



EMBARKING ON A RENEWAL PATH

MENA Commission on Stabilization and Growth

October 2022

The Commission and its TORs

How risky is the current development path in MENA, and especially in highly indebted Egypt, Jordan, Morocco and Tunisia ?

How to avoid financial crises and recessions, and initiate and sustain inclusive and more sustainable growth?

What reforms are needed: (i) debt workouts and stabilization measures; (ii) innovative economic, social and climate-related structural reforms; and (iii) improvement in governance and state capacity

Responsibility of the Commission not shy away from the very political choices that confront MENA societies

Report to be followed by country studies

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Key Messages of the Commission

1

Current path leads to financial crisis.

But austerity-only adjustment leads to social crisis

2

IMF program,

debt workout

are not sufficient –

**need a national renewal plan
credible enough to ignite growth**

3

Considerable growth potential:

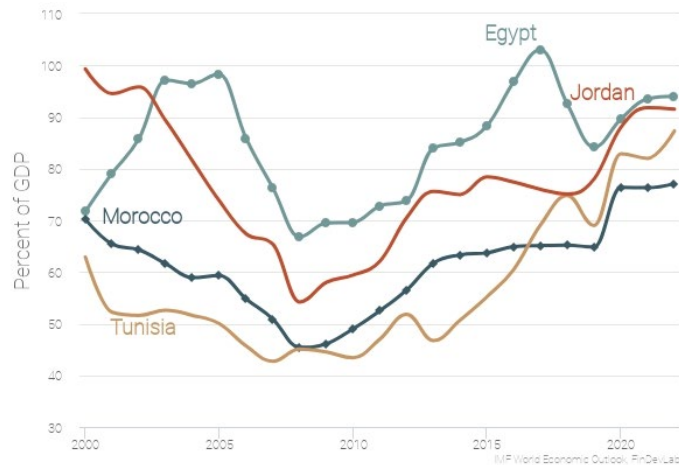
**pro-growth macro
modern state
democratic market
high-tech
global warming
de-globalization
regionalism**

4

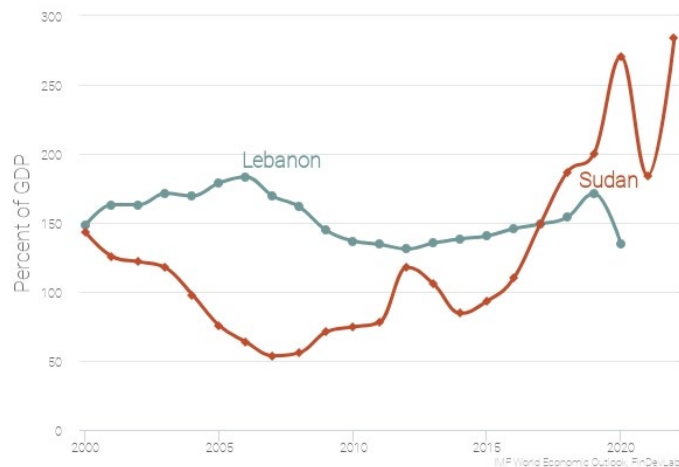
Economic reforms are eminently political.

**Need to entice opposition, mobilize support,
to generate trust and confidence in the future**

Diagnosics and Debt Sustainability (1/2) – Overview



- **Lebanon and Tunisia are in deep state of crisis**
- **Other economies are vulnerable:** pressure to devalue, increase interest rates, cut expenditures lead to more unemployment and poverty
- **Public debt not sustainable:**
 - **High deficits/low growth** problems predates COVID
 - **Bad debt dynamics** due to low economic growth
 - **Weaknesses exacerbated by new shocks (Ukraine, inflation)**









Risks forward

- **Debt service squeezes expenditures**
- **At some point, sudden stop of capital flows it impossible to refinance domestic and external debt**
- ... which could lead to **XR collapse, hyperinflation and risks of exploding domestic banking systems (as in Lebanon or Sudan)**

Public debt to GDP

Need for “adjustment” in order to prevent a crisis. Austerity and growth both be necessary -- How to balance?

Debt Sustainability Analysis (2/2) – 3 scenarios

	DSA baseline	DSA historical	DSA shocks	Comments
 Tunisia				<ul style="list-style-type: none"> ➤ High external liquidity risks, exacerbated by political uncertainty ➤ Sizeable fiscal adjustment is needed, to be combined with sizeable external support
 Egypt				<ul style="list-style-type: none"> ➤ Moderate debt vulnerabilities in the short term ➤ All eyes remain on the pursuit of economic reform and BOP inflows
 Morocco				<ul style="list-style-type: none"> ➤ Mild debt vulnerabilities in the short term, owing to favorable funding costs ➤ Ongoing structural reforms will be decisive for the outlook
 Jordan				<ul style="list-style-type: none"> ➤ Debt sustainability achievable, under strong fiscal exports ➤ Sizeable external vulnerabilities are materializing (on commodities and funding costs) requiring stronger efforts on growth
 Lebanon				<ul style="list-style-type: none"> ➤ Situation of debt distress: sovereign default in March 2020
 Sudan				<ul style="list-style-type: none"> ➤ Situation of debt distress: sovereign default in 1991

Lessons from Lebanon



What happened in Lebanon

- Since late 2019, triple crisis in Lebanon: fiscal, banking and BOP, triggering massive inflation and devaluation, declines in standards of living, a GDP collapsed by c. 50% and poverty skyrocketing
- Geopolitical context weakened the economy -- but the crisis was meant to happen as $G \ll R$ for many years in a row
- To avoid a crisis, should have reduced debt, improved growth beforehand

Lessons to be learned for MENA countries

- lessons on how to manage a crisis :
 - **Avoid capital flight, multiple exchange rates**
 - Find rapidly **political agreement on loss distribution (to fix the banking sector)**
 - **Rebuild the state finances - protect the poor, ensure basic services**
 - [Most importantly] **build a credible growth strategy** that can back a deal to create hope for the future

1 Message 1a: Debt reduction alone is not *the* answer

Structure of public debt

	Total (\$bi)	in % of total				
		Domestic	External	Multilateral	Bilateral	Commercial
Jordan	41.6	46.2	53.8	18.8	8.4	21.2
Tunisia	37.1	39.4	60.6	32.9	10.8	15.0
Egypt	326.4	72.9	27.1	7.0	10.1	9.9
Morocco	100.3	75.6	24.4	11.8	2.9	7.9
Lebanon	42.9	22.2	77.9	3.5	1.2	73.2
Sudan	72.9	5.0	95.0	9.5	72.3	13.2

Main takeaways

- **Structure not favorable to workout:**
 - Much of public debt domestic
 - External debt largely multilateral
 - Some bilateral and market debt
- **To finance reform, need new funds**
- **Big need to increase internal effort**
 - Increase saving rate
 - Increase tax revenue (base and rates)
 - Increase labor force participation

1 Message 1b: Both Status quo, and austerity-only adjustment paths lead to crisis

The challenge ahead is stark

- Inaction leads to a financial crisis
- ... but austerity alone (about 5% GDP) stabilizes debt only in the very short term and at the cost of high social tensions
- Growth is the only solution...

Failing to develop a convincing response raises the threat of a vicious cycle of further decline, political turmoil and social polarization

The IMF alone is not an answer

- IMF support will be necessary
- It needs to be more generous and to attract complementary flows
- But it also needs to be made conditional on launching credible national revival strategies, as opposed to austerity only-based approaches

2 Message 2: A critical juncture - Build a national renewal plan

3-pillars

- **Adjust expenditures to limit primary fiscal deficit and improve quality of spending**
- **Igniting growth by activating structural reforms – expectation shift**
- **Political adjustment to get domestic support is central – facilitated by igniting growth**

	Average 2000-2010		Average 2011-2020	
	Real GDP growth	Total investment	Real GDP growth	Total investment
Egypt	5.0%	21.6%	3.7%	16.2%
Morocco	4.7%	29.6%	2.5%	33.3%
Tunisia	4.2%	24.9%	0.7%	23.1%
Jordan	6.2%	32.2%	2.0%	25.6%
Lebanon*	5.1%	24.5%	-1.8%	20.7%
Sudan**	5.4%	23.9%	-1.2%	15.0%

* Non-availability of investment data for Lebanon data in the IMF WEO, Lebanese Economic Monitor (WB Group) only starts in 2013

** Non-availability of investment data for Sudan in the IMF WEO, latest Article IV (Mar-20) only starts in 2017

2 Message 3a – Reduce deficit, shift and improve expenditures

Reduce unnecessary expenditures

From subsidies to social safety nets (e.g., from Sudan)

Wage bill through adjustment (e.g., Tunisia vs. Egypt)

Cost of domestic debt but careful about the health of the banking system (e.g., Egypt)

Losses in SOEs (e.g., electricity in Jordan or Lebanon)

Increase growth related expenditure, improve efficiency

- **Improve investment in human capital (health, education)**
- **Improve investment in infrastructure**
- **Tackle climate change**
- **Improve efficiency of expenditure – e-government, horizontal accountability mechanisms**

3 Message 3b: Igniting growth/ shifting expectations

Short-term policies	Initiate MT renewal policies to signal seriousness	.. to unleash old and new growth opportunities
<ul style="list-style-type: none">➤ Pro-growth expenditures➤ Stable macro and social➤ Pro-business monetary policy (IR, XR)➤ Improvement of the overall business climate	<p>Need an expectation shift to:</p> <ul style="list-style-type: none">➤ Recreate hope in the future among citizens to help ST effort➤ Improve expectations, leading to a quick supply response➤ Improve creditworthiness, leading to more external support and flows	<ul style="list-style-type: none">➤ Private sector development➤ Expansion of public services (care, education)➤ Digitalization➤ Re-localization➤ Infrastructure➤ Climate adaptation➤ Regional cooperation

Seek more external financing in support of a national renewal plan

4 Message 4: Build political support nationally, regionally, and globally

Political activism central

- Economic reforms are eminently political
- Political elite needs to rebuild confidence in society
 - Explain risks with brutal honesty: status quo would lead to collapse
 - Convince that upside of reforms is promising and possible

Political reforms needed

- Mobilize the business community – fair level playing field, RoL
- Mobilize civil society as problem solver – respect for human rights, freer media
- Build coalition for change with winners and neutralize veto players
- Be willing to experiment and scale up what works

regional and global cooperation

- Internet
- Climate
- Agriculture
- Trans-boundary rivers
- More voice on global initiatives (SDRs, MDB reforms, Green finance..)