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**The Impact of Oil Prices on the Economic Growth and Development  
in the MENA countries**

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## **1. Abstract.**

This paper discusses the impact of oil prices on the economic growth and development in the Middle East and North Africa (MENA) countries. Volatilities in oil prices have considerable effects on macro economy of both developed and developing countries. These volatilities can affect economic growth through affecting cost of production, consumer spending, and exchange rate that is in turn affect international trade. MENA region is sensitive to changes in oil prices simply because some member countries are major producers and exporters who likely to hardly hit by lower oil prices as a great portion of their revenues come from oil exports, while other member countries are oil importers who may benefit from low oil prices as an input of production of some goods but they may negatively affected in the form of reducing remittances, less foreign aid, and less foreign direct investment as a result of decline in revenues in oil exporting countries resulted from oil price decline.

The recent plunge in oil prices has been driven by a number of factors, *inter alia*, several years of upward surprises in the production of unconventional oil, weakening global demand, a significant shift in OPEC policy, unwinding of some geopolitical risks, and an appreciation of U.S dollar.

Literature has shown that oil price shocks have asymmetric effect in the sense that positive and negative shocks in oil price of equal size may have differential effects on economic growth of a given country.

**Key Words:** Oil Prices, Economic Growth, MENA countries

## **2. Introduction.**

Oil has a strategic nature and is an important commodity that affects the world economy. Both oil exporters and importers are likely to feel the effects of oil price developments. Oil prices dropped sharply since June 2014 bringing an end to a four-year period of relative price stability. The size and speed of decline has been significant but not unprecedented. Over last four decades, five episodes of price declines in excess of 30 percent were observed, coinciding with major changes in political scene in the Middle East; global economy and oil markets. Due to such sharp declines, the causes and consequences of and policy responses to the recent plunge in oil prices have led to intensive debates.

Oil prices have plunged recently, affecting everyone; producers, exporters, governments and consumers. Overall, we see this as a shot in the arm for the global economy. While there is no two countries will experience the drop in the same way, they share some common traits: oil importers among advanced economies, and even more so emerging markets, stand to benefit from higher household income, lower input cost, and improved external positions. Oil exporters will take in fewer revenues, and their budgets and external balances will be under pressure<sup>1</sup>.

Oil price fluctuation is not only one of the most important causes of many crises in oil exporting countries as a main source of government revenues, but also a main cause of fluctuation in oil importing countries as an important input in production function. Since 1970s, macroeconomists have viewed changes in oil prices as an important source of fluctuations, as well as a paradigm of global shock, likely to affect many economies simultaneously. Such a perception is largely due to the two episodes of low growth, high unemployment and high inflation that characterized most industrialized economies in the mid and late of 1970s<sup>2</sup>.

The political and technical reasons that resulted in the current sharp decline in oil prices are various. the expected consequences of this decline will have an impact on economic growth, trade, inflation in the world, and the effect of such decline on oil exporting economies, such as Saudi Arabia, and the Arab importing countries such as Egypt and morocco, and international economies such as China and USA, Europe,

Japan, South Korea and India and the Arab and Asian labor and their remittances to their countries<sup>3</sup>.

This paper seeks to answer a gamut of questions ,*inter alia*;(1) what are the main causes of oil plunge in recent years, in particular, after mid-2014; (2) what is the impact of oil shocks on economic growth in the MENA region;(3) testing whether impact of oil price is symmetric or asymmetric on economic development;(4) the impact of oil Prices drops on MENA's financial markets and exchange rates (5) the impact of oil shale production on oil prices (6) the effect of oil price decline on commodity markets, and (7) monetary and fiscal policies to mitigate the impact of dramatic drop in oil prices in oil exporting countries.

### **3. The Main Causes of Recent Plunge in Oil Prices:**

The recent plunge in oil prices has been driven by a number of factors, *inter alia*, several years of upward surprises in the production of unconventional oil, weakening global demand, a significant shift in OPEC policy, unwinding of some geopolitical risks, and an appreciation of U.S dollar. In spite of the fact that the relative importance of each factor is difficult to pin down, OPEC's renouncement of price support and rapid expansion of oil supply from unconventional sources appear to have played a crucial role since mid-2014. Empirical estimates also show that supply (much more demand) factors have accounted for the lion's share of the latest plunge in oil prices. although the supply capacity of relatively high-cost and flexible producers, such as the shale oil industry in the United States, will need to adjust to lower prices, most of the underlying factors point to lower oil prices persisting over the medium-term, with considerable volatility in global oil prices<sup>4</sup>.

In recent years, the understanding of the nature of energy prices shocks and their effects on the economy has evolved dramatically. Only a few years ago, the prevailing view in the literature was that at least the major crude oil prices increases were caused by oil supply disruptions triggered by the political disturbances in the Middle East. At the same time, there has been increasing recognition of the importance of shifts in the demand for oil. Robust evidence is provided by recent research that oil demand shocks played a central role in all major oil price shocks episodes since the 1970s<sup>5</sup>.

As a matter of fact, there is no consensus in the literature on how to model the global market for crude oil. In the literature, one strand views oil as an asset whose price is determined by desired shocks, in the sense that, shifts in the expectations of forward-looking traders are reflected in changes in the real price of oil and changes in oil inventories. The other strand of the literature, views the price of oil to be determined by shocks to the flow of supply of oil and the flow demand for oil giving little attention to the role of inventories in smoothing oil consumption<sup>6</sup>.

Recent research shows that shocks to the flow supply of crude oil have had little impact on the real price of oil since 1973, while shocks to the flow demand for oil associated with the global business cycle have been responsible for the long swings in the real price of oil, particularly, in 1973/74, 1979/80, and 2003-2008.

Furthermore, speculative demand shocks that reflects forward looking behavior by traders played an important role in 1979 (in the aftermath Iranian Revolution), in 1986 (in the aftermath of the collapse of OPEC), in 1990/91(in the aftermath the invasion of Kuwait), in 1997-2000( in the aftermath of the Asian Crisis) and in 2008 ( during the global financial crisis). The speculative demand shocks can cause large immediate effects on the real oil prices in response to geopolitical events for instance<sup>7</sup>.

#### **4. The Impact of Oil Shocks on Economic Growth in the MENA region.**

Oil endowment facilitated unprecedented economic and social development in Saudi Arabia and the Gulf region. Since the 1970s oil income has enabled economic prosperity through large spending on infrastructure, investment in human capital and provision of a wide range of social services. It has also generated positive externalities for growth across the region by increasing trade and cooperation and contributed to an impressive rise in human development indicators. However, abundant oil wealth also has a negative impact on economic development. The conjecture of a negative correlation between oil endowment and economic growth is broadly called oil curse. This correlation has been researched widely in the literature with particular focus on two main sources of the oil curse<sup>8</sup>.

One main source is the loss of competitiveness due to domestic currency pegging to the U.S.dollar, the reserve currency in which oil is priced globally. Although the expediency of pegging enables stable inflation and interest rates, it reduces non-oil export competitiveness. The Gulf Cooperation Council (GCC) countries' currencies are pegged to the dollar. In those countries, loss of non-oil export competitiveness curbs non-oil sector growth and diversification that cannot be compensated for by other means (technology, know-how, export sophistication). Low economic diversification limits private sector investment opportunities and causes private investment to become dependent on the stimulus of government expenditure. Another main source of the oil curse is the ill effects of rent seeking and political largess oil income enables resulting in inefficient use of the resource, particularly in the absence of strong institutions and checks and balances for the management of oil income<sup>9</sup>.

The Middle East and North Africa (MENA) region continues to experience tepid economic growth for the fourth consecutive year as it struggles to promote inclusive

and more widely shared prosperity for growing population and to markedly reduce unemployment –a critical issue facing nearly all countries. The energy- rich region of some 44 million people and financial resources is plagued structural bottlenecks, weak institutional structures, social disintegration and total chaos in Syria, Iraq, and Libya and to lesser extent Yemen<sup>10</sup>.

As a matter of fact, the empirical research has generated an evolving impression about the magnitude of oil price effect on aggregate economic activity. After the World War II and extending through 1970s oil price shifts had a very large impact on economic activity. It was estimated that the oil price elasticity was as high as -0.29 suggesting that a 10 percent increase in world oil prices would translate into a 2.9 percent decline in real GNP. Price elasticity fell sharply when data of the 1980s were added to the sample period to the degree that during the mid-1980s the structural relationship appeared to change and researchers started to entertain the possibility that oil prices had an asymmetric effect on economic activity. Oil prices increases continued to have a negative impact (albeit smaller) on economic activity; however, large oil price decrease failed to produce an economic boom. Over the last decade, research conducted showed that oil prices have become more volatile while the impact on the economic activity appears to have continued to diminish<sup>11</sup>.

The traditional approach in the literature used to explain the effect of oil price change on output growth in oil exporting countries is the Dutch disease theory. Higher oil prices have adverse effects on economic performance of oil-exporting countries because they change the structure of the economy in favor of the booming oil and non-traded sectors and against the traded manufacturing and agriculture sectors. Furthermore, higher revenues as a result of oil price increase will lead to the appreciation of local currency; increasing imports of intermediate and consumer goods. Oil-exporting developing economies heavy reliance on imports will harm their domestic industries as they will be unable to compete with imported goods when oil prices are high, on the other hand, there countries cannot sustain their production level when both oil prices and imports decrease. Therefore, and according to Dutch disease theory, a temporary foreign exchange windfall will have a detrimental rather than beneficial effect on the economy. Following the same transmission mechanism, the decrease in oil prices will work in the opposite direction<sup>12</sup>.



Most papers in the growth literature do not include natural resource abundant economies in their cross-country empirical analysis, in particular, in oil exporting countries. Furthermore, the literature that specifically deals with resources abundant economies tends to treat revenues that flow from such resources as "intrinsically temporary" and only considers the short-term effect. The more recent literature on resource abundance and economic growth focuses on the political economy considerations and argues that large windfalls from the resource create incentives for rent-seeking<sup>13</sup>.

However, institutional weakness may have a greater impact on long-term economic performance of oil exporters than the Dutch disease. Many studies have found a negative correlation between oil endowment and growth. A common finding of most studies is that resource curse cannot be attributed to resource availability but rather to the way it is exploited and managed. The point is that government should be concerned with the institutional arrangements that ensure sound policies for resources exploitation, revenue management and investment in order prevent political largess, rent seeking, waste and corruption. Great benefits can be reaped through developing institutions that ensure firm rules for resource management, including transparency and decentralized decision making independent of political interference. With strong institutional arrangements for efficient resource use, revenue management and investment, oil endowment may not have a negative impact on economic diversification and growth<sup>14</sup>.

The sharp decline in oil prices will have significant consequences for the economies of the Middle East and North Africa (MENA) countries. For MENA oil importing countries, such as Egypt, Tunisia, Jordan and Lebanon, will benefit from decrease oil prices as these countries will, on one hand, enjoy lower import and subsidy fuels bills, but on other hand they may suffer decrease in aids, investments, tourism revenues and expatriate remittances received from oil exporting countries in the region, particularly, Gulf Cooperation Council (GCC) countries as a result of oil prices decrease in these countries. As for the consequences of oil prices decrease on the oil exporting countries, they will lack the ability to meet domestic spending commitments and draw down reserves, public salaries reduction, cutting spending on fuel subsidy.

Growth in the Middle East and North Africa was stable in 2015, at 2.5 percent. Accelerating activity in most oil-importing countries more than offset a slowing in oil exporters. Growth is expected to jump to more than 5 percent in 2016 and 2017. In most oil-exporting countries (Algeria, Iran, and Libya ), growth slowed, as oil-production and investment fell with the steep decline in oil prices since mid-2014. The situation was worsened in Libya by ongoing conflict, in Iraq; however, despite protracted conflict, expansion in the oil sector was sufficient to reverse an economic contraction in 2014. In the contrary, in most oil-oil importing countries, growth strengthened in 2015, as lower oil prices provided support demand and allowed reductions in fuel subsidies. Activity in Egypt and Morocco rebounded significantly, reflecting rising domestic consumption (Egypt) and a strong rebound in the agriculture sector (Morocco) <sup>15</sup>.

In recent years, the MENA region has increasingly developed a long three divergent paths: the GCC , politically stable and underpinned by prudent policies and ample external financial assets( estimated by IIF at \$2.27 trillion at the end of 2104; the non-GCC oil exporters, losing production and export revenues due to sabotage in oil fields ( Iraq and Libya) or international sanctions ( Iran) , with only Algeria maintaining a steady growth trajectory; and finally the non-oil countries, impacted directly or indirectly by regional chaos- thus resulting in a varied performance ranging from a precipitous decline in Syria to anemic growth in Egypt, Lebanon and only modest jobless growth in Jordan and Tunisia and slightly improved performance in Morocco<sup>16</sup>.

Although the decline in oil price benefits oil importers, whoever, its the economic impact is relatively modest. Their growth would improve by 0.5 percent on average, while current and fiscal accounts would improve by 0.5 and 0.2 percent of GDP on average respectively. GCC countries are vital sources of official aid and bulk of inward investment into non-oil countries. Hence, a protracted downturn in the developed Gulf (though unlikely) will negatively impact exports, tourism, remittances and capital flows to less developed MENA sub-region<sup>17</sup>.

## **5. Symmetric and Asymmetric Impact of Oil Price on Economic Development:**

Oil price shocks affect macroeconomic performance in both oil-importing and oil-exporting countries. The recent research on oil-macroeconomic relationship in oil- importing countries shows that oil price shocks have asymmetric effects on their economic growth; the adverse effects of higher oil prices are larger than the stimulating effects of lower prices. The effects of oil price shocks on economic performance and their mechanism in oil- exporting countries are different than those in oil-importing countries<sup>18</sup>.

The economy of the most oil-exporting countries is heavily dependent on oil revenues and, therefore, any change in oil prices has a dramatic effect on their economic performance. While oil revenues have the potential to contribute to economic growth by providing the financial resources for investment in oil-exporting developing countries, they may also undermine economic growth as they may exacerbate economic conditions conducive to economic growth through appreciation of exchange rate, rent seeking, and poor policy making. The empirical literature also points to two opposite directions that oil price shocks might take: oil being a blessing or curse. However, most studies do not discern the positive and negative shocks of oil prices and, therefore, have implicitly assumed symmetric effects of change in oil prices on macroeconomic activities<sup>19</sup>.

In conclusion, it has been established in the literature that the oil price shocks has asymmetric effect on both oil-importing and oil exporting countries, although such effects on oil exporting countries are different from those on oil importing countries. In oil-exporting countries, the government's size and its excessive role make it a main economic power that controls the oil revenues, total investments and other economic activities. Furthermore, the fiscal policy in these countries is often procyclical rather than countercyclical<sup>20</sup>.

To get the long story short, in the literature it has been established that the relationship between oil prices shocks and economic output is asymmetric (Mory,1993;Mork,1994 and Hamilton, 2000; Mendoza and Vera, 2010). Furthermore, it can be implied that this relationship may be symmetric through an indirect transmission channels (Herrera; Lagalo and Wada, 2011).

## **6. Economic Development Reaction to Oil Prices Under Different Market Conditions:**

The expected impact of oil prices decrease on economic growth and development in MENA region will depend on the length and expectations oil prices trends. As stated above, the oil exporting countries may suffer negative consequences; therefore, these countries can mitigate these consequences through counter cyclical expenditure policies. For the oil importing countries, the lower oil prices may create favorable conditions for continuing subsidy reforms that may support medium term growth and job creation. However, oil importing countries should not overestimate the positive impact of decline in oil prices on their economic growth and development. In testing the effect of oil price shocks on MENA countries, some studies concluded that, oil price shocks has a positive and statistically significant effect on Algeria, Iran, Iraq, Jordan, Kuwait, Oman, Qatar, Syria, Tunisia and United Arab Emirates, on the opposite, has no statistically significant effect on Bahrain, Djibouti, Egypt, Lebanon, Morocco and Yemen.

## **7. The Current and Future State of Oil Shale Industry:**

During the second half of 2014 U.S. oil production outlook for 2014-15 was upward, in part, due to the post-2009 rise in oil prices and exceptionally favorable conditions that made extracting oil from tight rock formations and tar sands profitable, using hydraulic fracturing and horizontal drilling. Shale oil as an "unconventional" source tends to have a relatively capital cost if compared to the conventional sources and accordingly tends to be more elastic to price changes than from conventional sources<sup>21</sup>.

Shale development has added yet another layer of complexity to the global oil markets. Despite the low oil price situation, the U.S. shale boom will not likely to end anytime soon as industry is adopting to find a new equilibrium. Companies are seeking for more financial leverage, as their hedging position end, reconsidering their asset portfolio, with some looking for extensive consolidation, mergers and acquisitions. Oil shale will continue to be an important resource. While currently limited in its capacity to influence the market as a result of overreliance on junk bonds

to fund operations, the coming shale cycle will surely depend on what can be done in partnership to raise productivity and reshape operations<sup>22</sup>.

### **8. The Impact of Oil Shale Production on Oil Prices:**

Shale oil (light tight oil) is a new unconventional resources rapidly emerging as a significant and relatively low cost in USA. There is potential for shale oil production to spread globally over the next couple of decades, the matter that would revolutionize global energy markets, providing long term energy security at a lower cost for many countries. It was estimated that the global shale oil production has the potential to reach up to 14 million barrels of oil per day by 2035 which represents 12% of worlds total oil supply. Most importantly, by 2035 and as a result of shale oil production, oil prices will reduce around 25%-40% and global Gross Domestic Product (GDP) will increase by around 2.3%-3.7%<sup>23</sup>.

### **9. Relationship Between Rig Count and Oil Production and Prices:**

As a matter of fact rig count is considered a good indicator of future production and prices of oil. However, the literature does not show a linear relationship between the rig count and output of oil for two reasons, **first**, all rigs are not equal simply because technological advances over the last few years which mean that modern rigs can drill more wells than older ones during the same amount of time, **second**, the productivity of shale oil can vary dramatically.

### **10. The Impact of Oil Prices Drops on MENA's Financial Markets and Exchange Rates:**

Several oil exporting countries are exposed to global financial markets. A reassessment of growth prospects of oil-exporting countries has already contributed to capital outflows, reserve losses, and sharp depreciations. Economic growth slowdown in oil-exporting countries could strain balance sheets of corporate and raising nonperforming bank loans albeit the banking system in the exporting countries are resilient to oil price changes , however, financial strains may eventually intensify<sup>24</sup>.

Decline in oil prices have financial implications either directly through the effects of oil prices themselves or indirectly through the induced adjustment of exchange rate. Lower oil prices weaken financial position of firms in the energy sector, especially those borrowed in dollars, and by implication weaken the position

of banks and other institutions with substantial claims on the energy sector. The proportion of energy firms with an interest coverage ratio( the ratio of cash flows to interest payments) below 2 percent stands at 31 percent in emerging countries, indicating that some of these companies may indeed be at risk<sup>25</sup>.

As for the effect of oil prices on exchange rate in MENA countries, in Egypt , Jordan and Lebanon, real effective exchange rate( REERs) appreciated during 2015, weighing on export competitiveness. In Egypt, the appreciating REER reflects high inflation, which averaged 10.3 percent in the first ten months of 2015. The Central Bank of Egypt (CBE) carried out several nominal devaluations and restricted access to foreign currency, in an attempt to resolve a deepening foreign currency shortage. In Jordan and, in particular , Lebanon whose currencies are pegged to the U.S dollar, real appreciation mostly reflected in the rise of the U.S dollar against the Euro, as inflation was negative through most of 2015. Among oil exporters, the currencies of Algeria, Iran, and Libya have depreciated, partially offsetting the local currency revenue loss from lower U.S. dollar prices of oil exports<sup>26</sup>.

## 11. The Impact of Oil Price Plunge on MENA's Terms of Trade:

The following table reflects the impact of drop in oil prices on trade in oil in some MENA countries.

Table (1)

	Change in oil trade balance (US\$ m/n)	Change in oil trade balance (%GDP)	Change in fiscal balance (US\$ m/n)	Change in fiscal balance (%GDP)
Bahrain	-29	-0.1	-2602	-7.7
Kuwait	-30051	-16.2	-40050	-21.9
Oman	-12235	-14.9	-12868	-15.2
Qatar	-8741	-4.1	-19193	-8.9
Saudi Arabia	-63082	-8.2	-103114	-15.1
United Arab Emirates	-39440	-9.6	-41.655	-10
Iran	-17739	-4.4	-8648	-1.9
Iraq	-34984	-14.1	-34504	-14.9
Libya	-8599	-14.7	-15427	-26.9
Yemen	-2628	-6.1	-1970	-4.7
Egypt	1504	0.5	....	....
Tunisia	292	0.6	935	2
Jordan	997	2.2	...	...

Source: World Bank staff estimates. The assumption of \$65 Brent crude oil and no policy change are used for projections. Oil trade balance is net oil exports.

## **12. The Effect of Oil Price Decline on Commodity Markets:**

The five-year decline in most commodity prices continued in the third quarter of 2015 due to ample supply and weak demand the decline was led by energy prices which dropped by 17 percent (WB Quarterly Report, Commodity Market Outlook, Oct.2015,p.74).

The given fact is that energy accounts for up to 50 percent of the production cost of many commodities; therefore, the drop in oil prices will definitely reduce the cost of production of many other commodities. In terms of agricultural commodities, corn for example, is the most directly affected by lower oil prices, where the lower energy costs reduce the cost of production, increase the margins and encouraging more planting<sup>27</sup>.

Furthermore, the decline in oil prices have already affected the prices some commodities, for instance, the prices of fertilizers declined by around 8.5 percent; prices of precious metals declined by around percent; food prices declined by around 4.8 percent; metal prices declined by around 2 percent and raw materials prices declined by around 1 percent.

## **13. Monetary and Fiscal Policies to Mitigate the Impact of Dramatic Drop in Oil Prices in Oil Exporting Countries:**

From the monetary perspective, the sharp decline in oil prices significantly reduced global inflation in the course of 2015, increasing the number of countries with low or even negative inflation. In this regard, central banks might react with more accommodative policies that react to all factors and shocks that could lead to a deviation of the forecasted inflation from the medium term policy objectives. The monetary policy adopted by central banks will vastly depend on the source of the oil shock (supply or demand driven) and its impact on aggregate demand and labor market conditions<sup>28</sup>.



The fall of oil prices since has been spectacular, and has had a dramatic effect on the headline inflation rate, pushing consuming price inflation close to zero. There no mechanical formula that can tell how to adjust interest rates to deal with sharply falling oil prices. The appropriate monetary policy response depends on both the nature and the persistence of oil shock, in particular how households and businesses respond to it<sup>29</sup>.

On the fiscal perspective, it is well known that a number of developing countries provide large fuel subsidies to their populations which, in some cases, exceeds 5 percent of GDP. Fuel subsidies tend to have distributional effects and tilt consumption and production toward energy-intensive activities. The falling of oil price reduces the need for fuel subsidy and introduces an opportunity for subsidy reform with limited impact on the prices paid by consumers. Such subsidy reform could lead to a comprehensive and permanent shift towards more market-based fuel prices and accordingly distortions and inefficiencies associated with subsidy to be removed. Fiscal resources released by lower fuel subsidies could either be saved to rebuild fiscal space lost after the global financial crisis or reallocated towards better-targeted programs to assist poor households; support critical infrastructure and human capital investment<sup>30</sup>.

Table (2): Recently Announced Fiscal Measures in MENA Oil Exporting Countries:

Country	Fiscal Measures Adopted
<b>GCC Countries</b>	
Bahrain	Authorities announced gradual increases in gas prices(from April 2015)and employee medical insurance and visa fees ( from early 2015). Savings amount to about 1/2 percent of GDP.
Kuwait	Fuel subsidy reform: diesel and kerosene prices were increased (saving 1/2 percent of GDP), while non-essential current spending has been curtailed
Oman	The 2015 budget includes reduction in defense spending. Capital spending is protected.
Qatar	Qatar continues its policy of restraining current expenditures, while maintaining a medium term cap on public investment.
Saudi Arabia	Large fiscal spending packages were announced in January and April 2105.
United Arab Emirates	Tariff for water and electricity were raised in January 2015, saving 1/2 percent of GDP. Other planned measures for 2015 include a reduction in capital transfer to Abu Dhabi government related entities.
<b>Non-GCC MENA</b>	
Algeria	In 2015,a public sector hiring freeze was instituted. A supplementary 2015 budget law was adopted in July that cut capital spending by 2.75 percent.
Iran	The 2015/2016 budget aims to limit the drop in Oil revenue through number of measures include:(1) increase the value added tax rate, reducing tax exemptions, and improving tax collection efforts (2) Increasing oil exports that goes to the budget.(3) Depreciating the official exchange rate by 10 %.
Iraq	The 2015 budget includes increases in non-oil taxes and aims to contain spending through reprioritizing capital expenditures and stricter cash management of current spending.
Libya	Political and security turmoil haseverely restricted the scope of policy action. The central bank has been withholding payments across the board to safeguard reserves.
Yemen	The reform agenda is on hold because of the security situation.

Source: Regional Economic Outlook: Middle East and Central Asia, chapter 4, Fiscal Adjustment to Lower Oil Prices in MENA and CCA Oil Exporters, p.70.

Table (3): Subsidy Reform Progress in Selected MENA countries:

Type of reform	Egypt	Jordan	Morocco	Tunisia
Budgetary Subsidy Reform	The five-year plan to eliminate subsidies is on track. There have been slippages on fuel subsidy reform.	Completed conditional cash transfer in case of oil prices exceeding US\$100 per barrel will be maintained.	Liquid natural gas subsidies have been eliminated.	Reform to eliminate energy subsidies has started but progress has been slow.

Source: Regional Economic Outlook: Middle East and Central Asia, chapter 4, Fiscal Adjustment to Lower Oil Prices in MENA and CCA Oil Exporters, p.79.

Conclusion on fiscal policy: the degree of fiscal space will determine the pace of desirable policy adjustment. However, over time all oil exporting countries will need to adjust to the new low oil price environment. Countries that do not have fiscal buffers have no option but to adjust in the short term, regardless of their cyclical positions. On the contrary, countries that have fiscal buffers can use them to smooth their policy adjustment to support growth, although they still need to pursue fiscal consolidation over the medium term simply due to the fact that oil prices are expected to remain low. There is no room for complacency even if the fiscal buffers appear strong. In cases where the public debt rises rapidly to high levels, credit to the private sector may get crowded out and may be accompanied by adverse effects on non-oil growth. Specific programs should be set out now to adjust fiscal policies and rebuild buffers over the medium term<sup>31</sup>.

If we take for example two countries, one is a big producer, Saudi Arabia, and a big importer, Egypt, we will be able to see the impact of drop in oil price in more focus.

For the Kingdom of Saudi Arabia announced this week historic spending reductions in its 2016 budget aimed at controlling a deficit that came in at 376 billion riyals (\$98 billion) this year , i.e. around 15 percent of GDP. The Saudi government said it would cut subsidies on fuel, electricity, and water and would impose a new value added tax and tax on tobacco as well as gradually privatizing some state-owned entities, the financial news agency Bloomberg said. The moves came amidst pressures on dwindling state revenues on the back of oil prices that have hit record lows. According to Al Arabia news oil revenues accounted for 73 percent of total Saudi government revenues, which are down 23 percent compared to last year, to cover the deficit, the Saudi government has been drawn on its foreign reserves, and these dropped by more than \$ 95 billion in the first 11 months of this year to \$627.7 billion, Bloomberg noted. Following the budget announcements, the government sharply increased domestic fuel prices , according Saudi News Agency. Economists have long argued that subsidizing fuel leads to distorted usage and other ills. Jeffery Nugent, an economist at the University of Southern California in the US, said that such countries had achieved little progress in raising non-oil revenues and had failed to convert oil resources into physical and human capital at a recent conference organized by the Economic Research Forum in Kuwait. The IMF meanwhile is forecasting growth of 3.4 percent for the kingdom in 2015 and 2.2 percent in 2016<sup>32</sup>.

The low oil prices that have triggered the dilemma Saudi Arabia is facing are the product of oversupply in the market. As the IMF put it in its October Regional Economic Outlook for the Middle East and Central Asia" the shale revolution, the decision by the Organization of Petroleum Exporting Countries (OPEC) to protect its market share, and the anticipated lifting of sanctions on Iran are all putting downward pressure on prices". "Persistently weak global growth has also contributed to lower oil prices from the demand side , most recently amid concerns over slowing growth in China and emerging market vulnerabilities more generally"<sup>33</sup>.

As for Egypt, the decline in oil prices has a tangible impact on the subsidization in fuel in Egypt as the subsidy bill in the sector has decreased by L.E13.9 billion through the first quarter of the fiscal year 2015-2016, furthermore, it is expected to decrease more through the second and third quarter respectively, and consequently secure 7 L.E billion for public budget in Egypt, where the total amount of fuel subsidy is 63 L.E billion<sup>34</sup>.

#### **14. Conclusion.**

The sharp decline in oil prices since June 2014 is significant but not unprecedented. A combination of supply related factors and a shift in OPEC policy played a crucial role in such decline. Sharp decline in oil prices has a mixed effect on both importing and exporting countries, for oil-importing countries they can attain a significant real income increase, as for the oil exporting countries, they may suffer financial problems accompanied by adverse contagion effects on other emerging and frontier markets. However, oil price decline may invite the oil-exporting countries to reform fuel subsidy and allocate more resources for households; infrastructure and human capital.

To get the long story short: Arab countries should deal with the new fact in the oil market on effective and flexible ground. Arab countries should look for new sources for public revenues through (1) developing the taxation system provided that tax collection be from the wealthy not from the poor, for fairness purposes;(2) amending budgets to austerity budgets with the purpose of rationalizing the public expenditure, to the extent possible;(3) diversify economic sectors and developing convertible industries and services through financing them of the accumulated surpluses through 2003 until mid-2014, where the oil prices were uprising,. All Arab countries are invited to work hard and depend extensively on science as a source of wealth and income. The Arab countries should not restrict their revenues on depleted resources, even if their usage is necessary. This region will not achieve progress unless they go through the way the developed countries went through in the past.

The oil price drop is expected to have a large permanent component. For oil exporters will need fiscal adjustments according to the size of buffers (fiscal vulnerability). In this regard, exchange rate flexibility could facilitate adjustment particularly in exporting countries with external vulnerabilities and/or fiscal rigidities. Furthermore, the monetary policy response is to be tailored to the domestic position, inflation expectation, and external pressures. Most importantly, lower oil prices also underscore the need for real reforms in financial sector in order to foster diversification oil exporting countries' economies. As for oil importing countries, these countries, should, on one hand, decide how much of the windfall to

save, on the other hand, they should balance rebuilding policy space with managing domestic cyclical risks. Oil importing countries with significant vulnerabilities should save much of their windfall, while countries suffering large output gaps may spend the windfall. Oil importing countries should use the period of declining oil prices as an opportunity to strengthen their monetary policy frameworks.

Finally, the oil prices drop will provide a window of opportunity for both oil-importing and oil-exporting countries to undertake serious fuel pricing and taxation reform. As a result of such reforms, the stronger fiscal balance would create space for either increasing spending priority or/ and cutting distortionary taxes, thereby imparting a sustained economic growth.

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