Arab economies and the Arab spring: the monetary policy opportunity

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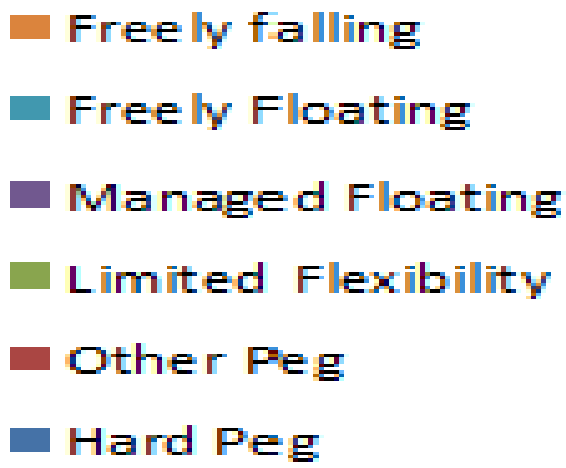
What are the economic implications of the Arab spring?

three sorts of possible implication:

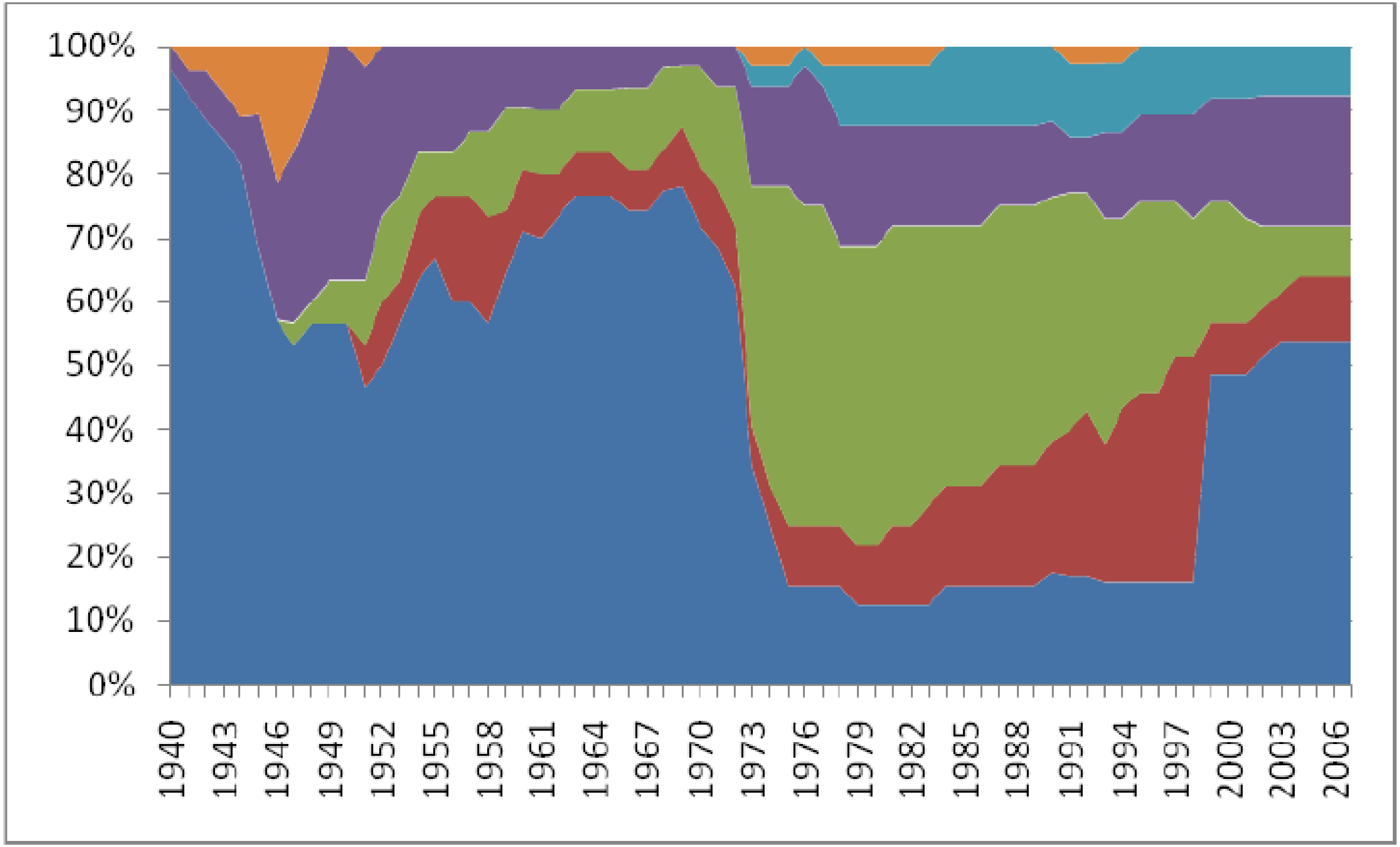
- effects on the world economy, via effects on oil price
- direct effects on the Arab economies from economic agents responding to changed environment, e.g.:
    - end of anti-competitive 'crony capitalist' restrictions on entrepreneurial activity, which could lead to increased investment and innovation by 'non-regime' agents
    - shift in income distribution towards wages of working and middle class, away from profits and top salaries, which could lead to a rebalancing of demand towards non-traded and domestically produced goods and services
- indirect effects on the Arab economies from changes in economic policy, especially through increased openness and accountability, e.g.
    - possibility of 'modern' monetary policy: for discussion here

Monetary policy and exchange rate regimes

- most MENA countries have fixed exchange rates or heavily managed floats
- in other regions fixed exchange rates have become less popular
- for example, according to the Reinhart and Rogoff (2004, updated 2007) classification of exchange rate regimes, which identifies *de factor* rather than *de jure* regimes and divides them into:



Advanced Economies



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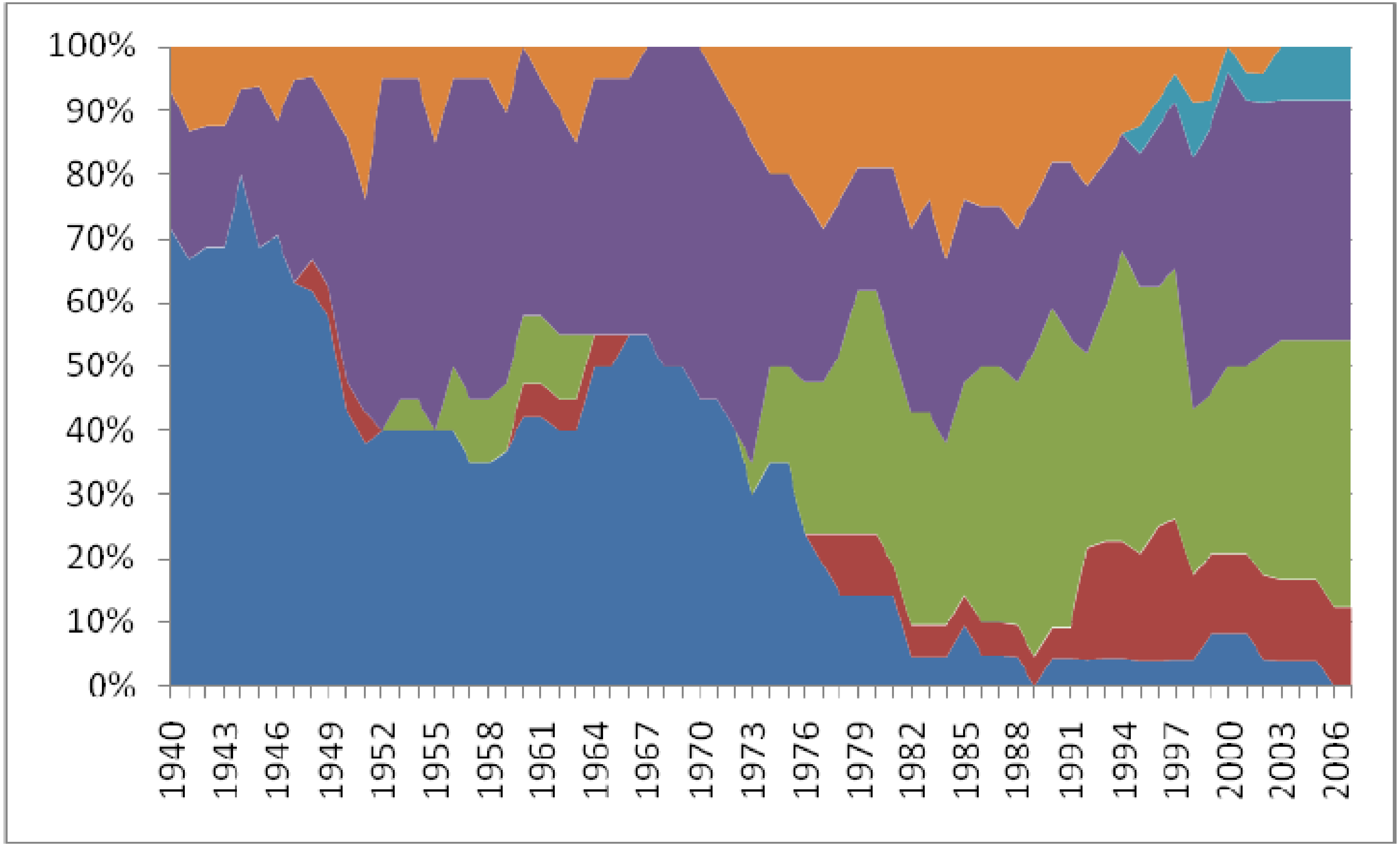
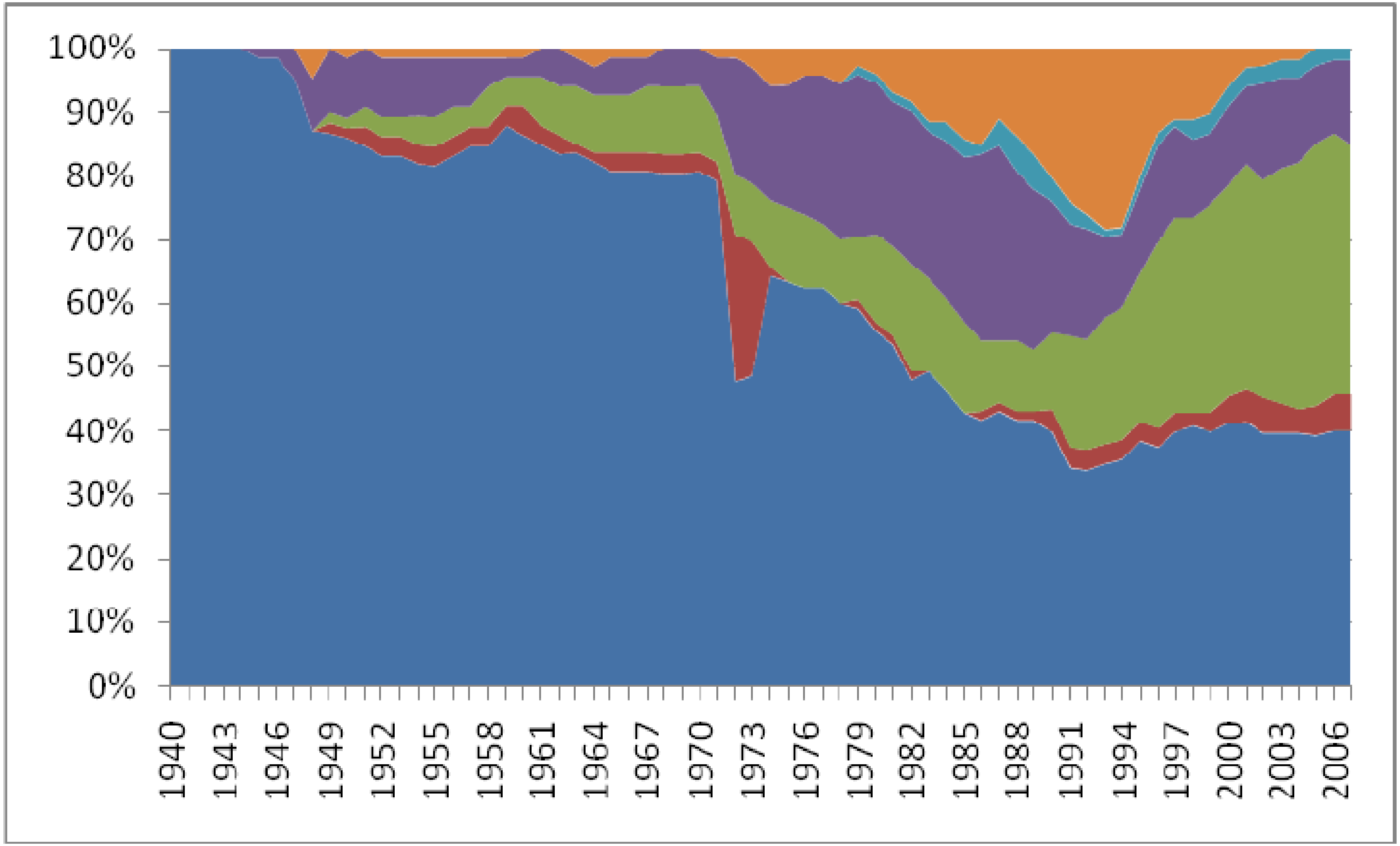
Emerging Markets



Developing Countries



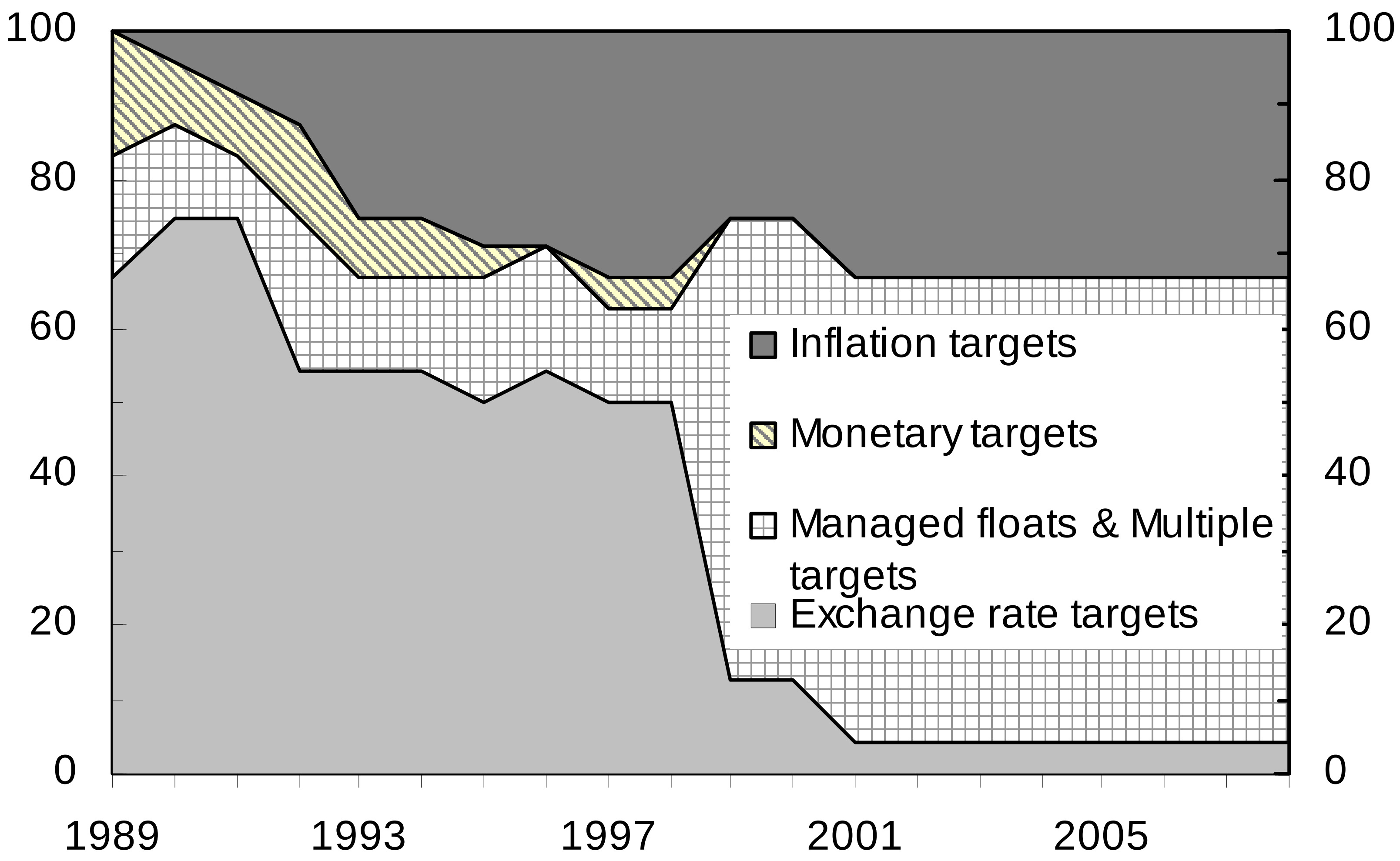
MENA countries are classified thus (2005-7):

freely falling: --
freely floating: --
managed float: --
limited flexibility: Syria
other peg: Algeria, Morocco, Sudan, Tunisia
hard peg: Bahrain, Egypt, Jordan, Kuwait, Lebanon, Oman, Qatar, Saudi Arabia, UAE
[not classified by R&R: Libya = ??, Yemen = other peg?]

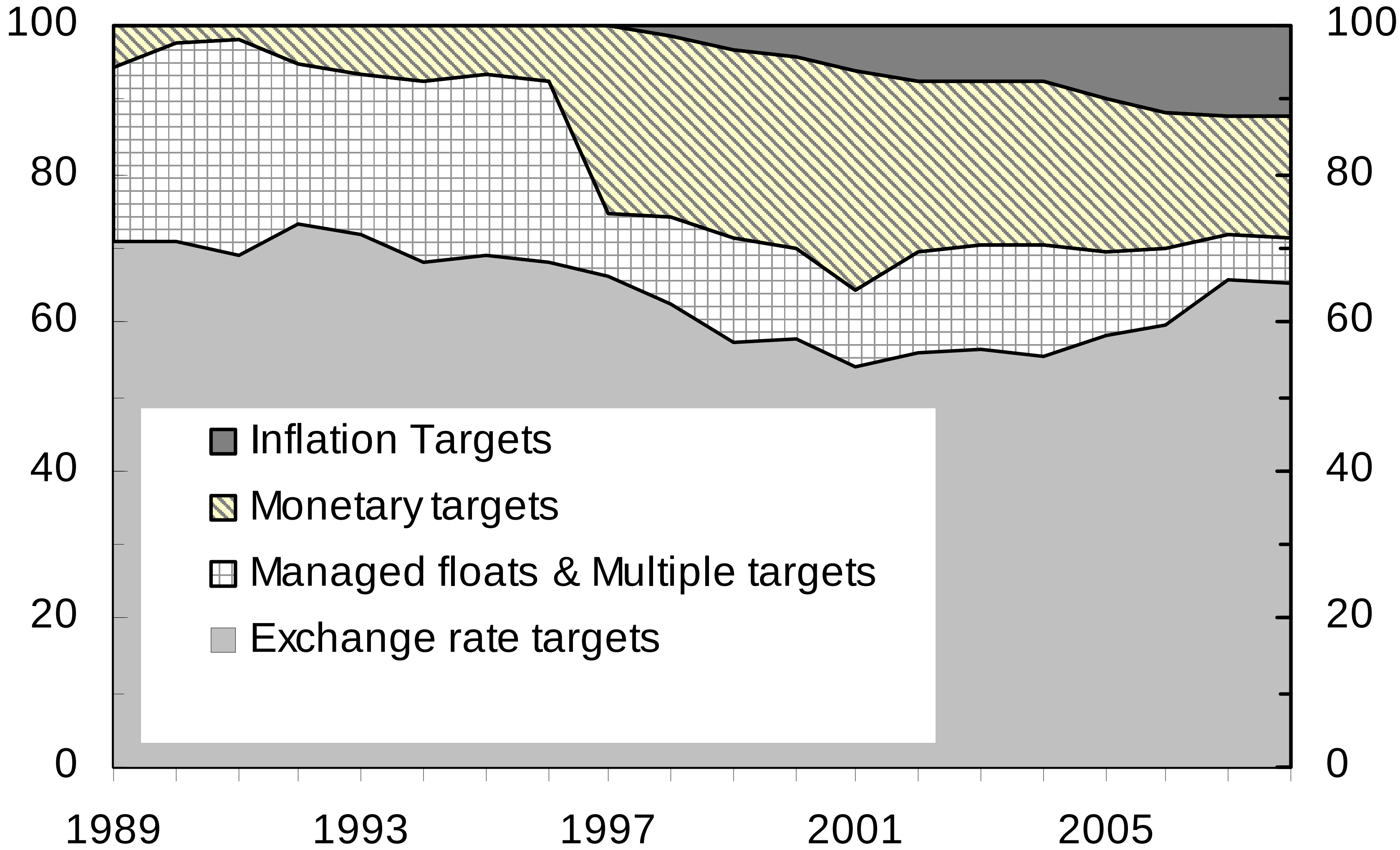
- so while emerging market countries, in particular, have moved away from hard pegs, there has been very little such movement by Arab countries

- at the same time many emerging market countries have embarked on or are considering adopting a ‘modern’ monetary policy strategy which focuses primarily on inflation, such as ‘inflation targeting’ (IT), which is a sort of extreme version of this ‘modern’ monetary policy

- IT involves publicly announced targets for inflation and allows exchange rate to float



Evolution of monetary policy regimes, industrial countries. Source: Roger (2010)



Evolution of monetary policy regimes, non-industrial countries. Source: Roger (2010)

- but most MENA countries would be classified here as having exchange rate targets, or managed floats and multiple targets
- fixed exchange rates can be regarded as a second best *substitute* for monetary policy, when the institutions of a country are not capable of operating a serious monetary policy (which would involve the use of discretion within some constraints or 'rules'): it typically provides some price stability but at the cost of exposure to price and output shocks in the economy of the anchor currency
- MENA countries have also shown little sign of change: even the three which have talked about moving to IT – Egypt, Morocco, Tunisia – have seemed unable to bring themselves to make any real commitment
- but perhaps this was the result of a situation which has now changed, as the result of the Arab spring (at least, insofar as the spring has really happened)?

A 'modern' monetary policy

- it is widely agreed that inflation over medium term is determined by (a) variations in aggregate demand pressure (as measured by e.g. output gap, unemployment) and (b) inflation expectations

- it is agreed that 'modern' monetary policy requires central bank to be independent and with high level of technical competence, e.g. it needs to be capable of forecasting inflation under alternative policies

- modern monetary policy is usually operated through interest rates, and that requires an active interbank money market, other financial infrastructure – which may have significant setup and running costs

- modern central banks put much emphasis on their ability to influence inflation expectations, and that's why IT central banks, in particular, have high 'transparency' and 'accountability'

- in order to influence inflation expectations, central bank under IT needs to explain its policy decisions, issue regular forecasts of economic activity and inflation, expose itself to critical scrutiny and engage with and answer its critics

What is the status of central banks in MENA?

first, governance – source: B Laurens, M Arnone and J-F Segalotto, *Central Bank Independence*, *Accountability and Transparency*, Palgrave for IMF, 2009:

	economic independence	political independence	transpar-ency	account-ability	overall governance
Algeria	0.63	1.00	0.40	0.47	0.56
Bahrain	0.63	0.25	0.47	0.45	0.45
Egypt	0.63	0.13	0.37	0.37	0.37
Iran	0.75	0.00	0.23	0.27	0.29
Jordan	0.50	0.25	0.53	0.48	0.46
Kuwait	0.50	0.13	n.a.	n.a.	n.a.
Lebanon	0.75	0.25	0.17	0.33	0.34
Libya	0.63	0.25	n.a.	n.a.	n.a.
Morocco	0.75	0.25	0.44	0.37	0.43
Oman	0.50	0.13	n.a.	n.a.	n.a.
Qatar	0.25	0.13	n.a.	n.a.	n.a.
Saudi A	0.75	0.25	0.26	0.23	0.33
Sudan	0.63	0.00	n.a.	n.a.	n.a.
Syria	0.50	0.38	0.23	0.27	0.31
Tunisia	0.75	0.63	0.47	0.52	0.56

	economic independence	political independence	transpar-ency	account-ability	overall governance
UAE	0.50	0.38	0.47	0.43	0.45
Yemen	0.50	0.38	n.a.	n.a.	n.a.
Memorandum items					
Advanced	0.81	0.70	0.70	0.69	0.72
Emerging	0.75	0.56	0.67	0.66	0.66
Developing	0.71	0.45	0.46	0.58	0.54
MENA	0.60	0.28	0.37	0.38	0.41
Latin American sample					
Argentina	0.75	0.75	0.63	0.80	0.73
Brazil	0.75	0.50	0.79	0.63	0.68
Chile	0.88	0.50	0.79	0.72	0.73
Costa Rica	0.88	0.50	0.56	0.62	0.62
Mexico	0.75	0.63	0.65	0.65	0.66
Peru	1.0	0.38	0.63	0.80	0.71

second, central bank expertise – source Cobham (2011):

	website monetary data	website economic data	monetary policy reports	monetary policy statements	research papers	forecasts published
Algeria	yes	no	limited	yes	no	no
Bahrain	timely	timely	no	yes	no	no
Egypt	timely	yes	no[1]	yes	no	no[1]
Iran	yes	yes	no	limited	limited	no
Jordan	timely	timely	no	yes	no	no
Kuwait	yes	yes	no	no	no	no
Lebanon	timely	yes	no	no	no	no
Libya	yes	yes	no	no	no	no
Morocco	timely	timely	yes	yes	no	yes
Oman	timely	no	no	no	limited	no
Qatar	yes	limited	no	no	no	no
Saudi A	timely	no	yes	no	no	no

	website monetary data	website economic data	monetary policy reports	monetary policy statements	research papers	forecasts published
Sudan	yes	no	no	no	no	no
Syria	yes	no	no	no	no	no
Tunisia	timely	timely	no	no	no	no
UAE	yes	no	no	limited	no	no
Yemen	timely	no	no	no	no	no
Memorandum item						
India	timely	timely	yes	yes	yes	yes

Source: constructed by the author from central bank websites.
Column 1: ‘timely’ requires that monetary data available in early January 2010 covered part of 2009 Q4; column 2: ‘timely’ requires that real economy data available in early January 2010 covered 2009 Q3; column 3: ‘yes’ requires regular and up-to-date bulletins discussing policy choices; column 4: ‘yes’ requires significant recent statements or speeches about monetary policy decisions by the Governor or the monetary policy committee.

how do the Latin American countries score here?

	website monetary data	website economic data	monetary policy reports	monetary policy statements	research papers	forecasts published
Argentina	timely	timely	yes	no	some	y but not π
Brazil	timely	timely	yes	yes	yes	yes
Chile	timely	timely	yes	yes	yes	yes
CostaRica	timely	timely	limited	no	no	no
Mexico	timely	timely	yes	yes	yes	yes
Peru	timely	timely	yes	no	yes	yes

- so MENA central banks are seriously lacking in independence, relative to other emerging and developing (as well as advanced), and in technical expertise, relative e.g. to India, Latin America

- now consider Polity IV measure of democracy-autocracy – scale from -10 (complete autoc) to +10 (full democ), 2009 – and World Bank Voice & Accountability index (% ranking out of 212 countries) 2008

	Polity IV	Voice and accountability		Polity IV	Voice and accountability
Algeria	2	18	Sudan	-4	4
Bahrain	-7	24	Syria	-7	5
Egypt	-3	14	Tunisia	-4	12
Iran	-7	8	UAE	-8	21
Jordan	-3	27	Yemen	-2	15
Kuwait	-7	33			
Lebanon	7	36	Argent	8	57
Libya	-7	2	Brazil	8	61
Morocco	-6	28	Chile	10	77
Oman	-8	17	CostaR	10	77
Qatar	-10	25	Mexico	8	50
Saudi A	-10	5	Peru	9	49

where Voice & Accountability ‘captures perceptions of the extent to which a country's citizens are able to participate in selecting their government, as well as freedom of expression, freedom of association, and a free media’

- so there seems to be some correlation between central bank independence and expertise, on one hand, and measures of democracy and accountability, on other hand

- likely that MENA’s historic ‘democratic deficit’ is closely linked to inability of MENA countries to adopt modern monetary policy:
    - governments couldn’t agree to make their central banks independent because this would dilute government’s control and power
    - governments couldn’t accept to have their policies criticised openly and then to have to engage with their critics

Conclusion

- in the area of monetary and exchange rate regimes we seem to have a clear example of economic development being held back by inadequate political development/weak institutional capability

- so Arab spring holds out possibility of increased accountability on the part of central banks (and other organs of government), and that would permit more efficient 'modern' monetary policy, in which central bank can influence inflation expectations, and so get and keep inflation down without needing to induce recessions, and will no longer have to do this through the 'second best' of fixed exchange rates