CDPR CENTRE FOR DEVELOPMENT POLICY AND RESEARCH
School of Oriental and African Studies

Development Viewpoint
Number 63, June 2011

The Economic Prospects of the 'Arab Spring': **A Bumpy Road Ahead**

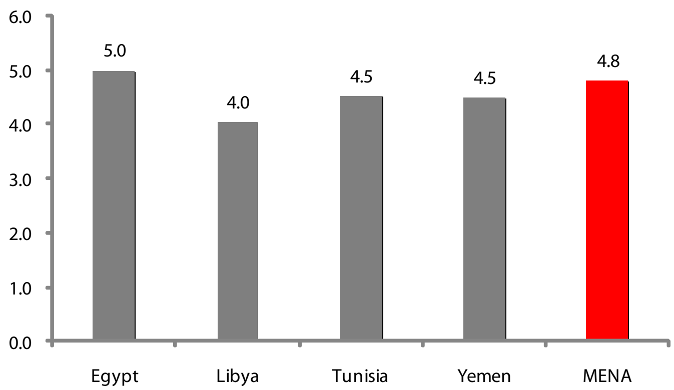
by Hassan Hakimian, Director of the London Middle East Institute and Reader, Economics Department, SOAS

In the euphoria generated by the downfall of the Tunisian and Egyptian dictators and the anxieties produced by the uncertain fate of recent uprisings in Syria, Libya, Yemen and Bahrain, it is easy to lose sight of the underlying importance of the economic conditions facing the new republics that are emerging in the Middle East.

With an entire region's *political* landscape potentially being reshaped, the relevance of the 'dismal science' is perhaps not obvious. Indeed, for the masses who are risking their lives to get rid of autocratic leaders, it follows axiomatically that the new order should offer them better economic conditions—regardless of the constraints and uncertainties.

However, past trends do not offer useful insights into the region's future. During 2000-10, Tunisia, Libya, Yemen and Egypt all achieved—under dictators—respectable growth rates of real GDP, namely, 4-5% a year (Figure 1). But the hoped-for trickle-down effect of such growth either failed to materialise or was not sufficiently robust to prevent widespread and deepening disillusionment and unrest.

Figure 1: Real GDP Growth Rate (2000-10) (Average annual %)



Source: IMF, World Economic Outlook, April 2011

Against this background, the enormity of the task ahead for new regimes is only just beginning to dawn. While direct disruptions and closures caused by revolutionary turmoil can be quickly left behind (and these were admittedly short-lived in Tunisia and Egypt), the same cannot be said of the impact of the explosion in popular expectations that has accompanied such regime changes.

Egypt's Conditions

For example, in a country like Egypt, where living standards have been eroded by double-digit inflation in recent years and food inflation is currently more than 20% and rising, a new government will find it hard to turn a blind eye to the plight of low-income groups. Based on a national income threshold for overall poverty, 40% of Egyptians are estimated to be poor, for example.

Last February's 15% increase in public-service wages cost the government about seven billion Egyptian pounds (US$1.2b). Similarly, government expenditure in the current financial year is expected to rise by a quarter, with salaries for Egypt's 5.8 million public-sector workers increasing by 20% and expenditures on health and education also expanding. Egypt is now a net oil importer and fuel subsidies alone add up to about $16.6 billion annually—accounting for a fifth of all government spending.

Revolutionary upheavals are well-known for causing economic disruptions. Iran's revolution in 1979 ended two decades of average 9% annual economic growth under the Shah; but in the first decade after the revolution, the country's real GDP shrank by almost 1.5% per annum. True, some of this decline was caused by the devastating eight-year war with Iraq and the collapse of international oil prices, but important internal factors were at work too, such as expropriations, capital flight and policy confusions and ambiguities.

Egypt now faces some of the same problems. Tourism, which employs two million people and generated a total income of $12 billion (5.3% of GDP) in 2010, fell by almost half in the first quarter of 2011. The loss of tourism is currently costing Egypt about $1 billion a month.

The country also relies on a large volume of remittances from its temporary workers in oil-rich states in the region. For example, 1.5 million workers are estimated to have been in Libya when the conflict broke out there. A recent downward trend in remittances has made another dent in the country's foreign reserves (which have declined from $36 billion in January to $28 billion in May).

The overall consequences of the unrest have been dire: Egypt's economy is projected to shrink by about 3% this year; factories are reportedly working at half capacity; unemployment is now officially at double-digit levels (up from 9% in the last quarter of 2010 to nearly 12% in the first quarter of 2011); and the budget deficit is expected to worsen, from 8.6% of GDP to around 11%.

The Threat of Conditionalities

The resultant rapid shrinking of 'fiscal space' has, not surprisingly, left Egypt's finance minister, Samir Radwan, in search of short-term fixes. The IMF's recent agreement to provide Egypt with a standby loan of $3 billion was officially described as helping with the country's 'economic recovery, generating jobs, and assisting low-income households.'

This might provide welcome short-term relief, but the spectre of submitting to IMF conditions is hardly comforting for Egyptians. Despite official assurances by Mr Radwan that Egypt shall not be "accepting any conditionality—none whatsoever", the experience of other countries that have resorted to IMF financing suggests otherwise.

Indeed, the communiqué from the G8 leaders that announced a $20 billion commitment to assist with long-term development in Tunisia and Egypt explicitly linked the assistance to reforms to promote 'democratic and tolerant societies' in these countries. Whether any generosity from the Gulf states will be free from strings is also doubtful since an occasion to assist an ally also opens up new opportunities for widening regional influence for any governments with the spare cash to hand out.

Short-term difficulties should not, however, be exaggerated just as realism about current challenges should not be allowed to detract from the exciting and long-overdue opportunities for transformation that are now available to the region.

So what lies ahead and how can the new governments make sure that their future record of economic growth and development is radically different from the legacy left by the ousted dictators?

The Road Ahead

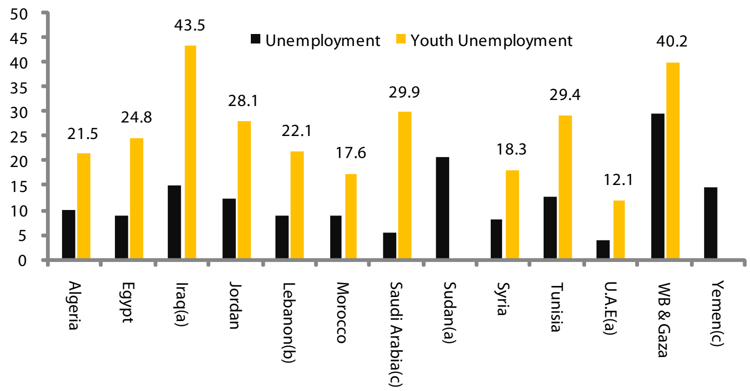
One of the critical economic lessons of the last decade has been that it is not growth *per se* but the *type* of growth that matters. As Figure 1 above showed, the MENA region as a whole experienced average annual growth of nearly 5% during 2000-2010, a rate that compared favourably with those of regions of similar income levels. For example, the growth rate of Latin America and the Caribbean was only 3.4%.

Yet, the region's Achilles heel has been its inability to translate such growth into ample productive jobs for its youthful population. As is well known, MENA's population is generally very young. The working-age youth (those between 15 and 29 years of age) account for about one-quarter to one-third of the total population across countries in the region. Similarly, the median age in the region is among the lowest in the world. For Tunisia and Egypt, for instance, it is 29 and 24 years respectively; for the West Bank and Gaza it is 20 years and for Yemen as low as 17 years.

Unfortunately, this youth bulge in the region suffers from high unemployment rates. Figure 2 shows that while the total unemployment rate is in double digits across the region, youth unemployment is often twice as high (between two and four out of ten people aged 15 to 25 years are unemployed).

The new republics will thus be judged ultimately by their abilities (or failures) to bring about lasting transformations in the livelihoods of ordinary people, particularly the young, who badly need greater access to opportunities for productive employment.

Figure 2: Total Unemployment and Youth Unemployment Rates* (%) Selected Arab Countries (2010)



Source: ILO Department of Statistics, May 2011. Notes: * Youth unemployment refers to those aged 15 to 25 years; (a)-2008; (b)-2007; (c)-2009

Thus, imaginative and bold development strategies will be needed, including growth strategies that are job-centred, inclusive and responsive to the aspirations of the youth, who have been the driving force behind recent uprisings.

Neither populism (stressing redistribution at the expense of growth) nor its polar opposite, neoliberalism (putting growth before equity and redistribution), can be the way forward. The experience of countries such as Brazil, Chile and Turkey—past autocracies that have been successfully transformed into today's democracies—shows that growth and distribution policies need not be at odds with each other. New regimes in the Middle East can draw valuable lessons from such experiences to seize an historic opportunity for real change.

In the short and medium terms, the road ahead is likely to be bumpy. Striking a balance between satisfying the legitimate aspirations for social justice at home with the imperatives of maintaining independence in the face of pressures from abroad will continue to be a formidable challenge. For some time to come, therefore, it will look as if the new republics in the Middle East are being obliged to choose between a 'rock and a hard place'.

An earlier version of this text was first published in the UAE's daily newspaper, The National on 18 June 2011