The Economic and Financial Impacts of the Arab Awakening

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I. Introduction

“No repression, No suppression, No Oppression.”

In the midst of the recent speculation on the “Arab Awakening,” much emphasis has been placed on the political aspect of these popular revolts. While this facet is undoubtedly of utmost importance, one should be mindful that these uprisings have also brought the economic, financial and social dimensions yet again to the forefront. Indeed, these dimensions had a fundamental role in triggering the desire for a democratic change across a region and will play a determinant role in the sustainability of this New Arab Order by complementing the political achievements.

In this talk, I shall assess the economic and financial implications of these developments on the regions’ stability and long-term growth prospects.

I shall begin with a brief review of these uprisings, from their origination to the latest developments, highlighting their political and economic roots and analyzing the response of the international community. After that, I shall revert to the common strengths and challenges of the MENA region in view of a better understanding of the dynamics and transmission channels impacting its economic outlook. I shall then describe the immediate implications that we were able to witness during and following the turmoil.
and underline the dynamics for the medium outlook. At the end, I shall try to define the constituents of the paradigm change, which I refer to as being the proper mix between the political, economic and social reforms.

II. Demystifying the Arab Awakening

It all started out in Tunisia in December 2010 with the tragic suicide of a young vegetable seller from a small provincial town. The Bou Azizi incident came to represent the widespread malaise of the Tunisian youth and it reignited the political activism and social mobilization which were contained during decades of regime repression. The spillover effects of the Tunisian provincial revolt in 2011 - which has also toppled heads of state in Egypt and Libya, threatened Jordan and Morocco, and swept to Bahrain, Yemen and Syria - led to unrest throughout the entire region.

But how can a single incident initiate such popular uprisings and lead to regime collapses? What are the contagion channels through which the revolution has been exported?

The knee-jerk response is that these countries share a common denominator, a “distress triggered by coupled socioeconomic, generational and geographical disparities” - the kind of “economic marginalization” that has time and again launched successful revolutions against ageless, despotic, political regimes throughout history.

But, with hindsight, a more truthful analysis indicates that increased access to information via social media and new media, hastily-assembled grassroots mobilization by small numbers of individuals, and momentum were perhaps the more vital elements leading to the rapid spread of these revolts - building fundamentally, from the quick win in Tunisia, the country where the democratic transition arguably had the greatest chance of success.
I question whether the international community and the many analysts scrutinizing these events are considering regional developments through unfiltered lenses that truly serve our understanding of matters. Some characteristics of these uprisings, for instance, are largely ignored – namely the fact that the vast majority are taking place in Arab nations that have been close western allies and which have tried to emulate western financial, market and trade structures.

With the exception of Syria, all Arab regimes facing popular discontent have either been staunch US allies or, as in the case of Libya, satisfied with a status quo that benefits US interests in the region. “Democracy” borne from the Arab Awakening will necessarily mean more representative government, which, early observations indicate, will mainstream moderate Islamist groups, disturb alliances with Israel and reduce Arab hostility to Iran – all of these anathemas to stated US objectives in the region.

In addition, if the turbulence spills into oil-exporting countries in the MENA region, this could not only impede the economic interest of western oil companies but also have serious economic impact globally. The reluctance is perceptible in the much-awaited speech of Barack Obama in the 19th of May 2011, where he offered slim pickings to the Arab Spring.

Subsequently, under a collaborative arrangement, the Group of Eight (G-8) decided to guide the new, rapidly evolving Middle East in a favorable direction by engaging with opposition groups at a time while it still has leverage, rather than later, after newly elected representatives are in power. Likening it to the fall of the Berlin Wall that changed the face of Europe, the G-8 countries pledged in May 2011 to support Middle Eastern and North African countries that are transitioning to free and democratic societies through the launching of the “Deauville Partnership with the Middle East,” a global partnership with countries wishing to support transition in the region, among which are the International Monetary Fund, the World Bank, as well as United Nations agencies and multilateral and regional development banks. The IMF, which has already been
assessing the region’s financing needs, announced it could make available as much as USD 35 Billion as part of a broader international effort\textsuperscript{vi}.

The IMF external support was considered as vital to bridge the gap between the financing need in the transition period and the costly borrowings from the markets in light of the high uncertainties. IMF experts cautiously advised that it could “send a signal of confidence to the markets as well as to other multilateral and bilateral lenders” and “provide reassurance to investors and the official community, helping countries find additional financing from other sources”\textsuperscript{vii}.

Opponents of IMF support claimed that aid packages were unevenly extended to recipient countries. Given the generous financial support to Libya, Tunisian officials expressed their discontent towards this favoring, and denounced the hard-to-meet conditional arrangements\textsuperscript{viii}. As an alternative to international community aid, they called for the investment of the Arab World’s excess liquidity within the region.

The response of the Arab League, Arab Monetary Fund and other Inter-Arab organizations have been unsurprisingly quasi-absent, once more reinforcing the absence of leadership in the region, the inefficient institutional functioning and the reliance on Western support and patronage. In my view, we are not being sufficiently alarmist in drawing attention to the fact that the global economic crises, lack of liquidity for unanticipated expenditures and overwhelming demands on the same sources of funding suggests that nascent Arab revolutions will not receive sufficient external financial support to meet their needs. If we do not plan ahead for contingency funds that are utilized wisely, the region risks fundamental destabilization, which will in turn further political, social and economic distress.

A final, underemphasized point merits some mention. The increasing use of financial tools by the US and EU to undermine opponents and bolster supporters throughout the Middle East will have ramifications depending on the outcome of regional political shifts caused by popular democracy movements. The over-zealous and open-ended use of the
Sanctions stick (good politics but bad policies) could give way to unintended political price such as the banning of dollar- or euro-based trade and investment and shutting off markets to American and European goods and brands for indeterminate time periods let alone the unsuccessful sanctions to Cuba and the tragic human consequences in Iraq.

III. The Strengths and Challenges of the MENA Region

A thorough understanding of the dynamics requires delving a little deeper in the specificities of the MENA region.

Though the term “Middle East” itself is a concept dreamed up by Orientalists, technically the Middle East and North Africa (MENA) region today is an assembly of 22 nation states regrouped into the Levant, the Gulf and the Maghreb. IMF regional classification also includes Afghanistan and Pakistan in this grouping\textsuperscript{x}.

These nations were brought together for ease of geographical grouping and referencing regardless of the underlying mosaic of cultures, ethnic and religious affiliations. The MENA countries feature vastly diverse political systems, geography, population size and growth, per capita income, natural resources, gender participation, literacy rates, etc. And therefore, talking about the “prospects of the region” as a whole is an overgeneralization in view of these differences.

Further emphasis can be placed on the distinction between two clusters: the MENA oil importers and the MENA oil exporters. The former includes including Afghanistan, Djibouti, Egypt, Jordan, Lebanon, Mauritania, Morocco, Pakistan, Syria and Tunisia, and the later includes Algeria, Bahrain, Iran, Iraq, Kuwait, Libya, Oman, Qatar, Saudi Arabia, Sudan, the United Arab Emirates and Yemen\textsuperscript{x}.

At a glance, the region’s main strengths are its:
1. **Vast oil and gas resources**, whereby eight of the twelve OPEC nations are within the MENA region\textsuperscript{xi} gathering between 57 and 60 percent of the world's oil reserves (810.98 billion barrels) and between 41 and 45 percent of the proven world's natural gas reserves (2868.886 trillion cubic feet)\textsuperscript{xii xiii}. These resources enabled the accumulation of high levels of Gross Official Reserves reaching around USD 1,080 billion at end of 2010.

2. **Large population characterized by a dynamic young generation.** With 355 million people, the MENA population in 2010 represented 7.1\% of total Emerging and Developing countries and varies considerably across the region from over 78 million people in Egypt to 800,000 in Djibouti\textsuperscript{xiv}. A closer look reveals a common trend across the region - large pools of young people constitute 65\% of the region’s population under the age of 25\textsuperscript{xv}. Owing to its demographics and its distinctive geographical location as a doorway between East and West, the MENA is viewed as a large regional trade market.

Despite these strengths, the region is burdened with inherent challenges that can be summarized as follow:

1. **Weak and deteriorating governance.** There is general consensus that corruption is widespread in the MENA region and deeply entrenched in “the political infrastructure of the state, the institutional infrastructure of the public sector” that provides “relatively little opportunities for public participation”\textsuperscript{xvi}.

World Bank Governance Indicators point out that ten out of the fourteen MENA countries have been scoring higher on the long-standing authoritarian political stability stance compared to Voice and Accountability. In addition, MENA country positions deteriorated between 1998 and 2008 as indicated in the falling scores\textsuperscript{xvii}.

2. **Inequitable growth** between the population of each country and within the region, as well as weak social policies.
2010 GDP per capita figures reveal the disparities across the region with Qatar ranking at the top level at USD 76,168 and Mauritania at the lowest at USD 1,195. Moreover, the growth gap is further widened between the countries rich in natural resources and those dependent on such resources. While the average real GDP annual growth for the MENA region between 2000 and 2007 was at 5.4 percent, MENA oil importers grew only by 4.7 percent\(^\text{xviii}\).

Most important is the inability to “match the GDP growth with a comparable increase in employment”\(^\text{xix}\). Therefore, with the exception of Saudi Arabia, Qatar and UAE, the elasticity of employment to GDP growth in the MENA region on average is around 0.5.

Those inequalities are reflected in the levels of poverty and unequal rates in regional development. As such, in 2010, five percent of the MENA population were below the lowest $1.25 a-day poverty line and suffer from many forms of deprivation, including malnutrition. As many as 17 percent of Egyptians, 15 percent of Yemenis and 10 percent of Moroccans had consumption levels which are no more than 50 cents per day above $2 a-day poverty line\(^\text{xx}\).

3. Intrinsic talent weaknesses where the demographic strengths fuels the high levels of unemployment, especially among youth and women. In 2009, unemployment levels reached 14.9 percent in Sudan, 13 percent in Tunisia and Jordan\(^\text{xxi}\). The share of youth (aged 15–24) in total unemployment exceeds 40 percent in all MENA countries, registering around 60 percent in Egypt and Syria\(^\text{xxii}\). The region’s female labor force participation rate of 26 percent is well below the 39 percent rate in Low and Middle Income countries\(^\text{xxiii}\).

This comes down to imbalances between the available and required skills, quality of education, gender gaps and the functioning of the labor markets as indicated in the Middle East talent highlights for 2007-2012\(^\text{xxiv}\). The World Bank has estimated that the region needs to create 100 million jobs by the year 2020 just to keep up with current employment levels and absorb new entrants into the labor market.
4. **Lack of economic diversification** whereby earnings from oil and gas account for about 70 percent of total MENA exports and 75 percent of MENA budget revenues\textsuperscript{xxv}. The region also suffers from low level of competitiveness for Private Sector Investments. MENA median ranking is positioned at 108 out of 183 countries on the 2011 Ease of doing business index\textsuperscript{xxvi}, which refers to the level of conduciveness of the regulatory environment to the establishment and operation of a local firm, and disguises a significant competitiveness gap between Saudi Arabia (ranking 11) and Iraq (ranking 166).

Lastly, the MENA region is also facing other equally important challenges such as the *increase of child labor* which has drastic social consequences owing to sexual and physical abuse, the increase in illiteracy, and the low level of financial access which limits access of households and small enterprises to finance\textsuperscript{xxvii}.

**IV. The Economic and Financial impacts**

*Short term Outlook*

Following the global financial crisis, the MENA region was witnessing a strong recovery supported by the rebound in oil prices which had a boosting effect on the non-oil sectors and an extended effect on the oil importers. In October 2010, the IMF World Economic Outlook projected that these positive factors will contribute to an expected growth rate for the region as a whole of 4.1 percent in 2010 and 5.1 percent in 2011 while the global activity was forecasted to expand by 4.8 percent in 2010 and 4.2 percent in 2011\textsuperscript{xxviii}.

In 2011, however, two new developments affected the outlook of the region: the Arab political uprisings and the surge of global oil and food prices. The immediate economic impacts of these developments have shown a clear divergence between the two clusters.

With the exception of Libya and Yemen which have experienced profound political turmoil, for oil-exporting countries the rise of oil prices has led to a higher growth and
stronger fiscal and external balances, despite the increase in government spending\textsuperscript{xxix}. Projected real GDP growth is at 4.9\% in 2011 and 3.9\% in 2012\textsuperscript{xxx}. However, this overall trend masks the actual fiscal stance of many countries, as measured by the non-oil fiscal and primary balances.

For oil-importing countries the outlook is mixed. While Jordan, Mauritania, and Morocco benefit from a continued growth owing to high prices for phosphate and iron, the political turmoil in the affected countries translated in a sharp drop in growth rates, reflecting disruptions of economic activity during the protests, a decline in tourism receipts, and lower Foreign Direct Investments. Furthermore, in view of the rise of oil and food prices, inflationary pressures are expected to rise and current accounts to weaken. Fiscal pressures are likely to be high as governments are responding to political pressures and increased prices by expanding fuel and food subsidies, civil service wage and pension increases, as well as other forms of government spending\textsuperscript{xxxi}. Accordingly, projected real GDP Growth is at 1.4\% for 2011 and 2.6\% for 2012\textsuperscript{xxxii}.

The World Economic Forum Global Competitiveness Report for 2011-2012 indicates that “Over the past year, the MENA region has been affected by a great deal of turbulence that will have an impact on national competitiveness and might further exacerbate the competitiveness gap between the Gulf economies and the rest of the region. This trend is reflected in the 2011 Global Competitiveness Indicators’ results, where most Gulf countries continue to move up in the rankings, while the competitiveness of many countries from North Africa and the Levant stagnates or deteriorates.”\textsuperscript{xxxiii}

In a nutshell, MENA growth in 2011 was distressed by the disruption of activity, the reduction of Investment, the fall of Foreign Direct Investment (FDI) inflows coupled with capital flights and lowered tourism receipts. At the same time, surging global commodity prices have pushed governments to respond by increasing spending, including those on wages, food and fuel subsidies, which increased the average fiscal deficit likely to exceed eight percent of GDP in 2011. Therefore, forecasts of economic activity for the MENA
region have been revised downward compared with previous projections. The latest projected growth for the region stands now at 4.0 percent in 2011 and 3.6 percent in 2012\textsuperscript{xxxiv} - while the previously forecasted level was at 5.1 percent for 2011.

As widespread protests threatened the old order, rating agencies have been revising their sovereign ratings to account for the increased political risk. Back in March 2011, Fitch Ratings announced that “narrowly defined political risk, including regime legitimacy, stability and effectiveness, internal tensions and external threat, reduced the region’s 11 Long Term Foreign Currency Issuer Default Ratings (IDRs) by an average of four notches even before recent downgrades”\textsuperscript{xxxv}. In line with the deteriorating investor confidence, Sovereign Credit Default Swap (CDS) spreads widened and countries’ borrowing cost in international markets have, therefore, increased which added an important financial burden.

Moreover, from the financial sector perspective, domestic banking sector balance sheets deteriorated, reflecting the downturn’s adverse impact on the quality of loan portfolios as well as on regional stock markets\textsuperscript{xxxvi}. According to Bankscope data, the aggregate size of the financial sector in 17 MENA countries was USD 1.915 trillion in 2010 with a large domination of banking intermediation of around 77 per cent. Fund managers investing in the MENA have had some difficult calls to make especially in order to protect the steadily built-up investor capital during the preceding years\textsuperscript{xxxvii}.

\textit{Medium Term Outlook}

In the context of delayed political transition awaiting the outcomes of elections in some countries and prolonged conflicts in others, the main persisting downside risk in the medium term would be the inability to re-establish confidence and anchor investors’ expectations.

The problem facing Tunisia, Egypt, Libya and other countries is that under today’s environment of political, social and economic uncertainty, their financing needs to cover external current account deficits and public financing are growing, while at the same time
their borrowing cost on the markets has increased drastically. Thus, restoring confidence at this stage is a must.

Financial assistance through Foreign aid is often linked to austerity and grievances measures right through country-specific programs. But, what are the Key Success Factors for such programs? Previous IMF experiences show that the most successful ones are those “that are homegrown and owned not just by the authorities, but by the people”³xxxviii. Accordingly, these measures should be implemented in view of their “suitability with national institutional capacities”³xxxix.

Nevertheless, restoring confidence is greatly dependant on the outcomes on the political front. Will the uprisings lead to democracies, freedom and accountability or will they bring more chaos to the region? Will they keep changing regimes or merely replace rulers? Will the uprisings be limited to just a handful of countries or will they spread over other, or the majority of, countries in the region? Would these tectonic shifts possibly entail any change in the geography of the region? Even though oil-producing countries have benefited in the near-term and others have deteriorated fairly drastically, the future for all remains uncertain.

V. The Paradigm Change: The proper Political, Economic and Social (PES) Mix

For these countries to stabilize their medium term outlook it will be necessary that some fundamental political and institutional changes are enacted to set the stage for a genuine paradigm shift.

It is imperative for each nation to seize this, rather, unique opportunity to establish a tailored Political, Economic and Social mix of measures that will build on the aforementioned strengths, address deep-rooted national challenges and catalyze the synergies across countries towards a new era in the region.
Any momentum achieved on the political front should restore the “social contract” and translate into citizens’ empowerment by means of (1) Reaching out to the long-time overlooked parties within civil society such as academics and non-governmental organizations; (2) Reducing the gender representation gap leading to an increase in women’s economic participation; and (3) Introducing Governance Structures reforms and social protections. Governance reforms are expected to improve the conditions for doing business through reduction of entrance barriers and increased transparency hence supporting an efficient public institutional functioning and a private sector’s development.

On the economic front, in the quest to fulfill potential growth, the MENA countries should attempt to (1) take advantage of the large regional market and geographical location in order to support more regional and global integration; (2) diversify their economies and rid themselves of dependence on oil revenues through the encouragement of entrepreneurship activities; (3) reform their educational system to enhance their ability to truly sustain talent. The domestic financial sector could play a pivotal role in increasing financial depth and channeling funds through extending credit to the domestic economy. Hopefully then, the growth will (1) generate enough private-sector jobs to absorb unemployment and support a fast-growing labor force; and also (2) provide the most vulnerable with the direly-needed social protection.

On the social front, and likely the most important one, the message echoing the citizens’ demands for social justice and accountability is clear: No matter which political system will emerge from these uprisings, good governance and citizen participation will be the key for successful economic development.

IV. Conclusion

The Arab Awakening has provided an opportunity to lay the foundation for a belated, but essential, socially-inclusive growth agenda. The quest for civil and political freedoms and
rights go hand-in-hand with greater economic freedom. The reverse holds true as well. Economic potential and development can only flourish with greater political freedoms and civil rights. The path towards sustainable economic growth will be long and difficult as it is conditioned by the success of a genuine paradigm shift throughout the region. With strong, representative, achievement-based governments that reject yesterday’s system of patronage, corruption and nepotism, there is real opportunity for reform across the board. It is critical that the international community support these nascent democracies in a nurturing and consultative manner.

The global ramifications of a severe Mideast depression and destabilization could otherwise be significant. The region has the potential to emerge from the current “Arab Awakening” or “Arab Revolutions” status to the desired “Arab Spring” not “Arab Winter” or “Arab Chaos.” It can certainly emerge stronger than before, but this will also require some paradigm shifts in the way international organizations and western governments operate in regard to the Middle East in both the political and economic arenas. Globalization means that we are all in this together, and it is perhaps the most important message I can bring across to this elite audience today about events in the Middle East.

Thank you.
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