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The Political Economy of the Post-Arab Spring

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Introduction

As of early 2015, it has been slightly over four years since the Arab Spring movement began sweeping the MENA region. While predictions of Middle East events have always been difficult,[1] this has been especially the case with regard to events associated with the Arab Spring and its aftermath. A sampling of predictions show that many were way wide of the mark[2]–the monarchies would be easily overthrown, democracy would be finally established throughout the region, economic growth would become more inclusive, and new social pacts between the surviving autocratic regimes would replace those that had become unsustainable.

One reason for these failed predictions for the region as a whole is that often they do not take into account the region's diverse political/socio-economic settings. One solution has been to divide countries into more homogenous groupings. From an economic perspective MENA countries are often divided into two broad groupings–oil exporters, and oil importers, with each setting possessing its one dynamic[3]. Political scientists on the other hand feel more comfortable focusing on regime type–democracy, or autocratic to provide insights as to the critical forces driving events.

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[1]F. Gregory Gause II, "Why Middle East Studies Missed the Arab Spring: The Myth of Authoritarian Stability," *Foreign Affairs*, July/August 2011 http://www.foreignaffairs.com/articles/67932/f-gregory-gause-iii/why-middle-east-studies-missed-the-arab-spring

[2]Kevin Connolly, "Arab Spring: 10 Unpredicted Outcomes," *BBC News: Middle East*, December 12, 2013. http://www.bbc.com/news/world-middle-east-25212247

[3]The approach taken by the International Monetary Fund in its *Regional Economic Outlook Series*. Cf IMF, *Learning to Live With Cheaper Oil Amid Weaker Demand*, January 2015. http://www.imf.org/external/pubs/ft/reo/2015/mcd/eng/mreo0115.htm

A second, and related, reason that may account for the rash of poor predictions of Arab Spring outcomes is the tendency to focus either on the political[4] or economic forces[5] playing out. For many observers, the secular decline in governance[6] and the increase in corruption, crony capitalism,[7] together with the promise of democracy was seen as the driving force in the uprisings. Others[8] have stressed that economic issues were fundamentally more important–lack of integration into the global economy[9], high unemployment, inability to undertake comprehensive economic reforms,[10] underdevelopment of private sector activity[11], failure to develop a competitive manufacturing sector[12], and the resulting widening income and wealth inequalities and the failure to converge[13] with the more advanced counties all created the conditions for the uprisings, and go a long way in explaining subsequent developments. A complete list of forces at work prior and after 2011 are beyond the scope of this paper. However, the left portion of Figure 1 summarizes the more important ones.

As the following sections show, a blending of the economic and political explanations into a political economy approach provides a useful framework for tracking, understanding and assessing events in the region.

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[4]Cf. Mark Lynch ed., *The Arab Uprisings Explained: The New Contentious Politics in the Middle East*, (New York: Columbia University Press, 2014), and Marc Lynch, *The Arab Uprising: The Unfinished Revolutions of the Middle East*, (New York Public Affairs Press, 2013).

[5]Ania Thiemann, *The Arab Spring: The Economic Causes Underlying the Crisis*, (Paris: OECD, December 2011)

[6]Robert Looney, "Governance-Constrained Growth in the MENA Region," in Abbas Kadhim ed., *Governance in the Middle East and North Africa: A Handbook*, (London: Routledge, 2013).

[7]Antonio Nucifora, Erik Churchill and Bob Rijkers, "Cronyism, Corruption, and the Arab Spring: The Case of Tunisia" in Index of Economic Freedom 2015 (Washington: Heritage Foundation, 2015). http://www.heritage.org/index/book/chapter-4

[8]Mohsin Khan, The Economic Consequences of the Arab Spring, The Atlantic Council, February 2014. http://www.atlanticcouncil.org/publications/issue-briefs/the-economic-consequences-of-the-arab-spring

[9]Robert Looney, Why has the Middle East been so Slow to Globalize?" Review of Middle East Economics and Finance, 3:1 173-201, December 2005

[10]Salam Ben Nasser Al Ismaily et. Al., *Economic Freedom of the Arab World: 2014*, (Vancouver: Fraser Institute, 2014). http://www.freetheworld.com/2014/efaw/economic-freedom-of-the-arab-world-2014-english.pdf

[11]Robert Springborg, "The Precarious Economics of Arab Springs," *Survival* 53:6 December 2011

[12]Robert Springborg, "The Political Economy of the Arab Spring," *Mediterranean Politics* 16:3 2011 427-433.

[13]Hafez Ghanen, "Growth and Convergence in the Arab Region," Brookings Institution, 2014.

Operationally, and fully recognizing the uniqueness of each nation state, this proposed grouping places countries into one of three distinct groups: (a) gulf monarchies[14], (b) countries classified by the IMF as Arab Countries in Transition (ACT countries) countries[15], and (c) autocratic regimes[16].

Of particular interest are the ACT countries. The IMF considers these countries as those in which the effects of the Arab Spring have been more disruptive, producing a period of political transition. They include Egypt, Libya, Tunisia and Yemen, whose regimes have been reversed. The IMF also places Jordan and Morocco, both monarchies marked by constitutional reforms, have also been included in the ACT group. Countries in the ACT group were all profoundly affected by the revolutionary wave of 2011, and their economies are going through a difficult phase of adjustment.

Moving away from 2011, the ACT countries along with the other two groupings appear to be experiencing fairly unique patterns of economic growth, governance structures, and economic freedom. In turn, these factors provide valuable insights to many of the forces at work producing change in the region. The general pattern has been one of consolidation and growth for the oil monarchies, while the autocratic countries are experiencing stagnation, declining governance structures, reversal of economic freedoms, and potential instability.

Several countries, Jordan, Morocco and Algeria fall into an intermediate regime, each with the potential of transitioning into either the growth or stagnation groupings. Drawing on the key patterns in each of our three main groupings, an attempt will be made to identify the factors that must be present for Jordan, Morocco, and Algeria to graduate to the growth group–the right-hand portion of Figure 1.

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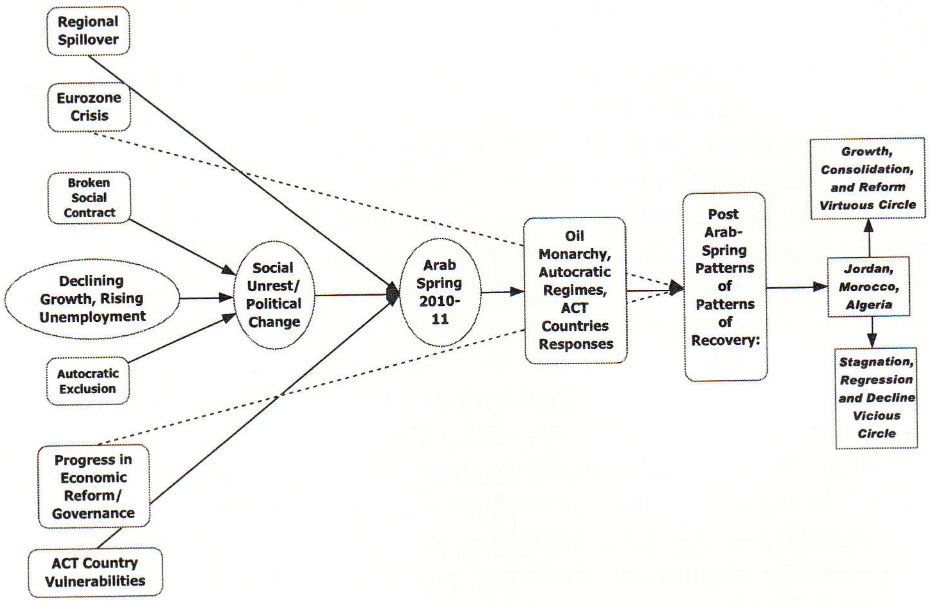
[14]F. Gregory Gause II, *Kings for All Seasons: How the Middle East's Monarchies Survived the Arab Spring,* (Washington Brookings, September 2013)

[15]Arab Countries in Transition: Economic Outlook and Key Challenges, Washington IMF, October 9, 2014. http://www.imf.org/external/np/pp/eng/2014/100914.pdf

[16]Timo Kivimaki, "Democracy, Autocrats and U.S. Policies in the Middle East," *Middle East Policy* XIX:1 Spring 2012

Figure 1
The Arab Spring: Causes and Consequences



Diverging Patterns

Economic growth in the MENA region both in the pre-Arab Spring years (2005-2010) and the post-years (2011-2014) has been mixed (Table 1). In particular, the oil monarchies have experienced the highest and most consistent patterns of economic expansion (here measured by constant price gross domestic product, GDP). In general their rates of expansion have been slightly slower at 5.3% (vs 6.5% earlier) in the post-Arab Spring years, but there are exceptions, with Kuwait and the UAE experiencing higher rates of growth in the 2011-14 years than in the years leading up to the Arab Spring.

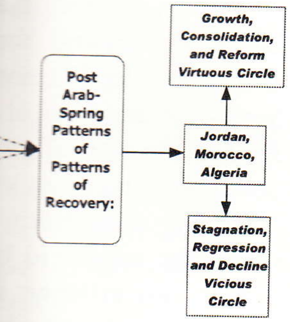


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Table 1
MENA: Annual Growth in GDP

Country	2010	2011	2012	2013	2014	Average 2005-10	Average 2011-14
Oil Monarchies							
Bahrain	4.3	2.1	3.4	5.3	3.9	5.8	3.7
Kuwait	-2.4	10.2	8.3	-0.4	1.4	2.8	4.9
Oman	4.8	4.1	5.8	4.8	3.4	5.2	4.5
Qatar	16.7	13.0	6.1	6.5	6.5	16.3	8.0
Saudi Arabia	7.4	8.6	5.8	4.0	4.6	6.1	5.7
UAE	1.6	4.9	4.7	5.2	4.3	2.9	4.8
Average	**5.4**	**7.1**	**5.7**	**4.2**	**4.0**	**6.5**	**5.3**
ACT Countries							
Egypt	5.1	1.8	2.2	2.1	2.2	5.9	2.1
Jordan	2.3	2.6	2.7	2.9	3.5	6.6	2.9
Morocco	3.6	5.0	2.7	4.4	3.5	4.6	3.9
Tunisia	2.6	-1.9	3.7	2.3	2.8	4.4	1.7
Yemen	7.7	-12.7	2.4	4.8	1.9	4.6	-0.9
Average	**4.3**	**-1.1**	**2.7**	**3.3**	**2.8**	**5.2**	**1.9**
Autocratic Regimes							
Algeria	3.6	2.8	3.3	2.8	3.8	3.1	3.2
Iran	6.6	3.9	-6.6	-1.9	1.5	4.3	-0.8
Syria	3.4					5.1	
Sudan	3.0	-1.2	-2.7	3.3	3.0	4.8	0.6
Average	**4.2**	**1.9**	**-2.0**	**1.4**	**2.8**	**4.3**	**1.0**

Data Source: IMF, WEO Database, January 2015

A completely different picture emerges in the ACT countries. Here, domestic and external shocks resulted in significantly poorer performance (1.9%) than in the earlier period (5.2%). For the most part, these countries faced greater political turmoil and social unrest than the other two country groupings. The result was loss of foreign investment confidence, decreased tourism, and increased budget deficits and current account shortfalls leading to a sharp fall-off in growth. Specially growth declined to an average of 1.9% for 2011-14 versus 5.2% over the 2005-10 period. The largest decline was in Yemen, a country experiencing considerable instability, while Morocco, a country with relative peace, experienced the smallest downturn in growth (3.9% vs 4.6%).

With the notable exception of Syria, the Autocratic regimes were able to quell internal unrest. However, their economies have declined sharply in the post-Arab era, falling to 1.0% rate of economic growth compared with 4.3% in the earlier period. No doubt the regional spillovers from the deterioration of the economies in their immediate neighborhood played a significant role in this regard.

Rates of investment have also varied considerably from one group to another (Table 2). In the pre-Arab spring years both the oil monarchies and autocratic regimes had similar rates of capital formation at around 27% of gross domestic product (GDP). The ACT countries had somewhat lower rates at 24%. However, in the post Arab Spring years, investment has fallen to 22.6% in the Arab Oil monarchies as they re-oriented their budgets toward providing more subsidies and services to their populations.

Table 2
MENA: Total Investment (%GDP)

Country	2010	2011	2012	2013	2014	Average 2005-10	Average 2011-14
Oil Monarchies							
Bahrain	27.3	16.4	20.1	16.4	18.9	30.1	17.9
Kuwait	17.9	13.5	12.8	14.1	13.9	17.8	13.6
Oman	26.2	19.1	25.3	28.0	28.4	29.7	25.2
Qatar	29.2	29.7	28.9	30.7	29.0	39.6	29.6
Saudi Arabia	30.7	26.8	26.3	28.2	30.8	26.4	28.0
United Arab Emirates	25.7	22.7	19.1	20.2	22.3	23.5	21.1
Average	**26.2**	**21.4**	**22.1**	**22.9**	**23.9**	**27.8**	**22.6**
ACT Countries							
Egypt	19.5	17.1	16.4	14.2	14.5	19.8	15.5
Jordan	23.5	25.0	21.7	20.7	21.7	28.1	22.3
Morocco	35.0	36.0	35.3	34.2	34.3	33.3	34.9
Tunisia	25.7	23.6	24.3	22.0	20.6	24.1	22.6
Yemen	11.7	5.5	8.7	8.1	8.4	15.5	7.7
Average	**23.1**	**21.4**	**21.3**	**19.8**	**19.9**	**24.1**	**20.6**
Autocratic Regimes							
Algeria	27.6	25.7	30.3	35.4	37.7	24.9	32.3
Iran	41.2	41.3	41.9	44.8	43.0	37.2	42.8
Sudan	20.1	19.1	18.7	20.0	17.5	22.2	18.8
Syria	26.7					25.4	
Average	**28.9**	**28.7**	**30.3**	**33.4**	**32.7**	**27.4**	**31.3**

Data Source: IMF, WEO Database, January 2015

On the other hand, the autocratic regimes increased their rates of investment to 31.3% of GDP in an effort to sustain higher rates of economic growth in the face of deteriorating governance and economic freedom. Uncertainty, and heightened political risk in the ACT countries was no doubt a factor in investment declining to 20.6% for this group.

One of the main factors precipitating the Arab Spring was high and chronic rates of unemployment. Unemployment figures are of notoriously poor quality in the MENA region. Also the aggregate figures reported here do not break out youth unemployment which is usually considerably higher than the overall-rate. With these caveats in mind, there are still several rough patterns that distinguish the three country groupings (Table 3).

Table 3
MENA: Unemployment Rate (% labor force)

Country	2010	2011	2012	2013	2014	Average 2005-10	Average 2011-14
Oil Monarchies							
Bahrain	3.6	4.0	3.9	4.3	4.1	4.2	4.1
Kuwait	2.1	2.1	2.1	2.1	2.1	1.6	2.1
Oman							
Qatar							
Saudi Arabia	5.5	5.8	5.4	5.5		5.7	5.6
UAE							
Average	**3.7**	**3.9**	**3.8**	**4.0**	**3.1**	**3.8**	**3.7**
ACT Countries							
Egypt	9.2	10.4	12.4	13.0	13.4	9.8	12.3
Jordan	12.5	12.9	12.2	12.2	12.2	13.3	12.4
Morocco	9.1	8.9	9.0	9.2	9.1	9.7	9.1
Tunisia	13.0	18.9	16.7	15.3	15.3	12.8	16.6
Yemen							
Average	**11.0**	**12.8**	**12.6**	**12.4**	**12.5**	**11.4**	**12.6**
Autocratic Regimes							
Algeria	10.0	10.0	11.0	9.8	10.8	12.2	10.4
Iran	13.5	12.3	12.2	10.4	11.6	11.8	11.6
Sudan	13.7	12.0	14.8	14.8	13.6	16.0	13.8
Syria	8.6					8.7	
Average	**11.4**	**11.4**	**12.7**	**11.7**	**12.0**	**12.2**	**11.9**

Data Source: IMF, WEO Database, Januaary 2015

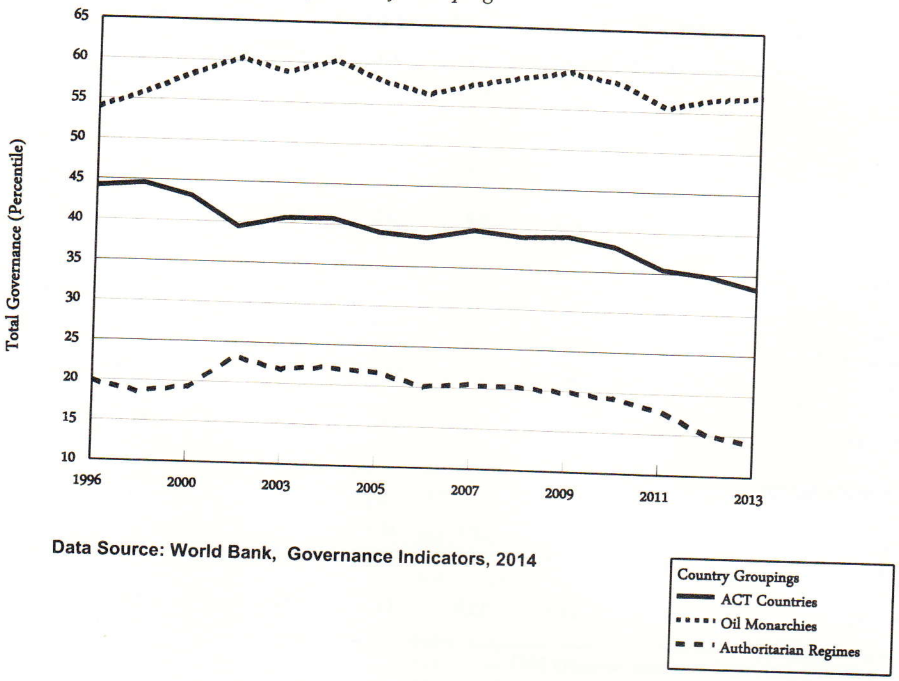
For the Arab Oil monarchies, overall unemployment rates are by far the lowest, averaging 3.8% and 3.7% respectively in the pre-and post-Arab spring years. Saudi Arabia has the highest rate decreasing from 5.7%pre- to 5.6% in the post-Arab Spring era.

Ironically, the ACT countries have had an increase in unemployment in recent years. For this group, unemployment increased from 11.4% in the pre-Arab Spring years to 12.6% post-Arab spring. Tunisia has had the highest rates of unemployment increase, rising to 16.6% in the post Arab spring period from 12.6% previously. Morocco the lowest rate at 9.1% falling from 9.7% pre-Arab Spring.

Of the factors facilitating steady sustained growth, governance, experiences significant differences between the three groups (Figure 2) Aggregating the

World Bank's individual Governance Indices of: voice and accountability, political stability/absence of violence, government effectiveness, regulatory quality, rule of law and control of corruption into an total governance summary measure produces a striking pattern (Figure 2).

Figure 2
MENA Patterns of Governance by Country Grouping



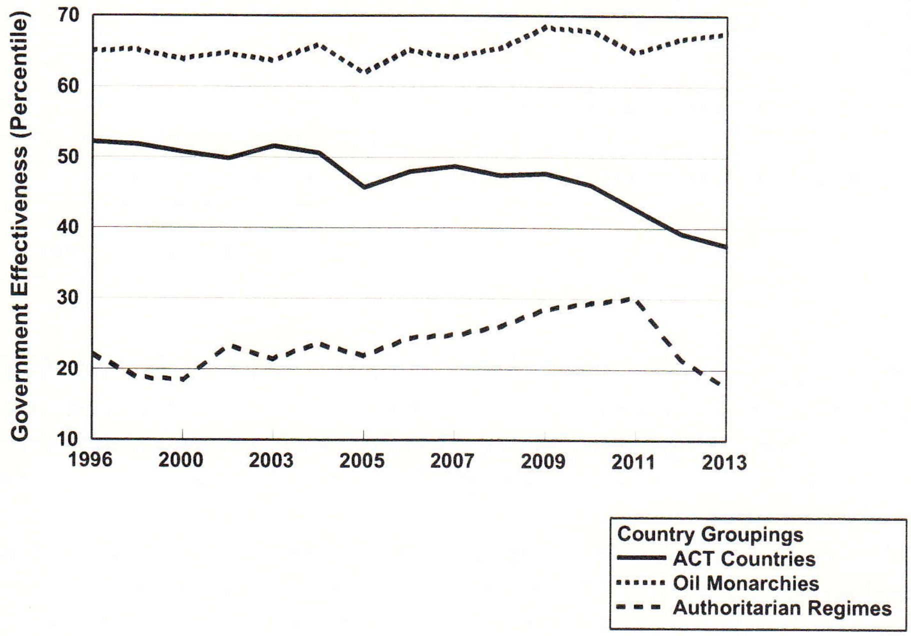
Data Source: World Bank, Governance Indicators, 2014

Since 1996, the start of the series, the oil monarchies have, given several ups and downs, shown a slight long-run improvements in governance. This groups scores are considerably above those of the ACT countries who hold a similar lead over the autocratic regimes. However, since 1998 there has been a secular decline in governance in the ACT countries as a group. Starting in 2002 the autocratic regimes also have had a gradual deterioration in their governance structures.

Of particular significance is the government effectiveness component of the overall governance index. As defined by the World Bank, government effectiveness reflects perceptions of the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies.

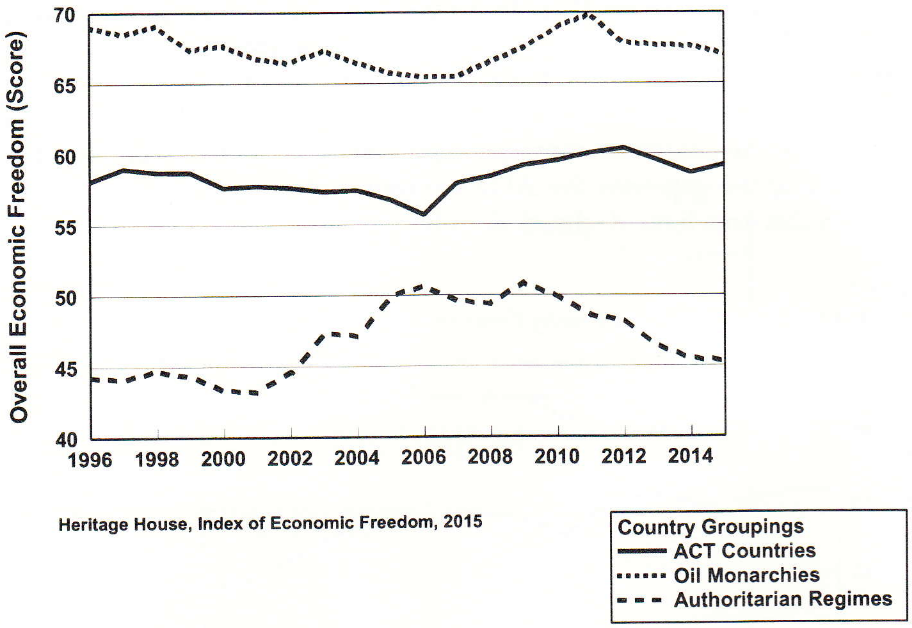
Again, three distinctive patterns in the MENA region have developed over time (Figure 3). The oil monarchies have significantly higher levels of government effectiveness than two other groups. Furthermore, starting around 2005 this group has seen a secular strengthening in this area. By contrast the ACT countries have seen a long term secular decline in government effectiveness, with levels today considerably below those in 1996. While the autocratic countries significantly lag in this area, they had been closing the gap with the ACT countries. However since 2011, their efforts in this area have declined sharply.

Figure 3
MENA Patterns of Governance by Country Grouping



A broadly similar picture (Figure 4) emerges when examining changes in economic freedom over time. Following the Heritage Institute approach the economic freedom index is a summery measure of progress made in eleven reform areas: business freedom, trade freedom, fiscal freedom, government spending, monetary freedom, investment freedom, financial freedom, property rights, and freedom from corruption and labor freedom. In general reforms leading to greater reliance on market forces and less government intervention increase a country's economic freedom score.

Figure 4
MENA Patterns of Economic Freedom by Country Grouping



Again the oil monarchies score the highest, followed by the ACT countries, with the autocratic regimes with consistently the lowest rankings. As in the case with governance, the oil monarchies have maintained their scores over time, with perhaps a slight decrease in their rankings over the 1996-2014 period.

The ACT countries following a secular deterioration in economic freedom from 1997 to 2006 experienced a fairly sharp improvement in economic freedom up to the time of the Arab Spring. Since 2011 however, scores have again began to fall.

Finally, the autocratic regimes experienced a sharp improvement in economic freedom in the early 2000s, leveling off in 2006. Since the Arab Spring unrest, however this group has seen a sharp fall in its economic freedom.

Empirical studies[17] suggest that improvement in governance by laying a solid foundation for growth tend to precede improved rates of economic

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[17]Cf. Rock-Antoine Mehana, "Governance and Economic Development in MENA Countries: Does Oil Affect the Presence of a Virtuous Circle." *Journal of Translational Management* 15, 117-150, June 2010

growth. Similarly, improved levels of economic freedom through facilitating increased efficiency of resource usage also lead to higher rates of economic growth.

The Legatum Institute Prosperity Index[18] provides a useful data set for looking past governance and economic freedom in order to identify a series of factors also associated with growth and development–the broader institutional determinants aspects of growth. In addition to governance and the performance of the economy, the index is comprised of entrepreneurship and opportunity, education, health, safety and security, personal freedom and social capital. Countries are ranked from 1-140 on each dimension with 1 the highest level and 140 the lowest.

Again our three country groupings show some striking differences in the manner in which they have evolved since the start of the Arab Spring (Table 4). The economy dimension is a composite of a number of factors usually associated with a vibrant economy: it includes among other variables, capital per worker gross domestic savings, 5-year rate of growth.

Table 4
Post-Arab Spring Shifts

(rankings)

	Economy			Governance			Entrepreneurship		
Oil Monarchies	2010	2014	Difference	2010	2014	Difference	2010	2014	Difference
Kuwait	36	16	20	36	44	-8	31	35	-4
Saudi Arabia	28	49	-21	49	49	0	48	49	-1
UAE	30	10	20	38	32	6	24	31	-7
Average	**31.3**	**25.0**	**6.3**	**41.0**	**41.7**	**-0.7**	**34.3**	**38.3**	**-4.0**
ACTs									
Egypt	72	119	-47	78	119	-41	84	89	-5
Jordan	93	99	-6	42	58	-16	70	71	-1
Morocco	35	52	-17	63	52	11	68	80	-12
Tunisia	49	87	-38	50	94	-44	45	56	-11
Yemen	99	137	-38	103	137	-34	106	121	-15
Average	**69.6**	**98.8**	**-29.2**	**67.2**	**92**	**-24.8**	**74.6**	**83.4**	**-8.8**
Autocratic									
Syria	79	134	-55	79	124	-45	92	122	-30
Algeria	90	50	40	90	103	-13	79	95	-16
Sudan	109	135	-26	109	135	-26	93	113	-20
Iran	105	114	-9	105	120	-15	86	93	-7
Average	**95.8**	**108.3**	**-12.5**	**95.8**	**120.5**	**-24.8**	**87.5**	**105.8**	**-18.3**

Data Source: Letathum Institute, Prosperity Index, 2010, 2014

[18] Legatum Institute, Prosperity Index 2014 (London: Legatum Institute 2014)

Table 4 (contd)
Post-Arab Spring Shifts

(rankings)

	Social Capital			Total Non-Economy		
	2010	2014	Difference	2010	2014	Difference
Oil Monarchies						
Kuwait	28	62	-34	95	95	0
Saudi Arabia	18	23	-5	115	147	-32
UAE	36	43	-7	98	73	25
Average	27.3	42.7	-15.3	102.7	105.0	-2.3
ACTs						
Egypt	95	107	-12	257	327	-70
Jordan	83	100	-17	195	228	-33
Morocco	13	84	-71	144	184	-40
Tunisia	50	135	-85	145	237	-92
Yemen	79	120	-41	288	395	-107
Average	64	109.2	-45.2	205.8	274.2	-68.4
Autocratic						
Syria	75	127	-52	246	380	-134
Algeria	74	95	-21	243	248	-5
Sudan	21	112.8	-91.8	223	383	-160
Iran	106	106	0	297	327	-30
Average	69.0	110.2	-41.2	252.3	334.5	-82.3

Data Source: Letathum Institute, Prosperity Index, 2010, 2014

The oil monarchies have maintained the best overall ranking during the post-Arab Spring years. In fact they have increased their ranking somewhat during this period with their average ranking increasing from 31.3 to 25. During this period, the ACTs experienced the largest deterioration in rankings falling from an average of 69.6 to 98.8. The autocratic regimes did not suffer quite as severe decline, but their average ratings still fell from 98.5 to 108.3.

The Legatum measure[19] of governance on the horizontal axis includes a score of factors similar to those in the World Bank's Governance Indices data base. In addition Legatum incises such factors as: efforts to address poverty, confidence in the judicial system, and confidence in the military.

Overall the oil monarchies experienced a slight decline in this measure of governance during the post-Arab Spring period, while both the ACT countries and Authoritarian regimes averaged a decline of 24.8 positions in the country rankings. Jordan and Morocco faired the best in the ACT

[19]A full description of the Legatum indices are contained in the Institute's annual Prosperity Index. http://www.prosperity.com/#!/

group with Jordan falling only 16 places and Morocco moving up in the rankings eleven places. Algeria was the leader of the autocratic countries seeing their ranking fall by only 13 places

The Legatum measure of entrepreneurship incorporates such diverse elements as R&D expenditure, business startup costs, the environment for entrepreneurship and an infrastructure network oriented to supporting entrepreneurial activity.

The oil monarchies have experienced a slight decline in entrepreneurship during the post 2011 period, followed by the ACTs with a moderate (8.8 positions) decline and the autocratic regimes with a major decline of 18.3 positions.

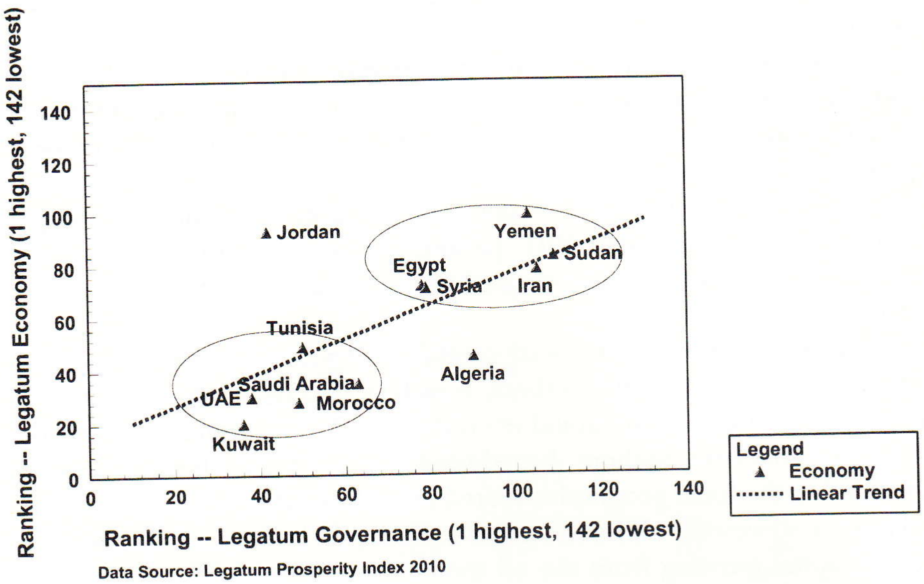
The Legatum measure of social capital incorporates elements of trust in others, views on reliability of others, as well as helping strangers, donations, and volunteering. Social capital is critical for the functioning of a market economy, because without broad-based trust, many transactions are confided to the local geographical area or within tribes.

Here, a somewhat different pattern emerges. Instead of the falloff in social capital growing from the oil monarchies to the ACT countries and the autocratic regimes, the ACT countries had the greatest decline in social capital, with Tunisia losing 85 places in the country ranking. Algeria only declined by 5 places, while Jordan and Morocco experienced declines of 33 and 40 places respectably

In sum, not only have the ACT and autocratic counties seen their economic positions decline, but perhaps more importantly the factors, governance, entrepreneurship and social capital. These elements which might have facilitated economic recovery after 2011 have declined, and in many cases at a rapid rate.

While the numbers tell a story, the significance of these shifts can be best seen in plots of several of the variables against each other, and then making a comparison of the situation in 2010 with that in 2014. Again, the Legatum index ranks countries from 1 (the highest) to 140 (the lowest). As expected, in 2010 the Oil Monarchies scored well on the economy and governance dimensions (Figure 5), and were clustered towards the origin. Similarly, many of the Autocratic countries scored low on both dimensions and were clustered toward the top right corner.

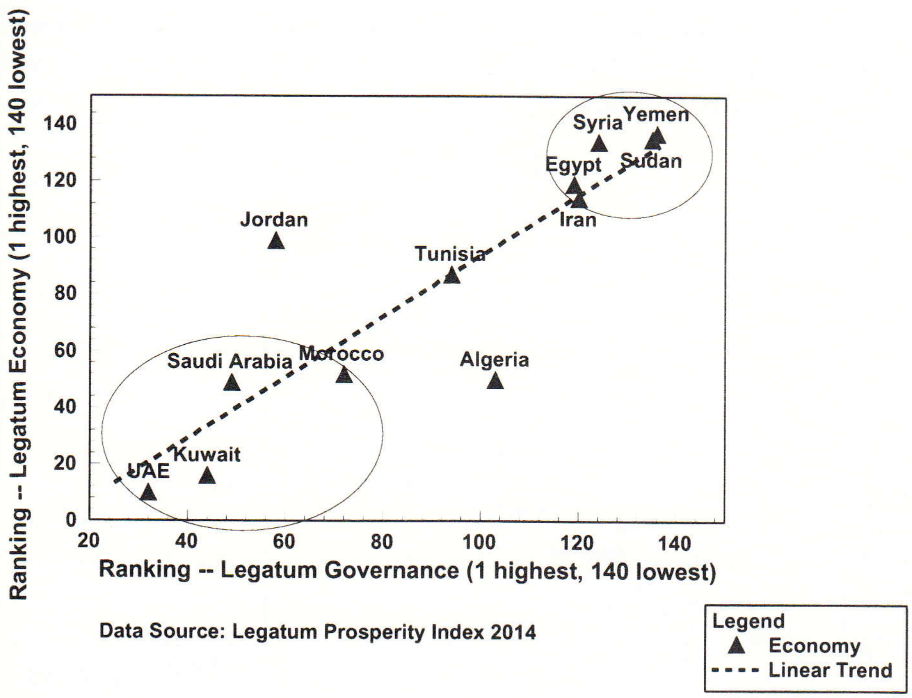
Figure 5



The countries that were to become the ACT group exhibited more variety with Egypt and Yemen exhibiting characteristics of the Autocratic regimes, while Tunisia and Morocco more like the oil monarchies. Two countries were outliers, Jordan and Algeria. Because Jordan lies above the linear trend line, it appears to be underachieving economically–the governance structures are there, but the expected economic performance is not. Similarly, Algeria lies below the linear trend line suggesting its economic performance is somewhat better than usually supported by its level of governances. Clearly other factors, such as oil revenues in Algeria's case, account for these patterns.

By 2014 changes in governance and economic performance had separated the two clusters even further (Figure 6) with now three countries Jordan, Tunisia and Algeria in something of an intermediate range. One possible explanation is that both vicious and virtuous circles are operating. For the good governance/economic performance group, increased government expenditures, and reform consolidation are sustaining economic growth and laying the foundation for further reforms. For the poor governance/economic performance group, increased uncertainty, falling levels of investment and increased unemployment are creating an environment of deeper uncertainty. By this interpretation, Jordan, Algeria and Tunisia are possibly at a point where they could go in either direction– improved governance and future prosperity, or declining governance and economic stagnation.

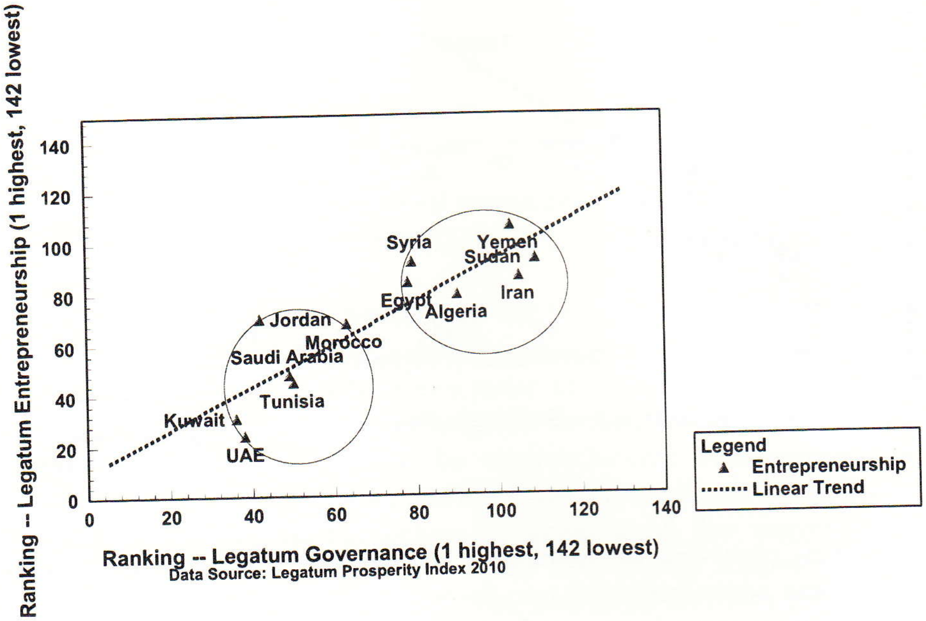
Figure 6



For many observers, the inability of the MENA countries to create jobs and become better integrated into the world economy stems from the fact that the private sector is very underdeveloped in most countries. Related to this is the fact that the manufacturing sector, usually a major source of job creation in developing economies is greatly underdeveloped compared with other regions of similar incomes. Compounding the problem is the fact that the governments have more often than not taken the lead in investing and production through state enterprises. While governments have tended to pull back in recent years, there has not been a significant increase in private sector production outside of the oil monarchies. One of the factors limiting the private sector is limitations on entrepreneurial activity. Again deficient governance structures are at the heart of the problem.

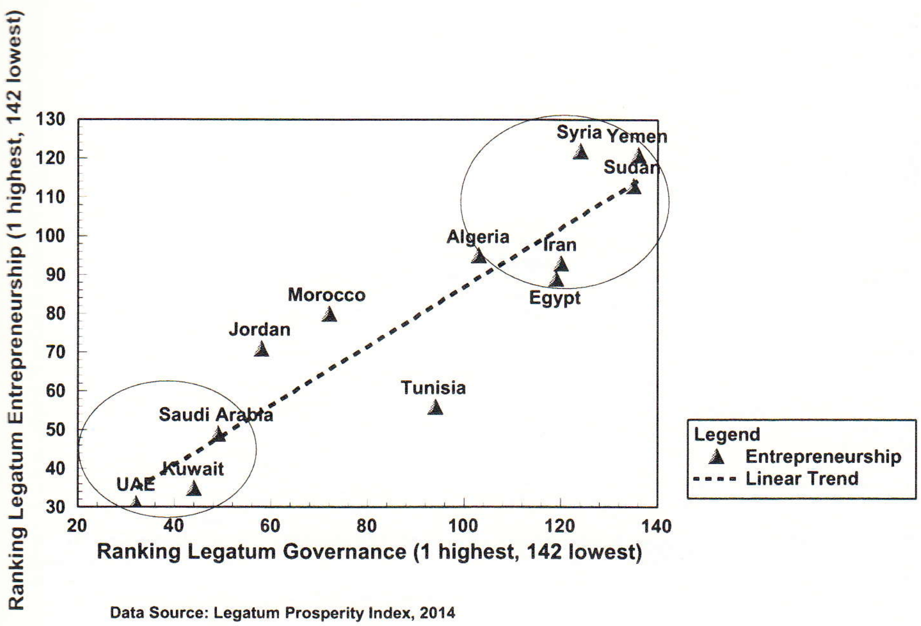
Plotting the Legatum data on entrepreneurship and governance for 2010 produces another pattern dominated by two fairly distinct groupings (Figure 7). The first characterized by good rankings in governance and entrepreneurship includes the oil monarchies plus Jordan, Morocco and Tunisia, while the second grouping clusters the autocratic countries along with ACT countries, Egypt and Yemen. Most countries are near the trend line suggesting a strong relationship between improved governance and the entrepreneurial function.

Figure 7



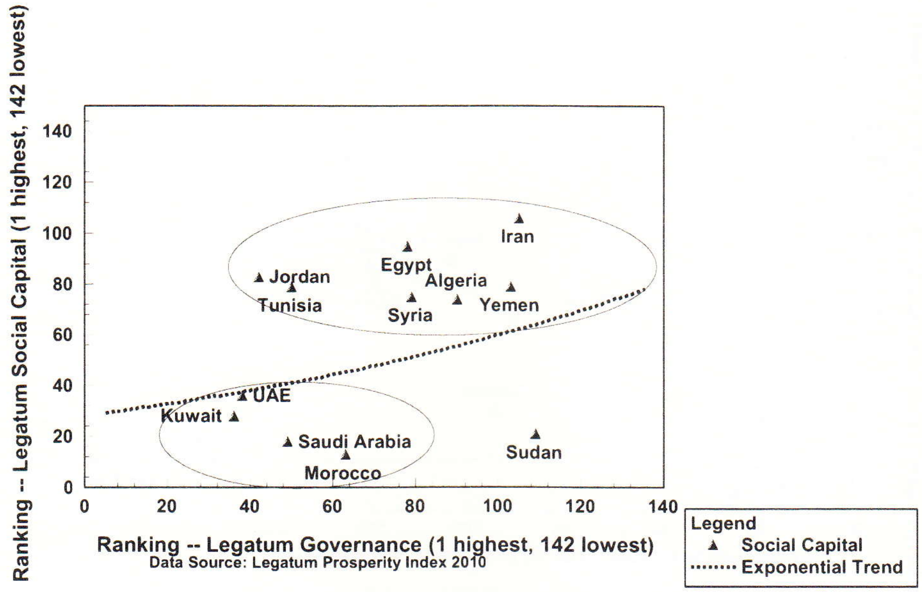
By 2014, the declines in governance and entrepreneurship in Morocco, Jordan and Tunisia had separated them between the oil monarchies and autocratic groups of countries. At the same time, their declines did not match those of the autocratic group, with the distance separating them increasing considerably (Figure 8).

Figure 8



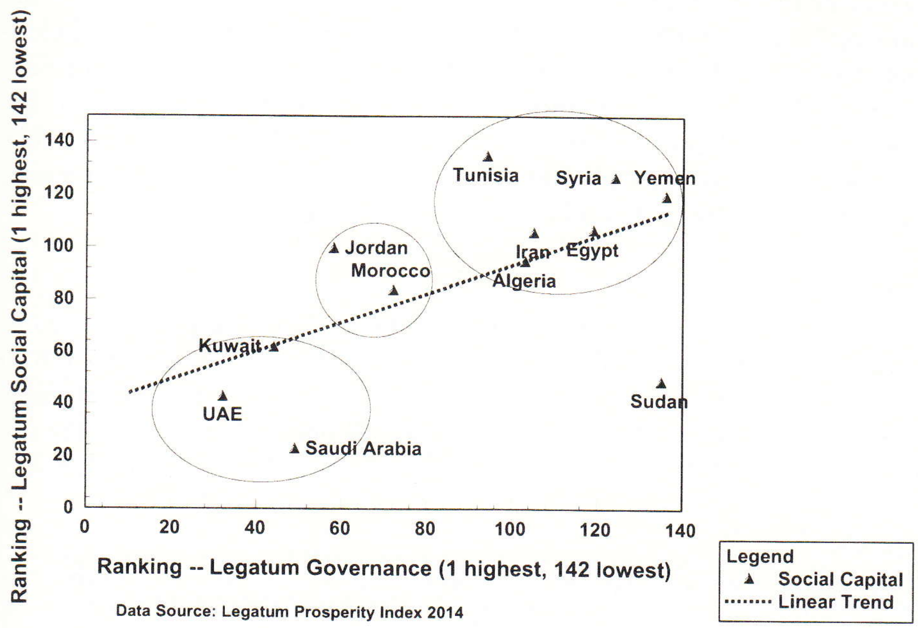
The relationship between governance and social capital is not as strong as that between governance and entrepreneurship or governance and the economy. Still, some interesting patterns with implications for future economic performance have emerged in the MENA region. In 2010 the MENA countries formed two broad groups–those with relatively good rankings in governance and somewhat better rankings in social capital and those with poor levels of both (Figure 9). Morocco was a member of the high ranking countries while Jordan, Tunisia, Egypt and Yemen were members of the lower ranking group. Sudan was the one outlier at the time with very good social capital. The oil monarchies and Morocco had very good levels of social capital given their governance, while the autocratic countries a number of Act countries had lower than anticipated social capital given their governance. Tellingly, all of the countries that were to experience regime change or high levels of domestic violence in 2011 had abnormally low levels of social capital.

Figure 9



By 2014, declining levels of governance and social capital again separated the two main groups even further, but with Jordan and Morocco now in an intermediate group between the low and high ranking countries (Figure 10). During this time, the pattern between governance and social capital was becoming more distinct with countries generally moving closer to the trend line.

Figure 10



The patterns of the economy, governance, entrepreneurship and social capital and the clustering of two relatively divergent groupings is suggestive of virtuous and vicious circles at work. A working hypothesis might be constructed as follows: for the good performers high levels of governance have helped maintain good economic performance through creating incentives for entrepreneurship in a more cooperative/trusting setting. In turn, entrepreneurs may have exerted pressure on the government for further reforms or at least fought against the tendency of governments to backtrack on governance and economic freedom during a period of high uncertainty.

In contrast, low and declining levels of governance have tended to constrain growth in the poor performing countries. Governance levels and social capital have not been strong enough to support a vigorous entrepreneurial class and growing markets. With no strong interest group advocating reforms, governments in these countries have let governance and economic freedom decline, and with the decline, poorer economic performance, contracting entrepreneurship, and eroding social capital have followed.

To sum up: except for some progress towards democracy in Tunisia there is little to show for the Arab Spring movement. If anything, many of the factors in the ACT countries and autocratic regimes responsible for the uprising in the first place, rather than improving, have significantly deteriorated since 2011. On the other hand, the oil monarchies have not only maintained levels of governance and economic freedom, but have for the most part started been taking reforms, both political and economic. more seriously. Progress has slow, but at least it has been in the right direction, and with it stability and good economic performance.

Turning Points

As noted earlier, several countries may be at a turning point–poised to begin reforms and gradually converge the growing group, or prepared to postpone reforms and see their economies gradually descend and stagnate, or experience regime change along the way. Yemen and Syria have already met that fate, will the same thing happen to Jordan, Morocco or Algeria?

Jordan

The analysis above (Figures 4, 5) suggest that the Jordanian economy has been underperforming. Specifically, economic performance is considerably below what one would expect given the progress made in improved governance. However a number of factors can account for this discrepancy.

Jordan has borne the brunt of the regional instability brought on by the Arab Spring. First, supplies of low-cost natural gas from Egypt were disrupted by sabotage, costing the kingdom billions to replace. Then, the tourism trade was hit, as fears of unrest kept visitors away. Next, the Syrian conflict has disrupted Jordan's trade with Turkey, adding significant transport costs to many of Jordan's key exports[20].

In addition, the country has been flooded with refugees from the Syrian conflict. It is unclear how many Syrian refugees are in the country, since most are not in refugee camps, but instead have made their way to cities like Amman. The Jordanian government has sometimes estimated that at the beginning of 2015 there were as many as 1.4 million Syrians in Jordan–a country of less than 7 million people. Of these, approximately 736,000 are refugees, with perhaps 20 percent of the refugees in camps[21].

[20]Emmanuel Comolet, *Jordan: The Geopolitical Service Provider*, (Washington: Brookings Institute, February 2014) http://www.brookings.edu/research/papers/2014/02/jordan-geopolitical-service-comolet

[21]Ian Black, "Patience Running Out in Jordan After Influx of Syrian Refugees," *The Guardian*, December 1, 2014. http://www.theguardian.com/world/2014/dec/01/jordan-syrian-refugees-patience-running-out

The large influx of Syrian refugees has strained the government's ability to deliver social services to Jordanians and increased social tensions and competition for jobs, especially in northern cities. The US Agency for International Development estimates that hosting the refugees will cost the government about 900 million dollars in 2014[22].

The US plans to increase its annual aid to Jordan to US$1bn a year from the current US$660m to help it to pay for the cost of housing Syrian and Iraqi refugees and the fight against Islamic State (IS), but even this amount is far from the likely economic cost born by the country[23].

The government's reform efforts, both economic and political have been underway for years. These have resulted in steady improvements in governance, economic efficiency and public participation. The country's reform process began in the late 1980s when the country suffered a debt crisis that necessitated the introduction of an IMF-supported stabilization program. Prior to this program, the government had played the dominant role in the economy controlling prices and undertaking all infrastructure development.

With the accession of King Abdullah II to the throne in 1999 the reform process gained increased impetus. A number of programs to streamline the bureaucracy, reform the legal framework for business, improve the effectiveness of the judiciary, upgrade education and vocational training, and encourage investment have been instituted.

In terms of economics, the new agenda includes a series of innovative programs designed to directly address many of the country's long-standing impediments to prosperity and stability. Although Jordan's relatively strong growth has helped create employment opportunities for both nationals and expatriates, the official unemployment rate has hovered at 13% and the unofficial rate at around 30%. To absorb the anticipated annual flow of around 60,000 new entrants into the labor force each year would require annual a real GDP growth of around 9%–nearly 6% higher than recent growth rates[24].

Given these stark realities, Jordan's development policy emphasizes the development of small- and medium-sized enterprises (SMEs). Smaller businesses in Jordan are a crucial part of the economy, especially in terms

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[22]Alina Romanowski, "For Jordan U.S. Support Guaranteed," (Washington: USAID, June 27, 2014). http://blog.usaid.gov/2014/06/for-jordan-u-s-support-guaranteed/

[23]"U.S. plans to boost aid to Jordan to $1 billion per year, *Reuters*, February 3, 2015. http://www.reuters.com/article/2015/02/03/us-jordan-aid-idUSKBN0L72ET20150203

[24]*Jordan: Staff Report for the 2012 Article IV Consultation International Monetary Fund*, (Washington, International Monetary Fund, 2012)

of job provision, with SMEs accounting for around 40% of GDP and 70% of employment. In short, Jordan has laid a solid foundation for private sector activity, with a steady improvement in governance and social capital that would appear to support a major expansion in the small and medium business sector[25].

In addition to creating jobs and improving incomes, SME development in Jordan has the potential to expand the country's middle-class and, with it, political stability. Sara Tobin found[26] that the emergent middle class in Amman and its sense of "aspiring cosmopolitanism" has reoriented key groups of Jordanians away from failed political reforms. Her interviews suggest that "middle-classness" and aspiring cosmopolitanism are an emergent means of constructing internal homogeneity. Despite the real divides between economically globalized and culturally emergent West Amman and the poor and working class Palestinians who occupy East Amman, increasing numbers from the east are crossing into West Amman for work and leisure. The result has been to create links between otherwise varied segments of society, which increasingly share both common experiences and similar visions of a prosperous future.

Despite these positive developments, Jordan's situation may be the most precarious of the monarchies. The country is resource poor and situated where many of the region's problems are actively playing out. Still, Jordan is far from joining Tunisia, Egypt, Libya, Syria and Yemen. Even the regime's most vocal critics frame their goal as changing the system, not overturning the monarchy. Most believe that the regime will pursue the correct reforms, and the time thus bought by the country's social capital may be sufficient for many of the country's positive trends to prevail.

In short, Jordan is laying a solid foundation for stable economic growth. If and when the region's conflicts subside, the country is in a good position to take advantage of its reform efforts with a major expansion in economic activity and the reduction in unemployment. The country's prospects for convergence towards the MENA good performance group appear good.

Morocco

The analysis above suggests that Morocco has made steady progress in most areas critical to long run growth and stability. Governance levels are relatively high and have improved even further since 2011. In contrast to

[25] *Jordon's National Employment Strategy 2011-2020* (Geneva, ILO, 2011)

[26] Sara A. Tobin, "Jordan's Arab Spring: The Middle Class and Anti-Revolution," *Middle East Policy* XIX:1 Spring 2012

Jordan, Morocco's economic performance has been consistent with its progress in governance, not under or over performing. However there has been a fall-off in entrepreneurship and a large decline in social capital since 2011.

Over the years Morocco had been able to accumulate by far the largest stock of social capital in the Arab world, ranking 13th highest of all countries in this important dimension[27]. No doubt this accumulation of trust was a key factor enabling Morocco to be the one country where protests during the initial Arab Spring of early 2011 produced fundamental yet peaceful reform, and without regime change.

The country emerged from the Arab Spring with a new constitution that promises a more open political system and improved human rights. A coalition government led by the Parti de la justice et du développement (PJD), which is inspired by the Muslim Brotherhood and Turkey's ruling Justice and Development Party, enjoys popular support. Experienced officials and business leaders keep the government and economy running. The conservative kingdom has avoided the chaos that has engulfed much of the region.

This unusual combination of seemingly fundamental change combined with aspects of stability has inspired loose talk by some Moroccan officials about a supposed Moroccan "third way" of incremental Islamic democratization[28]. The implication is Morocco could be a model for other Arab monarchies, or even beyond.

Contrary to other Islamic parties, the JPD has espoused a neo-liberal approach to economic policy-making[29]. In establishing benchmarks for progress, the PJD expresses considerable interest in the key indicators employed in the World Economic Forum's Global Competitiveness Reports[30], the World Bank's Doing Business Report[31], and Transparency International's Corruption Perceptions Index[32]. Indeed, the slogan "good governance" appears more frequently in the PJD's electoral platforms than in those of any other Islamist party.

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[27]Legatum Institute, *Prosperity Index, 2010* (London: Legatum Institute, 2010)

[28]Marina Ottaway, *Morocco: Can the Third Way Succeed?* (Washington: Carnegie, July 31, 2012) http://carnegieendowment.org/2012/07/31/morocco-can-third-way-succeed

[29]Valentina Bartolucci, "Morocco's Silent Revolution," *Open Democracy*, January 17, 2012. https://www.opendemocracy.net/valentina-bartolucci/moroccos-silent-revolution

[30]World Economic Forum, *The Global Competitiveness Report 2014-2015*, (Geneva, World Economic Forum 2014).

[31]World Bank, *Doing Business 2015* (Washington: World Bank, 2015).

[32]*Corruptions Perception Index 2014*, Transparency International, 2014

It turns out that the policies of the JPD are fairly consistent with the Morocco's overall growth strategy for the past decade. The strategy can be loosely characterized as "inclusive growth," with a focus on achieving[33]: (a) a more equal distribution of income; (b) a decrease in absolute poverty; (c) more equal opportunities, including access to basic services; and (d) a higher level of employment.

To the great surprise of many critics, the strategy has achieved some notable successes. Over the past decade, approximately 1.7 million Moroccans moved out of poverty, and the overall poverty rate decreased by more than 40 percent. The share of the population that fell beneath the national poverty line decreased from about 16 percent in 1999 to less than 9 percent in 2008. While the reduction in poverty has been more or less uniform between urban (about 50 percent) and rural areas (about 40 percent), high income inequality persists and has even increased slightly in both urban and rural areas.

Following the outbreak of Moroccan protests and Arab Spring uprisings in neighboring countries, the king announced the immediate implementation of an already existing decentralization development strategy. The social capital and trust created by this announcement was a further deterrent to local protests raging out of control.

Decentralization, which transfers managerial authority, skills and capacities to sub-national levels, reflects the government's stated desire to advance democracy from the bottom up. In terms of the economy, local communities are tasked with assessing their challenges and opportunities, and then creating and implementing a development plan that reflects their shared priorities–for example, job creation, education and health, and the environment. The rationale is that development projects designed by local citizens to meet their own needs have a greater chance of being completed and maintained.

While much of Morocco's model is unique to that country, key elements, such as decentralized development planning, might be successfully adopted by other Arab nations. The Moroccan model is especially valuable in that it increases social capital by reducing poverty, responding to popular calls for direct political engagement, while identifying with the Islamic concepts of shura (participation and mutual consultation regarding

[33]Hafez Ghanem, *Agriculture and Rural Development for Inclusive Growth and Food Security in Morocco*, (Washington: Brookings Institution, February 2015). http://www.brookings.edu/research/papers/2015/02/agriculture-development-inclusive-growth-food-security-morocco-ghanem

all matters involving the whole community); umma (a decentralized yet integrated worldwide Muslim community that brings about human rights and social justice); and ijma (consensus-building).

According to the UNCTAD World Investment Report[34], Morocco ranked first in North Africa in terms of the nominal amount of foreign direct investment (FDI) it received in 2013. The kingdom lured investment inflows worth USD 3.6bn in 2013. This good performance can partially be explained by its relatively political and economic stability during the Arab Spring as well as the diversification of its export base.

Still there are major concerns over the economy's ability to meet an increasing number of challenges. Growth has failed to meet optimistic forecasts and registered only 3.5% in 2014–far from the 7-8% annual levels needed to employ a population of whom around one-third is aged 10-24. Nearly a third of those aged 15-29 are unemployed, according to World Bank data[35]. The state cannot afford to employ more people: public sector salaries are equivalent to 11% of gross domestic product and 48% of government revenue.

Clearly much remains to be done before Morocco's stability is assured. However, given the progress to date in laying a solid institutional foundation there is good reason the country will be up to the challenges ahead.

Algeria

The analysis above found considerable differences between Algeria and Jordan/Morocco. In contrast to Jordan, Algeria is an over-achiever. That is given the country's level of governance economic performance is considerably higher than one would expect. In contrast to Morocco, Algeria has very low levels of social capital. It is also clear that the country suffers from the lack of entrepreneurship and thus a dynamic private sector.

Still, in recent years, the country has had the best economic performance of countries in the autocratic group. Furthermore, despite the fact that Algeria's immediate neighbor to the east, Tunisia, was the epicenter of the Arab Spring and that other Northern African countries, Egypt and Libya, were to follow shortly after, Algeria remained immune from similar instances of widespread public unrest calling for regime change. Is Algeria an exceptional case and if so, what are the country's prospects for the future?

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[34] *World Investment Report 2014* (New York: United Nations, 2014).

[35] World Bank, "The Challenge of Youth Inclusion in Morocco," May 14, 2012. http://www.worldbank.org/en/news/video/2012/05/14/taking-up-the-challenge-of-youth-inclusion-in-morocco

From a natural resource perspective, Algeria is a rich country. Algeria possesses the third largest oil reserves in Africa, behind Nigeria and Libya. The country has proven oil reserves estimated at 12.2 billion barrels. Algeria also has the second largest natural gas reserves in Africa after Nigeria, and is ranked among the ten countries with the largest shale gas reserves in the world. With foreign currency reserves reaching $200 billion before the 2014-15 oil price drop, Algeria is able to fund its imports for more than three years.

Algeria's irony is that while the country may be an over-achiever, given its level of governance, it is an under-achiever in terms of its resource base[36]. In essence, resources have enabled the country to achieve decent rates of economic growth in spite of its underdeveloped governance structures.

The forces of the Arab Spring were avoided largely because oil revenues have enabled the government to provide generous benefits as a response to social and economic needs, and also as a means to buy social peace. Close to $500 billion has been disbursed since 2000 for infrastructure development projects, paid internships for the youth, subsidies and generous salary increases for public employees[37].

Deficient governance has taken a toll in concentrating incomes and wealth with little economic betterment spreading out to broad segments of the population. Unemployment rates are high, reaching 21.5 percent among people aged fifteen to twenty-four. Most of the jobs created over the past decade are low-wage and unstable. Few offer social coverage.

The energy sector accounts for more than one-third of Algeria's gross domestic product (GDP), two-thirds of government revenues, and 98 percent of exports. Successive governments have failed to sever the economy's excessive reliance on the global oil and gas market, making the Algerian economy one of the least diversified: agriculture accounts for only 8 percent of the GDP, while the manufacturing industry accounts for 5 percent. Only a few sectors contribute to economic growth, such as construction and public works.

The distorted structure of the Algerian economy can be easily traced to the government's industrialization policies. The country's state-led development strategy was not concerned with creating a broad-based

[36]Luchen Achy, "Algeria's Economy in Decline Despite Vast Resources," Al Monitor, October 2, 2013. http://www.al-monitor.com/pulse/business/2013/11/despite-resources-algerian-economy-is-declining.html

[37]Azzedine Layachi, "The Deluge: Algeria's Pending Succession Crisis," *World Politics Review*, February 24, 2015.

manufacturing sector with numerous competitive firms responding to market forces. Instead industrial strategy was largely designed to preserve political balances in society by granting economic privileges to insider elites. The result was to reinforce the natural tendency of an oil based economy to evolve into a rentier economy[38].

In a classic rentier economy fashion, Algeria has failed to create a legal and regulatory environment, to encourage entrepreneurship, private investment, and economic diversification, all key to long-term economic growth and stability[39]. Large segments of the country's small- and medium-sized (SMEs) businesses face nearly insurmountable barriers to profitability. They face a series of barriers including: access to markets, funding from banks and obtaining permits.

The government has simply provided few incentives and much discouragement for potential private sector firms to undertake industrial and service-related projects, activities that historically have been the key to improved competitiveness and job creation[40]. In the World Bank's Doing Business 2015 report[41], Algeria ranks 154 out of 189 countries in terms of the ease of doing business–behind most MENA countries. As an indication of the obstacles faced by the private sector, Algeria ranked 171 out of 189 countries in the critical area of ease in gaining access to credit.

More importantly, however, falling oil prices are signaling a new era in Algeria's economy[42]. The oil price decline of 2014-15 is expected to last for at least several years. That being the case, Algeria will be forced to run large and increasing budget deficits largely because during the period of budgetary surpluses the government did not pursue a strategy to diversify its revenue sources. Instead, the focus was on infrastructure construction and a policy of untargeted price subsidies, all of which has caused operating expenses to surge without changing the nature of the Algerian economy[43].

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[38] Lahcen Achy, *Arab States Need Industrial Policy Reform*, (Washington: Carnegie, September 17, 2013). http://carnegie-mec.org/2013/09/17/arab-states-need-industrial-policy-reform

[39] Clement M. Henry, "Algeria's Agonies: Oil Rent Effects in a Bunker State," *Journal of Northern African Studies* 9:2 Summer 2004, 68-81

[40] Robert Springborg, "The Precarious Economics of Arab Springs," *Survival* 53:6

[41] *Ease of Doing Business 2015* (Washington: World Bank, 2015) http://www.doingbusiness.org/rankings

[42] Patrick Markey and Hamid Ould Ahmed, "Algeria Walks Economic tightrope as Oil Falls," *Reuters*, January 26, 2015. http://www.reuters.com/article/2015/01/26/algeria-economy-idUSL6N0V03OR20150126

[43] Lies Sahar, "Algeria's Silver Lining," Sada, January 22, 2015. http://carnegie-mec.org/2015/01/22/algeria-s-silver-lining

There is no indication the government has plans on changing its development strategy or undertaking major economic and governance reforms. In fact the government has drawn up a fresh five-year plan for 2015-19, envisaging total capital spending of 262 billion dollars[44].

The previous two five-year plans have set a worrying precedent, as the record for project execution and resultant economic growth have been poor, while wastage and corruption have been rife. The overall picture is one of gross misallocation of resources. As shown earlier, (Table 1) Algeria's investment averaged 24.7% of GDP from 2005-10 to 32.3 percent in 2011-14. Still growth increased by only 0.1% (3.2% to 3.3%) as a result.

Many private businesses, largely well connected elites have benefitted from government spending on massive infrastructure projects. Again, however there has not been much of a trickle-down effect from these expenditures due to the difficulties encountered by smaller private firms in obtaining credit. Credit to the domestic private sector has averaged at only about 16% of GDP in recent years, which is significantly below the level in most of the oil and gas producers in the MENA region.

Barring reforms, plummeting oil prices may ultimately produce regime change. After the global oil price crash in 1986 led to internal turmoil which in turn led to the rise of the now banned, "Front islamique du salut"[45].

Conclusions

Forecasting events in the Middle East is a fool's errand. There do appear to be some distinctive trends in the region taking the form of virtuous and vicious circles. Both groups are diverging, with little indication that this separation will abate any time soon. Countries such as Jordan, Morocco, and Algeria have not yet been pulled into one group or another yet all are starting to show signs of their likely direction.

One can say with some confidence that Jordan and Morocco are likely to converge in the direction of the virtuous circle countries. They have laid a solid foundation for sustaining prosperity. One could go even further and speculate that the two may be on the verge of a virtuous circle where a young, new, and increasing influential entrepreneurial class helps reform minded governments push through deeper reforms thus producing higher rates of economic growth, employment and thus the incentive for more reforms.

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[44] Hamid Ould Ahmed, "Algeria to Launch $262 bn Five-Year Investment Plan," *Reuters*, August 27, 2014. http://english.alarabiya.net/en/business/economy/2014/08/27/Algeria-to-launch-262-bln-five-year-investment-plan.html

[45] "The Long Good-by," *Africa Confidential* January 9, 2015.

Still these countries will have to walk a narrow line between success and failure. If sufficient jobs are not created fairly quickly each may find itself overwhelmed with restless populations and the prospects for regime change. In this regard, the one sure thing each monarchy has in its favor is the fact that their populations have witnessed the cataclysmic events that followed the populist-driven regime changes of the Arab Spring.

The Algerian situation is a completely different story. While the economy has experienced some successes in the past, the country's state led development model has clearly hit diminishing returns. Even before the drop in oil prices the economy would have been hard pressed to stave off eventual stagnation without undertaking major economic and governance reforms. With the oil price drop it may be too late to move in that direction even if the government were so inclined.