External finance in the Middle East : trends and prospects

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This report examines recent financial flows to and from the Middle East with two objectives in mind: first, to assess the levels and types of recent flows in order to understand their past contributions to investment and growth, and thereby to gain a better sense of what might be feasible in the future; and second, to explore the need for a new approach to external finance and identify the related actions that should be pursued by domestic policymakers and the international community. Throughout, the main focus is the process of change-change in the character of the financial flows, change in the nature of the development process, and by implication, the need for change in the strategy pursued by the region and in the support provided by the international community.

Keywords: External finance; Oil sector; External debt; Debt relief; Debt reduction; Financial flows; Capital inflows; Capital output ratio; Capital flight; Public finance; Debt overhang

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External Finance In The Middle East:
Trends And Prospects
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EXTERNAL FINANCE IN THE MIDDLE EAST:
TRENDS AND PROSPECTS

Abstract

This paper examines recent financial flows to and from the Middle East with two objectives in mind: first, to assess the levels and types of recent flows in order to understand their past contribution to investment and growth, and thereby to gain a better sense of what might be feasible in the future; and second, to explore the need for a new approach to external finance and identify the related actions that should be pursued by domestic policy makers and the international community. Throughout, the main focus is the process of change -- change in the character of the financial flows, change in the nature of the development process, and by implication, the need for change in the strategy pursued by the region and in the support provided by the international community.

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FINANCEMENT EXTERNE AU MOYEN-ORIENT:
TENDANCES ET PERSPECTIVES

Riswmi

Cette tude analyse les r6cents flux financiers a destination et en provenance du Moyen-Orient k deux fins. Il s'agit, premierement, d'6valuer le niveau et le type de ces flux rdcents pour determiner leur contribution pass6e I l'investissement et a la croissance et, par la, se faire une meilleure idWe des perspectives d'avenir; et, deuxiemement, de voir s'il y aurait lieu d'adopter une nouvelle approche du financement externe, et d'identifier les mesures que devraient prendre a cet effet les responsables de la r6gion et la communaut6 intemationale. Tout au long de l'6tude, l'accent est mis sur le processus de changement - changement de caractare des flux financiers, changement de nature du processus de d6veloppement, et, de ce fait, necessite d'une 6volution de la strategie suivie par la region et de l'appui apport6 par la communaut6 internationale.

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EXTERNAL FINANCE IN THE MIDDLE EAST: TRENDS AND PROSPECTS

This paper examines recent financial flows to and from the Middle East with two objectives in mind: first, to assess the levels and types of recent flows in order to understand their past contribution to investment and growth, and thereby to gain a better sense of what might be feasible in the future; and second, to explore the need for a new approach to external finance and identify the related actions that should be pursued by domestic policy makers and the international community. Throughout, the main focus is the process of change -- change in the character of the financial flows, change in the nature of the development process, and by implication, the need for change in the strategy pursued by the region and in the support provided by the international community.

The focus is on a group of countries in the Middle East that have similar characteristics with respect to international finance -- they are net debtors to the rest of the world, receive large amounts of official assistance, and rely on large unrequited transfers to equilibrate their balance of payments. These countries are: Algeria, Morocco, and Tunisia in the Maghreb region; Egypt, Jordan, Lebanon, the West Bank and Gaza, Syria, and Yemen in the Mashrek region; and Israel.

During the period 1970-90, net inflows of capital averaged 16 percent of GNP in the Mashreq, 14 percent in Israel, and 3.5 percent in the Maghreb.1 These are very high flows by international standards. Indeed, for several countries, capital flows were a more important source of foreign exchange in the late 1970s than exports of goods and services. As such these inflows had a proportionately large effect on the evolution of these economies, especially the expansion of the public sector, and have marked deeply their current state of operation.

But today, the regional oil boom of the 1970s is a distant memory. At the onset of the Gulf crisis, capital inflows -- while still large by international standards in some countries-- had shrunk to 8 percent of GNP in the Mashreq, 6 percent in Israel, and 0.5 percent in the Maghreb.

The increasing scarcity of capital inflows wrought havoc in economies accustomed to two decades of cheap foreign exchange. It also prompted various countries to engage in different types of socio-economic adjustments whose implications are still largely undecided. Yet, several points of consensus have emerged: first, on the need for fiscal stabilization to prevent run-away inflation; second, on the wisdom of greater reliance on market-based allocation mechanisms to increase the efficiency of resource use; and third, on the necessity of gradual and controlled change to prevent social dislocation.

I1 Capital inflows are defined here as the balance of goods and non-factor services. From the financing side, a range of positive and negative financial flows - foreign direct investment, remittances, grants, loans, unilateral transfers, debt servicing, reserve accumulation - combine to fill the gap.

Although performance has been uneven, policy change has begun to create profitable opportunities for new private investment. This is generating an increased demand for investable funds from abroad, a demand based on business opportunities. These rising sources - foreign direct investment, remittances, commercial loans, and foreign savings of domestic residents - are likely to dominate as public sectors continue to retrench. For example, in 1992, direct foreign investment in Morocco and Tunisia exceeded bilateral loans and grants for the first time. In Egypt, Jordan, and Lebanon, private inflows, mostly past capital flight, were the largest source of external finance. And Algeria is attempting to ease its difficult external finance situation by experimenting with new types of oil-based forward contracts with private firms.

Yet, much remains to be done to develop private finance further. In particular, private inflows have often remained in short term financial instruments, and have not yet led to an increase in long-term investment. And private entities in the region are still unable to access the international bond market.

An exclusive focus on flows, however, would miss vital information for the purposes of this paper -- the outstanding stock of debt on the one hand and the accumulation of capital abroad on the other. For the region as a whole, these stocks are estimated respectively at 71 and 90 percent of regional GNP in 1991. These are large ratios by international standards. For example, the comparable debt to GNP and capital abroad to GNP ratios stood at half these levels

in Latin America (at 38 and 36 percent respectively; Global Economic Prospects, World Bank, 1993). There are however variations within the region. With respect to debt, differences reflect past borrowing strategies, current strategies for managing debt, and the past provision of debt relief by creditors and donor groups. Jordan, Syria, and Yemen are the most indebted countries in the region, followed closely by Morocco. With respect to savings abroad, differences reflect the evaluation of the risk/return tradeoff by local agents. The potential for a strategy based on attracting back such capital, however, varies among countries - in Egypt, Jordan, Lebanon, Syria, and the West Bank and Gaza, for example, the ratio of capital abroad to GNP exceeds 150 percent but in Tunisia, Morocco, and Yemen, these ratios are quite small.

The possibility of fueling a private sector-led strategy of economic development by attracting capital back to the region offers at the same time both an exciting prospect and a difficult challenge. This challenge is complicated by the debt overhang. Besides the burden that the debt imposes on current resources, the weight of public debt is scaring away private investors -- both domestic and foreign -- and delaying the return of past capital outflows. In assessing future prospects, therefore, it is important to consider the need, if any, for exceptional measures of debt relief as countries move to more market-oriented paths of development.

Indeed, as in Latin America, debt relief has become a crucial component of ongoing reform

2

programs. However, because the core of the debts in the Middle East and North Africa are bilateral, the Brady Initiative does not hold much promise. The model instead lies with the conditional debt reduction granted by the Paris Club to Egypt (and Poland) in 1990-91, which set a new precedent for linking reduction with the reform process. An alternative model can achieve the same aim in some circumstances without debt reduction per se. Here the basic formula is an increase in grants sufficient to offset the outflows related to debt payments. Later, we contrast these two approaches and analyze the conditions under which one dominates the other.

With these points in mind, the remainder of the paper comprises two sections. The first reviews past patterns of external finance to the region, summarizes the legacy from the past in terms of debt and private capital abroad, and assesses the prospects for future flows. It emphasizes the theme of diversity and explores inter-country differences in the level of financial flows during the 1970s and 1980s and their effect on economic performance. The focus is principally on the type of financial flows and their impact on the quantity and quality of investment and ultimately on economic growth. The section makes five points:

* historically, capital inflows have accrued primarily to the public sector;
* foreign savings fluctuated significantly, peaking in the late 1970s and collapsing after the mid-1980s;
* economic performance mirrored the movements in foreign savings;
* the legacy of this approach can be found in large stocks of public debt and the accumulation of private capital abroad;
* and, future flows to the region's public sectors are unlikely to again reach the levels of the late 1970s.

These observations provide the foundation for the development of a new approach to external financing, a task undertaken in the second section of the paper.

The second section presents the central conclusion of the paper, that:

* in the future, the regional strategy for external financing ought to reflect a shift in balance in favor of more funding for the private sector.

This reflects the view that, on the one hand, changed extemal circumstances will necessitate a revised approach to external finance, and on the other, that past exodus of private capital offers the prospect of a new and better strategy based on appropriate domestic policies and on

3

financing and investment subject to the test of the market. But successful realization of this strategy, in the form of adequate and sustained flows of private capital, will require adopdon of appropriate domestic policies and a resolution to the debt problems confronting several countries.

Thus the two legacies of the past present both an opportunity and a constraint.
The section then turns to a two-step assessment of the feasibility of such a strategy. The first step examines the following question: assuming that countries adopt appropriate domestic policies, what is the likelihood that they will be able to attract adequate funding for a market-based, private sector-ied approach to external financing? This way of posing the question focusses attention on the debilitating influence of the debt overhang and allows a preliminary grouping of countries into those that will be able to wgrow out" of their current difficulties, those that will probably need some form of assistance Oimited access to grants or very concessional assistance), and those that will require exceptional debt relief. But not all countries are pursuing appropriate domestic policies. Accordingly, the second step of the analysis explores post-1990 developments in the region for each of the three groups and assesses the extent to which countries are already pursuing this strategy, what flows have been forthcoming, and what more needs to be done. While this assessment can point to some successes -- domestic reforms in Morocco and Tunisia accompanied by increased flows of foreign direct investment, debt relief in Egypt associated with returning capital flight, financial inflows in Jordan and Lebanon -- the overall conclusion is that considerable progress on the domestic policy front supported by appropriate forns of intemnational assistance will be required before it can be said that a new approach to external financing has really taken hold in the region.
Box I: Data-sources
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1. FROM THE OIL BOOM TO THE GULF CRISIS:
EXTERNAL FINANCE, INVESTMENT, AND GROWTH
Tabk 1: Net Capital InflowS as a share of GNP urscent)

COUNTRY	MO7-74	197S-79	L980-84	185-89	1990	1	1992 d
Algeri	3.18	6.33	-3.61	-0.51	-3.40	-8.83	-4.48
Morocco	1.76	15.35	12.23	S.39	6.18	S.93	S.88
Tunisia	2.51	8.30	8.33	3.69	7.49	5.09	4.62
Magbreb	2.48	9.22	1.23	1.02	0.51	-1.73	0.56
Egypt	7.85	18.80	16.95	15.42	13.28	7.39	11.48
Jordan	28.40	45.74	44.70	26.55	34.04	24.81	30.48
Weg Bank and Gaza	30.60	33.03	37.27	34.45	30.69	41.42	
Syria	3.37	15.11	14.16	5.35	-16.17	-7.11	8.03
Yemen b	..	..	..	14.42	12.76	6.97	
^.Maubreq '	8.34	20.37	19.47	15.16	8.31	6.04	11.71
Israel	18.80	18.01	12.30	6.84	6.30	9.63	10.65
Region	8.25	14.48	9.28	6.44	4.06	3.99	6.89

a. Negative of the balan of goods ad Dnonfo smivces.
b. 198549 avep tefen to 19S9 only.
c. Dos not iclde Leban ani Yeme.
d. Dta for Egypt sn kr finl year IM n data for Syria rfer to baance of Soods only.
Once: DIP Paco of Paymnt., Wod ank Intemational Economcs Department

Table 1 summarizes the regional experience with capital inflows. With one exception - the West Bank and Gaza where inflows remained high throughout - the region experienced a pronounced pattern of boom and bust -- capital inflows were largest in the period 1975-79, and smallest during the period 1985-89 before rising again in the early 1990s during the Gulf war. However, the magnitude of the boom, and the timing and severity of the bust differed. With the exception of Tunisia and the West Bank and Gaza where boom and bust were relatively modest and gradual, the boom and/or bust were of major proportions in all other countries, amounting to about 10 percentage points of GNP. By the early 1990s flows to the region were negative in Algeria and Syria, moderate relative to GNP but positive in Morocco, Tunisia, and Yemen, large relative to GNP (and rising) in Egypt and Israel, and very large (relative to GNP) and positive in Jordan and the West Bank and Gaza.
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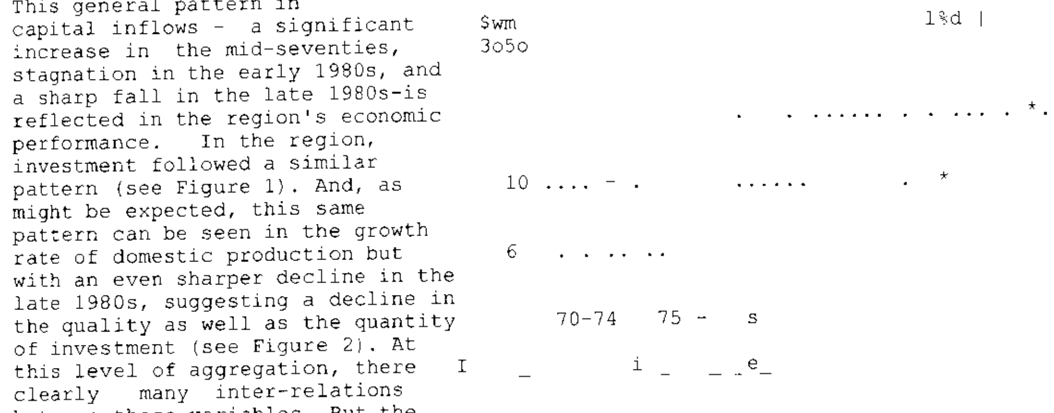
FM4ure 1: Net Inflow and Invesnents: 1970-89



Flgure 2: investment and Economic Growh. 1970-89

This general pattern in capital inflows - a significant increase in the mid-seventies, stagnation in the early 1980s, and a sharp fall in the late 1980s-is reflected in the region's economic performance. In the region, investment followed a similar pattern (see Figure 1). And, as might be expected, this same pattern can be seen in the growth rate of domestic production but with an even sharper decline in the late 1980s, suggesting a decline in the quality as well as the quantity of investment (see Figure 2). At this level of aggregation, there clearly many inter-relations between these variables. But the lisbetween these avariabliuty of links between the availability of capital and investment on the one hand and the level of investment and growth on the other hand, remain important causal elements for understanding performance during these two decades within each country. Equally important, but less predictable, are the relations between the policy framework and private sector external finance -- especially capital flight, and the relation between the quality of investment and the availability and type of

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subsections explore these links in more detail for the two subperiods - the boom of the 1970s and the bust of the 1980s.

The Boom of the 1970s

The boom of the 1970s had several distinctive features. The first has to do with the sheer magnitude of the increase in capital flows. In dollar terms, external finance for the region rose sharply in the first half of the 1970s, increasing from $2.2 billion in 1970 to $10.4 billion in 1975, and to $12.7 in 1979. The boom was equally impressive in relative terms. As Table 2 shows, the level of foreign inflows jumped by about 12 percentage points of GNP in the Mashreq between the beginning and end of the decade (from an average of 8.5 percent of GNP during 1970-74, to an average of 20.4 percent of GNP during 1975-79). In the Maghreb, the boom was less spectacular, but still impressive by international standards: capital inflows rose by 6.7 percent of GNP during this period (from an average of 2.5 percent of GNP during 1970-74, to an average of 9.2 percent of GNP during 1975-79). The boom was especially marked in Egypt, Jordan, Morocco, and Syria. In Israel the boom had started earlier and the 1970s actually saw a slight decline in net flows as a share of GDP, but the absolute amount increased.

The second feature is that most of the increase accrued to the public sector. A comparison between the first two columns of table 2 shows this clearly (see also Table 5). In the Mashreq and in Israel, the private sector contribution was negligible on a net basis (that is, remittances minus estimated capital flight) and nearly all the increase in foreign savings accrued to the public sector.2 In the Maghreb, the increase was also dominated by flows to the public sectors (+4.1 percent of GNP), but the private sector provided (on a net basis) about 40 percent of the added flows. The situation however varied across countries, with the contribution of the private sector being dominant in Morocco, Jordan, and Yemen.3

V The implications of this aspect of foreign inflows on the organization of the state has been extensively studied in the literature. See for example, Beblawi and Luciani (1989) for a regional analysis, and Handoussa (1989) for the case of Egypt.

2I For a comparative study of Saudi Arabia - where foreign revenues have mostly accnred to the public sector - and Yemen - whero worers remittances prodominated, swe Chaudhry, 1989.

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Table 2: From Capital Inflows to Economic Growth
CHANGES FROM 1970-74 710 1975-79 &

Country	Total Net Transfers to Public Sector (% of GNP)	Net Capital Inflows (% Of GNP)	Investment (% of GNP)	GDP Growth f%per amons)
Algeria	+2.8	+3.1	+9.2	+ 1.0
Morocoo	+5.7	+13.6	+ 10.0	+ 1.8
Tunisia	+3.3	+5.8	+7.8	-2.4
Maghreb	+4.1	+6.7	+ 10.7	+0.9
Egypt	+11.9	+10.9	+17.1	+5.8
Jordan	+8.7	+17.3	+15.0	+8.2
West Bank and Gaza	..	+2.4	+7.8	-1.8
Syria	+8.4	+11.7	+11.8	-6.8
Mashreq	+11.0	+11.8	+15.0	+2.1
Israel	-0.5	-0.8	-3.9	-3.8
Region	+6.7	+6.2	+9.9	+0.2

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b. Avenge (1975-79) mniia averae (1970-74)
Source: IMF Balance of Paynma, World Bank rnwmational Economics Depatment, Bank of Lml

The third feature of the boom is the large rise in investment. In most of the countries studied here, investment increased by more than 10 percent of GNP. In addition, the rise in investment was often larger than the rise in foreign savings, implying that domestic savings also rose (see table 2). This was specially true in Algeria and Egypt (two countries where the state played an important role in industrialization), and to a lesser extent in Tunisia, but not in Jordan, Morocco, and Syria. There are several reasons that can explain this phenomenon, two of which are particularly relevant for the region. The first possibility is that a rise in private sector investment opportunities in complementary projects raised the return to domestic savings. The second is that domestic transfers from the private to the public sector (in the form of various forms of taxation) increased. While more detailed analysis is needed to disentangle these two effects, the second explanation seems more plausible for Algeria, Egypt, and Tunisia given evidence of an acceleration of capital flight during the late 1970s in these countries (see below).

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The fourth distinctive feature of the boom is the relatively disappointing impact on regionwide growth although country circumstances varied significantly. With increases in total investment averaging about 10 percentage points of GNP in the Mahgreb and 15 percentage points in the Mashreq, one could have expected significant improvements in growth rates. On average this was not realized -- the region as a whole saw no change in the growth rate in the period 1975-79 compared with 1970-74. This outcome, however, reflects the offsetting forces of widely different experiences in individual countries. Egypt and Jordan for example saw

extraordinary increases in growth whereas Algera and Morocco experienced only modest increases. In Tunisia and Syria, growth rates fell despite the significant increase in investment as the efficiency of investment deteriorated. Israel also saw its growth rate fall but in this case investment had also declined. And the decline in the growth rate in Israel goes a long way to explain the decline in the West Bank and Gaza.

The Bust of the 1V80s

During the first part of the 1980s, the inflows of capital to the region slowed down, and so did economic growth. By the second half of the decade, the capital inflow led boom was clearly over. Comparing averages between the periods 1975-79 and 1985-89, capital inflows fell by 8.2 percentage points of GNP in the Maghreb, 5.2 percentage points in the Mashreq, and 11.2 percent in Israel. Hardest hit were Morocco, Israel, Jordan, and Syria where foreign savings fell by more than 10 percent of GNP (Table 3). The only exception to this trend was the West Bank and Gaza where new opportunities in Israel replaced jobs lost in the Gulf.

The net effect was a massive reduction in the flow of capital to the public sectors of the region - in both the Mahgreb and the Mashreq the net trnsfer to the public sector as a share of GNP fell by 8 to 9 percentage points. While flows accruing to the private sector were negligible in the aggregate, there were important differences between countries. Unlike the earlier period, increased capital inflows accrued to the private sector in Egypt and to a lesser extent Algeria, where remittances rose and capital flight decreased. On the other hand, countries that saw increased private sector flows earlier did not do as well, especially Jordan and Syria where remittances collapsed and capital flight rose.

As during the boom, the distribution of this shortfall between the private and public sectors differed across countries. In some countries, the amount of foreign savings accruing to the private sector increased (i.e., remittances rose and capital flight decelerated), in spite of the overall bust. This was particularly the case in Egypt, Algeria and Tunisia. But both the private

and public sectors lost in Morocco and Jordan. And in Syria and Israel, the loss experienced by the private sector was the principal reason behind the aggregate decline.

Table 3: Dedining Capial Inflows and Economic CoUapse

CHANGES FROM 1975-79 TO 1985-89'

Country	Total Net Transfers * to the Public Sector (% of GNP)	Net Capital Inflows (% of GNP)	Investiment (% of GNP)	GDP Growth (Xper annwn)
Algeria	-9.8	-6.8	-15.0	-6.3
Morocco	-7.1	-10.0	-3.7	-2.1
Tunisia	-7.3	4.6	-7.3	-3.1
Maghreb	-8.8	4.2	-9.7	-5.1
Egypt	-11.7	-3.4	-6.7	-8.0
Jordan	-14.7	-19.2	-7.0	-25.1
West Bank and Gaza	..	+1.4	+0.2	-0.6
Syria	+3.7	-9.8	-9.4	-3.1
Mdsureq	-7.6	-5.2	-6.8	-6.7
Israel	-0.9	-11.2	-8.7	+0.4
Region	-6.3	-8.0	-8.7	-4.3

a. Include officil gmnt

b. Averae (19S549) mi-us avemage (1975-79)

Source: IMF Balanc of Pymezits, World Bank Iernational Economics Deparment, Bank of Israei

In response to the increased scarcity of foreign exchange, countries adjusted mainly by cutting investrnent; by about 7 percent of GNP in the Mashreq, nearly 10 percent in the Maghreb, and about 9 percent in Israel. There are however important country variations within these groups. In the Maghreb, and over the same periods, the reduction in investment was much more marked in Algeria (15 percent of GNP) than in Morocco (4 percent) or Tunisia (7 percent). In the Mashreq, the variation was less. The fall in investment was larger than the shortfall in foreign savings in some countries (i.e, domestic savings fell), especially in Algeria and Egypt (the same countries where the initial boom in inflows was magnified by an increase in domestic savings), but smaller in others, and especially, in Morocco and Jordan (where the

initial boom was also dampened).
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Investment bore the brunt of the adjustment effort in most countries. In the public sector, the shortfall in financing skewed public expenditures and gave rise to distortionary forms of taxation. But the inability to raise revenue significantly or to adjust costly and non-targeted consumer subsidies and unusually high military expenditures led to steep reductions in public investment.' Private investment also declined (as a share of GNP) as investors saw the combination of risk and return move against investment in domestic production and in favor of investment abroad.' The decline in rates of investment led inexorably to deteriorating economic performance which assumed crisis proportions in some countries (see Table 3). Compared with the second half of the 1970s, GDP growth rates declined by about 5 percentage points in the Maghreb and 7 percentage points in the Mashreq, with Jordan, Egypt, and Algeria hit hardest (in this order). Indeed, during the late 1980s, GDP declined in Algeria, and Jordan. GDP per capita declined in Syria. And in Egypt and Tunisia GDP per capita grew at around one percent only. This decline in economic performance was unusually severe and indeed more so than might have been expected from the observed falls in investment.

The explanation of the severity of the collapse is related to a set of policies that have: inhibited the growth of private entrepreneurship in favor of a structure of production dominated by the public sector; shunned the use of markets and encouraged instead govemment control; and led to highly protected trade regimes. In several countries, the public wage bill initially soared as governments sought to increase their hiring in order to offset the rising unemployment in the rest of the economy. With public investment budgets slashed, labor productivity in the public sector collapsed.' Monetization of the fiscal deficit has also led to episodes of high inflation, (Egypt, Algeria, Yemen, but especially, Israel and Lebanon), and to the development of parallel markets when price controls were instituted in order to repress it (Egypt, Syria, Algeria, Yemen).7 Inventories, especially of imported goods, have remained high in order to hedge against inflation and against the risk of devaluation or sudden trade restrictions. On the external front, the tightening external financing constraints and the inability to raise exports in the short run led to increased import restrictions.

V/ For a fascinating account of the difficulties encountered in trying to cut expenditures and increased revenues in Egypt, see Sadowaki, 1991.

S/ But in general, there is some evidence indicating that the share of private investment in total investment increased, although much of it occurred in the grey economy where it could escape increased taxation (Umari, 1993).

6i/ For an analysis of the Egyptian case, see Handoussa, 1993.

2/ On the cases of Lebanon and Israel, see respectively, Makdissi (1987) and Bruno and Meridor (1989).

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The deterioration in the quality of investment can be gauged by comparing the incremental capital to output ratios (ICORs) over time (Table 4). These ratios typically deteriorated in the late seventies when capital inflows peaked. This is understandable, since the rise in investment activity must have hit decreasing returns. It is more worrisome when the productivity of capital falls at the same time as the availability of capital is reduced. This is however what happened during the mid-1980s in all countries. Towards the end of the 1980s, some countries - especially Israel, Morocco, the West Bank and Gaza, Tunisia, and Syria -- began to see improvements in the productivity of capital. In Syria, this is explained by the dramatic rise in oil production; in the other three countries, by a recovery related to ongoing economic reform programs. But there was further deterioration in Algeria and Egypt, two economies dominated by their public sectors. In Jordan, the negative ICORs reflect the effects of the large devaluation that occurred in 1988-89.

Table 4: Incremental Capital Output Ratio (puma,)

COUNTRY	1970-74	1975-79	1980-84	198549
Algeria	6.39	8.06	8.71	-569.34
Morocco	4.25	4.82	7.42	5.14

Tunisia	3.88	5.19	7.71	6.49
Maghreb	5.63	7.08	8.44	25.92
Egypt	2.83	2.55	3.66	7.01
Jordan	6.47	4.79	-7.81	-13.26
West Bank and Gaza	1.52	3.66	69.65	4.01
Sya	..	4.21	9.57	5.65
M ~ a req'2.72		3.09	6.25	7.56
isael	4.31	6.55	6.96	4.24
Region	3.65	5.54	7.59	11.22

a. Does not include Lbon d Yemen
SouM: Wodd Bank brmatioin Economics DeparimeM
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ComDosion of Pst Flows

This subsection moves behind the aggregate statistics on financial flows that have been presented so far to explore the composition of flows with four objectives in mind.$ First, to examine the shifts in the composition of inflows between the public and private sectors. Second, to analyze the changing sources of public sector finance. Third, to explore the relative magnitudes of the main private sector inflows (workers' remittances) and capital outflows. And fourth, to examine the different 'cost' implications of different compositions of public inflows and hence the extent to which different blends of financing have contributed to the legacy of debt.

During the boom of the seventies, much of the increase in financial inflows accrued to the public sector in the form of grAs and loans CTable 5). In part this reflects the major event of this period - the increase in the price of oil - and the consequent flow of Arab assistance. The extraordinary increase in oil revenues - the Arab oil producers exported $213 billion worth of oil in 1980 - trickled down to all the countries but especially those of the Mashreq in the form of increased aid budgets. In the Mashrek, remittances also increased (from an average of $0.3 billion during 1970-74 to an average of $3.1 billion during 1975-79; see table 5) as a result of the oil-price boom and these of course accrued to the private sector. However, they were offset especially in Egypt by an equal rise in capital flight, usually a private sector phenomenon (see Box 2 and table 5). As a result, the boom accrued mostly to the public sector when capital outflows are netted out (se table 5). Financial assistance increased from the capital-rich Arab countries (from an annual averagc of $0.7 billion during 1970-74 to an average of $2.8 billion during 1975-79; see table A6), the countries of the OECD (from an average of $0.15 to $1.15 billion; see table A5), the CMEA block, and multilateral sources (table A7), all of which accnied to the public sectors. Only in Jordan, the West Bank and Gaza, and Yemen were remittances the dominant form of capital flows. Foreign direct investment increased, especially in Egypt and Jordan, but remained of limited importance (tables A12).

U/ A detailed diwcusion of ecch typ of fnancing is presented in Appendix 1.
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(from an average of $0.4 billion a year during 1970-74 to $1.4 billion during 1975-79; see table A5) as did commercial borrowing (from an annual average of $0.4 billion during 1970-74 to $2.2 during 1975-79; see table A8) much of it by Algeria. Increases in net flows to the private sector were negligible - both workers' remittances and capital flight increased by the same magnitudes (tables 5). In Israel, the boom had started earlier and the 1970s actually saw a slight decline in capital inflows as a share of GDP, but the absolute amount stagnated (at about $1.3 billion, see table 5). These flows came mostly from the OECD, and accrued mainly to the public sector.

Table 5: Composition of Capial J;ows: 1970-89

1970-74

($ billions)	Maghreb	Mashreq	Isrel	e.Mashre;.-		
Total net transfers	4.0	5.6	6.7	1 5	27.4	27.
Of which:						
Public sector	2.6	4.4	2.2	.5 3	22.16	
Private sector	1.4	1.2	4.4 -	,	5.3 :.0	
Pubic sector flows						
Net flow of debt	3.4	1.2	2.		4	5.-
Grants	-0. 1	3.5	1.4965.			
Interest payments	0.7	0.3	1.6	4	1.5 ''	
Private setor flows						
Worker remittances b	2.7	1.5	4.6	5.:: 15.5		5.
Other inflows	0.5	0.8	.	1.:- .	2.0 -:	0.
Capital outflows	1.8	0.3	1.0	6.9	1.3	.;

1980-84 I

^ON OA ~~~~~~~~~~~~~~.... . . . .':.'"-'".-'-;.:: .'""r.-::-::::.::::

($ billions)	Maghreb	Mashreq	Israel			
.... e ..' :.... .:..	:: :. ;-.	: ..	:-- J:~~........			
Tot net transfers	8.7	49.7	-0.5	4 4	.0	.
Of which:						
Public sector	-2.1	36.3	-3.4	-3 i	' ,.'	
Private sector	10.8	13.3	2.87		11.5	
Public sector flows						
Net flow of debt '	8.6	26.7	1.7	"9'2	-21.61 166	
Grants	0.3	14.2	7.7	S	:11.3	16 3
Interest payments	11.0	4.6	12.7 ,	3 4	7.2.2 s	
Private sector flows						
Worker remittances b	8.1	30.7	6.0	13- 4 .S		69
Other inflows'	1.8	3.6	.1 0.	9 0		4
capital outflows	-0.9	20.9	4.3	.17 0.2.. .... .2.		

a. urbemmts mins prpncacp repaynta ot mium- and Oongterm d t

b. icludes net private trmnars

c. Foreign direct inveainent and non-gartmn*d medium- and longterm debt

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During the 1980s, the supply of official funds became increasingly constrained. By 1986, Arab oil revenues had dwindled to only $53 billion and thir aid budgets stood at about 20 percent of their 1980 level. At the same time, interest payments increased especially in the Mahgreb which had relied more heavily on commercial and non-concessionary bilateral assistance. And access to new commercial loans, especially for Algeria but also to some extent for Morocco, became increasingly constrained. There were some offsetting effects -- the increase in remittances from both Europe and the Gulf that occurred in the late 1970s and early 1980s continued in

FIgure 3: Cata Fght wd Externa Debt of GNP)

the case of the Mahgreb and was at least 1
maintained in the case of the Mashreq. In the
Mashrek, capital flight increased by about as U
much. As a result, the only positive
developments were related to increased
OECD assistance and foreign direct
investment, especially in Egypt. - npiw li m.p
Over the whole period 1970-1991, the
accumulated financing received by the public sectors of the countries studied here, netted out of principal repayment on loans, adds up to about $200 billion (table A4). To give a sense of magnitudes, this is about one half of the debt accumulated by Latin America during the same period. In absolute terms, the largest recipients have been Egypt, Israel, and somewhat surprisingly, Syria, followed at a distance by Algeria, Morocco, and Jordan. Unlike Latin America, where most of the transfers were in the form of non-concessional loans, in the Middle East and North Africa, about half of total assistance was in the form of grants, with the rest equally divided between concessional and non-concessional loans. In relative terms, the West Bank and Gaza, Israel, Lebanon, and Jordan, received more grants (in that order), while Yemen, Egypt, Morocco, and Tunisia received hard loans. Algeria is the only country that has received most of its financing in the form of non-concessional loans. The sources of finance, and their terms, have fluctuated over time. In the aggregate, multilateral, CMEA and Arab bilateral assistance decreased steadily, while at the same time OECD assistance rose (table A4). In relative terms, Egypt, Algeria and Morocco have received more assistance from the OECD,

while Jordan, the West Bank and Gaza and Syria have relied more on Arab aid (table A5 and A6). But in some countries, sources have shifted over time. Egypt initially relied on the CMEA zone, then benefitted from Arab assistance, before turning to the OECD after 1980. In Jordan and the West Bank and Gaza, the shift away from Arab financing and towards OECD financing is more recent.

An important consequence of these shifts in source has been an increase in the cost of external funds - the average interest on loans has increased and the share of grants in total official assistance has at best remained constant (with the exeption of Israel and Egypt, see Table 6). As debt accumulated and terms hardened, debt service payments increased, reducing the net intake of foreign finance (the net transfer) especially in countries with a large share of non-concessional debt. Nevertheless, Algeria and Syria are the only countries with negative net transfers at the end of the 1980s (table 1).

Table 6: Cost of Borrowing

1970-74		1975-79		1980-84		1985-89		
Shim of		Share of		Share of		Shar of		
Interests	Grants	Interest	Grantab	Inernst'	Grants!	Intrest'	GrantsO	
Algeria	5.6	-14.3	7.7	-0.5	8.7	-0.6	8.5	-0.2
Egypt	3.9	34.9	4.6	17.6	6.1	8.2	6.6	24.6
Israel	NA	38.6	NA	37.9	NA	32.2	N.A	60.9
Jordan	2.3	82.6	4.0	70.2	6.2	64.4	7.1	41.8
Ibanon	4.1	78.0	4.4	84.8	7.2	51.2	7.0	57.9
Morocco	4.1	10.6	6.2	2.9	7.5	3.4	7.2	4.1
Syria	3.2	43.6	3.3	66.7	1.6	52.8	0.9	25.7
Tunisia	3.6	18.1	4.6	9.4	6.1	4.2	6.3	6.0
Yemen	1.2	NA	0.8	58.3	1.4	38.6	2.2	28.8

a. Average interest rate on loans.
b. Share of grants in total not flows to public sector.

The Leeacy of the Past: Publk External Debt and Private External Assets

The combination of the external financing strategy, the rising cost of financing the public sector, the public sector investment boom, and inappropriate domestic policies that prevailed through most of the last two decades left the countries of the Middle East and North Africa with

http://www-wds.worldbank.org/servlet/WDSContentServer/WDSP/IB/2000/10/14/000094946 00093005462651/Rendered/INDEX/multi page.txt 1/31/2002

two major legacies - a large stock of mainly public debt, and a significant stock of mainly private external assets. Both have important implications for any revision of the external financing strategy. Figure 3 shows the almost parallel evolution of the stock of capital held abroad (see Box 2 for the flow estimates and the definition) and the face value of external debt. The face value of debt can, however, be a misleading measure of debt burden.
Alternative types of debt can have very disparate terms, resulting in very different debt burdens. To correct for this it is useful to calculate the present value of future debt service due. Unlike the face value of debt, this accounts fully for different degrees of concessionality (see Box 3).
Table 7 provides a country-by-country comparison of the capital stock held abroad and the present value of debt. For the region as a whole the two stocks are enormous and of similar magnitude, about $150 billion. These numbers highlight two of the central propositions of this paper, that past outflows of private capital constitute a valuable stock that could be attracted back to the region and that the existing burden of debt may prove a severe obstacle to the pursuit of such a strategy.

Table 7: Present Value of External Debt and Accumulated Savings Abroad, 1991

Stock of Savings Country 0 Dabs)	Savings Abroad Abroad (percent)	Present Value over GNP 0BM1) Ilerlo)	Present Value of of Debt	Debt to GNP
Algeria	32.5	80	28.1	69
Egypt	82.6	271	21.5	71
Israel	19.7	32	33.0	54
Jordan	6.2	163	7.9	208
Lebanon	N.A	N.A	1.8	51
Morocco	9.6	36	19.5	73
Syria	26.1	161	12.1	75
Tunisia	4.5	36	7.5	60
Yemen	N.A	N.A	5.4	74
Region b	179.0	90	136.8	71

a. AsumiW th full conditional debt rduction gsmntd by the Paris Club goes through.
b. Mme muemm of sving abroad exclude Lebanon and Yemen.
Sources: World Debt Tables, and Authors' conputations (see boxes 2 and 3 for methodology).
Accumulated savings abroad for the countries where estimates are available is estimated to be 90 percent of GDP in 1991, or $180 billion. This measure does not include the savings abroad of Lebanese and Palestinian nationals, which by themselves could reach tens of billions of dollars. Yet, relative to GNP, the estimate still represents about twice the amount of savings
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abroad estimated for Latin America (World Bankc, 1993; Claessens and Naude, 1993). The extent of capital flight and accumulated savings abroad however varies among countries -- in Egypt, Jordan and Syria, for example, the ratio exceeds 150 percent but in Tunisia, Morocco, and Israel, these ratios are quite small.9
At the same time, the potential of the debt overhang to thwart a strategy based on inflows of private capital also varies. Using the criteria developed by the World Bank's World Debt Tables, Jordan, Morocco, Syria, and Yemen are countries with a severe debt problem (table A15).'° Virtually all countries in the world that have reached such levels of indebtedness have encountered serious and long-term debt servicing problems, with a significant negative impact on growthi prospects.
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Prsnects for the Future

We have documented above the contraction in the external sources of public finance that took place since the mid-1980s. After reviewing recent developments, we argue here that this situation is not likely to be reversed, requiring a redirection in growth strategy toward more emphasis on the private sector. Indeed, an important argument in preferring a market-based strategy now is that the balance in the availability of external funds is shifting away from public to private sources.

In total, the region's public sectors received between $8 and $9 billion of net flows (oans minus principal repayments) in each of 1990 and 1991 (down from an average of $12 billion in the preceding decade), over 80 percent of which was in the form of grants (instead of 50 percent in the late 1980s; see table A4). In each of these two years, interest payments amounted to $7 billion for the region, leaving less than $2 billion in net transfers (net flows minus interest payments) accruing to the public sector. The net intake however varied among countries. In the Mashreq region, the net transfer to the public sector remained sizable in 1990-91 at about $3 billion, but it was negative and growing in the Maghreb region ($-1.6 billion in 1990, $-3.1 billion in 1991).11 But at the same time, the net inflows accruing to the private sector were the principal source of external finance throughout the region: workers remittances, foreign direct investment, and a reversal of capital flight generated inflows of $9.2 and $4.6 billion in 1990-91 in the Mashreq, and $5 and $6.3 billion in the Maghreb. In Israel, The net transfers to the public sector rose slightly to $1.1 and $1.7 billion, while those to the private sector stagnated at $1 and 0.3 billion in 1990-91 (tables A4, AIO, All, A12, and A13).

For several reasons, assistance from Arab, OECD, and multilateral sources is likely to be constrained and, with the conclusion of the Cold War and the collapse of the Soviet Union, the former Eastern Bloc has ceased to be a source of assistance and is indeed now competing with the Middle East and North Africa for the limited quantities of international assistance.12 Although Arab assistance increased during 1990, when $4 billion were disbursed (as opposed to less than $1 billion in 1989; see table A6), prospects for future transfers are mixed. Aid to Jordan, Yemen, and the Palestinians was reduced substantially after the Gulf war in 1991. More fundamentally, relatively low oil prices, the fall in reserves related to the cost of the Gulf war, and rising domestic expenditures make it unlikely that Arab aid will increase dramatically in the

1/ Preliminary estimates suggest however that capital inflows fell further to all countries after 1991 when the exceptional element associated with the Gulf crisis disappeared.

12/ This ast point alone amounts to a significant change in circumstances - at its peak CMEA provided the region with $2.5 billion a year (in 1983).

near future. The longer term outlook for oil revenues is however more promising.'3 But although there is considerable scope for increased investment by Gulf businessmen in other Arab countries, a rise in Gulf states assistance is not expected in the medium term either because of various internal and geo-political reasons.

At the same time OECD countries are facing the dual problem of difficult domestic fiscal situations and extraordinary demands for exceptional assistance for the former Soviet Union and Eastern Europe. In 1993, donors pledged over $2 billion for reconstruction programs in the West Bank and Gaza over the period 1993-98. In spite of promises to the contrary, this is likely to constrain assistance to other countries of the region further.

Nor can the region rely in the future on multilateral institutions for increasing levels of net flows. In some cases because of the large volume of lending in recent years, multilateral institutions have reached exposure levels that limit new lending. In others, such as the Arab multilaterals, new lending is limited because of capital constraints. And as far as multilateral concessional lending to the region is concerned, two factors are likely to hold it down. First, concessional lending from multilaterals requires aid allocations from industrial country governments; and the climate for increased concessional assistance is not good. Second, there are many competing demands for multilateral concessional assistance; and the relative wealth

of the Middle East and North Africa, as in the past, will limit their access to these funds, with the possible exception of the West Bank and Gaza and Yemen.
ARl of this suggests that any future strategy should be based on the presumption that flows of external assistance directed to the public sectors of the region are likely to be more in line with those of the bust of 1980s than the boom of 1970s. The critical question then becomes: what can be expected from private flows?
In the past, remittances from workers abroad have been the most important source of external funding for the private sector. Migration had served an important role in alleviating pressures in domestic labor markets and redistributing wealth from Europe and the oil-rich countries of the Gulf to the labor-surplus countries of the Maghreb and Mashreq. Remittances
12/ In the short term, demand is hold down by the recession in the OECD countries, while supply has risen as the former Soviet Union has reduced domestic conumption and increased export. Iraq is also expected to reintegrat the mulcet somntimes in the near future. Demand is however expected to rise dramatically in the medium to long term, principally in China and India. The OECD predicts that prices will rise from their current levels of about $15 per barel to about $30 by 2005. It also predicts that the share of OPEC is production would rise from a third - its current level - to about half of world production (OECD, 1993).
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Box 4; What Can Be Expected Of Workers Remni*tances in the Future?
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Establishing extemal creditworthiness is also a necessary condition. The recent experience of Latin America is instructive in this regard. Net flows had dried up after the mid-1980s, a reflection of the inability of most of these countries to grow out of their debt crisis. However, after the Brady plan to reduce the debt overhang in countries that had built a track record on adjustment came into effect, the international financial market quickly recognized and rewarded improvements in creditworthiness. For these countries, the restructuring of external debts has facilitated re-entry to international capital markets, and contributed to an environment where strong policies were easier to sustain. Is a comparable strategy required for the Middle East and North Africa and if so is it feasible? These questions are addressed in the next section.
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II. TOWARDS A NEW STRATEGY

The preceding analysis has demonstrated that the dominant strategy in the region in the

recent past has entailed heavy reliance on extemal financing of the public sector in the form of official loans and grants. Two structural weaknesses have emerged with this strategy:

* Vulnerabilty to external shocks: the availability of such financing has fluctuated; as we have seen this form of financing declined significantly in the second half of the 1980s.
* Low quality of investment: such financing is not usually subject to a market test. As such, the possibility of low-return or even negative-return investments is always present. Moreover, the probability of such an outcome increases as the public sector expands and moves into areas of the economy where the role of a market test becomes increasingly vital. This happened in the Middle East as the flow of external resources expanded in the late 1970s leading to enlarged public sectors. The inefficiency of this strategy was painfully revealed in deteriorating ICORs, falling growth rates, capital outflows, and increasingly unmanageable public debt burdens.

Two additional factors point in favor of such a revised strategy. First, as we have seen, future flows from the traditional sources of public finance are unlikely to be as plentiful as they were during the boom of the late 1970s. And second, we have documented the accumulation of capital held abroad by domestic residents. Together these two points suggest that a revised strategy in favor of greater reliance on private financing may not only be desirable for internal reasons; it may also be necessitated by external circumstances. But, while the prospect of limited public flows seems a very realistic assessment at this point, the potential for increased private flows remains just that -- a potential. The key issue confronting the revised strategy, therefore, is whether countries can attract adequate inflows of private capital.

The collapse of growth in the 1980s remains the predominant concern of the policy maker. The social implications of the divergence between the job-creating capacity of present growth rates and the demand for jobs from new entrants to the labor market are now fully manifest in the form of high and increasing rates of unemployment (see box 5). These outcomes point to the urgent need for a new or revised approach to economic and social development. To achieve renewed economic growth, the quantity and especially the quality of investment must be increased.

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Box 5: Recent Developments

A new strategy must therefore grapple with two questionS: how to mobilize the needed resources so that investment can be increased without unduly hurting consumption; Jand how to ensure that the new investments will have high rates of return. The preceding analysis strongly suggests that past reliance on public investment financed by external capital has to be modified in favor of a more balanced approach both to secure adequate financing and to improve the quality of investment. To encourge private investment and attract private finance, new profit opportunities must be created. In this respect, domestic policy reform is doubly important: to put in place the macroeconomic framework, the structure of incentives, and the domestic financial intermediation that will SUpport high-retum investment; and to provide a stable economic environment that will prove attractive to owners (foreign and domestic) of capital.

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But this may not be sufficient. External creditworthiness is also crucial for increased private investment and capital flows, and, given the legacy of past borrowing in the form of heavy debt burdens, this may in turn require an explicit exercise to reduce the debt overhang before the full benefits of domestic policy reform can be realized.

Debt Overhang and Methods for Relief

The burden of extemal public debt can depress investment and economic growth through

two types of channels: illiquidity effects, and incentive effects. The illiquidity effect arises because there are only limited resources to be divided among domestic consumption, investment, and external transfers to service existing debt. Because there are limits to how much consumption can be reduced, funds that could potentially be used for investment are used instead for debt service. Liquidity considerations become important when the debt overhang is important enough so as not to allow a country to refinance its repayment obligations with new voluntary loans.

The dis-incentice effects, by contract, arise because expectations of future debt burdens tend to reduce the incentive for new lending, or for current investments. First, the domestic private sector's access to external funds, and the interest of foreign investors are weakened in the presence of a debt overhang. The old debt deters new investors because there is no easy way to guarantee their seniority. Even if they found very profitable investment opportunities, the prospects for profit repatriation will be reduced by the long line of claimants on the country's foreign exchange reserves. New investors will abstain from funding otherwise good investment opportunities out of a fear of being 'taxed" by the old creditors (Diwan and Rodrik, 1993). In the extreme case, expectations of increased taxation can become self-fulfilling, resulting in a run out of the domestic currency. Second, the incentives for domestic investment are also affected. The servicing of external public sector debt requires both an external transfer (from the country to the creditors) and an internal transfer (from the private to the public sector). To earn sufficient foreign exchange, devaluations may be needed. And to collect the foreign exchange from the private sector, various taxes may have to be imposed, including the inflation tax, or domestic public debt must be accumulated. These events - as well as the expectations that they may need to take place in the future -- depress investment and growth (Krugman 1988, Sachs 1989), and lead to capital flight (Eaton, 1987). The uncertainty created by the debt overhang also exerts a destabilizing influence on domestic financial markets and they become less effective in intermediating between savers and investors. Financial instability is exacerbated when the public sector also has large explicit and implicit liabilities at home, such as the implicit guarantee of private savings deposited in the domestic banldng sector, social obligations contracted in the

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past, or liabilities toward social groups that would stand to lose disproportionately from reform (Calvo, 1988). Because capital accumulated abroad by domestic residents cannot be tapped by the public sector, these effects can appear even when the private sector has sizable foreign assets.

These illiquidity and disincentive effects can pull highly indebted countries in a downward spiral. The country suffers because potentially productive investments are left unexploited. The country's creditors suffer because the unrealized growth depresses their payoffs. In such a situation, coordination within the creditors group can create Pareto-optimal improvements involving the provision of liquidity and/or debt relief. Coordination between the creditors' group and the debtor can improve things even more, but both parties must commit themselves to some future action. Creditors must provide liquidity and credib!e assurances that in the future, they will not extract repayments that are too large, and they can do so by agreeing to some combination of new loans, debt write-offs, and lower interest rates on rescheduled debt."4 The debtor must show evidence of a committment to invest a large share of any additional resources under the relief plan, with perhaps the most credible committment being shown by taking part in conditionality programs of the Intenational Finance Institutions (Claessens and Diwan, 1990).

Because the existing literature has concentrated mainly on the relation between commercial banks and a set of Latin American countries, the role of grants -- an, instrument that is used only by official lenders -- as provider of relief has not been explored. The provision of new grants acts to some extent like debt relief: if we ignore incentive effects, it increases liquidity without increasing the stock of debt. In fact, the two can be made exactly equivalent in net present value terms. Thus, $1 of debt forgiveness is exactly equivalent to a stream of future grants which when discounted at the market rate of interest yields a net present value of $1. This will happen if the provision of grants exactly equals the interest rate - $0.1 a year forever discounted at a rate of 10 percent has a net present value of $1.

In practice, however, this simple equivalence breaks down and precisely for this reason arguments can be marshalled for choosing between an approach to debt relief based on debt

reduction and one based on a prolonged flow of grants. These arguments have to do with the dead-weight costs involved with debt reduction on the one hand and the credibility of a promise to provide grants in perpetuity on the other. The costs related to debt reduction -- loss of reputation on the part of the borrower and, regulatory costs that have to be borne by the lenders -- have been noted and discussed in the context of the Latin American debt crisis. While such

141 See Froot (1989) for an analysis of the optimal mix of liquidity and debt relief.

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a concern should not be exaggerated, it nevertheless supports an approach based on grants rather than debt reduction - a flow of grants can be put in place that provides debt relief equivalent (in net present value terms) to debt reduction and avoids any cost associated with debt reduction.

There is a powerful argument, however, against the use of grants which has to do with the credibility that the private sector attaches to a once-only event (debt reduction) versus a possibly protracted process (grants). A key argument running throughout the paper is that a strategy based on attracting inflows of private capital to the region rests heavily on the private sector's assessment of the credibility of the domestic reform program and of the likelihood of a successful resolution of the problems arising from the debt overhang. Debt reduction achieves the second in a very convincing way. An equivalent (in net present value terms) approach based on grants achieves the second goal only to the extent that the private sector is convinced that the future grants will indeed be forthcoming. In other words, the certainty stemming from an approach based on debt reduction is replaced by the uncertainty arising from the possibility that future grants will not be forthcoming. Moreover, this uncertainty is likely to increase with the size of the debt overhang because the grants will have to be larger and/or the period during which grants will be required will have to be longer, both of which eventualities are likely to decrease the private sector's confidence that debt problems are indeed being resolved.

The uncertainty arises because donors are rarely able to commit to a predetermined flow of grants into the future, and, even if they were, the private sector may still not be convinced.

When there are many donors, coordination failures exacerbate the commitment problem and further reduce the value of a grant-based strategy relative to debt reduction. Donor coordination is typically weakened considerably when the donor group is large and diverse, and when the debt overhang is large, because burden-sharing considerations and strategic behavior become predominant. A specific example may help clarify the issue further: Western donors will be reluctant to lend to Yemen given its debt overhang to Russia. Guarantees that the resources will benefit Yemen, rather than Russia, must be provided, complicating the process.

These arguments suggest that despite the formal equivalence in net present value terms, debt reduction will become more attractive as:

the debt overhang increases, and

the number of donors increases.

In other words, at some point the private sector will hold the view that the level of grants required to resolve the debt problem is so unlikely to be sustained that the feasibility of a grant-

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based strategy is undermined. This in turn reduces the willingness of donors to pursue such a strategy.

All these methods of relief have been used in the region. Algeria, Egypt, Israel, Jordan, Morocco, Syria, and Yemen have experienced debt servicing difficulties in the 1980s. Jordan and Morocco have rescheduled their debts with the Paris Club (official bilateral debt or bilaterally-guaranteed debt) and the London Club (commercial debts) repeatedly (see table A 16).

Algeria has attempted to organize concerted lending and refinancing operations without going through formal rescheduling agreements. Because these reschedulings were at below market interest rates (adjusted for risk), they incorporate some element of concessionality (see Box 8).

But as the debt overhang became more serious, several countries were granted increased levels

Box 6: Debt Reduction in Egypt

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of capital flight. Jordan and Morocco have followed a mixed strategy emphasizing both an increase in grants and some limited debt reduction (Saudi Arabia forgave $2.7 billion of Moroccan debt, and Jordan repurchased its CMEA debt and has concluded a Debt and Debt Service Reduction agreement with its commercial creditors modelled after the Argentinian deal). While Yemen and Syria were not able to reach any agreements with creditors, they were equally unable to meet debt service payments as scheduled and have had steadily mounting debt in arrears since the mid-1980s.

These arguments and examples suggest that there is no single strategy that dominates all others; different countries with different types of debt overhangs arising from differences in donors' groups and in growth potentials should follow different strategies. To explore this issue further, a simulation model is used to classify countries into three groups: those that can grow in the absence of any debt relief (but that may need liquidity relief); those for which a grant-based approach is sufficient; and those for which any reasonable level of grants would be insufficient and hence for which debt reduction becomes the only viable strategy.

Who Does and Does not Need Debt Reduction?

The following analysis assumes that domestic policy reforms are implemented and investigates what type of financial framework is consistent with such an outcome. There are three possible sources: domestic savings, external sources that accrue to the public sector, and private inflows. In the short to medium term, domestic savings are constrained by the need to keep domestic consumption from falling too much. External flows to the public sector are limited on the supply side. Private flows are thus seen as the main source of financing with a real potential in the short and medium term. The main question of the subsection then is: can a strategy built on attracting private sector finance succeed given the existing public sector debt, and if not, what is the most desirable type of debt work-out?

This set of issues is addressed by using a simulation model calibrated to test whether these countries can attract the needed financing and grow faster than their external debt without having to cut consumption unduely, under the best of circumstances about real reforms, and taking into consideration the current structure of production and demographics. While no simulation model can handle all the underlying determinants of growth, the capital-based model used here is a useful tool for quantifying the financing requirements associated with alternative growth paths. The approach adopted involves specifying growth rates of GDP that will be sufficient to absorb expanding labor forces and allow for a gradual rise in real wages. It also specifies lower ICORs, on the assumption that a reform program is implemented (see box 8),

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Box 7: Thle Casc of Israel: ShiQting from Loans to Grants

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be unlikely to succeed because it would be difficult to convince the private sector that austerity will be maintained long enough to resolve the public sector imbalances and that the fruits from investment will not end up taxed away in the future.

Box 9: How Large are Sustnalc Debt to Export Ratios?

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which a country can be expected to fully honour its obligations in the future. For simplicity, we use here the ratio of debt to export plus remittances (DIX) as the relevant indicator of the capacity to service debt in the long run, recognizing however that the exact D/X ratio corresponding to a country's credit ceiling will vary from country to country. A review of recent evidence suggests that credit ceilings are reached when the D/X ratio of a country falls somewhere between 150 and 225 percent, with the exact figure being country-specific (see Box 9).

To determine the most desirable strategy for escaping a debt overhang, it is necessary to also pass a judgement about whether a country can attract and maintain grants over time. Such an evaluation is however not an easy matter. In general, a country's ability to attract concessional assistance is related to the size of its population and its GNP, how poor it is, and its geo-political importance. For highly indebted countries, concessional assistance in the form

of new loans at below market rates depend on the extent of the liquidity crunch, the existing investment opportunities, and the perceived ability of the country to use new resources efficiently. The geo-political factor has been key in the region. In fact, when the only control variables used are population and GNP, the region seems to attract much more than its 'fair' share of assistance (see box 10). In particular, the Mashreq and Israel have been receiving about 4 times their "normal' share of concessional assistance relative to both their GNP and their population. Within the Mashreq, Egypt and Jordan have been able to attract more than their fair share of grants. In the Maghreb, Jordan, Syria, and Yemen, an important share of grants has been provided in the context of new loans with a high degree of concessionality.
Specifically, we divide our sample of countries into three groups by applying the following tests on their resulting levels of grants and debts. First, we ask how the debt ratios would evolve with a continuation of the level of grants observed in the recent past. The creditworthiness test is brought to bear on the simulations in a fashion that is consistent with recent international experience. If after 5 years of reforms, the D/X ratio remains below 150 percent, external debt is not seen as a constraint to a market-based reform strategy as long as the grants remain at their current level. When this is judged to be realistic, the country is classified as belonging to Group I. In these countries, the debt ratios remain low if reforms are implemented and thus, the external debt burden does not constrain future growth. For the remaining countries, the external financial situation would remain fragile unless the provision of grants is increased. In order to evaluate how feasible a grant-based strategy is, we compute the factor by which grants need to be increased to yield a ratio of debt to export of 200 percent 5 years into the reform program. If the grant multiplier is small, the country is classified as belonging to group I. However, if the needed grant multiplier is large, the country would find
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it hard to convince investors that a grant strategy is feasible, and it would thus be unable to attract private inflows on a sustainable basis to fill its investment needs unless debt is reduced. These countries are classified as belonging to group HI.

Box 10: External Assistance

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Table 8 reports the results. Tentatively, the emerging classification is as follows. Israel, Tunisia, Egypt, and Algeria belong to group I. Lebanon, Morocco, and the West Bank and Gaza belong to group II. And Jordan, Syria, and Yemen belong to group m. The discussion below elaborates on the robustness of this classification in view of the recent developments on the reform front in each of the countries studied here.

Tab.k 8& Projeded Present vaxe of Debt to Eport Ratios (percent)
In Fie Yeas
Grant Factor

Countries	1991	Cumrnt	Needed '	
Grant levd	to insure			
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West Bank and Gaza b/ cl		0	320	1.6
Tunisia		124	80	n.a
Egypt (post Patis Club full debt reduction)		148	143	0.5
Ismel		153	135	C.2
Lebanon b/		140	225	1.7
Algeria		196	140	n.a
Morocco		235	173	0.8
Egypt (first-phase Paris Club debt reduction)		252	228	1.3
Yemen		244	281	3.0
Syria		252	279	4.2
Jordan (pre-1992-93 debt reductions)		259	217	1.3
Egypt (pre-debt reduction)		331	290	1.8

a. Factor by which cwurat gtan level mus be multiplied to yield a ratio of PV of debt to expots of 200 5 yean after the mt of the reform progrm.

b. Incudes reconaction program (se box 9).

c. In 10, rather than 5 yea to account for he kgh of the reconstmcdon program.

d. Means dot creditworthiness is retained even if grants arm completely elininated.

mnplementlng the Strateg

The broad classification of countries presented above is a useful starting point but hardly sufficient. Implementation of the strategy even within each group will depend on the actual developments in the three key dimensions of domestic policy reform, external financial assistance, and external debt. For the first group of countries, the debt overhang has been reduced to manageable proportions so that the success of the strategy depends mainly on the

strength and credibility of domestic policies and the continuation of current levels of grants. As will be seen shortly, differences in progress on this front have resulted in differences in volumes of inflowing capital, in different types of inflows, and in differences in the use made of the inflows. For the middle group, a grant-based strategy can work if the reform process is supportive. And for the countries in the third group, debt reduction conditional on policy performance is required.

GROUP I. Group 1 countries -- Algeria, Egypt, Israel, and Tunisia -- have manageable debt burdens for different reasons: Egypt (debt reduction) and Israel (grants) have implemented the strategy outlined above, and Tunisia has followed a longstanding policy of careful economic management and experienced neither the boom nor the bust except in relatively mild forms. And Algeria's debt remains relatively small in spite of the liquidity crunch it has generated lately. The main factor determining inflows to these countries therefore is domestic policy. The reforming countries have seen their efforts rewarded with increased inflows but in different forms and to different effect. The contrast between Tunisia and Algeria is especially revealing in this respect.

Performance in Tunisia is perhaps the best example of the potential of the strategy outlined in this paper. Given Tunisia's careful economic management in past years, it faces neither a serious debt burden (the ratio of debt to exports was 140 percent in 1990) nor an accumulation of savings abroad (capital held abroad is estimated at $4.5 billion in 1991). Moreover, its creditworthiness is not expected to deteriorate, and it is not vulnerable to changes in the level of extemal assistance. Accordingly its strategy has focussed on attracting foreign direct investment. The results have been impressive -- flows of foreign direct investment have increased from $185 million in 1990 to $250 million in 1992 and are expected to stabilize at about $300 million a year. In this case, therefore, inflows have responded to Tunisia's reform pmrogram and can be expected to contribute significantly to economic growth precisely because foreign direct investment is usually subject to the severest of market tests before it is committed.'6

For different reasons, Israel also has low stocks of debt and of capital abroad. And like Tunisia, Israel initiated in the late 1980s an ambitious program of reforms. But growth in per

capita GDP has remained small at about 1 percent a year and foreign direct investment has remained negligible. While the business sector has shown some dynamism recently reflecting improved efficiency, there are no massive investments in the types of industries that can sustain

16I For a critical review of the Tunisian experience with reform, see Ben-Slama, 1993.

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growth and unemployment has increased. The moderate supply response seems to be mainly related to regional risk since creditworthiness is expected to be maintained in the medium term (vulnerability to changes in grants is also small, see table 8). It is increasingly apparent that the uncertain geo-political situation has exerted a dampening effect on investment, with private investors -both local and foreign -preferring to wait on the side-line and invest in financial instruments rather than put their funds at risk in long-term business ventures. In many ways, the current situation in Israel may be indicative of the ultimate constraint to growth that all countries of the Mashreq will confront once their reform agenda is well advanced. Unless the peace process moves ahead further in the near future, it will become increasingly apparent that geo-political instability limits the developmental potential of market-based strategies.

The outcome in Egypt has been different for quite specific reasons. Unlike Tunisia, Egyptian residents hold significant amounts of capital abroad -- an estimated $83 billion in 1991. In these circumstances, a strategy of attracting this capital back to Egypt to finance private investment seems reasonable. This strategy, however, has been only partially successful. Following the debt deal, country risk has fallen. Egypt is now expected to remain creditworthy in the medium term, and its vulneralibity to changes in the level of grants it receives has also fallen (see table 8). As a result, capital has returned - about $5 billion in 1992-93. However, this has not been translated into increased private investment. Rather, foreign reserves have risen sharply and now stand at about $18 billion. Why? Besides the regional outlook, the answer seem to lie in the limited progress that has been made on the reform program. In particular, privatization -- seen as the answer to both chronic public deficits and the inefficiencies that plague the economy -- has not taken hold probably because of concerns about labor shedding. In addition, the rapid increase in the public sector's domestic debt has driven up interest rates. As a result private investors remain unconvinced about government policy and rightly concerned about the high cost of credit. The clear but difficult policy conclusion for Egypt is to proceed as quickly as possible on the remaining structural reforms or else risk losing the benefits that have already emerged from the debt deal and the reforms taken to date.

Algeria offers a sharp contrast with Tunisia with respect to progress on domestic reform. In Algeria a small improvement in the efficiency of the economy would be sufficient to improve creditworthiness substantially. In the simulation, the ratio of debt to exports falls rapidly from 196 to 140 percent in the first five years, a reflection of its high investment ratio but low efficiency of capital. While the debt burden is sustainable from a medium term perspective, the bundling of payment is creating a liquidity crunch. At the same time, the reform program is unlikely to proceed before the debt burden in the short term is alleviated because of the large transitional costs associated with the transformation of a command economy into a market driven

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one. Algeria's present strategy of servicing its past debt according to schedule while seeking voluntary refinancing has not paid off, and the reform process has stalled. The fragility of the external financial situation is underscored by the fact that nearly all the grants received by Algeria are embodied in the terms it receives on new finance. However, this 'forced lending" situation has remained a bilateral affair between Algeria and each one of its large creditors. Unless this strategy yields benefits soon, a formal rescheduling agreement in the context of a well defined reform agenda will become inevitable (see box 11).

Box 11: Algeria: To Reschedule or not?

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Box 12 Rebuilding InfirQstrUCtUre: Financing Needs in te OT and Lebanon
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of grants it receives is moderate (see table 8). A continuation of recent trends should make it creditworthy in a few years, but adverse shocks (to agriculture for example) could derail such a scenario unless international assistance in the form of increased grants (as has happened during the Gulf crisis) is forthcoming promptly to smooth such developments. At the same time, such assistance would be forthcoming only to the extent that domestic reforms remain on track. For the future, acceleration of reforms especially in the financial market is necessary.

In both the West Bank and Gaza and Lebanon, significant improvements in public infrastucture and services are needed not only to improve living conditions directly, but also to support private business activities and economic growth in general. In both cases, financial needs are large and international support is required (see box 12). In both cases, extemal debt is small, residents have access to large deposits abroad that can be repatriated under the right circumstances, but financing needs are considerable given the pressing need to rehabilitate infrastructure. Given the likely fragility of the public sector revenues during the transition period, external assistance over the short-term should include large element of concessionality (see table 8). Public debt must also remain low to elicit the flow of private capital. Nevertheless, and to hedge against the risk of low public inflows, Lebanon has been attempting to find alternative sources of funds and may end up being the first country of the region to establish access to the Eurobond market (Saidi, 1992).

GROUP m. In three countries - Jordan, Syria and Yemen - a strategy of growth out of debt is unlikely to work in the absence of debt reduction. In Jordan, the situation is close to borderline. But in both Syria and Yemen, even with optimistic assumptions about domestic reforMs and the provision of grants, the debt ratios will increase because large amounts of international financing are required to boost investment above its current low level in both countries. At the same time, a grant based strategy of growth out of debt does not appear feasible in all cases.

In Jordan, a moderate increase in grants would allow the debt ratios to fall over time. But Jordan has been receiving exeptionally large amounts of grants relative to the rest of the region, and it is unlikely that the private sector could trust a strategy that is built on the
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expecttion of larger grants for years to come. Jordan has made progress on the domestic front. The acceleration of the reform agenda is now crucial to take full advantage of the potential created by the flow of return migrants. However, the debt overhang -- and especially its internal transfer aspect - is constraining the supply response. The ratio of debt to exports stands at 260 percent in 1991, and it would not be possible to reduce it below 220 percent in less than five years, even under optimistic assumptions about domestic reform, unless a larger share of international assistance is provided in the form of grants (about 20 percent more than current

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levels), or some debt relief is forthcoming. But Jordan already receives more than its normal share of grants - whether the comparison is with the rest of the developing countries, or within the region. This would suggest that a grant-based strategy will be difficult to follow for Jordan. There has been some recent progress on debt reduction (Jordan has reportedly bought back most of its debt to the former Soviet Union), and a debt reduction agreement with commercial creditors is now under negotiation. However, more debt reduction is needed. For example, a swap of military debt into a long term instrument could also be considered in the context of the ongoing Peace Initiative.17

With the caveat relating to the poor quality of the Syrian data -- Syria and Yemen receive less than their 'share' of assistance. Nevertheless, a grant-based strategy would be difficult to achieve since existing grants would have to be increased by a factor of 3 to 4 to allow for creditworthiness five years after the initiation of the reform program. Thus, debt relief will be needed. In Syria, the public sector's domestic debt is also large and needs to be reduced substantially. But more progress on domestic stabilization and reform is key before debt relief would have a constructive role to play. The development of a more active dialogue with the international community about the conditions needed for a re-entry into the international financial markets would be helpful in boosting the reformist agenda. But the accumulated arrears on loans by the World Bank and some bilateral institutions (both in Western Europe and the Former Soviet Union) are a complicating factor. Yemen, hard hit by the Gulf crisis, and by political uncertainty leading up to the recent elections, has yet to take measures that would be likely to attract past capital flight or foreign direct investment in any serious way.

In both Syria and Yemen, a strategy of conditional debt reduction would have to grapple with the heterogeneity of their creditors' groups. In both countries, debts to the former Soviet Union is substantial amounting to more than $10 billion in the case of Syria and more than $5 billion in the case of Yemen, accounting for a significant proportion of the total debt of the two countries (probably more than 50 percent depending on the exchange rate). A concerted agreement between all creditors is unlikely to be feasible given the wide divide between OECD countries' and Russia's discount factors. This suggests that a buyback-based strategy of debt reduction, in the context of an overall adjustment program, is likely to be preferable. Some operations have already been reported in the press - Syria is reported to be repaying its debts at a discount through debt-to-export exchanges. The issue of buybacks is potentially important because liquidity-constrained Russia may agree to liquidate its debts at attractive prices. Of course other creditors may object because resources which could be paid to them (or invested

17/ See Sadowski (1993) for a specific proposal.

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at home to increase the debtor's capacity to repay in the future) are now paid to a single creditor. Such an operation can, however, benefit both the debtor and the other creditors in the long run if the price is low enough. Overall the debtor benefits if it is less liquidity constrained than the single creditor, and the other creditors benefit if the buyback price is below their own marginal valuation of country debt.

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CONCLUDING REMARKS

To generate economic growth and create new employment opportunities, the main challenge of policy-makers in the region will increasingly be to implement domestic policy-reforms that can simultaneously improve the quality of the incentive framework thereby increasing the overall productivity of the existing human and physical capital and creating new profit opportunities to attract new investment on market terms. The success of such a strategy will be shaped by three main considerations: the resolve of the decision makers to move with reform and their institutional capacity for implementation; the presence of capital accumulated abroad by their residents; and the extent of their debt overhang.

Several countries in the region -- Morocco, Tunisia, and Israel - have been following a reformist agenda for some time with promising results. While the stage has been set for private sector growth, further action is needed -- on both stabilization and adjustment -- to enhance the dynamism of the supply response. In these countries, the financial sector is still plagued by various restrictions, the banking sector needs to be restructured, and privatization has not yet been pursued seriously. But the needed change is now incremental rather than comprehensive.

Jordan has also initiated successfully microeconomic reforms (in the areas of trade and financial markets). But its finances -- both external and intemal -- remain fragile after the Gulf Crisis. Both internal and external adjustment must be pursued vigorously to allow it to employ its labor force effectively and become less dependant on external transfers.

The success of these early reformers has encouraged other countries to accelerate the pace of their programs. Egypt has recently initiated bold and far reaching reforms. Its finances have also improved substantially thanks to the debt reduction granted by official creditors. At this stage, the main constraint to change seems to lie with institutional capacity. In Lebanon, the stabilization policies being pursued will go a long way towards contributing to renewed growth if they are maintained. Algeria, Syria, and Yemen are still plagued with serious macroeconomic and microeconomic problems but are now giving consideration to the elimination of macroeconomic imbalances, reducing policy induced price distortions, and improving the management of public resources.

Besides the likelihood of a peaceful resolution of the old conflicts plaguing the region (see box 10 on the likely effects of peace on economic performance), the elements of the external balance sheet discussed above --the levels of external assets and liabilities-- are likely to continue to shape in important ways the strategies of domestic policy reform. Indeed, the emerging overall architecture of reform seems to fit quite closely the circumstances of each country with respect to the stocks of savings accumulated abroad and the stocks of debts contracted in the

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Box 14 E,ffect of Peace on Economic Perfon7nance

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inflows to finance shrinking public sector deficits (in 1992, private capital inflows are estimated at about $5 billion in Egypt, $600 million in Jordan, and $2 billion in Lebanon). However,

investment has not yet increased substantially: in Egypt, mainly because of slow reform on the real side; in Jordan, because of the uncertainties created by the debt overhang; and in Lebanon, because of continuing fiscal instability. In all cases, the possibility of reversal of the recent flows cannot be completely discounted if the macroeconomic gains are not maintained and deepened.

In the medium term, sustainable growth is not possible without real side reforms (and reconstruction of infrastructure in the West Bank and Gaza and Lebanon).

A second group of countries have smaller stocks of capital abroad. They have moved faster on real reforms than on financial markets and exchange rate reforms. Their strategy has emphasized in particular trade reforms aimed at increasing efficiency, and the mobilization of domestic savings and foreign direct investment. This group comprises Morocco, Tunisia, and Israel. In Morocco, foreign direct investment averaged $160 million in 1989-90, and it increased to $375 in 1991 and to over $600 million in 1993. In Tunisia, the progression has been equally impressive, with $75 million in 1989-90, $164 million in 1991, and $300 in 1993. In Israel, foreign direct investment had risen to about $120 a year after the stabilization of 1985. While recent flows have been smaller, foreign direct investment is expected to stabilize at about $300 a year in the 1990s. Algeria also belongs to this group, although it has had a smaller measure of success, partly because the weight of past policies has slowed down the pace of change, and partly because of financing difficulties. Yemen is an intermediate case but its simultaneous pursuit of foreign direct investment, foreign grants, and the repatriation of resident savings has met with little success to date.

Another important difference across countries is in the extent of their external indebtedness. Egypt, Israel and Tunisia can clearly attract the needed financing and keep their debt ratios low without unsurmountable austerity. In Egypt however, the situation is somewhat more uncertain since the recent debt reduction granted by its official creditors is conditional on future performance with reform. In contrast, in Syria and especially in Yemen, reforms have been much slower. In these countries, it is not realistic to expect that the resulting financial needs will be met throughout the interim, nor that the supply response will materialize because the countries remain far from creditworthy, even if reforms proceed as assumed. The main reason for this result lies in the fact that they both start with very low levels of investment. As a result, they cannot be expected to grow out of debt unless unrealistically harsh austerity is maintained for long periods. The remaining countries fall in between these two extremes and have followed cautious reform policies. In Algeria, the political situation and the uncertainties created by the comprehensiveness of the needed reforms are reducing the potential for voluntary refinancing of the debt obligation falling due. The resulting liquidity crunch is unlikely to be

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resolved in the absence of a formal rescheduling agreement unless some positive shock occurs.

In the West Bank and Gaza, and in Lebanon, the situation is close enough to the border-line to exert some destabilizing influence, but creditworthiness is expected to be maintained under the most likely scenario. The situation could however quickly deteriorate if large negative shocks were to hit these countries because they have little headroom available. This would arise if the level of grants does not rise to offset future financing needs related to reconstruction (in the case of the West Bank and Gaza and Lebanon). Morocco and Jordan present more complex cases.

Both have already benefitted recently from some debt reduction. And a continuation of current policies would result in sustainable debt ratios in the future. The question is one of transition and degree: can austerity be maintained long enough to allow for a strategy of growth out of debt to work? In both cases, the debt overhang is likely to exert some negative influence on private capital inflows, unless government resolve on adjustment and reform is perceived to remain strong. These perceptions are however likely to be affected by expectations about the future level of grants. In this respect, Morocco's situation appears more robust than Jordan's, since Morocco could achieve creditworthiness even if grants are slightly reduced, while -- in the absence of additional debt reduction -- Jordan would need an increase in grants over their already large levels.

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ANNEX 1: SOURCE OF FINANC(ING

Official Armb Biateral Assistance

Starting in 1973, the Arab oil-exporting countries became large donors to LDCs, disbursing aid of about $90 billion between 1970 and 1990. Aid peaked in 1980 ($10 billion) before falling to its lowest level in 1989 ($1.5 billion). Within the Arab donors community, Saudi Arabia has played a dominant role (over 60 percent of total net disbursements), followed by Kuwait (about 16 percent), and the UAE (10 percent). The other Arab donors have been relatively smaller: Iraq (3 percent), Libya (3 percent), Qatar (2 percent), and Algeria (1 percent). While some of the Arab assistance was provided in the form of concessional loans before 1985, Arab aid has been mostly provided in the form of grants. It is also reported that it is has usually been disbursed as general assistance, rather than on a project basis.

Bilateral Arab (net) assistance to the 10 countries of the Middle East and North Africa under study have amounted to $47 billion between 1970 and 1990, about 52 percent of total Arab assistance to developing countries. Iran and Israel did not receive Arab assistance. The Palestinian did, but there is no official data to gauge the magnitude of this. As for total Arab assistance, these flows fluctuated with oil revenues, booming in the second part of the 1970s, stagnating with a downward trend in the first part of the 1980s, and falling to a much lower plateau after 1985.

Until the Camp David agreement in 1979, Egypt was the largest recipient of that aid, receiving more than half of total Arab assistance to the region (or about $2 billion a year on average between 1975-79). During this period, Syria (about 25 percent of Arab assistance or $830 million a year on average), Jordan (12 percent or $460 million), Yemen (6 percent, or $240 million), and Morocco (5 percent or $220 million) were the other main recipients.

In 1979, Arab aid to Egypt was completely cut off in the wake of the Camp David agreements, but this was amply compensated with bilateral, multilateral, and private loans from the West and especially the U.S. (see later). At the same time Arab aid to Syria, Jordan, and Morocco increased both in relative and in absolute terms, with Syria receiving over $1 billion on average during 1980-84, Jordan about $810 million, Morocco about $440, and Yemen $300 million. Assistance to Lebanon also increased. Nevertheless, the bulk of the aid was concentrated at the beginning of the period. As oil prices edged down after 1982, aid also decreased. By 1985, Arab assistance had collapsed. During 1985-89, Syria and Jordan still received about $350 on average per year (but aid to Syria was discontinued for a while in the late 1980s), but the other recipients received less than $100 million a year on average.

I/ The discussion in this section is partly based on Nowels and Sandford, 1991, and van den Boogaerde, 1990.

Annex 1: Page 1

OECD Assistance

During the period 1970-1991, Western and Japanese governments -- the 18 members of the OECD -- disbursed $90 billion in (net) assistance to the countries of the region. The total level of assistance had grown steadily over time, averaging $5 to 6 billion annually during the 1980s. It is now the largest source of finance in the region, although in real terms (or as a share of the size of the region's economy), it has shrunk relative to the early 1980s. In the past two years (1990-91), this assistance was exceptionally increased to about $7 billion, but this amount is expected to be reduced in 1992.

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Annex 1: Page 2

CMEA Sources

Four countries in the region -- Algeria (mostly in the 1960s, less in the 1970s), Egypt (mainly in the 1960s), Syria (over $11 billion in the 1980s), and Yemen (about $2 billion in the 1980s) have received assistance from the Soviet Union in the past. Jordan has also received some, albeit smaller assistance. The total debt of the region to Russia (which has taken over the FSU debt) is about $25 billion. All the countries (with the exception of Egypt) have been running arrears in recent years on these debts. Jordan is reported to have bought back recently all of its Russian debts at a discount from face value. Syria is reported to be repaying about 20 percent of its debt service, mainly in exports (and possibly at a discount). Yemen has not serviced its Russian debt in recent years.

Multilateral Institions

The region's dependence on multilateral lending is large and has grown steadily during the last two decades. Between 1970 and 1991, multilateral lenders poured more than $15 billion dollars in total net flows into the region, one third on concessional terms. From 1975-79, these flows were predominately from Arab multilateral funds and were mainly concessional. Since then, nonconcessional flows have dominated, and net flows from Arab multilaterals have been much less important. The World Bank has been the single largest source of multilateral lending to the region, accounting for one third of multilateral net flows since 1970.

Multilateral concessional lending is of minor importance for most regional governments. These flows to the region have been on a steadily downward trend since the beginning of the 1980s. Multilateral concessional loans account for less than 3 percent of total end-1991 regional debt. Egypt and Yemen, the two IDA-eligible countries, are exceptions. In Egypt, concessional loans from Arab multilaterals were a major source of net inflows in the late 1970s. Yemen is an exception in that concessional multilateral flows have remained important. IDA has consistently been the predominant multilateral lender to Yemen, accounting for 60 percent of total multilateral flows over the period; in recent years, IDA has accounted for well over half of all net debt-related flows to Yemen.

By contrast, multilateral nonconcessional lending to the region has tended steadily upward. The $1 billion in 1991 from multilateral nonconcessional sources accounted for more than 80 percent of total debt-related flows to regional governments. The World Bank is the largest multilateral creditor, accounting for two thirds of outstanding end-1991 multilateral debt (and 6 percent of overall debt). The African Development Bank and the EC and European Investment Bank have, over time, replaced Arab multilateral institutions as major sources of net flows. In some countries, these two institutions have been larger sources of net flows than the World Bank in recent years. In 1991 the African Development Bank was the single largest net lender to the region, disbursing more than $600 million.

Commercial Borrowings

Private-source borrowing by govemments has been a relatively unimportant source of capital inflows, accounting for about 10 percent of the region's public-sector debt. By contrast,

Annex 1: Page 3

almost two thirds of the public sector debt of Latin America is held by private creditors. Even in Algeria, where private creditors are most important, they account for less than 30 percent of total government debt. Two other countries, Jordan and Morocco, have non-negligible amounts of private debt. Both have rescheduled with commercial banks, their main private creditors; and Algeria has had a concerted refinancing of its commercial bank debt.

Net flows from private creditors to the region have been almost uniformly negative in recent years. This statement is true across all countries of the region and across all forms of lending, commercial bank loans, bonds, and suppliers' credits.
The existing government debt to private creditors arises from two short bursts of lending. The first followed the commodity price boom of the mid-1970s. Algeria, Morocco, and Tunisia were the beneficiaries. The second followed the 1985 collapse of oil prices. Two countries, Algeria and Jordan, were the borrowers. Algeria borrowed as a direct consequence of the oil price decline in an attempt to maintain its import-dependent production system. Jordan borrowed to replace inflows from Arab oil producing countries.
Commercial bank lending traditionally has been the major source of regional access to external private funds (two thirds of the total of net flows to the region since 1970). Net flows from commercial banks have been heavily negative in recent years, -$1.1 billion in 1991. Suppliers' credits were mostly a 1970s phenomenon. Import credits without the guarantee of an industrial country government have almost disappeared. Net flows on suppliers' credits to the region have been negative since 1984. With the exception of Israel, and to a lesser extent, Algeria, bond issues by have been rare. In Algeria, the last government external bond issue was a 1989 $200 million Algerian borrowing.
Worker Remittances
Remittances have played an important and growing role in the total flow of foreign exchange into the labor surplus countries of the Middle East and North Africa (see Table A9). Remittances to the Maghreb from Western Europe have increased steadily since the early 1970s amounting to nearly $3 billion or 3.5 percent of GNP by the early 1990s. In contrast, remittances to the Mashreq from the Gulf have been much more volatile.2 They exploded from less than $200,000 million in the early 1970s to well over $5 billion or 9.2 percent of GNP by the early 1980s. The next decade saw modest declines in dollar terms and larger ones relative to GNP with a slight recovery to more than $6 billion and 10 percent of GNP in 1992. In Israel, a major component of unilateral transfers to the public sector is the transfers of the National Institutions out of United Jewish Appeal funds. In recent years (1978-89) they have range between $314 and $410 million; in 1990 they increased to $782 million.
The changes over time and the differences between the two sub-regions call for explanation. Much of it can be found in the economic fundamentals determining overall development in sending and receiving countries but demographic and political factors have also
2/ See Choucni (1986) and Shafik (1993).
Annex 1: Page 4

played a part. The available econometric evidence suggests that the flow of remittances depends on two types of consideration. One has to do with the migrant's concern for his family's welfare and the other has to do with his interest in securing the best possible return on the wealth he accumulates abroad.
Both considerations suggest that differences in the return to labor between the receiving and sending countries will be a key factor influencing the flow of migrants and hence the flow of remittances. This of course accounts for the surge in migration to the Gulf following the oil price increases in the mid and late 1970s. In 1975 the non-national labor force in the GCC numbered 1.1 million, slightly less than half the total labor force. By 1985 there were 4.4 million non-national workers accounting for 70 percent of the total -- a growth rate of almost 15 percent a year. Between 1985 and 1990, however, the rate of growth fell to just over 3 percent a year as the impact of the fall in oil prices took effect (ESCWA, 1993). In contrast, migrant workers in Western Europe have numbered about 2.4 million throughout the late 1970s and 1980s with only mild fluctuations of + 0.1 million (Elbadawi and Rocha, 1992).
These figures illustrate the drawing power of the Gulf and Western Europe. But these regions attract labor from many sources and the numbers given above refer to total migrants, not just Arab migrants. A second key determinant therefore is the competition among labor-sending countries. In the Gulf, the proportion of Asian workers has increased steadily -- from 36 percent in 1975 to 49 percent in 1985 with most of the shift occurring in the 1980s. Meanwhile the Arab share of the total non-national labor force in the GCC has declined from 57 percent in the mid 1970s and, based on data for Saudi Arabia and Kuwait the two main sources of Arab employment, is now thought to be between 30 and 35 percent (ESCWA, 1993).

In Western Europe the competition has come from other European countries -- Portugal, Turkey, and Yugoslavia. But here the Arab share of the non-national labor force has remained roughly constant at about 25 percent throughout the late 1970s and 1980s (Elbadawi and Rocha, 1992).

Political factors also influence the size of the Arab migrant work force, with the most recent example being the events surrounding the Gulf crisis. Recent estimates suggest that 390,000 Egyptians, 225,000 Jordanians/Palestinians, and 723,000 Yemenis left the Gulf and Iraq (ESCWA, 1993). While some may return or be replaced by other Arab workers, these events are likely to strengthen the trend towards Asian workers. Political events in Europe will also influence the national composition of migrant workers. As Eastern Europe and the former Soviet Union release workers, the competition for jobs in Western Europe will intensify.

The size of the migrant population is clearly an important determinant of the flow of remittances but other factors affect the amount remitted per worker. One such factor is economic performance in the host country -- remittances are positively correlated with the income cycle of the labor receiving country. One econometric estimate for North Africa suggests that a one percent increase in the real income of the host country is associated with an increase of 0.6 percent in remittances (Elbadawi and Rocha, 1992).

Other factors also influence the flow of remittances per worker. Recall the two considerations underlying the decision to migrate and remit. The first of these was a concern with the welfare of the family left at home. This suggests that as the duration of migration

increases, and as families join the migrant worker in the labor-receiving country, the flow of remittances will fall. A comparison of Algeria and Morocco supports this point -- Algeria with its relatively long history of migration to France received around $750 per migrant per year during the 1980s compared with over $4,000 for Morocco (Elbadawi and Rocha, 1992).

Factors associated with the second consideration -- maximizing the return to wealth accumulated abroad -- are also important. The size of the black market premium in the labor-sending countries, for example, has been shown to influence remittances but it is unclear whether this represents a shift from unofficial channels to official ones or a genuine increase in the total flow of remittances. The inflation rate -- a general indicator of the quality of domestic policy in the labor-sending country -- has also been shown to influence remittances. One study suggests that if inflation increases by 10 percent, the flow of remittances per worker will fall by 0.3 percent (Elbadawi and Rocha, 1992). Similar work on Egypt comes up with a slightly smaller elasticity (Kibbe, 1992).

Foreign Direct Investment'

During the past five years, foreign direct investment to developing countries increased more than any other source of finance, increasing from an average of $17 billion (net) a year during 1987-90 to $31 billion by 1991, and reaching nearly $40 billion by 1992 (this amounts to about $5 per capita on average). However, this inflow was very unevenly distributed, with 70 percent of the total flowing to the top 20 performers (who received on average about $30 per capita).

The benefits of foreign direct investment seem to go well beyond the size of the financing provided. A major gain is the positive externalities that arises when foreign technology and know-how is transferred from foreign to domestic firrns. In some cases, the demonstration effect may be sufficient to stimulate technology diffusion. In other cases, diffusion can occur from labor market turnover as employees move from foreign to domestic firms. For example, in a recent case study of the level and growth of factor productivity in Morocco, Haddad (1993) finds that foreign investment has caused increases in domestic firm's productivity.

During 1985-90, foreign direct investment to the region exceeded the developing country average, but was far short of the amounts received by the top performers. For this period, foreign direct investment averaged $9 per capita for the region as a whole (excluding Iran). In addition, performance in attracting foreign direct assistance has consistently improved over time: compared to the early 1970s, foreign direct investment per capita (in 1987 constant dollars) doubled every five years on average.

Performance in attracting foreign direct investment varied within the region and over time. Over the past decade, the best performers were Tunisia ($22 per capita), Jordan ($18 per capita), and Israel ($12 per capita), followed by Egypt (the flow of FDI in table 12 includes

investment in oil; when netted out of this source, FDI per capita averaged only $4 per capita
31 This section is partly based on El-Rifai, 1993.

during 1979-89) and Morocco ($3 per capita). Algeria, Iran, Syria, and Yemen received insignificant amounts of foreign direct investment in recent years.

When looking at performance at the country level, no simple trend emerges however. Algeria did well in the 1970s but badly during the 1980s. Egypt and Morocco did better in the 1980s. Jordan and Tunisia did well during the late seventies and early 1980s, but performance deteriorated in the late 1980s. In Israel, foreign direct investment weakened during the early 1980s, and increased dramatically in the late 1980s.

Much less information is available on source countries. However, OECD data (which cover flows from the OECD countries only) suggests that among the OECD countries, the US, France, and Germany account for about 75 percent of total OECD investment in the region, followed by Italy, Japan, and the Netherlands. While it is not possible to disentangle the extent of Arab foreign direct investment, it does appear that it is mainly concentrated on Jordan, Tunisia and Egypt.

While these trends reflect the combined impact of a number of factors, it appears that a favorable economic situation is crucial. Tunisia and Jordan did better than Algeria (or Israel), even though their overall level of development was lower, probably because they had a more appropriate macroeconomic policies in place. But in addition, it appears that flows of foreign direct investment weaken during adjustment periods (early 1980s in Israel, late 1980s in Morocco, Egypt, Tunisia, and Jordan), with investors waiting on the side-lines during stabilization, and coming in a rush when the strategic uncertainty is resolved. Good examples are provided by the recent booms in foreign direct investment in Morocco and Tunisia, two countries that were well advanced in their structural reform programs by the late 1980s. In Morocco, foreign direct investment averaged $160 million in 1989 and 1990, and it increased to $320 in 1991, and to over $500 million in 1992. In Tunisia, the progression has been equally impressive, with $75 million in 1989 and 1990, $145 million in 1991, and $215 million in 1992.

It also appears that the creditworthiness of a country is a crucial element in attracting foreign direct investment. For example, the main reason why Egypt under the Infitah was not able to attract sizable foreign direct investment was related to its poor credit standing which scared away potential investors (Esfahani, 1990). Similarly, the collapse in foreign direct investment in Jordan after 1988 coincided with the onset of its debt crisis. Finally, political stability appears to be an important factor. Political turmoil in Algeria during the late 1980s and political uncertainties in Jordan during the same period explain much of the recent decline in inflows into these countries after extended periods of satisfactory macroeconomic performance.

The data also helps in correcting some misconceptions about some of the factors that are thought to be favorable to foreign direct investment. In particular, country size does not appear to be an important determinant (Jordan and Tunisia did better than Algeria, Morocco, and Egypt), indicating that export-oriented foreign direct investment is increasingly replacing import-substituting investment in the region. Similarly, low wages do not seem -- by themselves -- to be an important determinant (Morocco and Egypt which have the lowest wages did not receive as much foreign direct investment as Jordan, Tunisia and Israel). This points to the importance of infrastructure, both physical as well as human, in attracting foreign investors.

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ANNEX .2--

A REGIONAL DATA-BASE
Dec'em%ber, 1993

ANNEX 2: REGIONAL DATA-BASE

Annex 2-Table 1: Real GDP Growth

COUNTRY	1970-74	1975-79	1980-84	1985-89	1990	1991
Algeria	5.18	6.20	5.25	-0.06	-1.46	1.19
Morocco	4.70	6.45	3.25	4.34	4.04	4.83
Tunisia	8.72	6.33	4.22	3.28	7.64	3.80
Maghreb	5.41	6.26	4.75	1.18	0.66	2.29
Egypt	5.14	10.94	6.99	2.92	2.54	2.27
Jordan	5.84	14.05	-14.06	-11.06	-11.71	-20.76
West Bank and Gaza	9.57	7.75	0.43	7.17	20.01	
Syria	13.29	6.49	2.98	3.39	14.04	8.20
Mashreq	7.55	9.65	4.78	2.95	4.63	-1.47
Israel	7.60	3.82	2.95	4.18	6.14	7.12
Region	6.40	6.56	4.39	2.28	2.91	2.24

Source: World Bank Intemational Economics Department

Annex 2-Table 2: Per Capita Real GNP Growth (percem)

COUNTRY	1970-75	1975-80	1980-85	1985-90	1990	1991	1992
Algeria	2.3	2.6	2.1	-3.0	-4.0	-3.2	-1.7
Morocco	2.2	3.6	0.4	2.0	2.9	2.2	-4.6
Tunisia	6.6	3.6	1.3	1.3	6.6	0.7	7.6
Maghreb	2.9	3.1	1.9	-1.5	-1.4	-1.5	-1.2
Egypt	3.2	7.4	3.6	0.6	-2.4	0.0	0.3
Jordan	2.5	13.2	0.2	-15.8	-19.2	-9.9	8.8
West Bank and Gaza	11.2	5.5	-1.0	3.8	12.4	-9.1	
Syria	9.5	3.2	-0.7	-0.9	11.9	4.1	3.0
Mashreq	5.3	6.9	1.7	-0.8	0.5	0.2	-0.6
Israel	4.1	I.S	1.1	2.5	3.1	1.6	2.8
Region	3.9	3.7	1.5	4.6	0.1	0.2	0.6

a. Does not include Lebanon and Yemen

Source: World Bank Intnuational Econornics Department

Annex 2-Table 3: Inves*ment ' as a share of GNP @prcem)

COUNTRY	1970-74	197S-79	1980-1984	1985-89	1990	1991	1992
Algeria	37.63	46.87	38.24	31.83	30.53	31.48	31.59
Morocco	18.04	28.00	26.70	24.31	26.03	23.16	25.95
Tunisia	23.16	30.94	32.05	23.64	27.59	24.30	25.47
Maghreb	28.44	39.13	34.97	29.41	28.97	27.58	28.64
Egypt	15.19	32.26	30.75	25.56	24.49	21.98	18.51
Jordan	17.06	32.04	38.46	25.08	32.05	26.36	34.00
West Bank and Gaza	13.55	21.30	23.12	21.51	19.85	17.03	n.a.
Syria	17.26	29.04	24.44	19.64	16.24	n.a.	n.a.
Yemen b	n.a.	n.a.	n.a.	18.92	16.88	14.52	n.a.
Mashreq	15.73	30.72	29.11	21.81	21.54	19.52	18.32
Israel	30.09	26.17	21.91	17.50	18.26	22.00	21.90
Region	24.11	33.99	30.67	23.73	23.42	23.37	23.35

a. Gross domestic investment
b. 1985-89 average refers to 19S9 only
c. Doec not include Lebanon for the years 1970-34; 1991-92 are estimates

Source: World Bank Intemational Economics Department
Annex 2: Page 2

Annex 2-Table 4: Total Public Sector Finance, Net Flows ' (S billion)

Cumulative COUNTRY	1970-74	1975-79	1980484	198549	1990	1991	Total 1970-91	Share or Grants	Share of Non-cone.
Algeria	2.21	12.40	1.48	4.75	-0.06	-1.32	19.46	-2.81%	51.34%
Morocco	0.58	5.10	5.56	3.70	1.39	0.91	17.24	12.64%	16.61%
Tunisia	0,47	2.10	1.88	1.30	0.29	0.41	6.46	13.45%	19.47%
Maghreb	3.26	19.60	8.92	9.75	1.62	0.00	43.16	5.80%	32.69%
Egypt	2.27	11.87	15.70	12.03	3.65	3.40	48.90	34.32%	24.84%
Jordan	0.98	3.57	6.97	5.63	0.86	0.50	18.49	66.29%	10.13%
Lebanon	0.15	0.49	1.42	0.49	0.27	0.17	3.00	83.25%	12.71%
Syria	1.09	6.04	12.43	11.39	-0.73	0.09	30.32	54.31%	0.89%
West Bank and Gaza	..	..	0.85	0.91	0.18	..	1.95	100.00%	0.00%
Yemen	0.23	1.58	3.59	2.37	0.30	0.21	8.28	43.40%	1.13%
Mashreq	4.72	23.55	40.97	32.81	4.53	4.36	110.95	48.26%	13.31%
Israel	3.82	10.83	9.37	14.43	2.80	3.88	45.15	83.70%	8.02%
Region	11.81	53.98	59.27	56.99	8.96	8.25	199.25	47.10%	16.31%
MEMO ITEMS 4- (shares)				in Percent					
Bilateml, Arab	27.84	2S.46	24.04	9.02	45.49	12.33	21.63		
Bilateml, OECD'	29.68	36.44	59.11	40.35	75.17	76.27	47.36		
Bilateral, CMEA'	2.8s	0.77	9.26	15.37	-7.13	-2.06	7.03		
Multitateral, Anb	0.09	4.04	1.20	2.58	0.76	-2.24	2.12		
MulUiateral, IBRDI/DA	2.05	2.98	3.99	4.24	4.66	3.51	3.68		
Commercial'	33.08	24.63	-6.12	12.48	-16.23	-12.37	9.15		
Grans	43.41	31.00	44.69	53.64	94.67	54.47	47.52		
ConceuionAl	14.94	20.37	25.58	23.40	4.14	20.49	21.70		
Non.Coacesuional	41.61	48.63	29.71	22.97	1.12	-4.96	30.77		

a. Net flows include gants and conceasional and non-concessional loans
b. Bilateral ilows include guamnteed export credits
c. Does ot include CMEA grnts due to data unavaiability
d. Commercial credits include bonds, banks and supplier' credits
Source: World Debt Tables Bank of Israel
Annex 2: Page 3

الجمهورية اللبنانية
مكتب وزير الدولة لشؤون التنمية الإدارية
مركز مشاريع ودراسات القطاع العام

Annex 2-Table 5: Net Flows' from OECD Donors (s billion)

Total COUNTRY	1970-74	1975-79	1980-84	1985-89	1990	1991	1970-91	Share of Grants	Share of Non-Cone.
Algeria	0.86	4.47	3.84	2.22	0.78	-0.61	11.55	16.44%	80.30%
Morocco	0.62	1.37	2.72	2.28	0.46	0.13	7.58	34.97%	34.95%
Tunisia	0.56	1.21	1.35	0.97	0.24	0.17	4.49	40.25%	26.U4%
Maghreb	2.04	7.05	7.91	5.47	1.48	-0.31	23.62	26.91%	5SS58%
Egypt	0.21	4.51	14.22	11.28	3.09	3.75	37.03	40.65%	30.49%
Jordan	0.34	0.67	1.30	1.29	0.64	0.67	4.91	34.03%	37.12%
Lebanon	0.02	0.09	0.25	0.31	0.06	0.06	0.79	95.91%	0.47%
West Bank and GA	..	..	0.08	0.18	0.03	..	0.28	100.00%	0.00%
Syria	0.01	0.27	0.32	0.25	0.05	0.11	1.02	38.19%	1.59%
Yemen	0.08	0.18	0.55	0.67	0.15	0.18	1.82	81.03%	0.88%
Mashreq	0.67	5.71	16.72.	13.97	4.03	4.78	45.S8	42.81%	28.67%
Israel	0.75	6.76	9.82	3.33	1.08	1.40	23.15	84.37%	15.63%

Region	3.45	19.52	34.46	22.77	6.59	5.87	92.66	49.14%	32.27%
					in Percent				
MEMO rTEMS (shares)									
Grants	47.49	27.04	30.20	78.81	79.57	84.45	49.54		
Concessional	28.83	22.88	15.85	16.39	13.68	21.61	18.22		
Non-Concessional	23.69	50.08	53.95	4.80	6.75	-6.06	32.24		

a. Net flows include grants and concessional and non-concessional loans
Source: World Debt Tables, Bank of Israel
Annex 2: Page 4

Annex 2-Table 6: Net Flows ' From Arab Donors fs billion)

COUNTRY	1970-74	1975-79	198044	19S5-89	1990	1991	Total	1970-91 Share of Grants	Share of Non-Come.
Algeria	-0.03	0.07	-0.04	0.25	0.09	-0.02	0.32	41.90%	7S.81%
Morocco	0.01	1.08	2.21	0.55	0.36	0.47	4.68	32.78%	2.S3%
Tunisia	0.01	0.27	0.12	0.08	0.05	0.02	0.55	21.88%	5.64%
Maghreb	-0.02	1.42	2.29	0.38	051	0.47	S.55	32.21%	7.49%
Egypt	1.81	5.92	-0.23	0.03	2.19	0.50	10.22	75.08%	7.90%
Jordan	0.32	2.32	4.06	1.66	0.43	-0.01	8.77	95.16%	0.05%
Lebanon	0.10	0.26	0.67	0.05	0.14	0.06	1.28	100.00%	0.00%
West Bank and Gaza	..	..	0.46	0.28	0.02	*-	0.76	100.00%	0.00%
Syria	0.88	4.13	5.14	1.71	0.58	0.09	12.53	96.27%	0.16%
Yemnen	0.19	1.22	1.46	0.49	0.14	0.00	3.50	80.86%	0.38%
Masureq	3.30	13.86	11.53	4.21	3.50	0.64	37.07	38.93%	2.2S%
Region	3.28	1S.28	13.82	5.09	4.01	1.12	42.62	31.54%	2.96%
				in Percenl					
MEMO ITEMS (Shares)									
Grants	92.66	67.38	81.95	98.05	98.40	102.48	81.57		
Concessional	6.59	24.71	19.31	-0.27	40.64	-2.18	15.48		
Non-Concessional	0.76	7.91	-1.26	2.22	2.24	-0.30	2.95		

a. Net flows include gants and concessional and non-concessional loans
Source: World Debt Tables
Annex 2: Page 5

Annex 2-Table 7: Total MutiWlateral Assistance, Net Fows ($ billion)

COUNTRY	1970-74	1975-79	198084	1985-89	1990	1991	Total
Algeria	-0.01	0.26	0.25	0.83	0.35	0.57	2.25
Morocco	0.14	0.47	0.93	1.66	0.38	0.40	3.96
Tunisia	0.10	0.23	0.36	0.83	0.27	0.40	2.19
Maghreb	0.23	0.95	1.54	3.32	1.00	1.36	8.40
Egypt	0.01	2.36	1.30	1.12	-0.01	-0.16	4.62
Jordan	0.01	0.08	0.23	0.36	0.10	-0.02	0.77
Lebanon	-0.01	0.05	0.05	-0.03	-0.01	0.00	0.05
Syria	0.01	0.24	0.23	0.42	-0.01	-0.03	0.86
Yemen	0.01	0.17	0.41	0.32	0.01	0.03	0.97
Mashreq	0.04	2.91	2.22	2.20	0.09	-0.17	7.27
Isracl	0.01	0.00	-0.02	-0.05	0.00	0.00	-0.07
Region	0.27	3.86	3.73	5.47	1.08	1.19	15.61
Memo Items (shares)							
o/w Arab	0.04	0.56	0.20	0.28	0.06	-0.18	0.28
olw WB	0.47	0.30	0.46	0.40	0.38	0.25	0.37
o/w IMF	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Concessional	0.46	0.58	0.39	0.22	0.15	0.09	0.34
Non-Concessional	0.54	0.42	0.61	0.78	0.85	0.91	0.66

a. Arab Multilaterals include the Arab Fund for Social and Economnic Development, Islanuc Development Bank, GODE (Gulf Organizalion of Egypt), OPEC Special Fund, Arab Monetary Fund and OAPEC Special Account; Israel not included.

Source: World Debt Tables
Annex 2: Page 6

Annex 2-Table 8: Public Sector Borrowings from Commercial Sources, Net flows ($ billion)

COUNTRY	1970-74	1975-79	1980-84	1985-89	1990	191	Total
Algeria	1.92	7.80	-1.75	1.85	-1.24	-1.22	7.35
Morocco	-0.01	2.64	0.19	0.07	-0.01	-0.03	2.84
Tunisia	-0.05	0.58	0.08	-0.25	-0.11	-0.07	0.18
Maghreb	1.86	11.02	-1.49	1.66	-1.36	-1.32	10.36
Egypt	0.07	0.64	1.76	0.53	0.05	0.18	3.22
Jordan	0.02	0.25	0.16	0.88	0.00	-0.08	1.24
Lebanon	0.00	0.00	0.03	-0.02	0.00	0.00	0.00
Syria	0.09	0.09	0.19	0.24	-0.02	-0.05	0.55
Yemen	0.00	0.00	0.01	0.16	0.00	-0.01	0.1S
Mashreq	0.18	0.97	2.14	1.79	0.03	0.04	5.16
Israel	1.86	1.26	-3.27	3.85	-0.08	0.19	3.81
Region	3.90	12.25	-2.61	7.30	-1.41	-1.09	19.33
Memo Items (shares)							
Bonds	0.42	0;:10	1.01	0.77	-0.07	-1.33	0.47
Banks	0.38	0.59	-2.42	0.37	0.69	1.98	0.39
Suppliers' Credits	0.21	0.31	2.41	-0.14	0.39	0.34	0.15
Other Private	-0.01	0.00	0.01	0.00	0.00	0.02	0.00

Source: World Debt Tables
Annex 2: Page 7

Annex 2-Table 9: Pnvate Non-Guaranteed Debt (S miluion)
DOD

COUNTRY	1970-74	1975-79	1980-84	1985-89	1990	1991	million
Algeria	0	0	0	0	0	0	0
Morocco	28	60	99	31	0	0	200
Tunisia	0	70	24	4	(7)	(5)	213
Maghreb	28	130	123	35	(7)	(5)	413
Egypt	0	200	365	425	(81)	(50)	950
Jordan	0	0	0	0	0	0	0
Lebanon	0	0	0	0	0	0	0
Syria	0	0	0	0	0	0	0
Yemen	0	0	0	0	0	0	0
Mashrea	0	200	365	425	(81)	(50)	950
Israel	323	420	1,149	(252)	655	(1,660)	
Region	351	750	1,637	208	567	(1,715)	

DOD Debt Outtnding and Disbursed
Source: World Debt Tables

Annex 2-Table 10: Total Interest Paid (S miliion)

COUNTRY	1970-74	1975-79	1980-84	1985-89	1990	1991
Algeria	367	2,848	6,872	8,139	1,909	1,952
Morocco	180	1,047	3,025	3,648	871	1,088
Tunisia	120	419	1,124	1,653	391	384
MaMhreh	666	4,313	11.022	13,440	3,170	3,423
Egypt	235	1,131	3,533	5,126	1,127	652
Jordan	15	119	557	1,283	300	304
Lebanon	11	11	121	170	32	41
Syria	39	195	355	474	122	131
Yemen	2	15	81	261	28	28
Mashreq	301	1,471	4.647	7,315	1,609	1,156
Israel	1,607	4,615	12,726	12.885	2,740	2,502

Reition	2,574	10,400	28,395	33,640	7,519	7,081

Source: World Debt Tables, Bank of Israel

Annex 2: Page 8

Annex 2-Table Ha: Worker Remittances (5 million)'

COUNTRY	1970-74	1975-79	1980-84	1985-89	1990	1991
Algeria	1,526	1,773	1,446	3,838	1,528	1,213
Morocco	796	3,102	4,855	7,322	2,320	2,270
Tunisia	342	930	1,769	2,244	708	680
Maghreb	2.664	5.805	8.070	13,404	4,556	4,163
Egypt	545	6,035	14,945	16,385	4,284	4,054
Jordan	140	1,957	4,312	3,749	429	389
West Bank and Gaza	472	1,194	2,287	2,982	794	737
Syria	136	1,735	2,328	1,797	385	450
Yemen b	179	4.604	6.812	3,879	1.366	800
Mashreq '	1,472	15,525	30.683	28,792	7,258	6,430
Israel	4.647	5.489	6.022	6.912	1,963	2,167
Regzion	8.783	26.819	44.776	49.107	13.777	12,760

a. Includes current trnsferc for Algeria, Tunisia and larael

b. 1985-1989 average refer to 19 9 only

c. Does not include Lebanon

Source: IF Balance of Paymenu

Annex 2 - Table Hib: Worker Remittances a as a share of GNP (percent)

Country	1970-74	1975-79	1980-84	1985-89	1990	1991
Algeria	4.4	1.7	0.7	1.4	2.6	3.0
Morocco	2.7	5.4	6.7	8.3	9.3	8.6
Tunisia	2.9	3.5	4.4	4.9	5.9	5.4
Maghreb	3.5	3.0	2.4	3.1	4.8	5.2
Egypt	1.2	8.2	12.1	10.6	13.5	13.3
Jordan	3.0	18.2	18.4	14.3	12.1	10.5
West Bank and Gaza	20.2	22.9	30.5	26.8	26.4	25.6
Syria	0.8	3.7	3.1	3.1	3.0	2.8
Yemen b	n.a.	n.a.	n.a.	6.6	21.8	10.9
Mashreq C	1.8	8.1	10.3	9.9	11.5	10.6
Israel	11.4	7.4	4.9	3.8	3.7	3.5
Region	4.6	5.5	5.4	5.2	6.23	6.1

a. Refers to Current Transfers for Algeria, Morocco, Tunisia and Israel.

b. 1985-1989 average referm to 1989 only.

c. Does not include Lebanon and Yemen, because of lack of data.

Source: IMF Balance of Payments

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Annex 2-Table 12a: ForeiRn Direct Investment (s million)

COUNTRY	1970-74	1975-79	1980-84	1985-89	1990	1991
Algeria	319	586	221	(20)	(39)	(91)
Morocco	34	181	321	382	217	375
Tunisia	158	386	1.164	473	185	164
Maghreb	512	1.153	1,706	835	363	448
Egypt	0	1,681	2,768	5,727	711	241
Jordan	(1)	103	339	107		
Syria	0	0	0	0		
Yemen	0	23	115	9		
Mashrecq I'	(1)	1,807	3.222	5,842	711	241
Israel	440	205	(66)	602	(75)	(170)
Regicn	951	3,165	4,862	7,280	1,000	519

a. Does not include Lebanon and Yemen
Source: IMF Balance of Payments

Annex 2 - Table A12b: Foreign Direct Investment/GNP (percent)

Country	1970-74	1975-79	1980-84	1985-89	1990	1991
Algeria	0.30	0.60	0.11	-0.01	-0.07	-0.22
Morocco	0.20	0.31	0.43	0.38	0.87	1.41
Tunisia	1.41	1.55	2.90	1.06	1.54	1.31
Maghreb	0.48	0.64	0.50	~ 0.20	0.38	0.56
Egypt	0.00	2.09	2.30	3.71	2.25	0.79
Jordan	-0.04	0.89	1.46	0.38		
Syria	0.00	0.00	0.00	0.00	0.00	0.00
Mashreq'	0.00	1.26	1.40	2.43	1.48	0.48
Israel	1.04	0.29	-0.04	0.31	-0.14	-0.28
Region	0.46	0.75	0.70	0.85	0.51	0.27

a. Does not include Lebanon and Yemen
Source: IMF Balance of Payments
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Annex 2-Table 13: Capital Flight (S billion)

COUNTRY	1970-74	1975-79	1980484	198549	1990	1991
Algcria	1,073	5,236	(1,001)	10,196	813	0
Morocco	536	1,016	781	5,202	(796)	(2,671)
Tunisia	159	621	(651)	1,613	40	971
Maghreb	1,768	6,873	(871)	17,011	57	(1,700)
Egypt	30	10,364	14,923	14,089	(2,011)	3,096
Jordan	62	157	1,405	2,565	191	(1,104)
Syria	250	1,734	4,599	6,934	488	N.A
Yemen	19	122	448	557	N.A	N.A
Masbreq	282	12,255	20,926	23,588	(1,331)	1,992
Israel	968	5,126	4,276	3,232	1,646	(39)
Region	3,018	24,254	24,332	43,831	371	253

Source: Authors' computation (sec box 2)

Annex 2-Table 14: External Debt Outstanding, Ratios to GNP and Exports a (percent)

	1970		1975		19S0		1985	
COUNTRY	EDT/GNP	EDTIXGS	EDTIGNP	EDT/XGS	EDT/GNP	EDTIXGS	EDT/GNP	EDT/XGS
Algeria	19.73	70.10	30.03	88.00	47.05	129.S8	32.48	130.79
Morocco	19.28	98.19	19.42	67.50	53.28	224.55	136.56	400.47
Tunisia	40.22	153.63	24.40	69.89	41.57	95.97	61.60	163.74
Magbreb	22.36	91.05	25.89	79.50	48.04	14231	51.92	187.98
Egypt	20.24	155.59	38.87	147.20	97.49	227.04	134.16	385.52
Jordan	9.35	96.76	21.22	59.90	59.24	78.99	84.77	134.34
Syria	11.32	72.67	10.02	50.12	27.15	106.23	66.36	374.35
Mashreq '	17.25	131.50	27.37	109.80	69.84	175.66	108.55	337.63
Israel	49.89	339.73	52.24	309.92	56.97	212.54	72.50	265.86
Region	18.58	93.99	17.36	49.7	34.52	131.29	35.32	202.2S

a. Include. worker remittances
b. Does nao include Lebanon and Yemen
EDT = External Debt
XGS - Exporth of Goods and Scrvices
Source: World Debt Tabies
Annex 2: Page 11

Annex 2-Table 15: External Debt Burden, 1991

1991

PV	EDT	Shares	PV/	PV/	INT/	TDS/	Avg	Avg

Republic of Lebanon
Office of the Minister of State for Administrative Reform
Center for Public Sector Projects and Studies
(C.P.S.P.S.)

COUNTRY ald. Mult. in $ millions in Percent	Com.		in Percent			XGS	GNP'	XGS (Yr.)	XGS	Iat	Mat
Algeria	28,106	28,636	18.4	9.5	64.8	195.62	69.0S	13.59	68.36	7.96	10.3
Morocco	19,515	21,219	49.4	23.9	21.6	234.94	73.54	13.04	27.56	7.56	19.0
Tunisia	7,475	8,296	38.1	32.7	15.4	123.62	59.62	6.15	22.72	6.13	19.8
Maghreb	S5,096	58,151	323	18.0	42.0	191.84	69.08	11.86	46.95		
Egypt	21,435	40,571	68.6	8.2	12.0	147.92	68.80	4.00	16.67	5.60	27.8
Jordan	7,904	8,641	46.0	10.8	30.8	259.23	206.11	9.97	20.92	6.53	17.2
Lebanon	1,833	1,858	12.8	4.3	14.0	174.54	38.31	3.90	16.21	6.97	23.0
Syria	12,118	16,815	77.7	6.2	4.8	245.30	82.16	2.65	14.55	1.13	23.8
Yemen	5,400	6,471	61.5	16.4	2.4	244.12	73.56	1.27	7.28	2.34	23.5
Mashreq	0,765	76,181	66.0	8.7	11.8	171.64	75.70	4.83	17.97		
Israel	33,049	33,049	..	..	..	153.21	53.59	11.12	32.52		
Region	138,910	167,381	46.0	10.2	1S5	173.92	66.64	9.06	32.32		

a. This rtio is computed by using the official exchange rate. Using instead the pamallel market rate, the ratios rise to 140 in Algeria, 235 in Yemen.
PV = Present Value
EDT -External Debt
XGS - Export of Goods & Services
INT = Interest Paid
Avg Int - Average Interest Rate (S)
Avg Mat - Avorage Maturity (Yr.)
Source: World Debt Tables.
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الجمهورية اللبنانية
مكتب وزير الدولة لشؤون التنمية الإدارية
مركز مشاريع ودراسات القطاع العام

Annex 2-Table 16a: Recent Paris Club Debt Reschedulings (s million)

PARIS CLUB	Proportion of Debt / Amount Consolidated	Date / Maturity (M)	Grace (S)	Yrs	Mtba	Yrs	Mths
Egypt							
May 1987	100	5,563	9	3	4	9	
May 1991	100	28,164	-	Menu			
Jordan							
July 19S9	100	500	9	3	4	9	
Feb. 1992	100	603	19/14	5/3	9n	11/9	
Morocco							
Oct. 193	85	1,228	7	3	3	9	
Sep 1985	90	1,083	8	3	3	9	
Mar. 1987	100	1,074	9	3	4	9	
Oct. 1988	100	1,100	9	3	4	9	
Sep. 1990	100	1,886	19/14	5/5	9/7	11/11	
Feb. 1992	100	1,303	19/14	5/7	9/8	11/11	

Source: World Debt Tables

Annex 2-Table 16b: Recent London Club Reschedulings $s milion)

Amount LONDON CLUB	Date	Maturity Recheduled	Grace New Money	ST Credit	Interest Years	Mths.	Years	Mths	Margin
Algeria									
Feb. 1992		1,500		5-8	0	3	0	1I/21-3/8	
Jordan									
Sep. 1989	580			11	0	5	0	13/16	
Nov. 1989		50		10	6	4	0	13/16	
Morocco									
Sep. 1983	531		610	7	0	3	0	1-1/4	
Sep. 1987	2,415			11	0	4	0	1-3/16	
Sep. 1990	3,200		1. 1-20			7-10			