Perspective on the Middle East, North Africa and South Asia (MENASA) region
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This report is a result of research carried out by McKinsey & Company. Its objective has been to conduct an in-depth analysis of the economies in the MENASA region and to understand the drivers of growth. This publication is not intended to be used as the basis for making investment decisions or for undertaking any other complex or significant investment activity without consulting appropriate professional advisers. All information used in the compilation of this report has been obtained from publicly available sources.

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Foreword

The economies of countries throughout the Middle East, North Africa and South Asia – a group that we have labeled ‘MENASA’ – are developing at a remarkable pace. Real economic growth rates for MENASA approach that of China, while the region’s aggregate annual volume of economic activity – as measured by GDP – is on par with the United Kingdom and China. At the same time, MENASA countries face significant challenges as they strive to raise standards of living for all of their citizens.

The growth throughout the MENASA countries has sparked considerable interest in the region. Corporations are considering whether to launch new businesses to exploit MENASA opportunities, investors are exploring whether to allocate capital to the region, and a range of governments, multilateral institutions, and non-governmental organizations want a better understanding of the region’s economic development.

This document aims to provide a portrait of the MENASA region, offering data and analysis about its economic history, its current status and the different paths along which it is expected to develop.

The report examines key economic trends that are unfolding across the MENASA region, before taking a closer look at some of its subregions and countries. It also examines the state of the private equity market, where transparency hitherto has been limited.

We hope that you will find the report useful.

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Middle East (ME)
The Gulf Cooperation Council including Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and United Arab Emirates
The Levant including Jordan and Lebanon
Turkey

North Africa (NA)
Algeria, Egypt, Libya, Morocco and Tunisia

South Asia (SA)
India and Pakistan
Introduction

What is MENASA?

MENASA refers to the countries that are spread across the Middle East (ME), North Africa (NA), and South Asia (SA). We will focus our analysis on the following 16 countries and in the remainder of this document, MENASA refers to these countries:

**In the Middle East:** Bahrain, Jordan, Kuwait, Lebanon, Oman, Qatar, Saudi Arabia, Turkey, United Arab Emirates

**In North Africa:** Algeria, Egypt, Libya, Morocco and Tunisia

**In South Asia:** India and Pakistan.¹

It is fair to assess these 16 countries as one economic bloc. The economic and political linkages between the MENASA countries date back thousands of years, as they have been trading partners throughout history and have been governed by the Persian, Ottoman and British Empires and the Caliphate. This common history has created shared customs, traditions, languages and religions that have stood the test of time and have become a catalyst for expanded economic opportunity and growth.

Today, the MENASA region is home to approximately 25 percent of the world’s population, or 1.6 billion people, producing a combined GDP of USD 3.1 trillion in 2007, which is comparable to that of China.² Since the turn of the century, this region has been in the midst of unprecedented economic developments.

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1 Bangladesh, Sri Lanka, Yemen, Syria, Sudan, Iran, Iraq, Israel and the Palestinian territories are geographically a part of the MENASA region but they are not included in the analysis in this report.

2 China’s GDP was USD 3.2 trillion in 2007; if Bangladesh, Sri Lanka, Yemen, Syria, Sudan, Iran, Iraq, Israel and the Palestinian territories are included then in 2007 the total MENASA population was 2.0 billion and total MENASA GDP was USD 3.8 trillion; Global Insight, World Market Monitor.
Why look at MENASA now?

Never before has the inflow of financial liquidity into the MENASA region from hydrocarbons and the availability of skilled labor been so large, and never before has economic development in the region been accompanied by comprehensive government reforms.

The MENASA countries currently account for 29 percent of global oil production and 15 percent of global gas production. This share is likely to increase, as the region houses 45 percent of the world’s proven oil reserves and 28 percent of the world’s proven gas reserves. Cumulative financial inflows from hydrocarbon exports could exceed USD 9 trillion by 2020.¹

Progressive leaders across the MENASA region – from Morocco to Jordan to Pakistan – are initiating and implementing reforms that will liberalize the economies of their countries. Governments are promoting the role of the private sector and foreign investments, while they move towards more regulatory and monitoring roles.

The growing level of financial liquidity is increasingly being invested back into the region as both governments and entrepreneurs witness the need for – and opportunity in – regional investments. Between 2002 and 2007, USD 3 trillion was invested in the development of the MENASA economy, accounting for 4.3 percent of global investment.² Over the next 10 years, cumulative investments could exceed USD 15 trillion.

The resources of the MENASA countries are complementary and diversified – some countries have hydrocarbon wealth, while other countries have large pools of talented labor. The Gulf Cooperation Council (GCC) countries, as well as Algeria, Libya and to a lesser extent Egypt, account for 99 percent and 96 percent of MENASA’s total oil and natural gas reserves, while India, Pakistan, Egypt and Turkey account for 92 percent of the region’s population. This leads to countries exploiting their resource richness: hydrocarbon-rich countries invest in other parts of the region, and workers from population-rich countries migrate to those parts of the region where they find opportunities to work. As a result, MENASA countries received in total more than USD 59 billion in remittances of which USD 16 billion originated from the MENASA region, predominantly the GCC countries.³

Building on the region’s common history and complementary resources, the individual MENASA countries are becoming increasingly integrated. Trade between the MENASA countries increased from USD 45 billion in 2002 to USD 136 billion in 2006, growing at an annual rate of 26 percent per year. Cross-border M&A activity, as measured by the value of transactions, increased more than forty-fold between 2002 and 2007. Mobility within the region has also increased – as demonstrated by the increase in flight capacity within the region, from 33 million passengers in 2000 to 58 million passengers in 2007.⁶

As the MENASA countries face similar development needs and as the region is deepening its economic integration, businesses are drawn to the opportunity to offer products and services in multiple countries. The development of

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² Global Insight, World Market Monitor.
³ BP Statistical Review of World Energy, June 2007; Global Insight, World Market Monitor; World Bank; EnergyFiles.
⁴ PCTAS; Dealogic; OAG via BACK Aviation Solutions.
regional businesses – such as the UAE-based Emirates Airlines, Orascom Telecommunications from Egypt, and logistics provider Aramex from Jordan – highlights the opportunities available to savvy entrepreneurs.

Looking ahead

The region’s promise is one of growing global share; the region is well positioned to claim a higher stake in the global economy than ever before:

• While currently having a 5 percent share of global GDP MENASA is projected to generate 9 percent of the world’s total growth in GDP in the next 10 years.  
7

• MENASA is currently home to approximately 25 percent of the global population, but is projected to account for 34 percent of the world’s population growth over the next 10 years.

• MENASA will grow its global share in many industries. For example:
  - MENASA accounts for 24 percent of today’s global hydrocarbon production, and is expected to generate 34 percent of the growth in global hydrocarbon production over the next 10 years.  
8
  - While currently having 10 percent of global aluminum production, MENASA is expected to account for 40 percent of growth in global production.  
9
  - The 15 percent share of global telecommunication subscribers the region has today, will grow as MENASA is expected to account for 26 percent of global growth in subscribers.  
10

For all of the progress underway throughout MENASA, a few fundamental challenges remain. First, MENASA governments will need to continue developing the private sector in order to create jobs for the large and young MENASA populations. Second, the region’s infrastructure needs to be modernized and expanded. Failing to improve the ‘hard’ infrastructure (roads, housing, power generation, water) and the ‘soft’ infrastructure (education, healthcare), will threaten MENASA’s future ability to continue down the path of economic growth. Finally, the region will need to find ways to absorb the rapid increase in liquidity whilst keeping inflation under control.

In this report, we explain how the combination of rapidly growing liquidity levels, supporting demographics, government reforms and increasing economic integration has generated significant growth in the region and has laid a foundation for future growth. We will explore economic developments and opportunities in the medium term within the countries of MENASA 11, and close with an analysis of the regional private equity market.

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7 Global Insight, World Market Monitor.
8 EnergyFiles.
9 Brook Hunt; James King.
10 Euromonitor.
11 In general, the horizon for our analysis is 5-10 years and we do not assess shorter term economic or political volatility in a systematic way.
Chapter 2
The MENASA region: overview and common themes
The MENASA region: overview and common themes

Overview of the region

The MENASA region extends from Morocco in the West to India in the East. It spans eight time zones across 10,000 kilometers and is home to 25 percent of the world’s population.

Its people, economies and resources have made MENASA an emerging economic powerhouse. The region has experienced unprecedented development and growth in recent years and numerous indicators signal that this growth will continue.

Although the region is no stranger to conflict and political turmoil, this has not interrupted regional economic development, as many of these conflicts are contained in local areas. The MENASA countries are, in fact, largely stable and distinguished overall by rising levels of prosperity.

To understand the dynamics of this fast-growing region, it helps to think of each of the 16 MENASA countries (Exhibit 1) as belonging to one of five economic subregions:

- **Gulf Cooperation Council (GCC):** Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and United Arab Emirates (UAE). Together, the GCC countries are MENASA’s hydrocarbon powerhouse, with 89 percent and 84 percent of MENASA’s oil and natural gas reserves, respectively. They are responsible for 77 percent...
and 60 percent of MENASA's oil and natural gas production. The GCC's GDP grew at 7.0 percent per year in real terms between 2002 and 2007, and at USD 22,100 the GCC countries have the highest GDP per capita in MENASA. The GCC countries account for 27 percent of MENASA's GDP yet they are home to only 2 percent of MENASA's population.

- **North Africa:** Algeria, Egypt, Libya, Morocco and Tunisia. This subregion accounts for 14 percent of MENASA's GDP and 10 percent of MENASA's population. North Africa's GDP grew at 5.0 percent per year in real terms between 2002 and 2007. Libya and Algeria have hydrocarbon-driven economies, while Tunisia and Morocco are based on services and select manufacturing. Egypt's economy spans across hydrocarbons, services and manufacturing. The North African region's strategic location facilitates access to both the mature European markets and the sub-Saharan African countries. North Africa's close ties with the GCC countries make it an attractive region for GCC-based companies that are looking to expand internationally.

- **Turkey:** As MENASA's most mature economy, Turkey accounts for 16 percent of MENASA's GDP and 4.5 percent of its population. Turkey's economy grew at 6.3 percent per year in real terms between 2002 and 2007. It is a services- and manufacturing-driven economy, and it enjoys close economic relationships with a number of countries across Europe, while also serving as an economic gateway to countries in Central Asia and the Arabian Gulf.

- **The Levant:** Jordan and Lebanon. MENASA's smallest subregion, the Levant accounts for 1.0 percent of MENASA's GDP and 0.5 percent of MENASA's population. The Levant's GDP grew at 4 percent per year in real terms between 2002 and 2007. Its location and ties with its neighboring countries makes the Levant a gateway to neighboring Iraq which has the potential to become an important economic player, given that it is home to 9.5 percent and 1.7 percent of the world's oil and natural gas reserves, respectively.

- **South Asian Subcontinent:** India and Pakistan. The South Asian Subcontinent is MENASA's workhorse, and is home to 83 percent of MENASA's total population. It is the largest economic subregion, accounting for 42 percent of MENASA's combined GDP in 2007, and demonstrating the highest real annual growth rates in MENASA – between 2002 and 2007, it grew at a real annual rate of 8.5 percent. The regional economy has historically been driven by agriculture, but it is moving towards skilled labor-intensive services such as business process off-shoring and high-end manufacturing. The South Asian Subcontinent is an exporter of labor to the rest of the MENASA region, with approximately 9 million South Asian expatriates working in the GCC countries alone.

While Bangladesh, Sri Lanka, Yemen, Syria, Sudan, Iran, Iraq, Israel and the Palestinian territories are geographically a part of the MENASA region, they are not included in the analysis presented in this report. All MENASA data and analysis excludes these countries.

The MENASA region's combined GDP has increased from USD 2.2 trillion in 2002 to USD 3.1 trillion in 2007. Its current combined GDP is comparable to that of the
Over the next 10 years, it is estimated that the MENASA region will achieve real growth rates of 6 to 7 percent (Exhibit 2).14

### Exhibit 2

#### MENASA macroeconomic indicators

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Source: Global Insight, World Market Monitor

Capital markets in the region are achieving greater depth (measured as a percentage of GDP), and the financial sector is maturing. The total market capitalization of the equity markets has experienced significant increases in the last 4 years. The market capitalization of equity markets is approaching levels found in developed western markets including the US and UK (Exhibit 3). For example, the combined MENASA market capitalization is 92 percent of combined GDP, versus 117 percent in the US and 131 percent in the UK.

**Drivers of current and future momentum in the MENASA region**

Four forces have shaped the MENASA region in the last few years and enabled it to deliver real growth rates averaging more than 7 percent per year. It is expected that these four forces are likely to support continued growth:

1. Accumulation of wealth and financial liquidity
2. Supportive demographics
3. Government reforms
4. Economic integration within the region.

## 1. Accumulation of wealth and financial liquidity

The total level of wealth in the MENASA region is growing rapidly. For example, the total liquid assets owned by institutions and nationals from the GCC and Egypt

14 All GDP numbers expressed in 2007 terms; Global Insight, World Market Monitor.
alone were estimated to be USD 3 trillion in 2006, and are expected to grow to between USD 4.5 trillion and USD 5 trillion by 2012.\textsuperscript{15}

There have been three primary factors in the wealth creation across the region: hydrocarbon-related inflows, ‘monetization’ of the large labor force and increased Foreign Direct Investment (FDI).

A sustainable repricing of hydrocarbons is driving the accumulation of liquidity and wealth mainly in the GCC countries, Algeria and Libya. In contrast to historical price hikes, much of the recent spike\textsuperscript{16} is being driven by greater structural demand for hydrocarbons, notably from emerging economic powers such as China and India. Global hydrocarbon demand increased by 2.4 percent per year from 121 million barrels per day (bpd) to 136 million bpd between 2002 and 2007.\textsuperscript{17} By comparison, hydrocarbon demand increased by 1.6 percent per year between 1998 and 2002. India and China’s combined demand increased from 6.2 percent of global hydrocarbon demand in 1998 to 9.2 percent in 2007.\textsuperscript{18}

This demand for hydrocarbons is expected to continue to increase between 2007 and 2017, demand is projected to rise 2.2 percent annually to 170 million barrels per day by 2017. During the same period, India and China’s combined demand is expected to rise by 6.0 percent per year, from 13 million bpd in 2007 to 22 million bpd in 2017.\textsuperscript{19} Given that significant proven reserves of oil and gas exist in the MENASA region (Exhibit 4), large capital inflows are likely to continue. In 2007 MENASA countries earned more than USD 500 billion in hydrocarbon export revenues.

\textsuperscript{15} Merrill Lynch, Capgemini Wealth Report 2007.
\textsuperscript{16} At the time of writing, the price of light crude oil was above USD 125 per barrel.
\textsuperscript{17} Barrels of oil equivalent – oil and natural gas combined.
\textsuperscript{18} EnergyFiles.
\textsuperscript{19} EnergyFiles.
The second key factor driving wealth and liquidity in MENASA countries is ‘monetization’ of the strength and size of their labor forces. This monetization takes two forms: first, migration of labor to labor-deficit countries, resulting in inflow of remittances; second, using the labor forces domestically to serve the international business services market.

In 2007, the MENASA countries received USD 59 billion of foreign funds in remittances. More than 10 million people from South Asia, Levant and North Africa work in hydrocarbon-rich GCC countries. The amount of remittances sent from GCC countries is more than from any other place, except the United States. In 2007, USD 27 billion of remittances went to India, the largest amount of remittances into any single country in the world. In India and Pakistan, remittance inflows (USD 27 billion and USD 6 billion, respectively) were larger than the FDI received (USD 21 billion and USD 5 billion, respectively). In both Jordan and Lebanon, remittances were equivalent to more than 15 percent of GDP.20

At the same time, MENASA countries deploy their skilled workforce domestically to capitalize on opportunities presented by outsourcing and offshoring. The widespread use of English in India, Pakistan and Egypt and French in Morocco, coupled with these countries’ significant pool of skilled people and the relatively low labor costs, make them attractive destinations for companies looking to outsource support functions and value-added services such as legal and accounting services. Revenues from IT and business process offshoring in India alone were USD 40 billion in 2007.

20 World Bank; Global Insight, World Market Monitor.
The third key factor driving wealth and liquidity in MENASA countries is FDI. Increased investor confidence has pushed total FDI in the MENASA region from USD 16 billion in 2002 to USD 128 billion in 2007, which is more than the combined FDI of China and UK.\textsuperscript{21} India, UAE and Turkey all ranked in the top 20 on A.T. Kearney's list of global FDI index, which was released in July 2007. Turkey is a prime example of the benefits that come with an increase in investor confidence: since inflation fell below 10 percent in 2004, FDI has increased nearly eight-fold, from USD 2.9 billion in 2004 to USD 23 billion in 2007. Turkey currently has the highest FDI in the MENASA region.

**Investing its liquidity in the region**

This liquidity and wealth is increasingly invested in the region, aiding the development of the local and regional economies. Between 1998 and 2002, investment of capital in the MENASA economy was low relative to other emerging economies. Total annual investments grew from USD 270 billion to USD 280 billion, while the share of investment relative to GDP decreased from 23 to 21 percent. During the same period, average investment relative to GDP in other emerging economies including China, South Korea, Brazil, Singapore and Russia increased from 27 to 29 percent (Exhibit 5).

Since 2003, the investment levels in MENASA economies have been rising. Total investment in 2007 was USD 830 billion, or 27 percent of the combined MENASA GDP. While this is still low relative to investments made by China, South Korea, Brazil, Singapore and Russia, which average 32 percent of combined GDP, it is significantly higher than its 2002 value, especially in absolute terms. Furthermore, some countries have achieved higher investment rates, such as Qatar, which has an investment rate that is more than half its GDP.\textsuperscript{22}

Cumulative investments in the MENASA economy between 2008 and 2017 are expected to vary between USD 15 trillion to USD 18 trillion, based on the current MENASA level of 27 percent of GDP and 32 percent of GDP, the level seen in other developing countries (Exhibit 5).

**Sectors with growth potential**

Increased financial liquidity and investment of this liquidity into the economy are fueling development of select sectors across the MENASA countries. A story of growing global share is common among key sectors described next (Exhibit 6).

**Hydrocarbon production:** Oil, natural gas and petrochemical industries are expanding their production capacities. Between 1998 and 2007, the oil and natural gas production of MENASA countries grew from 26 million barrels of oil (BOE) equivalent per day to 32 million BOE, or 24 percent of global hydrocarbon production. This production capacity is expected to increase to 44 million BOE, or to 25.4 percent of total global hydrocarbon production by 2017.\textsuperscript{23}

Hydrocarbon upstream expansions in MENASA will account for 34 percent of total global planned hydrocarbon expansion through 2017. These expansions will require significant investments – in the GCC alone ongoing and planned projects are valued at nearly USD 275 billion.\textsuperscript{24}

\textsuperscript{21} FDI of UK and China in 2007 was USD 95 billion and USD 20 billion, respectively; Global Insight, World Market Monitor.

\textsuperscript{22} Global Insight, World Market Monitor; McKinsey Global Institute.

\textsuperscript{23} EnergyFiles.

\textsuperscript{24} Middle East Economic Digest projects.
The region’s large hydrocarbon reserves enable expansion of hydrocarbon production capacity. MENASA’s global share in hydrocarbon production is likely to increase, as MENASA countries are home to 45 percent of globally proven oil reserves and 28 percent of globally proven gas reserves, yet account for just 29 percent of global oil production and 15 percent of global gas production. Furthermore, MENASA-based oil producers have a cost advantage compared to other oil-producing countries, with a combined capital and operating cost of USD
1.50 to 5.50 per barrel versus USD 7.0 per barrel for Russia and USD 18.0 per barrel for Alaska.25

**Oil refining:** In addition to extraction, the MENASA countries are expanding their downstream oil refining capacity. Between 2002 and 2006 the total oil refining capacity in the MENASA region grew from 9 million bpd to 10 million bpd, or 11 percent of global refining capacity. By 2016, total refining capacity is projected to increase to 14 percent of global refining capacity, or 14 million bpd. Of the total global growth in oil refining capacity over the same period, MENASA countries are projected to contribute 39 percent.26

**Petrochemicals:** The MENASA countries are also expanding downstream into the production of petrochemicals. Production volume increased from 46 million tons in 1998 to 99 million tons in 2007, accounting for 8 percent of global world production. Planned expansions are expected to increase total production to 225 million tons, or 13 percent of global capacity, by 2017. Over the next decade, 27 percent of growth in global capacity of petrochemicals is expected to come from increased production in MENASA countries.27

**Energy-intensive industries:** The production of energy-intensive commodities is increasingly moving to the MENASA region. For example, the total global aluminum production capacity is expected to increase from 43 million tons in 2007 to 65 million tons in 2017. Currently, 4.4 million tons are produced in the MENASA region, and this capacity is expected to increase by 8.6 million tons over the same period. During this period, 40 percent of the planned growth in global aluminum production capacity is expected to come from expansions in the MENASA region.28

The MENASA region is already home to two of the world’s largest aluminum producers, Dubai Aluminium (Dubal) and Aluminium Bahrain (ALBA). Several other smelters are under development within the region. Emirates Aluminium (EMAL) will have a UAE-based, greenfield smelter that will have a total production capacity of 1.4 million tons. Algeria is also setting up a smelter to produce 700,000 tons of aluminum.29

In addition to aluminum, the production of other energy-intensive commodities is also moving to the MENASA region. For example, the GCC countries currently account for 8.2 percent of annual global ethylene production, 8.8 percent of global polyethylene production, and 2.3 percent of global propylene production. Over the next five years, GCC countries are estimated to be responsible for 32, 30 and 25 percent of the additional capacity in those chemicals, respectively.30

**Financial services:** The financial sector has grown at an average rate of 25 percent per year since 2002, with the total value of banking assets in select29 MENASA countries reaching USD 2.3 trillion in 2007. Today, these countries account for 3 percent of the global assets, and these assets are expected to grow to USD

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27 Tecon.
28 Brook Hunt; James King.
29 Emirates Aluminum; Dubai Aluminum.
31 Data for six countries, Algeria, Egypt, India, Pakistan, Saudi Arabia and Turkey, were available. Together, these countries account for 80 percent of MENASA’s GDP across the period discussed: Global Insight, World Market Monitor; Economist Intelligence Unit.
4.9 trillion by 2012. Between 2007 and 2012, these countries are projected to account for 9 percent of overall growth in total worldwide banking assets.\textsuperscript{32}

**Telecommunications:** The telecommunications industry has been growing very rapidly across the MENASA region – between 2002 and 2007, the number of mobile phone subscribers grew from 62 million to 476 million. Today, the MENASA countries account for 15 percent of mobile phone users worldwide. By 2017, the number of mobile phone users in the region is expected to increase to over 1 billion. This would represent 26 percent of overall growth in the number of mobile phone users worldwide.\textsuperscript{33}

**Tourism:** The MENASA tourism industry has grown from 62 million international visitors in 2002 to 104 million international visitors in 2007, accounting for 6 percent of the global tourism market. By 2017, this industry is expected to grow to 167 million. During the next 10 years, over 7 percent of overall growth in global tourism is expected to be from the MENASA region. Given MENASA’s rich history and culture, beaches and sunny weather, there is potential for significant development in this sector.\textsuperscript{34}

**IT and Business Process Offshoring:** In 2007, the size of the India’s IT and Business Process Offshoring (IT/BPO) industry was USD 40 billion. By 2010, India’s revenues from the IT/BPO industry are estimated to increase to USD 75 billion. Other MENASA countries are also breaking into the IT/BPO field. Egypt and Morocco are expecting to generate over USD 1.1 billion and USD 1.7 billion in revenues by 2010 and 2013, respectively.\textsuperscript{35}

More industries are expected to increase their global share, most notably aerospace and aviation, logistics and real estate.

2. **Supportive demographics**

The MENASA region is home to a large young population; its ageing is driving the need for significant job creation and investments in infrastructure. Over the next decade this population segment is likely to become a large consumer class.

**A large and growing population**

The combined MENASA population is 1.6 billion: roughly 25 percent of the world’s total. Population growth in the region was 1.6 percent per year in the last 5 years, and the growth is expected to continue at 1.4 percent per year over the next 10 years – almost double the population growth in Europe. By 2017, more than 240 million people will be added to the MENASA population, thus accounting for 34 percent of the global population growth.\textsuperscript{36} This increasing population will require significant growth in infrastructure.

The underlying demographic developments in the region are bipolar. First, with 42 percent of the region’s population under the age of 20, the MENASA region’s youth population of 680 million is equal to twice the combined populations of the US and Canada. Youth in MENASA account for 29 percent of the total youth worldwide. As this young population ages, it will have to be absorbed into the workforce. In

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\textsuperscript{32} Economist Intelligence Unit.

\textsuperscript{33} Euromonitor.

\textsuperscript{34} World Travel and Tourism Council.

\textsuperscript{35} NASSCOM; Zawya; Yankee Group.

\textsuperscript{36} Global Insight, World Market Monitor.
the next 10 years, the labor force in MENA countries (including Turkey) will grow by roughly 1.3 million per year, and in India and Pakistan it will grow by 11.9 million per year.37

Second, the elderly (above 65 years) are also a rapidly growing segment of the population, as life expectancy is increasing. The elderly population will grow from 80 million to 110 million between 2007 and 2017. In 10 years, MENASA will be home to 18 percent of the total elderly population worldwide, and will drive 21 percent of the total global growth in the elderly population. Specialized healthcare facilities will have to be developed to cater to this ageing population.38

**Demographic developments driving demand**

These demographic developments will drive demand for both ‘hard’ infrastructure such as housing, water, roads and energy, and ‘soft’ infrastructure such as healthcare and education, as well as an overall increase in consumption. Between 2008 and 2017, more than USD 3.3 trillion will be required for infrastructure development across the MENASA region.39

The required expansion in ‘soft’ infrastructure is large. For example, to bring the availability of healthcare up to the average level found in Organization for Economic Co-operation and Development (OECD) countries, approximately 750,000 additional hospital beds will be needed in MENA (including Turkey), and approximately 5.4 million additional hospital beds will be needed in India and Pakistan, by 2017.40

On the consumption front, increasing overall wealth, coupled with a young population, is creating a new class of consumers. Private consumption has almost doubled from USD 780 billion in 2002 to USD 1.5 trillion in 2007, which is more than China’s private consumption of USD 1.2 trillion.41 Today MENASA’s total consumption is 4.8 percent of total global consumption. This consumption is expected to more than double to over USD 3 trillion by 2017.

Different types of goods and services will drive the consumption industries across the MENASA region. In countries such as India and Pakistan, with low per capita GDP (at or below USD 1,000 per year), private consumption will be driven by basic household durables and foodstuffs. For example, the penetration of mobile phones in India and Pakistan was 21 percent and 32 percent of population in 2007, respectively. In comparison, the penetration of mobile phone users in the US was 83 percent of the population. On the other hand, consumption in the richer GCC countries is expected to be driven by luxury goods and services. For example, in the GCC countries, the total spend on tourism and leisure activities increased from USD 23 billion in 2002 to USD 30 billion in 2007.42

**3. Government reforms**

During the last 5 to 10 years, most governments in the MENASA region have been implementing free market economic reforms. These have helped to create an environment more supportive of entrepreneurship and economic growth.

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37 Global Insight, World Market Monitor.
38 Global Insight, World Market Monitor.
39 Morgan Stanley, Merrill Lynch.
40 Euromonitor; OECD: Global Insight, World Market Monitor.
41 Global Insight, World Market Monitor.
42 UAE and Saudi Arabia figures extrapolated for all GCC; Euromonitor.
These changes are being initiated by a new generation of progressive leaders. Saudi Arabia, UAE, Bahrain, Kuwait, Qatar, Jordan and Morocco have had a recent generational change in leadership. In addition, several government officials and ministers now have extensive business knowledge and experience – both domestic and international.

**Deregulation and increasing international competition supporting economic development**

Across the MENASA region, governments are opening up a number of sectors for private ownership and investment, including financial services, utilities, telecommunications, aviation and logistics. Increasingly, foreign companies are being encouraged to start new businesses and provide both services and competition to local companies.

Some governments are repealing limits on foreign ownership. Pakistan and Jordan allow foreign ownership in almost all sectors. In the GCC, most countries allow foreign ownership of listed and unlisted companies, from 25 percent ownership in Qatar up to potentially 100 percent in Kuwait and Bahrain. The UAE is considering reforming the commercial code and ownership laws to allow majority foreign ownership in selected sectors.\(^\text{43}\)

In addition, governments in the MENASA countries are establishing special economic freezones to attract foreign investors and companies. These freezones, special areas in which 100 percent foreign ownership is allowed without the traditional need for a domestic ‘sponsor’\(^\text{44}\) and with additional tax or tariff breaks, have become popular. There are more than 60 such freezones in the GCC alone.\(^\text{45}\)

Another important reform has been the accelerated pace of privatization of state-owned enterprises and companies. For example, Jordan’s privatization program, which started in 1996, has to date seen more than 64 transactions. These include the (partial) sale of Jordan Cement Factories, public transport concessions, Jordan Telecommunications Corporation, Jordan Aircraft Maintenance Company (Joramco) and Central Electricity Generating Company. A number of other privatizations are in the pipeline, including the postal services.\(^\text{46}\)

These economic reforms have often been implemented in conjunction with new laws governing domestic capital markets, the demutualization of local exchanges, and creation of independent capital market authorities. For example, India, Egypt, Pakistan, Turkey, the UAE, Qatar and Saudi Arabia now have independent capital market regulators.

One effect of the reforms has been the revitalization of stock exchanges. International partnerships have accelerated development of trading procedures, technology and governance. Dubai’s DIFX has invested in NASDAQ, and Abu Dhabi Securities Market (ADSM) has partnered with the New York Stock Exchange. Specialized exchanges are also being developed. For example, the Dubai Mercantile Exchange, the first energy futures exchange in the Middle East, is a joint venture between Dubai Holding, New York Mercantile Exchange and Oman Investment Fund. The Dubai Gold & Commodities Exchange, established in 2005,

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43 Respective stock exchanges.
44 Sponsors are local partners with majority ownership of assets.
45 World Bank estimates, excluding Saudi Arabia.
46 Arab News; Jordan Investment Board; Jordan Times.
is the region’s first commodities and commodity derivatives exchange. This is a partnership between Dubai Multi Commodities Center, Financial Technologies (India) Limited and Multi Commodity Exchange of India Limited. Nilex, a bourse for small- and medium-sized firms, was established in 2007 in Egypt, and is the first of its kind in the MENASA region.

Across the MENASA region, the total market capitalization of listed companies has increased from USD 720 billion in 2004 to USD 2.9 trillion in March 2008. There were 382 IPOs in 2006 and 2007, with a value of USD 53 billion.47

The MENASA economies are further bolstered by relatively stable currencies and strengthening domestic monetary policies. All GCC currencies (except the Kuwaiti Dinar), the Lebanese Pound and Jordanian Dinar are pegged to the US Dollar. The Kuwaiti Dinar, Moroccan Dirham and Libyan Dinar are pegged to a basket of currencies, while the Tunisian Dinar, Egyptian Pound, Turkish Lira, Algerian Dinar, Pakistani Rupee and Indian Rupee are free floating. Most MENASA currencies are fully convertible.

Creating a business-friendly environment
To complement liberalizations and capital market reforms, governments in the MENASA region are working to reduce bureaucracy and red tape in everyday transactions. While much work still remains, MENASA countries have made significant progress towards improving their business environments.

As a result of these reforms, countries in the region are seeing a marked improvement in their global rankings. For example, in the World Bank’s ‘Doing Business’ report (Exhibit 7), several MENASA countries demonstrate improved standings. Of the 178 countries ranked throughout the world, most in the MENASA region are ranked between 23 and 129, with Saudi Arabia being the highest.

MENASA countries are in general performing well, according to The Heritage Foundation’s Economic Freedom Rankings (Exhibit 7). Countries such as Bahrain have been consistently ranked in the top 25 since 2005. Other countries such as Turkey were ranked very low at 132 in 2005, but have since moved up to 74 in 2008. Libya is the only MENASA country that has remained at a low rank of 154 since 2005, without showing any improvement.

The assessment of the risks of doing business in MENASA countries such as Saudi Arabia, India and Turkey has steadily declined (Exhibit 8). The difference between Saudi Arabia and the US in terms of the risk of doing business is smaller today than at any point in the last 10 years.

Furthermore, the overall Moody’s risk ratings for most of the MENASA countries are in the A and B range (Exhibit 9). All GCC countries have a rating between Aa2 and A2, comparable to that of China. The remaining MENASA countries have ratings between Baa2 and B3, with Libya and Algeria not yet rated.

Thirteen MENASA countries are part of the World Trade Organization (WTO), with Saudi Arabia being the latest one to join in 2005. The remaining three countries, Algeria, Lebanon and Libya, established Working Parties in 1987, 1999 and 2004, respectively, to facilitate accession to WTO. Of these, the Algerian and Lebanese Working Parties are already in access negotiations.

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47 Dealogic, including convertible issues and secondary issues; Bloomberg as of March 25, 2008.
4. Economic integration within the region

The MENASA countries share a set of similar characteristics: strong economic growth, rapid population growth, the need for ‘hard’ and ‘soft’ infrastructure and the potential for high growth in consumer markets. At the same time, hydrocarbon-rich economies need to attract labor and are looking for attractive opportunities to invest their wealth (Exhibit 10). Together this is creating arbitrage opportunities
to ‘spread’ the hydrocarbon and labor force richness across the region, from the surplus countries to the deficit countries, leading to increased regional integration.

The potential for economic cooperation is facilitated by the close connections among countries in the MENASA region. The populations are linked together by common religions (Pakistan and India are home to the second- and third-largest Muslim communities in the world, respectively, after Indonesia), common customs

<table>
<thead>
<tr>
<th>Country</th>
<th>Sovereign Risk</th>
<th>Country</th>
<th>Sovereign Risk</th>
</tr>
</thead>
<tbody>
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<td>UAE</td>
<td>Aa2</td>
<td>Egypt</td>
<td>Baa3</td>
</tr>
<tr>
<td>Qatar</td>
<td>Aa2</td>
<td>Morocco</td>
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</tr>
<tr>
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<td>Aa2</td>
<td>India</td>
<td>Ba2</td>
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<td>Saudi Arabia</td>
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Ratings scale: Aaa, Aa1, Aa2, Aa3, A1, A2, A3, Baa1, Baa2, Baa3, Ba1, Ba2, Ba3, B1, B2, B3, Ca1, Ca2, Ca3, Ca
Source: Moody’s, Bloomberg

Exhibit 10

MENASA countries have complementary resources

GCC, Algeria, and Libya have hydrocarbon wealth

India, Pakistan, Turkey and Egypt have human capital

<table>
<thead>
<tr>
<th>Hydrocarbon production, thousand barrels per day</th>
<th>GCC, Algeria, and Libya have hydrocarbon wealth</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt;500</td>
<td>Algeria</td>
</tr>
<tr>
<td>500–1,000</td>
<td>Egypt</td>
</tr>
<tr>
<td>1,000–2,000</td>
<td>Kuwait</td>
</tr>
<tr>
<td>2,000–3,000</td>
<td>Saudi Arabia</td>
</tr>
<tr>
<td>&gt;3,000</td>
<td>Bahrain</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Population, million</th>
<th>India, Pakistan, Turkey and Egypt have human capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt;50</td>
<td>Algeria</td>
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<tr>
<td>50–100</td>
<td>Egypt</td>
</tr>
<tr>
<td>100–1,000</td>
<td>Pakistan</td>
</tr>
<tr>
<td>&gt;1,000</td>
<td>Turkey</td>
</tr>
</tbody>
</table>

NOTE: Oil production and population in 2007
Source: Global Insight, World Market Monitor; EmergeFiles
and shared languages, as well as family ties that cross borders (an estimated 25 percent of the population in the GCC countries originate from India and Pakistan).48

The MENASA countries have experienced periods of shared governance and similar legal and political traditions, over almost 15 centuries (Exhibit 11). In the last 400 years most MENASA countries were either part of the Ottoman Empire, British protectorates or members of the British Commonwealth. In fact, as recently as the 1960s, the Gulf countries used the ‘Gulf Rupee’, issued by the Reserve Bank of India, as their currency.

The region is deepening its economic integration through trade, as well as labor flows. Increased transportation is building linkages between the countries, as new low-cost airlines are being launched and new destinations are being added to existing route networks to further support labor mobility (Exhibit 12).

Emerging regional businesses
The net effect of this rapid economic integration has been a growing number of cross-border business initiatives that have fostered the emergence of regional businesses. These are companies that typically pursue business across borders to utilize the skills they have developed in their home markets. By taking this path, these companies can diversify revenues and capitalize on high growth opportunities. Many businesses have started to pursue cross-border business in the MENASA region.

Some of the regional businesses have the potential to become global leaders over time. For example, Aramex of Jordan is the world’s fifth-largest logistics provider.

48 United Nations; Arabian Business.
Similarly, UAE-based EMAAR is the seventh-largest listed real estate developer in the world (market capitalization of USD 19 billion), and has built a presence across the globe with a focus on MENASA (Exhibit 13).

In addition to these listed ‘large caps’, family-owned businesses have a significant presence in the region’s corporate landscape and are expanding into cross-border activity. For example, the Al Shaya Group operates more than 1,300 retail outlets in 15 countries – including all GCC countries, Turkey, and Egypt – and provides many of the world’s leading brands in fashion and footwear, health and beauty, casual dining, optical, pharmaceutical and sports fashion. Similarly, the Rotana Hotels group operates hotels in UAE, Kuwait, Egypt, Sudan, Lebanon and Syria, while the Majid Al Futtaim Group operates malls and shopping centers across the region.

**Economic impact of global credit crisis and food price crisis on the region**

As this report was being written, two global crises were unfolding: the global credit crunch and the global food crisis. The credit crunch has had relatively little direct impact on the region’s general economic performance; nor has it had much impact on the region’s private equity markets. First, with a few exceptions, regional MENASA banks have had little exposure to sub-prime credit products and their derivatives. Second, private equity investments in the region are skewed towards the provision of growth capital, which is less dependent on financial leverage to drive returns. Third, the typical private equity transaction sizes are still relatively small, averaging USD 62 million across MENASA in 2007. Comparable to mid-market transactions in mature markets, the relatively low transaction values make them easier to digest for providers of financing.
But the indirect effect of the credit crunch – a slowing global economy – could adversely impact the MENASA economies. Many of the MENASA economies depend on mature economies as export markets, and demand for MENASA exports will inevitably diminish at a time when global economic growth is slower.

Another challenge is inflation. Saudi Arabia, UAE, Qatar, Oman, Bahrain, Jordan and Lebanon have pegged their currencies to the US Dollar, thus limiting the ability of the central banks to use monetary policy to control price stability. This dollar peg,
in tandem with high economic growth that is characteristic for emerging markets, and the high inflow of liquidity, causes high inflation. For example, reported inflation rates in UAE and Egypt were 6.7 percent and 7.5 percent, respectively, per year between 2002 and 2007.49

More recently, the increase in global food prices has caused turmoil in many of the world’s developing countries. It is too early to say whether the price hikes in numerous food commodities are temporary or structural. They are, however, currently raising consumer price indices around the world, and are likely to have a more material impact on emerging economies – like some of those in MENASA, where food spending is a large proportion of household budgets. From an investor’s point of view, however, food price inflation will also create business opportunities around increasing productivity, particularly in agriculture, by introducing new farming methods and technologies, stimulating greater use of fertilizers or the irrigation of land previously too expensive to be cultivated.

**What the future could look like**

With current economic and demographic trends in MENASA countries likely to continue for the foreseeable future, the region is destined to be home to a number of global businesses. Dubai, for example, is building the world’s largest airport, and Qatar and UAE are expected to become regional and global aviation hubs.50 Other global leaders are likely to emerge in financial services and telecommunications, as well as energy-intensive sectors such as aluminum and fertilizers. Meanwhile, the region will continue to be home to one of the world’s largest pools of human capital.

The combination of rising wealth and liquidity, favorable demographics, market-based reforms, and regional economic integration is making the MENASA region an increasingly important actor in the global economy. The chapters that follow will explore economic developments and opportunities in the medium term within the countries of MENASA, and explain how each of them is benefiting from and also helping to shape these trends.

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49 Global Insight, World Market Monitor.
50 Zawya; AME Info.
Chapter 3
The Gulf Cooperation Council
The Gulf Cooperation Council

The Gulf Cooperation Council (GCC) is an economic and political policy-coordinating council that was established in 1981. The six GCC countries (Exhibit 14) – Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates – are located in the Arabian Gulf and have a predominantly Muslim Arab population, as well as a long history of shared culture, traditions and trade, dating back to 8000 BC.

Exhibit 14

Overview of the GCC

The GCC is MENASA’s hydrocarbon reservoir. It is home to 40 percent of global oil reserves and 23 percent of global gas reserves. In 2007, the GCC economy had a combined GDP of USD 810 billion, accounting for 27 percent of MENASA’s combined GDP. It is expected to grow at a real rate of 5 percent per year through 2017 (Exhibit 15). While the hydrocarbon sector, which accounts for almost half of the GCC’s GDP today, is expected to continue to be the primary driver of growth, other non-hydrocarbon sectors are also becoming increasingly important.51

Understanding the GCC’s economic past... history repeating or a region reinventing itself?

Over the years, the GCC’s fortunes have risen and fallen with the price of and demand for oil. However, recent trends indicate that the GCC economy is moving away from its boom-bust-boom past to a more secure and sustainable economic future (Exhibit 16). In the following section the GDP, GDP per capita and oil prices are all reported in real terms, based on 2007 price levels.

51 Global Insight; World Market Monitor; BP Statistical Review of World Energy June 2007; GCC Economic statistics.
Booming 1970s

During the 1970s, the economies of GCC countries boomed: from 1970 to 1980, GDP in real terms grew more than four fold from USD 96 billion to USD 400 billion while real GDP per capita more than doubled from USD 12,000 to USD 29,000 (Exhibit 16). Oil prices increased from USD 10 to USD 93 per barrel, led by two major oil price spikes. The first oil spike was driven by the Arab Oil Embargo (1972 to 1974), the second by the Iranian Revolution and Iran-Iraq conflict (1978 – 1981). Although oil exports generated huge windfalls, these funds were not absorbed into the local economies. Instead, they were either spent on imports or invested abroad. The boom, therefore, was significant but short lived.52

Exhibit 15

Summary of GCC

<table>
<thead>
<tr>
<th></th>
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<td>6.7</td>
<td>5.0</td>
<td>1</td>
<td>1.5</td>
<td>33</td>
<td>23,200</td>
</tr>
</tbody>
</table>

Source: Global Insight, World Market Monitor

Exhibit 16

GCC’s boom-bust-boom performance

Booming 70s
Struggling 80s
Volatile 90s
Soaring 2000s

* GDP and oil price in real terms, based on 2007 price levels


Struggling 1980s
As a result of oil prices declining to USD 30 per barrel, the economic growth of the 1970s was reversed in the 1980s: real per capita GDP in 1989 fell to USD 16,800, less than 60 percent of its 1980 value. From 1980 to 1989, GDP in GCC countries decreased by more than 6 percent to USD 374 billion, and overall debt increased from 3 to 27 percent of GDP from USD 6 billion to USD 42 billion. This decline in oil prices was in turn the result of increases in non-GCC oil production, a decrease in global oil demand owing to more efficient fuel consumption, and the US recession of the early 1980s. By the end of the 1980s, most of the wealth from the 1970s windfall had disappeared.

Volatile 1990s
The economic performance of the GCC in the 1990s was volatile and unsustainable. Between 1990 and 1999, GDP grew by 35 percent to USD 525 billion, and per capita GDP increased by less than 10 percent to USD 18,100. Combined debt, however, more than doubled from almost USD 41 billion to USD 92 billion. Oil prices fluctuated significantly between USD 17 and USD 38 per barrel but overall remained low. Factors driving the fluctuation included the 1990-91 Gulf War, shifting OPEC quotas, a decrease in supply from Russia, and an increase in demand from East Asian countries.

Soaring 2000s
The GCC countries have witnessed an economic boom since the turn of the millennium. The real GDP growth rate has been 7.0 percent since 2002, almost double the 3.7 percent observed between 1990 and 2000. At the same time, GDP per capita has increased to USD 22,100. This growth was driven by increases in oil prices from USD 35 to over USD 125 per barrel today, led by an overall increase in oil demand.

At the same time, the overall health of the GCC economy has improved. Between 2000 and 2007, the total foreign exchange reserves of the GCC have increased from USD 44 billion to USD 150 billion, or 19 percent of the combined GDP. The GCC countries are increasingly investing these petrodollars into investment funds that are currently valued between USD 1 trillion and USD 1.5 trillion.

Since 2002, over USD 650 billion from this new oil windfall has been reinvested in the GCC economies (Exhibit 17). Concurrently, the governments have been liberalizing their economies, laying the foundation for more sustainable economic growth.

Hydrocarbon wealth fueling the growth of multiple industries
Since the discovery of oil in Bahrain in 1932, GCC countries have enjoyed a significant inflow from hydrocarbon revenues. Since 1993, hydrocarbon exports generated USD 2.3 trillion in revenues. During the same period, the price of oil has increased more than five-fold from USD 25 to over USD 125 per barrel. Given

53 Global Insight, World Market Monitor.
56 Global Insight, World Market Monitor.
58 Global Insight, World Market Monitor.
59 McKinsey Global Institute; Institute of International Finance.
the increasing demand and depleting oil reserves, it is estimated that the price of oil will remain above USD 50 per barrel until 2020.\footnote{IEA; Energy Information Administration Annual energy outlook, February 2007; FACTS.} If this oil price increase is structural and sustainable, then the GCC countries will see large inflows of petrodollars, of between USD 5 trillion and USD 9 trillion, over the next decade (Exhibit 18).

**Wealth accumulation led by hydrocarbons**

Hydrocarbons are the primary driver of economic growth in the GCC – in 2007 hydrocarbon exports totaled USD 380 billion, up from USD 204 billion in 2005, equivalent to almost half of the GCC’s 2007 GDP. There is significant potential for GCC to increase its share of global oil and natural gas production. Today, the GCC is home to 40 percent of proven global oil reserves and 23 percent of proven global natural gas reserves but accounts for only 23 percent of global oil and 8 percent of global natural gas production. In addition to its reserves, the GCC also benefits from a cost advantage in hydrocarbon extraction, with the total operating costs and capital expenditure needed to extract oil being significantly lower than in the other oil-producing countries. These lower costs are a result of oil being closer to the surface, and therefore easier to find and extract.\footnote{The combined capital and operating cost of extraction in the GCC countries is USD 1.5 to USD 5.5 per barrel of oil equivalent, as compared to USD 7 and USD 18 in Russia and US Alaska, respectively; Wood Mackenzie, GEM; BP Statistical Review of World Energy, June 2007.}

Foreign direct investment supplements the hydrocarbon windfall. FDI in the region increased from less than USD 3 billion in 2002 to USD 45 billion in 2007. This growth is expected to continue, at a pace of 7 percent per year over the next 3
years. While this FDI is equivalent to just 12 percent of the USD 380 billion that GCC countries earned from oil exports in 2007, it nonetheless represents about 6 percent of the GCC’s total GDP. All of the GCC countries, except Oman, are in the top 50 United Nations Conference on Trade and Development FDI Potential Index.

Accumulated wealth invested back in the GCC economy
Accumulated wealth in the GCC is increasingly being invested in the local economies: more than USD 1.1 trillion was invested between 1993 and 2007. Cumulative investment between 2007 and 2020 is projected to exceed USD 3 trillion, almost three times what was invested in the last 14 years.

There is a strategic shift by the leaders in the GCC countries to diversify the local economies and reduce the dependence on oil exports. There is an increasing focus on the development of hydrocarbon downstream industries, energy-intensive commodities, the real estate sector, tourism and telecommunication, in addition to further developing upstream hydrocarbon production capacity.

Upstream hydrocarbon production: Expansions are underway to increase today’s hydrocarbon production capacity. Between 2007 and 2017, oil and natural gas production is expected to increase from 23 million to 32 million BOE per day. This will represent a 25 percent increase in the global production capacity. Saudi Arabia, Kuwait and UAE are actively trying to increase the oil extraction capacity, while Qatar, Oman and, to a lesser extent, Kuwait, are focusing on exploring their natural gas reserves.

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64 EnergyFiles; Institute of International Finance.
Political systems of the GCC countries

**Saudi Arabia** is an absolute monarchy. King Abdullah bin Abdel-Aziz Al Saud ascended to the throne in August 2005. The Council of Ministers holds both legislative and executive powers and is headed by the King. A Consultative Council was appointed in August 1993.

**UAE** is a federal presidential elected monarchy, a federation of seven absolute monarchies: Abu Dhabi, Dubai, Sharjah, Ajman, Ras al-Khaimah, Umm al-Qaiwain and Fujairah. The ruler of Abu Dhabi, Sheikh Khalifa bin Zayed Al Nahyan, is the President and the Head of State of the UAE. The ruler of Dubai, Sheikh Mohammed bin Rashid Al Maktoum, is the Prime Minister and the Head of Government of the UAE. The national legislature consists of a unicameral Federal National Council of 20 appointed and 20 elected members representing the separate emirates.

**Kuwait** is a parliamentary, constitutional monarchy. The Head of State is the Emir, Sheikh Sabah Al-Ahmad Al-Jabr Al-Sabah, who was sworn in in 2006. Kuwait has the oldest directly elected parliament of the countries in the Arabian Gulf, with 50 elected members chosen in elections every four years. An additional 15 cabinet ministers may also be given membership in the parliament.

**Qatar** is an absolute monarchy with Emir of Qatar, Hamad bin Khalifa Al Thani, being the Head of State and the Head of Government. The Cabinet includes appointed ministers and is headed by the Prime Minister, Hamad bin Jassem bin Jabr al-Thani. Under the 2003 constitution, a two-thirds elected, 45-member parliament will be formed, which will have the power to draw up laws and question ministers.

**Bahrain** is a constitutional monarchy. King Hamad bin Isa al-Khalifa ascended to the throne in 1999, and Sheikh Salman bin Hamad al-Khalifa was declared Crown Prince. Sheikh Khalifa bin Salman al-Khalifa, the Prime Minister, is the Head of Government. Bahrain’s bicameral legislature consists of the Chamber of Deputies with 40 elected members and the Shura Council with 40 appointed members.

**Oman** is an absolute monarchy with Sultan Qaboos Bin Said Al-Said being the Head of State and the Head of Government since 1970. A Consultative Council with 84 seats is elected and a State Council is appointed from representatives of the government and the private sector.
This increased capacity anticipates increasing global demand for oil and gas, from 135 million BOE per day to over 170 million BOE per day, between 2007 and 2017.65

**Downstream hydrocarbon processing – refining and petrochemicals:** In 2006, GCC countries accounted for 23 percent of global oil production but only 5 percent of global oil refining capacity. Between 2006 and 2016, oil refining capacity in the GCC is planned to increase from 4.2 million BOE per day to 6.4 million BOE per day, representing 22 percent of growth in global oil refining capacity over the same period.66

The GCC countries accounted for 49 million tons of petrochemical production in 2007, up from 38 million tons in 2002. By 2017, total petrochemicals production is expected to more than double to 132 million tons, accounting for 18 percent of the increase in global production capacity.67

In an effort to increase upstream and downstream hydrocarbon production and processing capacity, an estimated USD 400 billion is already invested or planned to be invested68 (Exhibit 19). Saudi Aramco, Saudi Arabia’s state-owned oil company, has recently announced plans to invest USD 129 billion to increase crude gas refining and petrochemical capacity. About USD 70 billion of the total would be spent on international and domestic joint ventures.69

### Exhibit 19

**Announced hydrocarbon capacity expansions in the GCC**

<table>
<thead>
<tr>
<th>Country</th>
<th>Expansion details</th>
</tr>
</thead>
<tbody>
<tr>
<td>Saudi Arabia</td>
<td>- Increase net oil production capacity from 10.5 million bpd to 13.6 million bpd by 2017</td>
</tr>
<tr>
<td></td>
<td>- Increase net gas production capacity from 78 bcm per year to 136 bcm per year by 2017</td>
</tr>
<tr>
<td></td>
<td>- Increase oil refining capacity from 2 million bpd to 3.5 million bpd in 2016</td>
</tr>
<tr>
<td>UAE</td>
<td>- Collaborate with upstream production partners including Exxon Mobil, Royal Dutch/Shell, BP and Total</td>
</tr>
<tr>
<td>Kuwait</td>
<td>- Increase production capacity from 2.8 million bpd to 4 million bpd by 2017</td>
</tr>
<tr>
<td></td>
<td>- Increase oil refining capacity from 0.9 million bpd to 1.5 million bpd in 2016</td>
</tr>
<tr>
<td>Qatar</td>
<td>- Allocate USD 83 billion for hydrocarbon projects, two-thirds of which is directed towards increasing natural gas production</td>
</tr>
<tr>
<td></td>
<td>- Increase net gas production capacity from 64 bcm per year to 182 bcm per year by 2017</td>
</tr>
<tr>
<td>Oman</td>
<td>- Allocate USD 13 billion for development of gas sector and associated downstream industries</td>
</tr>
<tr>
<td></td>
<td>- Increase net gas production capacity from 26 bcm per year to 43 bcm per year by 2017</td>
</tr>
</tbody>
</table>

Note: bpd = barrels per day; bcm = billion cubic meter; all capacities are for 2007, unless stated otherwise

Source: Institute of International Finance; EnergyFiles

65 EnergyFiles.
66 McKinsey Refining Capacity Survey; EnergyFiles.
67 Tecnon.
68 Middle East Economic Digest.
69 Saudi Aramco; Wall Street Journal.
Energy-intensive industry: The GCC countries are developing energy-intensive industries. The production capacity of energy-intensive commodities such as aluminum, ethylene, polyethylene, polypropylene, styrene and steel is expected to more than double between 2006 and 2011, from 27 million tons per year to 63 million tons per year. The focus is on increasing production capacity of export-oriented commodities, such as aluminum, instead of those used for regional consumption, such as steel.

These energy-intensive industries enjoy a significant cost advantage in the GCC. The main reason for this advantage is the low cost of energy. For example, the average energy cost is USD 105 per ton of aluminium produced in the GCC, compared to USD 630 per ton in China.

This cost advantage is enabling companies in GCC’s energy-intensive industries to emerge as global leaders. Bahrain’s ALBA and UAE’s Dubal are already the world’s seventh- and eighth-largest aluminum producers, respectively. UAE-based EMAL is targeted to be the largest single site aluminum smelter in the world. Saudi Arabia’s SABIC is the world’s third-largest producer of polyethylene and fourth-largest manufacturer of polyolefins of all kinds, with revenues above USD 20 billion.

As these global companies emerge, it is unclear whether they will expand downstream in the processing of energy-intensive commodities. While such a move will create additional jobs for the growing workforce, it will partially offset the energy cost advantage. In downstream processing, being close to the markets (e.g., the US, Europe, Asia) is more important than the cost advantage in energy.

Real estate sector: The GCC real estate sector is estimated to be the fastest growing in the world. Between 2000 and 2010, an estimated 16.35 million square meters of gross leasable area (GLA) is expected to be added in the region – this is about 45 percent of the total GLA in Frankfurt. Given that the total GLA was 2.46 million square meters in 2000, the expected expansion represents an annual increase in GLA of more than 20 percent per year over the same period. By comparison, in China GLA has been growing at an approximate rate of 16 percent per year.

Almost 75 percent of the planned increase in the GCC’s GLA will be built in Saudi Arabia and UAE, with Kuwait, Qatar, Bahrain and Oman accounting for the remaining 25 percent. These developments will encompass housing, retail, office, industrial and hotel space. The current value of all planned and ongoing real estate and construction projects in the GCC is USD 1.3 trillion – equivalent to more than 150 percent of the region’s 2007 GDP. The 23 major planned real estate development projects alone are worth more than USD 300 billion (Exhibit 20).
Large regional real estate developers are emerging to meet the vast needs of the GCC. The UAE-based real estate developer EMAAR is the seventh-largest real estate developer in the world by market capitalization with a market capitalization of USD 19 billion.79

Tourism sector: The tourism industry in the GCC is large and growing – approximately 37 million international tourists visited the region in 2007. This is more than half of the 70 million tourists that visited Italy in the same year. The annual growth rate of tourists in the GCC region was 10 percent between 2002 and 2007, as compared to the 2 percent growth rate in tourists visiting Italy over the same period.80

In 2007, tourism revenues were approximately USD 28 billion. By 2017, tourism is expected to generate USD 69 billion. To develop the necessary infrastructure to support these increases, GCC states have allocated more than USD 380 billion to tourism development projects through 2018.81

GCC countries boast a number of prime destinations for tourists, including religious sites and festivals, special events and novelty attractions. Saudi Arabia is home to the Islamic holy cities of Mecca and Medina, and attracted 15 million visitors in 2007. Qatar hosted the Asia Games in December 2006 and Bahrain is home to Formula 1 Grand Prix. In the UAE, Abu Dhabi will soon be home to satellites of the Louvre and Guggenheim museums, while Dubai is building Dubailand, an entertainment complex that will include one of the largest theme parks in the world.

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79 Bloomberg; Datastream.
80 World Travel & Tourism Council; GCC Chambers of Commerce and Industry; Bahrain News Agency.
81 World Travel & Tourism Council.
To accommodate this growing volume of travelers, the GCC’s regional travel infrastructure is being expanded. Since 2002, ten additional air carriers have been introduced into the GCC – four of them low-cost airlines – bringing the number of airlines in the region up to 17. More than 280 large-bodied aircrafts have been ordered for the GCC airline fleets since 2006, to accommodate growing travel demand. The total number of passengers traveling to and from the GCC has almost doubled since 2002, from 45 million to 85 million.82 On the basis of this expansion, large regional airlines are emerging: Dubai-based Emirates is the fifth-largest airline in the world.83 Furthermore, there is still significant opportunity for low-cost airlines within the region – currently, about 5 percent of this passenger capacity is served by low-cost airlines, as compared to 28 percent in the US and 54 percent in the UK.84

In order to house the incoming number of tourists, the number of hotel rooms is also increasing – the total number of available rooms in the GCC increased from 140,000 to 180,000 between 2002 and 2007, with developments concentrating in the 5-star category. The total number of rooms is still low compared to the total number of hotel rooms in France or Italy, 620,000 and one million, respectively.85 Room rates in the GCC averaged USD 115 per night in 2005, as compared to USD 146 per night in Europe.86

Telecommunications: The GCC telecommunications market is large and growing fast – between 2002 and 2007, the number of mobile phone users grew from 9.7 million subscribers to 34 million subscribers, at an annual growth rate of 29 percent. In comparison, the global growth rate in the number of subscribers over the same period was 22 percent. Growth is expected to continue until 2017, albeit at a slower rate of 5 percent per year, as penetration has already exceeded 90 percent of the population.87

This rapid growth in telecommunications has led to the development of regional businesses. For example, Etisalat has over 33 million subscribers in 15 countries and has been ranked by the Financial Times Global 500 among the world’s largest corporations. Zain Group operates in 21 countries across the Middle East and sub-Saharan Africa with 45 million subscribers and revenues of USD 5.9 billion in 2007.

Changing demographics

The GCC’s population of 38 million is expected to grow at 2.1 percent per year over the next 10 years, which will exceed the global average of 1.2 percent. Saudi Arabia and the UAE account for approximately 80 percent of the GCC’s population, with the UAE growing at the fastest rate – 4.9 percent annually over the last 5 years. This increased growth rate is largely due to the influx of foreigners: 78 percent of the UAE’s population is made up of nonnationals, as opposed to GCC’s average of 65 percent.88

82 Lundkvist Fleet Database via BACK Aviation Solutions; Zawya.
83 Size is measured by the international revenue passenger kilometers; IATA World Air Transport Statistics.
84 Innovata schedules via APGDAT; OAG.
85 Euromonitor; World Tourism Organization.
86 Global Investment House.
87 Euromonitor.
88 Global Insight, World Market Monitor.
Infrastructure development across the GCC will have to increase to keep pace with the growing population. Historically, GCC countries have underinvested in the development of their infrastructure – between 1998 and 2007, 20 percent of GCC’s combined GDP was invested in the economy, as compared to 39 percent and 30 percent in China and South Korea, respectively. In recent years, however, the GCC countries have increased their investments. For example, in 2006, approximately half of Qatar’s GDP was invested in infrastructure development. In order to meet this growing need, the GCC countries are increasingly turning towards global players in power, water, transportation, housing, healthcare and education.89

Increased need for infrastructure investments

Spending on infrastructure in the GCC is increasing to meet the basic needs of the growing population. In the GCC, an estimated USD 175 billion was spent on infrastructure development in 2007, which is equivalent to more than 20 percent of total GDP. This was used to meet rising demand in power, water, transportation, housing, healthcare and education.

Power: Population increases, along with the continued growth of industrial and real estate developments, are going to heighten the demand for power. An increase of more than 60 gigawatts is expected between 2008 and 2015, representing 80 percent of current capacity. This is roughly equal to the cumulative power capacity added in India over the last 12 years. Investments of USD 50 billion will be required for developing the new power generating capacity and infrastructure. In addition, a regional electricity market is emerging as seen by the development of a USD 7 billion power grid that connects countries in the GCC, expected to come online in 2009.90

Increasingly, these needs will be met by private sector investors: in 2007, private developers won contracts for developing 7.2 gigawatts out of a total of 9.7 gigawatts planned electricity expansion across the GCC.91

Water: Recent UN studies have shown GCC countries to be among the world’s top 20 water-deficit countries. At the same time, these countries have very high water consumption – for example, the UAE consumes 0.4 cubic meters (m³) per capita per day, making it the world’s highest per capita water consumer, followed by the US and Canada. As a result, the GCC is the world’s largest desalination market, with almost half of the estimated 30 million m³ per day of desalinated water produced worldwide to be found in the region.92

Water demand in the GCC is expected to increase between 2007 and 2015, to more than 22 million m³ per day. Several GCC countries have already started increasing their water desalination capacity, and it is expected that investments of USD 20 billion will be required.93

Transportation: Transportation needs are growing across the region, especially in air and rail travel and the ports segments. All GCC countries are expected to add airport capacity over the next 10 years. Total GCC airport capacity is projected to expand by up to 400 million passengers by 2020, equivalent to building eight new London Heathrow Airports. In addition, port expansions of more than 850 million

89 Global Insight, World Market Monitor.
90 Middle East Economic Digest; AME Info; India Central Electricity Authority.
91 Middle East Economic Digest.
92 Consulate of Canada; United Nations; GCC Interconnection Authority.
93 Middle East Economic Digest; AME Info.
tons are planned across all the GCC countries by 2020, with global businesses such as DP World, the fourth-largest port operator worldwide, emerging to fill the need.94

Additional railway lines are also being added. Dubai is developing a metro system with 70 km of railways, which is about 17 percent the length of London’s Underground. Saudi Arabia is adding an additional 1,000 km of railway to the existing 570 km, to ensure connection from Jeddah at the Red Sea to Dammam situated in the Gulf. Total investments needed to keep up with the region’s increasing transportation needs will exceed USD 90 billion over the next 10 years.25

**Housing:** The total population in the GCC is expected to increase by 8.3 million people between 2007 and 2017. This will translate into a significant increase in the need for additional housing. In Saudi Arabia alone, an additional 4 million to 5 million housing units will be needed by 2020. Currently, mortgage financing regulations in Saudi Arabia are being revised to allow more Saudis to own property. National Commercial Bank estimates that outstanding housing credit is likely to rise from USD 1 billion in 2007 to USD 12 billion by 2010.96

**Healthcare:** Basic healthcare needs are increasing across the GCC. The demand for treatment is expected to more than triple by 2025.97 There are three factors behind this heightened demand. First, and most important, is the growth in the size of the GCC population. Second is the expected increase in the population of individuals over the age of 65, from 840,000 to 1.37 million over the next 10 years. Third is the increasing incidence of lifestyle diseases and risk factors (e.g., obesity). UAE, Saudi Arabia, Bahrain and Kuwait are among the top five countries in the world in incidence of adult diabetes, with 15 to 20 percent of their collective population diagnosed with the disease.98 Kuwait is ranked eighth in the world in prevalence of obesity.

Keeping pace with growing demand will require increased availability of healthcare. Based on population growth alone, 16,500 additional hospital beds will be needed over the next 10 years to simply maintain the current level of access to healthcare. An additional 110,000 beds will be needed to bring the number of beds up to OECD averages.99 The overall size of the GCC healthcare market is between USD 19 billion and USD 21 billion, and it is expected to grow to almost USD 60 billion by 2025.100

Most of this growth will have to be met by the private sector, which currently accounts for 20 percent of the GCC healthcare industry.101 New investments from the private sector include the Dubai Healthcare City, a USD 1.8 billion development. Overall, there will be 17 hospitals with a total of 2,325 beds to be available by 2010.102 Mubadala Development Company from Abu Dhabi and the Cleveland Clinic

94 IATA; Middle East Economic Digest; estimates based on airport data and announcements.
95 Dubai Metro; Saudi Railways Organization; Abraaj Capital; Transport for London, Mayor of London.
96 Global Insight, World Market Monitor; Saudi Arabia Ministry of Planning; National Commercial Bank.
97 McKinsey GCC Healthcare 2025.
98 International Diabetes Federation; Global Insight, World Market Monitor; World Health Organization.
99 Global Insight, World Market Monitor; OECD; Euromonitor.
100 McKinsey GCC Healthcare 2025; Global Insight, World Market Monitor.
102 AME Info.
are developing a 360-bed hospital in Abu Dhabi, expected to begin operations in 2011.\textsuperscript{103} Qatar is establishing Sidra Medical and Research Center, a 400-plus bed inpatient and outpatient medical care and research facility. Investments of USD 7.9 billion have already been pledged, and the facility is scheduled to begin operations in 2011.\textsuperscript{104}

**Education:** A top priority for all GCC countries will be to provide high-quality education – starting with kindergarten and continuing through secondary school (K-12), and into tertiary education programs. Over the last five years, 5 percent of the GCC’s GDP has been allocated to education, led by the UAE Federal Government, which spends about 25 percent of its federal budget on education.\textsuperscript{105}

The majority of GCC nationals receive K-12 schooling in public institutions. While significant investments have been made towards improving the public school system, results have been limited as students in GCC countries still perform poorly on standardized tests. Students from Bahrain and Saudi Arabia scored 438 and 398, respectively, on the science standard Trends in International Mathematics and Sciences Study (TIMSS) examination, compared to a global average of 473.\textsuperscript{106}

As a result, public school systems are increasingly looking to private operators to provide higher quality K-12 education. For example, the Abu Dhabi Education Council has partnered with international education providers to create a high-quality education system. Global Educational Management Systems (GEMS), a school management group based in Dubai, already operates over 30 schools in the GCC area and is planning to expand its operations over the next 2 years. For example, GEMS is developing K-12 schools for over 2,000 students at the King Abdullah Economic City, scheduled to open in 2009. The need for quality private schools is further driven by a growing student population – the size of the school-age population is projected to increase by an estimated 1.1 million students over the next 10 years.\textsuperscript{107}

At the same time, the GCC countries are developing vocational and higher education institutions to prepare their youth for the private job market. Over the next 10 years, between 3.5 million and 5 million people are expected to enter the workforce.\textsuperscript{108} So far, public sector education has failed to meet the demands of a more globalized workplace across the GCC. Only 10 percent of the national workforce across the GCC is employed by the private sector; the rest being employed in public sector jobs. With governments looking to reduce the public sector’s role in driving the economy, and to increase private sector involvement, quality education is key for developing the skills of GCC nationals.\textsuperscript{109}

In the last 5 years, UAE, Saudi Arabia, Kuwait, Bahrain, Qatar and Oman have all opened private universities. UAE has established the Dubai Knowledge Village and Dubai International Academic City – combined they cater to over 10,000 students and house more than 20 foreign universities.\textsuperscript{110}

\textsuperscript{103} Mubadala Development Company.
\textsuperscript{104} Sidra Medical and Research Center.
\textsuperscript{105} AME Info; World Bank.
\textsuperscript{106} IEA; TIMMS.
\textsuperscript{107} Global Insight, World Market Monitor; GEMS; AME Info.
\textsuperscript{108} Global Insight, World Market Monitor. Workforce is defined as the group aged between 15 and 64 years, with an expected participation rate based on current participation levels.
\textsuperscript{109} McKinsey Global Institute.
\textsuperscript{110} Dubai International Academic City.
Saudi Arabia, the awakening giant

Saudi Arabia is home to the world’s largest proven oil reserves with 22 percent of the global reserves. The country is the world’s largest oil producer, responsible for 13 percent of global output. Hydrocarbons account for almost half of the Saudi economy.111

Saudi Arabia has always been the largest economy in the GCC, and in 2007 it accounted for 48 percent of the GCC’s GDP and 68 percent of the GCC’s population. Yet this relative strength masks a weakness. Saudi Arabia has historically been a closed, slow-growing economy. Between 1990 and 2002, Saudi GDP grew by only 2 percent per year, and this slow growth was almost entirely driven by oil revenues. During the same period, the per capita GDP grew by only 0.2 percent.112

This weak economic performance, combined with a large population of 25 million growing at 2.6 percent annually, led Saudi Arabia’s leaders to diversify and liberalize the country’s economy beginning in 2002. Liberalization was accelerated in 2005, with the launch of the national ‘10 x 10’ program, aimed at making Saudi Arabia one of the world’s top 10 competitive economies by 2010.113 These reforms have helped Saudi Arabia improve its business environment, as reflected in the World Bank’s ease of doing business ranking; the country has already risen from 67th in 2005 to 23rd in 2007. Saudi Arabia has been hailed by the World Bank as one of the world’s top 10 reformers in 2006/2007, and was granted membership to the World Trade Organization in 2005.

The Saudi Arabia General Investment Authority (SAGIA) has established six ‘Economic Cities’ to promote private sector involvement (see box ‘Economic freezones’). These ‘Economic Cities’ are expected to add more than USD 150 billion to the Saudi GDP and generate more than 1.3 million jobs by 2020.114

Foreign investors have also taken note of the reform efforts. The volume of FDI in Saudi Arabia has increased eleven-fold since the establishment of SAGIA, from USD 2 billion in 2004 to USD 22 billion in 2007. The liberalization and reform efforts are projected to foster a real annual growth rate of 5 percent over the next 10 years.115

112 Global Insight, World Market Monitor.
113 SAGIA; competitiveness measured based on World Economic Forum’s (WEF) Global Competitiveness Index, the Institute for Management Development’s (IMD) World Competitiveness Rankings and the International Finance Corporation’s (IFC) Ease of Doing Business Index.
114 SAGIA.
115 Global Insight, World Market Monitor.
In Saudi Arabia, King Abdullah University of Science and Technology will open in 2009. It will cater to 20,000 faculty, staff and students, and will be the first university in Saudi Arabia to have male and female students in the same classes. To date, international collaborations have been established with several universities including University of Texas at Austin, University of California at Berkeley, Stanford University and Indian Institute of Technology.\textsuperscript{116}

Qatar’s Education City offers graduate courses by international universities – to date, five US institutions are based there, and each has a different focus: Virginia Commonwealth University offers art and design; Weill Cornell Medical College offers medicine; Texas A&M University offers engineering; Carnegie Mellon University offers computer science and business administration; Georgetown University offers international relations, and Northwestern University, due to open in the fall of 2008, will offer journalism and communication programs.\textsuperscript{117}

**Domestic consumer spending increasing**
Total private consumption within the GCC was USD 200 billion in 2007, increasing at an annual rate of 8 percent since 2002. The relative consumption is low – 24 percent of GDP, compared to 70 percent and 63 percent in the US and UK, respectively. This may be driven by the large, unskilled expatriate population that earns low wages. If consumption remains at the same level relative to GDP total private consumption will be USD 430 billion by 2017. However, if it doubles to 48 percent of GDP, which is approximately MENASA’s weighted average, then total private consumption will rise to USD 860 billion by 2017. This would be equivalent to almost half of the UK’s private consumption of USD 1.75 trillion today.\textsuperscript{118}

Per capita consumption in the GCC is USD 5,400. This is the highest in the MENASA region which has a weighted average consumption per capita of USD 925. By comparison, per capita consumption in the US and UK is USD 32,000 and USD 29,000, respectively. Per capita consumption in the GCC has been growing at 5 percent per year for the last 5 years, and with this trend expected to continue if not accelerate, there is a potential for further developing the retail markets within the GCC.\textsuperscript{119}

As a result of increasing private consumption, the retail sector has grown and is expected to continue growing. The total GLA in GCC shopping centers has more than doubled from 2.1 million square meters in 2000 to 4.9 million square meters in 2005. Total GLA is expected to more than double again to 12.6 million square meters by 2012. Projects worth over USD 770 billion are planned or underway, and by 2011 there will be more than 27,000 retail outlets within the GCC.\textsuperscript{120}

**Government reforms promoting private sector**
Over the last 10 years, a generational change in the leadership of GCC countries along with regional reformers has set the stage for the modernization of local economies (Exhibit 21). These reformist leaders recognize that the economic needs of their countries cannot be met by the government alone, and must involve the private sector. As a result, governments are actively encouraging and supporting

\textsuperscript{116} The New York Times.  
\textsuperscript{117} Qatar Foundation; Northwestern University.  
\textsuperscript{118} Global Insight, World Market Monitor.  
\textsuperscript{119} Global Insight, World Market Monitor.  
\textsuperscript{120} Retail Middle East.
the private sector to drive the economy, by putting in place regulations that will help to encourage investments in all sectors. All GCC countries are now part of the World Trade Organization, with Saudi Arabia being the last to join in 2005.

Market liberalization and privatization
Several sectors are being liberalized within the GCC, and opening up for private sector involvement. To date, there has been significant liberalization and privatization in the banking, telecommunications and real estate sectors. Now, utility companies are starting to be privatized. An overview of the market liberalization status of each of the GCC countries is discussed next.

**Saudi Arabia:** Privatizations in Saudi Arabia began in 2002, when Saudi Arabia divested 30 percent of the Saudi Telecommunications Company through an initial public offering. Since then, 20 sectors have been identified for privatization, including telecommunications, electricity, postal services, water, railroad, education and air transportation. Recent privatizations include the IPO of Saudi Kayan Petrochemicals in 2007 for USD 1.8 billion. Approximately USD 800 billion worth of assets are to be privatized over the next ten years.121

**UAE:** The most active privatization programs are in Abu Dhabi, which began the privatization processes in 1997 by forming a special committee for the sale of its assets in water and power. Since then, the government has divested assets in power and water, and has been focusing on transportation, ports, and oil and gas. Recently, Air Arabia, UAE’s first low-cost carrier and DP World, the world’s fourth-largest container port handler, were partially divested through IPOs.122

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122 Zawya; AFP.
Kuwait: The government has announced plans to privatize 23 companies across various sectors through IPOs or public auctions. Companies in the pipeline include Bank of Kuwait and Middle East, Kuwait Flour Mills and Bakeries, Kuwait International Investment Co, Kuwait Food Co, Kuwait Airways and Kuwait Finance House. In January 2008, the Kuwaiti parliament approved the sale of 40 percent of Kuwait Airways to the public, and 35 percent to a long-term investor within 2 years.123

Qatar: The government partially privatized the telecommunications company in 1998, corporatized the electricity and water sector, and sold most of the government’s power generation plants to Qatar Electricity and Water Company, which is majority-owned by the local private sector. Construction is underway on the first independent power and water plant, which is majority-owned by a foreign developer. There are plans to privatize Qatar Airways over the next decade.124

Bahrain: Privatization began with the divestment of telecommunication assets for USD 800 million in 2005. Bahrain’s ALBA was partially privatized with 20 percent of shares held by SABIC and 3 percent of shares held by Breton Investments. In January 2006, Al-Hidd power and water plant was sold for USD 738 million to a consortium of three international companies.125

Oman: Privatization is being pursued across several sectors. At the forefront is the power sector: Oman Electricity Transmission Company and Al-Ghubrah Power Desalination Company are the next in line to be opened up to private investors. Oman’s capital city, Muscat, plans to privatize all power generation and water desalination companies by 2009. Other companies earmarked for privatization are Muscat Electricity Distribution Company, Majan Electricity Company and Mazoon Electricity Company. Other services that might be privatized in the near future include the water distribution and waste water networks.126

Important role of family-owned businesses
Family-owned businesses in the GCC form a large part of the region’s economy: almost 90 percent of all commercial activity and non-oil related GDP in the region is controlled by family firms. There are more than 5,000 family firms with assets exceeding USD 500 billion, and accounting for 70 percent of total private sector employment.127 The ten largest family-owned businesses in the GCC were valued at over USD 100 billion in 2007, equivalent to almost 13 percent of GCC’s GDP.

These family-owned companies span across different sectors, forming large conglomerates often developed over many generations. For example, the Kharafi Group, one of the largest family-owned firms valued at USD 14 billion, was established as a trading company in Kuwait more than 100 years ago. Today, the Kharafi Group is involved in various sectors such as construction, manufacturing and commerce.128

123 Kuwait Finance House; Kuwait Minister of Finance speech; Abraaj Capital; Reuters.
124 Hoovers; Energy Information Administration; Power Technology; Reuters.
125 Zawya; Mumtalakat; Abraaj Capital.
126 Middle East Economic Digest.
127 Ithmar Capital.
128 Kharafi Group.
Deepening and reforming capital markets

The GCC comprises eight individual stock markets, three of which are in UAE. Several financial indicators show that the depth of the GCC capital markets has been increasing over the last few years (Exhibit 22). Currently, 627 companies are listed across the GCC. The combined market capitalization of these exchanges is USD 1.05 trillion, as compared to the Deutsche Börse in Frankfurt, which has a market capitalization of USD 1.60 trillion. Total market capitalization is 130 percent of the combined GDP of the GCC region. This is similar to what is seen in mature markets such as the US or the UK.129

These capital markets are overseen by capital market regulators, to ensure competition and regulatory compliance. Capital market authorities such as Saudi Arabia Capital Market Authority (CMA), Qatar Regulatory Authority and Dubai Financial Services Authority (DFSA) are based on UK standards.

To further strengthen these capital markets, formal partnerships with leading global exchanges are being developed. Borse Dubai, a company that holds a controlling stake in the Dubai Financial Market (DFM) and Dubai International Financial Exchange (DIFX), holds a 30 percent stake in the Nasdaq OMX group and has jointly signed a deal with Nasdaq to develop the DIFX. Abu Dhabi Securities Market and the New York Stock Exchange (NYSE) are jointly developing new opportunities in trading systems and related technology, investor and issuer services, and investment products including the region’s first derivatives market.130

Exhibit 22

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<td>131</td>
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Source: Bloomberg, March 25 2008; Zawya

To attract investors into the region, foreign ownership of local assets is being encouraged across the GCC. Of all the GCC capital markets, the Kuwaiti market is the most open to foreign ownership. For example, up to 100 percent foreign ownership of government-authorized Kuwaiti assets is allowed. In Oman, foreign investors can acquire up to 70 percent of the shares of most listed companies.

129 Bloomberg.
130 MENAFN; Misr Information Services and Trading.
Economic freezones

Economic freezones are geographical areas, subject to special rules and regulations, which seek to attract companies by easing establishment and by offering various tax and business incentives. There are three main elements that make freezones attractive for companies:

- Financial incentives: Freezones offer exemptions from corporate and personal income tax, as well as from customs and commercial levies that might exist elsewhere in the country.
- Reduced business barriers: Freezones can offer up to 100 percent foreign ownership, as well as minimum red tape and quick, hassle-free approval procedures. Businesses incorporated in the GCC freezones do not need local sponsors.
- Supportive infrastructure: Successful freezones offer modern, state-of-the-art infrastructure in an attractive working environment.

The GCC is home to more than 60 functioning freezones, of which around 20 are in UAE.\textsuperscript{131} The Jebel Ali Freezone Area (JAFZA), established in 1985 in UAE, is one of the largest economic freezones in the world. Starting from a base of 19 companies, it now accommodates approximately 6,000 companies from over 110 countries throughout the world.\textsuperscript{132} The Dubai International Financial Center (DIFC) and the Qatar Financial Center (QFC) are examples of financial freezones, hubs for commercial and investment banks and other financial institutions providing services including underwriting, private equity and foreign exchange trading. Typically, these financial freezones offer licensing services for wholesale and offshore operations and services such as information provision and visa application assistance.

The concept of freezones has been expanded to include economic, industrial or mixed cities. Within the GCC, the top 3 civil projects, worth approximately USD 400 billion – Dubailand, King Abdullah Economic City in Saudi Arabia, and Silk City in Kuwait – are freezones.\textsuperscript{133}

\textsuperscript{131} Zawya.
\textsuperscript{132} Zawya; Jebel Ali Freezone.
\textsuperscript{133} ProLeads.
For most companies listed in UAE and Bahrain, foreign ownership is allowed up to 49 percent of shares, while in Qatar, up to 25 percent of the stock can be owned by foreign investors. Even in Saudi Arabia, historically the market least open to foreign ownership, foreign investors can own up to 100 percent of industrial property and, through mutual funds, own shares in companies traded on the Saudi stock market. Across the GCC, complete foreign ownership of local assets is allowed in economic freezones (see ‘Economic freezones’).134

To further attract foreign investments, taxes are being reduced in an already low-tax environment. For most foreign, non-hydrocarbon companies, capital gains taxes range between zero and 35 percent. In Bahrain, no taxes are levied on income, capital gains, sales, estates, interest, dividends, royalties or fees. In UAE, most foreign businesses are exempt from taxes, except banks, which are taxed at 20 percent. In Kuwait, corporate taxes used to range up to 55 percent, but were reduced to a flat rate of 15 percent in early 2008. In Oman, Qatar and Saudi Arabia, corporate taxes range between 0 and 30 percent, 0 and 35 percent and 25 to 35 percent, respectively. Oman and Qatar are preparing to lower the maximum tax rate to 12 percent.135

Withholding taxes are also low. Bahrain, Oman, Qatar and UAE do not have withholding taxes, while Saudi Arabia and Kuwait utilize a 15 percent withholding tax rate.

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134 Respective stock exchanges.
135 Ernst & Young; KPMG Tax Survey; The Heritage Foundation; Zawya.
Chapter 4
North Africa
North Africa

The North Africa region comprises Egypt, Morocco, Tunisia, Algeria and Libya (Exhibit 23). These countries have a long and integrated history, with the first settlers appearing almost 8000 years ago. The modern nation of Egypt encompasses an area that was the world’s first state, settled around 3000 BC. Morocco, Algeria, Libya and Tunisia began as Phoenician colonies, and were established between 1200 BC and 900 BC, by settlers from what is today known as the Levant. Over the centuries, this region has been a part of the Roman, Greek, Islamic and Ottoman empires. In the 19th century, the area was occupied by France, the UK, Spain and Italy, and the North African countries did not gain independence until the 1950s.

Exhibit 23

Overview of North Africa

In 2007, North Africa’s GDP was USD 430 billion (Exhibit 24), or 14 percent of MENASA’s GDP. Egypt and Algeria are the two largest countries in the region, both with respect to population and economic output, accounting for about 60 percent of the region’s combined GDP and about 70 percent of its population. Real economic growth in North Africa averaged 5 percent annually from 2002 to 2007, and is projected to continue at 5 percent annually for the next 10 years.¹³⁶

Small but growing economy led by hydrocarbons and inflow of foreign funds

Hydrocarbons are an important source of revenue in North Africa’s economy. Revenues from hydrocarbon exports were USD 100 billion in 2007 – which is equivalent to 24 percent of North Africa’s combined GDP. These hydrocarbon

¹³⁶ Global Insight, World Market Monitor.
Export revenues were almost one-quarter of the hydrocarbon export revenues of the GCC. In 2006, 2 billion barrels of oil and 900 million barrels of oil equivalent of natural gas were produced in the region. This accounted for 5.3 percent of global oil production, and 5.0 percent of global natural gas production. Algeria and Libya are North Africa’s largest oil producers, each accounting for 41 percent of the total oil production in the subregion, with Egypt accounting for most of the remaining 18 percent. Algeria is the region’s largest natural gas producer – it is responsible for 59 percent of North Africa’s total natural gas production, with Egypt and Libya accounting for 31 percent and 10 percent, respectively.

Foreign funds in the form of FDI and remittances constitute an important source of foreign cash inflows and are equivalent to 10 percent of the total North African GDP. In 2007, FDI was USD 28 billion, equivalent to 6.5 percent of North Africa’s combined GDP. By comparison, FDI was equivalent to 5.4 percent of GDP in the GCC countries. In 2007, North African countries received USD 16 billion in remittances.

Growing population driving the need for additional infrastructure

North Africa’s population of approximately 160 million people, of which about half are in Egypt, has been growing at a rate of 1.7 percent per year since 2002. The total population is expected to continue growing at 1.5 percent per year over the next ten years, and is creating a demand for more robust infrastructure.

Power: To keep pace with increasing population growth and to support the region’s industrial development, power capacity will need to expand by at least 50 gigawatts by 2030, requiring an investment of USD 90 billion. This is in addition to the 44 gigawatts that existed in 2006. Egypt, Libya and Algeria account for 19, 15 and 12 gigawatts of total planned expansions, respectively.

Private sector investors – both domestic and foreign – are expected to play an increasingly important role in meeting the anticipated growth in power demand. In Morocco, The Jorf Lasfar power plant was developed as a joint venture between

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137 Economist Intelligence Unit.
139 Global Insight, World Market Monitor; World Bank.
140 Global Insight, World Market Monitor.
141 Zawya; IEA; Energy Information Administration; Economist Intelligence Unit.
the Jorf Lasfar Energy Company and the national power utility company, National de l’Electricité, as a 30-year build-operate-transfer arrangement.\textsuperscript{142}

**Water:** The total capacity of desalination plants is also being increased to meet the rising demand in water consumption. In Algeria, the largest desalination plant constructed to date was completed in early 2008, with a capacity of 200,000 cubic meters per day. This USD 250 million plant was a joint venture between the state-owned Algerian Energy Company and General Electric, with ownership split 30-70, respectively. Even now there is need for additional water – almost three-quarters of the 3.5 million people living in the capital city of Algiers only have access to fresh water 2 to 3 hours per day. A total of 13 additional desalination plants with a capacity to produce 2.35 million cubic meters of water per day will be constructed in Algeria by 2010.\textsuperscript{143}

In Libya, there are water shortages despite the government-owned General Electric Company of Libya (GECOL) being the sixth-largest operator of water desalination plants in the world.\textsuperscript{144} Over the next 10 years, more than USD 1 billion will be spent on developing 11 new desalination units. In Tunisia, two new desalination plants with a capacity of 600,000 cubic meters per day are being planned.\textsuperscript{145}

**Housing:** The total number of owned and rented houses in the North African countries increased from 26 million in 2002 to 30 million in 2007. By 2015, the total number of housing units is expected to increase to 36 million.\textsuperscript{146}

Additional housing units are being constructed across the North African region. In Libya, UAE-based Tameer Holdings is developing a project worth USD 20 billion, to house more than 500,000 people. In Egypt, UAE-based EMAAR is constructing New Cairo City with 5,000 housing units.\textsuperscript{147}

**Healthcare:** Currently, total healthcare expenditure in North African countries is between USD 12 billion and USD 16 billion.\textsuperscript{148} Population growth, coupled with the size of the elderly population expanding from 8 million to 11 million between 2007 and 2017, is expected to cause a rise in healthcare spending. Healthcare spending in Egypt alone is expected to increase from USD 7 billion in 2007 to USD 9.5 billion in 2011.\textsuperscript{149}

An additional 50,000 hospital beds will be needed by 2017 for North Africa to keep pace with population growth and maintain the current ratio of 1.9 hospital beds per thousand people. For this ratio to meet the OECD average of 4.1, an additional 400,000 beds will be needed.\textsuperscript{150}

Development of several healthcare facilities in collaboration with international healthcare providers is already underway. For example, Saudi German Hospitals

\textsuperscript{142} Power Technology.  
\textsuperscript{143} Zawya; Eleconomista.  
\textsuperscript{144} In 2007, GECOL had a total water production capacity of 9,876 million gallons per day.  
\textsuperscript{145} GECOL; Medibtikar.  
\textsuperscript{146} Euromonitor.  
\textsuperscript{147} AME Info; EMAAR.  
\textsuperscript{148} 2004 healthcare spend per capita was extrapolated to 2007. Global Insight, World Market Monitor.  
\textsuperscript{149} Zawya.  
\textsuperscript{150} Euromonitor; OECD; Global Insight, World Market Monitor.
(SGH) is building a 300-bed tertiary care hospital in Cairo as a joint venture with Olympic Group.\textsuperscript{151}

**Education:** The number of schools across the North Africa region will need to increase as the size of the school-going population is expected to grow from 47 million to 49 million by 2017. Literacy rates vary across this region – from 52 percent in Morocco to 83 percent in Libya. By comparison, Singapore has a 96 percent literacy rate.\textsuperscript{152} To raise the North African literacy rates to international standards will require additional schooling facilities.

Several international education providers already exist in the North African countries. For example, in Egypt, the Lebanon-based Choueifat is part of a worldwide network of private schools run by the SABIS International Services. Several American schools in Tunisia and Morocco are based on the American education system. It is likely that the number of private, international schools will continue to increase.

**Liberalizing and growing capital markets**

North African countries are developing their capital markets. The combined market capitalization of the five North African stock markets is still small in the international context, totaling USD 225 billion (as of March 2008). By comparison, China’s stock market capitalization is USD 3.75 trillion and the US’s is USD 16.2 trillion.\textsuperscript{153}

Even though they are small, North African stock markets are growing fast, and have experienced the highest growth of all stock markets across the MENASA region. North Africa’s stock market capitalization grew 65 percent per year between March 2004 and March 2008, from USD 30 billion to USD 225 billion. In the same period, markets in the Levant grew 44 percent annually, in the GCC 34 percent, in Turkey 26 percent, in South Asia 49 percent, and in the US 4 percent.\textsuperscript{154}

Despite this significant increase, there still is potential for growth in the North African capital markets. In 2007, the combined market capitalization of North African markets was 52 percent of the region’s GDP. By comparison, the market capitalization of China and US stock markets was 115 percent and 117 percent of their respective GDPs.\textsuperscript{155}

The capital markets in North Africa vary in performance and maturity (Exhibit 25). The older stock markets, including Egypt and Morocco, are relatively well established with market capitalizations equivalent to 100 percent and 138 percent of their GDPs, respectively. The younger markets in Libya and Algeria are relatively small and valued at 0.3 and 0.1 percent of their GDPs, respectively. There are just three companies listed on the Libyan stock exchange, and five companies listed on the Algerian stock exchange. The Tunisian stock market is in between – it is small but developing with a total market capitalization that is 16 percent of the country’s GDP.

\textsuperscript{151} Saudi General Hospital.  
\textsuperscript{152} CIA World Factbook; World Bank; Global Insight, World Market Monitor.  
\textsuperscript{153} Bloomberg.  
\textsuperscript{154} Bloomberg.  
\textsuperscript{155} Bloomberg; Global Insight, World Market Monitor.
The capital markets in Egypt, Morocco and Tunisia have been undergoing reform, and have shown significant growth over the last 4 years. An overview of the capital market development for these three North African countries is discussed next.

**Egypt:** Egypt’s Stock Exchange is made up of two exchanges, Cairo and Alexandria, both of which are governed by the same board of directors and share the same trading, clearing and settlement systems. The Alexandria Stock Exchange was officially established in 1888, with Cairo following in 1903.156

The Egyptian capital markets were reformed in the early-to-mid 1990s. Today, the Cairo and Alexandria Stock Exchange (CASE) is the largest exchange in North Africa. In March 2008, over 400 companies were listed on the CASE, with a total market capitalization of USD 130 billion. Since 2004, CASE showed an annual growth of 77 percent in market capitalization.157

Out of the total population of 77 million, about 1.6 million Egyptians, or 2 percent of the population, are shareholders. CASE is almost completely open to foreign ownership. In the case of individuals, mutual funds and international funds, no taxes are levied on dividends, capital gains and interest on bonds. Profits of Egyptian corporations from investing in securities are subject to a capital gains tax rate of 20 percent.158

A new bourse, Nilex, was established in early 2007 for small- and medium-sized firms, as part of the CASE. This is the first mid and small cap market in the Middle East and North Africa region.159

The Capital Market Authority (CMA) was established in 1979 with the objective of organizing and developing the Egyptian capital market and serving as its primary regulator.

**Morocco:** The Casablanca Stock Exchange (CSE) in Morocco was established in 1929, and it is the third-oldest stock exchange in Africa. CSE is open to foreign investments. There are no restrictions on foreign ownership of local assets, there is no capital gains tax and taxes on dividends and VAT are at a low rate of 10 percent. In March 2008, the market capitalization of the CSE exchange was USD

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156 MBendi.
157 Cairo and Alexandria Stock Exchange; MBendi; Bloomberg.
158 MBendi; Cairo and Alexandria Stock Exchange; Deloitte.
159 Nilex.
90 billion. Growth over the last 4 years has averaged 58 percent, and there are now 71 listed companies.\textsuperscript{160}

The CSE has two regulatory bodies. The Association Professionelle des Sociétes de Bourse develops trading rules and procedures, and Le Conceil Deontoligique des Valeurs Mobilieres monitors compliance.

**Tunisia:** The Tunis Stock Exchange was established in 1969, and it is a small and well-functioning public equity market. A total of 50 companies are quoted on the Bourse de Tunis, and they have a combined market capitalization of over USD 5 billion.\textsuperscript{161}

Limited foreign ownership of local assets is allowed. Since 1995, foreigners have been permitted to buy up to 10 percent of a company on the Tunis Stock Exchange and up to 30 percent of an unlisted company without central bank approval. There is no tax on dividends or capital gains.\textsuperscript{162}

In 2006 tax incentives were approved for firms that issue public equity. Financial reforms are ongoing, such as a plan to accelerate the process of making the currency fully convertible.\textsuperscript{163}

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**Egypt**

Egypt is the most populous country of North Africa, with 77 million people. The majority of the population lives along the Nile River, with Cairo and Alexandria being the biggest cities.

Egypt is a presidential republic with President Hosni Mubarak being in office since October 1981 and Prime Minister Dr. Ahmed Nazif serving since July 2004. The President is the Head of State. Egypt is formally bicameral with 454 members in the Maglis al-Sha’ab (People’s Assembly, or lower house) and 264 members in the Maglis al-Shura (Consultative Council, or upper house).

In 2007, Egypt’s GDP was USD 130 billion, and has shown a real annual growth rate of 5.3 percent since 2002. Egypt’s GDP is expected to continue growing at a real rate of 5.0 percent over the next 10 years.\textsuperscript{164}

**Diversified economy with growing role of hydrocarbons**

Hydrocarbons are becoming an increasingly important part of Egypt’s economy. Between 2002 and 2007, production of natural gas in Egypt increased from 400,000 BOE per day to 998,000 BOE per day. In 2006, hydrocarbons and their derivatives generated over USD 8 billion – more than half of Egypt’s exports. Given that Egypt is home to more than 1.0 percent of proven global natural gas reserves, investments are being made to increase the country’s hydrocarbon production.\textsuperscript{165}

\textsuperscript{160} Bourse de Casablanca; MBendi; Bloomberg.
\textsuperscript{161} MBendi; Bloomberg.
\textsuperscript{162} MBendi.
\textsuperscript{163} Economist Intelligence Unit.
\textsuperscript{164} Global Insight, World Market Monitor.
\textsuperscript{165} Economist Intelligence Unit; EnergyFiles; BP Statistical Review of World Energy, June 2007.
Egypt has a strong presence in refining hydrocarbons. It is North Africa’s largest oil refiner, with nine refineries capable of refining more than 750,000 barrels per day. There are plans to almost double this production capacity, with two projects already being considered. The largest new facility is a new refinery to be built near the Suez Canal, with a refining capacity of 500,000 barrels per day. This export-oriented refinery will be a joint venture between Egyptian, Saudi Arabian and Kuwati investors, scheduled to open in summer 2009. The second refinery has a capacity of 130,000 barrels per day and is being planned at the Red Sea coast.\(^{166}\)

Select energy-intensive industries are becoming increasingly important. For example, in 2007, Egypt had a total fertilizer production capacity of 10 million tons per year. In 2007, Abraaj Capital acquired 100 percent of Egyptian Fertilizer Company for USD 1.4 billion, making this deal the largest private equity transaction ever conducted in the Middle East and North Africa region.\(^{167}\)

Egypt produced 35 million tons of cement in 2007, of which 11 million tons were exported. The cement production sector is attracting significant foreign investments as evidenced by the USD 13 billion buyout of Orascom Cement (Orascom Construction Industries’ cement unit) in 2007 by France’s Lafarge, the world’s biggest cement maker. In 2007, the Egyptian government issued eight new licenses to cement manufacturers to increase their total production capacity. In 2008, the government announced plans to add 20 million tons of capacity.\(^{168}\)

**Growth in non-hydrocarbon industries**

In addition to the hydrocarbon industries, Egypt is developing six other sectors: transportation and logistics, tourism, business process offshoring, finance, textiles and agriculture.\(^{169}\)

**Transportation and logistics:** Given its strategic location between Europe, the Middle East, and Asia, Egypt is ideally positioned for development as a transportation and logistics hub. The country has plans to increase overall cargo transportation capacity, requiring investments in roads, airports, ports and railways.

Egypt is also an important throughway for the transit of oil from the hydrocarbon-producing countries in the Arabian Gulf to Europe and the US. The Suez Canal and Sumed pipeline complex connects the Red Sea and the Gulf of Suez with the Mediterranean Sea. In 2006, an estimated 3.9 million barrels per day of oil flowed northbound through the Suez Canal to the Mediterranean, while 600,000 barrels per day traveled southbound into the Red Sea. Over 3,000 oil tankers pass through the Suez Canal annually, and represent around 25 percent of the Canal’s total revenues of USD 3.8 billion. The Suez Canal Authority is planning to expand the Canal to accommodate larger carriers.\(^{170}\)

The 200-mile long Sumed, or Suez-Mediterranean, Pipeline provides an alternative route between the Red Sea and the Mediterranean. The pipeline can transport 3.1 million barrels per day of crude oil. In 2006, 2.3 million barrels of Saudi Arabia’s crude oil shipments were transported through the Sumed Pipeline. This pipeline is owned by Arab Petroleum Pipeline Co., a joint venture between Egyptian

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166 Energy Information Administration.
167 Global Investment House; Abraaj Capital.
168 American Chamber of Commerce in Egypt; Orascom.
169 Egypt State Information Service.
170 Energy Information Administration.
General Petroleum Corporation, Saudi Aramco, Abu Dhabi National Oil Company and Kuwaiti companies.171

Tourism: The tourism market in Egypt is large and growing: between 2002 and 2007, the number of tourists increased from 5 million to 11 million, and total tourist spending increased from USD 4 billion to USD 9 billion. By comparison, Italy attracted 70 million tourists in 2007 and generated USD 43 billion in tourism receipts. Among MENASA countries, Egypt ranks second (behind Saudi Arabia) in attracting international visitors, and 25th in the world.172

Given Egypt’s rich history, 2,500 km of coastline along the Red Sea and the Mediterranean coast, and sunny weather conditions almost the entire year, there is potential for the country to further develop its tourism sector. The government has set the target of attracting 18 million tourists per year by 2015, requiring private sector investments of more than USD 1.4 billion per year.173 To achieve this goal, Egyptian and foreign investors have already invested in developing hotels, transportation and entertainment infrastructure.

Business process offshoring: Egypt first entered the outsourcing and offshoring space in 2003, when Xceed, the country’s first international call center, opened for business. Today, Xceed has grown from 250 employees to more than 1,500, and services a number of Fortune 500 companies out of Egypt.174

Egypt plans to further develop its IT offshoring and business process outsourcing industry. In July 2007, A.T. Kearney ranked Egypt 13th in their list of top 50 outsourcing destinations worldwide, placing it in the top position among all African countries featured in the report. Egypt’s government has set a goal of making the country’s outsourcing industry a USD 1.1 billion market by 2010.175

Egypt has several advantages that could help develop its IT offshoring and business process outsourcing industries. It has a large professional workforce – approximately 300,000 students earn higher education degrees each year, and about 80,000 of them are schooled in IT and engineering courses. The country also has well-established communication and IT networks. Therefore, it could serve as an outsourcing hub for the GCC countries.176

Finance: Egypt has a growing and active financial market. Between 2002 and 2007, total banking assets grew from USD 71 billion to USD 105 billion. This growth is expected to continue, with total banking assets reaching USD 191 billion by 2012. Between 2004 and 2007, the banking sector experienced several mergers and acquisitions. Recently, the National Bank of Kuwait entered the Egyptian market by acquiring Al Watany Bank in Egypt for USD 1 billion.177

Textiles: The textiles industry is one of Egypt’s oldest, and it is still growing. Exports increased from USD 800 million in 2002 to USD 3 billion in 2007, accounting for almost one-quarter of non-hydrocarbon exports. The government aspires to increase these exports to USD 10 billion by 2020. The textiles industry has benefited from the Qualifying Industrial Zones agreement between Egypt, the

171 Energy Information Administration.
172 World Tourism Organization 2006; World Travel and Tourism Council.
173 Reuters; President Mubarak’s speech.
174 Xceed.
175 Yankee Group; BusinessWeek; A.T. Kearney Global Services Location Index 2007.
176 Xceed; Egyptian Statistics Agency.
177 CPI Financial; Economist Intelligence Unit.
US and Israel and from joint ventures with Indian and other Asian companies. However, this industry is facing price competition from China, and it is unclear how future production will evolve.\(^{178}\)

**Agriculture:** This sector accounts for nearly one-sixth of GDP and provides more than one-quarter of Egypt’s employment. In 2007, agriculture generated USD 19 billion of Egypt’s GDP.\(^{179}\)

Egypt has a total area of about one million square kilometers, of which less than 4 percent – a 35,000 square kilometer strip along the banks of the Nile River – is arable. In comparison, India and Pakistan have a combined cropland of 1,920,000 square kilometers. Even though the cropland area in Egypt is small, less than 0.2 percent of total global arable land, it is very fertile and produces high crop yields. Main agricultural products include cereals, roots and tubers and pulses, with yields of 7,200, 19,300 and 3,000 kg per hectare, respectively, compared to global averages of 3,100, 13,000 and 810 kg per hectare, respectively.\(^{180}\)

There are significant opportunities for utilizing the remaining area for agricultural production.

Despite this high yield, there are still opportunities for improvement. There is a need to modernize the farming techniques and utilize better agricultural tools. Agricultural logistics also need to be improved to minimize wastage of fruits and vegetables – for example, an estimated 30 percent of tomatoes are wasted because of poor warehousing capabilities.\(^{181}\)

**Growing domestic consumer markets**

Egypt is a large and growing market of 17 million households, with private consumption projected to almost double by 2017, from USD 90 billion to USD 170 billion. Given the low incomes of most of the population – 85 percent of households have an annual disposable income of USD 3,200 or less – basic household foodstuffs remain a focus of most shopping outlets. The processed food industry in Egypt was estimated at USD 1.2 billion in 2007.\(^{182}\)

Possession of basic consumer durables is increasing across Egypt. Between 2002 and 2007, the penetration of mobile phones increased from 13 to 30 percent of households. During the same period, the penetration of cars also increased, although at a lower rate, from 21 to 26 percent. Possession levels of whitegoods are high and increasing – the percentage of households with a refrigerator increased from 73 to 89 percent. Given these trends in consumption, there are increasing opportunities in the organized retail segment, as evidenced by the entry of large international supermarkets chains such as Spinneys and Carrefour over the last 5 years.\(^{183}\)

Possession of homes and spend on tourism, education and other services are on the rise as well. Home ownership is increasing – between 2002 and 2007, the

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178 Egypt Ministry of Trade and Industry; Zawya; Economist Intelligence Unit; Gherzi Consulting; Business Today.
179 Global Insight, World Market Monitor; Economist Intelligence Unit.
180 Earth Trends; CIA World Factbook.
181 Anima; Gafi; Middle East Economic Digest.
182 Economist Intelligence Unit; Global Insight, World Market Monitor; Euromonitor; Egypt Statistics Agency.
183 Euromonitor; AME Info.
number of homes owned increased from 10.7 million to 12.1 million. This number is expected to increase to 14.5 million by 2015. Between 2002 and 2007, total expenditure on tourism increased from USD 1.3 billion to USD 1.8 billion. During the same period, expenditure on education increased from USD 2.3 billion to USD 3.6 billion.\(^{184}\)

Increasingly, a more sophisticated consumer market is emerging: 2 percent of households, or 1.5 million people, have disposable incomes above USD 7,000 per year. This consumer class is becoming increasingly important, as sales of cars and luxury items are growing. Between 2002 and 2007, the number of cars sold per year increased from 47,000 to 170,000. There are growing numbers of investments in high-end retail to cater to this group of consumers through the establishment of shopping malls, luxury brands and international chains.\(^{185}\)

**Government shifting towards liberalization and privatization**

Over the past few decades, Egypt has gradually liberalized and opened up to foreign trade. Shortly after the 2001-02 economic downturn in the US and Europe, the government launched a series of reforms to further open up the economy. The country’s political leadership has undergone a generational shift and a number of accomplished business executives have moved into the public sector and are helping to initiate and implement economic reforms.

Egypt’s government has taken a number of steps to facilitate the country’s integration with the global economy. It is a member of the World Trade Organization, and has signed an Association Agreement with the EU (creating a framework for cooperation in areas such as trade and security) and a free-trade agreement with Turkey. Egypt is also negotiating a free-trade agreement with the US.

The Egyptian Pound (EGP) has undergone revaluation over the last 7 years. After the economic crisis in 2001-02, the central bank was forced to devalue the pound from 3.65 to 3.90 against the US Dollar.\(^{186}\) In January 2003, the Prime Minister announced a free float of the pound, which caused it to depreciate against the US Dollar until the end of 2005. However, since the second half of the fiscal year 2006 until the end of the fiscal year 2007, the pound gradually appreciated to 5.69 against the US Dollar.

Last year, the World Bank praised Egypt’s efforts to improve its business climate. Economic reforms implemented since 2003 include a decrease in customs and tariffs – a new taxation law implemented in 2005 lowered corporate taxes from 42 percent to the current 20 percent. These improvements have helped FDI in Egypt to increase from USD 700 million in 2002 to USD 15 billion in 2007. The UAE was the second largest investor, after the US, contributing USD 3 billion to FDI in 2007.\(^{187}\)

Privatizations of government-owned assets began in 1991, and in 2005 and 2006, 26 government assets were privatized. Large privatizations included the sale of 90 percent of Misr International Bank to Société Générale in 2005, and the sale of 80

\(^{184}\) Euromonitor.  
\(^{185}\) Motoregypt, the Automotive Marketing Information Council; Zawya; Egypt Statistics Agency.  
\(^{186}\) The Egyptian pound was further devalued to 4.15 against the US Dollar until the free float was announced; Institute of Economic Studies.  
\(^{187}\) World Bank; Government of Egypt; Global Insight, World Market Monitor; Central Bank of Egypt.
percent of Bank of Alexandria to Sanpaolo IMI in 2006. The government has also announced several potential privatizations, including Banque du Caire.  

To encourage foreign investments, Egypt has established 10 freezones that offer reduced taxes and tariffs, and more foreign ownership. These span media, pharmaceuticals, textiles and tourism. The General Authority for Investment and Free Zones is the governing body that approves all potential investment projects in these zones.

Egypt has established Qualifying Industrial Zones, and goods produced within these zones are granted duty-free access to the US markets, provided they satisfy the agreed-upon Israeli component of 11.7 percent. Since they were first established in early 2005, the number of participating companies has increased from 397 to approximately 700, generating more than USD 1 billion in combined revenues in 2007. Ready-made garments and textiles encompass the largest volume of exports to the US from these zones, and are expected to help develop Egypt's textiles industry.

In April 2008, Egypt's President Mubarak announced a 30 percent increase in public sector salaries. This was in response to strikes and demonstrations that had been staged to protest increases in the price of food. Over the last year, the average price of foodstuffs increased 24 percent, while the cost of cereals and bread increased nearly 50 percent. To further combat increasing food prices, the export of rice from Egypt has been banned until April 2009 and customs duties on imported rice has been temporarily lifted. In May 2008, the government raised the prices of subsidised fuel by more than 35 percent to help offset the increased cost of public wages. The economic and social impact of these measures is still unclear.

Morocco

Morocco is a parliamentary, constitutional monarchy under King Mohammed VI, who ascended to the throne in 1999. The King has extensive executive powers. The Prime Minister, Abbas El Fassi, was appointed by the King in 2007, and is the Head of Government. The legislature is bicameral with a directly elected lower House of Representatives with 325 members, and an electoral college-elected upper Chamber of Advisers with 270 members.

Total GDP in 2007 was USD 65 billion, and it has grown 4 percent per year over the last 5 years – a growth rate that is expected to continue over the next 10 years. The population is 32 million, which is about half the population of the UK. The official language is Arabic, although French is the business language. Spanish is spoken by a large portion of the population in the north.

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188 World Bank; Carana Corporation; Economist Intelligence Unit; Moody’s Investors Service; Financial Times.
189 General Authority for Investment and Free Zones.
190 United States International Trade Commission; QIZEgypt.
191 AFP; American Chamber of Commerce in Egypt; Al Jazeera News; Reuters.
192 Global Insight, World Market Monitor.
Historically agricultural economy now developing services and manufacturing sectors

Traditionally Morocco has been an agrarian economy, with agriculture accounting for almost half of employment. Over the last five years, growth in GDP has been led by the manufacturing and services sectors, which grew at real annual growth rates of 5.7 and 4.4 percent, respectively. In comparison, the agricultural sector grew by 3.2 percent over the same period.193

Tourism, business process offshoring and financial services leading development of services sector

The services sector in Morocco grew from USD 30 billion in 2002 to USD 38 billion in 2007.194 The main drivers of growth are tourism, business process offshoring and financial services.

Tourism: Morocco has a large and growing tourism industry – in 2007, the country attracted 7.7 million tourists, and they generated over USD 7.2 billion in revenues, up from USD 2.6 billion in 2002. The government has set a goal of attracting 10 million visitors by 2010, and extensive infrastructure has been and is being developed to support this goal. Infrastructure developments include high-speed trains linking Tangiers with Casablanca, an increase in flight capacity between Morocco and Europe (from 1.9 million seats in 2002 to 4.7 million seats in 2007), introduction of an Open Skies policy to enable low-cost carriers such as EasyJet and Ryanair to fly into Morocco, and development of new marinas and ports.195

Tourism real estate is also being developed, such as six coastal resorts by the Spanish developer Fadesa, which span 7 million square meters (m²). EMAAR is developing a USD 5.3 billion resort community project along the Atlantic Ocean coast, spread out over 3 million m² with 2,500 residences. Qatari Diar is developing a USD 600 million luxury tourist resort, including three hotels, 199 villas and 415 apartments. Supporting facilities will include an international exhibitions and convention center and an 18-hole golf course.196

Business process offshoring: For European companies, Morocco is an attractive location for offshoring since many of its citizens speak French and Spanish in addition to Arabic. The country has captured almost half of the market for call centers serving French-speaking companies. By 2013, offshoring is expected to create over 90,000 jobs and contribute USD 1.7 billion to Morocco’s GDP.197

Financial services: The Moroccan banking sector is concentrated, with three of the largest banks representing 75 percent of the industry’s total assets. These banks are further consolidating, indicating that the Moroccan financial sector is maturing. In an effort to increase growth, these large banks have been acquiring regional banks. For example, Banque Marocaine du Commerce Extérieur acquired a 35 percent stake in Bank of Africa, and Attijariwafa Bank merged with Senegalese-Tunisian Bank and acquired 79 percent of Compagnie Bancaire de l’Afrique Occidentale.198

193 Global Insight, World Market Monitor; Economist Intelligence Unit.
194 Global Insight, World Market Monitor.
195 World Travel and Tourism Council; Minister of Tourism; Arabic News; APGDat, IATA.
196 Fadesa; EMAAR; AME Info.
197 Zawya.
198 Business Intelligence Middle East; BMCE; Maghreb Arabe Presse; Attijariwafa Bank.
New manufacturing sectors emerging

Between 2002 and 2007, the manufacturing sector has grown from USD 8 billion to USD 11 billion.199

**Phosphates:** Extraction and processing of phosphates has historically been a major contributor of exports: in 2007, phosphoric rock and acid accounted for USD 2.3 billion, or 14.4 percent of total exports. Morocco has one of the world’s largest phosphate reserves and has attracted a number of foreign investors, including companies from Belgium, Canada and the US. These companies have established partnerships with Morocco’s state-owned company, Office Chérifien des Phosphates (OCP), which is among the world’s largest producers and exporters of phosphates.200

Morocco is increasingly moving towards downstream phosphates processing. OCP and Libya Africa Investment Portfolio plan to develop three phosphate derivatives plants, requiring investments of over USD 1 billion. These plants will produce 1 million tons of phosphoric acid, 800,000 tons of ammonium hydroxide and 1 million tons of fertilizers per year. OCP also announced in 2008 that it is opening its major phosphate hub to foreign investors, in a move that may ultimately lead to OCP privatization and further liberalization of the phosphates industry.201

**Skilled manufacturing:** Food processing, mechanical and electrical components, chemicals, materials and wood processing have all experienced 4 to 5 percent growth over the last 2 to 3 years. The electrical and mechanical industries are particularly important to exports and help to attract international companies to Morocco. Several European car manufacturers have moved select manufacturing to Morocco, taking advantage of the proximity to Europe and the country’s skilled, low-cost workforce. For example, Somaca, the automotive original equipment manufacturer, which is jointly owned by Renault Maroc, Fiat Auto and Peugeot, has located manufacturing facilities in Morocco.202

**Textiles:** Textiles accounted for almost 20 percent of total exports in 2007, or approximately USD 3 billion. While this sector is large, it has been shrinking in size over the last 10 years, due to increasing competitive pressure from Asian countries including China. In an effort to regain part of the textiles market, Moroccan textile manufacturers are shifting away from bulk, basic textile production to more technically complex clothing production.203

**FDI and remittances providing liquidity**

FDI in Morocco has grown from USD 0.5 billion in 2002 to USD 3.0 billion in 2007. A significant driver of foreign investments is the absence of restrictions on foreign ownership.204

Morocco also receives a large inflow of foreign funds in the form of remittances. In 2007, Moroccans living abroad sent back USD 5.7 billion in remittances.205

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199 Global Insight, World Market Monitor.
200 OCP; Economist Intelligence Unit.
201 Zawya.
202 Economist Intelligence Unit.
203 Economist Intelligence Unit.
204 Global Insight, World Market Monitor.
205 World Bank.
Together, FDI and remittances were equivalent to 13 percent of Morocco’s GDP in 2007.

**Government reforms underway**

The Moroccan government began implementing economic reforms in 1993, which set the stage for market liberalization and privatization. Between 2000 and 2006, 10 privatization deals were concluded, generating USD 7 billion in receipts. Important examples include Moroccan Tobacco being sold to Altadis for USD 1.6 billion, and a 35 percent stake in Maroc Telecom being sold for USD 2.5 billion.206

To promote the development of a domestic economy, the government has levied strict currency controls. These controls prevent Moroccans from investing outside the country, except for special cases, which require approval from the government. The government may loosen these currency controls in 2009.207

Taxation is a major constraint on business. The tax system is complex and tax rates are high compared to other countries in the region, such as Egypt. For example, Morocco has a corporate tax rate of 35 percent on all taxable profits, as compared to 20 percent in Egypt. The capital gains tax rate on property investments is 20 percent of profit and a minimum of 3 percent of the sale price.208

The government is creating a more favorable environment for international investors. For example, the Tangier Free Zone (TFZ) offers investors tax incentives to establish businesses on undeveloped land, and has attracted over USD 450 million in investments since 1999. Currently more than 350 companies have set up in the TFZ, and employ 16,000 people. Several international companies are moving to TFZ – for example, Renault-Nissan plans to build a USD 900 million industrial complex with an initial production capacity of 200,000 vehicles per year by 2010.209

Morocco and the US completed a free-trade agreement in 2004 that came into force in 2006. Tariffs for more than 95 percent of qualifying consumer and industrial goods have already been eliminated, and tariffs for most of the remaining qualifying goods will be eliminated by 2015.210

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**Tunisia**

Tunisia is the northernmost African country. It is a presidential republic with the President of Tunisia being the Head of both State and Government. The current President, President Zine El Abidine Ben Ali, has been in power since 1987. The government holds executive power while legislative power rests with both the government and the Chamber of Deputies, a bicameral legislative body with 189 members.

206 World Bank; Ministere de L'Economie et des Finances; Goliath; Vivendi Universal.
207 Economist Intelligence Unit.
209 Zawya; BNet; Global Insight, World Market Monitor.
210 Office of the United States Trade Representative.
The Tunisian economy is the smallest of the five North African countries in MENASA, with a GDP of USD 35 billion in 2007. Tunisia’s economic growth – averaging 6 percent per year over the last 5 years – is expected to continue for the next 10 years. With a population of 10 million, Tunisia is the second-smallest country in the North Africa region, after Libya, and its annual population growth rate of 1.1 percent over the last 5 years is one of the lowest among the MENASA countries. Over the next 10 years, the population is expected to grow at just 0.9 percent per year.  

**Economy driven by exports with increasing focus on tourism**

Tunisia’s economy is driven by exports, which reached almost USD 17 billion in 2007, equivalent to 50 percent of GDP. This represented an increase of 26 percent from 2006, when exports were USD 13 billion.  

Tunisia’s largest export sector is textiles, which accounted for USD 4.9 billion in 2007. While the total value of textile exports increased from USD 2.4 billion in 2002, this sector is under competitive pressure from China for low-end textile and garment production. As a result, Tunisian textile manufacturers are moving towards more technically advanced textile production with partners including Benetton and Adidas.  

The fastest growing export sector is mechanical and electrical equipment, which accounted for USD 2.6 billion, or 15 percent of total export revenues in 2007. Since 2002, this sector has grown at an annual rate of 7 percent.  

Tunisia is among the five largest phosphate producers in the world. Previously, Tunisia exported most of its phosphate rock production. Now, the country is moving towards higher value-added phosphate products such as phosphoric acid and mineral fertilizers production. Tunisia now processes more than 80 percent of its phosphate production. Exports based on phosphate and processed phosphates are dominated by state-controlled Groupe Chimique Tunisien (GCT). This is one of Tunisia’s largest companies, with 4,300 employees. Growth in the chemicals industry has averaged 3 percent per year since 2000.  

GCT is establishing joint ventures and partnerships to secure demand for its products and to develop better technology and extraction capabilities given the rising cost of raw materials. For example, a consortium comprising the Compagnie des Phosphates de Gafsa, GCT and two Indian companies, is planning to build a phosphoric acid plant with a capacity of 360,000 tons per year. The plant’s output will be earmarked exclusively for the Indian market.  

In addition to being a diverse exporter, Tunisia is positioning itself as a major tourist destination in North Africa. In 2002, tourism generated USD 1.5 billion, with 5.3 million people visiting from abroad. In 2007, tourism generated USD 2.6 billion and 7.3 million people visited the country. Tourism accounted for 524,000 jobs or 17 percent of total employment.  

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211 Global Insight, World Market Monitor.  
212 Economist Intelligence Unit.  
213 Economist Intelligence Unit.  
214 Economist Intelligence Unit.  
215 Groupe Chimique Tunisien.  
216 Ministry of External Affairs, Government of India.  
217 World Travel & Tourism Council.
Tunisia’s current image is that of an inexpensive sun-and-beach summer destination, drawing visitors from Western European markets. The Tunisian government plans to increase penetration into new geographies including Eastern Europe, to further increase tourism revenues.

Tunisia is also trying to develop itself as an ecological and medical tourism hub. Tunisia is the second most popular worldwide destination for thalassotherapy – the medical use of sea water and seaweed – with 28 centers, after France. Medical tourism is still in its infancy in Tunisia but plans exist to develop it further as part of the sector’s growth strategy.

**Government reforms underway**

Tunisia is ranked by the World Bank as the most competitive and open economy in North Africa. Between 1987 and 1994, the Tunisian government implemented an IMF reform program to increase the role of private sector in a then government-controlled economy. Between 1987 and 2008, 142 partial and total privatization transactions were carried out. One of the largest privatizations was the 2006 sale of 35 percent of Tunisie Télécom to a consortium from UAE, for USD 2.3 billion. Several total and partial privatizations are in the pipeline, including the national petroleum distribution company and the state automobile manufacturer.

Another element of the reform agenda has been the liberalization of laws that restrict foreign ownership stakes in Tunisian firms. Foreign investors can own 100 percent of local companies in most sectors, especially when the company is export-oriented. In the agriculture sector and fishing industry, however, foreign ownership is limited to 66 percent. The Tunisian government has indicated that it plans to further open up the country to foreign investors and to continue the liberalization and privatization of select sectors. The emerging reforms have attracted attention from foreign investors. In the last 5 years, FDI has grown from USD 0.8 billion to USD 3.8 billion.

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**Algeria**

Algeria experienced civil conflict from 1991 to 2002, during which time the country was effectively closed to foreign investors. The country has now opened itself to foreign investments, liberalized the economy and started privatizing state-owned businesses.

Algeria is a presidential republic. The President of Algeria is the Head of State. Abdelaziz Bouteflika has been in office since 1999, currently serving his second 5-year term. The Prime Minister, Ahmed Ouyahia, is the Head of Government. The parliament is bicameral, consisting of a lower house with 389 members and an upper house with 144 members.

Algeria’s economy is the largest in North Africa, with a GDP of USD 135 billion, which accounts for almost one-third of the total North African GDP. The country’s GDP grew 4.5 percent per year in real terms between 2002 and 2007, and is

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218 Tunisian Prime Minister’s Office; AME Info; US Department of State.
219 Tunisian Agency of Foreign Investment Promotion; Global Insight, World Market Monitor; US Department of State.
expected to achieve a real growth rate of 5.1 percent per year over the next 10 years.\textsuperscript{220}

**Economy dominated by hydrocarbons**

The Algerian economy is dominated by hydrocarbons – hydrocarbon exports generated USD 55 billion in 2007. Algeria is home to 1.0 percent of the world’s proven oil reserves (12.3 billion barrels), and is North Africa’s largest oil producer. In addition, the country has 2.5 percent of the world’s proven natural gas reserves. Algerian oil and gas production is expected to increase from 3.7 million to 4.2 million BOE a day between 2007 and 2017.\textsuperscript{221}

The hydrocarbon windfall will spill over to energy-intensive sectors. Access to cheap energy provides the basis for industries such as aluminum, steel and fertilizers. For example, Egyptian-based Orascom Construction Industries and the Algerian state-owned oil and gas company, Sonatrach, announced a joint venture in 2007 to design, develop and construct a fertilizer complex for almost USD 1.7 billion. This fertilizer complex will consist of Ammonia/Urea production, with capacity for 2 million tons per year. It is expected to start production in 2010.\textsuperscript{222}

Another example of development of the energy-intensive industries includes the USD 5 billion investment by UAE-based Mubadala Development Company and Dubai together with Sonatrach, to build an aluminum smelter at Beni Saf in the west of Algeria. This smelter will have the capacity to produce 700,000 tons of hot metal.\textsuperscript{223}

**Gradual reforms of the economy**

Algeria’s economy is liberalizing, with several privatization projects underway. In 2007, total FDI rose to USD 4 billion, growing from USD 2 billion in 2002. Also, 216 partial and total privatization deals were carried out in Algeria during the same period, with several companies in the pipeline for privatization. These companies span a number of industries, including banking, telecommunications, ports and Air Algeria.\textsuperscript{224}

Algeria is opening up to foreign investors and new investment codes are being implemented to motivate these investments. For example, foreign investors are given a 3-year exemption from the value-added tax on goods and services acquired locally or imported, as well as an exemption on property taxes. The incentives are more attractive for companies whose production is export-oriented. The share of production that is exported is exempt from taxes. Furthermore, foreign investors settled in the free-trade zones are exempt from taxes and customs duties.\textsuperscript{225}

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\textsuperscript{220} Global Insight, World Market Monitor.
\textsuperscript{221} Economist Intelligence Unit; BP Statistical Review of World Energy, June 2007; EnergyFiles.
\textsuperscript{222} Economist Intelligence Unit; Orascom Construction Material; Reuters.
\textsuperscript{223} Dubai; Mubadala Development Company.
\textsuperscript{224} Global Insight, World Market Monitor; Algeria Ministry of Investment Promotion; Oxford Business Group.
\textsuperscript{225} Arab Data Net.
Libya

For many years, Libya's economy was significantly affected by UN and US sanctions, which started in 1992 and 1993, respectively. Since the sanctions were lifted in 2003 and 2004 respectively, Libya has restored diplomatic relations with the EU, the US and its Arab neighbors, and started reforming its economy.

Libya is a Jamahiriya (republic of the people). Revolutionary leader, Colonel Muammar Qadhafi, is the Chief of State having been in power since 1969. The Secretary of the General People’s Committee (Prime Minister) is Baghdadi al-Mahmudi. Legislative power is held by the unicameral cabinet, the General People’s Congress, with approximately 2,700 members.

Libya is home to North Africa's smallest population with 6 million people, which has been growing at an annual rate of 2.0 percent between 2002 and 2007. It has a GDP of USD 65 billion, having grown at an annual real rate of 5.6 percent over the last 5 years, and is expected to continue growing at 5.3 percent over the next 10 years.226

Economy driven by hydrocarbons

The Libyan economy depends primarily upon revenues from the oil sector, which contributed 96 percent of export earnings, or USD 39 billion in 2007. This increased from USD 37.5 billion in 2006, and is likely to continue being the main driver of future growth.227

Libya is North Africa’s second-largest oil producer behind Algeria. It has the world’s tenth-largest oil reserves, which are estimated to exceed 42 billion barrels, and it has an oil-producing capacity of about 1.9 million barrels per day. Natural gas reserves reportedly exceed 8 billion BOE, with 335,000 BOE produced per day. By 2017, combined oil and gas production is expected to increase to 3.1 million BOE, per day as existing oil fields and gas projects mature and reach full capacity.228

Libya’s existing oil refining capacity is 380,000 barrels per day. The government plans to increase this capacity by building a greenfield refinery in association with the UK’s Klesch & Company. This refinery will have an additional capacity of 300,000 barrels per day, and is expected to be operational by 2011. There are plans to upgrade a 120,000 barrels per day refinery, and the state-owned National Oil Corporation is looking at foreign partners for this project.229

Economic growth will also be driven by expansion of the energy-intensive industries, such as aluminum smelting or fertilizer production. Klesch & Company has signed an agreement to develop a USD 8 billion aluminum smelter in conjunction with the oil refinery in Libya, with capacity to produce 725,000 tons of aluminum per year.230

The Libya Africa Investment Portfolio (LAIP) and Morocco’s state-owned phosphate facility, Office Cherifien des Phosphate (OCP), have signed a USD 1 billion deal to build three phosphate derivatives plants, producing phosphoric acid, ammonium

226 Global Insight, World Market Monitor. 227 Economist Intelligence Unit. 228 BP Statistical Review of World Energy, June 2007; EnergyFiles. 229 Zawya; Middle East Economic Digest. 230 Reuters.
hydroxide and fertilizers. The first plant (worth USD 350 million) will be built in Morocco, the second one (worth USD 500 million) will be built in Libya, and the third (worth USD 150 million), designed to produce fertilizers, will be constructed in one of the two countries.231

While the hydrocarbon industry will continue to underpin future economic growth, the government is pushing for greater diversification by building up the tourism industry. With 1,100 km of coastline as well as historic sites and desert oases, Libya has significant untapped tourism potential. The government has plans to increase the number of visitors from 130,000 in 2006 to one million by 2015. To encourage tourism, Libya is relaxing strict visa rules. The number of people traveling to the country is growing as Libyan Airlines is expanding their fleets and routes, while international carriers are increasing the number of flights to Libyan destinations. Foreign companies are entering the Libyan tourism market, especially for developing resorts along Libya’s Mediterranean coast. A total of USD 6 billion is already committed to the development of this industry.232

Opening up to private investors

Since the UN and US sanctions on Libya were lifted in 2003 and 2004 respectively, Libya has started opening up to foreign investors. As a result, FDI increased from just USD 0.1 billion in 2003 to USD 1.9 billion in 2007.233

As part of the reforms to attract foreign direct investment, the minimum investment limit was reduced from USD 50 million to USD 3.8 million. This limit can be further reduced to USD 1.5 million if the investment is a 50-50 partnership with a Libyan national. Furthermore, a foreign investor may now borrow up to 50 percent of its investment capital from local Libyan banks.234

The government is also encouraging foreign investors to enter into joint ventures with Libyan firms through tax breaks. For example, there is an 8-year tax break on corporate income tax for infrastructure projects, or for joint ventures with Libyan firms.235

Foreign ownership rules are being relaxed. A new type of company, Mushtarika, allows foreigners to own up to 65 percent of the company, thus allowing the foreign entity to maintain control of the company. The board of directors may be composed of a majority of foreign directors. In traditional companies, foreigners could own a maximum of 49 percent of the shares and the board of directors was required to include a majority of Libyan directors. The Mushtarika company can be established to carry out most activities except for retail, wholesale and import activities, with a minimum capital of USD 768,000 required.236

In addition to foreign investments, Libya’s economic reform agenda has led to proposals for privatization. While the government announced the privatization of more than 300 companies between 2004 and 2008, few have actually been

231 Zawya.
232 Euromonitor; Phoenicia Group.
233 Global Insight, World Market Monitor.
234 General People’s Committee, Government of Libya; Mondaq.
235 BBC News.
236 General People’s Committee, Government of Libya; Mondaq.
privatized. Privatization has been focused on the financial sector, with the country's main iron and steel plants on the list for privatization.\textsuperscript{237}

The financial sector is being reformed to promote and sustain overall economic growth. The Central Bank of Libya is focusing on modernizing the financial sector, restructuring the public commercial banks and further opening up local assets to foreign investors. Two of the largest banks in Libya have recently been privatized: Sahara Bank in 2007 (19 percent stake sold to BNP Paribas for USD 250 million) and Al-Wahda Bank in 2008 (19 percent stake sold to Arab Bank for USD 305 million). In both of these organizations, the acquiring banks have the option to increase their stakes to 51 percent, and have majority control of the boards of their respective targets.\textsuperscript{238}

\textsuperscript{237} Arabic News.  
\textsuperscript{238} Reuters; Zawya.
Chapter 5

Turkey
Turkey

Turkey is a land where ancient traditions and modern reality live side by side. Both geographically and culturally, Turkey provides a bridge between ‘East’ and ‘West’ (Exhibit 26). It is the oldest and arguably the best-functioning secular democracy in the Muslim world – and the only MENASA country with NATO membership and a customs union with the European Union.

Exhibit 26

Overview of Turkey

Turkey is a parliamentary republic with a strong tradition of secularism. The President, Abdullah Gül, was elected in August 2007 and is the Head of State. The Prime Minister, Recep Tayyip Erdogan, is the Head of Government. The legislative power is vested in the unicameral parliament of 550 members, elected in 2007 for a four year term.

With a GDP of USD 500 billion in 2007, Turkey’s economy is the second-largest in the MENASA region, surpassed only by India, a country whose population is nearly 15 times bigger. Recent economic growth has been robust, with an average real growth rate of 6.3 percent per year between 2002 and 2007. This growth is expected to slow somewhat, but remain strong at 4.7 percent per year over the next 10 years (Exhibit 27).239

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239 Global Insight, World Market Monitor.
Successful services and manufacturing sectors creating wealth

Services and manufacturing are dominating the Turkish economy. The services sector grew from USD 217 billion in 2002 to USD 290 billion in 2007, and accounts for 58 percent of total GDP with tourism and financial services being the main contributors. The manufacturing sector grew from USD 74 billion to USD 110 billion over the same period, and accounts for 22 percent of total GDP. Automobile and consumer electronics increasingly dominate the manufacturing sector. The agriculture sector grew from USD 43 billion to USD 49 billion during this period, but at a much lower real annual growth rate of 2.6 percent.\(^{240}\)

Within the services sector, tourism has shown especially strong growth. Turkey is on the World Tourism Organization’s list of top 10 tourist destinations, and 23 million international tourists visited the country in 2007. This is about one-third of the 70 million international tourists that visited Italy during the same year. The number of tourists visiting Turkey has grown, on average, 12 percent per year over the last 5 years. Income from tourism has also increased by almost 17 percent per year over the same period, and currently stands at USD 18.6 billion. By 2023 Turkey aspires to be one of the top 5 tourist destinations in the world, with a goal of attracting 63 million travelers. This would require expanded hotel and flight capacity, as well as greater availability of public transport and basic utilities such as electricity and water.\(^{241}\)

Within the manufacturing sector, the main drivers of growth have traditionally been Turkey’s proximity to Europe and abundance of low-cost labor. The estimated cost of labor per working hour in Turkey is USD 3.0, compared to USD 2.9 in Bulgaria, USD 5.6 in Romania and USD 16.6 in Greece. However, increasing competition from Asian countries, especially China, is eroding this cost advantage. As a result, the once vital textile and clothing industry contracted by 12 percent in 2005 alone. Turkey has consequently focused more on high-skilled manufacturing, and is successfully utilizing the country’s relatively well-educated workforce: the adult literacy rate was 87 percent in 2007.\(^{242}\)

As Turkey is moving toward the deployment of higher-skilled labor, the country’s manufacturing sector is growing. Turkey is home to 20 car manufacturers, focusing on passenger and commercial vehicles. Production has increased steadily, with close to one million vehicles produced and 700,000 vehicles exported in 2006,

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\(^{240}\) Global Insight, World Market Monitor; Economist Intelligence Unit.

\(^{241}\) World Tourism Organization; World Travel and Tourism Council; Ministry of Culture and Tourism.

\(^{242}\) Economist Intelligence Unit; CIA World Factbook.
up from 200,000 vehicles exported in 2001, and 40,000 vehicles exported in 1998. Automoblies accounted for USD 12 billion in total exports in 2006. Major global automotive players are present in Turkey including Fiat, Renault, Toyota, Ford, Honda and Hyundai.243

The country is also a major manufacturer and exporter of household durables and consumer electronics. Turkey's Vestel Electronics is one of Europe's largest producers of television sets, producing more than ten million units in 2007. Another major consumer electronics company, Arçelik, is one of Turkey's largest private-sector company with revenues of USD 5.1 billion in 2007.244

In addition, Turkey’s strategic location places it at a crossroads between Europe and the Middle East. With its pipeline constructions in recent years, Turkey is expected to become a major energy hub between the Caspian region and Western Europe. Already 2.4 million barrels of oil per day transit through the Bosphorus straits in supertankers, representing approximately 3 percent of daily global oil consumption. The Baku-Tbilisi-Ceyhan oil pipeline, just one of the many pipelines crossing Turkey, was completed at a cost of approximately USD 4 billion in 2005. It can transport up to one million barrels of oil per day, and generates between USD 140 million to USD 200 million per year in transit fees for Turkey.245

Large, young and growing population

Turkey is home to 75 million people and, in 2007, 36 percent of the country's population was under the age of 20. Turkey's total population is expected to increase by 10 million over the next decade246, placing considerable demands on the country’s ‘hard’ and ‘soft’ infrastructure and necessitating significant new job creation. Up to four million new jobs will need to be created over the next 10 years just to sustain the current levels of labor force participation. Turkey can no longer rely on its low cost of labor alone to fuel job creation. High-skilled jobs will need to be created to sustain the Turkish workforce.

This will require significant investment in education. By 2013, more than 75,000 additional students will need post-secondary education every year to meet the government’s goal of increasing the share of adults with higher education degrees to 48 percent by 2013, from 38 percent in 2005.247

Turkey's overall energy and power needs are expected to increase from 188,000 GWh in 2007 to 450,000 GWh by 2020, requiring infrastructure investments of USD 3.5 billion per year. Electricity demand is soon expected to outstrip current capacity and planned short-term expansion, and a supply shortfall is expected by 2011. The residential housing sector has considerable requirements. To keep pace with population growth alone, an additional 600,000 residential housing units are needed annually.248

Turkey is home to a growing elderly (over 65 years of age) population, which is expected to increase by 1.5 million by 2017, placing significant strain on the

243 Economist Intelligence Unit.
244 BusinessWeek; Bloomberg.
245 Energy Information Administration.
246 Global Insight, World Market Monitor.
248 Ministry of Energy and Natural Resources; Energy Charter Secretariat; Teias.
healthcare sector. To keep pace with the growing population, and maintain the current level of 2.4 beds per thousand patients, more than 21,000 hospital beds will need to be added by 2017. To increase this ratio to the OECD average of 4.1 beds per thousand patients, an additional 142,000 beds will have to be added.249

**Growing domestic consumption**

The service sector’s expansion has created a large number of employment opportunities and fueled the growth of wealthier Turkish consumers. Per capita GDP increased from USD 2,600 to USD 6,650 between 2002 and 2007. With more money to spend, consumption has also grown significantly: between 2002 and 2007, per capita private consumption grew from USD 1,700 to USD 4,300 per year. This represents an average annual growth rate of 20 percent, which is the highest in the MENASA region. Total private consumption in 2007 was approximately USD 325 billion, and the ratio of consumption to total GDP was 65 percent. This is significantly higher than any other MENASA country, and comparable to mature markets such as the US (70 percent) and Europe (63 percent). Total private consumption is forecasted to continue growing, reaching USD 588 billion by 2017.250

**Opening up of markets**

Politically democratic for 80 years, although with some internal military disruptions, Turkey has long boasted one of the better-regulated economies in the region encompassing Eastern Europe, North Africa and the Middle East. In recent years, the pursuit of EU membership has pushed the government to implement further reforms to comply with EU standards. These reforms have already yielded several benefits, including free trade with the EU through the customs union established in 1995. Other EU mandates require improving governmental and social institutions, increasing the speed and efficiency of the legal system and addressing human rights issues. These reforms are having a positive impact on Turkish society and business.251

Turkey’s political stability is being challenged by accusations of anti-secularism against the current ruling government, the AK Party. Turkey’s national prosecutor has indicted the AK Party and its political members, with the purpose of banning the party, including its Prime Minister Erdogan and President Abdullah Gül, from the political arena. The outcome of this process is yet unknown.

Turkey’s record of economic stability over the last eight decades has been tarnished by persistently high inflation. As a result, Turkey was not able to fulfill its potential as an attractive destination for FDI, which was equivalent to 1 percent of GDP between 1999 and 2003, compared to 4 percent for the UK over the same period.252

The financial crisis of 2001 was a catalyst for sustainable reform, and the government took steps to overhaul monetary policy. This helped control inflation, which in 2004 was reduced to less than 10 percent for the first time in 34 years, and has since remained low. Since then, the currency has remained relatively

249 Euromonitor; OECD; Global Insight, World Market Monitor.
250 Global Insight, World Market Monitor.
251 Commission of the European Communities; SETA.
252 Global Insight, World Market Monitor.
stable, fluctuating in a 25 percent band against the US Dollar. These reforms have helped to attract foreign investment, which increased from USD 2.9 billion in 2004 to USD 23 billion in 2007, making Turkey the top destination for FDI in the MENASA region.\textsuperscript{253}

In a further attempt to promote the private sector, the Turkish government has reduced taxation across the board. The basic corporate tax rate was lowered from 30 percent to 20 percent in 2006 and personal income tax rates are now between 15 and 35 percent (the top rate was 40 percent until 2006).\textsuperscript{254}

The Turkish capital market is well developed. The Istanbul Stock Exchange was established in its current form in 1986, and Turkey has had a thriving equities market ever since. The market capitalization of Turkey’s 329 listed companies is USD 200 billion, and has grown at an average annual rate of 26 percent from March 2004 to March 2008. Foreign investors have the same legal status as Turkish-owned companies, including the rights to free transfer of profits, fees and royalties, free repatriation of capital and free foreign exchange. Turkey first enacted liberal foreign investment laws in 1954, which made it one of the first OECD countries to do so. This has helped to attract significant foreign capital into the capital markets over the decades, a tradition that continues today: in 2005, foreign investors held USD 20 billion in equity in the Istanbul Stock Exchange.\textsuperscript{255}

The Turkish government has curtailed its direct involvement in the economy in part by completing a range of major privatizations notably in the telecommunications and banking sectors. These privatizations, in turn, have spurred interest from foreign investors, exemplified by Vodafone’s USD 4.6 billion purchase of Telsim and Citigroup’s USD 3.1 billion purchase of a 20 percent stake in Akbank. More large privatizations are expected in the transportation, petrochemicals, electricity distribution and power generation sectors.\textsuperscript{256}

A major investment milestone was reached in 2006, with the first foreign private equity investment in a Turkish company exceeding USD 100 million. Providence Capital acquired 46 percent of Digiturk, the largest TV platform in Turkey, for USD 250 million. In another deal, TPG Capital acquired 90 percent of Mey Içki, Turkey’s leading liquor manufacturer, for USD 810 million. In 2007, Abraaj Capital acquired 50 percent of Acibadem, a leading health provider currently operating six hospitals. In February 2008, BC Capital acquired 51 percent of the shares of Migros, the largest grocery retailer in Turkey, for USD 1.5 billion.\textsuperscript{257}

\textsuperscript{253} Global Insight, World Market Monitor.
\textsuperscript{254} Worldwide Tax.
\textsuperscript{255} Bloomberg – as of 25 March, 2008; Istanbul Stock Exchange.
\textsuperscript{256} Datamonitor; Citigroup; Government of Turkey.
\textsuperscript{257} Data Processing; Internet Securities; Araaj Capital; INS Communications.
Chapter 6
The Levant
The Levant

The Levant encompasses Jordan, Lebanon and Syria. Through Jordan and Syria, it shares a long border with Iraq (Exhibit 28). The cultural, political and economic ties between the Levant and Iraq have been strong for many years. Today, there is large but latent demand for new investment, goods and services across this subregion.

Exhibit 28

Overview of the Levant

The Levant nations and neighboring Iraq comprise a large, volatile and mostly underdeveloped economy. The region has been plagued by civil unrest for centuries, with the Israeli-Palestinian conflict, Iraq conflict and civil unrest in Lebanon being only the most current examples. As a result, much of the basic infrastructure across the region is in need of modernization.

The Levant region, defined here as Jordan and Lebanon, had a combined GDP of USD 40 billion in 2007 (Exhibit 29). In addition, the Levant region has access to Iraq, which has a GDP of USD 75 billion. In Jordan and Lebanon, combined annual economic growth between 2002 and 2007 has averaged 4.0 percent in real terms, and is expected to continue at 4.8 percent for the next 10 years.\(^{258}\)

Jordan is the most politically stable of the Levant countries – a relatively safe haven in a volatile region. This role was once played by Lebanon, which after World War II was the Arab world’s most prosperous and cosmopolitan nation – the

\(^{258}\) Global Insight, World Market Monitor.
gateway not merely to the Levant but to the entire Middle East. Beirut was called the Paris of the Middle East.

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Jordan

Jordan is a land of stability in the volatile Levant region and has maintained good ties with the US, Europe and its Arab neighbors. Jordan is striving to strengthen its role as the business hub of the Levant region and as the gateway to Iraq.\(^{259}\)

Jordan is a parliamentary, constitutional monarchy with the current ruler, King Abdullah II, having ascended to the throne in 1999. Executive authority is vested in the King and his council of ministers which is led by the Prime Minister, Nader al-Dahabi. There is a bicameral National Assembly with a predominantly elected Chamber of Deputies having 110 members, and a 40-member appointed Assembly of Senators.

A small country with 6 million inhabitants (including an estimated 700,000 Iraqis), Jordan has the MENASA region’s smallest economy with a GDP of USD 16 billion in 2007. Still, it has achieved strong growth over the last 5 years, averaging 6.4 percent in real terms. Economic growth is expected to continue at approximately 4.9 percent per year over the next 10 years.\(^{260}\)

**Service-driven economy supported by foreign aid and remittances**

Services represent the majority of Jordan’s economy, accounting for 70 percent of GDP.\(^{261}\) The sector generated USD 11 billion in 2007, and have grown 6 percent per year since 2002.

Tourism is the largest contributor to the services sector, accounting for an estimated 12 percent of total GDP in 2007, equivalent to USD 1.9 billion. Tourism revenues have grown 13 percent annually over the last 5 years, with an estimated USD 1 billion tourism contribution in 2002. This amount is expected to rise to USD 4 billion by 2017. Over 7 million tourists visited Jordan in 2007, compared to 4.7 million in 2002, about half of whom are Arabs and tourists from the GCC. Given Jordan’s appeal to Arab tourists, the Jordan Tourism Board has launched a marketing campaign targeting residents of GCC countries.\(^{262}\)

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259 Economist Intelligence Unit.
261 Global Insight, World Market Monitor.
262 Jordan Central Bank; Jordanian Tourism Board; World Travel and Tourism Council.
Another major contributor to the services sector is logistics, as Jordan has established itself as a regional logistics hub. The country is home to Aramex, which is one of the largest logistics providers in the world. Its revenues have grown 31 percent annually from 2003 to 2007, reaching USD 485 million in 2007. Aramex is now listed on the Dubai stock exchange and has operations in Europe, the Middle East, Asia and North America.263

The second-largest sector of Jordan’s economy is manufacturing, accounting for 16 percent of GDP in 2007. Manufacturing has grown at an annual average rate of 7 percent since 2002. Though Jordan’s industrial base is limited, the country has developed thriving sectors in pharmaceuticals, food processing, textiles, consumer goods, construction material and select heavy industries such as cement, oil refining and fertilizers.264

The pharmaceuticals sector is one of the success stories of Jordanian business, producing generics for the region as well as the US market. In 2006, approximately USD 300 million was generated from pharmaceutical export revenues. One of the larger companies, Hikma Pharmaceuticals, is listed on the London Stock Exchange with a market capitalization of USD 1.6 billion. Hikma operates facilities in the US, Portugal, Saudi Arabia and Tunisia, and is currently expanding into Italy. It generated revenues of USD 448 million in 2007.265

Jordan receives a large inflow of foreign funds as remittances. In 2007, they were equivalent to 18 percent of the country’s GDP – or USD 2.9 billion – coming mainly from Jordanians living and working in the GCC and the US and Palestinians working in the West Bank and Gaza. It is estimated that the 500,000 Jordanians who work in the GCC countries send back one quarter of the total remittances into the country. Given that Jordan has a well-educated population with a literacy rate of approximately 90 percent, it is likely that workers leave Jordan in search of skilled employment.266

Jordan also receives foreign funds in the form of aid. The US is Jordan’s principal source of aid, and has committed to increasing its support by 48 percent to USD 663 million in 2008.267 These funds support a vast array of initiatives, including tourism and infrastructure projects, managing water supplies, funding clinics in Palestinian refugee camps and establishing programs to help Iraqi refugees.

**Accelerating economic reforms**

In the late 1980s, Jordan faced many economic problems, culminating in a debt crisis in 1988-89. This prompted the government – supported by the IMF and World Bank – to launch a number of reforms. Those reforms were accelerated following the accession of King Abdullah II in 1999. He and his administration have succeeded in further stabilizing Jordan’s economy, opening the country to trade, privatizing state-owned industries and liberalizing the financial markets. As a result, FDI in Jordan was USD 3 billion in 2007, which is equivalent to 20 percent of the country’s GDP – the highest ratio of FDI to GDP in the MENASA region. By contrast, FDI in 2002 was approximately USD 100 million.268

263 Bloomberg; Aramex.
264 Economist Intelligence Unit; Global Insight, World Market Monitor.
265 Hikma; Economist Intelligence Unit; Research Insight.
266 World Bank; Euromonitor; United Nations; Economist Intelligence Unit.
267 CNN.
268 Global Insight, World Market Monitor; Economist Intelligence Unit.
Taking a cue from several successful examples in the region, Jordan’s government has embraced the concept of tax- and customs-free zones. The largest and most important of these districts is the Aqaba Special Economic Zone (SEZ), launched in 2001. This sprawling entity encompasses the entire Jordanian coastline (27 km), all of the country’s sea ports (including the port city of Aqaba) and a new international airport operating under an open skies policy. Within the zone, net profits are taxed at a flat 5 percent versus up to 35 percent, and businesses are exempt from social charges, land and building taxes and dividend and profit taxes. The zone also allows the duty-free import of goods in commercial quantities from the National Customs Territory and from overseas.269

There are Qualified Investor Zones (QIZ) set up in agreement with the US, where products produced jointly by Israeli and Jordanian manufacturers enjoy duty- and quota-free treatment in the US market. There are currently 13 QIZs, which are home to more than 50 factories. Also, a free-trade agreement was signed between Jordan and the United States in October 2000. It was the United States’ first free-trade agreement with an Arab state. It is intended to eliminate all tariff and non-tariff barriers to bilateral trade in virtually all industrial goods and agricultural products within 10 years.270

Since the late 1990s, Jordan has also privatized a number of companies in industries such as cement, transportation, telecommunications, water and mining. More privatizations are in the pipeline, including the divestment of major companies such as Royal Jordanian Airlines.271

Economic liberalization has helped Jordan’s capital markets to thrive. The Amman Stock Exchange was established in 1999 and already lists 245 companies with a total market capitalization of USD 42 billion. This is equivalent to more than twice the GDP of Jordan. It is overseen by the Jordan Securities Commission and is associated with other exchanges and international organizations including the Union of Arab Stock Exchanges and World Federation of Exchanges. The state places no restrictions on foreign ownership, and over 40 percent of the total market capitalization was held by foreign investors.272

Lebanon

Lebanon’s economic situation cannot be separated from the civil and political unrest that has dominated the country since 1975. Lebanon was once a growing, cosmopolitan country, positioned as the banking center of the Middle East. That profile, however, changed as the country descended into turmoil, and by the time 15 years of conflict had ended in 1990, the country had experienced a displacement of almost one million people, a crippling of the infrastructure, and a disruption in economic output. Real GDP fluctuated throughout the conflict period from a low of USD 9 billion in 1990 to a high of USD 26 billion in 1987.273

269 Financial Times.
270 Jordan Economic and Commerce Bureau; Office of the United State Trade Representative.
271 Jordan Investment Board.
272 Amman Stock Exchange; Bloomberg.
273 Global Insight, World Market Monitor; CIA World Factbook; Economist Intelligence Unit.
In 1992, Lebanon embarked on a massive reconstruction program to rebuild the country’s physical and social infrastructure, leading to significant accumulation of debt. However, in July 2006, conflict broke out once again, damaging Lebanon’s infrastructure and displacing close to one million people.274

Lebanon’s GDP was USD 24 billion in 2007, and real economic growth has averaged only 2.6 percent per year since 2002. While economic development has been exceedingly difficult to achieve in Lebanon’s conflict-ridden environment, the country nonetheless boasts a well-educated population, with an 87 percent literacy rate and 48 percent of the population having completed post-secondary education. This includes training at a college, university, institute of technology or polytechnic.275 In 2007, there were more than 140 universities, colleges and centers of higher education in the country.276 One of the first universities in the Middle East, the American University of Beirut, was founded in Lebanon in 1866 and is internationally recognized as a leading institution. A significant portion of the Lebanese population is trilingual – speaking English, French and Arabic.

An estimated 9 million Lebanese are living all over the world. As a result, the economy is largely fueled by remittances – an estimated USD 5.5 billion was transferred into the country in 2007. This is equivalent to 23 percent of the 2007 GDP. Approximately half of the remittances are from the Gulf countries.277

With no limits on foreign ownership, foreign investment grew from USD 1.3 billion in 2002 to USD 3 billion in 2007. An example of the foreign investment was Egypt-based EFG Hermes buying a 23 percent share in Lebanon’s second-largest bank, Bank Audi, in 2006.278

It is expected that the key determinant for Lebanon’s economic growth will be the country’s political climate. If instability can be managed, or even eliminated, the country will once again be an attractive destination for investments, drawing on its diaspora population and the once strong financial services and tourism sectors. But the outbreak of conflict in May 2008 provides a reminder of the challenges that still lie ahead.

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274 US Department of State.
275 US Department of State; UNESCO; Global Insight, World Market Monitor.
276 LebWeb, Lebanon colleges, universities and high educational institutions.
277 World Bank; Zawya.
278 Global Insight, World Market Monitor; Reuters.
Chapter 7
South Asian Subcontinent
South Asian Subcontinent

The South Asian Subcontinent encompasses India, Pakistan, Sri Lanka and Bangladesh (Exhibit 30). India and Pakistan comprise more than 90 percent of the Subcontinent’s economy and population. These two countries share a common history, stretching back to the Indus Valley Civilization in 3000 BC. They formally separated only 60 years ago, when British rule in the Subcontinent ended.279

The combined GDP of India and Pakistan was USD 1.3 trillion in 2007, or 42 percent of MENASA’s GDP. During the last 5 years, real annual economic growth has consistently exceeded 8 percent in India and 6 percent in Pakistan, the highest growth rates in MENASA. Combined real growth is expected to continue at an annual rate of 7 percent over the next 10 years (Exhibit 31).280

Today, India and Pakistan are two of the world’s ten largest nations by population – ranked second and sixth, respectively. Their combined population is 1.3 billion, and by 2017 it is projected to be 1.5 billion. The population of the two countries is expected to continue growing at an annual rate of 1.4 percent per year for the next ten years.281

The Subcontinent282 shares close historic ties with the GCC countries. Both regions are home to large Muslim populations. In 2007, 160 million Muslims were living

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279 Global Insight, World Market Monitor.
280 Global Insight, World Market Monitor.
281 Global Insight, World Market Monitor; State Bank of Pakistan.
282 From here on we will focus our analysis on Pakistan and India.
in Pakistan, and 151 million in India. The only country with a larger Muslim population is Indonesia.

For centuries, merchants from the Gulf and the Subcontinent have been trading partners. Trade between the cities of Mohenjadaro and Harappa in modern day Pakistan, and Babylon in modern day Iraq, dates back nearly 4000 years. In the early to mid 20th century, the Indian Rupee was used as currency in the countries of the Arabian Gulf until the Gulf Rupee was introduced in 1959. The Gulf Rupee issued by the Reserve Bank of India was equivalent to the Indian Rupee and remained in use until 1966.

This regional integration continues today – in 2007, Indians and Pakistanis together accounted for 9 million residents of the GCC countries, or 25 percent of the GCC's total population. Remittances sent back from this expatriate population in the GCC to India and Pakistan combined were USD 9 billion in 2007, or 27 percent of the total USD 33 billion received by these countries in remittances.

Increased need for investments in infrastructure

With the economies and the populations of India and Pakistan expected to continue growing, there will be a great need for infrastructure investments. In India, the Planning Commission has pledged over USD 490 billion for infrastructure developments between 2007 and 2012, of which USD 150 billion is expected from the private sector. The government has introduced various policies to incentivize private participation. Key incentives include: establishment of ‘viability gap funding’ to help fund financially non-viable projects by providing grants of up to 20 percent of total investment, development of the Indian Infrastructure Finance Company to raise long-term debt and the provision of tax incentives and lower interest rates.

India’s infrastructure build-outs offer several options for private sector involvement. Companies can acquire a direct equity stake with management participation in projects, leverage build-operate-transfer or build-operate-own models, or provide equipment and services required for development. There are also indirect opportunities through direct lending for infrastructure projects, strategic investment in Indian infrastructure companies or development of commercial properties through real estate venture funds.

283 CIA World Factbook; US State Department.
284 India Central Bank; Pakistan Central Bank; Arabian Business.
285 Planning Commission of India; World Bank; CMIE.
In Pakistan, the government has allocated at least USD 36 billion to the
development of large infrastructure. The government has clearly indicated that the
private sector will play an increasingly important role in meeting these infrastructure
demands.286

**Power:** Across the Subcontinent, power requirements are large and growing.
In 2007, India’s installed capacity was 140 gigawatts, while Pakistan’s was 18
gigawatts. By 2017, more than 300 gigawatts will be needed across the region to
keep up with population growth and enable ongoing economic growth.287

The increasing power needs are expected to be primarily met by the private sector
developers. For example, in India, three foreign power companies, CLP Group, AES
Corporation and Genting Sanyen, are already part of the Indian power industry,
having made their entry through acquisitions.

**Transportation and logistics:** Both India and Pakistan have pledged to significantly
increase their transportation and logistics infrastructure. By 2012, India is planning
to increase rail capacity by adding 15,500 km to its existing 63,000 km. Over the
same period, Indian port capacity is expected to be doubled to 1.5 billion tons.
This will require investments of USD 25 billion.288

Similarly, Pakistan has embarked on the ‘National Trade Corridor Improvement
Program’ to increase cargo capacity from 136 billion ton-km in 2007 to 204 billion
ton-km in 2012. To this end, the Pakistani government plans to invest USD 7.3
billion annually to fix roads, upgrade the rail network, improve port capacity and
link major ports to the rest of the country. This development program is also
attracting significant foreign investment – for example, DP World, the UAE-based
port company, plans to invest over USD 200 million in creating a second container
terminal at Port Qasim in Pakistan. A third port has been developed in Gwadar in
collaboration with the Chinese government, and is operated by Singapore-based
PSA International, the second-largest port operator in the world.289

**Housing:** Across the Subcontinent, the demand for housing units is expected
to increase from 232 million in 2007 to 263 million by 2015.290 International
property developers are planning for residential accommodation to meet this
rising demand.

**Growing demand for healthcare and education**

**Healthcare:** Over the next 10 years, the demand for healthcare is expected to
increase dramatically in India and Pakistan. An additional 130,000 hospital beds
will be needed by 2017 to maintain the current level of access to healthcare and
keep pace with the growing population. To reach OECD levels, an additional 5.3
million hospital beds will be needed by 2017.291

India is already home to a number of accredited hospitals that attract medical
tourists from all over the world. For example, Indraprastha Apollo Hospital is
accredited by the US-based Joint Commission International and receives patients

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286 US Department of Energy.
287 McKinsey Global Institute; Abraaj Capital; Government of Pakistan.
288 Ministry of Railway, India; Herald Tribune; Port World.
289 World Bank; Government of Pakistan; AME Info; Asia News.
290 Euromonitor.
291 Current hospital beds to thousand people ratio in South Asia is 0.6 and in OECD countries
is 4.1; Global Insight, World Market Monitor; OECD; Euromonitor.
from the Middle East, Europe and North America. International patients are further attracted by the existence of relationships with international insurance providers: Apollo Group in India works with insurance companies in the UK, Belgium and France to direct inflow of foreign patients into India.

**Education:** India and Pakistan will need to develop new education facilities over the next 10 years to meet the rising demand for education. India and Pakistan have relatively low literacy rates of 61 percent and 50 percent, respectively. By contrast, the literacy rate in China is 91 percent. At the same time, despite the overall low literacy rates, this region is still home to some of the most educated societies in the world. The literacy rate in Kerala, a province of 32 million people, is greater than 90 percent.\(^\text{292}\)

Currently only 12 percent of Indians and 5 percent of Pakistanis have completed post-secondary education, compared to 22 percent of Chinese.\(^\text{293}\) If the percentage of secondary school graduates obtaining higher education is to increase, many more higher education institutions will be necessary. Demand for higher education is further driven by the fact that several of India and Pakistan’s world-renowned universities – including the Indian Institute of Technology (IIT), Indian Institute of Management (IIM) and Lahore University of Management Sciences – attract foreign students. To accommodate the growing demand for higher education, the Indian government is seeking investment capital to build 6,000 new high-quality model schools, 30 new central universities, eight more IITs and seven more IIMs by 2014.\(^\text{294}\)

**Growing domestic consumer markets**

Total private consumption in India and Pakistan has grown from USD 375 billion in 2002 to USD 740 billion in 2007. This consumption is projected to increase to USD 2.3 trillion by 2017. Drivers of this growth are increasing population and rising per capita GDP, which more than doubled from USD 470 to USD 965 between 2002 and 2007. At the same time, the middle income segment is growing – in India alone the number of households earning between USD 2,000 and USD 11,000 annually is expected to grow from 102 million to 161 million between 2005 and 2015.\(^\text{295}\)

Over the next few years, an increase in the demand for basic household goods is expected to drive domestic consumption. Currently, India and Pakistan have relatively low levels of penetration of household goods (Exhibit 32). Cell phone penetration is approximately 21 percent and 32 percent of the population in India and Pakistan, respectively, compared to 83 percent in the US. The penetration of cars per household is low – 5.5 percent in India and 4.7 percent in Pakistan. As the GDP per capita is expected to increase from USD 965 in 2007 to USD 2,800 by 2017, consumption of household durables can be expected to increase. This translates into an increase in PPP-adjusted GDP per capita from USD 2,600 to USD 5,700, over the same period.\(^\text{296}\)

Expenditure on travel, leisure, education and other services has increased in the Subcontinent over the last 5 years. Total spending on tourism was USD 6.4

\(^{292}\) World Bank; Government of India 2001 Census.
\(^{293}\) UNESCO.
\(^{294}\) Indian Primer Minister’s speech; India Education News.
\(^{295}\) McKinsey Global Institute; Global Insight, World Market Monitor.
\(^{296}\) Euromonitor; Global Insight, World Market Monitor.
The luxury market is expected to develop – for example, the Indian luxury retail market is projected to grow from USD 3.5 billion in 2007 to USD 30 billion by 2015, according to an A.T. Kearney survey. This growth is fueled by an increasing number of high net-worth individuals and families. In India alone, 7 million people earn more than USD 22,000 per year, or USD 118,000 per year when adjusted for cost of living. By 2025, this number may increase to 50 million people. Today, there are approximately 100,000 high net worth individuals in India.\textsuperscript{298}

\textbf{Impact of increasing oil prices and the food price crisis}

India and Pakistan together accounted for the import of 2.4 million barrels of hydrocarbons per day in 2007. The level of imports is expected to increase to 4.5 million barrels per day by 2017. With oil prices increasing to over USD 130 per barrel, the impact is being felt across the Subcontinent.\textsuperscript{299}

Increasing oil prices have led to widening trade deficits in both India and Pakistan. The oil import bills for India and Pakistan were estimated at USD 68 billion and USD 13 billion in 2007, respectively. These high import bills could in turn cause a weakening of the Indian and Pakistani rupees. Rising oil prices result in higher

\textsuperscript{297} Euromonitor.

\textsuperscript{298} Individuals with net financial assets of more than USD 1 million, excluding their primary residence; Merrill Lynch-Capgemini; McKinsey Global Institute; A.T. Kearney.

\textsuperscript{299} At the time of writing this document, the price of oil was over USD 125 per barrel; EnergyFiles.
overall inflation, which have in turn led to higher interest rates, at least in Pakistan. It is likely that high oil prices will lead to reduced overall economic growth. The increasing cost of oil has also led to increased federal outlays. In 2007, the Indian government spent USD 17.5 billion to subsidize fuel for its citizens while the Pakistani government spent USD 2 billion.300

More recently, the global food shortage has raised concerns in India and Pakistan. In both countries, the per capita GDP is under USD 1,000, and more than 300 million people are living in poverty. In the last year, the price of rice in India and Pakistan has increased from USD 270 to USD 345 per ton and USD 241 to USD 378 per ton, respectively.301

Both India and Pakistan have implemented measures to offset the rising food prices. In India, import tariffs on several commodities, including wheat, wheat flour and palm oil, were eliminated. All exports of non-Basmati rice were banned until at least October 2008, and the minimum export price for Basmati increased from USD 1,100 to USD 1,200 per ton. The Indian government is considering a ban on trading in rice and wheat futures. The Pakistani government may consider banning export of rice. However, since rice is a major export for Pakistan, losing it as an exportable product could mean an annual loss of approximately USD 1.2 billion in export revenues.302

Potential for developing the agriculture sector

India and Pakistan have large agricultural economies – with 192 million hectares of cropland, they account for 13 percent of the total global cropland. The main agricultural exports are cereals, including rice and wheat. Together, India and Pakistan were responsible for exporting 263 million tons of cereal, or 12 percent of global production.303

However, productivity in the agricultural sector is low. Average crop yield of cereal was approximately 2,300 kg per hectare in India and Pakistan. If this productivity was raised to the global average level of 3,100 kg per hectare, total production of cereals could increase by one-third.304

The main reason for this low productivity is a low level of modernization in farming techniques. While the use of fertilizers, agrochemicals, improved seed varieties and irrigation has improved yields, overall impact has been limited. In a recent report by the World Bank, technology and agricultural R&D are identified as the main drivers of this growth.

Additional losses of agricultural products are caused by inefficiencies in the supply chain. For example, an estimated one-third of all fresh fruit produced in India is wasted due to lack of adequate cold storage.

Given the global food crisis, the Subcontinent’s agriculture sector is starting to attract foreign investment. For example, the GCC countries have been investing in developing agricultural businesses in Pakistan. Qatar Livestock Company is

300 The Economist; Time; Zawya; Associated Press of Pakistan.
301 Poverty line is defined by the World Bank as people living on less than USD 1 per day, adjusted for purchasing power parity; World Bank.
302 Arab News; Market Watch; Bloomberg.
303 Earth Trends.
304 Earth Trends.
investing USD 1 billion in farms in Pakistan, while UAE-based investors are looking at investment opportunities in agriculture and dairy sectors. Given that the GCC imports over 90 percent of its food and farm products, a market valued at more than USD 200 billion in 2007, agricultural exports could provide a significant opportunity for the Subcontinent.

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Pakistan

A recent headline in The Economist dubbed Pakistan ‘the world’s most dangerous place’. Three weeks later, the same publication called Pakistan ‘the world’s most dangerous haven’, prompting Merrill Lynch analysts to label the country ‘the greatest information-arbitrage opportunity in the world’. Indeed, despite all its troubles, Pakistan is full of overlooked opportunities and investments.

Pakistan is a semi-presidential federal democratic republic with Islam as the state religion. President Pervez Musharraf, serving since 2001, is the Head of State. Yousaf Raza Gillani was chosen to be the Prime Minister in March 2008 and is a representative of the Pakistan People’s Party, the largest party in the National Assembly.

Pakistan’s economy, with a GDP of USD 150 billion, achieved real growth averaging 6.5 percent per year between 2002 and 2007. Growth is expected to continue at 4.5 percent annually over the next 10 years.

Growth led by services and manufacturing, supplemented by inflow of foreign funds

Services and manufacturing sectors are the driving force of Pakistan’s economy.

Services: The services sector is the largest contributor to GDP in Pakistan, and in 2007 it generated USD 75 billion of economic output and was equivalent to about 50 percent of the country’s GDP. Between 2002 and 2007 this sector grew at an annual rate of 6 percent.

Within the services sector, finance and insurance have grown at an average annual rate of more than 15 percent since 2000. The total value of loans to the private sector grew from USD 31 billion in the second quarter of 2006 to USD 39 billion in the first quarter of 2008. This growth is in part fueled by the privatization of banks – since 2002, ten banks have been privatized. This has led to a more efficient use of capital and the rapid development of a consumer credit market.

The telecommunications sector has benefited from liberalization and from the overall growth in consumer expenditure. The number of mobile phone subscribers in Pakistan grew from 1.7 million in 2002 to 52 million in 2007. There is intense competition between seven major mobile operators. Orascom-owned Mobilink, Ufone, China Mobile-owned CMPak and Instaphone are established providers,

305 Zawya.
308 Global Insight, World Market Monitor.
309 State Bank of Pakistan; Global Insight, World Market Monitor.
310 Euromonitor.
while Norway’s Telenor and the UAE-based Al Warid Telecom started their services in 2005, and SCO began in 2006. There has been a significant amount of M&A activity in this sector. For example, Etisalat, UAE’s incumbent telephone provider, acquired a 26 percent stake in state-owned PTCL for USD 2.6 billion. China Mobile Communications Corporation bought 100 percent of Pakistan telecommunications operator Paktel Ltd. for USD 460 million and renamed it CMPak. Omantel bought 60 percent of Worldcall for USD 193 million.\textsuperscript{311} Similar activity is seen in the cable and other telecommunication value-added services.

**Manufacturing:** Manufacturing is the fastest growing sector in Pakistan. It grew from USD 17 billion in 2002 to USD 26 billion in 2007, which represents an annual growth rate of 9 percent. Large-scale manufacturing, led by the automotive industry, surged after the removal of import restrictions and tariffs in the 1990s.\textsuperscript{312} The number of vehicles produced in Pakistan more than doubled in the last 5 years, from less than 80,000 to more than 200,000.\textsuperscript{313}

Joint ventures with international car manufacturers are being established. For example, Honda Atlas is a partnership involving Honda Motors and Atlas Group. Pak Suzuki Motor Company, a subsidiary of Suzuki Motor Corporation, was developed as a joint venture between Pakistan Automobile Corporation Limited, representing the Government of Pakistan, and Suzuki Motor Corporation. Toyota, already a 25 percent shareholder of Indus Motors, is planning to increase its share to 38 percent.\textsuperscript{314}

**Agriculture:** The agriculture sector increased in size from USD 25 billion to USD 35 billion between 2002 and 2007. Pakistan has a total of 80 million hectares under cultivation, of which more than 80 percent is irrigated, one of the highest proportions observed in any large country. Grains constitute the most important food crops, with rice, wheat and corn being the major products. In 2007, 5.5 million tons of rice and 23.5 million tons of wheat were produced. Cotton, the most important cash crop, generates more foreign trade income than any other export item. Rice, sugarcane, tobacco, rapeseed and mustard are also large export earners.\textsuperscript{315}

**Significant inflow of foreign funds through foreign direct investment and remittances**

Foreign direct investment in Pakistan increased from under USD 1 billion in 2002 to more than USD 5 billion in 2007. By 2010, FDI is expected to have increased to USD 7 billion. FDI inflow is facilitated by the lack of constraints on foreign ownership of local companies and free repatriation of profits.\textsuperscript{316}

Pakistan also receives a considerable source of foreign funds in the form of remittances. Between 2002 and 2007, remittances increased from USD 3.6 billion to USD 6.0 billion. The amount of remittances increased significantly after the events of September 11, 2001. The Pakistani government cracked down on unofficial (‘hawala’) and black-market money transfers, thus steering more remittances through official channels.\textsuperscript{317}
The combined amount of FDI and remittances was USD 11 billion in 2007, equivalent to 7.5 percent of the total 2007 GDP.

**Government reforms**

Liberalization of the Pakistani economy began in 1991 and has continued ever since. Pakistan joined the World Trade Organization in 1995, and in 2005 the World Bank hailed Pakistan as one of the world’s top 10 economic reformers.

The Pakistani economy is very open with foreign ownership encouraged in industrial, manufacturing, energy, mining, engineering, tourism, IT, and oil and gas sectors. There is full repatriation of capital gains, dividends and profits. Tariffs on imports are low with zero import duties on capital goods, plant, machinery and equipment. Minimum foreign equity investment has been reduced from USD 500,000 to USD 300,000. The Pakistani Rupee is fully convertible and there are no restrictions on foreign ownership of most investments across sectors.

The Pakistani government is pursuing privatization, which has raised USD 7 billion to date, with the telecommunication and banking sectors generating the majority of revenues. Approximately 50 entities are listed on the government’s current privatization program. These are banks and also state-owned companies in the energy, utility and industrial sectors, including Pakistan State Oil, Sui Northern, Sui Southern, National Bank of Pakistan and Pakistan Petroleum.

As a result of privatization and deregulation, Pakistan’s finance sector is experiencing strong growth. The Karachi Stock Exchange index has posted annual average growth of 59 percent over the last 4 years, with market capitalization rising from USD 11 billion in 2004 to USD 75 billion in 2008. Pakistan’s stock market has a remarkable resilience in the face of political uncertainty. In early 2007, it was called one of ‘the best-performing stock market in Asia.’ Political volatility triggered dips in the overall stock market, but the market has quickly recovered on multiple occasions in the past (Exhibit 33). For example, following the assassination of the former Prime Minister, Benazir Bhutto, the stock market dropped by 10 percent. However, it recovered within 2 months, and has since grown.

The stock market regulator is the Securities and Exchange Commission of Pakistan (SECP), and it was established in 1999 in collaboration with the Asian Development Bank (ADB). The SECP’s purpose is to develop an efficient corporate sector and a capital market based on established regulatory principles. This commission has the authority and financial independence to carry out the reform program of Pakistan’s capital market.

Since its inception, the SECP has pursued several reform programs aimed at revitalizing Pakistan’s capital markets. These include modernizing infrastructure of stock exchanges, operationalizing automated trading and the central depository system, establishing basic regulatory frameworks for insurance, leasing and asset-

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318 Government of Pakistan.
319 Government of Pakistan.
320 Government of Pakistan; BusinessWeek.
321 Karachi Stock Index KSE 100.
322 Bloomberg.
backed securities, and strengthening disclosure and governance requirements for listed companies and non-bank financial institutions.\footnote{Securities and Exchange Commission of Pakistan.}

In 2007, the ADB pledged a loan of USD 400 million to help SECP support a second generation of capital market reforms. These reforms are aimed at turning domestic equity and bond markets into a source for long-term finance.\footnote{Asian Development Bank.}

\textbf{India}

India is a land of contrasts. It is home to more than 1 billion people, representing one-sixth of the world’s total population. There are more than 35 cities with a population in excess of 1 million, yet more than 70 percent of Indians still live in rural areas. More billionaires live in India than anywhere else in Asia, yet 25 percent of India’s population still lives in poverty.\footnote{Global Insight, World Market Monitor; Global Tech Forum; BBC; Forbes; World Bank.}

India is defined as a sovereign, secular, democratic republic. The President of India is the official Head of State. Pratibha Patil, the first Indian woman to hold this office, has been the President of India since 2007. Dr. Manmohan Singh is India’s current Prime Minister, having been in office since 2004 as head of a coalition government. The Prime Minister is the Head of Government and has effective responsibility for executive power.

Today, India boasts the largest and one of the fastest-growing economies in MENASA. It had a GDP of USD 1.15 trillion in 2007, and its real rate of annual growth has been 8.8 percent since 2002. This growth is projected to continue...
at an annual rate of 7.8 percent until 2017. It is the 12th largest economy in the world, behind Russia. India’s GDP is approximately 40 percent of the UK’s GDP.326

**Services driven economy with significant inflow of FDI and remittances**

**Services:** India’s economy is dominated by the services sector. It accounted for more than 50 percent of total GDP in 2007, and has been the major driver of growth over the past decade – increasing from USD 285 billion in 1998 to approximately USD 600 billion in 2007. Despite its size and rapid growth, the services sector accounts for only 20 percent of total employment. The services sector is expected to continue driving India’s economic growth – between 2008 and 2015, the sector’s average annual growth rate is projected to reach 13.5 percent.327

Information technology and business process outsourcing represent one of the largest and fastest drivers of growth in India. The industry’s revenues grew from estimated USD 17 billion in 2004 to USD 40 billion in 2007. By 2010, revenues from this industry are expected to be USD 75 billion.328

Over the next decade, there will be additional opportunities in infrastructure management services that manage an enterprise’s core IT systems (hardware, software, connectivity and people). Global revenues generated by these services, which are likely to lead the next wave of opportunity in offshoring, increased from USD 2 billion in 2006 to USD 6 billion in 2007. With over 50 percent share in this market, India-based companies generated approximately USD 3 billion in 2007. This industry has the potential to capture USD 13-15 billion by 2013.329

**Telecommunications** in India is experiencing rapid growth. Between 2002 and 2007, the annual growth rate in the number of subscribers was 80 percent, from 13 million to 250 million subscribers. By comparison, the global growth rate in the number of mobile phone users was 22 percent during the same period. The number of subscribers is expected to increase to 650 million by 2017.330

**Finance sector** has demonstrated strong growth as evidenced by the increase in total banking assets from USD 348 billion to USD 1,274 billion between 2002 and 2007. By 2012, the value of total banking assets is expected to more than double to USD 3,135 billion.331

This growth is being driven by the emergence of a strong middle income group and more sophisticated institutional investors, leading to the design of financial services and products that can accommodate a wide range of investor needs. The asset management industry has grown 47 percent per year since 2003, reaching total assets under management (AuM) of over USD 92 billion in March 2007. Yet penetration is low compared to global levels, suggesting that vast untapped potential remains to be captured. Further, the industry enjoys a high degree of

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326 Russia had a GDP of USD 1.3 trillion in 2007; Global Insight, World Market Monitor.
327 Reserve Bank of India.
328 McKinsey Global Institute; Gartner; IDC; NASSCOM Strategic Review 2005.
329 NASSCOM.
330 Euromonitor.
331 Economist Intelligence Unit.
profitability. Industry operating profit, as a percentage of average AuM, is 32 bps in India as compared to 12 bps in the UK and 18 bps in the US.332

**Agriculture:** This sector accounts for 21 percent of GDP in 2007. While the overall size of the sector grew from USD 168 billion in 1998 to USD 236 billion in 2007, its relative share of GDP shrank from 27 percent in 1998 to 21 percent today. However, agriculture is still a vital part of the Indian economy, as it is responsible for almost two-thirds of total employment.333

**Manufacturing:** The size of India’s manufacturing sector increased from USD 96 billion to USD 115 billion between 1998 and 2007. During the same period, this sector’s relative share of GDP stayed constant at 16 percent. India’s largest manufactured exports are engineered goods (USD 35 billion) and textiles and clothing (USD 20 billion).334

Within the manufacturing sector, there has been a recent shift towards engineered goods, including automobile and electronic components production. Between 1999 and 2007, the total number of vehicles produced increased from 4.2 million to 11.1 million. During the same period, the total value of electronic components produced increased from USD 11 billion to USD 31 billion.335

Skill-based manufacturing sectors are attracting foreign investment. In the automotive sector, Hyundai and Ford have set up manufacturing facilities in India. Total exports of vehicles was 160,000 in 2006, to countries including Italy, Germany, France, Latin American countries and African nations. ABB has outlined plans to manufacture electrical and electronic products for domestic and export markets.336

Several international pharmaceutical companies are becoming active within the Indian markets. For example, Japan’s second largest drug maker, Daiichi Sankyo, acquired a majority stake in India’s Ranbaxy Laboratories, in 2008. The Indian pharmaceuticals market has the potential to grow to USD 20 billion by 2015 and become one of the world’s top 10 markets and join the league of markets such as US, Japan and Canada and the UK.337

**Significant inflow of foreign funds from FDI and remittances**

Since 2002, foreign direct investment has consistently grown – from USD 6 billion to USD 21 billion in 2007. Annual FDI growth between 2002 and 2007 was 30 percent. There is still potential for growth as FDI is still only equivalent to 1.8 percent of total GDP, which is significantly lower than other emerging economies. In the GCC, FDI is equivalent to 5.6 percent of GDP.338

The Indian government is continuously revising policies to liberalize foreign investment ceilings and promote FDI. For example, the real estate sector in India was opened up to foreign investment in 2005. Up to 100 percent foreign ownership of select real estate projects is now allowed. Between 2005 and

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333 India NSSO survey; Global Insight, World Market Monitor.
334 Economic Intelligence Unit; Global Insights, World Market Monitor.
335 Economist Intelligence Unit; Global Insight, World Market Monitor.
336 Total of 13,132 cars exported in the month of January 2006, was extrapolated for the entire year; Ministry of Finance; India Today.
338 Global Insight, World Market Monitor.
2007, FDI targeted at the real estate sector increased from USD 3.8 billion to an estimated USD 8 billion.\textsuperscript{339}

Remittances are another source of foreign funds for India: they grew from USD 16 billion in 2002 to USD 27 billion in 2007. Remittances from the GCC countries, where 6 million Indian nationals currently live and work, accounted for almost USD 6 billion, about 25 percent of total remittances. India’s combined inward FDI and remittances in 2007 was USD 48 billion, which is equivalent to 4 percent of the 2007 GDP.\textsuperscript{340}

Role of private sector
The liberalization of the Indian economy has helped to rejuvenate India’s private sector. The number of billion dollar enterprises in India increased from 32 in 1998 to 88 in 2007. The cross-border M&A market is booming. In 2007, the total value of deals involving Indian companies was more than USD 20 billion, having increased from USD 10 billion in 2006.\textsuperscript{341}

Several factors have triggered this growth. Indian companies can now make overseas investments equal to 400 percent of their net worth on an automatic approval basis. Companies also have easier access to capital, boosted by active participation by private equity firms. Nearly 20 percent of the M&A deals were backed by private funds in 2006.\textsuperscript{342}

Many of India’s best-known companies are family-owned businesses, reflecting the country’s resurgent entrepreneurial spirit (Exhibit 34). While these companies are strengthening their operations at home, they are increasingly also becoming international players. In recent years, cross-border mergers and acquisitions involving Indian buyers have increased. Notable examples include Tata Motors’ recent acquisition of Jaguar and Land Rover from Ford for USD 2.3 billion, Tata Steel’s USD 12 billion acquisition of Corus and Hindalco’s USD 6 billion acquisition of North American aluminum giant Novells.\textsuperscript{343}

Government reforms liberalizing the Indian economy

After independence in 1947, India was one of the world’s most promising economies. Its foreign reserves were among the largest globally, and at USD 21.1 billion in 1950-51, it accounted for 2.4 percent of international trade. Yet in 1990 the country faced an economic crisis when the government was close to defaulting on its debt. Since then India embarked on an economic reform program. Political momentum and consensus have supported liberalization – reforms have continued even though there have been six Prime Ministers and five different governments since 1991.\textsuperscript{344}

Under the liberalization program, the country successfully laid the foundation for economic growth and transformed itself from a closed agrarian economy into an open economy based on service and industry. Between 1993 and 2007, foreign exchange reserves jumped from about 5 percent of GDP to 24 percent of GDP.\textsuperscript{345}

\textsuperscript{339} Associated Chambers of Commerce and Industry of India.
\textsuperscript{340} World Bank; Global Insight, World Market Monitor; Reserve Bank of India.
\textsuperscript{341} Prowess; CMIE; Dealogic.
\textsuperscript{342} Prowess; CMIE; Dealogic.
\textsuperscript{343} Tata Motors; Tata Steel.
\textsuperscript{344} Global Insight, World Market Monitor.
\textsuperscript{345} CMIE; Economist Intelligence Unit; Bloomberg; Global Insight, World Market Monitor.
One of the first reforms enacted in 1991 was the elimination of the so-called ‘License Raj’ requirements, which forced businesses to obtain government permission for nearly any action – including the decision to open a business. Import tariffs once as high as 300 percent were reduced, and now average under 40 percent. Foreign equity ceilings were relaxed for many sectors including aviation, banking, petroleum, real estate and single-brand retailing.346

Taxes in India have also been reduced. Corporate tax rates decreased from 39.55 percent in 2001 to 33.66 percent in 2006. On the consumer side, a value-added tax has, in most states, replaced the older sales tax system. This modification has simplified the system and made it more transparent, thereby helping reduce tax evasion.347

The government has created more than 400 Special Economic Zones (SEZ) to attract foreign investment and create local jobs, of which more than 40 are already operational. Businesses in these zones have complete access to the domestic market, but are protected from domestic tariffs.348 To date, SEZs have attracted USD 16 billion in investments and generated over 60,000 jobs, and both the investment and the job creation are expected to increase as the SEZs develop further. For example, Apache SEZ currently employs more than 5,000 people, but its workforce is expected to grow to 20,000.349

**Developing capital markets**

India’s economy has benefited from the rapid growth and development of its capital markets. In March 2008, total market capitalization was USD 1.26 trillion,
equivalent to roughly 33 percent of the total market capitalization of the London Stock Exchange. India has more than 20 stock exchanges across the country. The Bombay Stock Exchange (BSE) was established in 1875 and is Asia’s oldest stock exchange. 350

The Indian stock market is regulated by the Securities and Exchange Board of India (SEBI). Established in 1992, SEBI’s main function is to protect the interests of investors in securities and to promote the development and regulate the activities of the securities market. SEBI has pushed systemic reforms aggressively and has been active in setting up the rules and regulations in collaboration with India’s Ministry of Finance. For example the SEBI is in the process of finalizing regulations for setting up real estate investment trusts – the first draft was issued in December 2007.351

The Indian stock market has witnessed increasing interest from foreign institutional investors (FII) since 1993, when they were first allowed to enter the country. Cumulative net FII investment in Indian equities exceeded USD 66 billion in 2007 with USD 20 billion invested in 2007 alone. The total number of FIIs registered with the SEBI was 1,219 at the end of 2007.352

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350 Bombay Stock Exchange; Bloomberg.
351 Securities and Exchange Board of India.
352 India Brand Equity Foundation.
Chapter 8
Private Equity in the MENASA region
Private Equity in the MENASA region

Global investors traditionally paid little attention to the MENASA region, but that has begun to change over the last 5 years – a period when public equity and private equity markets have developed rapidly. Investors throughout the world are increasingly expressing interest in the region’s growth story. In many equity analyst reports, in addition to references to the traditional ‘BRIC’ countries (Brazil, Russia, India and China), there are also references to the value of investing in MENA or MENASA. For example, a daily comment by the French brokerage firm Cheuvreux observed that ‘MENA has become quite a buzz word in the fund industry, much the same way that “BRIC” has been in recent years’.353

Public equity markets in the MENASA region have grown on average 41 percent per year in the period 2004-2008. The combined market capitalization in the MENASA public equity markets has reached a value equivalent to 92 percent of GDP in 2007. Even though there are some outliers with still relatively lower penetrations (Algeria, Lebanon, Pakistan), the overall regional penetration of public equity is comparable to mature markets like the US and the UK, as well as to other emerging markets such as China. Even in public equity markets that do not allow non-GCC investors access, such as Saudi Arabia, ’workaround’ solutions have been created, such as nominee brokerage accounts or GCC investor-owned mutual funds that are sold to global investors (sometimes only holding one stock, so replicating the investment performance of a single share).

As a reflection of global investor interest, the velocity354 of the region’s stock exchanges increased from 20 percent in 2000 to 73 percent in 2003 and about 90 percent in 2007 (albeit strongly impacted by the very liquid Saudi Arabian Exchange). By July 2008, some of the stocks listed on the UAE exchanges were approaching their limits in terms of foreign ownership.

During the same time period, Private Equity (PE) activity accelerated in the region as well: the first PE firms were established, the first funds were raised and transaction volumes reached new heights. Despite the rapid growth in PE activity, transaction volumes are still relatively low when measured as a percentage of GDP. The MENASA subregions show total transaction values in relation to GDP ranging from 0.1 to 2.6 percent in 2007, which is comparable to other emerging markets, but low compared to mature markets, which typically had a penetration of 4 to 5 percent in 2007.

In contrast to the public equity markets where analyst coverage is increasing and information is increasingly available (even if it is less than that available in mature equity markets), the private equity landscape in the MENASA region is very opaque. While there is a diverse collection of investors, many of them pursue strategies that are unknown in other emerging regions and there is a dearth of reliable data on transaction volumes and deal flow.

The growth potential of private equity, the presence of a wide variety of ‘unknown’ players, and the opacity of the private equity market – in contrast to the well-

353 CA Cheuvreux Middle East GCC Equities Sales Daily July 7 2008.
354 Velocity in a year is measured as total value traded divided by average market capitalization during the year.
researched public equity space – underline the importance of researching the MENASA region’s private equity landscape, while reminding the reader that private equity is just one of the asset classes that can give investors exposure to the region.

**Private equity in MENASA: Key observations**

The relatively young MENASA private equity industry is characterized by a wide diversity of investors, a wide range of investment strategies (though predominantly focused on growth capital) and relatively little transparency.

Given the wide range of market participants and their different levels of disclosure, it is impossible to pinpoint the exact size of the MENASA private equity market. However, there are three characteristics or trends distinguishing the MENASA private equity market from that in other regions:

1. The existence of a diverse landscape of players, with conventional firms, government-sponsored investment firms and family-driven investment firms.

2. Surging fundraising activity, with the number of funds as well as the average fund size increasing across the MENASA region, and more and more funds focusing on a part of the region rather than a single country.

3. The industry has potential for growth, driven by the broadly shared expectation that transaction volumes and sizes will continue to grow, and by the fact that debt financing seems to hardly be affected by the global credit crunch.

**Diverse landscape of players**

There are three different categories of investment firms in the MENASA region. The first category is that of the conventional investment firms, set up like buyout firms, dedicated investment companies or principal investment arms of banks and asset managers. The second category is that of government-sponsored investment firms, which are either globally investing Sovereign Wealth Funds (SWF) or government-sponsored investment companies investing directly in (and outside) the region. The third category is that of investment activities that are part of family-owned businesses or conglomerates.

**Conventional investment firms**

Among the conventional investment firms, there are very few large buyout houses with a Limited Partner-General Partner (LP-GP) set up, similar to typical PE houses in mature markets. Most investment firms are structured as investment companies with permanent capital. Examples of firms with an LP-GP set up are Abraaj Capital, Swicorp and Investcorp (its Gulf Growth Capital fund). Even though Investcorp has been investing private wealth from the Gulf region in assets in mature markets since the early 1980s, its Gulf Growth Capital fund is its first commitment of resources to the Gulf region (and the first time in an LP-GP fashion). Investcorp closed its Gulf Growth Capital fund in 2008 at an estimated USD 1.1 billion.355

Besides the LP-GP set up, there are principal investment arms and captive investment firms of banks and asset managers. Examples are Eastgate (captive of National Commercial Bank of Saudi Arabia), Shuua Partners (captive of Shuua

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355 Investcorp.
Capital, one of the investment banks in the Gulf region) and NBK Private Equity (captive of National Bank of Kuwait).

In addition to these firms, all of which have their origin in the region, a number of the largest global firms have set up shop in emerging markets. For example, TPG Capital, Blackstone, Apax and Providence have opened offices in India. But the global firms have a limited presence in the Middle East. As of 2007, only the Carlyle Group, which was already present in India, China and Brazil, had established a presence in the MENA region, with offices in Beirut, Cairo, Dubai, and Istanbul. This relative absence of global players has created a vacuum that the players originating from the region have been able to fill.

**Government-sponsored investment firms**

The second type of investment houses that are actively providing private equity capital are those linked to government-sponsored investment activities. In some cases these are fully funded with government money. Sovereign wealth funds, such as Abu Dhabi Investment Authority (the largest sovereign wealth fund with an estimated value of assets under management of up to USD 850 billion), Kuwait Investment Authority and the newer Qatar Investment Authority, are typically mandated to preserve financial wealth. As they are managing some of the world’s largest funds, they have emerged as the world’s largest fund-of-fund investors with global portfolios.

A new type of government-sponsored investment firm has an increased focus on the region. One example is Mubadala Development Company of Abu Dhabi, which focuses on investments and initiatives with a regional strategic and developmental impact as well as generating financial returns. Mubadala manages a broad set of regional investments and commercial initiatives, in capital-intensive sectors such as aerospace, energy, infrastructure but also in healthcare. Another example is Dubai International Capital (DIC), the investment arm of Dubai Holding, owned by the Dubai government. Since 2004, DIC has built up a portfolio of global assets and has allocated funds to regional investments. Their ‘emerging markets investment portfolio’ comprises stakes in MENA-based companies. A third example is Mumtalakat of Bahrain, which is an ownership vehicle for many of Bahrain’s government assets, and is evolving towards becoming an active investor in regional assets.

**Family-driven investment firms**

The third type of private equity investing relates to investment activities undertaken by family-owned businesses or conglomerates. Their structures range from financially oriented and well-organized family offices to more business-oriented and direct holdings of assets by family members. These assets can be related to the activities of the family-owned business, such as retail, but there is an increasing focus on real estate as an asset class.

These family-owned businesses manifest themselves as target, competitor and exit opportunities. Hence, other private equity investors engage with these family-owned businesses in many ways ranging from acquiring a portion of their holdings.

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356 TPG Capital; Blackstone; Apax and Providence.
357 Carlyle Group.
358 Financial Times.
359 Mubadala Development Company; Dubai International Capital; Mumtalakat.
to competing with them (or their subsidiaries) for acquisitions or on the market for talent.

**Surging fundraising activity**

The private equity industry in the MENASA region is relatively poorly tracked. The available data on fundraising and especially transaction volume and sizes is incomplete and unreliable. But based on available data on announced funds, it appears that fundraising in MENASA has increased considerably over the last 6 years (Exhibit 35).

**Exhibit 35**

**Fund raising has surged in recent years**

- **Announced funds**

<table>
<thead>
<tr>
<th>MENASA region</th>
<th>MENA subregion</th>
<th>SA subregion</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of funds</td>
<td>2002 - 04: 54</td>
<td>2002 - 04: 36</td>
</tr>
<tr>
<td>Average fund size</td>
<td>2002 - 04: 220 USD million</td>
<td>2002 - 04: 11.5 USD billion</td>
</tr>
</tbody>
</table>

Source: Merger Market; Zawya; AVCA

The number of funds with a focus on subregions of MENA or MENASA has more than tripled in recent years – increasing from 54 in the period 2002 to 2004 to 180 in the period 2005 to 2007. The average announced size of these ‘funds’ increased from USD 220 million to USD 320 million in the same period. The combined announced value increased from USD 12 billion to USD 58 billion in that period. Fundraising in South Asia (predominantly India) had picked up earlier. It was mostly in MENA where fundraising dramatically increased in recent years, in terms of number of funds raised as well as average announced value per fund.\(^{360}\)

The vast majority of these funds were of small to medium size, reflecting the stage of the PE industry evolution. Smaller funds have traditionally had either a specific sector focus, or an investment stage focus, such as growth capital. PE firms with a regional focus are now emerging in the PE market as the MENASA countries deepen their economic integration. In fact, funds focused on one country are now a minority in terms of funds raised. A broader regional focus will be needed to deploy the raised funds (Exhibit 36).

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360 Mergermarket; Zawya; AVCA.
An industry with potential for growth

Private equity activity in the MENASA region has potential to continue growing in the years ahead. Based on available data related to private equity transaction volumes as a percentage of GDP, the region is still underserved relative to other regions throughout the world. In addition, the credit crunch is expected to have limited impact on regional transaction activity. A recent survey shows that the private equity community in MENA shares this outlook.361

Debt financing in the region hardly affected by global credit crunch

The MENASA private equity market seems to have largely been insulated from the unraveling of the credit markets in the US and other parts of the world. Regional banks are in a position to provide leveraged finance, given their abundance of deposits and limited exposure to sub-prime credit products. And private equity investments in the region still have a smaller average transaction size, which makes private equity deals easier to digest for local banks. In addition, private equity investments are skewed toward the provision of growth capital, which is less dependent on the kinds of leverage that are now out of fashion in financial markets. According to the above mentioned survey, 57 percent of the private equity community believes that the credit crunch has had no real effect on MENA private equity markets, and 17 percent of the respondents mentioned at least one positive effect. Positive effects mentioned included the increased relative attractiveness of the MENA PE market and a slowdown in entry by new GPs.

PE in MENASA still nascent

While there has been a surge of private equity investing in the MENASA region, private equity remains an emerging industry. For example, while mature markets

such as the US and UK have an annual transaction value of around 4 to 5 percent of GDP. MENASA has transaction values of only 0.5 to 2.6 percent of GDP (Exhibit 37). The earlier mentioned survey shows that transaction volumes and values are expected to increase. Of all respondents, 94 percent believe that investment activity will increase over the next 12 months, and 83 percent believe that deal sizes will increase. Similarly, 71 percent expect exit activity to increase over the next 12 months; with 42 percent predicting that trade sales will be the dominant exit route and 39 percent believing that an IPO will be the dominant exit route.\(^{362}\)

**Exhibit 37**

MENA still underpenetrated compared to mature markets
PE and VC transactions in 2007

<table>
<thead>
<tr>
<th>Region</th>
<th>Total Transaction Value as % of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Turkey</td>
<td>0.8</td>
</tr>
<tr>
<td>MENA total</td>
<td>0.5</td>
</tr>
<tr>
<td>Egypt</td>
<td>2.6</td>
</tr>
<tr>
<td>North Africa excl. Egypt</td>
<td>0.1</td>
</tr>
<tr>
<td>GCC</td>
<td>0.2</td>
</tr>
<tr>
<td>Levant</td>
<td>1.5</td>
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Source: Mergermarket, Zawya, AVCA

Besides traditional sources of transactions, like privatization of government-owned assets, one additional source of increased future transaction volumes will come from family-owned businesses, which still dominate economic activity in the region. In the GCC about 5,000 family-owned businesses control 90 percent of the region’s non-oil GDP and deploy over 70 percent of the private sector labor force.\(^{363}\)

As these family-owned businesses grow and start to pursue cross-border opportunities, they are likely to be attracted to the expertise offered by private equity investors. And the upcoming generational change in the region is expected to significantly boost transactions among family-owned businesses: their portfolios will be increasingly reviewed, streamlined and refocused. Other family-owned businesses that were set up by expatriates are now looking to exit, potentially leading to investment opportunities for private equity investors.\(^{364}\)

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\(^{363}\) Ithmar Capital.

\(^{364}\) Rivoli Group is an example of a company that was set up by expatriates and partially bought out by a regional investor, Dubai International Capital.
Frequently Asked Questions
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1. What has changed in the last decade?

Over the last decade, the MENASA region has achieved strong momentum based on a combination of promising long-term fundamentals and solid short-term performance. All indicators suggest that this momentum is poised to continue.

The MENASA region has demonstrated strong, sustained economic growth since 2002. The size of the MENASA economy has grown from USD 2.2 trillion to USD 3.1 trillion in 2007, which is roughly the size of the Chinese economy. Over the next decade, the combined MENASA economy is expected to grow to USD 6.1 trillion. This growth outlook is helping the MENASA region to attract greater FDI – USD 128 billion was invested in 2007, which is an eight-fold increase since 2002. The MENASA stock markets are growing in line with combined market capitalization, which increased from USD 722 billion in March 2004 to USD 2,855 billion in March 2008.

As governments are liberalizing markets across the MENASA region, there is significant opportunity for foreign and private sector businesses. For example, governments are relaxing foreign ownership and investment laws, reducing tax rates and setting up economic freezones to promote foreign investments. At the same time, the inflow of petrodollars is fueling the regional economy and providing additional liquidity. Between 2007 and 2020, USD 5 trillion to USD 9 trillion in hydrocarbon revenues is expected to flow into the GCC economies, more than double the USD 2.3 trillion generated between 1993 and 2007.

Next to these developments, there is a significant need for investments within the MENASA economies. The region’s large population of 1.6 billion people is expected to continue growing at a rate of 1.4 percent per year for the next decade. This population growth is creating pressure on the already underdeveloped infrastructure. On top of the growth in absolute population size, per capita income is also increasing, leading to the development of large consumer markets. Private consumption in MENASA was USD 1.5 trillion in 2007, having grown from USD 780 billion in 2002.

2. How does the region’s political instability affect economic performance?

The MENASA region is no stranger to conflict. However, the regional economies have become fairly resilient even amidst considerable local turmoil. Over the last 10 years the region has experienced two Gulf Wars, the Lebanon conflict, and the ongoing Kashmir and Israeli-Palestinian conflicts. MENASA’s GDP has still grown to USD 3.1 trillion, increasing on average by 7 percent.

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365 All GDP numbers are expressed in 2007 levels; Global Insight, World Market Monitor.
366 Global Insight, World Market Monitor; Bloomberg.
368 Global Insight, World Market Monitor.
per year since 2002, as compared to the average global growth rate of 3 percent.\footnote{Global Insight, World Market Monitor.}

Several factors are enabling the resilience of the MENASA economies in the face of political instability. The chronic pockets of unrest are contained within relatively small and isolated regions (e.g., Lebanon, Kashmir), and so they have had limited impact on the overall MENASA economy. At the same time, there is a new generation of reform-minded leaders across the MENASA region who see promoting the economic development of their countries as a priority, and are determined to minimize political unrest by pursuing economic and social reforms.

While most of the chronic unrest is contained, there is the risk that certain situations will worsen. For example, rising tensions in Iran may lead to a political crisis. However, if such a situation develops, then the impact is likely to be felt globally, and not be localized to just the MENASA region.

Overall, the increasing political stability across the region is reflected in the risk ratings of the MENASA countries. For example, the overall risk score of Turkey, India and Saudi Arabia, as published by the Economist Intelligence Unit, have all decreased since 1998 (Exhibit 8). If these countries continue to stabilize politically, economic growth is likely to continue accelerating.

3. What is the effect of fluctuations in oil prices on the MENASA economies?

MENASA is well positioned to benefit whether oil prices are high or low, as the region is home to both oil producers and consumers. MENASA countries account for 29 percent of global oil production and 15 percent of global gas production. However, they house 45 percent of the world’s proven oil reserves and 28 percent of the world’s proven gas reserves. At the same time, MENASA countries account for 10 percent of global oil and gas consumption.\footnote{If hydrocarbon reserves and production in Iran, Iraq, Syria and Yemen are included, this region is responsible for 38 percent of oil and 17 percent of natural gas production, and 66 percent of proven global oil reserves and 45 percent of natural gas reserves; Energy-Files.}

While it is unclear what the future oil prices will be, most analysts predict that by 2020, they will be above USD 50 per barrel. However, given current oil price levels, future prices may exceed USD 100 per barrel.\footnote{At the time of writing the oil price was USD 125 per barrel; Energy Information Administration Annual Energy Outlook February 2007; IEA; FACTS.} Over the period 2007 – 2020, cumulative oil revenues between USD 5 trillion and USD 9 trillion will flow into the GCC economies alone, depending on the price of oil. Coupled with existing foreign exchange reserves of USD 770 billion across the MENASA region, this additional injection of petrodollars will boost liquidity levels in the region, and help to create the economic conditions that will support MENASA’s long term growth.\footnote{McKinsey Global Institute; Global Insight, World Market Monitor.}
4. How does MENASA compare to other emerging markets in terms of business environment?

MENASA countries compare favorably with other emerging economies in terms of levels of corruption and protection of foreign investors along several key rankings and indices.

Most MENASA countries score relatively high on the World Bank’s ‘Ease of Doing Business’ rankings. Of the 178 countries ranked throughout the world, most in the MENASA region are ranked between 23 and 129, with Saudi Arabia being the highest (Exhibit 7).

MENASA countries are in general performing well, according to The Heritage Foundation’s Economic Freedom Rankings (Exhibit 7). Countries such as Bahrain have been consistently ranked in the top 25 since 2005. Other countries such as Turkey were ranked very low at 132 in 2005, but have since moved up to 74 in 2008. Libya is the only MENASA country that has remained at a low rank of 154 since 2005.

The assessment of the risks of doing business in MENASA countries such as Saudi Arabia, India and Turkey has steadily declined. The difference between Saudi Arabia and the US in terms of the risk of doing business is smaller today than at any point in the last 10 years (Exhibit 8).373

Furthermore, the overall Moody’s risk ratings for most of the MENASA countries are in the A and B range. All GCC countries have a rating between Aa2 and A2, comparable to that of China. The remaining MENASA countries have ratings between Baa2 and B3, with Libya and Algeria not yet rated (Exhibit 9).

Thirteen MENASA countries are part of the World Trade Organization (WTO), with Saudi Arabia being the last one to join in 2005. The remaining three countries, Algeria, Lebanon and Libya, established Working Parties in 1987, 1999 and 2004, respectively, to facilitate accession to WTO. Of these, the Algerian and Libyan Working Parties are already in bilateral market access negotiations.

5. What could be the effect of inflation on the region?

As in most countries across the globe, inflation has risen significantly in the MENASA countries. In some of the MENASA countries, year-on-year inflation as per mid- 2008 is running above 10 percent. The recent increases in commodity prices are responsible for a significant part of the inflation. However, some of the MENASA countries suffer from additional upward pressure on prices, for example through currency-peggs or rapid increases in real estate prices.

It is too early to make decisive statements on the impact of the increase in inflation on the MENASA economies. In most of the MENASA countries, increases in food and oil prices are ‘countered’ by increasing revenues from oil or food production to governments or businesses that will feed into the domestic economy. Also, as many of the MENASA countries experience growth rates that are far higher than in Europe or the US in the remainder of 2008, foreign direct investment is likely to continue to flow into the region. A number of drivers can be clearly identified

373 Economist Intelligence Unit.
that investors will need to keep a close eye on; their full impact however remains uncertain for now:

**Inflow of liquidity.** The increase in energy prices is spurring an economic boom in hydrocarbon-rich countries which in turn boosts domestic demand and money supply (e.g., across the GCC, money supply growth as measured by M3 is generally above 20 percent on a year-on-year basis), and, ultimately, risks an overheating of already fast-growing economies.

**Dollar-peg.** All GCC countries (excluding Kuwait) and Jordan and Lebanon have their currencies pegged to the depreciating US Dollar, leading to an increase in imported inflation. In addition, this exchange rate policy effectively limits the monetary authorities in addressing inflationary pressures as their monetary policy is de facto a carbon-copy of that of the US. As a result, nominal interest rates are below actual inflation rates in many of the MENASA countries, spurring aggressive investments in infrastructure, housing and other fixed assets, even though banks in especially the GCC have so far kept mortgage rates stable at around 7-8 percent per annum. On the positive side, the low real interest rates will help accelerating the build-out of the necessary infrastructure that is required to cater to the needs of the growing populations. The countries that have not pegged their currency to the dollar, except for Pakistan, have by and large seen their currency appreciate against the dollar, limiting the impact of imported inflation.

**Rising housing expenses.** Despite large investments in real estate, demand has been outgrowing supply, leading to high growth in real estate prices and rents in many MENASA countries. However, it is fair to say that this increase in real estate prices was already ongoing before the ‘spike’ in food and oil prices and is more a matter of supply and demand than anything else. The potential for further increase in rental rates is as of now unclear: supply might catch up with demand in the coming 2-3 years, when a large number of developments will come online.

**Rising global commodity prices.** The increase in global food and fuel prices has caused turmoil in many of the world’s developing countries. It is too early to say if all the commodity price hikes are here to stay. However, they are currently having negative effects on consumer budgets, especially on those of the poor in developing countries. They strain government budgets, not just because government consumption is more expensive, but because governments around MENASA subsidize fuel consumption by their populations. On the positive side, the increase in food prices creates business opportunities. For example, it is commonly known that the effective yield of food-producing areas in Pakistan and India is far below the global average because of outdated harvesting methods, poor transportation and storage capabilities. Similarly, the increase in oil prices leads to unprecedented increases in hydrocarbon revenues in the GCC, Algeria, Libya and Egypt which, given the strong ties between the different MENASA countries, will likely find their way into the broader MENASA region.

**Rising wages.** The increase in inflation is most notably felt in food prices, the price of fuel and in rents. As a response, workers across the MENASA have tended to demand higher wages to compensate for increased costs of living. Especially in hydrocarbon rich countries, governments spend significant currency on compensating civil servants for increases in cost of living. As an example, the
Kuwait parliament ratified a 5 percent increase in wages for Kuwaiti’s earning less than 3,700 USD per month, in early July. The impact of these measures is still unclear: on the one hand, these wage increases underpin consumer spending; whilst on the other hand they risk creating a spiral of wage inflation.

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