

I. ECONOMIC ENVIRONMENT

(1) INTRODUCTION

1. Brunei Darussalam is a small, relatively open economy and has one of the highest standards of living amongst its ASEAN partners with an estimated per capita income of over US\$30,000, almost double its level at the beginning of the review period, in 2002 (Table I.1). Situated on the northern end of the island of Borneo, Brunei has a total area of 5,765 square kilometres, some 80% of it forested. Brunei's population in 2006 was estimated at around 383,000, of which, it appears, some 20% are expatriate workers. The economy grew at a modest and stable annual average real rate of 2.5% between 2002 and 2006. The Government provides a wide range of free or heavily subsidized public services and employs 25% of the labour force.¹ However, some of its policies, practices, and measures, including those pertaining to trade and foreign investment, are rather opaque.

2. The country continues to owe its economic prosperity overwhelmingly to its abundant petroleum and natural gas resources, whose share of current GDP grew from 53% in 2002 to 69% in 2006; in the same period, the share of petroleum and liquefied natural gas in exports rose from 88% to 96% and its share in total government revenue increased from 86% to 94%. The oil and gas sector's increased shares of GDP and exports, together with its contribution to government revenue, are largely due to the rise in oil and gas prices.

Table I.1
Basic economic and social indicators, 2002-06

	2002	2003	2004	2005	2006
Real GDP (B\$ million, 2000 prices)	11,041.5	11,362.1	11,419.4	11,463.7	12,053.0
Real GDP (US\$ million, 2000 prices)	6,166.4	6,521.8	6,756.1	6,887.6	7,585.4
Current GDP (B\$ million)	10,463.1	11,424.2	13,305.8	15,864.1	18,370.2
Current GDP (US\$ million)	5,843.4	6,557.4	7,872.2	9,531.4	11,561.0
GDP per capita (B\$)	30,398.0	32,678.0	37,188.0	42,864.0	47,964.0
GDP per capita (US\$)	16,976.5	18,757.0	22,001.7	25,753.4	30,185.4
	<i>(Annual percentage change)</i>				
GDP by economic activity at constant 2000 prices					
Oil and gas sector	3.2	4.5	-1.0	-2.6	5.7
Oil and gas mining	3.3	3.7	-0.7	-2.7	6.1
Oil and gas manufacturing	2.7	7.2	-2.0	-2.2	4.5
Non-oil and gas sector	4.8	0.9	2.5	4.1	4.5
Government services	1.7	-0.5	3.1	2.9	8.9
Private sector	6.5	1.6	2.2	4.8	2.2
Agriculture, forestry and fishery	5.2	11.3	12.0	1.3	-9.9
Non-oil & gas manufacturing	30.6	-15.9	4.0	-0.4	-19.0
Electricity and water	5.5	3.8	0.4	4.1	0.1
Construction	9.3	2.9	4.2	8.0	-3.7
Wholesale and retail trade	12.3	6.0	3.1	2.2	2.6
Hotels and restaurants	-0.6	1.9	4.9	-29.5	3.4
Transport and communication	6.4	2.0	-3.6	4.1	0.9
Finance	-0.5	3.1	5.2	9.9	13.9
Business	-5.2	8.2	3.0	5.4	15.2

Table I.1 (cont'd)

¹ The authorities consider that government subsidies have helped to lower household income inequality in Brunei as measured by the Gini Coefficient, which declined from 0.413 in 1998 to 0.401 in 2005.

	2002	2003	2004	2005	2006
Real estate and ownership of dwellings	2.8	-1.1	0.3	1.2	0.3
Private health and education	33.6	9.0	7.2	68.3	1.8
Other services	2.3	-5.9	-10.5	-3.9	5.9
			(Per cent)		
Share of main sectors in current GDP					
Oil and gas sector	52.9	57.2	61.9	66.4	68.8
Oil and gas mining	40.4	44.5	50.7	55.9	59.4
Oil and gas manufacturing	12.5	12.7	11.2	10.5	9.4
Non-oil and gas sector	47.1	42.8	38.1	33.6	31.2
Government services	16.3	14.8	13.4	11.6	10.9
Private sector	30.8	28.1	24.7	21.9	20.3
Agriculture, forestry and fishery	1.1	1.2	1.1	0.9	0.7
Non-oil & gas manufacturing	3.2	2.6	2.1	1.8	1.1
Electricity and water	0.9	0.9	0.7	0.7	0.6
Construction	3.7	3.5	3.2	2.6	2.9
Wholesale and retail trade	3.9	3.6	3.3	2.9	2.6
Hotels and restaurants	0.6	0.6	0.5	0.4	0.4
Transport and communication	4.1	3.9	3.4	2.9	2.7
Finance	3.4	3.1	2.8	3.0	3.0
Business	4.6	3.8	3.3	2.9	2.9
Real estate and ownership of dwellings	3.9	3.5	3.1	2.6	2.3
Private health and education	0.5	0.5	0.5	0.7	0.6
Other services	1.0	0.9	0.7	0.6	0.5
Memorandum					
Population ('000)	340.8	348.8	359.7	370.1	383.0
Annual rate of increase (%)	2.4	2.3	3.1	2.9	3.5
Migrant workers ('000)	..	..	..	..	76.0
Life expectancy at birth (years)	75.8	75.9	76.1	75.8	..
Infant mortality rate (per 1,000 live births)	8.3	9.5	8.8	7.4	6.8

.. Not available.

Source: Department of Statistics, Department of Economic Planning and Development, *Brunei Darussalam Statistical Yearbook 2005* and 2006; and *Brunei Darussalam Key Indicators (various issues)*; and data provided by the authorities.

3. Petroleum's large share of GDP has continued to be a cause for concern in recent years, mainly due to fluctuating international prices, which leaves Brunei vulnerable to an eventual depletion of resources over the next two to three decades. Since 2000, when the Government issued a landmark report acknowledging the country's lack of a sufficiently diversified economic base², a series of plans to reduce unemployment, attract new foreign investment, and restructure the economy away from over-dependence on limited petroleum reserves have largely failed to achieve the desired changes.

² Following the regional crisis and the collapse of the local Amedeo Development Corporation (ADC), Brunei's largest non-government employer, the Government set up the Brunei Darussalam Economic Council (BDEC) in 1998 to examine the economic situation of the country. In its report, the BDEC warned that the Bruneian economy was unsustainable, citing the inability of income growth to keep pace with the rising population and unemployment; the Government's chronic budget deficit; and Brunei's weak private sector. Highlights of the report can be found in the 2001 Trade Policy Review of Brunei (document WT/TPR/S/84, pp. 5-6). The Secretariat of the BDEC was subsequently renamed the Department of Economic Planning and Development, and moved to the Prime Minister's Office.

(2) RECENT ECONOMIC DEVELOPMENTS**(i) Macroeconomic performance****(a) Overall trends**

4. By the start of the review period in 2002, the overall level of economic activity had recovered from the recession of the late 1990s.³ Real GDP growth picked up from 2.7% in 2001 to 3.9% in 2002, reflecting increased production of oil and gas and government development spending. GDP growth slowed to 0.5% and 0.4% in 2004 and 2005 respectively, owing to temporarily lower oil and gas production as production facilities were repaired and upgraded. Non-oil economic activity, however, strengthened, reflecting large oil revenue inflows and increased government spending. Based on the new national accounts data for 2006, annual economic growth was estimated to have been 5.1%, due primarily to high energy prices and thus strong earnings from oil and gas exports (Table I.2). The non-oil and gas sector, benefiting from the spillovers from higher oil prices, grew by 4.5% year-on-year.

Table I.2
Selected macroeconomic indicators, 2002-06

	2002	2003	2004	2005	2006 ^a
National accounts					
			<i>(Percentage change)</i>		
Real GDP (2000 prices)	3.9	2.9	0.5	0.4	5.1
Consumption	-0.7	6.3	8.4	-0.8	7.8
Private consumption expenditure	0.7	15.8	12.3	-0.6	3.7
Government consumption expenditure	-2.0	-2.6	4.1	-1.0	12.8
Gross fixed capital formation	43.2	-21.0	2.9	0.8	1.7
Exports of goods and non-factor services	5.8	2.3	-0.7	-1.3	3.7
Imports of goods and non-factor services	13.3	-8.1	3.8	2.8	4.1
Unemployment rate (%)	3.5	4.5	3.5	4.3	4.0
Prices and interest rates					
			<i>(Per cent)</i>		
Inflation (CPI, % change (2000=100))	-2.3	0.3	0.9	1.1	0.2
Deposit rate (end-of-period)	..	1.06	1.04	1.01	1.04
Prime lending rate (end-of-period)	5.50	5.50	5.50	5.50	5.50
Money credit (end period)^b					
			<i>(Percentage change)</i>		
M1	9.8	3.0	9.0	1.3	10.9
M2	1.9	4.0	16.0	-4.5	2.2
Credit to private sector	4.3	3.4	6.4	3.5	-0.9
Exchange rate					
B\$/US\$ (annual average)	1.791	1.742	1.690	1.664	1.589
Real effective exchange rate (% change)	-1.0	-1.8	-0.6	0.8	..
Nominal effective exchange rate (% change)	-1.5	-2.7	-2.2	-0.6	..

Table I.2 (cont'd)

³ Brunei's abundant natural resources had for years ensured a high standard of living for its citizens. A combination of internal and external shocks during 1997 and 1998, however, led to a contraction of the economy in 1998. Contributing factors included a sharp decline in international petroleum prices, the regional economic crisis, and the collapse of the Amedeo Corporation, which had interests in a number of sectors, including construction and telecommunications services. Although the shocks were cushioned by transfers from the Brunei Investment Agency (BIA), fluctuations in international petroleum prices in particular highlighted the need for a more stable source of government revenue (e.g. by widening the tax base) and policies to encourage economic diversification and private-sector participation in the economy.

	2002	2003	2004	2005	2006 ^a
	<i>(Per cent of GDP, unless otherwise indicated)</i>				
Government balance^c	-5.0	5.5	11.3	21.1	21.3
Revenue	40.8	55.8	48.1	53.2	50.0
Tax revenue	22.3	30.0	27.7	33.1	30.0
Non-tax revenue	18.5	25.8	20.4	20.1	20.0
Expenditure	45.8	50.3	36.8	32.1	28.7
Current expenditure	36.1	40.2	30.1	25.8	21.9
Capital expenditure	9.7	10.1	6.7	6.4	31.0
Government total debt (end-period, calendar year)	..	..	..	..	..
Domestic debt	..	..	..	..	..
Saving and investment					
Gross national savings	47.2	48.6	51.4	59.1	62.4
Gross domestic investment	21.3	15.1	13.5	11.4	10.4
Savings-investment gap	26.0	33.6	37.9	47.8	52.1
External sector					
Current account balance	42.5	49.6	47.9	56.0	60.2
Net merchandise trade	37.5	48.3	47.3	50.7	56.8
Merchandise exports	63.4	67.4	64.2	65.6	70.0
Oil and gas	55.8	59.1	58.7	61.8	66.5
Merchandise imports	25.8	19.1	17.0	14.8	13.1
Services balance	-7.9	-9.1	-6.7	-5.2	-4.4
Capital account	-0.0	-0.0	-0.1	-0.1	..
Financial account	-6.9	-24.3	-26.3	-20.6	..
Direct investment	4.0	1.9	0.9	1.8	..
Overall balance of payments	0.8	0.7	0.3	-0.1	..
Errors and omissions	-34.8	-24.6	-21.2	-35.4	..
Merchandise exports (% change)	1.7	19.4	14.4	23.6	29.4
Merchandise imports (% change)	37.3	-16.9	6.5	5.8	7.6
Service exports (% change)	-10.6	-0.5	24.8	13.6	19.9
Service imports (% change)	-16.2	14.8	4.4	3.4	8.5
Foreign exchange reserves ^d (US\$ million, end-period)	437.8	481.5	505.1	494.2	523.3
in months of imports ^e	2.3	2.4	2.4	2.2	..
Total external debt (US\$ billion; end-period)	..	..	..	..	..
Debt service ratio	..	..	..	..	..

.. Not available.

a Provisional.

b M1 equals the sum of currency outside deposit money banks and demand deposits other than those of the central government. M2 equals M1 plus time, savings, and foreign currency deposits of resident sectors other than central bank.

c From 2004, Brunei's government data changed from calendar year to fiscal year (April-March). Data for 2003 include January 2003 to March 2004.

d Excluding gold and including SDR holdings and reserve position in the Fund.

e Next year's imports of goods and services.

Source: Department of Economic Planning and Development, *Brunei Darussalam Statistical Yearbook 2006* and *Brunei Darussalam Key Indicators (various issues)*; IMF, *International Financial Statistics*; IMF Country Report No. 06/428, *Brunei Darussalam: Statistical Appendix*, December 2006; and data provided by the authorities.

5. With an expected decrease in oil and gas output, real economic growth for 2007 is expected to be sluggish. The IMF estimates a growth rate of 1.9%⁴, and the Brunei authorities' published figures for the first two quarters of 2007 show growth of 0.3% in the second quarter following negative growth of 3.6% in the first three months of 2007.⁵ Furthermore, the non-energy sector, helped by the

⁴ IMF (2007).

⁵ Department of Economic Planning and Development (2007b).

construction of a methanol plant, is recording steady growth in Brunei, which would be more in line with long-term economic plans. Although petroleum products still account for more than two thirds of the economy, the contribution of financial services, food retailing, and private health and education to GDP growth has increased in recent years.

(b) Employment

6. Brunei's population is growing at an annual rate of about 3%, and reached an estimated 383,000 in 2006 (Table I.1). Out of an estimated working-age population of 180,400 in 2006, about 173,100 were economically active (Table I.3). Relatively high salaries and generous benefits offered by the Government continue to act as a disincentive to private sector employment, and according to the latest Labour Department statistics, 25% of the working population is employed by the Government.

Table I.3
Brunei labour statistics, 2001-06

	2001	2002	2003	2004	2005	2006
Labour force ('000)	154.2	158.8	158.9	164.4	169.2	180.4
Employed ('000)	145.6	153.3	151.8	158.6	162.0	173.1
Labour force participation rate (%)	69.3	69.8	69.8	69.9	70.0	71.7
Unemployed ('000)	8.6	5.5	7.1	5.8	7.2	7.3
Unemployment rate (%)	5.6	3.5	4.5	3.5	4.3	4.0
Government sector employment						
(number of persons)						
Total government employees	39,671	41,066	41,505	42,191	43,469	43,516
Division I: heads of department/section	566	599	640	662	711	788
Division II: Senior officers	5,447	5,736	6,165	6,759	7,351	7,615
Division III: Supervisory	10,062	10,400	10,269	10,266	10,206	10,167
Division IV: Clerical and operators	11,358	11,644	11,651	11,571	11,818	11,618
Division V: Clerical and operators	12,238	12,687	12,780	12,933	13,383	13,328
Private sector employment by industry (number of persons)						
Agriculture, forestry, and fishing	3,942	4,235	4,196	4,465	4,832	..
Production of oil and liquefied natural gas	3,701	3,920	4,215	4,590	4,379	..
Sawmilling and timber processing	628	701	662	681	673	..
Other mining, quarrying, and manufacturing	16,304	19,098	19,204	21,560	18,508	..
Construction	27,597	28,667	28,315	27,236	26,900	..
Wholesale and retail trade	16,537	15,144	16,280	16,740	16,863	..
Coffee shop, restaurants, and hotels	8,404	7,926	9,239	9,582	10,079	..
Transport, storage, and communication	5,232	5,063	5,174	5,122	5,258	..
Financial, insurance, and business services	6,522	6,739	6,854	7,082	7,475	..
Other community, social and personal service activities	9,505	9,098	10,681	11,413	11,853	..
All industries	98,372	100,591	104,820	108,471	106,820	..

.. Not available.

Note: Between 2001 and 2005, figures for government sector employment plus private sector employment are approximately 5,000 to 12,000 lower than the number of employed (shown in line 2), depending on the year.

Source: Department of Economic Planning and Development (2006 and 2007), "Labour Department's Annual Census on Employees", *Brunei Darussalam Statistical Yearbook 2005 and 2006*.

7. Other large-scale employers are Brunei Shell Petroleum and Royal Brunei Airlines. The "Bruneization" policy, which encourages companies to give preference to Bruneians in their employment policies, and which was put in place to reduce unemployment among Bruneians, has been successful mainly in the government and petroleum sectors. It is estimated that over 90% of the Bruneian labour force are employed by the public sector, including state-owned enterprises. In the private sector, chronic labour shortages, in professional and unskilled areas, have been alleviated by the recruitment of foreign workers, who made up an estimated 44% of the total working population in 2006. According to the latest (2005) figures for the private sector, employment is concentrated in the construction sector (over 17% of total employment), followed by non-oil and -gas mining, quarrying, and manufacturing (11%) and wholesale and retail trading (10%).

8. Despite the need for foreign workers and the underlying excess demand for labour, registered unemployment is estimated at about 4%, owing to the reluctance of Bruneians to accept manual-type employment (in construction, for example) and an apparent mismatch between vacancies and suitably qualified candidates. It seems, however, that actual unemployment may be higher, as many unemployed people fail to register, particularly teenagers. The Brunei Darussalam Economic Council suggested almost ten years ago, that economic growth must be faster in order for Brunei to absorb its growing labour force. The Government has thus been encouraging economic diversification, mainly into manufacturing and services, especially financial services, tourism, and transport.

9. Despite encouragement and a recent freeze in government salaries, it has been difficult for the private sector to compete for labour. The Government remains the most attractive employer in Brunei; the annual salary is supplemented by various allowances and benefits including rent subsidy, low interest housing and car loans, and an allowance for the *haj* pilgrimage. This is the case in particular for small and medium-sized enterprises (SMEs), which are encouraged by the Government through various tax and non-tax incentives. The authorities, however, maintain that the gap between public and private sector salaries has been declining owing to a freeze on salaries in the public sector.

10. An Employees Pension Fund, created in January 1993, required mandatory contributions by employers for private-sector employees, in the hope that this would improve the attractiveness of jobs in the private sector. In addition, the Government pledged to increase expenditure devoted to human resource development during the 8th Plan period (2001-05).

(c) Prices

11. Overall, inflation, as measured by changes in the CPI, has remained subdued at (mainly) under 1%, supported by the currency board arrangement fixing the exchange rate at par with the Singapore dollar. Consumer prices rose by 1.2% in 2005 before falling back to 0.2% in 2006. While inflation in Brunei has generally moved in line with trend price developments in Singapore, because of the currency peg, deviations in overall annual inflation performance can arise through supply disruptions, changes in administered prices, price developments in the non-traded goods sector, and the composition and pattern of imports. Inflation continues to be constrained by the imposition of price controls and subsidies on essential foods and petrol.

(ii) Macroeconomic policies

(a) Fiscal policy

Overview

12. With revenue heavily dependent on petroleum and natural gas, and a narrow tax base (consisting mainly of corporate taxes levied on oil and gas companies), the overall budget was in

deficit in 2002, at 5% of GDP, but rising petroleum prices have resulted in a surplus, reaching an estimated 21% of GDP in 2006. In 2006, tax revenue accounted for 30% of GDP, a considerable increase over its 2002 share (22%) due to higher income tax receipts from oil and gas companies (Table I.2 and Table AI.1). Non-tax revenue increased its share of GDP in the same period from 18.5% to 20%, due mostly to oil/gas-related dividends and to royalties rising from B\$1.6 billion to B\$2 billion.

13. Brunei's economic growth is due in large part to high energy prices. The saving of windfall revenues associated with those high energy prices has helped stabilize the economic cycle and provided a comfortable fiscal position. The fiscal surplus for FY2005/06 was much larger than budgeted due to high energy prices and slow expenditure execution. Energy-related revenues were more than double the budget projections, which were based on an average oil price of US\$25 per barrel. The FY2006/07 budget, projected to be in balance, and presented for the first time to the Legislative Council, is also based on conservative oil and gas price assumptions, suggesting another significant revenue windfall.

14. The Ministry of Finance has apparently drawn up a strategic plan aimed at achieving long-term fiscal stability⁶; minimizing the economic impact from short-term revenue volatility, and preparing for the eventual depletion of hydrocarbon reserves; strengthening non-oil revenues; containing the size of the government and public sector wage bill; and reducing subsidies. The IMF has pointed out that fiscal management could be further strengthened by improving the governance framework for the two oil-related funds⁷, the Consolidated Fund and General Reserve Fund.

Revenue

15. Government revenues continue to be dominated by receipts from the hydrocarbon sector in the form of corporate income tax, royalties, and dividends. Consequently, revenues fluctuate with oil and gas production and prices, and the profitability of the oil and gas industry. Oil and gas sector revenue as a share of total revenue increased from 87% in 2001 to 94% in 2006 (Table AI.1). With over 90% of revenues coming from oil and gas, sustainability appears to be the main medium-term concern.

16. In 2006, royalties and dividends from oil and gas accounted for 89% of total non-tax revenue, while corporate taxes from oil and gas companies accounted for some 98% of total corporate tax revenue. Brunei has no personal income tax or sales taxes. The corporate income tax rate is 55% for petroleum companies and natural gas companies, both of which pay taxes on a quarterly basis, and 30% for all other companies that are not included under tax exemption schemes. Corporate tax accounted for the largest share of tax revenue in 2006 at around 98%; the other major tax is customs duty, which accounted for around 1.9%, down from 4.8% of tax revenue in 2002. Other minor taxes are those on goods and services, estate duty, and stamp duty.

Expenditure

17. The Government's budgetary expenditure consists of current expenditures (which includes public sector salaries, pensions and gratuities, and operational costs) and capital expenditure (which includes "development expenditure" or spending decided in the context of the five-year NDPs). Brunei's budget policy is founded on the principle that all its people should share in the revenues from the exploitation of oil and gas and, based on this policy, current expenditure has provided public

⁶ It is not clear whether this includes a broadening of the tax base.

⁷ IMF, *Public Information Notice No.06/137*, December. Viewed at: <http://www.imf.org/external/np/sec/pn/2006/pn06137.htm>.

sector employees with generous remuneration and an elaborate welfare system. Current expenditure accounted for over one third of GDP in 2002; this fell to 23% of GDP in 2006 (Table AI.2), reflecting restraints on government salaries and employment. Nevertheless, it appears that since 2006 the Government again needs to monitor its growing expenditures following a salary increase for civil servants and recent increases in 2007 for health and education expenditures.

The National Development Plan and other expenditure

18. While the main objective of NDPs has been to diversify the economic base through expansion of agriculture and industry, the emphasis has tended to shift on different spending categories. Under the 8th NDP (2001-05), for example, the structural reforms to promote economic diversification included: encouraging oil and gas downstream activities, such as petrochemical and gas-based industries and refining; promoting Brunei as a services hub for tourism, transshipment, and promotion of the Brunei international financial centre; and developing agriculture and fisheries, to provide for Brunei's domestic requirements and promote exports of halal food. The aim was to achieve economic growth of 5% to 6% per annum during the plan period, noting that productivity needed to be enhanced in value-added activities including technology-intensive industries.⁸ B\$7.3 billion was allocated for the 8th Plan, of which the Government intended to provide only B\$2.9 billion. For the first time, foreign and local investors were to supply the remaining funding.

19. Expenditure under the 8th Plan was concentrated in social services (19.9% of total development spending), public utilities (16%), transport and communications (11%), and industry and commerce (15%).⁹ In FY2005/06, actual expenditures were around 90% of the full-year target, mainly due to slow execution of development spending. It appears that generally disbursement increasingly fell behind schedule, reflecting in part a lack of administrative capacity. The authorities have provided a brief assessment of progress under the plan and the extent to which targets were met; annual economic growth during the period was under half of the targeted growth (Box I.1). The authorities have indicated to the Secretariat that after 20 years of development, significant achievements were made in improving the quality of life, maintaining a low inflation rate and a clean and healthy environment. However, progress has been slow to moderate in human resource development, maintaining full employment, increasing the level of productivity, and the development of the non-oil and gas industry.

20. Other expenditures are made through a number of government funds. The General Reserve Fund (GRF), administered by the autonomous Brunei Investment Agency (BIA), is a sovereign wealth fund containing savings set aside for future generations; information on this fund is not available as the BIA presents its accounts only to the Sultan. There are two other reserve funds: the Consolidated Fund (CF), administered by the Ministry of Finance, comprising the Government's tax and non-tax revenues (including transfers from the GRF), and from which the Government's ordinary and charged expenditures are paid; and the Development Fund, allocated in accordance with the NDP from which development expenditures are paid. The Government Trust Fund, another extra-budgetary fund, finances loans on favourable terms to government employees.

⁸ Brunei Darussalam National Development Plan Committee (2001), p. 20.

⁹ Brunei Economic Development Board (undated).

Box I.1: Assessment by the Brunei authorities of the 8th National Development Plan (NDP)

The 8th NDP, which began in 2001 and ended in 2005, was the fourth and last phase in the implementation of the 20-year long-term national development plan, which started in 1986.

The objectives of the 8th NDP were to: improve the quality of life of the people; maximize the economic utilization of national resources; develop non-oil industries (diversification of the economy); accelerate human resources development so as to meet demand of an increasingly sophisticated economy; maintain full employment and increase productivity; maintain a moderate rate of inflation; foster a more disciplined, self-reliant, and caring society; encourage and nurture the development of *Rakyat Melayu (Malay Citizen)* as leaders of industry and commerce; and have a clean and healthy environment.

The 8th NDP achieved some of its objectives in terms of developing the transport and communications sector, though it encountered difficulties in several key areas, such as increasing the contributions of the non-oil and private sector to GDP.

There have been significant achievements in some of the development objectives, such as quality of life, low inflation rate, and a healthy environment. More progress has been made in the development of non-oil industries and the creation of a disciplined and caring society *vis-à-vis* the fostering of self-reliance and the advancement of Malay citizens as leaders of industry and commerce.

On the economic front, progress has been mixed. After a period of robust growth during the 1990s, Brunei's economy has shown signs of weakness in the aftermath of the Asian financial crisis. The 8th NDP did not achieve the desired target of annual growth in GDP of 5-6 %: average growth for the past few years has only been 2.1%. However, this average growth rate is better than the 1.3% rate during the 7th NDP.

The difficulties in meeting the targets were attributed to: over-dependency on the oil and gas sectors; continued reliance on fiscal stimulus from Government's development projects; human resource constraints; a relatively small presence of the private sector; and a small domestic market due to a very small population.

Source: Brunei authorities.

(b) Monetary and exchange rate policies

21. There is no central bank in Brunei. The Ministry of Finance – through the Treasury, the Brunei Currency and Monetary Board (BCMB), the Financial Institutions Division, and the Brunei Investment Agency – exercises most of the functions of a central bank. The Brunei Currency and Monetary Board Order 2004, which took effect on 1 February 2004, replacing the outdated Currency Act of 1967, established the BCMB.¹⁰ The BCMB is the sole authority to issue and manage currency, and to maintain external reserves to safeguard the international value of the currency. Under the 2004 law, the BCMB may purchase, sell, discount, and rediscount Treasury Bills and short-term government securities denominated in Brunei dollars.

22. The Brunei authorities, who have limited monetary institutional capacities, remain committed to maintaining the Currency Interchangeability Agreement with Singapore.¹¹ Under this, Brunei has a currency board arrangement (CBA) whereby the Brunei dollar is pegged to the Singapore dollar at

¹⁰ According to the IMF, to further strengthen the credibility of the currency board arrangement, the BCMB should increase the minimum statutory foreign exchange coverage from 70% to 100% in line with international best practices and the actual coverage (IMF, 2006, p. 3).

¹¹ The Brunei dollar is issued by the Brunei Currency Board only against payments in, and at par with, the Singapore dollar, under the Currency Interchangeability Agreement, signed between the Brunei Currency Board and Singapore's Board of Commissioners of Currency of Singapore in 1967. Brunei's Currency Board deals only in Singapore dollars and does not quote rates for other currencies. There are no restrictions on commercial banks dealing in other foreign currencies and no exchange controls are imposed except on gold and jewellery, for which only banks licensed to operate in gold and jewellery may buy and sell gold bars. There are no capital controls, and no distinction is made between accounts held by Brunei nationals and non-nationals.

parity. The currency board system, anchored to the Singapore dollar, precludes an independent monetary policy.

23. The authorities appear to believe that the advantages of pegging the Brunei dollar to the Singapore dollar outweigh the disadvantages and that it imparts a high degree of stability to the financial system and the economy as a whole. One possible disadvantage is that the resulting steady effective appreciation of the Brunei dollar may impede the Government's efforts to diversify the economy and develop export industries. (The currency has strengthened steadily, trading at B\$1.51 to the U.S. dollar in April 2007.)

24. As with the exchange rate, trends in interest rates closely follow those in Singapore. Brunei's prime interest rates are set each month by the Brunei Bankers' Association, usually within a 0.25-0.5% margin of corresponding rates in Singapore, and act as a benchmark lending rate for commercial banks. The prime lending rate has remained a constant 5.5% since 2000. The authorities do not believe that prevailing interest rates in any way impede economic sector growth in Brunei.

(iii) Balance of payments

25. Sizable hydrocarbon exports and the steady accumulation of long-term foreign assets over many years have provided Brunei with a comfortable external payments position. During the period under review, Brunei's petroleum and natural gas reserves have in general ensured a sizeable surplus on the trade balance. Reflecting high energy prices, the external current account surplus widened to 56% of GDP in 2005 from 48% in 2004 and reached 60% in 2006 (Table I.2). This large surplus reflects the sizeable gap between savings and investment.

26. While the merchandise trade surplus grew from 37.5% of GDP in 2002 to more than 50% in 2006, the deficit on the services balance remained between 4% and 9%. Net outflows have occurred in the form of payments for foreign travel, trade-related transport, and occasionally high professional fees in the oil and gas sector. Both the trade and current account surpluses have shown increasing trends since 2002, due mainly to improved petroleum prices, but also to lower levels of imports over previous years. The value of exports as a share of GDP grew from around 63% in 2002 to 70% in 2006, while merchandise imports declined from 26% to 13%.

27. However, the overall balance of payments has recorded only small surpluses, of US\$24 million to 46 million since 2002; and a deficit of US\$11 million was recorded in 2005, owing, it appears, to huge unexplained negative items in the errors and omissions category.¹²

28. According to the Economist Intelligence Unit, Brunei's foreign assets are estimated at US\$30 billion, down from an estimated US\$80 billion in the early 1990s.¹³ The assets generate considerable investment income, which in many years seems to have exceeded the combined revenue from oil and gas, although the lack of available data on the Government's investment income renders the level of transparency of the BIA rather low. According to the Brunei Investment Agency Act¹⁴, the main aims of the BIA are the holding and management of the General Reserve Fund and all external assets of the Government, and providing money management services. The operations of the BIA are secret and Article 12 of the Act on the preservation of secrecy states that "no director, officer or employee of the Agency shall disclose to any person any information relating to the affairs of the

¹² According to data published by the IMF, errors and omissions were (in US\$): 2002: -2 billion; 2003: -1.6 billion; 2004: -1.7 billion; and 2005: -3.4 billion. The IMF notes that their "large scale reflects the lack of comprehensive balance-of-payments data" (IMF, 2006, p. 27).

¹³ Economist Intelligence Unit (2007), p. 20.

¹⁴ Brunei Investment Agency (2002).

Agency". The BIA is reported to have holdings in the United States, Japan, ASEAN countries, and Western Europe. A long-running dispute over billions of U.S. dollars, which it claimed were channelled from the BIA to private bank accounts during the 1990s, now appears to have been resolved.¹⁵

(iv) Structural policies: diversification of the economy

29. The authorities' medium-term economic objectives, as elaborated in the 8th National Development Plan, for the period 2001-05, were to diversify Brunei's productive base away from its heavy dependence on oil and gas and enhance economic efficiency by expanding the role of the private sector. The strategy to achieve these goals was based on a broad corporatization/privatization effort, greater foreign investment, and a more competitive labour market.

30. However, in 2007 as Brunei embarks on a new plan, its economy seems to have become even more heavily dependent on the oil and gas sector. Despite the Government's emphasis on diversification, non-oil and gas manufacturing remains weak and underdeveloped, and has shrunk to under 2% of current GDP. It would appear that, overall, Brunei's diversification policy has met with little success.

31. Despite some privatization in several key sectors of the economy, for example oil and gas, telecommunications, transport, and energy generation and distribution, there continues to be a strong government presence in the economy, often in the form of a state-owned monopolies, which can act unencumbered by any competition law. It appears that the resulting lack of competition has affected prices and the cost of doing business in Brunei. The very small size of the domestic market seems to discourage local and foreign participation in the economy and hampers the ability of non-oil and gas industries to achieve economies of scale and thus to compete against imports as well as in export markets.

32. The Government also continues to provide a wide range of subsidized public services and employs about half of the local labour force. Economic diversification remains seriously hampered by the relatively high level of remuneration in the government sector; the differential between public and private sector remuneration continues to act as a serious disincentive to private sector employment. Although tax and non-tax incentives are provided for investors in agriculture and a number of manufacturing activities, the non-oil, private sector – consisting mainly of SMEs providing around 90% of private sector employment – remains weak and dependent on government spending on construction and services.

33. The Brunei Economic Development Board, formed in 2001, has adopted a new approach to attract foreign direct investment (with a target of US\$4.5 billion) and job creation (7,700 new jobs by 2008) in a few large projects, including the Sungai Liang industrial site for petrochemical and manufacturing industries, which can capitalize on Brunei's proven gas reserves¹⁶, and the global mega

¹⁵ In an article of 9 November 2007, entitled "Hotels, houses, paintings and gems...the price of settling up with a sultan", the *Times online* reported that the Privy Council in London, Brunei's court of final appeal, settled the dispute between the Sultan and his youngest brother, a former chairman of the BIA, who was reportedly ordered to surrender several assets, including two hotels, three houses, diamonds, paintings and cash. Viewed at: <http://business.timesonline.co.uk/tol/business/law/article2836439.ece?print=yes&rand...> [9 November 2007].

¹⁶ In September 2004, the BEDB announced it had entered into final negotiations to establish a US\$720 million ammonia/urea plant and US\$350 million methanol plant. The Government has approved the methanol plant and is in the final stages of considering the proposed ammonia urea plant. If the project

port hub, which involves the construction of a deep water port facility (at Pulau Muara Besar). Efforts to develop private sector activities not directly related to the hydrocarbon sector and its downstream activities appear to remain hampered. Nevertheless, in the services sector, tourism and banking in particular are being encouraged with the development of the slowly but steadily increasing activities of the Brunei International Financial Centre (BIFC).

(3) DEVELOPMENTS IN TRADE

(i) Composition of trade

(a) Trade in goods

34. Brunei has had large surpluses on its balance of trade, owing to its exports of petroleum and natural gas. At the beginning of the review period, Brunei exported three times more than it imported in value terms, and by 2006 the value of exports was over four times higher than imports. Brunei's merchandise exports were US\$7.6 billion in 2006, more than double their value in 2002. Imports were US\$1.7 billion in 2006, up from US\$1.5 billion in 2002. (Charts I.1 and I.2 and Appendix Tables AI.3 to AI.6). The most significant development in the structure of exports is the steadily increasing share of mineral fuels, which includes petroleum and natural gas; this rose from 88% in 2002 to over 96% in 2006. During the review period, clothing accounted for a major share of non-mining and petroleum exports, declining from 5.8% in 2002 to under 2% in 2006. Similarly, Brunei's exports of machinery and transport equipment declined from almost 5% of merchandise exports in 2002 to around 1% in 2006.

35. Brunei imports almost everything, including most foodstuffs and beverages. Imports amounted to US\$1.7 billion in 2006 up from US\$1.5 billion in 2002, a 12% increase. The pattern of imports has not changed significantly; manufactured goods, machinery and transport equipment, and miscellaneous manufactures accounted for over 79% of total imports in 2006, down from nearly 85% in 2002. At over 17%, agriculture accounts for an increasing share of imports; the majority consists of food imports, which grew from almost 14% of total merchandise imports to 17% during the period.

(b) Trade in services

36. Balance-of-payments data indicate that the net services deficit has been substantial since 2001, when it was US\$580 million and declining to US\$466 million in 2006. Payments for services imports have generally been either slightly more or slightly less than US\$1 billion, and were US\$1.2 billion in 2006. In comparison, receipts for services exports were under US\$500 million between 1988 to 2003, increasing to US\$617 million in 2005 and US\$739 million in 2006. A breakdown of the data by major service sub-sectors is included in Table AI.7.

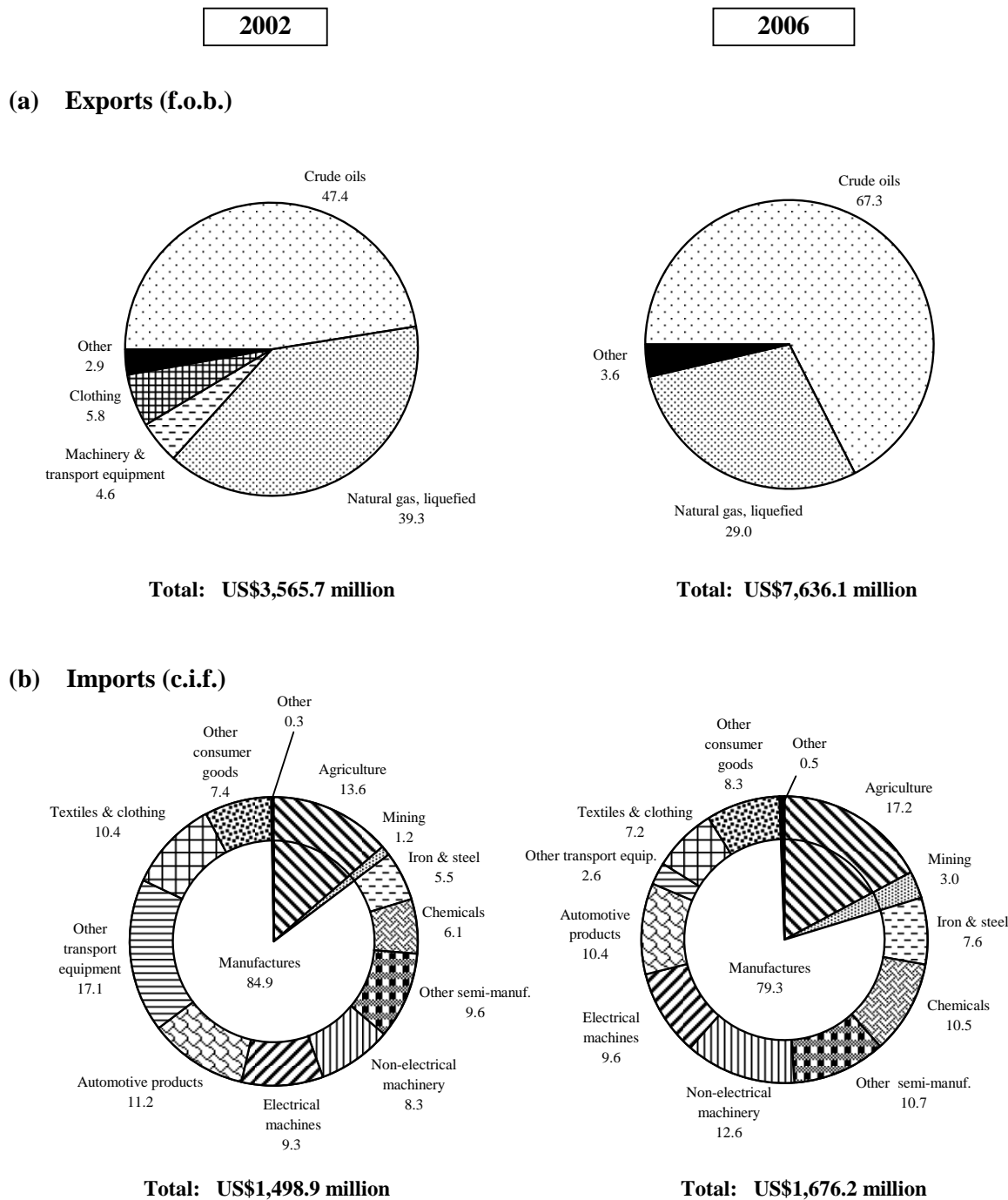
(ii) Direction of trade

37. Brunei's merchandise exports are mainly destined for the east Asian region. Japan remains Brunei's largest trading partner, although its share in exports fell from 40% in 2002 to around 30% in 2006. Exports, mainly of natural gas, have increased significantly to Korea, which accounted for 11.7% in 2002 and 15% in 2006. ASEAN's share increased from 22.5% in 2002 to 24.8% in 2006, with Indonesia in particular importing substantial quantities of crude petroleum in 2006. Outside the east Asian region, the shares of Australia and India have increased, whereas the shares of the United States and China have remained or declined. The share of the European Union was negligible in 2006 at 0.2%.

proceeds, the plant would be the largest urea manufacturing operation in Asia, with a capacity to manufacture 1.2 million tonnes of urea per year.

Chart I.1
Product composition of merchandise trade, 2002 and 2006

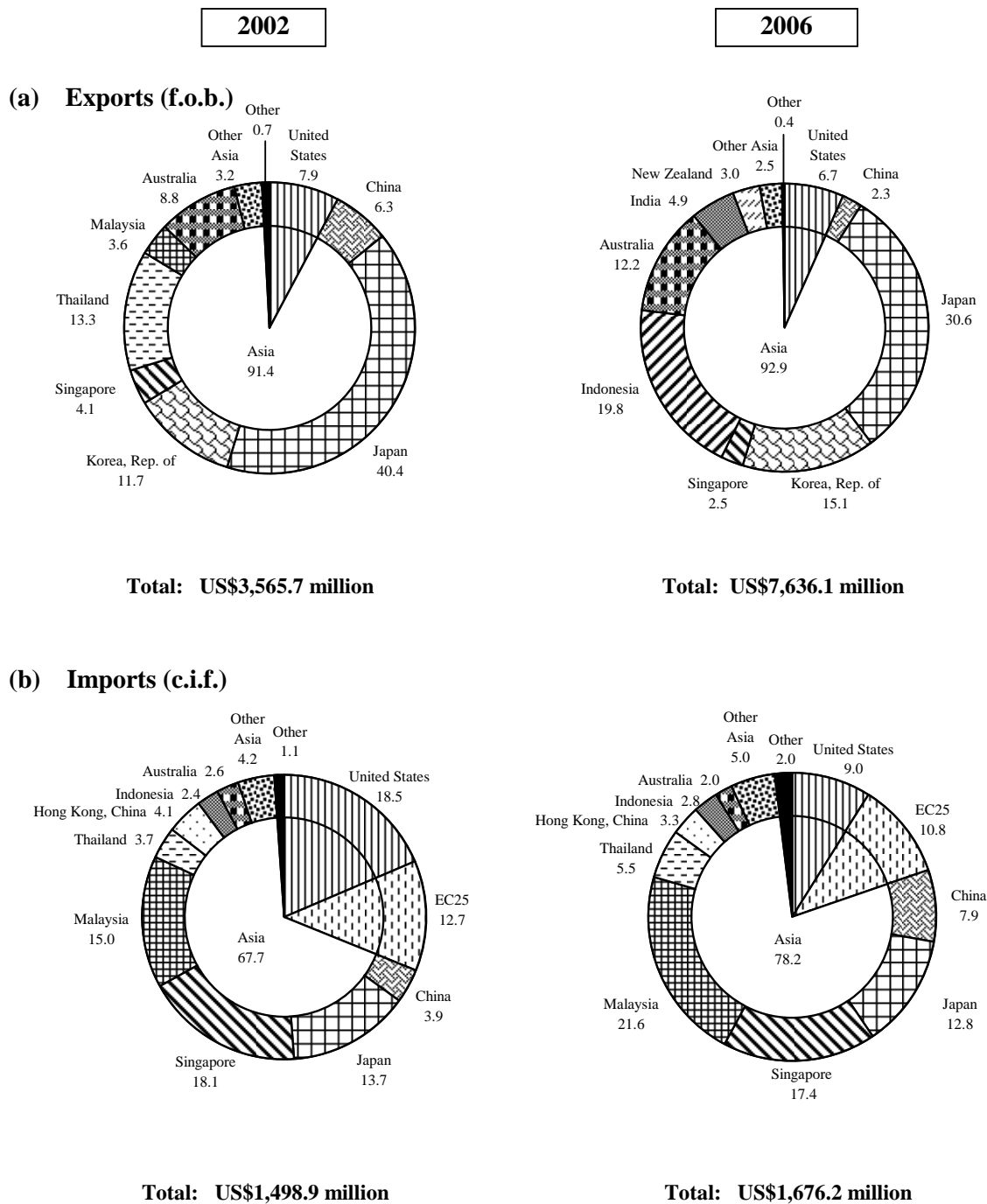
Per cent



Source : UNSD, Comtrade database (SITC Rev.3).

Chart I.2
Direction of merchandise trade, 2002 and 2006

Per cent



Source : UNSD, Comtrade database (SITC Rev.3).

38. Merchandise imports also originate mainly in east Asia. Malaysia has become the largest source of imports, increasing its share from 15% in 2002 to nearly 22% in 2006, followed by Singapore whose share declined slightly from 18% to 17%. Imports from ASEAN countries have grown steadily during the review period, to 48% in 2006, up from 39% in 2002, which suggests that the lowering of trade barriers within the ASEAN region through the ASEAN Free-Trade Agreement (AFTA) may have led to some trade diversion. Overall, Asian countries have increased their share of imports to Brunei from two thirds to over three quarters of total imports mainly at the expense of the United States and the EC whose shares declined from 18% to 9% and from 13% to 11%, respectively; the share of Hong Kong, China declined from 4% to 3% in the same period.

(4) DEVELOPMENTS IN FOREIGN DIRECT INVESTMENT

39. The authorities indicate that net foreign direct investment was slightly over US\$1 billion in 2002, then tripled to over US\$3 billion in 2003. Since 2003, FDI inflows have been somewhat volatile (Table I.4): in particular, oil and gas exploration and extraction accounted for virtually all of the US\$3 billion inflows in that year and for most of the inflows since then. An investment recovery since the start of the decade shows that net FDI has grown impressively and has been significantly higher than pre-crisis levels of around 4%, climbing to 17.7% of GDP in 2002, to an extraordinary 46% in 2003, before reverting to its more traditional level of between 3% and 4%. Most of the FDI flows went to the primary sector, in particular oil and gas, except in 2002, when more than half of foreign direct investment went to the tertiary sector.

Table I.4
Inflows of foreign direct investment by sector, 2002-06

	2002	2003	2004	2005	2006 ^a
Total inflows of FDI (B\$ million)	1,854.2	5,316.8	347.6	481.9	689.6
(US\$ million)	(1,035.5)	(3,051.8)	(205.7)	(289.5)	(434.0)
(as per cent of GDP)	(17.7)	(46.5)	(2.6)	(3.0)	(3.8)
	<i>(Per cent of total)</i>				
Agriculture, fishing, and forestry	0.2	0.0	0.0	0.0	5.6
Oil and gas	40.1	97.8	74.8	69.0	76.9
Manufacturing	3.1	1.2	12.9	22.1	15.0
Construction	0.2	0.4	2.4	1.1	0.7
Services	56.4	0.6	9.8	7.8	1.8
Wholesale and retail trade	0.8	0.3	6.3	5.6	1.3
Transport, storage, and communication	55.2	0.0	0.1	1.2	0.0
Hotels and restaurants	0.0	0.0	0.1	0.4	0.0
Real estate, renting, and business	0.0	0.3	2.8	0.6	0.4
Financial intermediation	0.0	0.0	0.5	0.0	0.0
Other	0.4	0.0	0.1	0.0	0.0

a Provisional.

Source: Department of Economic Planning and Development (2007), *Brunei Darussalam Statistical Yearbook 2006*.

40. FDI inflows have been dominated by investment from developed countries, the United Kingdom and the Netherlands being the two largest investors in 2002 and 2003. Since 2004, the United Kingdom has remained by far the largest investor, followed by France (Table I.5).

Table I.5
Inflows of foreign direct investment by country, 2002-06

	2002	2003	2004	2005	2006 ^a
Total inflows of FDI (B\$ million)	1,854.2	5,316.8	347.6	481.9	689.6
(US\$ million)	(1,035.5)	(3,051.8)	(205.7)	(289.5)	(434.0)
	<i>(Per cent of total)</i>				
ASEAN	2.1	1.2	9.3	6.8	2.2
Indonesia	0.3	0.1	0.5	0.4	0.0
Malaysia	0.6	0.5	6.3	4.9	1.8
Philippines	0.1	0.0	0.6	0.1	0.1
Singapore	0.9	0.5	1.8	1.4	0.4
EC(25) ^b	62.9	95.6	68.8	69.2	69.9
France	4.6	0.0	0.0	1.5	19.3
Netherlands	27.6	34.9	0.0	0.0	0.0
Spain	1.5	0.0	0.0	0.0	0.0
United Kingdom	29.2	60.8	68.3	67.7	50.5
Bermuda	1.6	0.0	6.6	6.5	7.7
Canada	0.0	0.0	0.0	0.0	3.0
China	0.0	0.0	1.4	0.0	1.1
Hong Kong, China	0.1	0.1	1.0	0.1	0.0
India	0.1	0.0	0.6	1.3	0.1
Japan	28.5	0.1	7.6	7.0	8.1
Korea, Rep. of	0.8	0.0	3.0	7.9	0.1
Mauritius	0.0	0.0	0.0	0.5	0.0
New Zealand	3.8	2.8	1.0	0.0	0.0
United States	0.0	0.0	0.0	0.0	7.3
Other	0.1	0.1	0.8	0.7	0.5

a Provisional.

b Up to 2005 EC(15).

Source: Department of Economic Planning and Development (2007), *Brunei Darussalam Statistical Yearbook 2006*.

(5) OUTLOOK

41. The major challenge to Brunei's economy stems from its continuing high dependence on oil and natural gas. The authorities need to deal with volatile government revenue caused by energy price instability, and prepare for the depletion of oil and gas resources by creating sustained growth in the non-oil private sector, while reducing the role of the Government. The Government recognizes the need for diversification away from petroleum and energy-based industries in the longer run, but to date Brunei's diversification policies seem to have met with little success.

42. A key, internal, long-term risk continues to be the slow pace of the Government's diversification programme. Implementation of the privatization plan, which has been ongoing for a decade or more, appears to have been slowed by concern about the effect of privatization on government revenue and prices. Despite investment incentives, the private sector in Brunei remains small and weak (a point noted by the Brunei Darussalam Economic Council eight years ago), in part because the public sector continues to be pervasive and provides attractive salaries with which very few private companies can compete. Efforts to develop the private sector are also hampered by the limited availability of human resources, particularly in the financial sector, which could reduce investor confidence.

43. A related factor is the apparent lack of transparency in government policies and the manner in which they are administered. Foreign investment policies, while encouraging investment in all sectors, are unclear about limits on foreign equity holdings and the sectors in which investment is restricted, thereby providing scope for discretion in government decision-making. According to the IMF, the financial and statistical database in Brunei is considered weak with regard to coverage, quality, timeliness, and frequency. Lack of reliable and timely data on, *inter alia*, investment income, balance of payments, monetary statistics, the labour market, and the national accounts, as well as scant or non-existent information about progress under the latest National Development Plan appear to highlight the general lack of transparency, and thus public accountability, in the management of the economy.