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RESEARCH ARTICLE

Shock-Absorption Capacity in MENAAP: A Regional Diagnostic Using the Policy Space Index

Alexei Kireyev¹

Abstract

This paper assesses the short-term shock-absorption capacity of the Middle East, North Africa, Afghanistan, and Pakistan (MENAAP) using the Policy Space Index (PSI). The PSI integrates fiscal, monetary, and reserve indicators and adjusts them for institutional constraints to measure nominal and effective shock-absorption capacity. The key finding is that MENAAP effective policy space averaged about 11 percent of GDP in 2024, roughly half the global average and heavily concentrated in oil exporters. The constraints lie in MENAAP's institutional arrangements and insufficient fiscal discipline. Easing them requires fiscal consolidation alongside structural reforms to address the institutional bottlenecks.

Keywords: Policy Space Index, Fiscal space, Fiscal policy, Monetary policy, Reserve adequacy, Exchange rate regimes, Sovereign debt, Macroeconomic resilience, MENAAP

JEL classification numbers: E61, E63, F33, H63

1. Introduction

MENAAP (Middle East, North Africa, Afghanistan, and Pakistan) authorities are confronting a complex array of interlocking shocks. Geopolitical fragmentation is disrupting trade flows and regional cooperation, while climate risks threaten infrastructure, agriculture, and long-term sustainability (IMF, 2025c; World Bank, 2025). Global financial conditions are affecting borrowing costs, while geopolitical tensions constrain access to capital, compounding fiscal vulnerabilities. Simultaneously, fast technological advancements, including in artificial intelligence, fintech, and nontraditional data analytics, are reshaping macroeconomic management, financial systems, and macro-policies (Ocampo & Vos, 2008; IMF, 2010). These pressures are layered atop long-standing MENAAP structural challenges such as oil dependency, high unemployment, and weak private sector dynamism. Together, they call for a

fundamental rethinking of macroeconomic strategies, institutional frameworks, and reform pathways to build resilience and ensure sustainable growth across the region.

Conventional assessments of shock-absorption capacity rely on isolated indicators such as fiscal and current account balances, debt levels, or reserve adequacy, without capturing the full range of constraints faced by policymakers (Kose et al., 2022; IMF, 2010). Substantial discretionary judgment is therefore required to evaluate response capacity, often yielding qualitative rather than quantitative conclusions. When buffers are deemed available, authorities are left uncertain about their magnitude and composition. When capacity is judged absent, no guidance is provided on the scale or structure of the adjustment required. Despite a growing literature on fiscal and monetary buffers, no comprehensive multidimensional diagnostic integrating fiscal, monetary, and reserve dimensions has been

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applied to MENAAP. This gap is consequential given the region's structural heterogeneity between oil and nonoil economies and its exposure to compounding shocks.

This paper provides a regional diagnostic of MENAAP short-term capacity to respond to economic shocks using the Policy Space Index (PSI). It addresses the following questions. How much policy space do MENAAP countries possess? How does MENAAP compare with other regions? How does nominal policy space differ from effective space once institutional constraints are accounted for? What explains the variation across oil and nonoil economies, and across components? How has MENAAP capacity evolved in recent years? Because the paper is diagnostic rather than causal, it does not formulate or test hypotheses. It measures and compares short-term shock-absorption capacity across the region.

Building on the PSI methodology of [Ferrer and Kireyev \(2023\)](#), this paper contributes to the literature in several ways. It applies the PSI to MENAAP as a regional case. It extends the framework to capture the structural duality between oil and nonoil economies. It uses the PSI as a comparative diagnostic tool to benchmark MENAAP against other regions. The regional focus opens avenues for peer learning and policy benchmarking.

The paper is organized as follows. Section 2 surveys the conceptual foundations of policy space and identifies the research gap. Section 3 presents the analytical approach. Section 4 details the construction of the fiscal, monetary, and reserve components and the institutional adjustments used to derive effective space. Section 5 presents the estimates for 2024 and the evolution between 2020 and 2024. Section 6 interprets the findings, Section 7 maps each finding to specific policy levers, and Section 8 concludes.

2. Literature review

The concept of policy space initially emerged in the context of trade and later expanded into macroeconomics. Early discussions emphasized the scope governments retain to pursue national development strategies within international economic rules ([Chang, 2006](#); [Page, 2007](#); [UNCTAD, 2004](#)). Later research extended the concept to macroeconomic stabilization, highlighting how fiscal and monetary buffers shape countries' capacity to respond to crises ([Ocampo & Vos, 2008](#); [IMF, 2010](#)). Empirical evidence suggests that economies entering crises with stronger fiscal and monetary positions experience milder downturns and faster recoveries ([Romer & Romer, 2017](#)). This strand reflects an ongoing debate over whether policy

space is best understood as national developmental autonomy or as macroeconomic buffers against shocks. The two views imply different approaches to assessment and different policy recommendations.

Recent research has focused mainly on fiscal space. In this literature, the debate focuses on whether fiscal space is best captured by a narrow set of debt-sustainability metrics or by a broader assessment that incorporates institutional and market-based determinants. [Kose et al. \(2022\)](#) constructed a global database of fiscal indicators capturing debt sustainability, interest burdens, and financing conditions. The [World Bank \(2025\)](#) expanded this approach by assembling a large set of fiscal risk indicators across countries. Other studies highlight emerging pressures on fiscal capacity from climate finance needs, defense spending, and demographic change ([Acalin et al., 2025](#)). Broader theoretical frameworks emphasize that fiscal space is shaped not only by debt levels but also by financial structures, contingent liabilities, and sovereign risk perceptions ([Brunnermeier & Reis, 2023](#); [Farhi & Tirole, 2025](#)).

Beyond fiscal indicators, recent research recognizes that policy space is multidimensional. Beyond fiscal space, monetary space has been discussed and shown to depend not only on policy rates but also on credibility, inflation expectations, and financial conditions ([Borio et al., 2021](#)). The discussion of reserve space has evolved from simple import-cover ratios toward more comprehensive measures of external vulnerability, such as the IMF's Assessing Reserve Adequacy (ARA) framework ([IMF, 2011; 2025a](#)). The need for multidimensional diagnostics has been also a long-standing theme in the country-risk and crisis-vulnerability literature, where composite indicators combining fiscal, external, and credit-market signals have been shown to outperform single metrics in predicting distress ([Cantor & Packer, 1996](#); [Frankel & Saravelos, 2012](#); [Manasse & Roubini, 2009](#)). Irrespective of the advances, the issue of how to integrate this multidimensionality into a single diagnostic tool remains unresolved.

Research on MENAAP reflects the tensions noted above. It often interprets policy space broadly as capacity for development autonomy, focuses on a single dimension (predominantly fiscal), and rarely integrates that dimension with others in a unified framework. Few studies compare MENAAP with other regions. [Ben Rouine \(2023\)](#), for example, argues that fiscal space for social protection in MENA can be created through a combination of taxation, an accommodating macroeconomic framework, and debt

restructuring. Ben Brik (2025) argues that public policy evaluation in MENA is shaped by regime type, administrative traditions, and institutional capacity, with developmental models and bureaucracies influencing fiscal performance. Yamout (2025) defines a country's fiscal limit as the highest level of public debt it can sustain before default risk becomes critical, and finds that oil-rich MENA economies have ample fiscal space, while nonoil economies operate close to their fiscal limits. Assa and Morgan (2025) rank the Middle East among the top three regions by available fiscal space, after North America and non-Euro-zone Europe, a result that this paper revisits using the multidimensional, institutionally adjusted PSI.

Three tensions thus remain unresolved. The conceptual tension between developmental autonomy and stabilization-buffer framings of policy space remains unsettled. The measurement tension between narrow debt-sustainability metrics and broader institutional assessments has not been bridged. The integration tension, namely how to combine fiscal, monetary, and reserve dimensions into a single, cross-country comparable diagnostic, remains unresolved. These tensions are particularly consequential for MENAAP, where most studies treat policy space narrowly as fiscal space, some do not differentiate between oil exporters and importers, and very few benchmark the region against the rest of the world. The PSI framework adopted in this paper addresses these gaps by combining the three dimensions and adjusting them for institutional constraints, as the next section explains.

3. Methodology

The analytical approach is diagnostic. The PSI measures and compares countries' short-term capacity to absorb shocks. It is not designed to estimate causal effects, test hypotheses, or predict crises. The unit of analysis is the country-year, and the output is a composite index expressed as a percentage of GDP. This allows cross-country and over-time comparison.

The dominant theoretical lens is the IMF-style macroeconomic stabilization framework, which centers on the buffers needed to respond to shocks without compromising stability. This lens is one of several traditions through which policy space has been developed, alongside political economy approaches emphasizing the autonomy of national development strategies and functional finance perspectives focused on the macroeconomic role of fiscal capacity.

Within this framework, and following Ferrer and Kireyev (2023), the paper treats policy space as the stock of useable fiscal, monetary, and external buffers that a government can mobilize to cushion a shock without compromising macroeconomic stability. The concept spans every financing channel, domestic and external, not fiscal instruments alone. Quantification rests on established benchmarks, namely the IMF Debt Sustainability Framework, the Assessing Reserve Adequacy methodology, and standard inflation-targeting practice, against which actual positions are measured.

Unlike broader definitions in the literature, this framing focuses on the immediate horizon (the current or following year) and integrates all available financing channels, not just fiscal instruments. It allows for quantification both in national currency and as a percentage of GDP, providing a practical metric for assessing short-term policy flexibility.

Table 1 sets out the framework as a five-by-three grid. Its columns hold the three quantitative pillars, fiscal, monetary, and reserve, and its rows hold the institutional features that condition them: whether the currency is a reserve or a national currency, the income group (advanced economy, emerging market, or low-income country), the degree of capital-market access (full, limited, or none), the risk of debt distress (low, moderate, high, or in distress), and the exchange-rate regime (flexible, soft peg, or hard peg).

The index reports two readings. The *nominal* reading is the distance between an indicator, such as debt-to-GDP or reserves in months of imports, and its threshold, carrying a positive sign when the

Table 1. Policy space matrix.

Institutional environment	Types	Fiscal space	Monetary space	Reserve space
Currency status	Reserve	A	U	A
	National	U	U	U
Debt distress (LIC)	Low	U	U	U
	Moderate	U	U	U
	High	P	U	U
	In distress	F	U	U
Capital market access	Full	U	U	U
	Limited	P	U	U
	None	F	U	U
Exchange rate regime	Flexible	U	U	U
	Soft peg	U	U	P
	Hard peg	U	F	F
Fiscal risk	Low	U	U	U
	Medium	P	U	U
	High	F	U	U

Note: A = amplified (white), U = unchanged (light gray), P = partially restricted (medium gray), F = fully restricted (dark gray). Source: author's presentation.

indicator sits inside the threshold and a negative sign when it does not. The *effective* reading then filters the nominal one through the country's institutional setting, keeping only the portion of nominal space the country can actually deploy. By construction it never falls below zero: it is either zero, meaning no useable space, or positive.

Shading in the grid records how tightly each institutional feature binds. A floating regime, for example, leaves monetary space fully useable, whereas a fixed regime compresses it, often to nothing absent strong capital controls, so that monetary space that exists on paper may be unavailable in practice. Since space that does not exist cannot be drawn down, the effective reading is bounded below at zero.

Each institutional dimension is coded from a standard external classification, namely reserve-currency status, IMF WEO income group, Moody's sovereign ratings, IMF AREAER exchange-rate regimes, and IMF–World Bank debt-distress ratings, and then applied to the corresponding nominal component to obtain effective space. Sections 4.4 to 4.8 set out each coding rule and its calibration, so the full detail is not repeated here.

Every threshold draws on an established surveillance framework: the IMF Debt Sustainability Framework anchors the fiscal limits, published inflation targets (or the income-group average where none exists) anchor the monetary limits, and the Assessing Reserve Adequacy methodology anchors the reserve limits. The fiscal and reserve thresholds vary by income group and capital-market access, while the monetary side adds an effective lower bound of –1 percent on policy rates. Sections 4.1 to 4.3 report the exact values and their sources.

The zero floor on effective space is a deliberate analytical choice. Conceptually, a country with a deeply negative nominal position is in qualitatively worse shape than one at the threshold, and that difference has implications for adjustment effort, the credibility cost of further deterioration, and the risk of disorderly outcomes. From the perspective of useable shock-absorption capacity in the current or following year, however, both countries face the same operational reality: no buffer can be drawn upon without breaching sustainability or stability constraints. The PSI captures this distinction through its components. The size of the negative nominal gap is preserved in the underlying fiscal, monetary, and reserve readings, while the effective index reports zero for any country whose adjusted aggregate is non-positive. This convention prevents deeply distressed economies from being recorded

as more constrained than countries marginally below their thresholds, when in practice both lack useable capacity. When nominal indicators exceed sustainability or adequacy thresholds, a country does not possess negative useable policy space but instead faces a need for policy adjustment. Negative values therefore represent a shortfall relative to policy thresholds and indicate the magnitude of the minimum adjustment required to restore neutral policy space. Such shortfalls are reflected in nominal policy space, while effective policy space captures only the useable portion of that space.

The PSI is designed as a diagnostic measure of countries' macroeconomic policy capacity to respond to shocks. The PSI is not designed primarily as a predictive model and therefore is not validated using crisis prediction performance. Instead, the PSI evaluates the availability of fiscal, monetary, and external buffers using benchmarks derived from established policy frameworks—such as the IMF Debt Sustainability Framework, reserve adequacy metrics, and inflation-targeting practices—which have themselves been extensively examined in the literature. The objective is thus to provide a transparent and comparable diagnostic of policy space rather than to predict macroeconomic crises.

The aggregation logic distinguishes between PSI component aggregation and cross-country aggregation. The components of policy space are combined using an equal weighting principle. In the absence of strong empirical guidance on the relative importance of fiscal, monetary, and reserve buffers, the three components are summed with equal weights. This approach is transparent, widely used in composite indicators, and avoids imposing a priori assumptions about substitutability across instruments. By contrast, aggregation across countries is based on GDP at PPP weights. Institutional constraints are incorporated through discrete adjustments based on standard classifications, including reserve currency status, IMF AREAER exchange rate regimes, Moody's sovereign ratings, and DSF debt distress ratings, each modifying the usability of the corresponding nominal component. Effective policy space is bounded below at zero, since useable space cannot be negative, while negative nominal values indicate the scale of adjustment needed to restore neutral policy space.

The limitations of the approach are acknowledged. First, the PSI lacks validation against realized crises or macroeconomic outcomes, since it is designed as a diagnostic measure rather than a predictive model. Second, results rely on the chosen thresholds, and although these are drawn from established frameworks suggesting their robustness, full threshold

dependency cannot be eliminated. Third, some institutional adjustments rely on discrete proxies that may not capture in full all relevant features of national policy environments. Fourth, aggregation of nominal policy space is sensitive to extreme values, as a few large economies dominate regional GDP-weighted results and, if hit by crises or the exchange rate collapse, generate outsized effects on the aggregate. Finally, data gaps require excluding several countries which affects the averages for country groups.

4. Empirical strategy

The empirical implementation of this approach proceeds in three steps. First, fiscal, monetary, and reserve space are computed for each country as the gap between current macroeconomic indicators and policy-relevant thresholds. Second, the three components are aggregated into a single nominal PSI using equal weights. The choice of equal weights follows a minimum-information principle: absent strong priors over the relative shock-absorption value of each component, equal weights are the least restrictive aggregation rule and avoid embedding judgmental scoring into the headline index. Third, nominal space is adjusted for four institutional constraints, namely reserve currency status, exchange rate regime, capital market access, and debt distress risk, to yield effective policy space, bounded below at zero. The institutional adjustments follow the calibration of Ferrer and Kireyev (2023). The procedure is applied to MENAAP countries and benchmarked against a global sample of 181 countries for 2020 and 2024. The 2020 baseline captures the post-COVID debt build-up. The 2024 endpoint reflects the latest WEO vintage available at the time of writing.

The next subsections describe each step.

4.1. Fiscal space

In the PSI, fiscal space captures a government's room to react to a shock without endangering debt sustainability or market access, and it has two parts, borrowing space and financing space. This reading is wider than the IMF's, which confines fiscal space to the scope for discretionary tax cuts or spending increases relative to baseline while preserving sustainability and market access (IMF, 2018a).

Borrowing space is a country's capacity to take on additional debt without undermining sustainability. It is adequate when the primary balance required to stabilize debt is feasible, rollover risks are low, and potential growth is preserved. *Financing space* is the capacity to cover gross financing needs without

straining liquidity. Gross financing needs are the debt amortization the overall fiscal balance does not cover (IMF, 2025b), equivalently the fiscal deficit plus public-debt amortization falling due in the year. When the deficit is modest and upcoming repayments are light, a government can lift spending or cut taxes if needed while still preserving debt sustainability and market access.

Fiscal space in the PSI is broader than just borrowing space. While borrowing space reflects the ability to take on debt without compromising solvency, fiscal space encompasses all financing options available to the government. Even countries with high public debt may retain some borrowing space if their gross financing needs remain low. Fiscal space therefore includes a wider array of instruments beyond debt issuance. If both borrowing space and gross financing needs remain below their respective thresholds in the year before projections and throughout the projection period, the contribution to fiscal space is positive. If either benchmark is breached, the contribution is negative.

Each part of fiscal space is measured as a distance to a threshold. Borrowing space compares the public-debt-to-GDP ratio with the debt threshold, financing space compares the gross-financing-need-to-GDP ratio with the financing threshold, and the two are summed. Both thresholds depend on income group (AE, EM, LIC) and capital-market access (none, limited, full), as reported in Table 2. For LICs the debt threshold is set in present value at a 5 percent discount rate, following DSF practice, whereas for AEs and EMs it applies to the nominal debt stock; the gross financing needs thresholds are all stated in levels.

4.2. Monetary space

In the PSI, monetary space is the room a central bank has to ease policy in support of activity without putting price stability at risk. It is present when projected headline inflation sits below target. Where this holds, the authorities can cut rates or ease unconventionally, at least until expectations adjust and inflation climbs back toward target; and

Table 2. Borrowing and gross financing needs thresholds (% of GDP).

Access to capital markets	Public Debt			Gross Financing Needs		
	AE	EM	LIC ^a	AE	EM	LIC
None	70	55	35	15	10	7
Limited	70	60	55	15	15	10
Full	85	70	70	20	15	15

^a In present value. Source: IMF, 2020a; author's calculations.

where inflation already sits at target, space remains if the authorities are willing to lift the target temporarily. A target defined as a corridor complicates the reading, because inflation that runs above the point target but below the ceiling, or even slightly above the ceiling when the central bank is credible, the ceiling is judged too tight, or the overshoot is transitory, need not signal the absence of space. For countries with no inflation-targeting framework, the 2024 income-group average target serves as an implicit benchmark.

The measure sits at the meeting point of a growth constraint and an inflation constraint. The growth side is limited by the lower bound on policy rates, which the PSI sets at –1 percent to allow for the modestly negative rates seen in some advanced economies. The inflation side is limited by the distance of projected inflation from target. Monetary space is then the central bank's scope to support activity through conventional and, if needed, unconventional tools while inflation stays near target, with conventional easing assumed to be exhausted before measures such as quantitative easing are used.

4.3. Reserve space

The PSI builds its reserve indicator on the standard reserve-adequacy metric. The traditional version rests on months of prospective imports, with three months of import cover and full cover of short-term debt as the most common benchmarks (IMF, 2013).

The latest metric is constructed as a weighted sum of potential sources of balance of payments pressures. The Assessing Reserve Adequacy (ARA) metric includes short-term external debt, other portfolio liabilities such as non-resident equity and debt holdings, broad money, and exports. These capture, respectively, risks of sudden capital outflows, portfolio withdrawal, resident capital flight, and a sudden loss of trade receipts. Reserve adequacy is then assessed by comparing actual reserves with this metric. Coverage of 100–150 percent of the ARA metric is considered adequate, below 100 percent signals insufficient reserves and heightened vulnerability, and above 150 percent implies more than adequate coverage (IMF, 2025a).

Reserve space in the PSI is the amount of reserves held above twice the adequacy benchmark, on the premise that reserves serve precautionary and liquidity needs, with the benchmark itself varying by income group and capital-market access (Table 3). Since the IMF ARA covers only 78 countries, the PSI substitutes a simplified benchmark to widen coverage, stated in months of next

Table 3. Reserve adequacy thresholds.

Access to capital markets	Months of Imports ^a			% of Short-term Debt		
	AE	EM	LIC	AE	EM	LIC
None	1	3	3	0	100	100
Limited	1	3	3	0	100	100
Full	1	3	3	0	50	50

^a Next year's imports. Source: IMF, 2015; author's calculations.

year's imports and in percent of short-term debt across income groups and conditional on market access. Under it, EM and LIC reserves count as adequate from three months of prospective imports, and must also cover the full stock of short-term debt where market access is at all constrained, or half of it where access is full; AE reserves count as adequate from one month of imports, with no short-term debt cover required.

Beyond the quantitative components, policy space is shaped by the institutional environment. Five components are considered here, namely the international status of the local currency (reserve or non-reserve), income classification, access to international capital markets, risk of debt distress, and the exchange rate regime. Between 2020 and 2024, the institutional environment deteriorated across most of these dimensions, adversely affecting the PSI.

4.4. International status of national currency

Reserve currency status amplifies policy space. By convention a reserve currency is one that central banks hold in sizable amounts within their foreign exchange reserves.

For the PSI, reserve currency countries (RCCs) are the United States and countries in the euro area. Their central banks issue reserve currencies (the US dollar and the euro), their governments repay debts mainly in national currencies, they can readily swap their currencies for others, and their currencies are widely accepted for international transactions. An important distinction from the U.S. dollar is that, although Eurozone countries benefit from a reserve currency, none of them controls it and therefore none controls its own monetary space. The euro is managed by the European Central Bank (ECB), which targets a weighted aggregate of inflation for the Eurozone as a whole and implements a unified monetary policy on behalf of all member states.

How much precautionary reserve cover a country needs therefore differs sharply by group. Issuers of reserve currencies, and economies with standing swap lines, can create domestic assets that convert

readily into foreign currency, so they rarely need large buffers. Economies without that assured access depend instead on external buffers, foreign exchange reserves among them, to guard against market dysfunction and liquidity shortfalls.

Non-RCCs labor under a clear institutional handicap. Because other countries do not seek their currencies to top up reserves or to settle cross-border payments, their central banks have little room to enlarge their balance sheets. In such economies money really can run out, since confidence in the local currency erodes once the central bank's credibility is in doubt.

4.5. Income group

The PSI uses three income groups. Advanced economies (AEs) follow the IMF WEO classification. Low-income economies are countries eligible for concessional financing from the Fund (IMF, 2023). All other countries are considered emerging markets (EMs).

Income level affects policy space. Advanced economies typically pair higher incomes with firmer institutions, stronger rule of law, and greater shock resilience than poorer economies, which the PSI reflects in lower reserve-adequacy thresholds for AEs. Combined with their higher debt and financing thresholds, their scope to run negative policy rates, and their lighter reserve requirements, this hands AEs extra policy space relative to other countries.

4.6. Access to capital markets

Access to capital markets directly influences policy space. The ability to borrow on international markets expands fiscal space, provided financing is available at a reasonable risk premium. When a country's debt is rated as highly speculative, fiscal space is effectively zero, since investors are reluctant to purchase its sovereign bonds and its ability to raise funds through debt issuance is limited.

The PSI gauges capital-market access from Moody's global ratings, chosen over other agencies for their wider country coverage and finer gradations. These long-term foreign-currency ratings express a view on the relative credit risk of obligations with an original maturity of a year or more (Moody's Investors Service, 2025). From them the PSI builds a three-valued indicator: full access for investment-grade ratings (value 2), limited access for speculative-grade ratings (value 1), and no access for ratings in or near default (value 0), with any unrated country set to 0.

4.7. Risk of debt distress

The risk of debt distress sharply curtails policy space. For low-income countries the DSF (IMF, 2020b) generates distress signals by checking debt-burden indicators against indicative thresholds over a projection horizon, and assigns one of four ratings: *low risk*, when no debt burden indicators breach their thresholds under the baseline or stress tests; *moderate risk*, when no indicators breach their thresholds under the baseline scenario but at least one breaches under stress tests; *high risk*, when an external debt burden indicator breaches under the baseline scenario but the country does not yet face repayment difficulties; or *in debt distress*, when the country is already experiencing servicing difficulties (such as arrears, ongoing or impending debt restructuring, or signs of a high probability of distress).

There are no IMF debt distress ratings for countries other than LICs. Sustainability for these countries is assessed relative to country-specific circumstances. IMF DSAs, usually published as part of surveillance or program staff reports, include a bottom-line assessment of debt distress risks. These assessments vary across countries, with no common terminology and multiple country-specific qualifications. Because of low cross-country comparability, debt distress risk is incorporated into the PSI only for LICs, where harmonized ratings are produced and published by the Fund. This also reflects an additional adjustment for the extra risk that lending to LICs can entail.

4.8. Exchange rate regime

The exchange-rate regime cuts both ways for policy space. A floating regime, free of any explicit or implicit commitment to a given rate, leaves more room than a managed one. The IMF AREAER (IMF, 2024) sorts de jure and de facto arrangements into ten categories, which the PSI collapses into three: hard pegs (currency board, no separate legal tender, conventional peg, and other managed arrangements), soft pegs (horizontal bands, stabilized arrangements, crawling pegs, and crawl-like arrangements), and floating (floating and free floating). On this basis the PSI becomes the regional diagnostic developed in the next section.

5. Policy space in MENAAP

5.1. Policy space in 2024

Countries differ markedly in effective shock-absorption capacity. The 181 countries in the PSI

Table 4. Policy space by Region, 2024(% of GDP).

Group	Nominal Policy Space				Effective Policy Space			
	Total	Reserve	Fiscal	Monetary	Total	Reserve	Fiscal	Monetary
Sub-saharan africa	−22.2	5.1	−27.5	0.3	2.1	0.3	1.5	0.3
Asia and pacific	−8.7	15.8	−24.8	0.3	14.6	6.4	8.0	0.2
Europe	19.1	12.9	6.1	0.1	46.5	10.3	36.2	0.1
Middle east and central asia	−0.4	21.5	−22.0	0.2	13.7	0.9	12.4	0.4
of which: MENAAP	−7.7	21.0	−28.8	0.2	11.0	0.0	10.6	0.4
Western hemisphere	−33.1	4.8	−38.0	0.1	24.0	3.6	20.3	0.1
Overall (world)	−7.7	12.6	−20.4	0.2	23.9	6.1	17.7	0.2

Source: Author's calculations.

sample as of mid-2025 (IMF, 2025d) are classified into five regional groups based on the WEO classification (Table 4). The MENAAP sample includes all 10 oil exporters (Algeria, Bahrain, Iran, Iraq, Kuwait, Oman, Qatar, Saudi Arabia, the UAE, and Yemen) and 10 nonoil economies (Afghanistan, Djibouti, Egypt, Jordan, Lebanon, Mauritania, Morocco, Pakistan, Sudan, and Tunisia). Libya, Somalia, Syria, and West Bank and Gaza are excluded for lack of data needed to compute the PSI.

Nominal policy space in MENAAP is broadly in line with the global average. Worldwide, nominal space is mildly negative (−8 percent of GDP in 2024), driven by deeply negative fiscal space (−20 percent of GDP), only partly offset by positive reserve space (13 percent of GDP) and a minimal contribution from monetary space. MENAAP nominal space is similarly negative (−8 percent of GDP) and likewise driven by negative fiscal space (−29 percent of GDP), pointing to the need for fiscal adjustment in many large nonoil economies. The substantial reserve buffer accumulated mainly in oil countries (21 percent of GDP, second only to Asia and Pacific in relative terms) partially offsets the fiscal shortfall.

Effective policy space, by contrast, reveals a substantially weaker MENAAP position. Once countries with no useable space are bounded at zero and institutional features are taken into account, the global average is about 24 percent of GDP in 2024. Fiscal space contributes most (18 percent of GDP), followed by reserve space (6 percent of GDP), with a negligible monetary contribution. MENAAP effective space (about 11 percent of GDP) is well below the global average, lower than in Europe, Asia and Pacific, and Western Hemisphere, but higher than in Sub-Saharan Africa. As elsewhere,

MENAAP effective space mainly reflects fiscal capacity, primarily in oil exporters. The gap between nominal and effective space (about 19 percent of GDP) is somewhat narrower than the global gap (about 32 percent of GDP), reflecting the dominance of oil producers whose nominal and effective space are closely aligned. The gap nonetheless remains substantial across all components other than reserve space, pointing to the need for both fiscal adjustment and structural reforms to remove institutional bottlenecks.

The aggregate for MENAAP hides substantial differences between oil and nonoil countries. Among oil exporters, overall policy space was positive in both nominal and effective terms (Table 5). Nominal space was supported primarily by substantial reserve holdings, while the fiscal component was negative and the monetary contribution marginal. In contrast, nonoil countries exhibited sharply negative nominal space when supportive institutional arrangements are not taken into account, driven predominantly by weak fiscal positions and pointing to the need for significant fiscal consolidation. However, effective space in nonoil countries was slightly positive, reflecting modest contributions from fiscal and monetary components. This suggests that institutional features, most notably fiscal restraints under IMF-supported programs and capital controls, may have helped preserve some capacity in selected cases. Reserve space was absent across both groups, reflecting fixed exchange rate regimes, reserve levels below adequacy thresholds, and a general reluctance to deploy reserves as an active policy instrument.

Policy space varied markedly across MENAAP countries in 2024. On the nominal side, the PSI

Table 5. MENAAP. Policy space by country Group, 2024(% of GDP).

Group	Nominal Policy Space				Effective Policy Space			
	Total	Reserve	Fiscal	Monetary	Total	Reserve	Fiscal	Monetary
Oil countries	25.3	31.2	−6.2	0.3	16.9	0.0	16.9	0.0
Nonoil countries	−58.1	5.3	−63.4	0.0	2.1	0.0	1.0	1.0
Overall	−7.7	21.0	−28.8	0.2	11.0	0.0	10.6	0.4

Source: Author's calculations.

reveals substantial room in most oil producers, such as Iraq, Kuwait, Oman, and Saudi Arabia, supported by fiscal space (low debt and often negligible gross financing needs) and the accumulation of sizable reserves. Yemen and Iran are exceptions, with more constrained nominal space. Among nonoil countries, all except Djibouti and Mauritania recorded negative nominal space, underscoring the need for significant fiscal consolidation. In effective terms, once institutional features are taken into account, MENAAP capacity was almost entirely fiscal and concentrated in the GCC countries, excluding Bahrain. Limited effective space was observed in Mauritania, Morocco, and Jordan, reflecting ongoing fiscal consolidation, often guided by Fund-supported programs. Several nonoil countries, including Lebanon, Sudan, and Tunisia, had no effective policy space at all.

5.2. Policy space evolution

Between 2020 and 2024, nominal policy space deteriorated globally and within MENAAP, while effective space remained broadly stable. The world lost about 18 percent of GDP in nominal space, driven almost entirely by rising debt; the contributions of reserve and monetary components were negligible (Table 6). MENAAP loss in nominal space (about 14 percent of GDP) was somewhat smaller than the global decline, although similarly driven by fiscal erosion from mounting debt (–16 percent of GDP). Western Hemisphere experienced the sharpest decline, while Asia and Pacific registered the smallest contraction. In effective terms, both global and MENAAP capacity remained broadly stable, with small positive movements as fiscal losses were absorbed by the zero floor on useable space and partly offset by other components. The contrast between the deterioration in nominal terms and the stability of effective space illustrates how the institutional adjustment

framework filters out negative nominal positions that would not, in practice, be available for use.

The evolution of policy space between 2020 and 2024 differed significantly between oil and nonoil MENAAP countries. In nominal terms, MENAAP overall capacity contracted by about 14 percent of GDP, with both subgroups losing ground but at very different magnitudes (Table 7). Nonoil countries lost approximately 26 percent of GDP, reflecting fiscal deterioration (–23 percent of GDP) and reserve depletion (–3 percent of GDP). Oil exporters lost about 10 percent of GDP, driven entirely by fiscal contraction and partly offset by reserve accumulation. In effective terms, MENAAP recorded a small overall improvement of about 0.5 percent of GDP, with oil countries flat and nonoil countries broadly unchanged. The contrast between sharp nominal contraction and stable effective space again reflects the zero floor: in the most distressed nonoil economies, nominal space deteriorated further from already non-useable positions, leaving effective space unchanged.

Country-level changes between 2020 and 2024 varied significantly. Among oil exporters, Oman, Iraq, and the UAE registered the largest nominal gains, primarily through expanding fiscal space combined with reserve accumulation. Iran, Algeria, and Bahrain experienced contractions, driven entirely by deteriorating fiscal positions. Among nonoil countries, Mauritania and Djibouti increased their nominal capacity, though Djibouti saw some reserve depletion, while Egypt, Lebanon, and Tunisia recorded notable declines. In effective terms, changes in oil exporters were shaped exclusively by fiscal dynamics. Only Saudi Arabia and Iran registered modest gains, while most other countries saw stagnation or slight deterioration. Among nonoil countries, Mauritania and Egypt improved their effective capacity, while Jordan and Morocco saw declines.

Table 6. Change in policy space by region, 2020–24 (% of GDP).

Group	Change in Nominal Policy Space (% of GDP)				Change in Effective Policy Space (% of GDP)			
	Total	Reserve	Fiscal	Monetary	Total	Reserve	Fiscal	Monetary
Sub-saharan africa	–21.1	–0.9	–20.2	0.0	–4.0	–0.2	–3.8	–0.1
Asia and pacific	–11.1	–4.2	–7.0	0.1	–3.1	–4.6	1.7	–0.2
Europe	–19.7	–0.9	–18.8	–0.1	1.7	–0.7	2.9	–0.5
Middle east and central asia	–11.9	1.7	–13.6	0.0	–0.2	–0.4	0.3	–0.1
of which: MENAAP	–14.1	1.4	–15.5	0.0	0.5	–0.3	0.9	–0.2
Western hemisphere	–27.6	–1.1	–26.5	0.0	8.9	–0.1	9.3	–0.3
Overall (world)	–17.8	–2.0	–15.8	0.0	0.7	–2.1	3.1	–0.3

Source: Author's calculations.

Table 7. MENAAP. Change in policy space by country group, 2020–24 (% of GDP).

Group	Change in Nominal Policy Space (% of GDP)				Change in Effective Policy Space (% of GDP)			
	Total	Reserve	Fiscal	Monetary	Total	Reserve	Fiscal	Monetary
Oil countries	–10.2	3.1	–13.4	0.2	0.0	0.0	0.0	0.0
Nonoil countries	–26.1	–3.0	–22.8	–0.3	–0.2	–0.6	0.8	–0.3
Overall	–14.1	1.4	–15.5	0.0	0.5	–0.3	0.9	–0.2

Source: Author's calculations.

6. Discussion

These results yield a few interpretive findings that warrant discussion in light of the literature.

First, MENAAP effective policy space is low. It is less than half the global average, exceeding only Sub-Saharan Africa. This finding extends the regional ranking by [Assa and Morgan \(2025\)](#), who place the Middle East third by available fiscal space after North America and non-Eurozone Europe. The divergence reflects the multidimensional nature of the PSI. Once monetary and reserve buffers are integrated alongside fiscal space, and once institutional constraints are applied, MENAAP relative position deteriorates substantially. This supports the argument that single-indicator assessments overstate effective shock-absorption capacity ([Borio et al., 2021](#); [IMF, 2025a](#)) and confirms the relevance of the multidimensional framing. The result is also consistent with a broader literature on composite vulnerability and country-risk diagnostics, which has long held that the joint configuration of fiscal, monetary, and external indicators is more informative than any single metric ([Cantor & Packer, 1996](#); [Frankel & Saravelos, 2012](#); [Manasse & Roubini, 2009](#)).

Second, the gap between nominal and effective policy space is substantial in MENAAP, although somewhat narrower than the global gap. The narrower MENAAP gap reflects the dominance of oil exporters whose nominal and effective space are closely aligned. The gap nonetheless captures the institutional drag the PSI is designed to reveal: fixed exchange rate regimes constrain monetary space, limited capital market access restricts fiscal flexibility, and reserves, although accumulated, are seldom deployed as an active policy instrument. These findings align with the institutional perspective developed by [Ben Brik \(2025\)](#), who argues that fiscal space in MENA is shaped by regime type, administrative traditions, and institutional capacity. They illustrate the integration tension identified in the literature review and demonstrate that resolving it through the nominal–effective distinction yields a sharper picture of regional capacity than fiscal-centered assessments.

Third, the oil–nonoil divide reflects macroeconomic and institutional choices, not resource endowments alone. Roughly 90 percent of MENAAP effective capacity is concentrated in oil exporters, and nearly 98 percent takes the form of fiscal space. Yet the picture within each subgroup is more nuanced than a simple resource story would suggest. Among oil exporters, nominal space is sustained primarily by reserves and is differentiated by fiscal discipline. Iraq, Kuwait, Oman, and Saudi Arabia have substantial space, while Yemen, Iran, and Bahrain have little. Among nonoil countries, effective space, although small, has been preserved in cases such as Mauritania, Morocco, and Jordan, precisely those undergoing fiscal consolidation under IMF-supported programs, while Lebanon, Sudan, and Tunisia have no effective space at all. This pattern is consistent with [Yamout \(2025\)](#), who finds nonoil MENA economies operating close to their fiscal limits, and extends it by showing that outcomes within the oil group depend on macroeconomic management rather than oil revenue alone. Institutional reform and fiscal discipline are thus at least as decisive as resource endowment in shaping shock-absorption capacity.

Fourth, MENAAP nominal policy space is eroding broadly in line with global trends, while effective space remains stable, with rising public debt as the dominant driver in both cases. Effective capacity, however, remained essentially flat in MENAAP and globally, because the most distressed nominal positions were already non-useable in 2020 and remain so in 2024. The zero floor absorbs further nominal deterioration without affecting the useable buffer. This trajectory is consistent with the broader literature on rising fiscal pressures from climate finance, demographic shifts, and defense spending ([Acalin et al., 2025](#)) and reinforces [Ben Rouine's \(2023\)](#) call for fiscal space creation through taxation, accommodating macroeconomic frameworks, and debt management. The stability of effective space should not be read as reassuring: it reflects that a substantial part of MENAAP nominal capacity has already become unusable, not that the region has weathered the period without loss of policy latitude.

Together, these findings point to a region whose shock-absorption capacity is constrained less by its resource base than by macroeconomic discipline and institutional design. They confirm that a multi-dimensional, institutionally adjusted diagnostic adds analytical value over fiscal-only or single-indicator assessments, particularly in regions with substantial structural heterogeneity. The next section translates each finding into specific policy implications.

7. Implications

The diagnostic points to several implications tied to one of the findings above. The first concerns the level of effective space. The diagnostic finds effective policy space to be low, dominated by the fiscal dimension and driven almost entirely by debt and gross financing needs, thus suggesting that fiscal consolidation is the central policy lever for MENAAP. In oil exporters, the framework points to fiscal consolidation aimed at reducing fiscal revenue dependence on hydrocarbons, broadening nonoil revenue bases, and aligning expenditure paths with sustainable long-term oil price assumptions. The experience of countries that retained substantial nominal space (Iraq, Kuwait, Oman, Saudi Arabia) is consistent with fiscal discipline mattering more than resource endowment. In nonoil economies where fiscal space is deeply negative or already at the zero floor (Lebanon, Sudan, Tunisia), the diagnostic suggests that comprehensive fiscal adjustment, combined where applicable with debt restructuring or rescheduling, would be required to restore useable capacity. Because effective fiscal space is bounded at zero, countries already at the floor will not register improvements from marginal nominal consolidation. Only sustained adjustment that lifts nominal fiscal space above zero would translate into a gain in effective shock-absorption capacity.

A second implication concerns the gap between nominal and effective space, which the diagnostic identifies as the binding constraint on usability. The institutional features that shape this gap, namely the exchange rate regime, capital market access, debt distress risk, and reserve currency status, each carry distinct policy implications. Because none of MENAAP currencies is a reserve or freely useable currency, maintaining strong macroeconomic credibility and external buffers is particularly important. Many MENAAP economies operate fixed exchange rate arrangements with open current accounts, which limit monetary autonomy. These regimes are not necessarily inappropriate, but the framework points to correspondingly stronger fiscal and financial frameworks as a

precondition for preserving macroeconomic stability. Perceived sovereign risk constrains capital market access for several oil and nonoil economies alike, pointing to credit-rating-oriented reforms in fiscal transparency, debt management, and structural policies. Where reserve deployment is perceived as politically sensitive, transparent reserve management frameworks would help convert nominal reserves into a useable instrument.

A third implication follows from the oil–nonoil divide and the role of macroeconomic and institutional choices within each subgroup. The diagnostic points to differentiated priorities. In oil exporters, monetary policy is structurally absent as a stabilization instrument because policy rates are anchored by fixed exchange rate arrangements, most prominently in the GCC. Expanding monetary space in this group is not a feasible objective without a regime change, so fiscal and reserve buffers would have to compensate for the structural absence of monetary capacity. In nonoil economies with flexible exchange rate arrangements but elevated inflation, headline policy rates are above neutral and provide no near-term scope for accommodation. Rebuilding monetary space therefore requires bringing inflation back to explicit or implicit target levels. Reserves play an asymmetric role across the divide. Oil exporters hold substantial reserves but contribute little effective space because reserves are seldom deployed as an active policy instrument. Clearer reserve management frameworks, intervention rules, and contingency protocols would convert nominal reserves into an effective tool. In nonoil economies with reserves below adequacy thresholds, the diagnostic suggests that continued reserve accumulation, particularly through current account improvement and prudent fiscal policy, would expand both nominal and effective capacity. The asymmetry between groups also points to a potential role for regional financing arrangements in raising the overall shock-absorption capacity of the region.

A fourth implication concerns the trajectory of policy space between 2020 and 2024 and the consequence of the zero floor for sustained adjustment. The flatness of effective space over the period should not be read as policy success. It reflects the binding zero floor, which absorbs further nominal deterioration in the most distressed economies without registering any change in useable capacity. The diagnostic implies that maintaining current effort is not sufficient to stabilize effective space in the face of ongoing nominal erosion. Sustained adjustment that lifts nominal positions back above the zero threshold is the only channel through

which improvements in effective shock-absorption capacity would be observed. This is particularly relevant for the most fiscally distressed nonoil MENAAP economies, where marginal nominal improvements would not yet show up in the effective index but where cumulative adjustment over the medium term would.

8. Conclusions

The PSI is a diagnostic tool applied to assess MENAAP's capacity to respond to economic shocks. It offers a multidimensional, cross-country comparable measure of short-term policy space, integrating fiscal, monetary, and reserve buffers within a unified framework adjusted for institutional constraints. This design allows countries' readiness to absorb shocks to be evaluated and benchmarked across peer groups, while accounting for differences in economic size and institutional context.

MENAAP effective policy space is well below the global average. Effective policy space in 2024 is estimated at about 11 percent of GDP, less than half the global average. Nominal capacity is broadly in line with the global average, but its usability is sharply reduced by institutional constraints. Not all of MENAAP headline nominal capacity is therefore useable in practice.

Effective capacity in MENAAP is unevenly distributed. The bulk resides in oil-exporting economies, with pronounced disparities within the group, ranging from countries with substantial space to those with virtually none. The remainder lies in nonoil economies, most of which have only minimal capacity. Across components, fiscal space dominates, with monetary and reserve space playing a marginal role. This distribution holds broadly across both oil and nonoil economies.

Between 2020 and 2024, MENAAP effective capacity remained stable while nominal capacity eroded. The stability reflects the binding zero floor on useable buffers rather than genuine resilience. The most distressed nonoil economies were already at the floor in 2020 and remained there in 2024. Further nominal deterioration does not register as a loss of useable space. Oil exporters retained the bulk of regional capacity throughout the period, while nonoil countries continued to operate near or at zero effective space.

On the institutional side, MENAAP structural features constrain, rather than amplify, their policy space. Because none of MENAAP countries issues a reserve or freely useable currency, maintaining strong macroeconomic credibility and adequate external buffers is particularly important. Many

economies operate under fixed exchange rate arrangements which, when combined with open current accounts, limit monetary policy autonomy. In such cases, stronger fiscal and financial frameworks are needed to preserve macroeconomic stability. Perceived sovereign risk also constrains access to capital markets, even for some oil producers, underscoring the need to improve sovereign creditworthiness and strengthen fiscal transparency. In some countries, the use of reserves is politically discouraged or viewed as a sign of weak policy, highlighting the importance of clearer reserve management frameworks and stronger fiscal institutions.

The diagnostic value of the PSI lies in its capacity to attribute observed shortfalls to specific components and to identify the channel through which each shortfall can be addressed. Future research can extend this diagnostic by validating the PSI against realized macroeconomic outcomes, refining the institutional adjustment factors, and applying the framework to additional countries and regions to support peer learning and benchmarking.

Ethics statement

Not applicable.

Data availability statement

The data used in this study are publicly available from the International Monetary Fund's World Economic Outlook (WEO) database, April 2025 vintage, through the IMF Data Portal at <https://www.imf.org/en/publications/weo/weo-database/2025/april>. No DOI is available for this database.

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