CHATHAM HOUSE

Chatham House, 10 St James's Square, London SW1Y 4LE
T: +44 (0)20 7957 5700 E: contact@chathamhouse.org
F: +44 (0)20 7957 5710 www.chathamhouse.org
Charity Registration Number: 208223

Middle East and North Africa Programme Meeting Summary

Economies in Transition: Strategic Planning in a Changing Middle East

September 2013

INTRODUCTION

This paper is a summary of the discussions that took place at a workshop held at Chatham House in partnership with the Arab Stabilization Plan on 17 September 2013 on the state of Middle East economies in the wake of the Arab Spring. Participants addressed the policy challenges posed by the damaging impact of recent political changes on economic performance, and considered how major international powers and institutions should respond to the fast-changing political and economic environment in the region.

Some of the main findings of the meeting include:

- The scale of the economic problems facing the countries where political upheavals have occurred should not be underestimated. The most glaring example of this is the big increase in unemployment over the past two and a half years. The response should be on a scale commensurate with the problem.

- The region still has the potential to achieve stability and prosperity in the long term. Its youthful demographics hold great potential if the region's youth are given the skills and opportunities to contribute to their economies. Realizing this potential will only be possible if critical issues such as fiscal unsustainability and wasteful subsidies are addressed, along with improvements to education, skills and the business environment.

- There is a strong culture of entrepreneurial ambition among the younger generation in the region, but they continue to face significant obstacles from government restrictions, bureaucracy, corruption and nepotism.

- There is an abundance of capital in the region, but inadequate mechanisms for it to be channelled into productive investment. Businesses face difficulties in running integrated operations within single countries, let alone operating on a regional canvas.

- The international responses to the changes in the region have been based on good intentions but have been muddled. Encouragement of democracy and economic liberalization has sometimes been perceived as post-colonial imposition of Western values. The difficulties that the West has faced, along with other factors such as the changes in the global energy market, have

diminished the appetite for intervention, not merely military, but also in the political and economic spheres.

The meeting was held under the Chatham House Rule and the views expressed are those of the participants. The following summary is intended to serve as an *aide-mémoire* to those who took part and to provide a general summary of discussions for those who did not.

The Chatham House Rule

'When a meeting, or part thereof, is held under the Chatham House Rule, participants are free to use the information received, but neither the identity nor the affiliation of the speaker(s), nor that of any other participant, may be revealed.'

THE MACROECONOMIC OUTLOOK FOR THE ARAB WORLD

The economic situation in much of the Middle East and North Africa (MENA) is precarious, despite the financial benefits that have accrued from a prolonged period of high oil prices. The uprisings against authoritarian rule and against the inequitable distribution of wealth in several Arab countries have brought more political instability and economic pain in their wake, although in the long term these upheavals may be seen as a necessary stage in the journey towards more inclusive political systems and more prosperous economies. One of the speakers cautioned against the tendency towards exceptionalism, noting that the recent developments in the MENA region have many parallels with other parts of the world, in particular Latin America. The transition in several Latin American countries from democracy in the early 1970s to dictatorship later in the that decade and back to democracy in the 1990s offers many lessons for the MENA region, not least in the time these kind of transitions can take. Likewise, the efforts in countries such as Brazil, Mexico and Colombia to enact economic reforms, in particular the reduction of energy subsidies, merit careful attention by governments in the region that are contemplating similar measures.

The economic indicators of the countries that have experienced political turbulence make grim reading. One participant noted that the rate of male unemployment in Egypt, according to the official figures, has doubled from five per cent in 2010 to 10 per cent in 2013. Reversing that trend will take a colossal effort and a long time. Creating jobs on the scale required will be difficult to achieve at the same time as governments have to grapple with reducing their bloated fiscal deficits. In the oil importing states of the region the fiscal deficits have risen to between five per cent and eight per cent of GDP on average, reaching 14 per cent in Egypt.

The region's economies have also been facing the consequences of three big shocks in recent years, namely an external environment that has not been supportive, above all for those economies whose trade is most closely tied to the Eurozone at a time of recession in the European Union; very high energy prices, which for energy importers have been coming down recently, but which remain above $100 a barrel for oil; and the internal shock of political instability following the regional uprisings of 2011, and refugee flows from the Syrian conflict affecting both Syrian and its immediate neighbourhood.

Structural economic challenges also include fiscal deficits and a low exposure to the world economy in economies in which the public sector has a huge claim on national resources. The International Monetary Fund (IMF) has been engaged with many of these governments in seeking to support reforms

aimed at bring down deficits. One of the problems that the IMF has faced is that many of the pre-Arab Spring regimes were implementing a similar range of policies, including subsidy reforms and broad liberalization, but these policies faced popular rejection. The IMF has reached agreements with the governments of Jordan, Tunisia and Morocco, but it has repeatedly faced political obstacles in its dealings with Egypt. Since the overthrow of President Hosni Mubarak in February 2011, the IMF has come close to concluding a loan agreement with Egypt on three occasions, the most recent being in the weeks preceding the removal of President Mohammed Morsi in July 2013, but has found that the political leadership has lacked the confidence to proceed.

In the discussion about the conditions that the IMF imposes, one participant argued that the fund has become more 'permissive' in recent years, but that this has limits, as the organization is not simply a donor, and has a strong interest in the success of its programmes, as measured by improvements in the economic performance of the country concerned and by safeguarding shareholders' funds. It was suggested that the IMF still attracts criticism for its conditionality because it is prepared to speak more openly than other lenders about its diagnosis of the problems and about its policy recommendations.

On the plus side, one of the drivers of the 2011 protest movements was the desire of people to improve their lot, and the region could be an interesting prospect for investment once the difficult process of transition is embarked on. This will be harder than for east and central Europe, where there were a number of endogenous and exogenous enabling factors, not least the engagement of the European Union and wider international community, but if a vision for the future of the MENA region can be spelt out, then early actions (such as improving fiscal transparency and encouraging e-government and a greater use of on-line transactions) could help underpin a broader consensus among public, private and civil society interests.

In this respect, assisting and promoting trade access is key to encouraging 'self-help', since greater exposure to export markets provides a discipline to be more productive, as well as increasing foreign direct investment (FDI) levels and the sharing of experience across wider markets. The IMF is also conscious of its role as a catalyst for change, and its emphasis on subsidy reform stresses the benefits of cutting public expenditure and using resources inefficiently, when other more targeted approaches would have the same desired outcome.

Regional governments might also be encouraged to focus on what might be termed 'micro-deliverables' in terms of focusing on objectives that are

important to society, but which are not necessarily expensive to deliver, but that have visible outcomes over a short space of time. It is often the case that the answers can be found in best practice examples elsewhere, but that not enough time is spent focusing on 'how' to deliver results, as opposed to 'what' the solution or desired outcome might be. One example of a 'nimble' action in many environments is to focus on investing in women's employment, for which there are a number of good models and cost efficiencies in doing so.

STRUCTURAL ECONOMIC CHALLENGES AND THE ROLE OF THE PRIVATE SECTOR

The session focused on microeconomic issues, in particular exploring how the private sector can play a much more important role in sustaining economic growth and creating jobs. Across the world, start-ups, as defined as businesses that are less than five years old, have been the main drivers of job creation, and surveys have shown in the MENA region that there is a strong entrepreneurial appetite among young people. However, aspiring entrepreneurs face formidable barriers. The procedures that new businesses have to go through in order to secure the required authorization to start operating are expensive and time-consuming. What this means in effect is that there is a built-in bias in favour of the already wealthy, well-established or well-connected; this is hardly unique to the Middle East region but is a concern often cited by youth in the region.

Incorporation of a new venture all too often requires boxes to be ticked, which may not correspond to the nature of the new business that is being created. Many countries also have fixed ratios for the equity of private companies, for example limiting foreign investors to a minority stake in certain sectors, which limits the flexibility that start-ups can offer in terms of their equity structure. Another serious obstacle to flourishing new businesses is the protective barriers to regional expansion, for instance stemming from complex and fragmented licencing and standards regimes. Requirements for frequent licence renewal can also cause uncertainty and delays.

There is a great tradition of enterprise and trade in the Arab world's history, and ambitions and ideas among the region's youth today, but the enabling environment is largely lacking. Despite such concerns, the private sector has grown in importance in the MENA region over the past 30 years as the role of the state in the economy has diminished. It was also pointed out that technology can offer 'quick wins' in terms of the changes it can bring to legal structures and the incorporation of businesses, including in by-passing

bureaucracy or the risk of corruption. There are now fairly universal norms available for setting up corporate structures that MENA economies could adapt and adopt fairly swiftly.

However, the state often wields significant influence over the operations of the private sector. Moreover, there is still a region-wide preference for public sector employment, often seen as more secure and better remunerated than the private sector, so the balance of incentives to recast the private sector as an attractive option needs to be reappraised.

During the discussion, the question arose of the dependence of many of the poorer and more populous Arab states on remittances sent home by their nationals working in the Gulf and further afield. Since 2010, Egypt's financial dependence on remittances has become more acute, as the total amount sent home by Egyptians abroad has risen by one-third in two years to reach $20 billion, making up about 30 per cent of the country's total current account receipts.

THE INTERNATIONAL RESPONSE

Western governments and international financial institutions (IFIs), such as the IMF and the World Bank, have struggled to come to terms with the changes in the MENA region. The Arab Spring uprisings opened the possibility of a virtuous cycle of democracy, good governance and enhanced economic growth, and Western governments and IFIs were quick to declare their readiness to support this process with financial and technical aid. Unfortunately, aid through the international system, including the Deauville Partnership, has been limited, insufficient, and tied to conditionalities that have not yet been met.

Despite the shocks to the region in recent, years, overall what one speaker termed the 'youth-quake' across the region could be a reason for optimism, in that it has unleashed a new set of energies across the region which now have to be mobilised properly. Focusing too much on the region's stability runs the risk of implying something static, whereas stability can also be dynamic. One area where progress has already been made is in devising new mechanisms for matching skills to productive jobs, and putting the concept of meaningful employment at the centre of job-creation efforts. While it is clear that focusing on small and medium enterprises (SMEs) is critical to this, there also needs to be a clear link between the right kind of education for new types of employment and the broader needs of changing economies. Educational

reform will take a generation, so there will have to be fiscal support for this in the meantime,

One paradox of the MENA region is that it is not short of money, but that investment levels and the investment climate lag behind the commitments that might be made. For this reason, more attention needs to be paid to finding the right financial vehicles to pool and mobilize multilateral funds, above all in matching donors to projects in a more efficient way. Regional models do already exist, such as the Yemen package, which could be scaled up for the region as a whole. The Deauville model, on the other hand, has disappointed the Arab world by promising $38 billion but then not delivering it.

In terms of 'quick fixes', there is much to be learnt from online mentoring schemes in India, for example, or in making more links between specific sectors and industries. Starting by focusing on public sector reform would also have add-on benefits for the private sector, as would the exploration of more public-private partnerships (PPPs). For economies already closely linked to Europe, greater use could be made of market proximity by increasing value chains in manufacturing, as in the assembly plant models that have thrived in Asia. Specialist technology and business centres known as 'technopoles' can also increase rapidly if the barriers to start-ups are dropped, as can new models of social enterprise (including venture philanthropy), which if set up on a franchise basis, can be scaled up quickly according to local circumstances.

In all these respects, international expertise and funding needs to be provided on both a bilateral and multilateral basis, where it is not a question of either/or. What is important is to start the momentum for change in areas where timely interventions and best practice examples can have a swift impact on the overall dynamic of economic development.

ABOUT THE MENA PROGRAMME

The Middle East and North Africa Programme, headed by Dr Claire Spencer, undertakes high-profile research and projects on political, economic and security issues affecting the Middle East and North Africa. To complement our research, the MENA Programme runs a variety of discussion groups, roundtable meetings, workshops and public events which seek to inform and broaden current debates about the region and about UK and international policy. We also produce a range of publicly available reports, books and papers.

www.chathamhouse.org/mena