

**LAPSE OF
TIME**

SM/22/144
Correction 1

July 27, 2022

To: Members of the Executive Board

From: The Acting Secretary

Subject: **Kingdom of Bahrain—Selected Issues**

Board Action:

The attached correction to SM/22/144 (6/9/22) has been provided by the staff:

**Factual Errors Not
Affecting the
Presentation of Staff's
Analysis or Views**

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Questions:

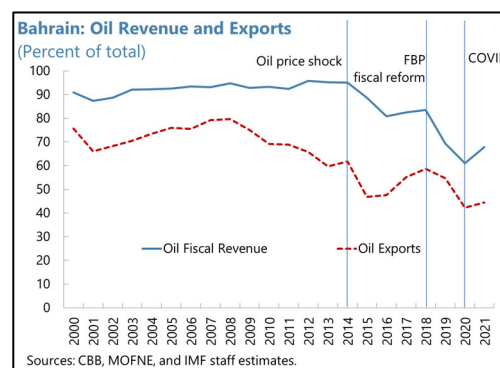
Ms. ElGanainy, MCD (ext. 39463)
Mr. Xin, MCD (ext. 36241)

BUILDING A LONG-TERM FISCAL POLICY FRAMEWORK¹

The Bahraini authorities are committed to implementing fiscal reforms to address large fiscal and external vulnerabilities, high debt, and reliance on oil revenue. However, medium- and long-term fiscal benchmarks, as well as unfavorable starting conditions for net financial wealth, call for ambitious fiscal efforts that should be embedded in a credible, well defined fiscal framework. The authorities launched the revised Fiscal Balance Program (FBP) that aims at achieving a fiscal surplus by 2024 and could deliver most of the needed post-crisis adjustment. This paper proposes a gradual transition from the current high-adjustment needs phase to a long-run steady state consistent with fiscal sustainability.

A. Introduction

1. Managing Bahrain's oil wealth is a central policy priority. Bahrain's economy is one of the most diversified in the GCC region with hydrocarbon extraction contributing approximately ~~1830~~ percent to Bahrain's real GDP. However, hydrocarbon revenues play a central role in both fiscal revenue and current account inflows. Oil fiscal revenue hovered around 90 percent of total revenue until the 2014 oil price shock, and, in more recent years, it declined to around 70 percent following the reforms introduced by the fiscal balance program (FBP) such as the introduction of VAT and excise taxes. The investment and redistribution of oil wealth in Bahrain allowed the rapid improvement of living standards, the development of a vibrant nonoil private sector, and the achievement of "high income" economy status.



2. Fiscal policy plays a key role in oil wealth redistribution and savings decisions. In the current oil sector set up, all revenue generated by the hydrocarbon sector accrues to the state monopolist—the National Oil and Gas Authority (NOGA), which oversees oil extraction, oil refining, and sets domestic prices of hydrocarbons. Each year, NOGA transfers directly into the budget what becomes the year's oil revenue. Through the Budget Law, the Ministry of Finance and National Economy (MOFNE) allocates oil revenues to savings for future generations and expenditures. Oil revenue redistribution to citizens over the years has been achieved through large public sector employment, a generous subsidy system, and significant capital expenditure (see IMF 2020a).

3. Bahrain's fiscal position deteriorated sharply with the 2014-15 oil-price shock and more recently with the COVID-19 pandemic. Oil revenue in 2015 plummeted to 13.8 percent of GDP from 21.4 a year earlier and, with a mostly inelastic expenditure side, the fiscal deficit reached

¹ Prepared by Giovanni Ugazio.