How the Arab World Can Benefit from Low Oil Prices

Shanta Devarajan
World Bank
www.brookings.edu/futuredevelopment
Current problems in the Arab World

Unemployment rate (latest available), percent

- Latin America & Caribbean: 6.2%
- Sub-Saharan Africa: 7.7%
- Europe & Central Asia: 9.6%
- Middle East & North Africa: 11.2%
- MENA Female: 21%
- MENA Youth: 30%
Limited diversification

(Ierfindahl index for inequality in export, higher numbers mean more concentration, 2000-2012)
Current problems in the Arab World (continued)

Poor quality public services

![Chart showing losses due to electrical outages and number of electrical changes in a typical month for different regions: MENA, SA, SSA, EAP, LAC, ECA.](chart)

- Losses due to electrical outages (% of annual sales)
- Number of electrical changes in a typical month

- MENA: 6.1
- SA: 4
- SSA: 4.9
- EAP: 4.9
- LAC: 1.3
- ECA: 1.2
Current problems in the Arab World (continued)

Volatility in macroeconomic performance

Real GDP growth in Egypt

-2 0 2 4 6 8 10
FY83 FY88 FY93 FY98 FY03 FY08 FY13

Real GDP, %
State of economic policies before the recent drop in oil prices (2014)

High fuel and energy subsidies

Total pre tax energy subsidies by region, 2011

- Sub-Saharan Africa: $19.3 billion (1.6% GDP)
- Middle East and North Africa: $236.5 billion (8.6% GDP)
- Advanced Economies: $25.4 billion (0.1% GDP)
- Central and Eastern Europe and Commonwealth of Independent States: $72.1 billion (1.7% GDP)
- Emerging and Developing Asia: $102.3 billion (0.9% GDP)
- Latin America and Caribbean: $36.2 billion (0.6% GDP)

Source: Clements and others (2013).

1 Includes petroleum, electricity, natural gas, and coal subsidies.
State of economic policies before the recent drop in oil prices (2014)

Large civil service

Ratio of public to private sector workers

- MENA
- Africa
- Latin America
- OECD
- Asia
- Europe and Central Asia
State of economic policies before the recent drop in oil prices (2014) (continued)

Limited counter-cyclical fiscal policies

Sources: IMF World Economic Outlook and IMF staff estimates.
Relationship between problems and policies

Fuel subsidies: (i) benefit old, large firms at the expense of young, dynamic ones

Relationship between problems and policies

Fuel subsidies: (ii) deplete water resources, hurting agriculture and industry
Fuel subsidies: (iii) contribute to congestion that undermines competitiveness

Total cost of traffic congestion for 11 main corridors in greater Cairo is estimated at:

$2 billion a year
Large and better-paid civil service crowds out private sector

Average public sector wages in selected countries (compared to private sector wages)

| Country          | Public Sector Wages
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Syria (pre war)</td>
<td>32% higher</td>
</tr>
<tr>
<td>Jordan</td>
<td>20% higher</td>
</tr>
<tr>
<td>Egypt</td>
<td>6% higher</td>
</tr>
</tbody>
</table>

Lack of fiscal rules means that governments have no buffers to withstand shocks — leading to pro-cyclical policies.
Examples of fiscal rules

- **All-consuming regime:**
  - the resource windfall is entirely transferred to households for consumption

- **All-investing regime:**
  - the resource windfall is entirely used for public investment in addition to the steady-state public investment

- **All-savings regime:**
  - the resource fund is entirely invested abroad in a sovereign wealth fund
  - the interest generated by the fund is transferred to households
  - a negative value for the sovereign wealth fund is equivalent to a debt held by the government

- **The balanced regime:**
  - A fixed share of the windfall is invested in the sovereign wealth fund and the remainder is invested in public infrastructure.
  - The interest generated by the sovereign fund is returned to households.
Welfare impact of persistent shocks to the resource price
(average of 100 simulations based on random draws of the resource price shocks)

The welfare measure is the percentage increase in the deterministic steady state consumption that gives the same level of utility brought about by the shock to resource price.

Why have these policies persisted?
Politics fueled by high oil prices

For oil exporters, high oil prices enabled a welfare state that was highly inefficient

- Subsidies and unproductive civil servants’ salaries are extremely inefficient ways of distributing oil revenues to citizens
- To quell dissent, rulers often increased these welfare payments, exacerbating the distortion

Post 2011
- GCC countries increased social spending by about $150 bln;
- Saudi Arabia’s welfare package included pay raises for government employees, new jobs and loan forgiveness schemes worth $93 bln;
- The UAE spent nearly $2 bln to provide housing loans to Emiratis;
- Qatar announced an $8 bln handout in wage, salary and benefit increases for all state and military personnel;
- Oman and Bahrain increased social spending by the billions.
Why have these policies persisted? (continued)

Politics fueled by high oil prices

For oil importers, remittances and aid from oil exporters enabled them to maintain a rentier state

- Remittances and aid meant oil importers didn’t need to have their own buffer fund to withstand terms of trade fluctuations
Why have these policies persisted? (continued)
Politics fueled by high oil prices

For **oil importers**, remittances and aid from oil exporters enabled them to maintain a rentier state (continued)

- Post Arab Spring, Tunisia, Egypt, etc. raised civil service wages and subsidies initially
- Citizens reluctant to pay more if they don’t trust government to deliver quality services
How low oil prices are changing policies since 2015

<table>
<thead>
<tr>
<th>Subsidy reform in oil exporters and importers</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Gasoline</strong></td>
</tr>
<tr>
<td><strong>Diesel</strong></td>
</tr>
<tr>
<td><strong>Natural Gas</strong></td>
</tr>
<tr>
<td><strong>Electricity</strong></td>
</tr>
<tr>
<td><strong>Water</strong></td>
</tr>
</tbody>
</table>
How low oil prices are changing policies since 2015 (continued)

### Other public expenditure reforms

<table>
<thead>
<tr>
<th>Country</th>
<th>Introduction of VAT</th>
<th>Lifeline tariff for electricity</th>
<th>Other measures</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bahrain</td>
<td>✓</td>
<td>✓</td>
<td>Cut in capital expenditure</td>
</tr>
<tr>
<td>Kuwait</td>
<td>✓</td>
<td>✓</td>
<td>Cut in capital expenditure</td>
</tr>
<tr>
<td>Oman</td>
<td>✓</td>
<td>✓</td>
<td>Cut in capital expenditure</td>
</tr>
<tr>
<td>Qatar</td>
<td>✓</td>
<td>✓</td>
<td>Cut in capital expenditure</td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>✓</td>
<td>✓</td>
<td>Reduced the wage bill to less than 15 percent of GDP in the 2016 budget through reducing public-sector wage increases and cut in capital expenditure</td>
</tr>
<tr>
<td>UAE</td>
<td>✓</td>
<td>✓</td>
<td>Cut in capital expenditure</td>
</tr>
<tr>
<td>Egypt</td>
<td></td>
<td></td>
<td>Property tax introduced in 2015</td>
</tr>
<tr>
<td>Algeria</td>
<td></td>
<td></td>
<td>Froze public-sector hiring, which accounts for 60 percent of employment</td>
</tr>
<tr>
<td>Iraq</td>
<td></td>
<td></td>
<td>Reduced the 2016 budget spending by USD 900 million</td>
</tr>
</tbody>
</table>
How low oil prices are changing policies since 2015  
(continued)

<table>
<thead>
<tr>
<th>UAE</th>
<th>Saudi Arabia</th>
<th>Bahrain</th>
<th>Oman</th>
<th>Qatar</th>
<th>Kuwait</th>
<th>Morocco</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Some Energy/Water Efficiency Initiative</td>
<td>• SWCC to target to double energy efficiency from the current level of about 26-27 per cent to 54-55 per cent</td>
<td>• Some Energy/Water Efficiency Initiative</td>
<td>• Corporate tax increased from 12 to 15% Increase in fees of vehicles and driving licenses</td>
<td>• Energy/Water Efficiency Initiative</td>
<td>• Limited Energy/Water Efficiency</td>
<td>• Morocco is subsidizing the acquisition of solar water pumps, to counter the large proportion of farmers using butane-fed gas pumps, fixing thermo regulation standards in buildings, which has become obligatory in 2016</td>
</tr>
<tr>
<td></td>
<td>• A number of pioneering projects announced, the world’s first solar-powered desalination plant</td>
<td></td>
<td>• Review the government vehicle fleet and ration fuel use</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• Replace all lighting with energy-saving LED bulbs and outsource electricity and water maintenance</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
How to benefit even more from low oil prices

Civil service reform to deliver better quality services to citizens who are being asked to pay higher prices

Fiscal rules to manage terms of trade shocks

For oil exporters, distribute oil revenues more efficiently (e.g. lump-sum transfers)