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ECONOMIC DIMENSIONS OF THE ARAB SPRING

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INDIRECT ECONOMIC IMPACT OF THE ARAB SPRING: THE CASE OF LEBANON

Two and a half years after the start of uprisings that became known as the Arab Spring, parts of the region are now witnessing increasing violence. In particular, the Syrian rebellion is shaping up as a major crisis, which among other things, is significantly impacting the economies of neighboring states. This is particularly true regarding Lebanon despite not having undergone its own Arab Spring internally. While the Lebanese government has officially adopted a policy of disassociation from Syria's conflict, Lebanon's sectarian splits are further polarizing its two main political blocs – each of which have stepped up ties either with the rebels inside Syria or with the Syrian government.

Lebanon's sectarian system has thus once again become entangled in regional conflict, and this is now unsettling the country's heretofore strong financial system. On 14 May, the credit rating agency Moody's warned it may cut Lebanon's government bond rating due to potential spillover effects from Syria's civil war, including suppressed growth and political instability. Though Moody's affirmed Lebanon's government bond rating, the agency changed the outlook from stable to negative. This reflects the impact of fighting in Syria, including the chance that the conflict could lead to increased political instability in Lebanon.[1]

In fact, the Lebanese economic situation has recently deteriorated. In 2012, Lebanon recorded a primary balance of payments deficit (i.e. excluding the cost of interest) for the first time in six years. Moody's has forecast a rise in the debt to gross domestic product ratio to 133 percent in 2014 from just over 130 percent at present,[2] while the state budget deficit is expected to stand at 9-10 percent of GDP in 2013 and 2014.

However, some Lebanese bankers have downplayed Moody's negative outlook, saying that they had already declined to increase their exposure to public debt due to issues cited in the warning, including a possible spillover of the Syrian conflict into Lebanon. In that regard, some bankers have recently said that they were not willing to buy new bonds as long as the government showed no willingness to cut spending, increase revenues, or implement badly needed reforms.[3]

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[1] Habib, Osama "Banks unfazed by Moody's warning" 16 May 2013 *The Daily Star* newspaper.
[2] http://www.moodys.com/research/Moodys-changes-outlook-on-Lebanons-government-bond-rating-to-negative--PR_270064 14 May 2013, accessed 16 May 2013.
[3] ibid

Lebanon is currently experiencing a political vacuum after the cabinet resigned earlier this year, with the formation of a new government dragging on and seemingly stymied. At the same time, the crisis in Syria does not look like it will end anytime soon, meaning that this abysmal situation may well stretch into 2014. Meanwhile, fiscal and other reforms remain unachieved as movement on these and other changes has been blocked.

In this context, Lebanon's politicians must speed up the formation of a cabinet and pursue economic and fiscal reforms in order to send a strong, positive message and to change investors' perceptions. Even though the Central Bank holds more than USD 36 billion in foreign currency reserves, it cannot keep financing the debt if successive governments fail to take drastic measures to reduce borrowing and achieve higher growth.

In any case, apart from the growing pressure on Lebanon from the Syrian situation and the slowing of Lebanon's economy in general having a negative impact on national finances, the country's three largest banks' non-domestic exposures in Syria, Egypt and Jordan is also proving to be problematic. Accordingly, along with the conflict in Syria, weak economic and fiscal situations elsewhere in the region are negatively impacting Lebanon's economic situation.

DIRECT ECONOMIC IMPACT OF THE ARAB SPRING: THE CASE OF EGYPT

Unlike Lebanon, Egypt has experienced major internal upheavals since its Arab Spring began in early 2011. As a result of this instability, the country's economic growth has slowed from over 5 percent in the last prerevolutionary year of 2010 to 2 percent in 2012, barely keeping pace with population growth. Foreign currency reserves have dropped by more than half since former president Mubarak resigned in the face of mass protests in February 2011, and have hovered around USD 13 billion for most of this year[4], or slightly below three months of imports, a level regarded as critical. Central bank measures to restrict currency trading have spurred the growth of a black market in dollars and euros, pushing inflation for many imported goods well into double digits. The government's budget deficit is running at about 12 percent of GDP.[5]

In such a situation, Egypt clearly needs help, but is also unable to establish enough stability to allow financial support to have a proper impact. As a result, a sort of stalemate between Egypt and its Western or international would-be benefactors persists. One explanation behind Egypt's inability to proceed with financing is due to its current government's obstinacy. For example, the International Monetary Fund's (IMF) has offered to lend Egypt USD4.8 billion, but President Morsi and his Muslim Brotherhood-led government have balked at the conditions, which include slashing subsidies for food and fuel. Successive rounds of talks between Egypt and the IMF have proved fruitless, and there is little reason to believe that Egypt will agree to an assistance package before parliamentary elections, which are expected this autumn.

Meanwhile, the U.S., for example, insists that its aid money be released to Egypt as pledged provided that an agreement is reached concerning the IMF credit, which will also ensure aid packages from institutions such as the World Bank, the European Bank for Reconstruction and Development (EBRD) and the African Development Bank, among others.

Egypt is thus caught in a vicious circle of lack of financial stability fueling uncertainty, which in turn exacerbates the country's finances and so on. According to the current U.S. ambassador to Egypt, Anne Patterson, "It is very hard for democracy to succeed if the economy is in bad shape. It is also fundamental to remember that at the start of the revolution, Egyptians' expectations were unrealistic, particularly in terms of financial expectations; it is hard for anyone to meet such demands."[6]

If there is in particular no energy subsidy reform, she added: "the country will simply eat through extra cash" concluding that "the critical issue currently at hand concerns tax and subsidy reform, which the IMF seeks to

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[4] It is interesting to compare this to the much higher level of reserves of Lebanon, which of course is a considerably smaller country than Egypt.

[5] Broadly similar to the level of Lebanon, which is nevertheless a richer country than Egypt and has fewer consumer subsidies

[6] http://english.ahram.org.eg/NewsContent/1/64/71312/Egypt/Politics-/QA-with-US-Ambassador-to-Egypt-Anne-Patterson.aspx accessed 23 May 2013

address."[7] In this situation, Egypt has relied more on regional and other non-Western financing than funding from Western sources or international organizations. However, aid and loans from such countries as Turkey, Russia, Libya, and Qatar are often heavily tied to strategic diplomatic, and political conditions, and less to implementing policies required at the socio-economic level. It remains to be seen how Egypt's domestic policies and stability could be affected by loans and aid being offered by these and other non-Western powers, whether from within or outside the region.

ATTEMPTS AT WESTERN FINANCIAL INTERVENTION: THE CASE OF THE EBRD

To help Egypt and other regional economies suffering from the short-to medium-term impact of the Arab Spring, Western countries have initiated various modes of financial support. For example, recognizing that the challenge for Europe in particular is to nurture stability among its neighbors, in July 2011 the EBRD decided to expand the institution's theater of operations beyond Europe into the Southern and Eastern Mediterranean (SEMED) region – in particular Egypt, Jordan, Morocco and Tunisia. The move came as a response to a decision made at the May 2011 summit meeting in Deauville, France of the Group of Eight, which promised to provide up to USD38 billion in aid and investment to Egypt, Jordan, Morocco, Tunisia, Lebanon, and Syria.

The decision was quite a departure for a bank that was initially created to foster the growth of market-oriented economies in the former Communist Central and Eastern Europe, and Soviet Union. However, having decided that this purpose has been largely fulfilled in many of those places, the bank felt that it was in need of a new mission, and helping countries jolted by the Arab Spring to make the transition from authoritarian regimes to prosperous and pluralistic societies was deemed appropriate.

Yet, so far, only a small fraction of the funds committed through this Deauville Process has been spent. Under this initiative and others, Western and other international lenders have tried to expand their activities in the Arab world, but progress has been slow. As such, the bank determined that it could lend and invest as much as the equivalent of USD3.2 billion annually in the SEMED, including Lebanon and Egypt.[8] However, nearly two years later, the EBRD has yet to deploy these amounts, mainly due to regional political uncertainty leading to economic weakness and instability. In any case, the EBRD is pursuing its mission to aid Arab states, including some non-financing activities such as public conferences on issues of transition.[9]

CONCLUSION

The Arab Spring is damaging trading links, impeding investment, and making many in the region jobless, compounding economic problems that helped spur the uprisings in the first place. Meanwhile, Arab governments are spending to ease public hardship and create jobs, but that is exacerbating financial weakness. Many Arab states struggling to contain social unrest have increased spending on wages, food, and energy subsidies, undermining already shaky finances and running down foreign currency reserves, risking both sovereign debt and balance of payments crises. Meanwhile government borrowing costs have been climbing as foreign investors pull out, forcing reliance on local banks to finance budget deficits.

Arab governments are now talking about the need for an inclusive model of economic growth that would create jobs and allow more people to share in prosperity. This might include better education, greater state investment in transport and healthcare, and more progressive tax systems. However, this remains idle talk until political and economic stability return, and even then, there is the matter of political will.

Yet when all that is finally achieved, the Arab Spring, like the fall of Communism in the former Soviet bloc over two decades ago, could help bring local economies further into the global supply chain, thus spurring regional growth In fact, the Arab Spring accelerated an already existing trend, leveling the public landscape and triggering a sense of

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[7] ibid

[8] As mentioned to the author in confidential interviews with EBRD officials in Tunis, March 2012

[9] For example, together with the Center for Mediterranean Integration of the World Bank, the EBRD has also organized a series of conferences - the T2T (transition to transition) Initiative - that aims to use the experience of Eastern and Central Europe to help inform the current process of change in the Arab region. In this context, events were held in Morocco (February 2012), Tunisia (December 2011) Egypt (October 2011) and Jordan (May 2012).

accountability. Arabs do not accept the use of political influence as they used to. Extended family-owned interests in sectors such as telecoms, news media, and banking, which had crowded out potential competitors, are now being dismantled, creating new opportunities; and banks have become freer to lend without political interference. In this context, the private sector, which was once stifled by government, will grow as change brings competition. Yet, such potential future gains are obscured by heavy present costs, though ultimately the Arab Spring will unlock opportunities for private companies, overturning entrenched interests and opening the field for new entrants.

With the price of crude remaining high, the region's oil-rich states will continue doing well in the short-term. Meanwhile, the economic situation in the non-oil rich Arab countries will stay poor, though in the longer run their situations will improve and eventually become better than they were before the Arab Spring. Yet a modicum of stability must exist for fresh financing to be useful to Cairo, otherwise the result would be augmented debt with little prospect of repayment. For other Arab states, such as Lebanon, major reform, not significant aid, is the key to long-term sustainability, regardless of the situation elsewhere in the region.

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