

I. ECONOMIC ENVIRONMENT

(1) RECENT ECONOMIC DEVELOPMENTS

1. Bahrain is an archipelago off the coast of Saudi Arabia in the Persian Gulf. It has a population of around 640,000, of which about 40% are expatriates. Per capita income was some Bahrain dinar (BD) 2,861 (around US\$7,600) in 1998 (Table I.1). Bahrain's economy depends largely on petroleum exports (around 64% of merchandise exports in 1999); the sector (including mining) accounted for some 14% of GDP in 1998, down from 19% in 1991. Bahrain's crude oil production comes mainly from an offshore oilfield.¹ Domestically produced crude petroleum, as well as imported crude petroleum, is refined domestically and exported. Bahrain's relatively small domestic petroleum and natural gas reserves have prompted economic diversification. As petroleum's share in the economy has declined, the role of manufacturing and services has become more important. Services accounted for almost 77% of GDP in 1998, its share rising from some 69% in 1990, while manufacturing accounted for 13% in 1998. Services is also the largest employer in Bahrain, providing employment to around 50% of the workforce in 1998.

Table I.1
Basic economic and social indicators, 1990-2000
(Bahrain dinar and per cent)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999 ^a	2000 ^b
National income											
Nominal GDP (billion Bahrain dinar)	1.70	1.74	1.79	1.96	2.09	2.20	2.29	2.39	2.33	2.58	2.90
GDP per capita											
At market prices	2,668	2,589	2,773	2,963	2,968	3,172	3,127	3,041	2,861	..	..
At constant prices	2,599	2,520	2,804	3,102	2,881	3,050	3,001	2,892	2,960	..	..
Share in GDP											
	Per cent										
Agriculture	0.8	0.8	0.9	0.9	0.8	0.9	0.9	0.9	0.9	..	..
Petroleum and mining	19.1	16.9	16.3	15.7	14.3	15.4	18.1	18.7	13.6	..	..
Manufacturing	10.9	11.2	10.9	12.3	14.5	17.5	14.7	14.7	12.7	..	..
Electricity and water	1.7	1.6	1.7	1.6	1.4	1.6	1.6	1.6	1.9	..	..
Construction	5.5	5.3	5.7	5.4	5.2	4.8	4.3	3.9	4.1	..	..
Services	69.2	70.1	64.9	73.1	73.3	69.1	69.9	70.0	76.9	..	..
Financial services	18.8	17.3	18.4	20.2	20.3	17.8	19.8	21.1	22.9	..	..
Trade	9.1	9.7	11.3	10.6	12.2	11.2	10.6	9.3	10.1	..	..
Hotels and restaurants	1.9	2.3	2.4	2.3	2.2	2.1	2.0	2.0	2.3	..	..
Transport and communication	7.5	8.4	8.2	7.9	8.0	7.4	7.2	7.1	8.3	..	..
Real estate	9.1	9.2	9.1	9.7	9.4	9.5	9.4	9.6	10.3	..	..

Table I.1 (cont'd)

¹ Production from the Abu Saafa field owned by Saudi Arabia, of which Bahrain currently receives 100%, is exported as crude oil.

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999 ^a	2000 ^b
Social and personal services	3.7	3.5	3.7	3.6	3.6	3.6	3.7	3.8	4.3	..	..
Government services	19.1	19.7	20.0	18.8	17.6	17.5	17.2	17.1	18.7	..	..
Less imputed banking services	..	..	9.2	9.5	9.9	9.0	8.6	..	..	..	..
Share in employment	Per cent										
Agriculture	3.5	3.6	3.6	3.5	3.4	3.4	3.4	3.1	3.0	..	..
Petroleum and mining	0.4	0.4	0.4	0.5	0.5	0.5	0.5	0.5	0.5	..	..
Manufacturing	12.3	12.2	12.1	12.0	11.6	12.3	12.3	12.4	12.1	..	..
Electricity and water	25.7	21.1	18.8	19.6	19.0	19.7	20.0	20.4	20.5	..	..
Construction	14.6	13.9	13.9	13.9	14.0	12.8	12.8	12.9	13.6	..	..
Services	43.5	51.2	51.2	50.5	51.5	51.3	51.0	50.7	50.3	..	..
Social indicators											
Population (million)											
Urban population	503	508	519	538	557	577	598	620	642	..	..
Unemployment (per cent)	..	..	..	..	..	..	..	..	2.3	..	..
Birth rate (per cent)	..	3.3	3.3	3.4	3.5	3.6	3.5	3.5	..	..	..
Life expectancy at birth	70	70	70	70	70	70	70	70	70	..	..
School enrolment ratio											
Primary	..	57	..	..	55	54	55	55	..	..	..
Preparatory	..	25	..	..	25	25	25	25	..	..	..
Secondary	..	18	..	..	14	14	14	14	..	..	..

.. Not available.
a Estimated data.
b Projected data.

Source: Ministry of Finance and National Economy (1998), *National Accounts, 1998*; and data provided by the authorities.

2. Real economic growth has averaged around 4.6% annually since 1992, slowing since 1994 (average annual growth between 1994 and 2000 was about 3.6% compared with some 8.1% during 1992-1994). Growth in 2000 is expected to be 3.5% (Table I.2). The slowdown since 1994 is generally associated with erratic petroleum production; growth in petroleum output in 1996 and 1997 was mainly attributed to an increased allocation of petroleum from the offshore Abu Saafa field; non-oil GDP growth has also been lower since the mid-1990s. Bahrain has relatively low inflation, measured by the consumer price index, which has averaged around 0.7% annually since 1992.

3. Slower non-oil GDP growth during 1994-97 was in part due to a decline in investment; gross domestic investment fell between 1992 and 1996 with fixed capital formation, as a percentage of GDP, declining to 12% in 1997. Private and public investment have declined. Lower public investment has reflected cutbacks in government capital spending as part of a programme to reduce the fiscal deficit; private investment also declined sharply until 1997 before showing signs of improvement in 1998 as economic activity picked up. Overall domestic investment has also risen, especially since 1997 (Table I.2).

Table I.2
Economic performance, 1992-2000
(Per cent and US\$)

	1992	1993	1994	1995	1996	1997	1998	1999 ^a	2000 ^b
Annual per cent change									
Real GDP growth	7.8	8.3	2.4	3.9	4.1	3.1	4.8	3.5	3.5
Oil (including refinery)	14.4	11.6	-0.8	2.0	6.7	3.4	11.4	-1.8	3.1
Non-oil GDP	6.6	7.6	0.8	4.2	3.7	3.0	3.6	3.8	3.5
Agriculture and fishing	..	..	2.9	18.5	12.8	-7.6	-0.5	..	..
Manufacturing	..	..	9.9	7.5	-2.5	2.4	2.0	..	..
Electricity and water	..	..	11.4	7.4	9.1	-4.2	15.5	..	..
Construction	..	..	-5.5	11.3	-14.6	-6.2	1.0	..	..
Services	..	..	2.0	0.8	5.2	4.1	2.7	..	..
Transport and commun- ications	..	..	7.0	-2.6	2.1	1.5	5.8	..	..
Social and personal services	..	..	9.9	3.6	3.6	6.3	6.4	..	..
Trade hotels and restaurants	..	..	-6.0	-2.1	4.1	3.4	7.4	..	..
Banking and insurance	..	..	9.7	-1.5	10.7	8.1	-1.8	..	..
Domestic banks	..	..	-14.3	6.2	10.0	13.6	8.2	..	..
Offshore banks	..	..	22.3	-14.0	15.1	11.5	-5.7	..	..
Government services	..	..	-0.3	4.6	3.2	2.0	1.8	..	..
Per cent of GDP									
Savings and demand									
Savings	19.8	25.0	27.2	31.3	33.8	..	..	..	..
Gross domestic investment	34.9	20.0	24.0	19.0	19.6	20.3	27.2	..	..
Fixed capital formation	29.8	31.2	20.6	17.3	12.4	12.0	14.0	..	..
Public	7.5	7.1	6.7	5.1	4.8	6.6	6.4	..	..
Private	22.3	24.1	13.9	12.2	7.6	5.4	7.6	..	..
Change in stocks	..	..	3.4	1.7	7.3	8.4	13.2	..	..
Final consumption	59.9	56.9	70.3	69.5	68.6	70.1	72.1	..	..
Percentage change									
Inflation and exchange rate									
GDP deflator	..	..	..	1.1	0.2	0.9	-7.1	7.7	8.9
CPI (period average)	0.0	2.1	0.4	3.1	-0.2	2.2	-0.3	-1.3	0.2
Nominal effective exchange rate	4.5	5.3	-2.0	-4.8	3.4	6.2	3.6	-0.3	..
Real effective exchange rate	2.6	5.1	-3.5	-4.7	-0.4	6.6	1.6	-0.3	..
Money and credit^c									
Broad money (M3)	..	..	..	7.4	3.1	7.9	16.6	5.4	12.6
Credit to public sector (net)	..	..	..	2.5	-3.5	1.6	4.5	3.2	0.4
Credit to private sector	..	..	..	2.4	0.5	8.0	5.3	7.6	11.1
Interest rate (3-month deposits, %)	..	..	..	6.2	5.7	5.9	5.7	5.2	5.2
Balance of trade and payments (US\$ billion)									
Exports	3.46	3.72	3.62	4.11	4.70	4.38	3.27	4.09	5.51
Imports	4.26	3.86	3.75	2.46	3.16	2.73	1.77	2.71	4.33
Services balance	..	..	..	0.04	0.05	0.00	0.07	0.14	0.16
Balance of payments (% of GDP)	-2.5	-2.0	-2.8	2.9	-1.0	1.6	-0.3	0.4	0.5
Current account balance (% of GDP)	-19.2	-3.6	-3.7	4.05	4.23	-0.49	-12.65	-4.97	2.9

Table I.2 (cont'd)

	1992	1993	1994	1995	1996	1997	1998	1999 ^a	2000 ^b
International reserves and debt									
Gross official reserves (Bahrain dinar)	1.27	1.26	1.37	1.35	1.38	1.43
(in months of imports)	3.3	3.4	4.2	4.1	3.4	3.8
Gross external debt (% of GDP)	36.6	33.7	29.5	29.9	26.1	22.8

.. Not available.

a Estimated data.

b Projected.

c Data from 1995 onwards based on a revised system of monetary statistics.

Source: Data provided by the authorities.

4. The fact that private sector participation appears to be increasing shows greater confidence in the reforms initiated by the Government, which albeit gradual, are opening up a larger number of activities to domestic and foreign investment and streamlining investment and commercial registration procedures. The Government has also been gradually privatizing public sector holdings, which will reduce the fiscal burden on the Government and also free up resources for private sector investment. In the view of the authorities, Bahrain's present reliance on the public sector, rather than on private investment, is not sustainable in the long run due to budgetary constraints and a need to raise real economic growth. The Government's longer term efforts will therefore concentrate on, *inter alia*, developing laws, regulations, and infrastructure that are conducive to investment by the private sector; directing local financial resources into investment, particularly in priority sectors such as downstream manufacturing and services, in particular financial services; and improving worker productivity and training.

5. Another challenge facing Bahrain is that of rising unemployment, especially among Bahraini nationals. In 1998, unemployment among Bahrainis was, according to the authorities, around 6%, compared with an overall unemployment rate of 2.3%.² Concerns about unemployment and a rapidly growing population (around 3% annually) have led the authorities to initiate a number of reforms and incentives to encourage employment, especially of Bahrainis. These measures include incentives for firms to hire a certain percentage of Bahraini nationals, the so-called Bahrainization policy, and training of Bahrainis (Box I.1).

(i) Macroeconomic policies

(a) Fiscal balance

6. Bahrain's budget is prepared on a biannual basis, with budgets set for two years at a time. The budget for 1999 and 2000 was approved by the Cabinet in January 1999.

7. Government revenue is derived mainly from the oil and gas sector, including Bahrain's share in the Abu Saafa field owned by Saudi Arabia³, export revenue from refined petroleum, from fees for processing Saudi Arabian crude oil in the Sitra refinery, and from local sales of refined petroleum and gas products. In addition, the Government charges a 46% corporate tax on the profits of petroleum

² Government of Bahrain (1999).

³ Around 79% of Bahrain's crude oil comes from the Abu Saafa field in Saudi Arabia. Under an agreement signed between the Governments of Bahrain and Saudi Arabia, 100% of Abu Saafa production is transferred to Bahrain, net of production costs (Chapter IV(3)(i)).

and gas companies. The revenue from oil and gas accounted for around 46% of total state revenue, or 14% of GDP in 1999, making the budget susceptible to changes in petroleum prices and exports. Another major sources of revenue is taxation, which accounted for 7.2% of GDP (27% of total revenue) in 1999; revenue from the tariff accounted for around 11% of the total, or about 2.5% of GDP budgeted for 1999 (Table I.3).

Box I.1: The labour market and employment policy

Bahrain has a large expatriate population (around 40% in 1999). The labour market tends to be segmented; employment of expatriates is generally higher in the private sector (around 90% of total private sector employment in 1997), while around 77% of public sector employees are Bahraini nationals. In addition, low-wage positions generally tend to be filled by expatriates.

Recently, it has been estimated that unemployment among Bahraini nationals has been rising for a number of reasons, including rapid population growth, greater participation of women in the workforce and a slowdown in growth associated with declining energy prices since the mid-1980s. Although the overall official unemployment figures were estimated at 2.3% in 1998, the unemployment rate for Bahrainis was 6% according to the authorities, and estimated by the World Bank in 1995 to be closer to 10%. As a result, there has been a recent shift in policy to encourage employment and training of Bahrainis.

Bahrainization

In 1989, the Government, with the help of international organizations, including the World Bank, the International Labour Organization, and the United Nations Development Programme, introduced its programme on "Bahrainization". The programme was aimed initially at creating 20,000 private sector jobs for Bahrainis by 1993; it was revised in May 1996 to increase the share of Bahrainis in the total workforce from 38% in 1996 to 50% by 2000. This involved setting quantitative guidelines for employment of Bahraini nationals by companies based on their size: for existing firms these quantitative targets were to raise their share of Bahraini employees to 50%; new companies with more than ten employees would be expected to ensure that at least 20% of their workforce were nationals of Bahrain, subsequently achieving the same targets as for existing firms through a 5% increase per year; for firms with fewer than ten employees, at least one of the employees other than the owner is required to be Bahraini. According to the authorities these targets are set on a flexible basis and are mindful of the need to improve economic efficiency as well as increased employment opportunities for Bahraini nationals.

In addition to quantitative targets for Bahrainis, the Foreign Employment Section of the Ministry of Labour and Social Affairs monitors the employment of expatriates through the issuing of work permits. Fees paid by expatriate employees for work visas were raised in 1996, doubling for a two-year work permit from BD 50 to BD 100 and increasing from BD 40 to BD 150 for renewal. The Government has also established an Employment Services Bureau, which operates as a job placement centre, matching registered unemployed Bahrainis with listed job vacancies.

Training

Another factor in the Government's employment policy is to increase training facilities for Bahrainis. Currently the training facilities in Bahrain include the Bahrain Training Institute, set up in 1992, which trains around 1,000 Bahrainis a year; the Industrial Garments Training Centre, which was opened in 1997 with an initial capacity to train around 240 trainees per year; and the private Bahrain Institute of Banking. The Bahrain Training Institute has also been accredited by a number of foreign institutions, including the Business Technology Education Council (BTEC), the City and Guilds of London Institute (CGLI), the London Chamber of Commerce and Industry, and the Royal Society of the Arts.

The results of the Bahrainization and training programmes appear to show a declining share of expatriate workers, from around 62% of the workforce in 1994 to 56% in 1999. In addition, the number of Bahrainis working in the private sector increased by 48% between 1992 and 1997.

Source: Government of Bahrain.

Table I.3
Fiscal balance, 1995-2000
(Per cent of GDP unless otherwise indicated)

	1995	1996	1997 ^a	1998 ^b	1999 ^b	1999 ^c	2000 ^b
Total revenue and grants (million Bahrain dinar)	560.8	633.3	615.0	630.0	566.0	660.0	572.0
Total revenue	25.5	27.6	29.6	33.8	21.9	25.6	19.3
Current revenue	23.8	26.8	27.6	22.2	20.1	24.2	17.7
Petroleum and gas related revenue	14.5	17.1	17.7	11.2	10.1	14.4	8.6
Non-oil revenue	9.3	9.6	9.9	11.1	10.9	9.8	9.1
Taxation	7.7	7.9	7.9	8.5	..	7.2	..
of which customs revenue	2.5	2.3	2.3	2.0	2.5	2.6	..
Non-tax revenue	1.6	1.8	2.0	2.6	..	..	..
Grants	1.7	0.8	2.0	1.6	1.8	1.5	1.6
Total expenditure (million Bahrain dinar)	626.1	627.3	704.0	705.0	726.0	724.0	732.0
Total expenditure	28.5	27.3	29.5	30.3	28.2	8.1	24.7
Current expenditure	23.7	22.8	23.2	24.1	23.2	23.1	20.3
Wages and salaries	15.0	14.8	15.2	16.4	15.2	15.2	13.5
Other goods and services	4.8	5.0	4.9	4.5	4.5	4.6	3.9
Interest payments	0.9	0.9	0.9	1.0	0.9	1.2	0.8
Subsidies and transfers	3.0	2.1	2.2	2.2	2.6	2.1	2.1
Capital expenditures	4.8	4.5	6.3	6.2	5.0	5.0	4.4
State budget balance (million Bahrain dinar)	-65.3	6.0	2.0	-151.0	-160.0	-64.0	-160.0
(as per cent of GDP)	-3.0	0.3	0.1	-6.5	-6.2	-2.5	-5.4
Extra budgetary operations (net)	-40.8	2.6	-93.0	57.0	..	-80.0	..
(as per cent of GDP)	-1.9	0.1	-3.9	2.5	..	-3.1	..
Overall balance	-106.1	9.0	-91.0	-93.0	..	-144.0	..
(as per cent of GDP)	-4.8	0.4	-3.8	-4.0	..	-5.6	..

.. Not available.

a Estimated.

b Budget.

c Preliminary.

Source: Ministry of Finance and National Economy (1999), *The Budget for the Fiscal Year 1999*; and data provided by the authorities.

8. State revenue thus depends closely on sales of petroleum and gas and international energy prices. As a result of a sharp fall in petroleum prices, the budget balance deteriorated sharply in 1998 to a deficit of 6.5% of GDP from a small surplus of 0.1% in 1997. The deficit was expected to be around 6.2% in 1999 although an increase in the price of oil in the latter half of 1999, resulted in an improvement in the budget balance, to an expected deficit of 2.5%. In 2000, the budget deficit is expected to be around 5.4% of GDP, although this may improve if oil prices remain at their present levels.⁴ Given this vulnerability to petroleum prices and the need to reduce the budget deficit, a number of steps have been taken both to raise revenue and to curb expenditure (Box I.2). The Government also intends to borrow funds for 1999 and 2000, of BD 100 million each year, from the

⁴ In addition to the State Budget, the Government of Bahrain also has extra-budgetary operations including external grants received, spending on defence and security, allocations for the Amir's financial assistance to needy Bahrainis, and loans to the domestic sector.

General Organization for Social Insurance (GOSI) and the Pension Fund Commission (PFC), by issuing government bonds, repayable over a 30-year period, to be traded on the Bahrain Stock Exchange.

9. Overall government spending has been declining during the 1990s, from around 36% of GDP in the beginning of the decade, to around 28% in 1999. Government expenditure is dominated by current expenditure, of which wages and salaries accounts for the largest share, at around 13.5% of GDP in 1999, declining from over 16% in 1998 due to a freeze on annual wage increases and additional hiring. Spending on subsidies, as a percentage of GDP, has also been declining. Capital expenditures, however, with the exception of non-essential projects, have been largely maintained, as has spending on healthcare and social services.

10. In the longer run, the Government hopes to streamline spending and increase productivity by improving public expenditure management, and contracting out and privatizing several public sector services.

(b) Monetary policy, exchange rate developments and the balance of payments

11. Monetary policy is focused on maintaining the nominal exchange rate peg of the Bahrain dinar to the SDR, at a rate of BD 0.47619 per SDR, and regulating short-term fluctuations in domestic liquidity. The exchange rate may be varied within a 7.25% margin of this rate against the SDR, which has been fixed since August 1978. In practice, the Central Bank, the Bahrain Monetary Authority (BMA), intervenes against the U.S. dollar in the exchange market.⁵ The middle rate of the dinar against the U.S. dollar is quoted by the BMA and has remained unchanged since December 1980 at US\$2.6596 per dinar.⁶

12. The BMA has a limited number of monetary policy instruments at its disposal. Treasury bills are used to regulate liquidity positions of commercial banks in Bahrain dinars. Liquidity is provided through secondary operations in Treasury bills, including discounted treasury bill operations and sales of treasury bills by commercial banks to the BMA with an agreement to repurchase them at a later date and at a higher price. The BMA also appears to have legal authority to fix interest rates but has not exercised this authority to date; instead it publishes recommended rates for Bahrain dinar deposits.

13. The nominal and real effective exchange rates of the Bahrain dinar have varied considerably since 1990. The real effective exchange rate (REER) depreciated between 1990 and 1996 with the exception of 1993; since 1996, its value has appreciated, although at a less rapid rate than the nominal effective exchange rate (Chart I.1).

⁵ IMF (1999).

⁶ The exchange system is free of restrictions on payments and transfers for international current and capital transactions and there is no legislation on exchange control. Bahrain accepted the obligations of Article VIII, sections 2, 3 and 4 of the IMF's Articles of Agreement on 20 March 1973.

Box I.2: Budgetary reform

According to the authorities, the medium-term objectives of fiscal policy include restraining and reducing current expenditures; enhancing non-oil revenues; and eliminating the structural budget deficit. In this regard a number of measures to increase non-oil revenue and to curb expenditure have been initiated in recent years. Most of these are on the expenditure side but some measures have also been taken to increase non-oil revenue.

Revenue enhancing measures

The price of natural gas was raised to US\$0.75 per million British Thermal Unit (MBTU), an increase of 80%, in March 1998. The measure is expected to raise additional revenue of BD 12 million. In addition, fees for a variety of services including for embassy and consular services, environmental services, housing, transport, postal services, and education services, were raised in November 1998.

Expenditure cutting measures

The Public Expenditure Management Strategy (PEMSY): was approved by Cabinet in 1996. It is aimed at increasing cost recovery on government services; contracting out of several publicly provided services to the private sector, where viable; and the privatization of selected government activities.

Enhanced cost recovery: in addition to restraining government expenditure, and postponing non-strategic expenditure for the 1999/2000 budget, the Cabinet approved the merger of Aluminium Bahrain (ALBA) and the Bahraini-Saudi Aluminium Company (BALCO), in February 1999, in order to reduce duplication of administrative costs. Cabinet also approved an increase in electricity and water, sewerage, and health service user charges in 1996. A policy decision was taken to implement a compulsory healthcare insurance scheme for expatriate residents, and an inter-ministerial committee including representatives from the Ministries of Health, Finance and National Economy, Commercial, and Labour and Social Affairs was formed to examine this issue. The Government hopes to recover around BD 8-10 million per year through this measure. A further measure was approved by Cabinet, in September 1998, under which, housing allowances rather than accommodation will be provided to expatriate residents, saving the Government around BD 700,000 per year. Proposals for higher utility tariffs and a levy on sewerage services are currently being considered by Cabinet.

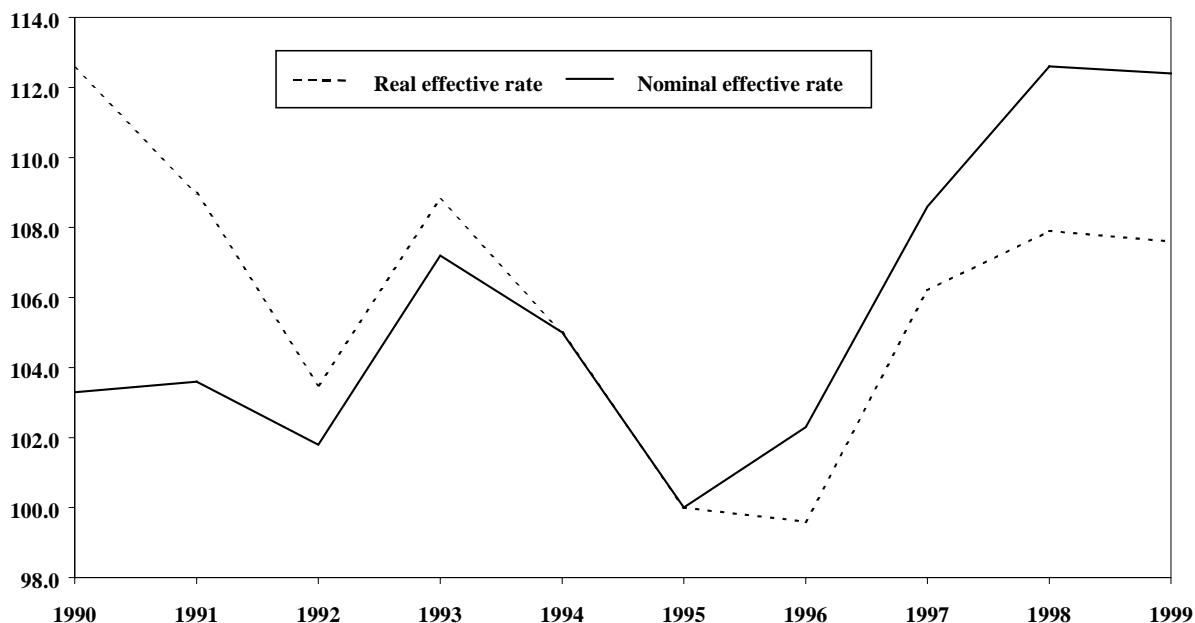
Contracting out and privatization: seven out of 40 activities carried out by various ministries were identified and approved by the PEMS Y steering committee and/or were in advanced stages of implementation for contracting out in 1998/99. The activities include municipality services such as refuse collection and street cleaning, maintenance of air-conditioning units, transportation of teachers, towage operations, maintenance of traffic signals, cleaning services in schools, and airport car park. The steering committee also approved the formation of an employee-sponsored company for operating towage services, which is awaiting approval. The privatization programme currently proposes to sell the government slaughterhouse and to privatize some public transport activities; the Government has also invited tenders from the private sector to build and operate the second phase of the HIDD power project. Much, however, depends on whether the early retirement scheme for potential redundancies from these sell-offs can be approved.

Other measures include: a programme and expenditure review (PER) commenced by the World Bank on the education sector, and a United Nations Development Programme recommended Performance and Programme Budgeting System (PPBS). The PER is expected to recommend measures to rationalize the education budget within the overall budget, improve resource mobilization, improve the efficiency of the education system, and enhance the role of the private sector. A similar study is planned for the health sector later. Based on the PPBS report, which was submitted to Cabinet in April 1999, a pilot programme has been initiated in Customs and Port Affairs; it will start with a reclassification of the accounting structure and would gradually implement a programme based budget structure.

Source: Government of Bahrain.

Chart I.1
Indices of real and nominal exchange rates, 1990-99

Index 1995=100, period average



Source: International Monetary Fund, *International Financial Statistics*.

14. As petroleum and petroleum products account for around 64% of Bahrain's total merchandise exports, the trade balance closely follows trends in international energy prices and levels of domestic petroleum production (including production from the offshore Abu Saafa field). The current account balance has thus fluctuated considerably since 1995, falling to a deficit of almost 13% of GDP in 1998 as a result of a decline in international petroleum prices in that year. An improvement in the price of petroleum in 1999 led to a substantial improvement in exports in 1999 and 2000. The current account balance is expected to move to a surplus of almost 3% of GDP in 2000 as a result of this improvement (Chart I.2 and Table AI.1). The overall balance of payments has also tended to fluctuate considerably, falling from a surplus of almost 3% of GDP in 1995 to a deficit of 1% in 1996; following a surplus of 1.6% of GDP in 1997, the overall balance registered a deficit of 0.3% in 1998 before improving to a surplus of 0.4% and an expected 0.5% in 1999 and 2000, respectively (Table AI.1).

(2) DEVELOPMENTS IN TRADE

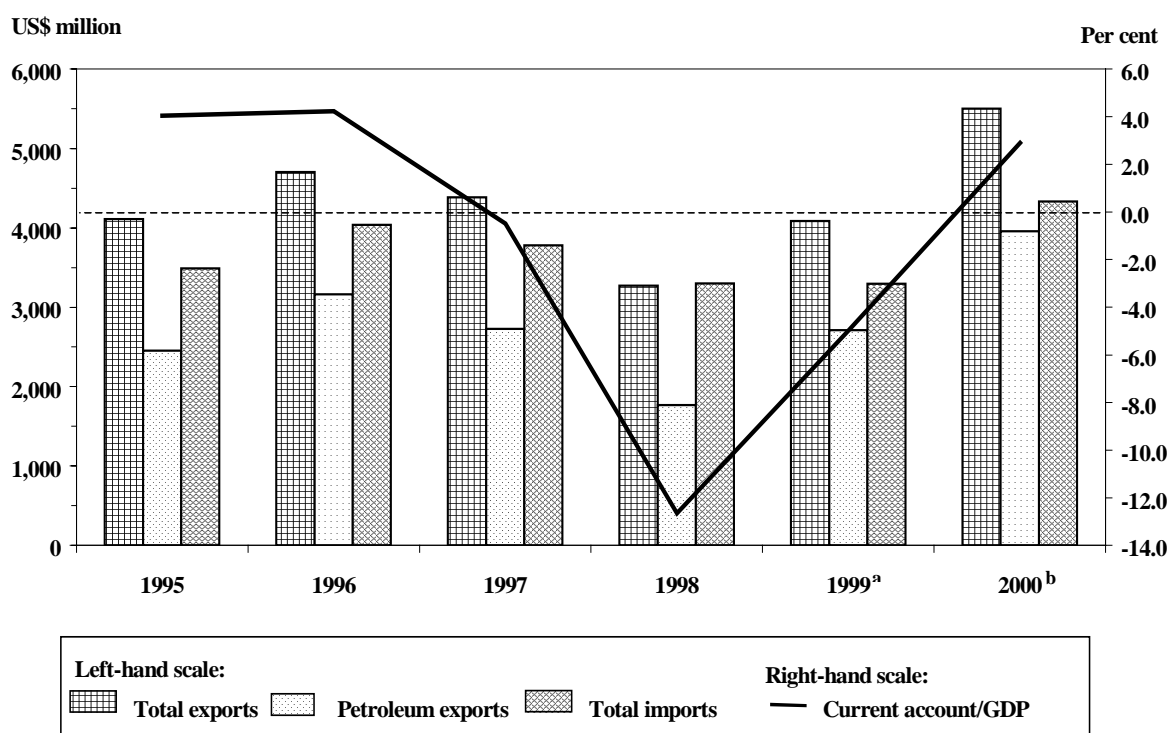
(i) Composition of trade

15. In 1999, Bahrain's total merchandise exports, including petroleum, totalled just under US\$4 billion (Chart I.3).⁷ The value of imports in 1999, including petroleum, was around US\$3.5 billion. Exports and imports excluding petroleum were valued at around US\$1.4 billion and

⁷ Data on merchandise trade provided by the authorities in the HS nomenclature, do not include data on petroleum, which represents around 64% of exports and 37% of imports; data on trade in petroleum by product only has been taken from the Bahrain Monetary Agency (1999). Thus, there may be some statistical discrepancy in these data.

US\$2.3 billion, respectively. Despite its share of total exports falling from some 89% in 1985 (Table AI.2), petroleum still accounted for around 64% of merchandise exports in 1999.⁸ Bahrain's other major exports include non-ferrous metals (18.7% of merchandise exports), textiles and clothing (5.9%), ores and other minerals (4.1%) and chemicals (2.7%). Bahrain's main imports are petroleum (37.2% of total merchandise imports), machinery and transport equipment (18.2%) and agriculture (13.7%).

Chart I.2
Balance of payments, 1995-2000



a Estimated data.

b Projected data.

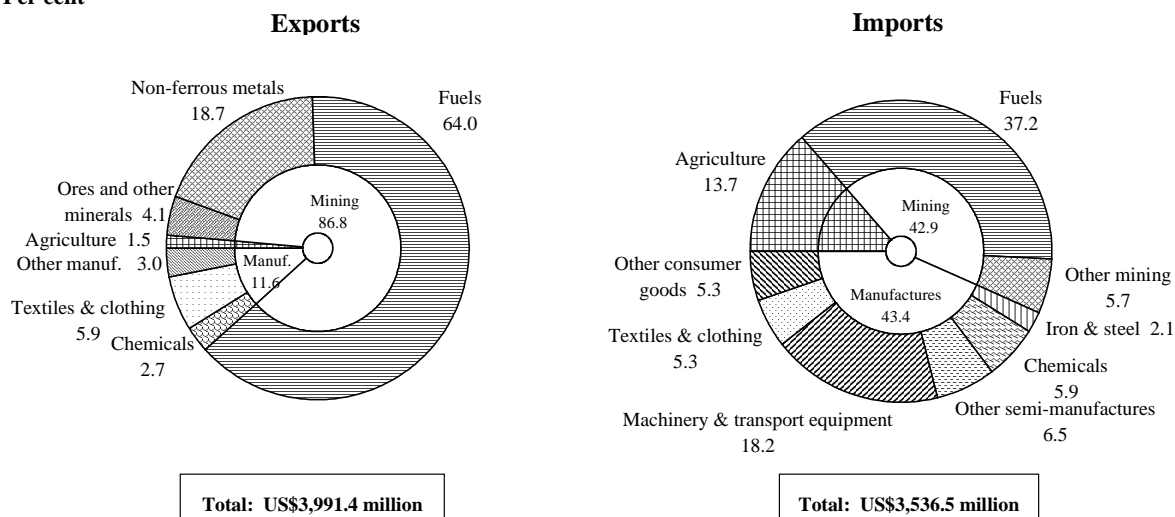
Source: Data provided by the authorities.

16. Non-oil exports are dominated by non-ferrous metals, the majority of which is aluminium (accounting for around 52% of non-oil merchandise exports in 1999), followed by textiles and clothing (16.5%), ores and other minerals (11.4%) and chemicals (7.5%) (Chart I.4). Major non-oil imports include machinery and transport equipment (29% of non-oil imports in 1999), agriculture (21.9%), other semi-manufactures (10.4%), chemicals (9.4%) and mining (9.1%).

⁸ Data on export and import shares of sectors may vary from those presented in Chapter IV due to the different nomenclatures used. Data in Chapter I are based on SITC Rev.1, whereas data in Chapter IV are based on ISIC.

Chart I.3**Product composition of merchandise trade, 1999**

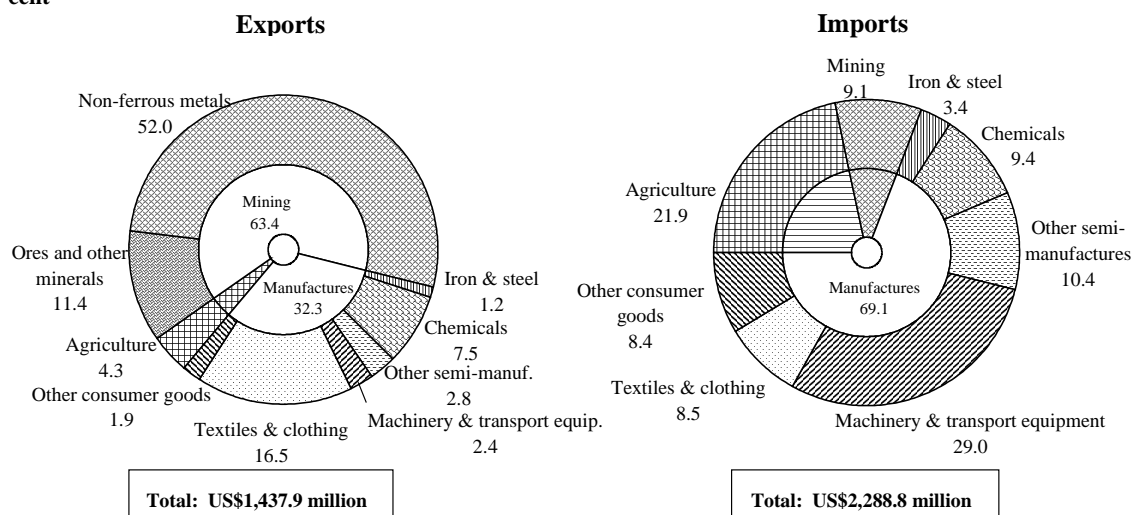
Per cent



Source: Data provided by the authorities; and Bahrain Monetary Authority (1999), *Quarterly Statistical Bulletin*, Vol. 25 No. 4, December.

Chart I.4**Non-oil product composition of merchandise trade, 1999**

Per cent



Note: Excluding petroleum (HS 2709), representing 64.0% of exports and 37.2% of imports.

Source: Data provided by the authorities; and Bahrain Monetary Authority (1999), *Quarterly Statistical Bulletin*, Vol. 25 No. 4, December.

17. Trade in services grew during the 1990s. In 1998 Bahrain's receipts from trade in services were US\$769 million, compared with US\$411 million in 1991, while debits were US\$740 million in 1998, growing slightly from US\$710 million in 1991.⁹ Bahrain's main services exports are travel

⁹ IMF (2000).

(47.6% of total services receipts), air transportation services (33.7%), and other business services (18.7%). In 1998, the main imports of services were freight transport by sea (43.2% of total debits from services trade), passenger air transport (24.9%), travel (19.2%), and other services (12.6%).

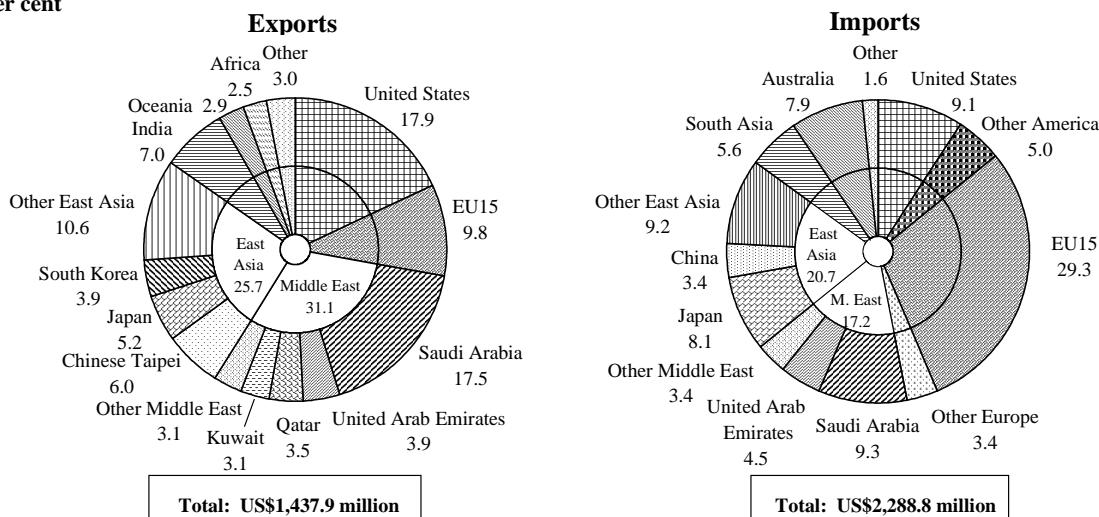
(ii) Direction of trade

18. The majority of Bahrain's non-oil merchandise exports, 31.1%, are destined for the Middle East (Chart I.5). The largest single destination is the United States, accounting for 17.9% of total exports in 1999, followed by Saudi Arabia with 17.5% and India at 7.0%. The European Union accounted for around 10% of total exports. Non-oil imports originate mainly in the European Union, with a share of around 29% in 1999. The largest single source of non-oil imports is Saudi Arabia at 9.3%, followed by the United States. Data, by partner, on trade in petroleum, which accounted for 64% of exports and 37.2% of imports in 1999, were not available.

Chart I.5

Direction of non-oil merchandise trade, 1999

Per cent



Note: Excluding petroleum (HS 2709), representing 64.0% of exports and 37.2% of imports.

Source: Data provided by the authorities; and Bahrain Monetary Authority (1999), *Quarterly Statistical Bulletin*, Vol. 25 No. 4, December.

19. Data on trade in services by partner are not available.

(3) TRENDS IN FOREIGN DIRECT INVESTMENT

20. In an attempt to improve economic growth, Bahrain has actively promoted investment, both foreign and domestic. Inflows of foreign direct investment (FDI) increased steadily from 1993 to 1996, when around US\$2.1 billion was invested in Bahrain. Since then, however, FDI inflows have fallen significantly, down to US\$329 million and US\$181 million in 1997 and 1998, respectively (Chart I.6).

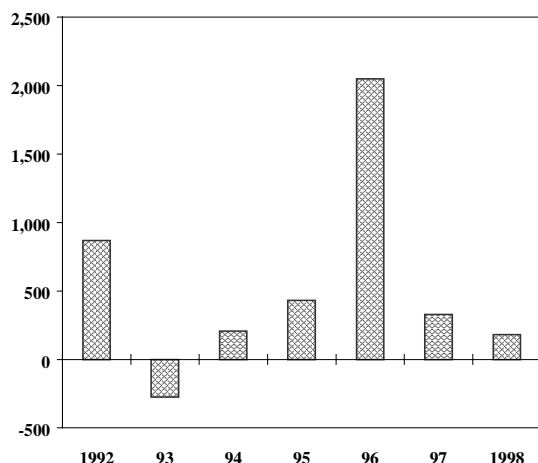
21. Data provided by the authorities show that the total stock of FDI in 1998 was some US\$700 million. The majority of this stock, around 60%, appears to be held by the United Arab Emirates (U.A.E.), followed by Kuwait (16.8%), Saudi Arabia (8.2%), and Qatar (6.6%). There appears to be very little FDI in Bahrain from outside the GCC region.

Chart I.6

Foreign direct investment (FDI)

FDI inflows, 1992-98

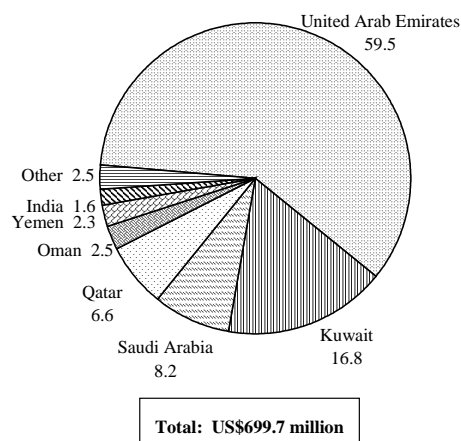
US\$ million



Source: International Monetary Fund, *International Financial Statistics* (various issues).

FDI by origin, 1998

Per cent



Source: Data provided by the authorities.

(4) OUTLOOK

22. Despite considerable success in increasing economic diversification, Bahrain's economy remains affected by volatility in the international market for petroleum products. The main challenges currently facing Bahrain are relatively low rates of real economic growth combined with low rates of private investment in the economy; a need for diversification to reduce Bahrain's vulnerability to international petroleum prices and declining reserves; and increasing unemployment, especially among Bahrainis. The Government's strategy has been to improve the economic climate for private domestic and foreign investment, while gradually restricting its own role to investment in large infrastructural projects. In this respect, new legislation has been enacted to raise limits on foreign investment in sectors of the economy that the Government believes play a key role in helping Bahrain to diversify its production base. A programme to improve fiscal management has also been initiated and includes contracting out some government services to the private sector; in the longer run, the privatization of some public sector companies is planned. The Government has also had an ongoing programme of Bahrainization, combining incentives for companies to employ Bahraini nationals with improved training methods.

23. As a result of these policies there was some success in raising the share of non-oil products in merchandise exports during the 1990s. Trade in services also expanded during this period. Private investment, including foreign direct investment flows, however, appear to have remained low, despite reform in this area, suggesting that the discretionary policy with regard to private investment in activities dominated by the public sector may also need to be addressed to make the environment more attractive to investors. The longer-term challenge remains that of raising real economic growth rates and increasing economic diversification. The Government has targeted services, especially financial services, and downstream manufacturing activities, and has further opened these activities to private investment. It is likely that the Government's privatization programme will have to be expanded, both to free up resources for the private sector but also to increase confidence in the economic reform programme.