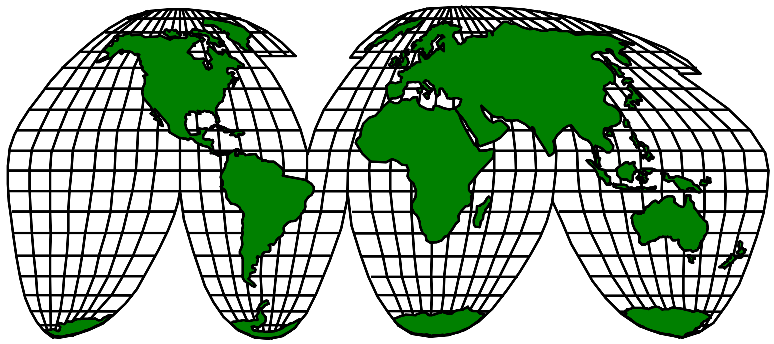


Investment and the Future of Emerging Markets

Transfer Risk Is Key - Driven by Political Stability

- **Political Stability**
  - *System of Government*
  - *Rule of Law And Legal Recourse*
  - *Transparency*
  - *External Stability*
- **Social Conditions**
  - *Income Distribution*
  - *Unemployment And Underemployment*
  - *Overall Social Development Index*
- **Exogenous Factors**
  - *International Interest Rates*
  - *Economic Activity In Industrialized Countries*
  - *Force Majeure*
  - *Rating Agencies' Opinion*
  - *Yield Spreads*

- **Domestic Economy**
  - *Real GDP Growth*
  - *Investment To GDP Ratio*
  - *Real Interest Rate*
  - *Inflation*
  - *Monetary And Fiscal Policy Volatility*
- **External Economy**
  - *Current Account Balance*
  - *Exports To GDP Ratio*
  - *Short Term Capital Flows + Portfolio Investment To Gross Capital Flows*
  - *International Reserve Coverage of Imports*
- **Debt**
  - *Foreign Currency Debt To GDP Ratio*
  - *Foreign Currency Debt To Exports Ratio*
  - *Debt Service Ratio*

Country Risk Can Be Broken Down Into 4 Types

- **Transfer Risk**
  - Inability To Convert Local Currency & Extricate FX
- **Liquidity Risk**
  - Short-Term Transfer Risk
- **Volatility Risk**
  - Market Value of Investments Fluctuates
- **Subnational Risk**
  - Lower Level Government Interference (Contract Frustration)

Rating	Definitions
CBF/1+	Risk is virtually non-existent
CBF/1	Risk is very remote
CBF/1-	Risk is negligible
CBF/2+	Risk is very minimal
CBF/2	Risk is minimal
CBF/2-	Risk is very low
CBF/3+	Risk is low
CBF/3	Risk is very moderate
CBF/3-	Risk is moderate
CBF/4+	Risk is rising markedly
CBF/4	Risk is moderately high
CBF/4-	Risk is high
CBF/5+	Risk is very high
CBF/5	Risk is very high & mitigating factors are diminishing
CBF/5-	Risk is very high and drastic action is required
CBF/6	Risk is very high & macroeconomic or political management is unpredictable

Transfer Risk Most Critical, All Risks Impacted By Politics

HOW TO ACHIEVE SUSTAINABLE GROWTH AND ATTRACT FOREIGN INVESTMENT

Emerging Market Economies: Three Rules To Live By

Consistency

Flexibility

Transparency

Predictability = Credibility

Credibility Is Hard To Earn And Easy To Lose

The Need For Transparency

- **Information**
- **Business-Relations**
- **Political and Judicial**

Leads To Educated Investment Decisions & Reduces Arbitrage

Data Transparency is Important But It Will Never Tell the Full Story

- Coverage
- Quality
- Periodicity
- Accessibility
- Integrity
- Timeliness

Data Transparency		
Major Emerging Market Economies	*Meeting The IIF Standard (among 25 variables)*	*Meeting The IIF Standard (among 18 variables)*
	1999	*1997*
India	*13*	*8*
Indonesia	*16*	*13*
Israel	*21*	*17*
Kuwait	*7*	*6*
Egypt	*4*	*1*
Saudi Arabia	*4*	*1*
South Africa	*15*	*12*
Morocco	*3*	*3*
Argentina	*23*	*12*

Source:IIF

Business Relations Transparency

Corruption Ranking

Rank	Countries
16	Israel
37	Jordan
38	South Africa
54	Egypt
71	India
77	Cote d'Ivoire
79	Pakistan
84	Kenya
90	Nigeria

Note: 1). Based on Survey Conducted by Transparency International in 2001

2). Total of 91 Countries Measured

I have come to the conclusion that politics are too serious a matter to be left to the politicians.
Charles De Gaulle (1890 - 1970)

- **Participatory Democracy: Elections Do Not a Democracy Make.**
- **A Comprehensive Legal Code.**
- **A Judiciary that Applies All Rules With Equity, Predictability and Swiftness.**

Some of the Issues in ANESA

1. Cultural Fragmentation

Largely The Result of Colonialism, Bottled Up During The Cold War. Since Then Imploded In Yugoslavia, Burundi, Rwanda, and Zaire. In West Africa, Horizontal Population Belts Stand In Contrast To Vertically Erected Borders of Nation States. Continent May Experience A Dramatic Phase of Remapping.

- Bangladesh
- India
- Indonesia
- Pakistan
- Sri Lanka
- South Africa

2. Transparency

In Pursuit of One-Dimensional Economic Growth One-dimensional Decision-Making May Be Effective, With Goal Diversification A More Pluralistic & Participatory Approach Seems Unavoidable In Order To Build Lasting Societal Consensus. This Transition Can Be Tumultuous.

3. Education

Laggards Must Catch Up. Stars Must Double Their Efforts. The Latter Must Climb Up The Development Ladder & Increase Their Production of More Value-Added Goods, Currently Held Back By An Insufficient Pool of Skilled Labor.

4. External Conflicts

India-Pakistan
Iraq-Gulf
Gulf-Gulf
The Global Emancipation of China. Territorial Disputes in South China Sea With Natural Resources Critical To The Region

Education, Education, Education

"Freedom Comes More Cheaply Than Equality. There Is Nothing About Freedom That Necessarily Leads To Equality. Just Having The Right To Vote Does Not Affect The Class-Based Education System". Jesse Jackson

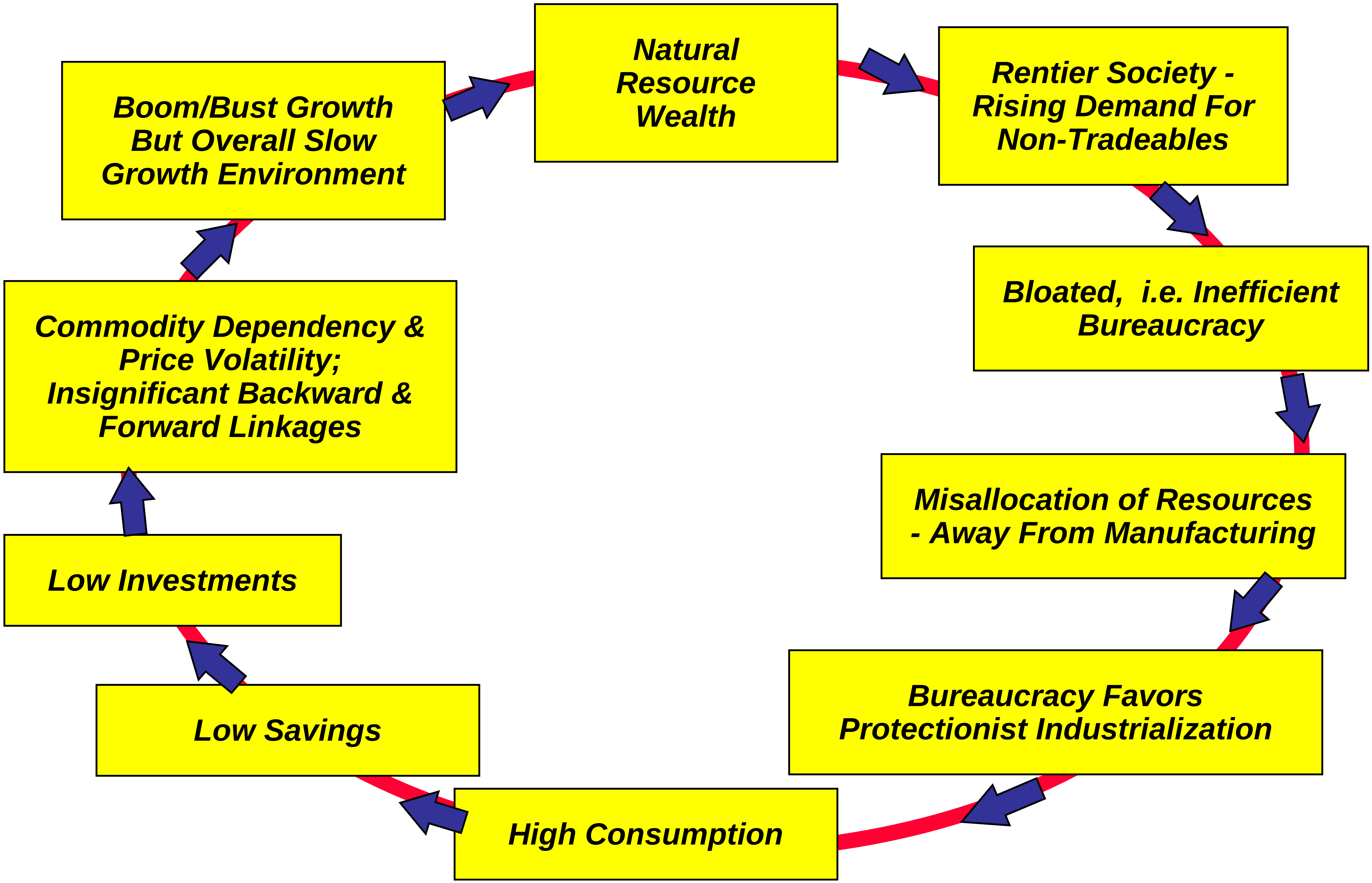
STARS

- **Much of Western Europe**
- **Parts of Eastern Europe**
- **Hong Kong**
- **Israel**
- **Japan**
- **Malaysia**
- **Oman**
- **Philippines**
- **S. Korea**
- **Singapore**
- **Taiwan**

LAGGARDS

- ***Most of Africa***
- ***Most of Latin America***
- ***Part of Middle East***
- ***Bangladesh***
- ***Greece***
- ***India***
- ***Portugal***
- ***Spain***
- ***Thailand***
- ***Turkey***
- ***South Africa***

The Vicious Circle Of Resource Wealth



Let The Poor Be Rich And The Rich Be Poor

Resource Rich

- ★ Argentina
- ★ Bolivia
- ★ Brazil
- ★ Mexico
- ★ Nigeria
- ★ Peru
- ★ Venezuela
- ★ Chile
- ★ Indonesia

Resource-Poor

- ★ Hong Kong
- ★ Korea
- ★ Singapore
- ★ Switzerland
- ★ Taiwan

Inefficient Allocation of Resources - Against The Background of Greater Price Volatility & Lower Diversification of The Economy

Morocco

	2000
Population (million)	28.7
GDP Nominal (bill US$)	32.9
GDP Per Capita (US$)	1,146

	1996	1997	1998	1999	2000	2001E	2002F
Current Account Bal/GDP (%)	-0.2	-0.3	-0.1	-0.5	-1.5	-1.2	-1.0
GDP Growth Rate (%)	12.2	-2.3	6.8	-0.7	0.3	5.5	4.5
Inflation Rate (%)	3.0	1.0	2.8	0.7	1.9	2.4	2.0
Fiscal Bal/GDP (%)-General Govt	-3.0	-0.7	-2.1	-2.8	-4.0	-9.0	--
Total Debt Service/Exports (%)	34.1	32.7	29.7	27.6	24.0	24.0	24.5

- World's leading producer of phosphate fertilizers. Reckless borrowing and expansion in early 1980s, based on assumption of rising demand and prices, led to forced rescheduling when prices collapsed.
- Extensive reform programs, assisted by IMF and World Bank, have laid the foundation for recovery since mid-1980s. Government role in the economy has been sharply reduced through deregulation, the ending of price controls and most subsidies, and privatization.
- Budget deficit huge problem, especially since new King assumed role. Poverty 50% greater than 10 years ago, unemployment over 20%. Hence King is under pressure to increase social expenditure. Drought has created additional problems for public sector. Public investment squeezed by adjustment efforts.
- Manufactured goods have replaced phosphates as leading exports. Textile sector dominated by European in-bond producers, similar to Mexican "maquiladora" industries. Tourism is important, but poor management has harmed performance.
- Large agricultural sector (15% to 20% of GDP) dependent on rainfall, produces wide swings in overall growth rates - explains low GDP growth in 1999-2000. Non-agricultural economy has expanded at steady 3% since late 1980s.
- Debt burden remains heavy. Last rescheduling occurred in 1992. Morocco has never received large-scale forgiveness, so external debt has remained more or less constant in absolute terms, with foreign investment covering most of modest current account deficits. Economic growth is slowly reducing the relative debt burden, but still at 54% of GDP. In addition high fiscal deficits financed at home have raised domestic debt burden from 38% of GDP to 43% between 1997 and 2000.
- Former French protectorate, Morocco is a monarchy. King Hassan II died in July 1999; had ruled since 1961. Succession to his oldest son, 38-year old Mohamed VI, has gone smoothly. Morocco is nominally a multi-party parliamentary democracy, but real political power remains with the king, who appoints the cabinet and can dismiss parliament.
- There has been some cautious liberalization in recent years. Elections in 1997, conducted under new legislation and generally free from government interference, produced a first-ever victory for a coalition of opposition parties. Political activity and speech are still limited, but relatively free by Middle Eastern standards. Hopes that the new king would tolerate a genuinely free press have been set back by the decision to ban two of the country's most outspoken newspapers late in 2000, in retaliation for their reporting on senior military and government officials.

South Africa

	2001
Population (million)	44.8
GDP Nominal (bill US$)	107.0
GDP Per Capita (US$)	2,501

	1996	1997	1998	1999	2000	2001E	2002F
Current Account Bal/GDP (%)	-1.3	-1.0	-0.8	-0.4	-0.3	-0.5	-1.0
GDP Growth Rate (%)	4.2	2.5	0.7	2.1	3.4	2.1	1.3
Inflation Rate (%)	7.4	8.6	6.9	5.2	5.3	5.7	5.0
Fiscal Bal/GDP (%)-Public Sector	-4.5	-5.0	-4.5	-3.5	-1.6	-2.6	--
Total Debt Service/Exports (%)	14.6	16.5	15.6	15.6	13.9	14.7	14.1

- Visionary leadership of Nelson Mandela and majority rule since 1994 pulled country from brink of civil war. New Constitution with broad racial approval, little short of miracle. **Political apartheid gone, but economic apartheid remains. Large poverty, income inequality and 35-40% unemployment.**
- Responsible management of monetary policy. Sophisticated financial sector. Large, yet illiquid stock market. Excellent physical infrastructure for business (roads, telecommunications, water and electricity).
- Mandela's GEAR plan had hoped to drive annual growth to sustainable 6% by 2000 to contain unemployment, but plan was completely unrealistic given low national savings and FDI. Medium-term growth of 4-4.5% may be achievable.
- Domestic costs high in South Africa and productivity relatively low. Labor laws are too rigid, becoming more so.
- **Tight fiscal policy is difficult because of rising social spending, yet steady deficit reduction has been achieved through better revenue mobilization.**
- Rising reserves to over $6 billion, partly because of additional borrowing. Considerable portion committed in forward dollar contracts, risky during currency crisis. No room for error. High liquidity risk. Won't permit complete removal of existing exchange controls or facilitate unbundling of industries.
- Exchange rate regularly under pressure, depreciated by 19% in 2000 and by 37% in 2001 **largely because of political uncertainties.**
- High levels of poverty and unemployment, growing immigration and guns from Mozambique and Angola have raised crime rates in Johannesburg to intolerable levels.
- Smooth political transition from Nelson Mandela to President Mbeki. Mbeki is strong supporter of economic reforms, but this will be increasingly difficult to sustain if growth and employment do not pick up. Authority has been hurt by poor handling of aids crisis, accusations of plots against him. **South Africa depends and can count on goodwill of international community (governments).**
- **Worsening crisis in Zimbabwe has hurt foreign investors' perceptions of South Africa -- with some justification, as ANC has been reluctant to criticize the Mugabe government's violent seizure of white-owned farms.**

Egypt

	2000
Population (million)	69.2
GDP Nominal (bill US$)	92.5
GDP Per Capita (US$)	1,337

	1996	1997	1998	1999	2000	2001	2002F
Current Account Bal/GDP (%)	-0.3	-0.9	-3.1	-1.8	-1.2	0.0	-2.0
GDP Growth Rate (%)	5.0	5.5	5.6	6.0	5.1	4.9	2.0
Inflation Rate (%)	7.2	4.6	4.2	3.1	2.8	2.4	2.4
Fiscal Bal/GDP (%)-General Govt	-1.3	-0.9	-1.0	-3.0	-3.9	-5.3	-5.1
Total Debt Service/Exports (%)	15.4	27.9	14.7	14.5	17.5	20.3	17.2

- After decades of mismanagement and decline, Egypt began first stage of economic reform in 1991. Some stabilization was achieved budget deficit fell from 20% of GDP in 1990 to less than 1% in 1998, inflation was brought under control (currently at 2.4%) and current account also improved.
- Growth lagged -- real per capita GDP rose by a total of only 6.5% in the first half of the 1990s, and current account surpluses owed more to weak imports than improving exports. Therefore, second stage of reform, begun in 1996, focused to improve through structural reform: deregulation, privatization, and the strengthening of capital markets, especially the stock exchange. Growth accelerated, but reform slowed down in last few years.
- Economic slowdown and fiscal deterioration are of serious concern (too much blamed on effects of 9/11). Poor government statistics have led to embarrassing misjudgment in both areas. Large off-balance sheet obligations, poor management of public investments as well as fiscal repression (government is not paying its suppliers) are drag on economy.
- **Egypt prime example for consequences of inconsistent and inflexible policies. For several years government wanted to keep dollar peg (at overvalued rate), but was unwilling to use reserves or monetary policy to defend it (with tacit IMF support). Result was periodic, artificial dollar "shortage", and heavy-handed official pressure on importers and currency "speculators". Therefore, stunted export growth. In 2001, pressures on exchange rate became unbearable. Central Bank acted incoherently changed course several times and was only reactive.** On balance, Egyptian pound depreciated by 18% in 2001, yet policy uncertainty remains. Political costs of freely floating exchange rate considered too high.
- Lack of entrepreneurship and liquidity constraints in Egypt are additional reason for its lack of competitiveness. Foreign currency debt burden is moderate. Nearly half of official debt was forgiven in early 1990s, and a sustainable current account position since then has lowered debt ratios to a manageable level, but domestic debt high at 65%of GDP.
- **In longer term, political and social pressures pose greatest threat.** Parliamentary elections in late 2000 produced small but surprising gains for "opposition" candidates, but these will have only a watchdog role. Without sustained economic growth, opposition is sure to increase. Islamic militants have some support, but more mainstream Muslim groups are in a better position to press for political change.

Israel

	2000
Population (million)	6.3
GDP Nominal (bill US$)	112.4
GDP Per Capita (US$)	17,841

	1996	1997	1998	1999	2000	2001E	2002F
Current Account Bal/GDP (%)	-5.6	-3.3	-0.4	-1.9	-1.3	-2.1	-3.0
GDP Growth Rate (%)	5.0	3.2	2.6	2.2	6.2	0.5	0.0
Inflation Rate (%)	11.3	9.0	5.4	5.2	1.1	1.5	3.5
Fiscal Bal/GDP (%)-Central Govt	-9.0	-6.0	-5.3	-5.0	-3.4	-4.5	-5.5
Total Debt Service/Exports (%)	18.1	20.4	21.5	21.8	22.9	24.9	23.5

- During first 25 years of existence, Israel's economy grew at annual rates of 10%. Between 1970 and 2000, per capita GDP rose from $1,830 to $17,841. Growth was accomplished in the face of adversity: numerous wars, international boycotts, and 300% population growth. End of Soviet Union led to a new wave of immigration, more than 800,000 between 1989 and 1999. High skill levels of newest arrivals gave significant boost to the economy, allowing rapid absorption of most job-seekers. Today 30% of Israel's industrial output is high-tech.
- Peace accords, rapid population growth stimulated rapid GDP growth in first half of 1990s. Reversal of those favorable circumstances led to slowdown. **Since beginning of 2001, chaotic and gradual collapse of regional truce. "Get-tough" policy of Sharon administration lose-lose proposition. Security situation worse than before and economy deteriorating all around. Growth has come to a crawl, current account worsening, because tourism obliterated and construction as well as agricultural have slowed. Shekel depreciating at unsustainable pace, raising – once again -- inflationary pressures. Fiscal position getting worse because of steep costs of war and economic slowdown.**
- Monetary policy was eased in 2001 as policy response to slowdown, but maneuvering room is limited by out-of-control depreciation and resulting price pressures, reducing ability for Israel to recover economically.
- Fragile coalition governments have meant that political pressure on the budget is relentless. Moreover, economic policy nearly always takes a back seat to security issues in politics, delaying action on key liberalization reforms.
- External debt is considerable, but much is guaranteed by U.S. or extended by world Jewish community at favorable terms.
- **Israeli political system incurably fragmented leading to permanently weak governments, even when led by political hawks, such as Ariel Sharon, who won overwhelming victory in direct election for prime minister held in early 2001.** Return to negotiating table is only way out for Israel (and the Palestinians). However, since early 2001, with Sharon's leadership and after 9/11 there is increased event risk of a broad all-out war, involving other Arab nations, whose track record has been dismal in such bellicose exercises. Yet, internal pressure is rising in many of those countries destabilizing existing regimes. There will be war, should Arafat be killed by Israeli forces. Consequences for the region and globally could be quite negative.

Jordan

	2000
Population (million)	6.7
GDP Nominal (bill US$)	8.8
GDP Per Capita (US$)	1,313

	1996	1997	1998	1999	2000	2001E	2002F
Current Account Bal/GDP (%)	-3.2	3.7	3.6	5.0	0.7	-2.5	-3.5
GDP Growth Rate (%)	2.1	3.1	2.9	3.1	3.9	3.0	2.0
Inflation Rate (%)	6.5	3.0	4.4	0.6	0.7	1.6	2.0
Fiscal Bal/GDP (%)-Central Govt	-5.9	--10.3	-10.0	-7.7	-7.5	-6.3	-7.0
Total Debt Service/Exports (%)	27.2	22.1	23.1	22.0	22.8	15.5	17..0

- A small, resource-poor country surrounded by more powerful, often-unfriendly neighbors. About 60% of the population is Palestinian by origin, having fled to Jordan in wake of Arab-Israeli wars, especially in 1948 and 1967. Political and economic power is held largely by "East-bank" Jordanians, who also make up all of professional military.
- Relatively well-educated population helps compensate for lack of oil, other natural wealth. Human capital is most important "export": hundreds of thousands of Jordanians work in the Arab Gulf countries and send home some $2 billion a year in remittances. Vital sources of foreign currency, but vulnerable to political and economic developments in host countries.
- Gulf War a turning point in two respects: Jordan's support for Iraq put an end to large cash grants from Gulf Arab countries, which had financed massive budget deficits since mid-1970s; Iraq itself, formerly Jordan's most important export market, has diminished role (23% of Jordanian exports went to Iraq in 1989, only 9% in 2000).
- Jordan had to reschedule large foreign debt and seek IMF assistance for economic restructuring. Partial success: budget deficit reduced to more reasonable - albeit high - levels and inflation held in check (although artificially through currency peg). Influx of relatively well-off Jordanians expelled from Kuwait and Saudi Arabia helped spark a post-war boom, aided adjustment efforts.
- But privatization still too dependent on the public sector. Trade liberalization led to WTO access and trade agreement with U.S. in 2001. Great potential in qualified industrial zones (QIZs), but success depends on settlement of Israeli-Palestinian conflict. Jordan also severely impacted by war-like state in region, because tourism 20% of exports and will be way down in 2002.
- King Abdullah succeeded father in February 1999 and has been invigorating force in economic renewal. High event risk of outright war in region negatively impacts short-term, and medium-term growth potential for Jordan, which could be politically destabilizing. New King Abdullah has re-established friendly relations with Gulf Arab states, some of which have made offers of renewed aid.
- **Country still has very high birth rates and even greater rates in past decades lead to an overwhelming challenge to economic policy making as growth has to be sustained at very high level to accommodate rapidly growing labor force. This social challenge will translate into the key political challenge to the current ruler.**

Kuwait

	2000
Population (million)	2.2
GDP Nominal (bill US$)	37.8
GDP Per Capita (US$)	17,181

	1996	1997	1998	1999	2000	2001E	2002F
Current Account Bal/GDP (%)	22.9	26.4	8.7	17.1	39.4	27.9	20.0
GDP Growth Rate (%)	-3.3	1.0	3.5	-4.8	3.6	1.9	2.0
Inflation Rate (%)	3.6	0.7	0.1	3.0	1.8	2.6	3.)
Fiscal Bal/GDP (%)-General Govt	4.5	23.1	10.0	-1.5	26.3	29.0	--
Total Debt Service/Exports (%)	41.9	33.9	20.1	10.7	8.5	7.3	6.0

- Independent since 1961. Oil production, economic development began in the 1940s, earlier than rest of Gulf. Proven oil reserves equivalent to 10% of world total, comparable to UAE. Before Gulf War, had accumulated more than $100 billion financial reserve in undisclosed "Future Generations Fund" -- at least $65 billion was spent in the course of the war. Now replenished to some $90 billion (this is in addition to country's official reserves of over $7.5 billion). Economy still on slow growth path.
- Public sector finances are in poor structural condition. Over-reliance on oil revenues means that budget outcome depends on oil prices -- for the moment these are high, so budget is in surplus. Expenditure is dominated by salary expense, generous public services, which will grow exponentially, causing severe problems eventually. One of few OPEC members with spare capacity, meaning oil revenues could rise at any time required. Also oil sector very diversified and production costs very low.
- Public domestic debt is fairly high -- cost of recapitalizing banking system in 1994, as well as forgiving most debts of private individuals after liberation. Partial recovery of assumed bank loans is reducing total debt, but re-constituted banking system remains vulnerable because of lending for shares purchases and high exposure to local real estate market.
- Parliament elected by male suffrage, re-established in 1992. Largely consultative role, but has become a quite vigorous public forum unparalleled among Arab countries. In 2001, following disagreements within ruling family, government was changed and more reform minded individuals put in place. **Internally key challenge to Kuwait is to create employment for a rapidly increasing local population, a challenge to all Gulf countries. Per capita income is misleading. Public sector costs will be ballooning as time passes.**
- Security situation remains tense, but for different reasons in 2002, i.e. lack of resolution and escalation of Israeli-Palestinian conflict may have serious external consequences and maybe internally destabilizing for Gulf regimes, although probably less so in Kuwait. Conflict has facilitated Iraqi commitment at Arab summit in March 2002 to forego any future aggression against Kuwait (credibility of Iraqi commitment somewhat doubtful, although suggest some progress).

Saudi Arabia

	2000
Population (million)	20.6
GDP Nominal (bill US$)	164.8
GDP Per Capita (US$)	8,014

	1996	1997	1998	1999	2000E	2001E	2002F
Current Account Bal/GDP (%)	0.5	0.2	-10.2	0.3	9.0	4.3	1.5
GDP Growth Rate (%)	1.4	2.7	1.6	0.4	4.1	1.5	1.5
Inflation Rate (%)	0.9	-0.4	-0.2	-1.2	-0.5	0.5	1.5
Fiscal Bal/GDP (%)-General Govt	-3.6	-2.9	-10.2	-6.5	7.3	-4.0	-7.0
Total Debt Service/Exports (%)	3.3	3.4	6.7	7.4	6.4	6.7	6.7

- World's largest oil exporter, 25% of world proven reserves.
- By far the largest population of the six Arab Gulf countries, with population growth rate of 3.5%. Per capita GDP has actually declined by more than half since 1980; real GDP growth has been sluggish most of this decade, limited by oil sector -- which accounts for 35% of output, but is stable.
- Huge cumulative current account deficit since 1983. During that period, official reserves and foreign assets were largely drawn down; public domestic debt rose sharply, from 25% of GDP in 1991 to over 100%in 2001.
- Despite attempts to diversify export base, oil and derivatives still account for 95% of total. Little scope for increasing export revenues -- size of market presence means that any volume increase would trigger further oil price falls.
- Budget is in structural deficit (although high oil prices can produce an occasional surplus), driven by undiversified revenue base (80% oil revenues; no sales or income taxes) as well as high and rapidly-growing expenditure. Overly generous welfare state: health, higher education, housing are free, most services and utilities are heavily subsidized, and state is employer of last resort. Rapid population growth means exponential growth in demand for all of these, enormous pressure on budget.
- Adjustment efforts have concentrated on reducing public investment; no longer an option -- will have to spend heavily on infrastructure to meet rising demand for power, water, transport, communications, etc. Government hopes to shift more of the financing and operational burden to the private sector.
- **Al-Saud regime by far the weakest in the region and yet most important to U.S. national security. Although domestic opposition is ill-organized, external instability post 9/11 and escalation of Israeli-Palestinian as highlighted fragility of regime. Large support for terrorist attack on U.S. among the young, ill-educated and unemployed. Social implosion of years to come maybe brought forward by current crisis. Crown Prince Abdullah's peace initiative in Middle East conflict an attempt to distract from internal Saudi uncertainties as well as to placate U.S. considering large involvement of Saudi nationals in attacks on September 11. Overthrow of regime still unlikely, but greater probability than in early 2001. Probability will rise as number of disenfranchised rises. Regime change likely to occur 5-10 year from now and likely to be chaotic in nature.**

United Arab Emirates

	2000
Population (million)	2.5
GDP Nominal (bill US$)	66.1
GDP Per Capita (US$)	26,849

	1996	1997	1998	1999	2000E	2001E	2002F
Current Account Bal/GDP (%)	12.9	12.6	-2.3	6.3	17.5	12.0	3.3
GDP Growth Rate (%)	6.1	8.3	1.4	3.9	7.3	1.9	2.8
Inflation Rate (%)	2.6	2.0	2.0	2.2	1.4	1.2	1.5
Fiscal Bal/GDP (%)-General Govt	-14.2	-5.1	-20.4	-14.0	-11.5	-11.8	-9.4
Total Debt Service/Exports (%)	6.6	6.8	8.4	8.4	7.6	8.0	8.5

- Loose federation of seven Emirates. Emirates maintain wide-ranging independence of economic policy-making. Two Emirates, Abu Dhabi and Dubai, produce virtually all oil (2,000,000 bpd and 250,000 bpd respectively). The other five emirates are relatively poor. Volatile economic growth in 1990s, as oil price movements fed a construction boom, then a sharp fall. Real GDP numbers are less important than nominal -- the dollar value of oil exports determines conditions in rest of economy.
- Moderate inflation, not officially reported. Currency link to the dollar and wide-open trade regime limit price pressures. Strong dollar has helped limit inflation since mid-1990s.
- Federal budget is close to balance, but individual emirates run very high deficits. Only 20% of UAE expenditures at federal level. 80% at level of seven emirates, but these accounts are not published. Difficulties in consolidating numbers. High deficits are financed with income transfers from Abu Dhabi's significant overseas financial assets: probably over $120 billion, the returns on which not included in fiscal accounts. Lack of data on those assets.
- Most diversified Gulf economy. Oil sector contributes 30% to GDP, accounts for 58% of exports and 85% of government revenue. Dubai is major re-export center in the region with long tradition. New links with the former Soviet Union, but economic problems in those markets have hurt trade.
- Low and stable debt ratios. Most debt short-term and trade-related, but growing volume of project-related finance. Government wants to increase role of private (mostly foreign) capital in providing infrastructure investment -- should raise inflows of both debt and equity capital.
- Increasing number of young technocrats appointed to leading political positions bodes well for future policy-making.
- Sheikh Zayed, founder of the UAE, now in his 80s. Eldest son will succeed him both as ruler of Abu Dhabi and president of UAE. Some rivalry with Dubai, but primacy of Abu Dhabi is now explicitly recognized by new constitution.

India

	2000
Population (million)	1,027
GDP Nominal (bill US$)	459.0
GDP Per Capita (US$)	456

	96/97	97/98	98/99	99/00	00/01	01/02E	02/03F
Current Account Bal/GDP (%)	-1.2	-1.4	-1.0	-1.1	-0.6	-0.4	-0.7
GDP Growth Rate (%)	7.8	4.8	6.6	6.1	4.0	5.0	5.0
Inflation Rate (%)	10.2	9.0	7.2	13.2	4.7	3.6	3.4
Fiscal Bal/GDP (%)-General Govt	-8.6	-9.2	-10.3	-9.7	-9.7	-9.0	-9.0
Total Debt Service/Exports (%)	33.0	27.0	24.9	23.7	19.2	19.0	19.7

- India exceeded 1 billion people in 1999 and will have largest population in the world in early 21st century. Large middle class. Often estimated at 250 million, but more likely at 165 million based on consumption estimates. Economy has underperformed since independence, annual average per capita income growth of only 2% since 1960.
- Despite trade liberalization and deregulation, Indian economy still very protected, because country followed import substitution. 20% of prices still administered. 20% of manufacturing produced by state-owned enterprises. Financial sector still dominated to 90% by government. Further liberalization meets resistance. Civil service needs streamlining. Red tape overwhelming, 20 certificates of compliance required to start a business.
- Huge and protracted fiscal deficits. Slight improvement on revenue side due to higher corporate taxes (increased from 35% to 38.5%), higher taxes on foreign corporations (increased from 48% to 52.8%). Not a favorable environment for investors. Also better tax collection.
- Privatization of public sector enterprises (PSEs) indispensable to resolve crisis, **but politically difficult.** More than 1,000 enterprises owned by states, 260 owned by central government. State electricity boards (SEBs) a particular drag. Social transfers and defense also big expenditure items. Consequently, domestic debt rising, debt service now 71% of current revenues. In addition, large deficits of oil pool, below the line. 70% of government securities are held by banks. Government still borrows from central bank (monetization), weakening monetary policy. Public sector crowds out private borrowing.
- Moderately high external debt ratios. International reserves relatively adequate, but not sufficient a condition to prevent liquidity crisis if markets get more conservative. External balance very dependent on oil prices. Currently 30% of imports are petroleum products.
- Agricultural sector still dominant but inefficient. Labor laws inflexible.
- Savings rates in the mid 20s not too bad, but ICORs unsatisfactory, because of role of public sector in economy and because of geographic spread of investments. More savings necessary to accelerate growth.
- Serious infrastructural bottlenecks. Peak hour shortage of electricity 30%. Demand grows 11% annually, supply only 3%. Private sector investments impeded by lack of transparency of tariff setting, lack of framework for risk allocation. Shows in historically dismal foreign direct investment, only 0.5% of GDP in 2000 compared to 3.5% for China, for example.
- **Fragmented political system in the world's largest democracy. Current government led by nationalist Hindu party (BJP) of Prime Minister Atal Behari Vajpayee includes over 20 parties and has only slight majority in Congress. Little reform implemented since came to power in 1999. Rule of law imperfect with 40 million case backlog in Indian court system.** Big setback for BJP in local elections, when Congress Party made some spectacular gains. India's internal security also at risk by sectarian conflicts, long bottled-up.
- Concerns of war with Pakistan rose again after attack on parliament December 13, 2001 by extremists with camps in Pakistan. India's provocative nuclear testing in May 1998 deepened political instability in Pakistan that led to coup in October 1999.

Pakistan

	2000
Population (million)	137.5
GDP Nominal (bill US$)	61.4
GDP Per Capita (US$)	446

	96/97	97/98	98/99	99/00	00/01E	01/02E	02/03F
Current Account Bal/GDP (%)	-7.4	-2.9	-3.6	-2.1	-1.9	-0.6	-1.5
GDP Growth Rate (%)	5.0	1.2	3.7	4.4	3.4	3.0	3.0
Inflation Rate (%)	10.4	11.4	5.7	3.6	4.4	5.0	5.6
Fiscal Bal/GDP (%)-General Govt	-7.8	-6.7	-6.0	-6.5	-5.2	-5.3	-5.6
Total Debt Service/Exports (%)	34.0	43.8	41.2	38.4	32.1	32.0	28.1

- Islamic Republic of Pakistan formed after break-up of former British India in 1947, and secession of then-East Pakistan (Bangladesh) in 1971 following civil war that cost several hundred thousands of lives and that was ended through Indian intervention.
- **Pakistan has experienced poor governance with high levels of corruption throughout its history. Highly personalized political processes. Political instability has led to often incomprehensible macroeconomic policy-making.**
- **On October 12, 1999 a military brought to power General Musharraf. Former Prime Ministers Nawaz Sharif and Benazir Bhutto had alternated in office for most of the 1990s, and the flagrant corruption and pointless, incessant quarreling of their governments greatly weakened support for democracy in Pakistan.**
- **Political complexities also due to strong role of religious divisiveness. 77% of population Sunni Muslims, 20% Shi'ite. Great hostility, even among different groups within the majority Sunni community. Regional and ethnic splits are at least as harmful, particularly because they are mirrored at the party level.**
- Economy still highly concentrated in agricultural sector 25% of GDP, weather dependent. Manufacturing sector weak, because of frequent power outages and strikes. In many ways centrally managed economy. Government sets targets for each crop, and "assessment committees" estimate during the year likelihood of meeting targets. Financial sector extremely weak.
- Savings rates in low teens. Consequently, investment rates low as well, yet savings/investment gap still unmanageably large, prohibitive for self-sustained long-term growth. High economic growth rate indispensable against the background of population growth rate of 3% per annum.
- Central government fiscally irresponsible, provincial governments even worse, state enterprises and utilities bankrupt for all practical purposes. 50% of domestic credit goes to public sector. Large and protracted twin deficits (fiscal and current account) have led to increase in country's domestic and external indebtedness and added to vulnerability of Pakistan to shocks.
- Economy flirted with collapse and debt default several times in late 1990s and early 21st century. In 1998, U.S. imposed sanctions on Pakistan because of its testing of nuclear missiles in May of that year. Liquid reserve levels were only $400 million. Pakistan was neither paying imports nor creditors, such as IBRD, IMF, IFC and ASDB. In desperate effort to attract foreign currency, government appealed to residents in 1997 to bring back foreign currency assets into the formal banking system, only to freeze all dollar-denominated bank deposits in 1998. Depositors likely to take significant loss on these deposits.
- In April 1998, government also reneged on convertibility guarantee for debt service payments and for repatriation of profits of certain infrastructure projects with foreign participation. Paris Club (bilateral donors) tried to ease Pakistan into defaults on eurobonds, but Pakistan resisted. U.S. lifted sanctions in December 1998, allowing IMF initiative and debt rescheduling (which is reason for improved ratios).
- Since coup in late 1999 some improvements in fiscal and debt management. However, outlook for FDI bleak because of government's strong-arm tactics with regard to IPPs.
- **Events of 9/11 had most profound impact on Pakistan, politically and economically President Musharraf decided to side with U.S., a gamble in short, medium a long term. In short term, Pakistan has been rewarded with financial assistance, in medium term all will depend, wheter U.S. remains committed, if not regime may crumble quickly giving in to those who opposed Musharraf's stance.**