

Institutional Reforms in Support of Economic Transition in Arab-Mediterranean Countries

Noha el-Mikawy
Center for Development
Research (ZEF)
University of Bonn

During recent years, Arab-Mediterranean countries have gone through various processes of institutional reform (see table 16), which has topped the agenda of Arab development in the 1990s. Reform was driven by fiscal crises,¹ by international diffusion of regulatory reform ideas, by the promise of trade opportunities with big markets such as the EU, and by technological innovations requiring new regulatory arrangements, for example in the service sectors. Institutional reform is still being promoted in the region as a fundamental requirement for catching up with those ahead. The Arab World Competitiveness Report (AWCR) (2001 and 2002) and the Arab Human Development Report (AHDR) (2002 and 2003) emphasise beyond any doubt the need for extensive institutional reform, by (a) promoting investment and enhancing financial transparency; (b) creating a more efficient and effective bureaucracy; (c) giving incentives to improve education, increase information flow, enhance knowledge acquisition and knowledge production; and (d) increasing the political participation of men and women.

Regulatory Reform

Regulatory reform «represents a mean of correcting market failures through rules, licenses, orders, and sanctions.»² Within the early phase signalling market liberalisation, Arab-Mediterranean governments engaged in measures of pro-competition regulatory reform. However, a legacy of anti-production, the persistence of protectionist interest in group politics, and dependency on rent revenue have helped maintain elements of discretionary state intervention which lack clear performance benchmarks in sectors and in firms (Graphic 6). Recent pressure to liberalise services has helped expand regulatory reform to new areas such as intellectual property and competition.

Several regulatory reform processes can be witnessed in Arab-Mediterranean countries. Morocco, Egypt and Jordan have overhauled their investment and privatisation laws. They have also issued laws and regulations that promote exports and establish free and special industrial zones. Competition and intellectual property laws based on international experience are being drafted. Notably interested in enhancing the processes of trade liberalisation, privatisation, industrial modernisation and public sector management are Morocco, Jordan, Tunisia and Egypt, who have been seeking the help of the IMF and the EU within the context of Association agreements. The result

has been the signing of free trade agreements with the EU and with the USA (in the case of Jordan). The Greater Arab Free Trade Area (Morocco, Tunisia, Egypt and Jordan) is in the process of creation.

Recent attempts to improve regulatory quality with respect to fiscal management can be observed in Lebanon, Jordan and Tunisia (with VAT, the reform of income taxation and expenditure management). The IMF and the World Bank have also been involved in strengthening banking supervision and indirect monetary policy instruments (such as open market operations, rediscount facilities and reserve requirements), and these efforts have also included the development of inter-bank exchange markets (in Morocco and Tunisia) and flexible exchange rate arrangements (in Egypt and Tunisia).

Banking and finance are still suffering from a reform deficit. A great deal more needs to be done to improve financial services in Middle East and North Africa (MENA) region via e-banking and e-commerce, and both require regulatory changes that ensure safety and quality.³ Egypt also requires a lot of assistance to improve its score. With regard to monetary policy, Morocco, Egypt, Tunisia, Jordan and Lebanon have good scores in the Heritage Foundation dataset, indicating low inflation rates of not more than three percent (with the exception of Egypt in 2002⁴ (Graphics 7 and 8).

¹ I. Limam (2003) «Introduction», in *Challenges and Reforms of Economic Regulation in MENA Countries*. Cairo: American University in Cairo Press, p. 15.

² I. Limam (2003), *op. cit.*, p. 1.

³ I. Limam (2003), *op. cit.*

⁴ The category of «monetary policy» measures a country's weighted average annual rate of inflation from 1992 to 2001. The authors created the «monetary policy» score by first weighting inflation rates for each of the past ten years so that the year farthest in the past has the least

TABLE 16	Institutions in the Arab World Competitiveness Report										
	Bahrain	Egypt	Jordan	Kuwait	Lebanon	Oman	Qatar	Saudi Arabia	Tunisia	United Arab Emirates	Regional average
Extent of discussion of legal and political reforms 1 = A great deal 7 = Very little	2.25	3.88	3.22	2.84	3.25	4.83	3.71	4.13	4.36	4.76	3.72
Time senior manager spends on bureaucratic red tape 1 = Less than 10 % 2 = 10-20 % 3 = 21-30 % 8 = 71-80 %	2.09	3.07	1.86	3.37	2.28	2.17	2.08	3.41	3.52	2.33	2.62
Judicial independence 1 = Not true 7 = True	5.08	4.74	4.97	6.05	3.35	5.00	5.58	4.50	4.75	5.16	4.92
Avail of trusted legal framework for business 1 = Not true 7 = True	4.74	3.93	4.72	5.53	3.97	5.33	5.52	3.50	5.13	4.63	4.70
Reliability of police protection for business 1 = Not reliable 7 = Reliable	6.28	4.58	6.19	5.68	4.75	5.67	6.38	5.00	5.75	6.56	5.68
Organised crime 1 = imposes sig costs 7 = Imposes no cost	6.04	5.74	6.69	5.68	5.97	6.25	6.50	5.88	5.57	6.43	6.08
Unreported profits and wages 1 = Less than 5 % 2 = 6-10 % 3 = 11-20 % 10 = More than 80 %	1.28	3.12	2.42	1.31	3.61	1.00	1.04	1.38	2.55	1.29	1.90
Informal sector 1 = Less than 5 % 2 = 6-10 % 3 = 11-20 % 9 = More than 70 %	2.30	4.24	2.29	1.86	4.17	1.00	1.36	2.60	2.39	1.86	2.41
Intellectual property protection 1 = Weak/non-exist 7 = Equal to world's most stringent	5.20	4.37	4.67	3.89	3.53	3.83	4.52	3.65	5.05	5.64	4.44

Source: Arab World Competitiveness Report 2002-2003.

The Role of the State and Bureaucratic Reform

Privatisation and the reduction of state intervention have been on the agenda of global discourse since the 1980s. However, states remained important for development because transitions to

liberal markets and to democracy have entailed institutional changes that require state initiative and commitment. The Asian experience highlighted the need for a capable state in areas of regulation, promotion, and the setting of performance benchmarks.⁵ The notion of «embedded autonomy», coined by

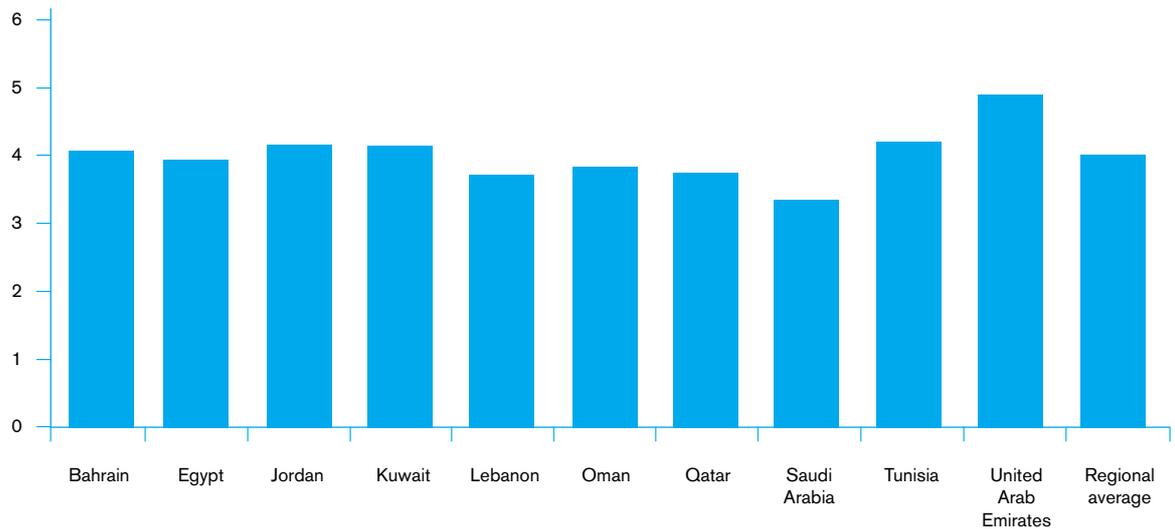
Peter Evans, pointed to the need for a coherent state in alliance with the private sector for developmental, rather than predatory and corrupt, purposes.⁶ Within the Arab-Mediterranean context, there are variations in the dominance of the state (and hence in the strength of the private sector), and also in the com-

weight and the current year has the greatest weight. Then the authors calculated an average of these weighted rates. In some cases, data were not available for all ten years; for these countries, the authors used as many years as the availability of data would allow. The reader should be aware that when governments have comprehensive price and wage controls, measured inflation may be distorted.

⁵ P. Evans, T. Skocpol et al (1985) *Bringing the State Back In*. Cambridge: Cambridge University Press.

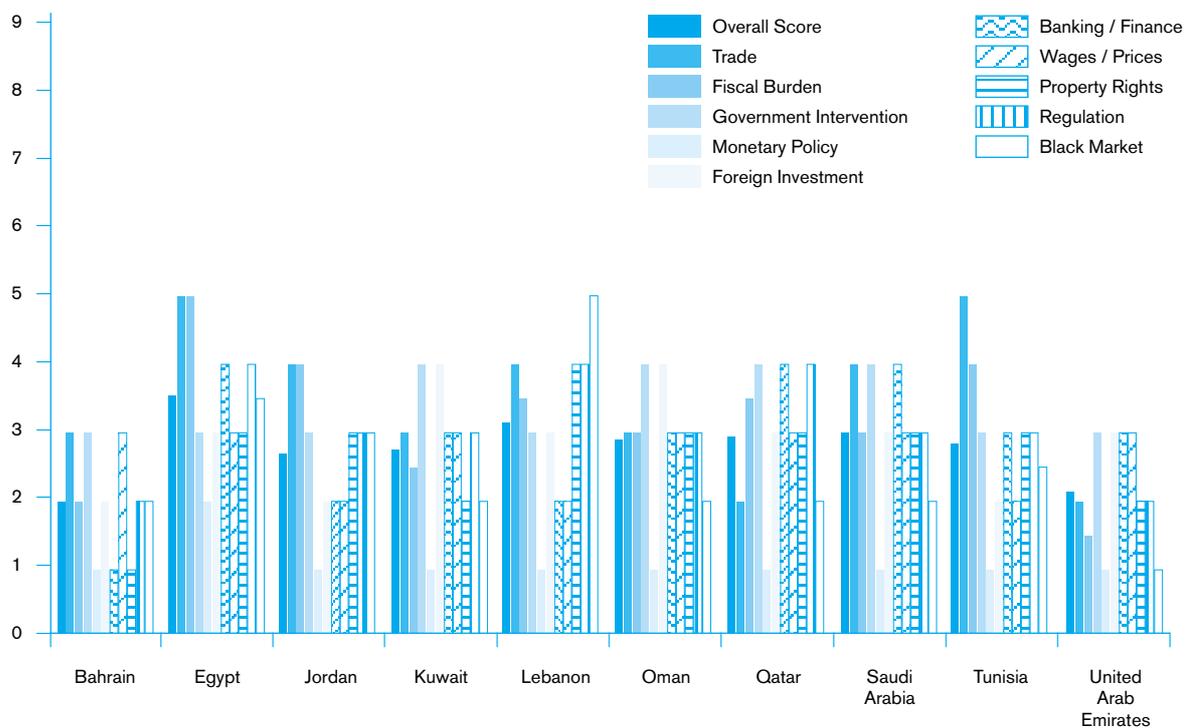
⁶ P. Evans (1996) «Government Action, Social Capital and Development: Reviewing the Evidence on Synergy», in *World Development*, vol 24, #6, p. 119-32. P. Evans (1992) «The State as Problem and as Solution: Predation, Embedded Autonomy and Structural Change» in S. Haggard et al (eds.) *The Politics of Economic Adjustment*. Princeton: Princeton University Press, p. 139-81.

GRAPHIC 6 Average of Responses to Survey Questions about Competition in Arab World Competitiveness Report



Source: Arab World Competitiveness Report 2002-2003.

GRAPHIC 7 Heritage Foundation - Economic Freedom Index 2002

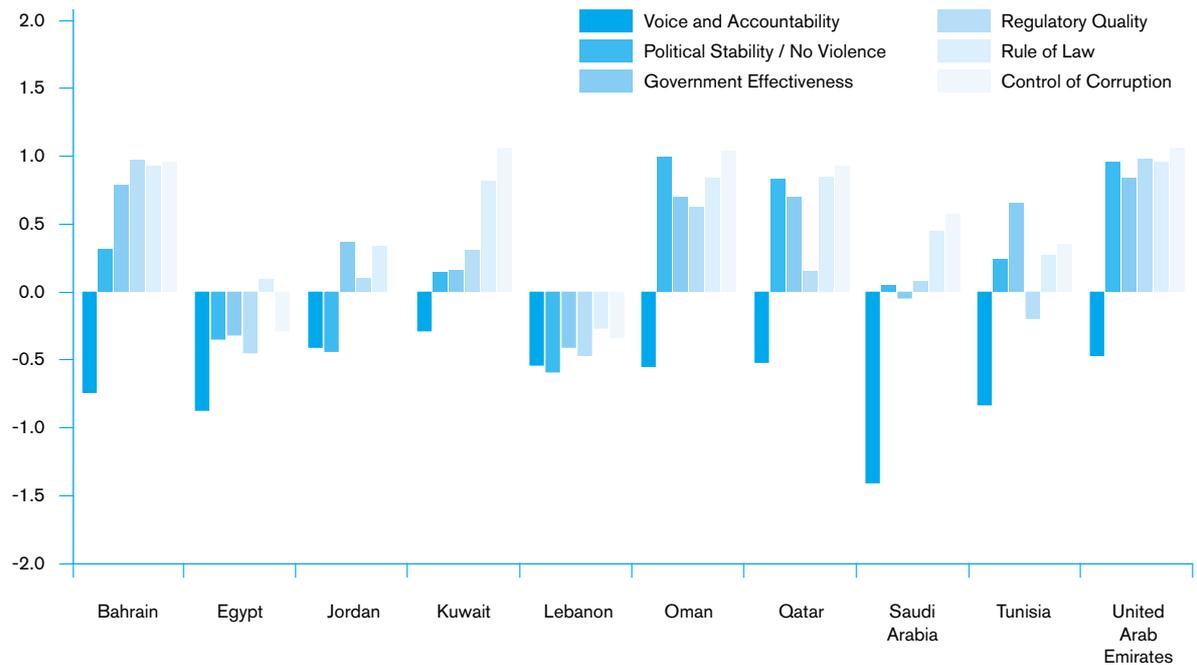


Source: www.heritage.org

petence of the state. Measuring the weight of the state in the economy, the Heritage Foundation uses indicators of government consumption, government production and government expenditure, as well as the tax burden (fiscal burden and government intervention indicators). The overall picture indicates that the burden of government in the Arab-Mediterranean countries is higher

than in the Arab Gulf region, yet the dominance of the government in the economy seems less in comparison to the Arab Gulf region (which is contrary to expectations, given that all Arab-Mediterranean countries have had statist developmental models) (graphic 7). While the Gulf region's scores are in accordance with its dependence on oil revenue for expenditure and its com-

parative dependence on state consumption, this region is also registering better bureaucratic performance, something that is especially notable in the UAE. Arab-Mediterranean countries have the opposite mix: a lower level of bureaucratic performance, which dilutes the humble advances made to reduce the fiscal burden of government and its intervention or domination



Source: D. Kaufmann, A. Kraay, and M. Mastruzzi 2003: *Governance Matters III: Governance Indicators for 1996-2002*.

of the economy, particularly in Egypt and Lebanon (graphics 7 and 8).

The trend is confirmed when we take the questions of the AWCR related to favouritism, irregular payments and business cost of corruption (called «government and country performance» in AWCR). We have created a score for ten out of seventeen questions which deal directly with these topics (Graphic 9). Here, the Arab Gulf countries again perform better than the Arab-Mediterranean ones. A lot more has to be done to combat corruption and raise the levels of bureaucratic performance on all levels of the bureaucracy.⁷ A lot more research may be needed to understand why and how some bureaucratic agencies have been better able to improve performances. The case of the Moroccan customs service would be a good place to start.

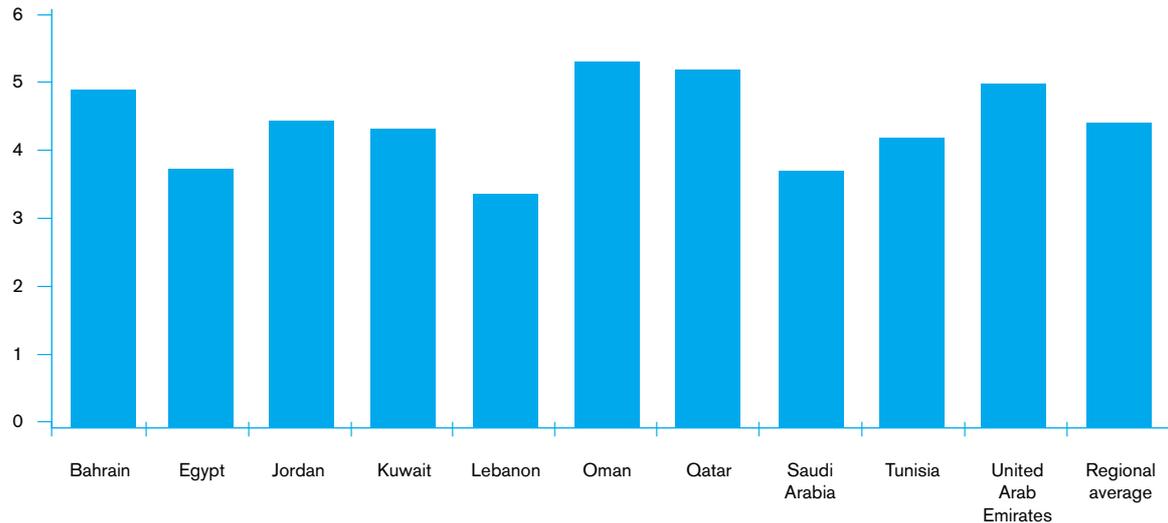
Education and Information Society

The Arab Human Development Reports (AHDR 2002 and especially AHDR 2003) have pointed out serious

deficits in Mediterranean human capital and information infrastructure. Though Arab countries have managed to increase the rates of literacy over the past thirty years, there still remain millions of Arab-Mediterranean citizens who cannot read or write, and the percentage of those who finish school and obtain higher education degrees is still below the world average. Most Arab-Mediterranean countries suffer from a shortage in well-qualified engineers and mathematicians. A survey of opinion done for the AHDR 2003 demonstrates a poor perception of the quality of education on the part of Arab citizens and education professionals. The same deficit applies to the acquisition of knowledge. Arab citizens watch television a great deal more than they read. What they watch on television is not conveying knowledge and is not conducive to critical thinking. Telephone lines and the internet are another source of acquiring information and eventually of accumulating knowledge. Here again, the Arab-Mediterranean countries have weak telephone and internet infrastructure; the Arab Gulf

surpasses them, and both Arab regions are way behind the world average. Knowledge production is also deficient in Arab countries. By observing indicators such as rate of publications and high tech exports, the AHDR 2003 has registered a massive need for them to catch up with other countries. This is partly due to a general environment of censorship and to a weak network between scientific establishments and industries. The AWCR has shown the weak rate of investment in firms in Research and Development. Several Mediterranean Arab countries have taken steps in the past few years to reduce these deficits. Morocco, Jordan, Lebanon and Egypt have been undertaking reforms to improve the accreditation, performance evaluation, and financial systems in higher education. Egypt has allowed private higher education institutions to flourish, especially in technical areas, the most recent of which has been the German University in Cairo (inaugurated in October 2003). The EU funded Tempus program for curriculum development and university management, as well as

⁷ For some practical suggestions in the case of Egypt see N. El-Mikawy and H. Handoussa eds. (2003) *Institutional Reform and Economic Development in Egypt*. Cairo: American University in Cairo Press.



Source: Arab World Competitiveness Report 2002-2003.

the Erasmus program, will support and sustain these efforts of higher educational reform.

Democracy

A. Stepan and G. Robertson (2003) have reinforced the democracy deficit underlined by the Arab Human Development Report (2002). In a comparison of Arab and non-Arab Muslim countries, they show that the democracy gap is particularly wide in the Arab world when compared to the non-Arab Muslim world. The particular factors that make the Arab region so special are mainly political. Security concerns related to the Arab-Israeli conflict, internal strife (in Morocco, Algeria, Sudan and Iraq), and border disputes (between Morocco and Algeria, Iraq and Kuwait, and the Gulf and Iran) keep the winds of democratisation from filling the sails of the reformers, and legitimise huge military spending.⁸ And the anti-terror campaign which Arab regimes have also adopted does not offer any

relief in the already tense security situation.

There are, however, some positive trends. Algeria conducted elections (the second since 1991) in May 2002. Though turnout was low (at forty-six percent) and many opposition parties boycotted the elections, parties other than the ruling party (including two moderate Islamic parties) won about one third of the seats. Morocco also ran parliamentary elections in September 2002 in which the Islamic opposition had a good showing, while the traditionally dominant parties kept their lead; however, the Monarch has not abandoned his un-written right to appoint the head of the cabinet with no reflection on election results. Jordan ran parliamentary elections in June 2003 after suspending the work of the legislative body in 2001; the newly elected Parliament has to address over two hundred laws passed in emergency status while the Legislature was not in session. And here a cautionary note: The repeal of progressive gender legislation by the newly elected parliament has alarmed many observers. Fi-

nally, the Egyptian ruling party has instituted several internal party reforms, with which the party has declared that the government is the party's government and not the contrary (the party is the government's party). In October 2003, the party declared its intention to start a national dialogue of opposition parties (excluding Islamic figures) on issues of freedom of expression and association. The party also established a higher council for women and for Human Rights. Time will show how fruitful such changes will be for making the government more accountable to the party and for advancing democracy in general.

These winds of change are being reinforced from the neighbourhood of the Arab-Mediterranean countries. In October 2002, Bahrain ran its first elections in thirty years for the Majlis al-Nuwab, in which the women of Bahrain participated for the first time as both voters and candidates. Furthermore, the Turkish ruling Islamic party has been setting precedents by taking steps to reduce the power of the military in politics.

⁸ A. Stepan and G. Robertson (2003) «An Arab More Than Muslim Electoral Gap», in *Journal of Democracy*, vol 14, #3, July, p. 30-44.

WORLD BANK REPORTS (2003)

In 2003, the World Bank wrote a series of reports on aspects that it considers vital for the development of Middle East and North Africa (MENA) countries.

Gender and development in the Middle East and North Africa: Women and the Public Sphere

Gender inequality has become one of the most important aspects for the economies of the MENA countries. The report addresses this inequality from the viewpoint of the economic costs the problem entails and points to a series of elements that could help overcome it. In spite of the enormous achievements made in areas related with education and women's health, this advancement has not led to any significant progress in the involvement of women in economic and political life.

The low participation of women in the job market represents a high cost both for the economy and for families. The low levels of participation are the outcome of a combination of socio-cultural (the traditional roles of women) and economic factors (unemployment, economic structure, among others). In order to overcome this situation, it is necessary to create a new agenda that can offer women wider access to political and economic life; an agenda that is based on such basic tenets as «good» governance, legislative reform in basic and employment rights, access to public life, and the continuation of education policies. An agenda that not only requires the commitment of political leaders, but also a higher level of political empowerment of these countries' women.

[http://lnweb18.worldbank.org/mna/mena.nsf/Attachments/GenderReport-overview/\\$File/GENDER-REPORToverview.pdf](http://lnweb18.worldbank.org/mna/mena.nsf/Attachments/GenderReport-overview/$File/GENDER-REPORToverview.pdf)

Better Governance for Development in the Middle East and North Africa

This report stresses the fact that the development of the MENA countries has been hampered by the weakness of public governance, which is a qualitative weakness and has been accompanied by a lack of transparency for measuring it. The MENA countries award values in the governance quality indicators that are significantly below those of other countries with similar income levels. According to the report, this fact hampers economic development, as a good level of governance helps determine the formulation and implementation of policies that favour investment and production. In addition, the weakness of governance has also limited the quality of public goods and services.

Overcoming these differences is both a challenge and an opportunity for the MENA countries. The term «good» governance is a means for ensuring growth and social improvement. The challenge is not so much to choose the right leaders or the right economic and social policies as to guarantee for everyone the possibility of expressing their preferences, taking part in the dialogue, and holding the government accountable. Good governance is not just the Government's responsibility; it also requires the involvement of the citizens.

[http://lnweb18.worldbank.org/MNA/mena.nsf/Attachments/govreport-eng/\\$File/GOVoverview-eng.pdf](http://lnweb18.worldbank.org/MNA/mena.nsf/Attachments/govreport-eng/$File/GOVoverview-eng.pdf)

Trade, Investment and Development in the Middle East and North Africa: Committed to the World

In the MENA countries, trade and private investment are needed to develop new me-

chanisms for growth and economic dynamism. For these countries, one of the most important challenges in the coming decade will be to create enough employment to meet with a rapidly growing labour force. Although they are seeking to strengthen their trade links with Europe (through the EuroMed agreements) or with their neighbours (through regional agreements), the results have been disappointing. These countries need to deepen and complete their reforms, and implement three basic changes: to develop non-energy resource-related industries; to shift from public sector dominated activities towards private market oriented activities; and to move from protectionism to competitive exporting. The intensification of trade and investment is at the core of these shifts. Furthermore, in order to realise the benefits of a greater level of economic integration, policies are needed which will reduce not only customs barriers, but also the internal restrictions within the countries of the area.

The report also warns that in some countries the reform process will initially cause a significant loss of jobs in certain sectors. This situation raises the need to carefully design the reforms for implementation, as has been done in other countries. In addition, the success of the project also depends on other key elements, such as liberalising services, making agriculture more dynamic, and particularly, leveraging the support of the MENA countries' main trading partners in order to anchor the reforms in regional integration agreements.

[http://lnweb18.worldbank.org/mna/mena.nsf/Attachments/Trade+Report/\\$File/trade-overview.pdf](http://lnweb18.worldbank.org/mna/mena.nsf/Attachments/Trade+Report/$File/trade-overview.pdf)