# What Lower Oil Prices Mean for MENAP Oil Exporters

By [Bruno Versailles]

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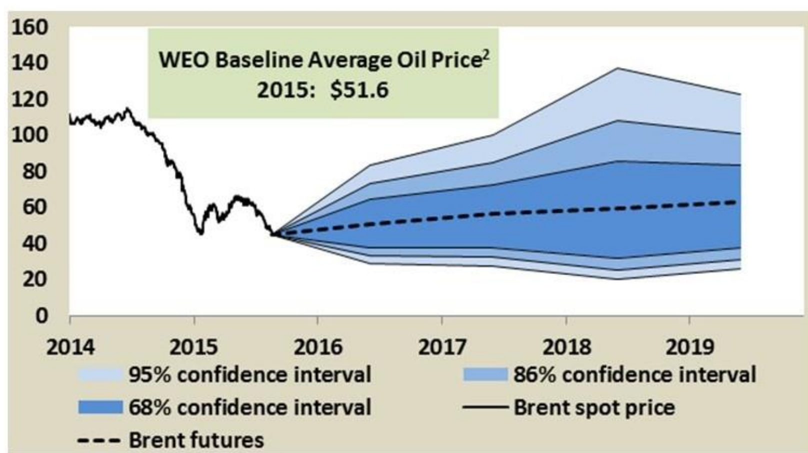
*Low oil prices have so far had only limited impact on the growth of MENAP oil exporters, but the external and fiscal losses have been substantial. Countries that built up fiscal buffers in the past are now wisely using them to support ecoWnomic activity, but will soon need to formulate comprehensive plans to put their public finances on a stronger footing over the medium term. Policymakers should also strengthen diversification efforts to boost the non-oil economy.*

### *The Drop in Oil Prices*

Let's start with what exactly has happened in oil markets over the past 15 months (Chart 1). Oil prices fell dramatically in the second half of 2014—a barrel of oil was worth $110 in July 2014, but stood at less than $50 by mid-October 2015. What's more, prices are expected to stay this way, with 2020 futures predicting them to be barely higher than $60. The supply and demand dynamics underlying these oil price developments are well documented in an IMFdirect blog and a Staff Discussion Note. In this blog, however, we focus on the impact of lower oil prices for MENAP oil exporters.

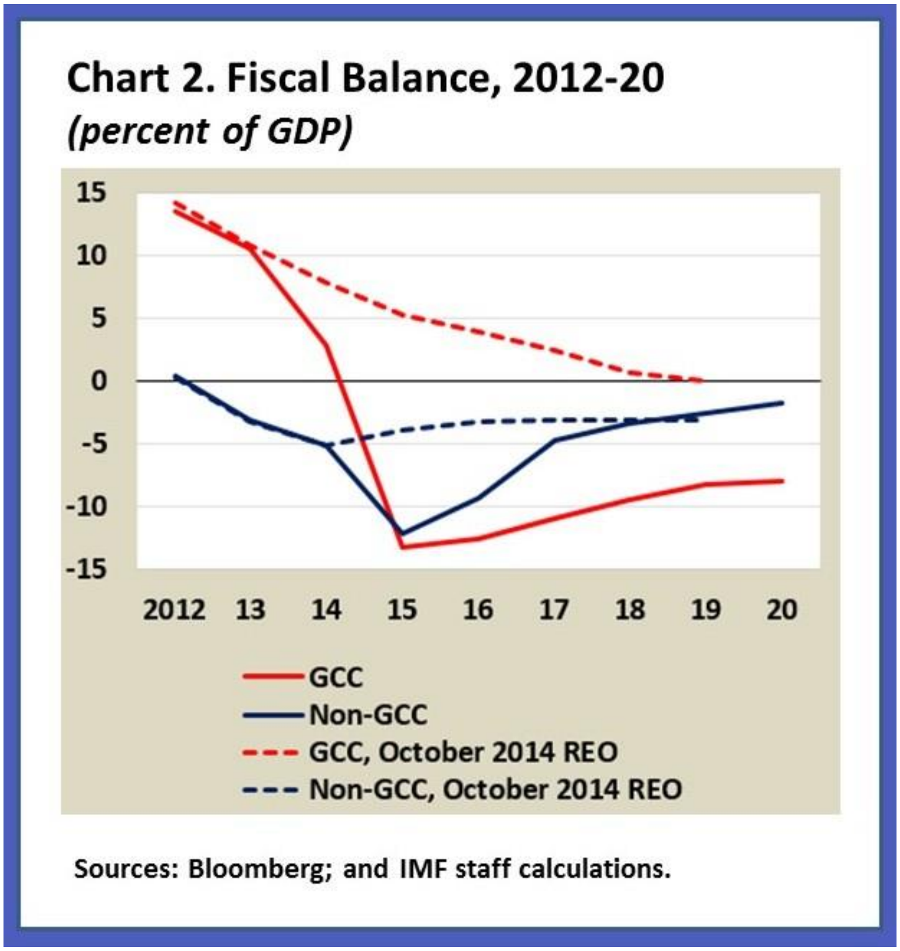
**Chart 1. Brent Crude Oil Price[1]**
***(U.S. Dollars per barrel)***




Sources: Bloomberg; and IMF staff calculations.
1 As of August 20, 2015.
2 Average of WTI, Brent, and the Dubai Fateh prices

***What are the Challenges for Oil Exporters?***

Lower oil prices imply a staggering $360 billion loss in oil export revenues in 2015. Fiscal projections by IMF staff show that both GCC and non-GCC country groupings (as referenced on pg. xi from the October 2015 Regional Outlook: Middle East and Central Asia Department) will post fiscal deficits in every year between 2015 and 2020 (Chart 2). Even assuming some deficit-reduction measures, cumulative financing needs between 2015 and 2020 for the 11 countries involved would reach more than $1 trillion.




As a first line of defense, countries used fiscal buffers to limit the impact of declining oil prices on growth, as oil revenue drives public spending, which in turn is a key driver of non-oil growth. However, this is not a sustainable strategy as most exporting countries—with the notable exceptions of Kuwait, Qatar, and the United Arab Emirates—would, according to IMF staff projections, run out of buffers within a decade. Compounding the problem, fiscal buffers will also need to be rebuilt over the medium term, to deal with any future shocks (see recent Fiscal Monitor Report).

### *What Are Oil Exporters Doing?*

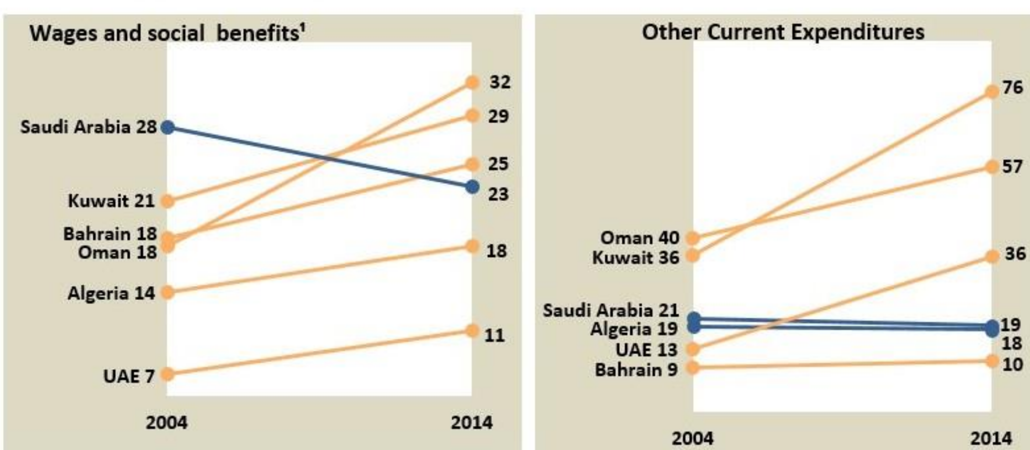
While most countries are making some progress in devising their medium-term adjustment plans, these efforts are not yet sufficient to put public finances on a sound footing.

Deficits will be partly reduced by a phase-out of one-off expenditures from previous years, as well as the lower fiscal costs of keeping domestic energy prices below international levels. This year, active consolidation measures, such as tax increases and spending cuts (for example, lower investment, hiring freezes, or energy price reform), exceed 1 percentage point of non-oil GDP only in Algeria, Kuwait, Iraq, Qatar, and the United Arab Emirates. Saudi Arabia has engaged in net fiscal stimulus in 2015 due to large fiscal spending packages. Encouragingly, several countries, such as Iran, Kuwait, and the United Arab Emirates, have introduced energy pricing reforms, which will also entail fiscal savings in the medium term. Additional savings measures are being considered by most countries. Overall, however, MENAP oil exporters have not yet clearly articulated their medium-term plans.

### *What Should Oil Exporters Do?*

Medium-term adjustment plans—including clear policy objectives and contingency scenarios—should be spelled out as soon as possible. Plans that are growth-friendly, equitable, and phased in over time are the best bet to reduce any adverse economic and social effects. The key elements are:

**Chart 3. Selected Spending Categories**
***(2004-14, percent of non-oil GDP)***




**Sources: IMF, World Economic Outlook database; and IMF staff calculations.**
**[1]In Kuwait excluding social benefits.**

- Increasing non-oil revenue fairly. This could include broader bases, greater income-tax progressivity, wider use of VAT, and higher property taxes (see Staff Discussion Note).
- Emphasizing cuts to current expenditures. There is space to do this given the run-up in wage, administrative, and security-related expenditures over the past decade (Chart 3). Essential social spending should be protected.
- Pursuing further energy price reforms.
- Streamlining public investment, while increasing its efficiency (as discussed in this Staff Discussion Note).

The burden of fiscal adjustment can be eased through other policies. For example, Iran and Algeria allowed their exchange rates to depreciate, which eased the need for fiscal adjustment, by facilitating higher local currency receipts from oil sales. This mechanism is, however, not relevant for the GCC countries—they are undiversified, and so the net impact of exchange rate changes on growth and external balances would likely be muted. The GCC countries should maintain their fixed exchange rates, but aid both fiscal and external adjustment by formulating adequate medium-term fiscal consolidation plans early on.

### *Implications for Jobs and Growth*

As policymakers grapple with their large budget deficits, savings measures will slow growth and job creation in the public sector. Meanwhile, some 10 million people are expected to enter the labor force in MENAP oil exporters by the end of this decade, underscoring the need for a more diversified private sector. Recommendations to this end include further improving the business environment, increasing incentives for nationals to work in the private sector, and making workers' skills more relevant to the private sector by improving the quality of education.

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