Turmoil in Arab World Ushers in 'New Reality' for All Governments

Published February 23, 2011 in Arabic Knowledge@Wharton

Though regional investors maintain a long-term perspective towards the Arab world's current political unrest, insurance premiums for exports and sovereign debt in the region are expected to climb.

Already, the cost to insure US$10 million of five-year government debt in Bahrain has risen to US$300,000, from US$175,000 before protests erupted across the small Gulf country. Exporters to Middle East and North Africa, meanwhile, should see shipping premiums up by 20%, according to the Export Credit Insurance Company of the Emirates.

"There will be a generic degree of risk applied everywhere in the region," says Neil A. Doherty, Frederick H. Ecker Professor of Insurance and Risk Management at Wharton. "Anywhere is a potential target for unrest now, all the way from Saudi Arabia to Iran."

Doherty says unlike investors, insurers are bound to make decisions and set policies based on 12-month outlooks. "Certainly there are risks directly tied to political and economic uncertainty, such as guarantees against non-performing loans," he says. "It is expected that as uncertainty goes up, most types of insurance go up, some more than others."

Political risk assessments will be the most vulnerable to the changing situation in the Middle East, he notes, adding those most likely to be nervous as events unfold will be the reinsurance companies guaranteeing regional insurance firms.

The very nature of an insurance company's business model is to try to insure non-systemic risks, he says, though there is no line between a systemic risk and an episodic risk. For that reason, he adds, there could be relief if protests settle.

"Was it possible to predict unrest was in the cards? To some extent, yes. Part of anticipating is determining what are your worst fears. The fact that there could be resolutions to the protests could provide some reassurance."

Attending the World Economic Forum in Davos, Erwann Michel-Kerjan, managing director of Wharton's Risk Management and Decision Processes Center, says a number of CEOs and government officials there intended to assess the level of their interdependence on the region, concerned with the short-term impact of the unrest.

But in an interview with Arabic Knowledge@Wharton, Michel-Kerjan says it is a mistake to view the mass economic protests as a trend limited to the Middle East. Given their speed and the unclear leadership behind their formation, the political protests that erupted in North Africa could happen to any country, Michel-Kerjan says, and their occurrence signaled a change in the world, not unlike the events of 9/11. No longer, he notes, can governments afford to ignore citizen concerns surrounding economic disparity.

At an earlier World Economic Forum on the Middle East and North Africa (MENA) held in Morocco last October, Michel-Kerjan had already briefed attendees that competition for natural resources and economic growth would become the top risk facing governments in the region. Add to that risk list, he says, a large populace with few opportunities for economic advancement, angered by a perceived widening gap between the rich and the poor.
An edited transcript of the conversation follows.

Arabic Knowledge@Wharton: What are the longer-term implications of the unrest we've seen in North Africa?

Erwann Michel-Kerjan: [For the past six years] at the World Economic Forum in Davos, the Wharton School issues what we call a Global Risk Report. This year, we looked at 35 different global risks. On the top of the agenda -- based on the work we had done up to December, before Tunisia and Egypt -- was geo-political risks and economic disparity. And I think many people didn't realize how that related to the new reality. We keep talking about economic growth everywhere, and we keep using as a metrics the gross domestic product (GDP) per capita to show that many countries are getting richer, when the reality is that it is a very limited metrics. You really want to know what the distribution of wealth is within your country. If people are getting richer and richer when others remain very poor, you have economic disparity that is really a ticking bomb. Because one day, people who want to access that middle path, who want to get somewhat richer as a benefit of globalization, will suddenly realize they're totally excluded from the system. Once you have access to information on how people outside of Tunisia and Egypt are living, you start realizing that they are living maybe a better life than you, you start asking yourself why is that? Can I benefit from globalization as well? If the answer is no because of the regime that's in place, that's where you start thinking, 'Well, is there any way we can get rid of the regime?' That's a very natural process. You also have social media that helps you quickly self-organize [in a way] impossible to do 10 years ago. People would have been afraid just to show up [fearing] to be just the only ones, and being caught and put in prison. Knowing that you'll be in the street with 100,000 or 500,000 other people makes you very, very strong.

That's the first impression on what's happening there. Why did it even happen, I think that's the first thing we still need to understand.

Arabic Knowledge@Wharton: There still isn't a definitive answer as to why Egypt decided to follow Tunisia's lead.

Michel-Kerjan: I think it's fair to say that it may take a few months to understand what really happened. These are complex issues. Just because it happened very quickly, that doesn't mean that it's simple. It's precisely the reverse. You had the perfect storm at the perfect time. It will take us a few months to understand even how so many people got together on the streets. Who is behind that? People say everyone organized on Facebook. Okay, who were the leaders that organized the protests? [Note: The interview was conducted before Google executive Wael Ghonim was released from Egyptian captivity, and claimed his role in organizing the protest.] Right now, no one wants to talk about that. Everybody is talking about how amazing the capacity of the social network is, that everybody is free, it's transparent, that we are free to even replace presidents. I think there is more, much more to what happened than just the capacity to self-organize.

Arabic Knowledge@Wharton: Well, people decided to come together and take that risk collectively, to create their own political alternative to what existed, either in the status quo or the opposition parties to sort of demand change.

Michel-Kerjan: I'm not sure it's a risk by the way. If you were [on the streets] and you knew that only 10 people would show up, obviously that's a major risk for you. But I think what happened, the social media effect was a real tipping point. You knew that in two hours, you have 250,000 friends on Facebook who signed up to go protest. You look outside the window and see 10 people going, and there are more and more, and then you know that because you have that critical mass on the streets, you're not vulnerable anymore. One example that people forget easily is how the Berlin Wall collapsed about 20 years ago. Something very similar happened. That was not social media, that was radio. Someone said on the radio, 'Yeah, we have a massive influx of people going to the wall. They want to destroy the wall.' It was a self-fulfilling prophecy, because people heard it on the radio and went there. And because they went there, more people went there. If one person approached the wall, the guards would have killed them. But the fact that thousands of people in Berlin within 20 minutes rushed to the wall, even the guards wondered, 'What's happening?' And the public told the guards that over, it's over, we heard on the radio that's its the end of the wall.
And then we really understood how the Berlin Wall collapsed. If you had asked even the experts a week before, how long will the Berlin Wall stand, they would have said maybe decades. No one ever anticipated what happened.

Arabic Knowledge@Wharton: What happens then to business in the region? Do the perceived risks of doing business in the region escalate?

Michel-Kerjan: Businesses don't like uncertainty at the end of the day. When you have insurgencies somewhere, the markets go crazy. Take a look at the price of oil. It rose 10% to 20% in two days. It's not so much because we're afraid. We are afraid of not knowing. So obviously people are very anxious about what could happen. If you had been doing business with Egypt and Tunisia for let's say 10 years, and you have good relationship with them, and now I'm telling you that your counterpart in Egypt or in Tunisia is being thrown away from the country or is not in power anymore, you know that that could happen to your business too. So that's a very natural reaction I think for the businesses in the region.

Arabic Knowledge@Wharton: Beyond the obvious immediate risks though, there are concerns that whatever new government forms, it will be untested and facing some unrealistic demands from the public. You know, it's been 30 years with one ruler, he's out and you're in, so let's see some change, let's see some progress.

Michel-Kerjan: Sure. I'm not Tunisian or Egyptian, but it's not clear to me what the crowd is asking for. It's easy to say, let's get rid of the ruler, but is that really what they're asking for? Even if you have a new government, if the population is not happy, you could easily imagine six months from now they'll be on the streets again.

I think the new reality is that things could change radically within a day or two, even in regions ruled by authoritarian governments. If it can happen there, it can happen anywhere. Businesses have to realize that if they work with the help of governments, they need to take care of the people there as well, because the population [collectively] can throw out the establishments, and all the businesses doing business with them.

It's not clear how that will translate into action in the future, but there is a very clear signal here, and you can expand that to even other the countries like China. China is doing well on average, but there are hundred of millions of very, very poor people in China. Is Chinese government ready to face similar demonstrations? I think it could happen in China. The Chinese government is extremely cautious about that. I remember a discussion I had with several Chinese senior officials a few years back. They were looking for harmony, to keep that balance between the poor and the rich because there could be a revolution otherwise.

Arabic Knowledge@Wharton: We'll assume that no government wants to be part of that trend. Does Egypt mean that other countries will make choices to avoid a similar fate, either by liberalizing and opening up their society, or by further locking down, and protecting against any expression that could veer towards the Egyptian experience?

Michel-Kerjan: I think that is the question that everybody is asking at that higher level. In the next few weeks, people will see that at as very credible threat. They tried once in Tunisia, they succeeded, they tried another time in Egypt and they succeeded again. Well, I don't want to be the third. That's exactly what happened in Yemen [Following Egypt's protests, Yemeni President Ali Abdullah Saleh declared he would not run for presidency, and neither would his son]. Over the long term, by which I mean a few months, a few years, people will have forgotten what happened, and secondly they will tell you time has passed and that its a very different environment compared to 2011. People will still try, may be they will succeed and others will fail, and that's always the case. Right now [these protests] are everywhere in the media, and if you're leading a country you don't want to be remembered for [being replaced] like that.

Arabic Knowledge@Wharton: The next country to witness such economic protests doesn't have to be in the Middle East, does it?

Michel-Kerjan: Absolutely not. The protocol could be applied anywhere when you think about it. So to go back to my original question, can we be somewhat more sophisticated in terms of thinking
about what really happened [in Tunisia and Egypt]? Rather than saying it's a bunch of kids who organized themselves for Facebook, that's the fairy tale story; the reality is more complex, and it will take us time to really understand what happened there. Once we do, we'll realize it's not specific to Tunisia or Egypt. I could give you a list of 50 other countries that are potentially at threat from this is the same type of crisis.

Anyone who says, oh it's Egypt, its from that same part of the world that's always going through a crisis, that's the illusion you create so you think that you're safe. But the reality is that the world has radically changed over the past few weeks. It's just different, like after 9/11. When you saw 9/11, you knew the world would change. It was al-Qaeda, it was the first terrorist attack on American soil, and the U.S. was a world superpower, so the reaction would be tremendous. That's actually what happened. We are still at war in Iraq and Afghanistan as we speak, so 10 years later we are still seeing the impact.

So I think that's exactly what's happening in Tunisia and Egypt. I'm French so it looks very much to me like the French Revolution, when Marie Antoinette told the poor people we have food, that's great, when people were suffering. What happened was exactly the same thing, you amass a critical group of people, and it becomes bigger and bigger. The French Revolution took several months, and we didn't have a social network then, but it was about the same thing. The wealth disparity issue will become critical because you have given a voice and political power to millions.

Arabic Knowledge@Wharton: How do the events that we've seen in Tunisia and Egypt raise the perception of risk locally and globally?

Michel-Kerjan: This goes back to the question of uncertainty. What happened is that a type of risk has been created that nobody thought of before. A natural catastrophe that impacts the price of oil, that's something that we know. We know what an earthquake is and what could happen, and we know what happens when a typhoon or a hurricane hits. But no one really thought about the protests happening in the way they did. It increases the level of risk and it increases the level of noise in the system. But it's too early now to realize what will be the impact on businesses.

Businesses will have to have the discussion that we had in Davos, which was about what does this mean for us. Everybody will be back from Davos talking to their board of directors about the level of interdependency they have with this region.

Arabic Knowledge@Wharton: For the governments who do plan on staying in power, what is the strategy going forward? Specifically, those countries that might be the vulnerable or in the same situation that Egypt and Tunisia are in?

Michel-Kerjan: I think to be selfish to them is taking care of others. You cannot ignore your population, or the signals that they are sending just because you're in power. Translating that into what you do, that's a different question. But the mentality should be, okay, I'm in power but I have to pay attention to the redistribution of wealth. That's the main conclusion here: For my own sake, being selfish and wanting to remain in power means I have to take care of my people more than I did before.