MEI@ND
www.mei.org.in
Middle East Institute @ New Delhi
...for Openness and Credibility

COMMENTARY

No.098 **Friday, 18 January 2013**

Arab Economies in Transition: Limited Room for Optimism

Ibrahim Saif

Carnegie Middle East Center, Beirut

As citizens across the Arab world call for better living conditions and greater personal freedoms, many countries have witnessed protests and revolutions. The year 2012 offers a clear example of how political transformations have impacted regional economies. Five Arab countries—Tunisia, Egypt, Syria, Jordan, and Lebanon—are experiencing transitions. However, their current economic performance will not allow them to meet the Arab Spring's demands for better living standards.

Expected growth rates for these economies have all fallen significantly, now standing at three per cent at best. Egypt's projected growth is estimated at two per cent, while estimates for Jordan and Lebanon stand at 2.5 per cent. Syria's growth rate is predicted to decline by 5.5 percent, while Tunisia's growth will shrink by two per cent.

If population growth is taken into account, the net economic growth will be negligible across the board. This will only further contribute to the deterioration in standards of living, making it difficult for new regimes to claim that the demands of the revolutions have been achieved.

These declining growth rates are accompanied by mounting concerns about the future, feeding into the conflicts plaguing the political process, particularly in Egypt and Tunisia. Political instability in turn exacerbates economic problems, making it exceedingly difficult to boost growth rates and attract investment. The first priority, then, is to achieve a political settlement that sends the right signals to parties across the political spectrum and gives private sector investors the confidence to resume business activities.

The five countries undergoing economic transitions share some common challenges. Chief among these is the problem of large budget deficits, which prevents governments from spending on stimulus packages. Public spending in these economies remains focused on covering public salaries and benefits, with very little allocated for investment in infrastructure and utilities, such as water and electricity—a situation that reflects the politicized nature of public spending policies in these countries.

Another challenge shared by the five countries is the lack of a clear economic program that sets out priorities and policy frameworks. This lack of a coherent economic vision deters local and international private investors, which explains the decline in the level of direct investment in these economies.

Egypt saw more than US$ eight billion in capital flight last year, while inflows fell to about US$ three billion. Apart from some investment from Gulf countries, Egypt is unable to attract foreign direct investment. Tunisia is in a similar situation and suffers from an unemployment rate of 19 per cent—its highest level in five years.

Instability and the lack of a clear economic vision have also affected critical sectors in these five countries. The tourism industry, for example, which is viewed as the most important contributor to foreign currency inflows and job opportunities in the five countries, has been hit particularly hard. For example, the Lebanese tourism sector declined at least 30 per cent last year, negatively affecting related economic activities. Jordan faced a similar situation, forcing the government to make difficult decisions to compensate for the resulting shortfall in foreign currency earnings. Egypt, where tourism is estimated to account for 30 per cent of overall employment, is experiencing comparable challenges. The fact that European countries, which are the primary source of tourists in the region, are experiencing an economic crisis of their own has also negatively affected spending in this sector. Morocco is the only exception; growth in Morocco's tourism sector is up 4.5 per cent despite difficult conditions.

Syria remains in critical condition. The country has not only experienced a deep economic decline, much of its infrastructure and key institutions have been destroyed as well. According to IMF estimates, Syria's GDP is expected to see a 5.5 per cent decline in 2012. This figure does not take into account the destruction of institutions or the time that will be needed to rebuild many sectors of the economy once the present crisis has come to an end. In light of these considerations, Syria's prospects for the next two years are anything but optimistic.

The outlook for economic growth in Tunisia, Egypt, Jordan, and Lebanon will depend primarily on the countries' abilities to recover stability and achieve political settlements. In Egypt, for example, the conflict between the Muslim Brotherhood and its opponents will remain the central political issue for the immediate future and will have a significant impact on the country's economy. Lebanon's tourism and financial services sectors will continue to be negatively affected by the ongoing conflict in Syria, given the close links between the two countries. If a resolution is reached in Syria, Lebanon's economic outlook would improve. The situation in Jordan will be determined by the outcome of upcoming parliamentary elections, but it remains to be seen whether the vote will contribute to a solution or only serve to deepen Jordan's internal conflicts.

The trajectory of economic conditions in the region remains uncertain. Even assuming that the situation will improve in some Arab countries as stability is regained and political solutions are achieved, the behaviour of political parties, the private sector, and foreign investors during the best periods of 2012 does not suggest a strong forecast for 2013. Ongoing challenges are likely to include a slowdown in economic growth and a deepening of instability, given that economic reforms have failed to achieve an acceptable degree of social justice.

Statistics of Note

The United Nations Economic and Social Commission for Western Asia expect a slowdown in most oil-importing Arab member states. According to IMF estimates, political uncertainty and the global economic crisis will reflect on the growth rates of oil-importing Arab countries over the coming two years. The need for financing is expected to rise given the weak state of economic activity, the increase in international fuel prices, and the effects of procedures to increase wages and benefits in response to social pressure. External financing needs in the region are expected to rise from US$48 billion in 2012 up to US$60 billion in 2013.

Syria

The Syrian economy is expected to see a 5.5 per cent decline in 2012. The current Syrian crisis is expected to affect the Lebanese tourism sector, however, cash inflows and remittances from GCC countries will improve growth rates from 2 to 2.5 per cent in 2012.

Egypt

Real GDP is expected to reach 1.5 per cent in 2012, while unemployment rates have hit 12.4 per cent, up from 9 per cent in 2011. The balance of payments has deteriorated with the outflow of capital and sharp declines in revenues from tourism and foreign direct investment. As a result, foreign reserves—including central bank foreign currency deposits in domestic institutions—have declined to US$15.1 billion as of March 2012 (about three months of revenues), down from US$43 billion in December 2010.

Jordan

Real GDP rose by about 2.5 per cent in 2011, while unemployment increased to about 13 per cent. Remittances declined, as did tourism revenues and inflows of foreign direct investment. International reserves fell to US$10.7 billion (equivalent to 6.67 months of inflows) in December 2011.

Morocco

GDP growth in 2011 stood at 4.9 per cent, in comparison to 3.7 per cent in 2010, mainly due to high agricultural yields. The Moroccan government increased spending on salaries, benefits, and pensions. Inflation still stands below one per cent. Unemployment fell to nine per cent; it remains higher, however, among youth, standing at around 17 per cent. Growth of exports remains strong. Tourism revenues and remittances demonstrated the ability to weather a slowdown in Europe. Growth in imports increased, mainly due to a spike in energy prices.

Tunisia

The GDP deflator is estimated at around 2.2 per cent, while financial expansion had no real effect, as investments and tourism declined. With the decrease in production and the return of Tunisian workers from Libya, unemployment rose to 19 per cent in 2011, with youth unemployment reaching 42 per cent. The decline in tourism revenues and foreign direct investment have contributed to the widening of the current account deficit, with a decrease equivalent to 20 per cent of foreign reserves, or about US$7.5 billion(equivalent to 3.8 months of inflows).

Note: This article was originally published in ***Carnegie Middle East Center, Beirut.*** Web Link: http://carnegie-mec.org/publications/?fa=50415&lang=en

Dr. Ibrahim Saif is a Senior Associate at Carnegie Middle East Center, Beirut. Email: isaif@carnegie-mec.org

---