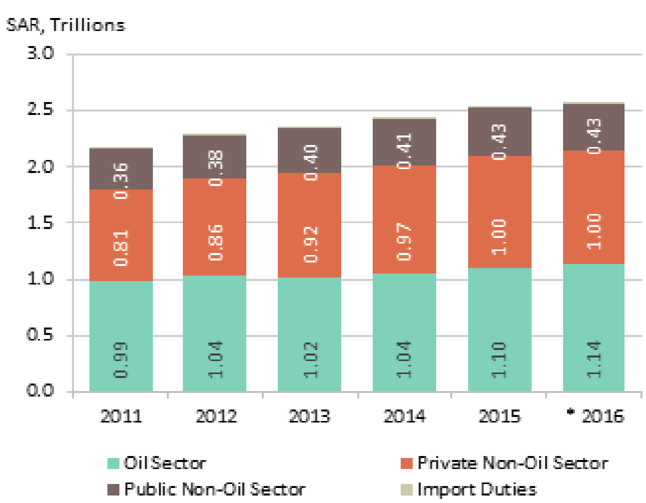
The first alarming results of the drop in oil prices were manifested in the 2015 macro-fiscal balances. Although the authorities increased oil output from 9.7 million bpd in 2014 to 10.1 million bpd in 2015, public expenditures exhibited little adjustments and, as a result, overall fiscal balances registered an estimated deficit at 15.1 percent of GDP and current account did so at an estimated 8.6 percent of GDP.

2016 witnessed more radical efforts to mitigate the economic and fiscal impacts of cheap oil by the Saudi authorities. Concerned with the emerging deficits, the authorities moved to consolidate the medium-term fiscal outlook. Domestic fuel prices were raised by 50 percent, gas and water prices are to be increased as well, and allocations for education, health and municipalities underwent significant cuts. A freeze on civil servants' basic salaries and reductions in benefits, introduced in 2016, is set to remain in place. In addition, a 5 percent Value Added Tax (VAT) has been scheduled for the coming years. Although the consolidation efforts helped prevent a widening in the fiscal deficit, they fell short of reducing it. The authorities cleared the arrears from the previous year (mainly payments to contractors in construction sector), which pushed the fiscal deficit up to an estimated 18.1 percent of GDP in 2016.

The major shift in policies, however, came with the announcement of Vision 2030 and The National Transformation Plan in the second quarter of 2016. The Vision aims to revamp the scope of public investments, raise the private sector's share in the economy, and rationalize government expenditures. Key reforms include an ambitious subsidy reform program; increased transparency and government efficiency; partnerships with private investors to localize renewable energy and industrial equipment sectors. An IPO of about 5 percent of ARAMCO, KSA's oil company with an estimated value at US$2 trillion, is also planned with potential implementation in 2017. The NTP aims to fulfill the Vision 2030 objectives by: (i) identifying strategic objectives and targets for participating agencies, (ii) translating the objectives to initiatives with implementation plans and feasibility studies, and (iii) promoting joint action for a number of national priorities.

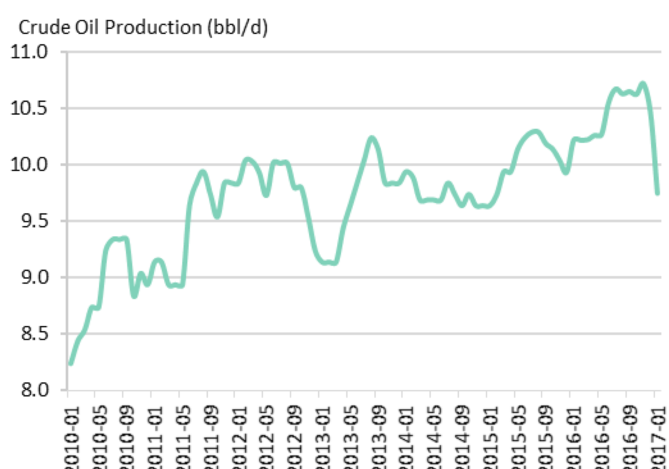
GDP growth slowed in 2016 driven by a slowdown both in oil and non-oil output growth; reflecting the impact of fiscal consolidation measures and tighter liquidity conditions. Fiscal austerity measures depressed the non-oil sector that is estimated to have grown by only 0.2 percent in 2016. Reduced government expenditure and a

FIGURE 1 Saudi Arabia / Institutional Composition of the GDP (Constant Prices)



Sources: KSA General Authority for Statistics.

FIGURE 2 Saudi Arabia / Crude Oil Production in the KSA



Sources: US Energy Information Administration.

slowdown in the issuance in new project contracts and delays in payments led to a contraction in the construction sector in particular. Oil production increased throughout the year in 2016 and reached a record of 10.7 mb/d in November 2016.

The introduction of subsidy reforms temporarily pushed up inflation. Nevertheless, price pressures have been contained and remained in low single digits at 3.5 percent in 2016. Monetary policy remains constrained by the peg to the US dollar. While the peg provides stability and predictability, it has also led to about a 40 percent real appreciation in KSA's effective exchange rate against major trading partners since July 2008.

As in other GCC countries, the bulk of low-income residents are migrant workers, but as the citizen population crosses the 20 million mark, inadequate access to economic opportunities is also an issue for nationals. With the prospect of low oil prices for some time, the old social contract—one based on government employment, generous subsidies, and free public services—is no longer sustainable. A reform agenda contained in the Vision 2030 document envisages deep structural changes that will profoundly impact the population in all aspects of their livelihoods.

The authorities are serious about mitigating the negative impact of reforms. They are launching a new social program to compensate the people for the effect of subsidy removal. However, identifying vulnerable groups has been difficult, and little evidence exists to inform policies about the level of support to be provided. In that respect, methods and institutions for welfare measurement and analysis need to be strengthened to fill the gap.

Outlook

Economic growth in the KSA is projected to slow further in 2017. Growth in the hydrocarbon sector is expected to be moribund in line with the recent OPEC agreement. The authorities have already reduced oil production to 9.8 million barrels a day in January 2017, which is comparable to the levels before the oil price drop in 2014. However, because the 2017 fiscal budget moderately eases consolidation measures, the non-oil economy should recover as the pace of fiscal adjustment eases and grow by 2.1 percent in 2017. Overall, GDP growth is projected to be 0.6 percent in 2017.

On the external side, the current account is projected to remain in the red, at 4.0 percent of GDP in 2017. Going forward, the annual average export prices should recover gradually in 2017 and 2018. With slower recovery in imports, the current account should revert to small surpluses from 2018 onwards.

The fiscal situation is stable in the short term with large reserves held by SAMA. However, with US$55 average oil price in 2017 (the latest World Bank projections) current fiscal measures are insufficient, and the fiscal deficit is projected at 10.6 percent of GDP. Efforts to raise non-oil revenues will likely yield some (albeit modest) revenues and expenditure cuts will occur gradually, focusing primarily on the capital budget. These measures are projected to reduce the overall fiscal deficit-to-GDP ratio.

Inflation is expected to be restrained by fiscal contraction on the demand side, but will be supported by hikes in utility prices on the supply side. Social indicators may deteriorate alongside fiscal consolidation and lower incomes, but data to assess the risks and vulnerabilities are not available.

Risks and challenges

With significant dependency on hydrocarbons, the Kingdom's economic outlook is especially sensitive to oil price movements. Although fiscal deficits are not likely to pose serious sustainability challenges in the short-term, they will lead to erosion of accumulated reserves and increases in the public debt (the authorities are likely to rely on both methods to avoid any sharp movements in either indicator) over the medium term.

The National Transformation Plan provides an important vehicle for maintaining fiscal sustainability and promoting diversification. However, in the absence of an overarching medium term macroeconomic and fiscal framework, the reforms may remain partial and uncoordinated across various implementing agencies.

TABLE 1 Saudi Arabia / Macro outlook indicators (annual percent change unless indicated otherwise)

	2014	2015	2016 e	2017 f	2018 f	2019 f
Real GDP growth, at constant market prices	3.7	4.1	1.4	0.6	2.0	2.1
Private Consumption	6.1	6.8	2.2	2.5	2.6	3.0
Government Consumption	12.0	-1.8	-2.1	1.6	0.3	0.3
Gross Fixed Capital Investment	7.5	3.6	-0.7	2.8	3.0	4.5
Exports, Goods and Services	-1.9	0.7	2.5	-3.0	1.9	2.1
Imports, Goods and Services	6.6	1.5	0.3	0.6	2.1	3.6
Real GDP growth, at constant factor prices	3.6	3.5	1.0	0.5	2.0	2.1
Agriculture	1.8	1.1	-0.2	0.0	0.2	0.2
Industry	3.1	4.0	1.0	-0.3	1.4	1.4
Services	4.5	2.9	1.2	1.8	2.9	3.3
Inflation (Consumer Price Index)	2.7	2.2	3.5	3.0	4.1	4.2
Current Account Balance (% of GDP)	9.7	-8.6	-6.5	-4.0	0.5	0.9
Fiscal Balance (% of GDP)	-3.4	-15.1	-18.1	-10.6	-6.7	-1.7
Primary Balance (% of GDP)	-3.3	-14.7	-17.7	-8.9	-6.2	-1.8

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice.
Notes: e = estimate, f = forecast.

TUNISIA

Tunisia has made great strides to advance its political transition but tangible economic dividends are taking longer than expected with growth too low to significantly make a dent in unemployment amid widening fiscal and current account deficits. A national unity government - a coalition of the main political parties and civil society groups - was formed in September 2016 to tackle the urgent economic reforms but has undergone its first, albeit minor, cabinet reshuffle in February 2017.

Recent developments

Tunisia's economy grew at an estimated annual rate of 1.0 percent in 2016 (2.0 percent excluding agriculture and fisheries) compared to 1.1 percent in 2015 (0.1 percent excluding agriculture). Growth in 2016 was driven mainly by the tradable services sector and the non-tradable activities sector, which grew each by 2.7 percent as well as the manufacturing industries sector (+0.9 percent). Non-manufacturing industries (phosphate, oil and gas) contracted by 1.9 percent (compared to a -4.1 percent in 2015) as phosphate production in mining regions has not yet fully recovered despite recent uptick in production levels.

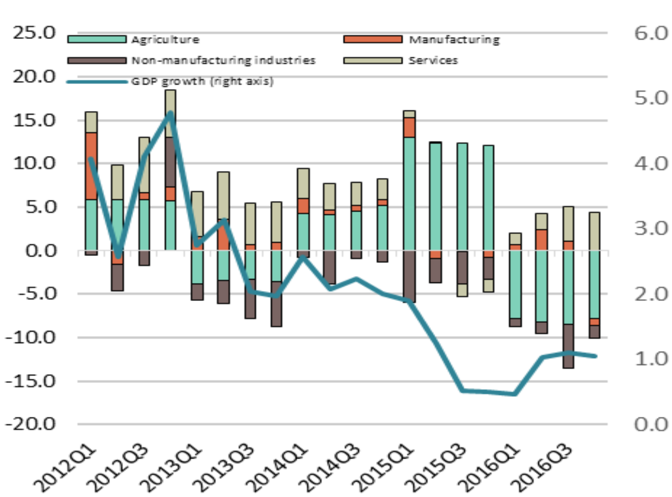
Inflation has steadily declined since its peak in 2013 and remains subdued despite a 8.3 percent depreciation of the Tunisian Dinar against the Euro and 8.6 percent against the US Dollar since mid-2016. The Consumer Price Index (CPI) increased on average by 3.7 percent in 2016 (against 4.9 percent in 2015). However, core inflation - without food and energy whose prices are administered – has accelerated since September 2016 and reached 5.1 percent in December (against 4.7 percent in December 2015).

The labor force participation rate remains low at about 50 percent mainly due to very weak participation of women in at only 26 percent. Unemployment has declined from its peak of 19 percent in 2011 to 15.5 percent in 2016. The majority of the unemployed are low-skilled workers. However, university graduates have the highest unemployment rate, which increased from 15 percent in 2005 to 23 percent in 2010 and to 31.6 percent in 2016, while female graduate unemployment reached 40.4 percent. Unemployment rates are also much higher in the hinterland compared to coastal regions.

Tunisia faces large fiscal and external deficits. The central government's fiscal deficit, excluding grants, increased to 6.0 percent of GDP in 2016 from 5.6 percent of GDP in 2015. The debt-to-GDP ratio has risen to 61.8 percent in 2016, from 55.4 percent in 2015. The current account deficit remained high at an estimated 9 percent of GDP in 2016. The significant current account deficit, combined with the deterioration of the capital and financial accounts, is eroding the country's foreign reserves buffer and leading to a depreciation of the Tunisian dinar. As of February 2017, foreign reserves were estimated at 13.8 billion Tunisian dinars, amounting to less than 4 months of imports.

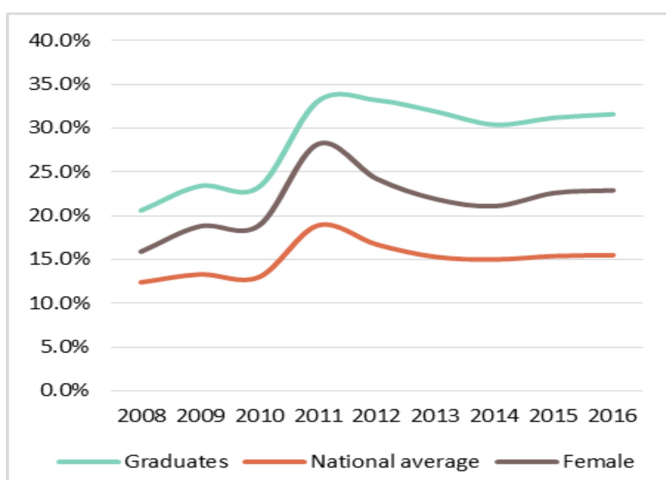
The national unity government formed in September 2016 has set its priority as strengthening the security environment, improving the business environment, ensuring macroeconomic and fiscal stability, and restarting growth. The new Government successfully organized an international investor conference in November 2016 (Tunisia 2020), which provided a platform to call for renewed support to Tunisia's young democracy and also to showcase improvements in the security situation as well as the potential of the country to attract investment. While the new government is expected to be more

FIGURE 1 Tunisia / Sectoral value added and GDP growth (y-o-y)



Sources: Institut national de statistiques, Banque centrale de Tunisie, and staff computation.

FIGURE 2 Tunisia / Unemployment rate



Sources: Institut national de statistiques, Banque centrale de Tunisie, and staff computation.

stable – especially at head of government and leading ministries – the recent small cabinet reshuffle indicated that changes should not be ruled out.

Outlook

Economic growth is projected to accelerate to 2.3 percent in 2017 through the recovery of the strategic sectors of agriculture, phosphate and manufacturing. In the medium term, economic growth is projected to pick up gradually to 2.8 percent in 2018 and 3.2 percent in 2019 against a backdrop of improved business climate through structural reforms and greater security and social stability.

The fiscal deficit is expected to remain high at 5.9 percent of GDP in 2017. Fiscal sustainability will require reining in the public wage bill, expanding the tax base, and creating space for increased investment spending.

On the external side, the current account deficit is projected to slightly narrow to 8.4 percent of GDP, with progressive recovery in manufacturing and mining industries and service exports, as well as agricultural export. In the medium term, the current account is likely to benefit from the gradual recovery of industries and services trade and would decline gradually until the end of the forecast horizon.

Risks and challenges

The main risks to the economic outlook remain the high level of youth unemployment and social unrest, as well as the fragile security situation domestically and in the region. While the government is deploying resources to improve the security situation, reforms to stimulate private sector growth and job creation are also needed to counter these risks in a sustainable manner. This would include, most notably: (i) adopting and implementing regulations to improve conditions for market access and to follow up concretely on the Tunisia 2020 conference; (ii) developing and implementing a comprehensive strategy on civil service reform and state-owned enterprises reform; (iii) improving governance, including fighting against corruption and elite capture; and (iv) establishing a dialogue aimed at tackling and resolving sources of social unrest, particularly with trade unions.

TABLE 1 Tunisia / Macro outlook indicators (annual percent change unless indicated otherwise)

	2014	2015	2016 e	2017 f	2018 f	2019 f
Real GDP growth, at constant market prices	2.3	1.1	1.0	2.3	2.8	3.2
Private Consumption	1.8	2.3	0.8	1.9	2.8	2.7
Government Consumption	4.2	8.8	8.9	-3.3	3.5	3.4
Gross Fixed Capital Investment	1.2	-4.5	2.2	4.1	6.5	6.6
Exports, Goods and Services	3.9	-3.2	3.2	1.7	4.2	4.3
Imports, Goods and Services	2.2	2.7	3.9	3.4	3.3	3.3
Real GDP growth, at constant factor prices	2.3	0.5	1.2	2.1	2.5	2.8
Agriculture	2.8	8.5	2.6	2.7	3.0	3.0
Industry	-1.1	-1.0	-6.6	-3.5	-1.2	-1.1
Services	3.8	0.0	4.3	4.2	3.7	4.1
Inflation (Consumer Price Index)	4.9	4.9	3.7	4.9	4.0	3.3
Current Account Balance (% of GDP)	-9.1	-8.9	-9.0	-8.4	-7.6	-7.1
Fiscal Balance (% of GDP)	-5.0	-5.6	-6.0	-5.9	-5.5	-5.0
Debt (% of GDP)	50.8	55.4	61.8	66.1	68.5	67.5
Primary Balance (% of GDP)	-3.2	-3.7	-3.8	-3.6	-2.8	-2.5

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice.
Note: f = forecast.

UNITED ARAB EMIRATES

The OPEC-mandated oil production cuts will limit growth in 2017 but as projected oil prices trend upwards, oil production capacity rises, and investments ramp up ahead of Dubai's Expo 2020, growth is expected to pick up in the medium term. However, the slowdown in the global economy and the tightening of regional liquidity pose risks to the outlook.

Recent developments

Persistently low oil prices and fiscal austerity continue to weigh on the UAE's economy. Overall real GDP growth is estimated at 2.3 percent in 2016, a significant drop from the pre-2014 oil shock average of 5 percent (2010-14). Austerity measures weakened business and consumer confidence and slowed growth in credit to the private sector in 2016. Hydrocarbon GDP growth is estimated to have slowed down to 3 percent in 2016 from an estimated 4.6 percent in 2015. The average rate of inflation eased to 1.6 percent in 2016 from 4.1 percent in 2015 due to the slowdown in activity.

Fiscal consolidation efforts began in 2015, including the raising of electricity and water tariffs, the removal of fuel subsidies and the scaling back of capital transfers to Government Related Entities (GREs). Despite these measures, the drop in hydrocarbon revenues has pushed the fiscal balance down from a comfortable surplus of 10.4 percent of GDP in 2013 to an estimated 3.5 percent deficit in 2016. The Abu Dhabi and Dubai sovereign wealth funds have recorded lower returns (3 percent y-o-y fall in 2015 net profits) resulting from global volatility. The deficit is financed by bank borrowing and, increasingly, by foreign-capital raising. The current account surplus also fell from 19.1 percent of GDP in 2013 to an estimated 1.3 percent of GDP in 2016.

Monetary policy is tightening, but government deposits have begun to rise again. Falling oil prices have tightened liquidity in the banking sector with M2 up by just 3.7 percent in 2016. However, the US$3.6bn month-on-month increase in government deposits in November reverses a trend of falling government deposits in the domestic banking system since 2015 Q2. Credit growth on the other hand has declined in Q4 2016 compared to Q3 2016. The central bank raised the interest rate on its certificates of deposit by 25 basis points in December, to 1.5 percent, in line with the latest increase in the key policy rate of the Federal Reserve.

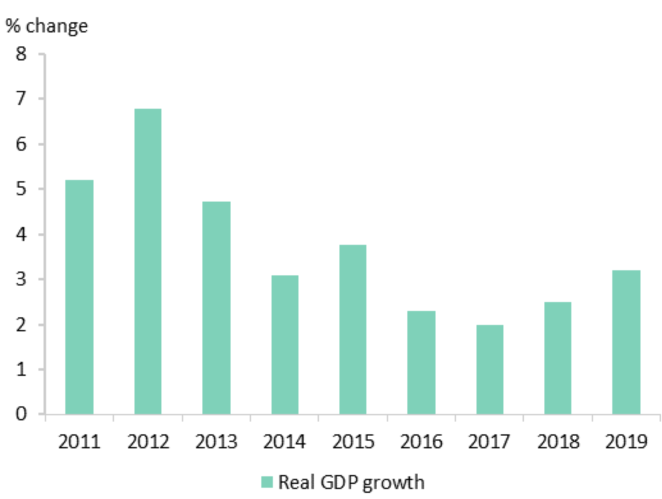
The real estate market continues to soften. Increased supply and weakening demand amidst the fiscal tightening resulting from low oil prices have led to reduced residential property transactions. In Abu Dhabi, property values dropped by 2 percent in the fourth quarter of 2016 (year-on-year). On the other hand, the launch of several major developments suggest an upturn in Dubai's real estate sector. Property prices have shown only a marginal improvement but are expected to firm up in the run-up to Expo 2020.

Each Emirate has an independent statistics agency, and while the federal-level statistical bureau was established in 2009, the harmonization of methods and statistical agendas for a country level welfare measurement is yet to be accomplished.

Outlook

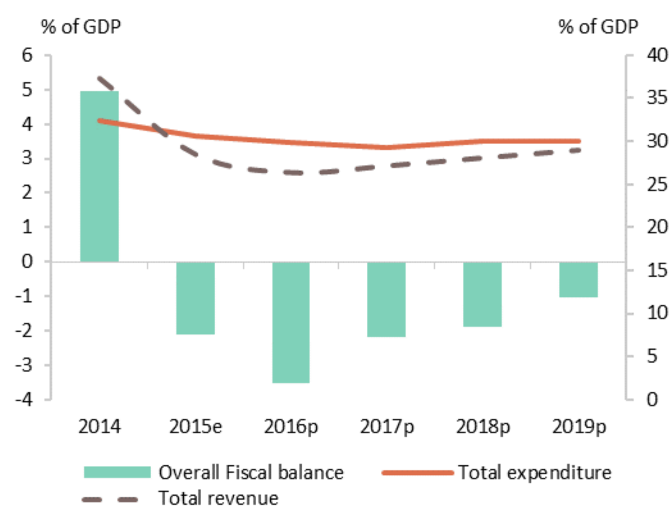
The OPEC-mandated oil production cuts are expected to limit growth in 2017, to 2

FIGURE 1 United Arab Emirates / GDP growth rate (percent per annum)



Sources: UAE authorities and IMF/World Bank Staff estimates.

FIGURE 2 United Arab Emirates / Government Operations (as share of GDP)



Sources: UAE authorities and IMF/World Bank staff estimates.

percent. Further down in the forecast period, growth is expected to recover slightly, reaching 3.2 percent in 2019. The federal government has set a targeted growth rate of 4 percent for 2017, which seems ambitious given the weak bank liquidity growth and likely OPEC-mandated oil output cuts that year. In 2018 on the other hand, oil production is expected to rise due to investments in oilfield development. Non-oil growth is projected to rebound (i) as the expected improvement in oil prices and its positive effects on confidence and financial conditions dampen the effects of fiscal consolidation; (ii) as megaproject implementation ramps up ahead of Dubai's hosting of Expo 2020; and (iii) as the lifting of sanctions on Iran translates into increased trade. Expo 2020 is expected to draw in a large number of visitors, boosting private consumption and services exports. Fiscal and external balances are expected to improve over the medium term; with a marked improvement in the fiscal deficit to 1 percent of GDP and an expected rebound in the current account surplus to 3.4 percent of GDP by 2019. The uptick in fuel prices, new levies and the introduction of the VAT are expected to push inflation to 3.3 percent.

Risks and challenges

Macro-financial risks are increasing, particularly from the financial management of Government Related Entities' megaprojects. In an environment of low oil prices, macro-financial risks could be exacerbated by declining liquidity in the banking system, increased volatility in the stock markets, and disruptive declines in the real estate sector. Despite Dubai's progress on refinancing and restructuring debt (accounting for 1/3rd of UAE's GDP), imprudent management of Dubai's megaprojects could be a source of macro-financial risks for its GREs, its banks, and ultimately the government. There are several risks to the growth outlook. Oil capacity expansion plans are vulnerable to further declines in oil prices and non-oil growth also depends on regional liquidity and global economic recovery. The UAE will, however, continue to benefit from its safe-haven status in a turbulent region and from the lifting of sanctions on Iran.

TABLE 1 United Arab Emirates / Macro outlook indicators (annual percent change unless indicated otherwise)

	2014	2015	2016 e	2017 f	2018 f	2019 f
Real GDP growth, at constant market prices	3.1	3.8	2.3	2.0	2.5	3.2
Private Consumption	25.3	-12.0	2.1	2.4	3.2	3.2
Government Consumption	5.8	16.6	-0.9	-0.5	2.5	2.5
Gross Fixed Capital Investment	8.3	10.6	3.0	2.8	7.9	10.3
Exports, Goods and Services	0.2	3.4	1.3	2.5	4.0	4.0
Imports, Goods and Services	12.3	-1.2	1.7	3.0	3.2	3.2
Real GDP growth, at constant factor prices	3.1	3.8	2.2	1.6	3.3	4.0
Agriculture	1.9	3.1	3.0	2.0	3.0	3.2
Industry	1.6	4.6	2.3	2.1	2.3	3.0
Services	4.1	3.2	2.1	1.2	4.0	4.7
Inflation (Consumer Price Index)	2.4	4.1	1.6	2.0	3.1	3.3
Current Account Balance (% of GDP)	10.1	3.3	1.3	3.0	3.2	3.4
Fiscal Balance (% of GDP)	5.0	-2.1	-3.5	-2.2	-1.9	-1.0

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice.

Note: e = estimate, f = forecast.

YEMEN

The conflict in Yemen has caused a dramatic deterioration of the economic and social conditions in the country. Output contracted sharply, driving household incomes downward. Important institutions like the Central Bank became dysfunctional in late 2016. Yemenis are facing a catastrophic humanitarian situation, massive displacement, and destruction of vital infrastructure. The UN recently launched a humanitarian appeal (US$2.1 billion) for helping the 8 million Yemenis suffering from rising food insecurity.

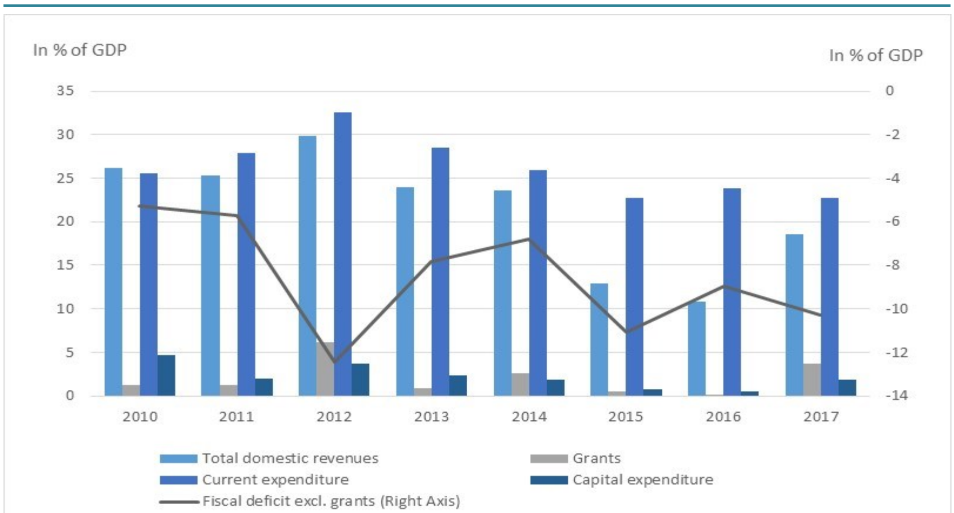
Recent developments

Official statistical reporting on Yemen is no longer available. However, the data gathered suggests that Yemen's GDP contracted since 2015 by about 40 percent, cumulatively. The country has effectively split into conflict zones. While the economy appears to have adjusted to the conflict mode, any positive economic impulse for 2017 can only originate from building peace in Yemen. The broadened conflict since March 2015 has led to widespread disruptions of economic activity and infrastructure. Oil and gas production and exports remain limited while production is being restored in Marib, the area influenced by the recognized government. Imports have greatly contracted since the Central Bank of Yemen (CBY) became dysfunctional in late 2016. Critical food and energy imports are facilitated exclusively through private channels without support from financial trade services offered earlier by the CBY. This is a particular challenge and creates uncertainty for supply of staple food, 90 percent of which has typically been imported. UNOCHA estimates a total of 8 million Yemenis in acute need of food. Annual inflation reached around 40 percent in 2015, and was contained in 2016 because of lack of fiscal resources which led to non-payment of public sector salaries and other arrears.

Public finances are under severe stress. Public investment has come to a complete stop. The government suspended many public expenditure obligations during 2016 while trying to mainly meet wage and interest payment obligations, which reached up to more than 100 percent of total available revenues in 2016. As a result, since September 2016, salaries are paid at best partially and arrears towards suppliers and domestic as well as foreign creditors have been accumulating. Given the massive, evolving humanitarian needs in Yemen, the UN launched in February 2017 a Humanitarian Response Plan, which appeals for US$2.1 billion. Many development partners engage in similar ways to support the UN. The World Bank is providing two large emergency and relief operations to Yemen, with a total of US$450 million, supporting critical service delivery in the health sector, and providing employment and labor intensive infrastructure improvements in local communities.

The protracted conflict in Yemen is continuing to inflict a heavy toll on the population. Latest reports put human casualties at 48,000, which includes 7,500 fatalities as of the end of the year 2016. More than 2 million Yemenis remain forcibly displaced from their homes. Destruction of essential infrastructure, disruption of trade, commerce and supplies and the wholesale collapse of the service delivery apparatus has drastically deteriorated living conditions. More than half of the population is suffering from food shortages, and it is estimated that 3.3 million children and pregnant or lactating women are acutely malnourished, including 462,000 children under 5 suffering from severe acute malnutrition.

FIGURE 1 **Yemen** / Public Finances, in % of GDP



Sources: Yemen Statistical Organization, IMF and staff estimates.

Outlook

Economic and social prospects in 2017 and beyond will depend critically on rapid improvements on the political and security fronts, and ultimately whether an end to the on-going conflict will allow for rebuilding the economy, the productive sphere, and Yemen's social fabric. If peace is restored by mid-2017, the fiscal deficit is estimated to be halved, to 6 percent of GDP. Foreign financing can resume in the second half of the year (with emergency assistance estimated to reach 4 percent of GDP). At the same time, tax collection can pick up with the resumption of hydrocarbon production, with hydrocarbon tax revenues recovering to about 6 percent of GDP, of which two-thirds would be due to increased domestic energy consumption. Non-hydrocarbon tax revenues are estimated to reach about 8 percent of GDP in such a scenario. The outlook for revenue mobilization is unlikely to meet the financing needs of a recovery. Massive foreign assistance would be required for Yemen in a post-conflict period, to facilitate recovery and restore basic services and rebuild confidence, including in Yemen's institutions. It would be important to leverage such support, in parallel with Yemeni efforts, to address some major drivers of conflict and build economic and social inclusiveness.

Risks and challenges

Yemen is facing enormous economic and social challenges. Restoring peace and political stability is critical to beginning reconstruction and addressing the country's deep-rooted governance, institutional, economic, social, and environmental challenges (including rapid depletion of ground water). Making peace sustainable in Yemen will require diversifying the economy, making employment more productive, designing fiscal and other policies that will support investment to create jobs and income for the many Yemenis who today only find a living by joining one or another militia or armed group.

TABLE 1 **Yemen** / Macro outlook indicators (annual percent change unless indicated otherwise)

	2014	2015	2016 e	2017 f
Real GDP growth, at constant market prices	-0.2	-28.1	-9.8	5.0
Private Consumption	0.1	-19.4	-0.8	2.4
Government Consumption	-7.1	-22.4	-8.8	0.1
Gross Fixed Capital Investment	-3.6	-83.7	-22.7	165.1
Exports, Goods and Services	-4.1	-65.7	-71.0	223.2
Imports, Goods and Services	-6.1	-43.0	0.7	29.6
Real GDP growth, at constant factor prices	-0.4	-28.8	-10.6	5.7
Agriculture	1.0	-25.0	-6.0	2.0
Industry	-3.8	-37.9	-24.3	19.3
Services	1.0	-25.0	-6.0	2.0
Inflation (Consumer Price Index)	8.2	39.4	5.0	20.0
Current Account Balance (% of GDP)	-1.7	-5.5	-5.6	-4.2
Fiscal Balance (% of GDP)	-6.8	-11.1	-9.0	-10.3
Debt (% of GDP)	48.7	66.7	85.4	79.9
Primary Balance (% of GDP)	-1.2	-3.6	-0.7	-3.1

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice.
Notes: e = estimate, f = forecast.

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