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The Arab Spring and economic transition: two years on

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Summary

- **Two years on, transition countries have, to varying degrees, seen deteriorations in economic performance brought about by political uncertainties, a challenging global economic environment and regional instabilities. Given political challenges, economic reform to promote stable and more inclusive growth has so far been limited.**
- **Transition countries will be in a better position to undertake economic reforms after upcoming elections in 2013. The UK and the international community are well placed to support these reforms.**
- **The UK should ensure IMF programmes are well balanced and sequenced in view of local political economy conditions, and offer expertise to transition countries, for communicating reform to wider society.**
- **The UK should use its G8 presidency to increase impetus for reform, through events such as the Deauville investment conference, and strengthen timely international assistance through IFIs and the Transition Fund. Full ratification of EBRD expansion will be critical for supporting private sector development.**
- **The UK should aim to strengthen consensus for reform in transition countries by fostering local economic policy dialogues and supporting governance reforms.**

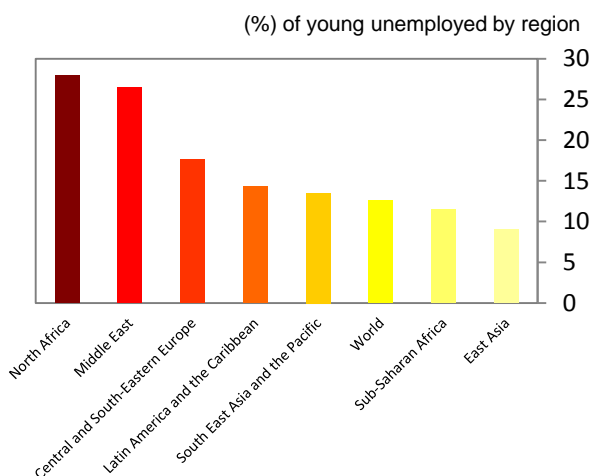
Introduction: the great expectations of the Arab Spring

1. **The Arab Spring, which led to a series of political changes in North Africa and the Middle East, was in part caused by economic underperformance and exclusion.** The region has historically been marred by high levels of inequality and unemployment. MENA has the highest level of youth unemployment in the world (figure 1), whilst female labour participation (at 25%) is also the world's worst. Significant state (and in some cases military) involvement in the economy has constrained private sector financing and growth (figure 2), and created large fiscal deficits.
2. **The uprisings ushered in new hope that economies in the region could be transformed in ways that would provide greater and more widely shared opportunities for their people.** Two years on,¹ this paper looks at economic performance and reform progress in key transition countries.² It also seeks to identify how the UK can focus support for reform, bilaterally and internationally, given difficult political economy dynamics in the countries themselves.

¹ The self-immolation of Mohammed Bouazizi, a Tunisian street vendor, on 17 December 2010 marked the beginning of the Arab uprisings.

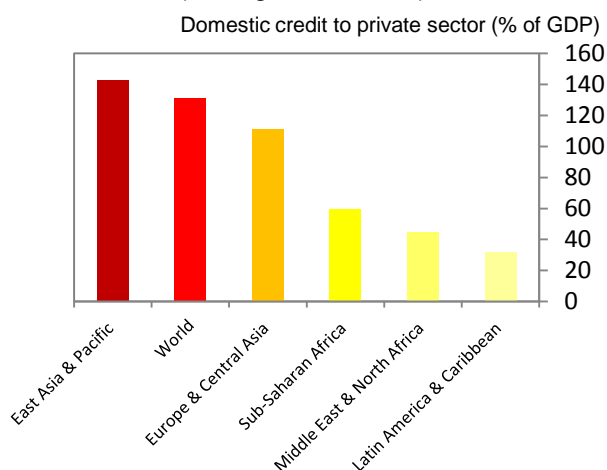
² The focus here will be on the six transition countries included in the Deauville Partnership: Egypt, Tunisia, Jordan, Morocco, Libya, and (since 2012) Yemen.

Figure 1: % of youth unemployed by region



Source: ILO (in each case the most recent data is included)

Figure 2: domestic credit to private sector as a % of GDP (average 2000-2011)



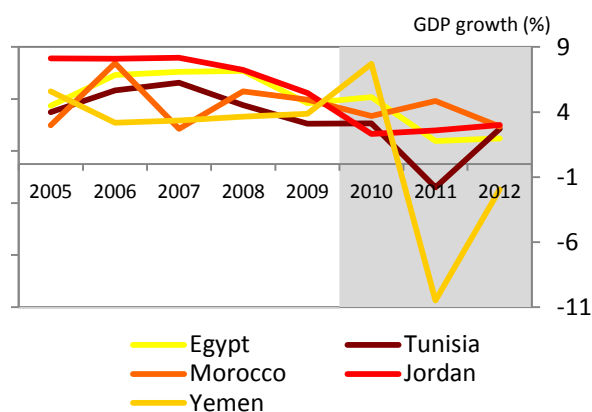
Source: World Bank

Two years on: the reality

Economic performance

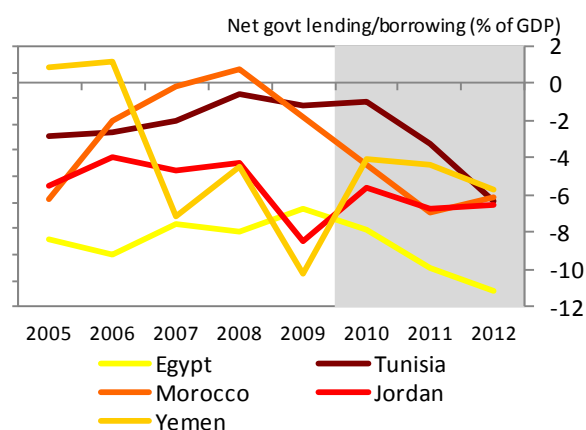
- Two years on from the Arab Spring, most of the transition countries have experienced a deterioration or stagnation in economic performance.** This is to be expected: IMF analysis³ suggests that countries undergoing political transitions tend to experience significant short term falls in investment and output for two years beyond the event and increased unemployment which starts to recover only after 4-5 years. Since 2010, MENA transition countries have seen reductions in growth (figure 3) associated with significant declines in investment, tourism revenues and exports - in Tunisia, FDI fell by 26% in 2011, whilst tourist arrivals in 2012 were around 25% below their levels in 2010. Unemployment has risen in most countries from already high levels and currently stands at around 19% in Tunisia and (officially) around 13% in Egypt and Jordan. Furthermore, excluding Libya, fiscal deficits in transition countries have increased (figure 4).
- The extent and duration of such deterioration has varied by country.** Libya and Morocco have recovered more quickly than other transition countries because of resumption of oil revenues, and more limited political disruptions, respectively. The IMF is forecasting real GDP growth of 16.7% for Libya in 2013 and 5.5% for Morocco. Yemen, supported by grants from Saudi Arabia, also appears to have stabilised its economy relatively quickly. Growth remains well below trend in Egypt and Tunisia (2% and 2.7% respectively for 2012) and Jordan's economy, whilst initially more insulated from the effects of the Arab Spring, is facing a build-up of economic pressures.

³ IMF, *Regional Economic Outlook for Middle East and Central Asia*, November 2012.

Figure 3: Economic growth before and after the Arab Spring⁴

Source: IMF

Figure 4: Budget deficit (% of GDP) before and after the Arab Spring



Source: IMF

5. **The economic conditions in transition countries have been, and will continue to be, affected to different degrees by a combination of domestic and external factors:**

- **Political uncertainties and tensions:** Political instability and a lack of clarity on the future direction of policy, has contributed to falls in investment, tourism and business activity in several countries. Libya, Yemen, Egypt and Tunisia were all affected by internal conflict or social disorder.
- **Weak global growth and the Eurozone crisis:** The Eurozone crisis has stifled the recovery of trade and investment in transition countries. This is especially noticeable in North Africa where Europe is a key trading partner, making up nearly half of all exports from Agadir Agreement countries.⁵ Furthermore, weak global growth has reduced the availability of financial assistance (except from the Gulf).
- **Increases in global commodity prices:** On average, food and fuel make up about one sixth and one fifth respectively of all imports into transition countries. High energy and food prices have put pressure on current accounts in transition countries (excluding Libya), increased prices for households or raised the costs of subsidies for government. For example, the cost of subsidies in Morocco increased by 80% in 2011 alone.
- **Regional spill-overs:** The costs of accommodating Syrian refugees in Jordan are estimated by the IMF to be 0.5% of GDP, whilst conflict in Libya in 2011 had a detrimental effect on Tunisia. Meanwhile, disruptions to cheap gas supplies to Jordan from Egypt have added further upward pressure to Jordan's electricity generation costs.

The reform agenda

6. **A number of reforms are needed to stabilise these economies and deliver greater economic opportunities demanded by the majority of the population.** These measures

⁴ Figures 3 and 4 exclude Libya given the impact of oil on growth and the budget.

⁵ Egypt, Tunisia, Morocco, Jordan.

could include: controls on current government spending and expansionary revenue raising measures; reduction of inefficient subsidies (and their replacement with targeted social protection); measures to ease the burden of business regulation; increased access to finance; labour market reforms including boosting vocational skills, particularly for young people and women; more transparent economic governance; and greater trade and regional integration.

7. **Progress on economic reforms needed to stabilise transition economies has been limited in view of challenging political conditions.** Political, rather than economic, reforms including the creation of new constitutions (e.g. Egypt, Tunisia) have tended to dominate, and in some cases there has been lack of focus on the urgency of the economic challenges they face. Transitional governments have lacked mandates to reform (Tunisia, Libya) and in countries such as Egypt the political space has been too contested to reach consensus. In several countries governments initially responded to popular pressure by increasing (rather than reducing) subsidies. On the other hand, countries that have been more insulated from political disruption have had more success in taking forward economic reforms - Morocco, for instance, has gained 31 places in the World Bank's *Doing Business* ranking since 2010, after making changes to improve regulation and transparency.
8. **Some reform is being implemented in Jordan, Morocco, and Yemen, supported by IMF programmes, although an IMF loan for Egypt has yet to be concluded for a summary of IMF programmes).** IMF programmes in Jordan, Morocco and Yemen include commitments by the authorities to reduce fiscal deficits and rationalise subsidies. In Jordan fuel subsidies were eliminated in November 2012 and replaced with targeted payments to the poor. Attempts to put in place a similar IMF-backed reform programme in Egypt have been hindered by political challenges. Following negotiations with the IMF at the end of 2012, some initial reform measures, which included a series of price increases and tax changes,⁶ were announced but swiftly withdrawn by President Morsi following public opposition. With so much focus on the parliamentary elections planned for the April to June period there is a real risk that an IMF-backed economic reform programme is not put in place until after the upcoming elections. Such delays are putting macroeconomic stability at risk: Egypt's reserves have fallen from over \$36bn at the end of 2010 to around \$13.6bn by January 2013, barely sufficient to cover 3 months of imports.

Where to go from here – ideas on building positive reform momentum

9. **Influencing the reform agenda remains the main lever available to both the UK and the international community.** The challenging global economic environment is likely to continue into 2013 and beyond, whilst the room for policy manoeuvre of transition countries (high fiscal deficits, lower reserves, high unemployment) is getting increasingly tight. On the other hand, political conditions for reform may start to improve (especially once elections in Egypt, Tunisia and Jordan have been resolved) with new instruments for the international community to support reform, such as the Deauville Transition Fund, now operational.. Deeper reforms – around economic restructuring, skills, trade and integration – should be started now but can be expected to take several years to bear fruit. However, some important short term reform issues include:

Issue: Macroeconomic stabilisation and IMF programmes – IMF programmes will need to be carefully balanced. If reform measures, especially fiscal consolidation, are too aggressive

⁶ These measures went beyond those actually negotiated with the IMF.

they could have destabilising effects and, if not feasible, undermine policy credibility further. Conversely, if they are too weak, reforms will not increase macroeconomic stability and investor confidence. To ensure these risks are minimised, local political dynamics must be taken into account when designing and implementing reform.

Issue: Communication of reforms - Greater attention needs to be given to the communication of reform measures in transition countries. The political unrest associated with economic reform, particularly fiscal consolidation, can be minimised by timing and communicating measures effectively. .

Issue: Strengthening investment and inclusive private sector development - Urgent reforms to improve the ease of doing business and improve conditions for investors need to be taken. This should include ensuring financial regulation supports private sector growth, particularly SMEs, and improves competition policy. Furthermore, a rapid injection and more effective channelling of credit are needed to boost private sector activity and create jobs in the near term. In terms of international support, effective implementation of the joint World Bank-IFC MSME Facility, support for local capital market development under Deauville, and achieving full EBRD expansion (enabling investments of up to €2.5 billion per year across four countries) will all be important.

Issue: Social protection - Social protection needs to be targeted and embedded across the region to protect the least well off and insure against loss of work. Currently systems of social protection exist in most countries but are of mixed quality. Through its £5m contribution to the World Bank's Multi-Donor Trust Fund for MENA, the UK is supporting the spread of best practise regarding social safety nets (and active labour market programmes) across several countries in the region. Approaches need to be tailored to local contexts, for instance to reflect preferences for means tested or community targeted models.

Issue: Subsidy reforms - Reform to energy and subsidies is important for creating more fiscal space and reducing economic distortions. Subsidy regimes are also highly regressive, disproportionately favouring high end users. However, subsidy reform is highly sensitive and needs to be handled carefully. International experience highlights the importance of good planning and timing of reforms, sound communication (both before and during implementation), and ensuring that well targeted and efficiently administered compensation arrangements are put in place.

Issue: Governance – Measures to reduce corruption and promote greater transparency in the short term could play an important role in strengthening the credibility of reform efforts in the eyes of citizens. Relatively straightforward steps such as the publishing of information on budgets could help to demonstrate greater openness and responsiveness of governments. Transparent use of natural resource revenue will be particularly important in Libya. Measures such as these can be, and are being, supported through IFIs, the Transition Fund, and the broader Open Government Partnership initiative.

Issue: Economic Policy Dialogue - Deepening of economic policy dialogue will be important for ensuring that economic challenges are better understood and undertaken with best practice in mind. It could also help to deflect some attention away from short term political tensions towards opportunities and gains that could be realised in the medium to longer term. For instance, there appears to be little awareness in some countries of potential gains from greater trade opening, e.g. through DCFTAs with the EU.

