The popular uprisings that swept the Middle East in early 2011 dramatically altered the political landscape of the region with the overthrow of autocratic regimes in Egypt, Libya, Tunisia, and Yemen. These uprisings gave hope to citizens that this was the beginning of a long-overdue process of democratic transition in the Arab world. The monarchies of Jordan and Morocco also went through profound political changes, even though the rulers maintained their power. While the promise of democracy in the Arab transition countries was seen as the driving force in the uprisings, economic issues were an equally important factor. The explosive combination of undemocratic regimes, corruption, high unemployment, and widening income and wealth inequalities all created the conditions for the uprisings. The citizens of these countries thus expected governments to simultaneously address their political and economic demands.

Unfortunately, over the past three years economic issues have taken a back seat to politics. The lack of attention to economic policies was presumably due to the fact that the primary focus of governments was in addressing political issues with the intention that once these were resolved they would turn to tackle the economy. Governments of the Arab transition countries have been late in realizing that politics and economics move in tandem, and political stability is very difficult, if not impossible, to achieve if the economy is in disarray.

Economic Developments since the Uprisings

What have been the main economic consequences of the Arab Spring? Virtually all the economies have floundered over the past three years, experiencing both low economic growth and high unemployment. Domestic and external shocks combined to create a perfect storm and left the economies in significantly worse shape than they were prior to the uprisings (Figure 1). These countries faced political turmoil and social unrest that caused the security situation to deteriorate and created great uncertainty for domestic and foreign investors. Higher oil prices resulted in serious external and fiscal imbalances, except for Libya because it is an oil exporter. The financial crisis in Europe led to a decline in the demand for exports, a reduction in tourism receipts, cutbacks in foreign direct investments, and a falloff in workers’ remittances. Finally, they all faced...
adverse regional spillovers from the deterioration of the economies in their immediate neighborhood.

All of these factors had serious negative consequences for economic performance. In 2011, the growth of real gross domestic product (GDP) fell sharply in all the countries except Morocco (Table 1).\(^3\) In Egypt, the largest economy in the group with a nominal GDP of around $250 billion, growth fell to less than 2 percent from over 5 percent in the previous year. The picture was broadly similar for Jordan. After growing by an average rate of 6 percent per year over the previous decade, the growth rate in 2011 sank to only 2.6 percent.

Libya, Tunisia, and Yemen actually experienced negative growth rates, a phenomenon rarely seen in the developing world. The Libyan case is admittedly exceptional as the civil war resulted in a drastic cut in oil production to less than 0.5 million barrels per day (mbd) from 1.7 mbd in 2010, and also because of the United Nations-sanctioned freeze on Libyan foreign assets. The collapse in oil production, the country’s main product and revenue source, and the concomitant fall in non-oil GDP led to overall real GDP falling by a staggering 62 percent. In Tunisia, real GDP declined by nearly 2 percent after having averaged a growth rate of 4.5 percent per year over the previous decade. Yemen, which had been growing at the same rate as Tunisia during 2000-10, had a contraction in real GDP of nearly 12 percent in 2011.

The following two years saw growth rates in the Arab transition countries stabilize, but at a low level. In Libya, as oil production came back online much faster than expected, real GDP grew by over 100 percent in 2012 before dropping again by 5 percent in 2013 as oil supplies were once again disrupted by strikes and political infighting.\(^4\) Taking Libya out of the mix, real GDP in the Arab transition countries grew by an average rate of only about 3 percent during 2012-13. This low-growth equilibrium is not sufficient to absorb new entrants into the labor force, let alone make any dent in the existing stock of the unemployed.

Despite the fact that unemployment was a major cause of the uprisings, the picture worsened in 2011-12 in all six countries.\(^5\) Official statistics show that, with the exception of Morocco, unemployment rates were all in double digits (Figure 2). In Egypt, the unemployment rate reached nearly 13 percent in 2012, and in Yemen it hit 35 percent. While these high unemployment rates are clearly a serious problem, far more worrisome is that the rates of youth unemployment are estimated to be two to three times the overall unemployment rate. Even in Morocco, which experienced better growth performance than the other countries, unemployment was more than 9 percent with the unemployment rate among people aged thirty-four years and younger estimated to be around 30 percent.

\(^{3}\) Morocco’s growth rate rose in 2011 to percent due primarily to strong agricultural production that year.

\(^{4}\) The doubling of real GDP in 2012 is due to the so-called base year effect. Real GDP dropped to half its level in 2011, and then came back close to its original 2010 level in 2012.

\(^{5}\) Official data on unemployment is only available through 2012. Unofficial estimates show wide variations for 2013.
The containment of inflation, except in Egypt and Yemen, was the only saving grace of the recessions in the Arab transition countries (Table 1). Nevertheless, with inflation in the countries running at an average annual rate of 8 percent, governments have to be cognizant of the trade-off between inflation and growth. While it is possible to generate a growth spurt through expansionary macroeconomic policies, as inflation rises it will eventually have an adverse effect on growth. Empirical estimates for the Middle East and North Africa (MENA) countries show that once inflation reaches 6-8 percent, its effect on long-term growth becomes negative. Clearly, Egypt and Yemen are very much in that danger zone.

The falloff in tourism receipts and workers' remittances have led to a widening of external current account deficits (Table 2) and a loss of international reserves. Egypt and Yemen managed to keep the current account deficits below 3 percent of GDP, while Libya has had the advantage of high oil prices and achieved substantial surpluses. Jordan has been running a current account deficit of over 10 percent of GDP, and Morocco and Tunisia are close to that same level. As a result, the Arab transition countries as a group, excluding Libya, lost some $30 billion in international reserves from the start of 2011 to wind up at $55 billion at the end of 2013. All five countries experienced this fall in reserves with Egypt and Jordan losing almost half their end-2010 stocks.

Fiscal deficits in the Arab transition countries increased as revenues stagnated with the slowdown in their respective economies and as governments engaged in expansionary fiscal policies to meet the populations’ demands to relieve economic hardships (Table 2). Public sector wages were increased in all six countries, with Libya taking the lead by raising public sector wages between 2011 and 2013 by 77 percent. Subsidies for food and energy are the other big-ticket item in the budgets of Middle East and North Africa countries. According to International Monetary Fund (IMF) estimates, almost half of the world’s subsidies for energy—amounting to nearly $2 trillion—are in the MENA level.

TABLE 1: Economic Effects of the Arab Spring, 2010-13

<table>
<thead>
<tr>
<th></th>
<th>Real GDP (percent change)</th>
<th>Inflation (percent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Egypt</td>
<td>5.1</td>
<td>1.8</td>
</tr>
<tr>
<td>Jordan</td>
<td>2.3</td>
<td>2.6</td>
</tr>
<tr>
<td>Libya</td>
<td>5.0</td>
<td>-62.1</td>
</tr>
<tr>
<td>Morocco</td>
<td>3.6</td>
<td>5.0</td>
</tr>
<tr>
<td>Tunisia</td>
<td>2.9</td>
<td>-1.9</td>
</tr>
<tr>
<td>Yemen</td>
<td>7.7</td>
<td>-12.7</td>
</tr>
</tbody>
</table>

Source: IMF; Institute of International Finance; author estimates.


7 In Egypt the government of Hazem El-Beblawi also recently announced a 75 percent increase in the minimum wage of public sector employees.

In the Arab transition countries, total subsidies in 2013 amounted to 14 percent of GDP in Libya, 10 percent in Egypt, 9 percent in Yemen, and 6 percent in Morocco.

Economic Policies after the Uprisings
In the first two years following the uprisings, none of the Arab transition countries developed a coherent and comprehensive economic plan. In large part, this was due to the preoccupation of the governments with establishing new political systems and institutions. Economic policy was a secondary priority. The other major reason was that, unlike the Central and Eastern European countries that adopted the liberal market-oriented European Union (EU) economic model in order to receive assistance from and eventually join the EU, the Arab countries did not have an economic model to adopt. As a consequence, governments have essentially been temporizing and conducting populist economic policies that cater to the immediate demands of the restive and now highly empowered public.¹⁰

Prior to the uprisings, most of the Arab transition countries had undertaken a series of market-oriented reforms in varying degrees designed to give the private sector a leading role in economic development. The reform programs were largely based on the so-called Washington Consensus that emerged in the 1990s.¹¹ These reforms included, among others, restructuring financial systems, reducing the size and dominance of the public sector, streamlining business regulations, privatizing state-owned enterprises, bringing public finances under control, and granting greater independence to central banks to conduct monetary and exchange rate policies.

The notable exception was Libya, where the regime of Muammar al-Qaddafi continued to exercise almost total control of the economy and severely constrained the development of the private sector.¹² Reforms were limited to the banking system, but even then state-owned banks continued to dominate the financial system. In

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Yemen too, there were few systematic efforts by the government of then-President Ali Abdullah Saleh to implement economic reforms. With the uprisings in early 2011, the reform programs in the Arab transition countries came to an abrupt end. Faced with a public demanding jobs and better standards of living, as well as the discrediting of the economic policies associated with the previous autocratic regimes, the governments reversed course and adopted more populist economic policies. Such policies are particularly evident in two main areas—job creation and subsidies.

Governments in the Arab transition countries, although preoccupied with political and security issues, understood that tackling unemployment had to be the main economic priority. But jobs cannot be created out of thin air. Improving the education system to eliminate the skills-mismatch between the types of graduates produced by schools and universities and the demands of the private sector is a long-term proposition that takes substantial time to show results. Promoting the expansion of private businesses through infrastructure development and the reduction and streamlining of business regulations so that they will hire more workers is also something that cannot be achieved overnight. The only way to create jobs in the short run is by expanding government employment, which is what several countries did. For example, in Egypt some 400,000 public sector jobs were created in 2011-12, and in Tunisia the budget for 2013 included an additional 23,000 government jobs. This was a clear reversal of the trend before the uprisings to shrink the public sector and reduce government employment. Currently, the public sector remains the largest employer in all of the Arab transition countries.

All the Arab transition governments apparently recognize that generalized subsidies systems are unsustainable. Not only are they very costly for public finances, they are highly inefficient as the benefits do not go just to the segments of the populations that need subsidies. Nevertheless, in the first two years after the uprisings, these subsidies were maintained, and in the case of Libya increased further.

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14 In Libya subsidies for food, fuel, and electricity rose from 10 percent of GDP in 2010 to 14 percent in 2013.
Arab transition countries benefit from subsidies and view them as an entitlement. In the tumultuous initial years after the uprisings, converting it to a more targeted system, say through the use of direct cash transfers to low-income households, was almost impossible for any politician to advocate in the face of opposition from the rest of the population. So to a large extent, tackling subsidies was put off for the future.

Governments have also considered other populist measures, such as raising import tariffs on “luxury” goods, imposing capital and exchange controls, increasing corporate and personal income taxes on high-income earners, putting caps on bank lending rates to support small and medium size enterprises (SMEs), and stopping, or even reversing, the privatization of state-owned enterprises. Fortunately, as yet many of these proposals are only on the drawing board. However, the danger is that they could be enacted, thereby undoing the economic reforms that had been implemented up to 2010 at significant political and economic cost.

**Role of the International Community**

Soon after the start of the Arab uprisings, the international community moved to assist the countries in their transitions. In May 2011, the G8 launched the Deauville Partnership, bringing together the main industrial countries, four Gulf Arab countries, Turkey, and the international financial institutions, along with the Arab transition countries, excluding Yemen. The objective of the Deauville Partnership was to encourage the Arab transition countries to continue along the stabilization and reform path and to assist them by providing substantial financing. A total of $40 billion was pledged, with $20 billion coming from the international financial institutions, $10 billion in the form of bilateral aid from G8 members, and the remaining $10 billion from Kuwait, Qatar, Saudi Arabia, and the United Arab Emirates (UAE).

Financing through the Deauville Partnership was conditional on appropriate economic policies and reforms to be undertaken by the recipient countries, a condition that would be met by having a program with the IMF. Since none of the Arab transition countries reached an agreement with the IMF until the second half of 2012, very little financing from the G8 and international financial institutions materialized. During 2011-12 Qatar and Saudi Arabia provided bilateral assistance to Egypt, and Saudi Arabia also provided such assistance to Jordan and Yemen. However, this financing did not carry any economic conditionality. Almost immediately after the fall of then-President Mohamed Morsi’s government in July 2013, Kuwait, Saudi Arabia, and the UAE promised Egypt $12 billion in external assistance. Again this financing to the new Egyptian government was motivated primarily by political considerations and carried no economic conditions.

Starting in the second half of 2012, several of the Arab transition countries realized the value of articulating a coherent economic plan and indicated their intention to sign on to an IMF program. By doing so, the countries stood to gain on two counts. First, an IMF program would give them access to external financing, both directly from the IMF as well as from other bilateral donors and multilateral agencies that, unlike the Gulf Arab countries, had made their financing conditional on the countries having an IMF program. Second, an IMF program would give international investors and the financial markets confidence that these governments were putting their economic houses in order and would not let populist pressures derail the economic reforms process.

Jordan and Morocco were early movers in this direction and reached agreement with the IMF in August 2012. Jordan has a 3-year Stand-by Arrangement (SBA) amounting to $2 billion, while Morocco signed a 2-year Precautionary and Liquidity Line for $6.21 billion. Both of these programs are on track, although in the case of Jordan some adjustments have been made to the fiscal deficit targets as a consequence of the unexpected cost to the budget associated with

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16 The type of assistance provided by the US and the EU has been documented in detail by Danya Greenfield and Amy Hawthorne, US and EU: Lack of Strategic Vision, Frustrated Efforts Toward the Arab Transitions, (Washington, DC: Atlantic Council, September 25, 2013) http://www.atlanticcouncil.org/images/publications/US_EU_Lack_of_Strategic_Vision_Frustrated_Efforts_Toward_Arab_Transitions.pdf. It is, however, difficult to come up with a bottom-line figure for the amount of assistance provided by the G8 countries.

17 For Morocco this means that rather than receiving the funding from the IMF over the duration of the program as is customary, it can draw on the credit line if and when it needs to do so.
the influx of Syrian refugees. Yemen also obtained short-term emergency financing of $100 million from the IMF in 2012, and intends to move to a full-fledged SBA amounting to about $500 million as soon as the political situation in the country was settled, most likely in 2014. In April 2013, Tunisia reached agreement for a 22-month IMF program worth $1.78 billion. However, until very recently the program was temporarily on hold as the Tunisian government was unable to carry out the agreed policies, particularly relating to government spending cuts and increases in indirect taxes. Now the program is back on track. Since Libya is an oil producer with large foreign exchange reserves it does not require external financing or an IMF program.\footnote{However, it is essential for Libya to develop its own economic program, which it is yet to do. See Khan and Mazran.}

Egypt’s negotiations with the IMF have been more tortuous. As early as June 2011, the Egyptian government and IMF staff reached an agreement for a $3 billion program, but it did not proceed as the military government backed away from finalizing the deal. Then in 2012, a larger SBA for $4.8 billion was agreed and its formal approval was scheduled to be discussed by the IMF executive board on December 19, 2012. However, on December 11, the Egyptian minister of finance requested a postponement of the IMF board meeting ostensibly “to give more time for social dialogue.”\footnote{Alaa Shahine and Miriam Fam, “Egypt, IMF Agree to Delay Loan Decision, Finance Minister Says,” Bloomberg, December 11, 2012, http://www.bloomberg.com/news/2012-12-11/egypt-imf-agree-to-delay-loan-decision-finance-minister-says.html.} Finally, in August 2013, following the overthrow of the Morsi government, the new Egyptian economic team announced that an IMF program was “essential” for the country.\footnote{Alaa Shahine, “Egypt Sees IMF Accord Crucial to Economic Rebound, Minister Says,” Bloomberg, August 5, 2013, http://www.bloomberg.com/news/2013-08-05/egypt-sees-imf-accord-crucial-to-economic-rebound-minister-says.html.} The IMF was also ready and willing to support Egypt.\footnote{Al Arabiya, “Christine Lagarde: IMF Ready to Resume Egypt Loan Talks,” October 13, 2013, http://english.alarabiya.net/en/business/economy/2013/10/13/Christine-Lagarde-IMF-ready-to-resume-Egypt-loan-talks-.html.} Once again, there was a change of heart by the Egyptians and no formal negotiations were initiated.

There are two main reasons that the current Egyptian government is reluctant to have an IMF program. First, the country has sufficient financing available to it from Kuwait, Saudi Arabia, and the UAE, so it does not need IMF financing for now. Second, and perhaps more relevant, is that the current Egyptian government is not ready to undertake any major economic reforms, such as cuts in subsidies, reductions in government employment, and removal of price controls, that would undoubtedly have high political costs. Essentially it is kicking the can down the road and leaving difficult task of introducing these reforms and negotiating an IMF program to the next government.

**What Lies Ahead?**

The three years since the beginning of the uprisings have been bleak for the economies of the Arab countries in transition. The period has been marked by significant macroeconomic instability, evidenced by large external and budget imbalances, high inflation, slow growth, and rising unemployment.

The first order of business is to bring about macroeconomic stability. Essentially this means putting public finances under control, reducing external imbalances, and increasing foreign exchange reserves. But growth and employment are the primary long-term objectives and governments have to strike a balance between the sometimes competing goals of macroeconomic stabilization and fostering higher growth. Furthermore, political leaders have to do this in an environment where the populations are impatient and demanding immediate improvements in their standard of living.

In the short run, this will require a judicious blending of classic macroeconomic stabilization that typically requires austerity with policies that generate a growth spurt. One way to do this is to stretch out the period of adjustment and not engage in a sudden or sharp fiscal correction and monetary contraction. With growth hovering at only 3 percent per year, and with unemployment in double digits, a fiscal stimulus, financed externally, can expand the economy in the short run.\footnote{For example, Egypt intends to spend a large amount of the Gulf financing to stimulate the economy focusing on infrastructure and easing the shortages of inputs that are forcing industries to operate well below capacity.} This approach has been accepted by the IMF and its programs with the Arab transition countries basically incorporate the concept of fiscal expansion coupled with a more gradual adjustment of macroeconomic imbalances.

The Arab transition countries need to continue with the economic reforms that were initiated prior...
to the uprisings to eventually become dynamic and vibrant economies that can compete in a globalized world and create sufficient jobs for their young and growing labor force. These reforms have proven value, as evidence from Asia and Latin America shows, and would at a minimum include:

- rationalizing the subsidy system;
- widening the tax base without inhibiting private investment and job creation;
- reducing public sector employment;
- advancing the privatization process;
- streamlining business and investment regulations;
- improving labor market flexibility by amending labor laws and regulations;
- developing a modern financial system to support the private sector and provide credit to SMEs and start-ups; and
- expanding education and vocational training to provide the youth with the requisite skills.

In order to simultaneously achieve gradual macroeconomic stabilization and introduce longer-term economic reforms will require a sound economic program as well as substantial external financial support for all the countries except Libya, which can manage without external assistance. The international financial institutions have indicated that they are prepared to provide financing under the condition that the governments adopt and maintain the economic policies necessary to achieve the stabilization and reform objectives. Such conditionality is critical to keep the countries committed to transforming their economies. The other major source of external financing is the Gulf Arab countries, but in the past they have not attached economic conditions to their support. They have to be convinced that economic conditionality is in the best interests of the Arab transition countries so that they can reform and modernize their economies with the financial resources that are being made available.23

After three years of steady economic deterioration there is some evidence that the economies will turn around in 2014. One positive sign is that several of the Arab transition countries have developed comprehensive economic programs with the assistance of the IMF that combine austerity with higher growth. Jordan, Morocco, and Tunisia already have IMF programs in place, and both Egypt and Yemen are likely to reach agreements with the IMF in 2014. If these countries adhere to the commitments in the agreements, and sufficient external financing is available to them, the economic picture from 2014 onward will improve significantly.

The challenge for the Arab transition countries will obviously be to balance short-term populist measures that the governments feel they have to take politically while keeping on a clear long-term economic reform path. High and sustained economic growth that leads to significant job creation will only come about if the Arab transition countries reform their economies to become more market-oriented and allow the private sector to take a leading role. Without these reforms and an economic turnaround, the political goals of the uprisings would be threatened. Economic failure could lead to another round of political instability and upheaval, and perhaps new uprisings by now-emboldened populations.

23 It is possible that the attitude of the Gulf Arab countries may be changing. For example, recent press reports claim that both Saudi Arabia and the UAE have advised Egypt to negotiate a $2 billion arrangement with the IMF. However, the Egyptian minister of finance has supposedly rejected this advice, even though it comes from Egypt’s main benefactors. See Wael Nawara, “Egypt’s Real Challenge: Reviving the Economy,” Al-Monitor, October 29, 2013, http://www.al-monitor.com/pulse/originals/2013/10/egypt-economy-challenge-treasury.html and “Gulf Attempts to Persuade Egypt to Resume Negotiations with IMF,” Al-Masry Al-Youm, November 26, 2013, http://www.egyptindependent.com/news/government-source-gulf-attempts-persuade-egypt-resume-negotiations-imf.
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