



Q3 2011 Commentary

300 Million Reasons

Fed up with high unemployment, rising food prices and repressive governments, Arab youth organized uprisings and overthrew their governments in Tunisia and Egypt earlier this year. Libyan rebels are attempting to oust ruler Muammar Gaddafi, while demonstrations have rocked governments in Bahrain, Yemen, Syria, and swept across other parts of the Middle East and North Africa.

One of the greatest sources of world growth over the past decade has been in emerging market countries such as China, Brazil, and India. These countries are still experiencing GDP growth rates over 4% vs. 2.5% for the US and the Eurozone. Sustained growth in these countries is all but assured by massive expenditures on domestic infrastructure, low labor costs, and most important, enormous populations. As Rob Kapito, President of BlackRock has said, "multiply 1.3 billion by anything and it's a big number."

But what about the notion of a new emerging market, namely, those in the Middle East and North Africa (the MENA countries), who for decades have been living under authoritarian regimes? The eight million demonstrators in Egypt last January represented the largest pro-democracy demonstration in the history of the world. According to foreign policy expert Fareed Zakaria, this seismic shift has "changed the narrative of Islam from one of radicalism to democracy....this is a game changer in bringing 300 million people into the modern world."

The transition from repression to democracy to an emerging economy is not one difficult to imagine. After all, it was only about 20 years ago that we witnessed Chinese soldiers firing on demonstrators in Tiananmen Square in the same year protestors ripped down the Berlin Wall. Since that time, most of Eastern Europe and certainly China have become formidable economic powers, (although China has not exactly embraced the "democracy" thing.) Moreover, their growth has lifted hundreds of millions of people out of poverty, having been slowly absorbed into these productive economies. For the first time in the history of the world, we are witnessing authentic global growth. According to Zakaria, "it is the birth of a truly global order."



To be sure, in the short term, the Arab uprising will likely have disruptive impacts on the MENA countries' economies as governments are reformed and stronger free-market policies are implemented to root out corruption and ensure basic capitalist values such as property rights. Issues such as women's rights, cultural differences, and cumbersome bureaucracies may hinder the immediate economic progress of these countries, but according to Grant Thornton, "a large majority of Gulf states have committed to improving social welfare and as such are planning increased investment in infrastructure."

But in the medium and long term, one would be shortsighted to underestimate the global economic potential of these countries. The MENA countries have demographics in their favor, as the average age of their population is 27 vs. 37 for the US. According to the IMF, school-age population growth for the next five years in Egypt is projected at over 10%. It is in the knowledge-driven areas such as education and healthcare and technology that help diversify an emerging economy and make the transition from a low-cost manufacturing economy to higher value-added one possible. Education is moving up the priority list of policy makers in the MENA countries. Credit Suisse notes that public sector expenditure on education as a percentage of GDP is nearly 10% in Saudi Arabia vs. 5.5% in the US and 3.5% in China. Egypt's literacy rate increased from 40% to 83% from 1980-2004 as education spending at the primary level increased, according to UNESCO.

There is no doubt that when the leaders of the World Economic Forum for the Middle East gather in Jordan this October there will be much discussion about the MENA countries' place in the global economic order. Risks in these countries still remain, but it is clear that the tide is turning. An official communiqué from the G8 recently noted, "the changes under way in the Middle East and North Africa are historic and have the potential to open the door to the kind of transformation what occurred in Europe after the fall of the Berlin Wall." The IMF has said it can provide \$35 billion to these emerging Arab democracies.

As Zakaria notes in his recent book "The Post-American World," it is not that America is a declining economic power, but it is the "rise of the rest" that we need to recognize. In fact, he sees this as a win-win. "The more countries that get rich, the more people there are producing, consuming, investing, saving, loaning money...If we didn't have the rest of the world growing, the US economy would be in much worse shape than it is today."

It is within this context that we are encouraged by the global growth and investment implications of the Arab Spring. While there are a number of reasons to embrace these historic events, we would simply focus on 300 million of them.

- The ClearRock Capital Team