

## Middle East and North Africa Reform: Rooted in Economic and Political Ground

### Paper at a Glance

- The key to successful reforms in the Middle East and North Africa (MENA) region is building on the linkages between democratic governance and market economies.
- Demographic pressures, an inefficient public sector, and the need for economic diversification led by the private sector are some of the top challenges facing MENA countries.
- Meaningful reforms require moving away from entrenched state monopolies on political and economic power.
- MENA governments should focus on creating an enabling environment for the private sector to lead sustainable economic growth and job creation.
- Through institutions of democratic governance, grassroots private sector voices can provide invaluable guidance on the design and implementation of reforms.



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**The Center for International Private Enterprise** is a non-profit affiliate of the U.S. Chamber of Commerce and one of the four core institutes of the National Endowment for Democracy. CIPE has supported more than 1,000 local initiatives in over 100 developing countries, involving the private sector in policy advocacy and institutional reform, improving governance, and building understanding of market-based democratic systems. CIPE provides management assistance, practical experience, and financial support to local organizations to strengthen their capacity to implement democratic and economic reforms. CIPE programs are also supported through the United States Agency for International Development.

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## Executive Summary

An intensifying demographic transition in the Middle East and North Africa (MENA) region calls for creating as many as 100 million new jobs in the next decade in order to accommodate the increasing number of entrants into the labor force. The shortcomings of past economic reforms foreshadow a massive labor crisis and potential social instability as the rising wave of youth unemployment sweeps through the region. But MENA may also have at hand a unique window of opportunity for sustained growth and development, provided that long-overdue institutional reforms – both economic and political – are introduced.

CIPE's extensive experience around the world suggests that the key to successful reforms lies in understanding the profound interconnections between well-functioning markets and democratic governance. They both rely on the same set of core values and require good, inclusive governance structures that facilitate the engagement of the broader business community in reforms. A majority of legitimate business interests are not often represented in the political process. This is the case in MENA, where a handful of powerful elites monopolize access to the government while the plight of smaller firms and informal entrepreneurs goes largely unheard. The challenge – and opportunity – is to empower those long-neglected segments of MENA societies and build more productive economies capable of capitalizing on the region's changing demographics.

Recent GDP growth in the MENA region was over 6 percent, the strongest in more than a decade, prompting some to consider MENA's economic reforms a success and the lack of political reforms as something unrelated that should be considered on its own terms. But market economies cannot exist without democratic systems that protect property rights and enable participation in the economy, open to all on equal terms. Democracy cannot in turn be achieved in the absence of free markets because market-based economic order and democratic governance complement each other and share the same core values: rule of law, competition, participation, transparency, accountability, freedom, equality, and responsiveness.

Therefore, reforms that help build market economies also help foster democratic institutions.

The recent spike in the region's macroeconomic indicators does not mean that such institutional reforms have been implemented; the spike is fueled by the oil price boom rather than rising productivity or better governance. But these reforms are crucial going forward in order to change the region's decades-old social contract, in which the state dominates the economy and limits political liberties in exchange for jobs and welfare. The ongoing demographic transition renders this rentier state model ineffective and incapable of absorbing the burgeoning workforce.

Yet MENA's population growth can be turned into an unprecedented opportunity for sustained economic growth, provided that the new entrants become productively employed. For that to happen, the region's explosive mix needs to be addressed.

- **Demographic pressures.** MENA's labor force is predicted to soar to 185 million by 2020. Unemployment currently stands at 10.9 percent in North Africa and 11.8 percent in the Middle East according to the ILO, and is the highest in the world. Unemployment among women and young people is even greater, generating widespread discontent.
- **Inefficient public sector.** Traditionally, MENA governments have been employers of first and last resort. Today, however, they are unable to keep up with their growing populations and can no longer ensure sufficient public sector employment levels to manage social expectations. Government wages in MENA – unlike anywhere else in the world – are higher than in the private sector. This trend skews labor market incentives and unproductively traps much of the region's human capital.
- **Constrained private sector.** MENA's state-centered economic model has severely stunted the private sector, which remains concentrated in a small number of large firms benefiting from governmental protection. The region's corporatist legacy makes the state the most important player

in the economy rather than an impartial, arm's-length regulator. Large firms with connections to state officials are able to manipulate the rules to their advantage, but smaller firms face an unequal playing field and must resort to bribes or informality.

Daunting as the task of in-depth reforms may seem, there is no reason to assume that MENA is not up to the task. There is nothing intrinsic about the current political and economic arrangements, and arguments about supposedly insurmountable cultural reasons for the persistence of the rentier model are misplaced. The missing linchpin is better democratic governance that could provide needed reforms with a sense of social ownership and grassroots participation.

Any successful course of reforms must capitalize on MENA's demographic transition. The change from high to low mortality and fertility creates a one-time "demographic bonus:" as the working-age population increases relative to younger and older dependents, the potential for economic growth peaks. The necessary precondition is sufficient job creation, and this can only be achieved in an environment of open and responsive governance.

MENA needs a new social contract that will make better governance possible. Past reform efforts were not only selective and incomplete, but above all lacked participatory quality. Top-down policies were pursued by the ruling elites and foreign technocrats, which contributed to the feeling of disconnect between the reformers and society at large. A more effective reform approach can be based on the following tenets:

- In-depth economic and political reforms are inextricably intertwined and should be pursued simultaneously.
- Top-down reforms are not viable because they lack the benefits of broader societal involvement, local knowledge, and ownership.
- If engaged in the policymaking process, the private sector (beyond crony firms) can provide solutions to MENA's employment challenge.

The private sector can offer crucial insights into economic policymaking. After all, local entrepreneurs

can best identify constraints to doing business and can formulate policy recommendations. One way to empower these local entrepreneurs is through public policy advocacy conducted by independent business associations, chambers of commerce, and economic think tanks. When a larger business community openly and transparently supports policies that benefit a broad spectrum of entrepreneurs, such policies are good for the economy as a whole and foster democratic governance.

Meaningful reforms require moving away from the state monopoly on political and economic power toward a system where the state creates an enabling environment for the private sector to lead economic growth. These reforms are difficult because they ultimately threaten the established elites. Until now, MENA leaders preferred not to "rock the boat," and instead preserved the unsustainable status quo with only superficial changes. But today, this stability may be threatened even more by not reforming.

There are no shortcuts and quick fixes here; reforms take time. Introducing good laws is not enough if the values behind them are not internalized by those to whom they pertain. At the same time, a chance to form broad social coalitions interested in the success of institutional reform has never been greater. For the private sector to become an active, credible, and informed participant in reforms, improvements are needed in:

- Building market institutions
- Developing political institutions
- Strengthening the rule of law
- Empowering women and youth
- Creating space for the private sector
- Improving access to information
- Enabling private sector input
- Combating corruption

As a first step, various parts of civil society – including private sector organizations – need to become involved in the public debate over reforms. This is already happening in many places, as illustrated by CIPE's work with the Egyptian Business Association, the Arab Institute of Business Leaders, and many other organizations in the region. These groups

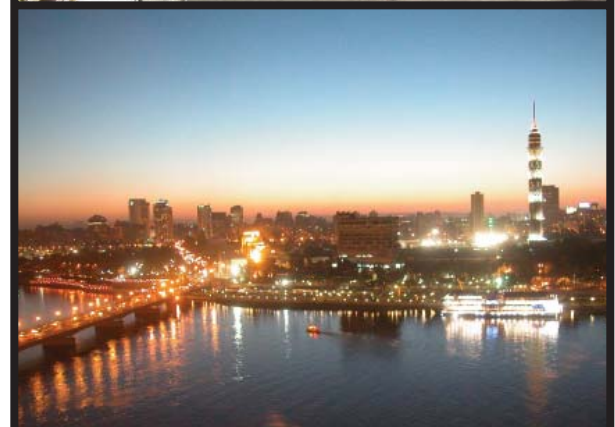
represent grassroots voices and seek local solutions. They involve broad segments of the private sector in the design and implementation of economic reforms. They engage in a democratic, public-private dialogue on policy issues with an understanding that successful economic reforms require political will. Finally, their successes inspire confidence that similar initiatives can be successful elsewhere and that the broader private sector can help drive positive change throughout the region.

## Introduction

Cairo. Crowded roads and bustling sidewalks. Giant billboards flash the logos of top global brands and shiny new office towers and upscale shopping malls rise up to the sky. This is a familiar scene throughout most of the Middle East and North Africa (MENA). Spurred by record oil-derived revenues, lavish investments catch a visitor's eye. But from street level the same city looks much different: scores of young people are unable to find work, petty traders eke out living in the informal sector, women face unequal opportunities for employment. An intensifying demographic transition in the region calls for creating as many as 100 million new jobs in the next decade to accommodate the increasing number of entrants into the labor force. Meanwhile, inefficient public sectors and constrained private sectors show little ability to provide enough jobs.

Today, MENA faces a crucial choice. The shortcomings of past economic reforms foreshadow a massive labor crisis and potential social instability as the rising wave of youth unemployment sweeps through the region. But MENA may also have at hand a unique window of opportunity for sustained growth and development, provided that long-overdue institutional reforms – both economic and political – are introduced. Such a demographic windfall can be realized if the broader private sector is given a chance to lead economic growth and job creation.

CIPE's extensive experience around the world suggests that the key to successful reforms lies in understanding the profound interconnections between well-functioning markets and democratic governance.



They both rely on the same set of core values and require good, inclusive governance structures that facilitate the engagement of the broader business community in reforms. While it is a common misperception that business is a monolith, in fact, a majority of legitimate business interests are not represented in the political process. This is the case in MENA, where a handful of powerful elites monopolize access to the government while the plight of smaller firms and informal entrepreneurs goes largely unheard. The challenge – and opportunity – is to empower the long-neglected segments of MENA societies and build more productive economies capable of capitalizing on the region’s changing demographics.

“When international agencies jet their consultants to the gleaming glass towers of the elegant quadrants of town to meet with the local ‘private sector,’ they’re talking to only a fraction of the entrepreneurial world. The emerging economic powers of the developing world are the garbage collectors, the appliance manufacturers, and the illegal construction companies in the streets far below.”

– *Hernando de Soto,*  
President of the  
*Institute for Liberty and*  
*Democracy, Peru*  
(Source: “Citadels of Dead Capital,”  
*Reason Magazine, May 2001*)

market-based economic order and democratic governance complement each other and share the same core values. Therefore, reforms that help build market economies also foster democratic institutions and need to be pursued in tandem as they are essentially two sides of the same coin.

The recent spike in the region’s macroeconomic indicators is fueled by the oil price boom rather than rising productivity or better governance. But implementing these twin institutional reforms is crucial to going forward. Those who have been following MENA’s other skyrocketing indicators – the numbers of unemployed and disgruntled youth – can clearly see that major reforms are still much needed in order to avert the looming unemployment crisis.

## The MENA Challenge

In 2006, GDP growth in the MENA region was 6.3 percent, the strongest in more than a decade. Foreign direct investment (FDI) also rose sharply: the year’s record \$24.4 billion figure marked an almost 40 percent year-on-year increase and was three times larger than in 2004.<sup>1</sup> With the exception of drought-ridden Morocco, growth remained strong in 2007, with investment at record highs. At the same time, the very countries praised for economic achievements rank rock bottom in political freedom and governance indicators. How are these two seemingly contradictory trends reconciled?

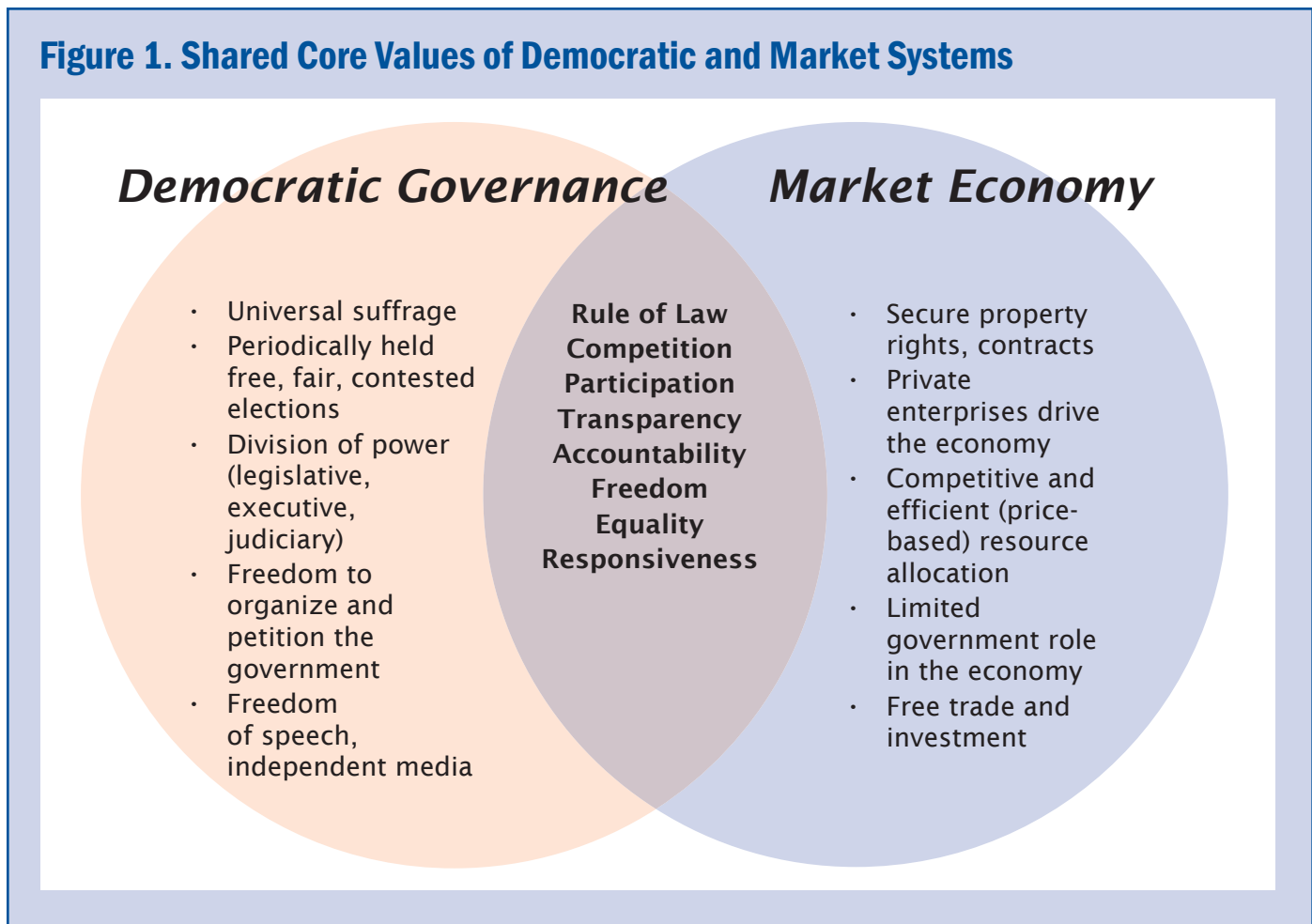
These impressive growth and investment figures prompted some to consider MENA’s economic reforms a success and the lack of political reforms as something unrelated that should be considered on its own terms. But underlying that logic are erroneous assumptions about the essence of market reforms and the meaning of democracy. Market economies cannot exist without democratic systems that protect property rights and enable participation in the economy – open to all on equal terms. Democracy cannot in turn be achieved in the absence of free markets, because

## Doomsday Scenario or Window of Opportunity?

The ranks of job-seekers are swelling across MENA, putting pressure on the existing economic and political systems. In the years to come, this increase in the youth population will continue to add millions of new entrants to the labor force. Absorbing them calls for a whopping 80 million new jobs by 2020, or 100 million if those currently unemployed are also counted.<sup>2</sup> If the urgent employment challenge is not met, dark scenarios of intensified social conflict or even internal violence may follow.<sup>3</sup>

But this is not the only possible future. MENA’s population growth can be turned into an unprecedented opportunity for sustained economic growth, provided that the new entrants become productively employed, increasing savings and investment.<sup>4</sup> This is what happened in East Asia in the 1980s and 1990s, giving rise to the “Asian Tigers.” Those countries benefited from earlier investments in health and education, managed to create plentiful employment opportunities, and reached record growth levels. Now MENA has a

**Figure 1. Shared Core Values of Democratic and Market Systems**



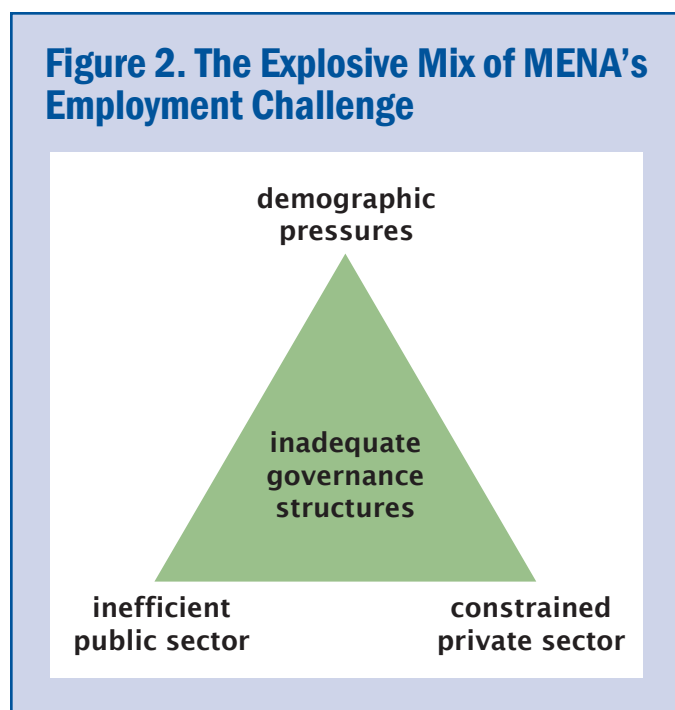
similar opening. But first the region’s explosive mix needs to be addressed.

MENA governments, unable to keep up with growing population pressures, can no longer ensure public sector employment levels sufficient to manage social expectations. Unfortunately, large cohorts of graduates do not have the skills or will to work elsewhere. Widespread informality and pervasive corruption and cronyism hinder the private sector as an alternative employer, and the lack of democratic governance makes it difficult for the region’s governments to seek societal input on how to reform the economy. Not surprisingly, reforms so far have been limited and incomplete.

MENA comprises economies<sup>5</sup> that are highly dependent on external rents – mostly derived from oil. These rents finance the region’s decades-old social contract in which the state dominates the economy and limits political liberties in exchange for providing jobs

and welfare. In rentier states<sup>6</sup> – the Gulf Cooperation Council (GCC), Libya, and, to some extent, Algeria – the bulk of GDP and public revenue comes from petroleum products exports and is based on a large gap between the cost of production and international prices, not on efficiency of domestic economies. The remaining MENA states are semi-rentier, meaning that even though they lack oil, they remain heavily dependent on external rents such as foreign aid, loans, oil pipeline crossings and transit fees, or remittances from expatriate workers. (Remittances are “quasi-rents” since they do not go directly to the government pockets but have still cushioned labor-exporting countries from the impact of growing population pressures.)

In all these countries, the ongoing demographic transition renders the existing rentier state model ineffective and incapable of absorbing the burgeoning workforce. The region will need to turn to institutional reforms for lasting solutions.



## A Path toward Effective Reforms

Daunting as the task of in-depth reforms may seem, there is no reason to assume that MENA cannot step up to the task. There is nothing intrinsic about the current political and economic arrangements, and arguments about supposedly insurmountable cultural reasons for the persistence of the rentier model are misplaced. The missing linchpin is better democratic governance that could provide needed reforms with a sense of social ownership and grassroots participation.

Any successful course of reforms must capitalize on MENA's demographic transition and turn its outcome from the feared unemployment crisis into a unique opportunity for endogenous economic growth. As the U.N. Population Fund notes, such a demographic window of opportunity opens only once for a given country. The change from high to low mortality and fertility creates a one-time "demographic bonus" – as the working-age population increases relative to younger and older dependents, the potential for economic growth peaks. The necessary precondition is sufficient job creation, and this can only be achieved in an environment of open and responsive governance.<sup>7</sup>

MENA needs a new social contract that would make better governance possible. Past reform efforts

were not only selective and incomplete but above all lacked participatory quality. Top-down policies were pursued by the ruling elites and foreign technocrats, which contributed to the feeling of disconnect between the reformers and society at large. CIPE's experience shows that a more effective reform approach can be based on the following tenets:

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The private sector can offer crucial insights into economic policymaking. After all, local entrepreneurs can best identify constraints to doing business and can formulate policy recommendations. One way to empower these local entrepreneurs is through public policy advocacy conducted by independent business associations, chambers of commerce, and economic think tanks. Understood as an effort to shape particular public policies in an open and transparent manner, advocacy may target laws and other legislative acts, regulations, executive decrees or orders, and so on in order to make them better reflect the social need for an improved policymaking process and more effective policies.

The larger business community (including small, informal, and female-owned enterprises) can openly and transparently support and demand policies – not favors – that benefit a broad spectrum of entrepreneurs. Such policies are good for the economy as a whole and foster democratic governance. Engaging the private sector in this manner in policy dialogue can help MENA redefine its social contract.

## The Components of Democratic Governance and Market Economy

Democratic governance and market economy rest on the same core set of principles, which is why

the criteria used by Larry Diamond and Leonardo Morlino for evaluating the quality of democracy<sup>8</sup> are equally well suited for gauging the quality of markets. In MENA, this exercise reveals the continued need for substantial reforms.

### Rule of Law

Markets cannot function without the predictability and elementary fairness of law, protection of property rights, and contract enforcement. In MENA, the rule of law remains weak, largely due to centralization of political and economic power and the persistent influence of the military over political systems fueled by recurring violence (or threats of violence). Rather than guaranteeing equal protection under the law, local regimes came to rely on corrupt business circles and coercive military establishments for preserving their rule. In the 2007 Corruption Perception Index, only three small MENA countries made it to the better half of the 10-point scale: Qatar (6.0), UAE (5.7), and Bahrain (5.0). The region's most populous countries, accounting for over a half of its population, scored much lower: Algeria (3.0), Egypt (2.9), and Iran (2.5).

### Competition

The ability to compete freely and on equal terms is the lifeblood of a market economy. Competition unleashes creativity, encourages entrepreneurship, spurs innovation, and increases efficiency. In most MENA countries, the lack of competition for political power is mirrored by the state-centered economies. As a result, the dominant form of competition is for state resources and government favors, deal flow remains low, and entrepreneurship is greatly constrained by numerous barriers to doing business.

### Participation

Just as democracy is not complete without universal suffrage, a market economy does not exist in its full form unless all members of a society have

an equal opportunity to participate. Participation means the ability to engage in business transactions on a level playing field. But it also means the ability of various parts of civil society, including diverse business groups, to have their voice heard in policy debate. In MENA, neither economic nor political participation functions well. Closed political systems prevent local populations from voicing their needs and concerns, and closed formal economies push entrepreneurs into the informal sector.

### Transparency and Accountability

At all levels of political and economic governance, be it in governments or private sector corporations, transparency and accountability are instrumental to sustaining good performance. Policymakers should be held responsible by internal checks and external watchdogs just as managers are held responsible by the board and shareholders for the business decisions they make. In MENA, states centralize political power

without effective mechanisms for scrutiny provided by voters, opposition parties, and independent regulators. Similarly, the lack of transparency in markets hinders the region's economic prospects and limits its ability to attract investment.

### Freedom

Freedom is at the heart of a market economy. Without the liberty to pursue one's creative ideas, individuals and societies cannot realize their full potential. Whether defined as freedom of business initiative and association or freedom from government interference, economic freedom complements political liberty and fosters the culture of entrepreneurship. Despite some improvements, MENA ranks relatively low in the 2008 Index of Economic Freedom. None of the MENA countries qualified as "free" and only one, Bahrain, was ranked "mostly free." Most were only "moderately free" or "mostly unfree" (Tunisia, Egypt, Morocco, Algeria,

"In the 1930s and 40s, perhaps even in the early 50s, people in MENA didn't expect the public sector to look after them. Most Egyptians, for instance, worked in the private sector. We are talking still about the same Egyptians today. They remained Muslim. So what has changed? I think it was the development model: it created new social expectations, new norms, such as that the state would take care of everyone. Now, if you're going to call that culture, go ahead, but empirically you cannot defend that position. Culture doesn't change that fast. What typically is referred to as 'culture' is just the pervasiveness of certain norms and expectations that are a byproduct of the last 50 years of state-run, state-managed economies in the region."

- Tarik Yousef, Professor  
at Georgetown University  
(Source: CIPE interview)

## The Successes of Local Reformers

**The Egyptian Junior Business Association (EJB)** provides a platform for cooperation among young, reform-minded businesspeople. CIPE worked with EJB on developing the first youth National Business Agenda in Egypt. Produced annually, the agenda became a key advocacy tool and a turning point in the public-private policy dialogue. It brought the policymakers' attention to the need for decentralization of government agencies, "one-stop shops" for investors, better competition and consumer protection laws, and reforms of customs duties and taxation. CIPE also worked with EJB on a manual for corporate governance in family businesses, engaging in particular the youth, women, and underprivileged sectors of the Egyptian society in reforms.

*To learn more, visit [www.cipe.org](http://www.cipe.org) and [www.ejb.org.eg](http://www.ejb.org.eg).*

**The Center for Private Sector Development (CPSD)** is a subsidiary of the Palestinian Businessmen Association and a leading advocacy institution. Since its inception in 2001, CPSD has worked with CIPE on improving the business climate, corporate governance, and competitiveness of local firms. CPSD identifies high priority issues that are then subjected to a vibrant public debate, and formulates policy recommendations pursued with relevant agencies, usually at the highest executive level. CPSD is also a respected watchdog on the performance of Palestinian public sector institutions and policies. CIPE and CPSD have been cooperating to successfully foster a broader culture of good governance and business ethics through varied initiatives involving Palestinian listed companies, SMEs, and institutes of higher learning.

*To learn more, visit [www.cipe.org](http://www.cipe.org) and [www.cpsd.ps](http://www.cpsd.ps).*

**The Lebanese Transparency Association (LTA)** is a chapter of Transparency International. In 2006, LTA and the Lebanon Corporate Governance Task Force (LCGTF), in cooperation with CIPE, launched the Lebanese Corporate Governance Code for Small

and Medium Enterprises. LTA is assisting companies in adopting these principles and working on similar codes for family-owned businesses and publicly listed firms to be disseminated and supported through Lebanon's recently established Institute of Corporate Governance. In addition, LTA and LCGTF are helping the government formulate governance standards for Lebanon's Commercial Code.

*To learn more, visit [www.cipe.org](http://www.cipe.org) and [www.transparency-lebanon.org](http://www.transparency-lebanon.org).*

**The Arab Institute of Business Leaders (IACE)** is a think tank created by a group of entrepreneurs striving to promote an entrepreneurial culture in Tunisia. CIPE and IACE cooperated on a nationwide survey of corporate governance – the first such study in Tunisia. The results revealed that while many firms agreed in principle with the need for greater transparency, accountability, and ethical standards in their corporate practices, 63 percent were reluctant to do so in practice, fearing high costs of compliance and expressing uncertainty as to how to implement such changes. IACE is now working on developing practical guidelines for company managers to facilitate easier adoption of corporate governance standards.

*To learn more, visit [www.cipe.org](http://www.cipe.org), [www.iace.org.tn](http://www.iace.org.tn), or [www.gouvernance-mag.com](http://www.gouvernance-mag.com) (French).*

**The Yemen Polling Center (YPC)** is a non-governmental research organization dedicated to building a free, open, and democratic society in Yemen. With CIPE's support, YPC conducted important polls on the issues of bribery and obstacles to doing business – the first ever such initiative in Yemen. The results were revealed in national press conferences and followed by symposia where various stakeholders discussed the outcome and proposed solutions. Political parties also used this poll data to help shape their platforms and better meet the needs of their constituents. This is a breakthrough in Yemen's democratic development, and polling is expected to be more evident in the 2009 round of elections for the Parliament and local councils.

*To learn more, visit [www.cipe.org](http://www.cipe.org) and [www.yemenpolling.org](http://www.yemenpolling.org).*

Yemen) and "repressed" (Syria, Iran, Libya). Only Sub-Saharan Africa shows a lower average score.

### Equality

A functioning market system provides equality of opportunity and guarantees equal treatment before the law. Constitutions of virtually every MENA country guarantee equality. However, equality in economic opportunities remains far from that ideal, especially for women and those in the informal sector. In the

GCC countries, a large majority of the population consists of expatriate workers (in the UAE, up to 85 percent of the population and 99 percent of the private work force<sup>9</sup>) who have only limited rights and legal protection.

### Responsiveness

Responsiveness is the ability of the government to react to citizens' wishes and concerns. In the context of a market economy, it refers to meeting society's need

for sustainable policies. In MENA, governments manage the economy by decree rather than through popular participation. This top-down approach has little ability to create inclusive governance or a sense of social ownership of the resulting policies.

### The Nature of Meaningful Economic Reforms

MENA’s recent positive economic growth combined with high unemployment and the lack of political reforms poses some questions about the nature of economic reform.

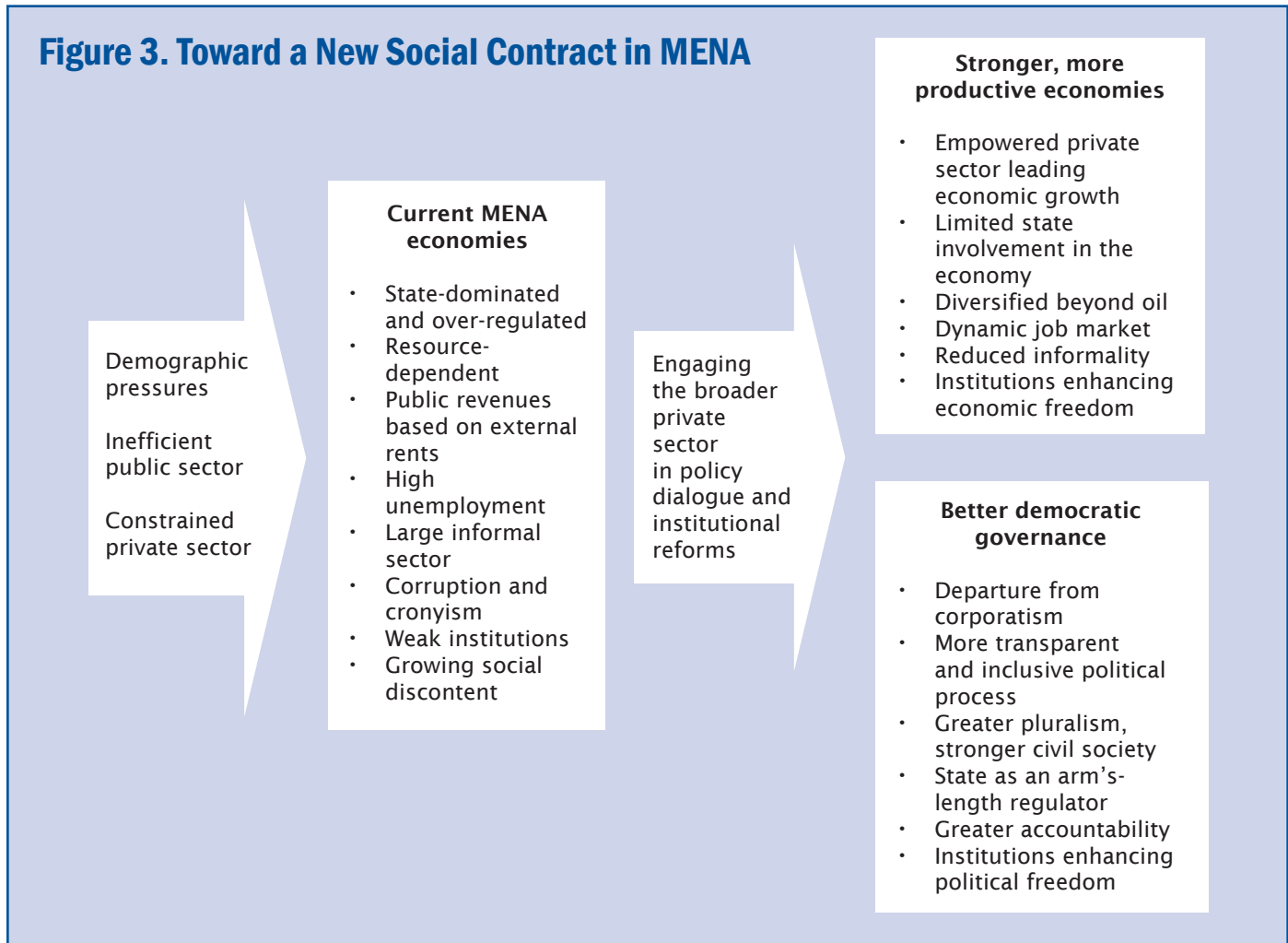
#### Does Economic Growth Equal Market Reforms?

The term “market economy” is often used loosely and may refer to just a subset of free market

“There have been some reforms [in MENA], but corruption is still a major problem for advancing business in that area. It keeps many good ideas down because they have little chance of competing. As long as there is no accountability, corruption will continue.”  
 – Khaled Saffuri,  
 Executive Director of the  
 Islamic Institute  
 (Source: CIPE interview)

characteristics. For instance, countries that have privatization programs, have deregulated some industries, or have reduced barriers to trade and investment the way MENA did in the 1990s are frequently cited as having implemented market reforms. This perception is linked back (often with plenty of skepticism) to the Washington Consensus, a phrase that came to signify neo-liberal policies advocated by Western donors to combat macroeconomic crises. But a true market economy rests on institutions and values that guarantee freedom and participation. It is not just a matter of attaining a measure of macroeconomic stability.

With that in mind, it is safe to say that a market system is yet to take root in MENA, impressive



growth figures notwithstanding. The gleaming skyscrapers of Dubai or Qatar's plans for the ultra-modern Energy City business center financed by the recent oil-derived growth surge are all too often taken as evidence of functioning markets and economic development. However, even high exogenous (externally derived) growth does not automatically translate into the institutional reforms necessary to sustain good economic performance over time, which is the essence of development. In fact, many MENA regimes use it to delay rather than advance market-oriented reforms by rewarding loyal elites with the benefits of partial economic liberalization.

### Are Political and Economic Reforms Linked?

The relationship between democracy and free markets has long been a subject of heated debates, especially regarding the Middle East. For instance, Eva Bellin says, "If democracy in the region is the goal, it must be pursued for its own sake, on its own (political) terms, and not as a means to an end of economic reform. Similarly, if economic reform in the region is the goal, it too must be pursued for its own sake and on its own terms. Economic and political reforms are indeed linked, but in ways that are complex and nondetermining."<sup>10</sup> While certainly the point about a lack of simple linear connection between economic liberalization and democratization is valid, it begs the question of defining democracy.

Democracy is often equated with elections. But what happens between elections matters as much as voting. In democratic governance, the right to elect leaders freely must be supplemented by civil liberties such as the right to

"In MENA, there is still a big difference between what people say and do. Despite significant economic growth and development - particularly in the Gulf - there has been little progress on true reform. For instance, many companies and auditors profess their adherence to corporate governance rules, but in reality they do not follow through."

- Hisham Awartani,  
Director of the Center  
for Private Sector  
Development, West Bank  
(Source: CIPE interview)

### Did you know?

Until recently, no single term had existed in Arabic for corporate governance, so a major challenge of addressing the issues of better transparency and accountability in business was just to be able to talk about them. Thanks to the efforts of Arab experts supported by CIPE, the region now has a term for corporate governance: *hawkamah ash-asharikat*. Meaning "the governance of companies," it is much more precise than vocabulary used in the past and was officially approved by the Arabic Linguists Council.

To learn more, visit the *Hawkamah Institute for Corporate Governance* at [www.hawkamah.org](http://www.hawkamah.org).

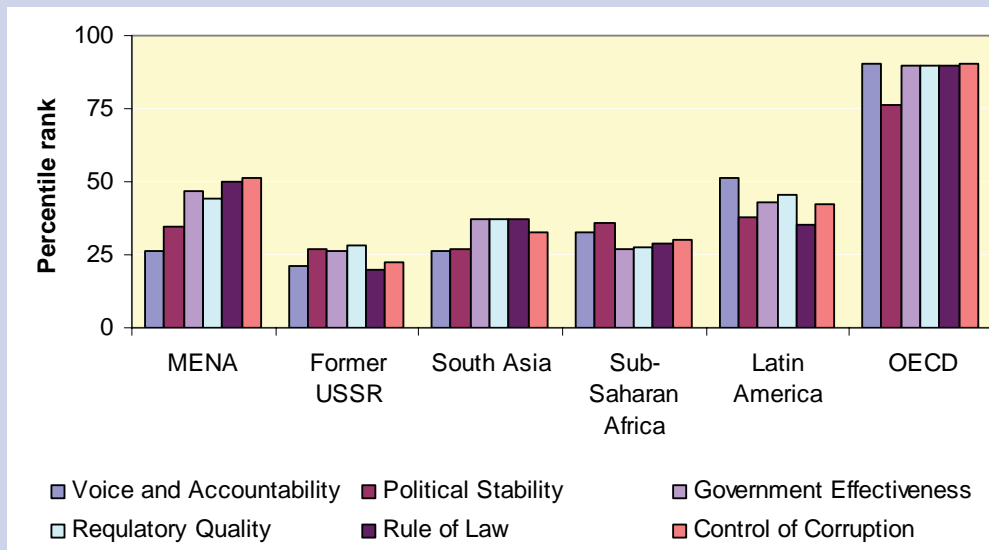
information, free association, and the right to petition the government. Since political decisions influence economic performance, this is precisely the link between effective political and economic reforms. They both require institutions that create transparency, hold those in power accountable, and enable broad participation in day-to-day policymaking.

There are no shortcuts or quick fixes here: meaningful reforms take time. Passing even the most pro-democracy and pro-market laws is of little use if they do not manage to modify human conduct on the ground. Introducing good laws is not enough if the values behind them are not internalized by those to whom they pertain. Therefore, successful reforms in the long run are about accomplishing a shift in value paradigms toward the principles of fairness, accountability, transparency, and responsibility that permeate functioning democracies and markets alike.

### MENA's Governance Gap

Prior to the 1950s, MENA was among the least developed regions of the globe. That changed, however, with the exponential rise in global demand for oil. Rapid inflow of oil rents into the state coffers – as well as foreign aid from the Cold War superpowers vying for influence over the region – decoupled state revenues from domestic taxation. This undermined the taxation-representation nexus, entrenched the power of ruling elites, and stalled the development of institutions necessary for democratic governance and productive market economies. Instead, MENA countries adopted a strong interventionist-redistributive orientation through reliance on state

**Figure 4. MENA Governance Indicators in the Global Context**



Source: Governance Matters 2007, Worldwide Governance Indicators, World Bank

planning, import substitution, nationalization of private and foreign assets, and a host of state-provided programs in education, housing, healthcare, and food subsidies.<sup>11</sup>

Subsequent decades witnessed the delivery of some dividends of those policies such as reduced mortality and poverty levels and increased school enrollment and literacy levels. But the rentier system remained deprived of proper mechanisms for representation and accountability, leading to corruption and nepotism as MENA governments went on to exercise tight control over political parties, trade unions, and other civil society organizations. An unwritten social contract has been forged, under which authoritarian rulers use their wealth and monopoly on power to distribute favors and build up support. Economic security became, in essence, a bargaining chip exchanged for the citizens’ democratic rights and freedoms. As a result, MENA economies became tightly controlled political levers rather than independent engines of prosperity.

“Institutions form the incentive structure of a society and the political and economic institutions, in consequence, are the underlying determinant of economic performance. (...) Polities significantly shape economic performance because they define and enforce the economic rules. (...) The difficulty of turning economies around is a function of the nature of political markets and, underlying that, the belief systems of the actors.”  
 – Douglass C. North, Nobel Prize Winner in Economics  
 (Source: “Economic Performance through Time,” Nobel Prize Lecture, 3 December 1993)

When compared with the rest of the world in terms of governance quality, MENA countries score consistently lower than expected relative to their income levels.<sup>12</sup> In Worldwide Governance Indicators, the region scores only around or below the 50th percentile. If the GCC countries are excluded, the picture looks even bleaker and more in line with Sub-Saharan Africa or the former Soviet Union. Most strikingly, the score on Voice and Accountability is low for all MENA countries, irrespective of income levels. This is a troubling trend, since OECD countries with incomes similar to the wealthy GCC states score incomparably better.

Without good governance, curbing corruption and creating productive economies capable of supporting long-term growth is difficult to achieve. Therefore, the need to close MENA’s governance gap is paramount for the success of reforms. The goal is not to prescribe a particular set of policies, because good governance in itself cannot guarantee “good” policies or leaders.<sup>13</sup> Rather, the role of democratic governance is to enable social dialogue and input from various stakeholders and to make sure those governments – and businesses – operate in an open and accountable manner.

**MENA’s Explosive Mix**

MENA is currently facing a threat of the deepest socio-economic crisis in its modern history. The inability of

MENA states to sustain good economic performance and deliver on their extensive social commitments first became apparent in the 1980s when the sudden drop in oil prices threatened the foundations of the rentier system. Those foundations remain equally vulnerable today, as the mix of a growing youth population, an inefficient public sector, and a constrained private sector is increasingly placing a strain on the existing social contract.

### Demographic Pressures

Declining infant mortality rates and rising life expectancy in the 1970s and 1980s resulted in the current steep population growth. In 2000, MENA's labor force was some 104 million workers, but by 2020 this number is predicted to soar to 185 million.<sup>14</sup> Even though the region is finally entering a period of declining labor force growth rates, for the years to come, this demographic boom will keep adding millions of new workers to economies that show little evidence of being able to create new jobs.

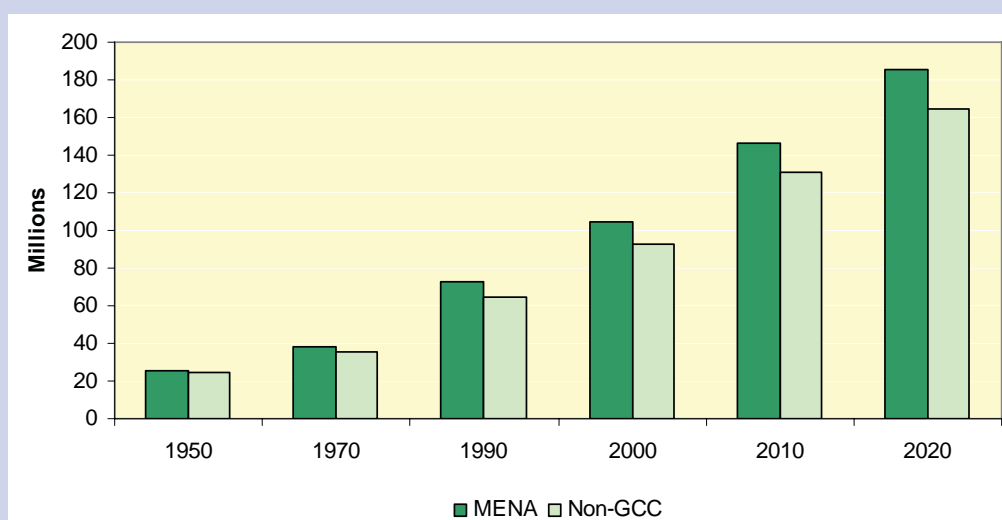
The outcome is increasing unemployment. The 2005 Zogby survey of Arab attitudes cited unemployment as by far the most important issue to the MENA population.<sup>15</sup> Exact estimates can differ significantly depending on the source – numbers reported by national authorities do not always give the full picture and up-to-date data is not available for all countries. The fact remains that MENA's unemployment is very high. According to the ILO's preliminary estimates for 2007, unemployment currently stands at 11.8 percent in the Middle East and 10.9 percent in North Africa and is the highest in the world. In North Africa, the total number of unemployed increased by almost a quarter over the last ten years and in the Middle East by one third. MENA also has the lowest

employment-to-population ratio and the lowest labor force participation rate worldwide, especially among women and youth.<sup>16</sup>

One important consideration in terms of MENA's unemployment averages is the stark difference between labor-abundant countries and labor-importing GCC states. The latter's unemployment rate is about half that of the former. The majority of the GCC labor force consists of non-nationals working at nearly full employment levels in the private sector. Unemployment persists largely among the nationals who prefer to queue up for more lucrative government jobs. For instance, in Saudi Arabia, the average unemployment rate in 2002 was 5.3 percent, but only 0.8 percent among expatriate workers as compared to 9.7 percent among nationals.<sup>17</sup>

Another caveat is that unemployment among women and youth is far more pervasive than in MENA's general population. In North Africa, unemployment rates for women in 2007 averaged 16.2 percent, compared to 9 percent for men, and the risk of unemployment for a young person was 3.5 times higher than for an adult. In the Middle East, the number of unemployed women has increased by 50 percent since 1997, and the youth unemployment rate stands at staggering 23.8 percent.<sup>18</sup> A somewhat counterintuitive phenomenon is that the level of education among the unemployed continues to grow. In fact, unemployment

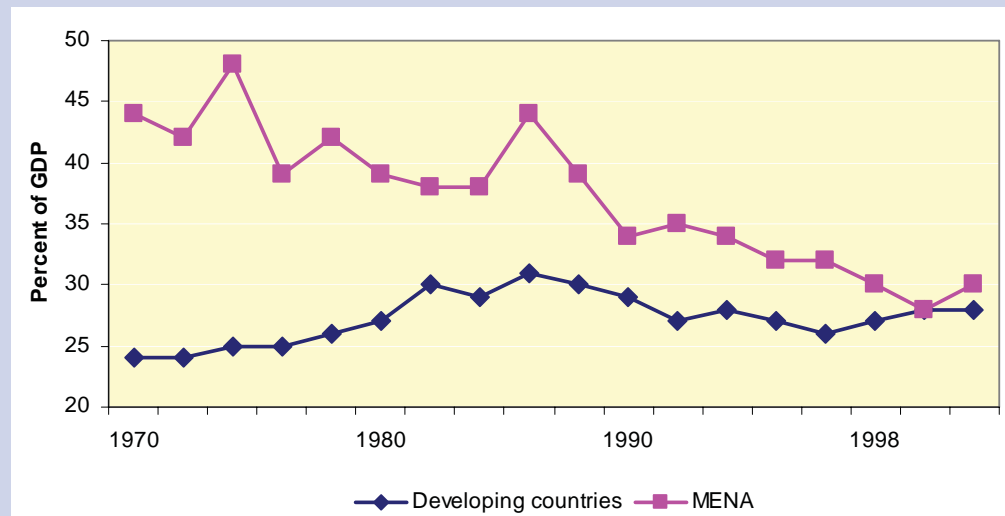
**Figure 5. MENA's Total Labor Force**



Source: World Bank, based on UN 2002 estimates

rates are the highest for young people with intermediate and upper-level education. In the 1960s, educational attainment in the Middle East was the lowest in the world, with an average of about one year of schooling per adult aged 15 years or older, but between 1980 and 2000, it increased faster than in any other region.<sup>19</sup> So did young people’s ambitions to secure high-paying government jobs.

**Figure 6. Central Government Expenditure**



Source: IMF Country Focus: The Middle East and North Africa, 2003; Note: MENA excludes Kuwait

**Inefficient Public Sector**

Government wages in MENA are extremely high: in the 1990s, they were about one-third higher than in the private sector.<sup>20</sup> That is unique on a global scale, given that public sector wages are typically lower. In MENA, those with less education are not eligible for government employment but manage to find inferior-paying jobs, whereas those with better academic credentials prefer to hedge their bets and stay unemployed while waiting for

opportunities in the public sector. At the same time, educated young people have problems finding jobs in the private sector at comparable wages. This testifies to the welfare nature of public employment in MENA and to the inadequacies of

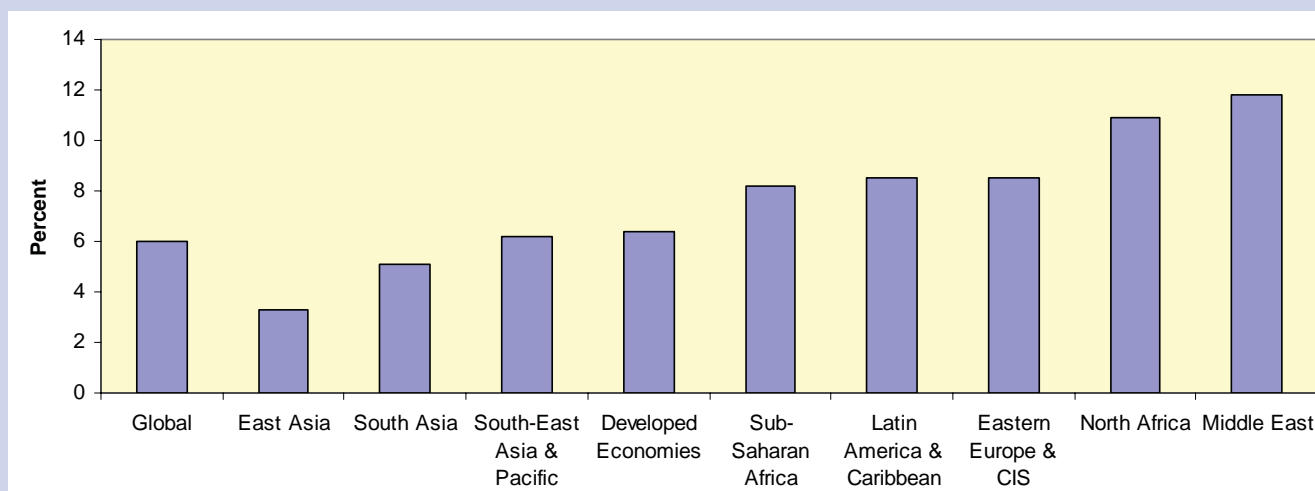
some cases actually spelled out as an official policy (in Egypt, for example). Consequently, the public sector has become a key source of employment for a large segment of the MENA population, cementing its loyalty to autocratic regimes with high wages, benefits, and lifetime job security. Public sector employment accounts for about 33 percent of the total employment in the region, compared to 27 percent worldwide and only 13.5 percent in the OECD countries. In many MENA countries this share is much higher than the regional average: over 70 percent among nationals in the GCC (with the high of 93 percent in Kuwait), 66 percent in Libya, 60 percent in Algeria, and 44 percent in Jordan.<sup>21</sup> The central government provides the bulk of public sector jobs.

The result of decades of skewed incentives is that much of the region’s human capital is unproductively trapped. Although the degree to which this has lowered economic growth is not entirely clear, studies estimate that between 1985 and 1995 the loss of GDP growth due to excessive public sector employment was 8.4 percent.<sup>22</sup> Estimates of labor redundancies in inefficient state-owned enterprises (SOEs) alone stand at about 35 percent in Egypt and nearly 40 percent in Jordan.<sup>23</sup> Wage bills spiraling out of control finally forced MENA governments to restrict the growth of public sector employment. But even though the region’s government expenditure-to-GDP ratio is now

“A deepening of political reforms [in MENA] is widely viewed as a prerequisite for firmly rooting badly needed economic reforms.”  
 – George T. Abed and Hamid R. Davoodi, International Monetary Fund  
 (Source: “Challenges of Growth and Globalization in the Middle East and North Africa,” IMF, 2003)

the region’s education systems, which de-emphasize practical skills and instead focus on granting accreditation to future bureaucrats.

The guarantee of government employment for the educated is a part of MENA’s social contract, in

**Figure 7. Average Unemployment Rates**

Source: ILO, *Global Employment Trends Brief*, January 2007

closer to other developing countries, MENA states still dominate the economy and employ disproportionately large segments of society.

A reduction in public sector jobs lengthened the lines of waiting graduates even more. In Egypt, for instance, the proportion of new job market entrants going directly into the public sector was 60 to 70 percent in the 1970s, but by 1998 fell to 25 percent.<sup>24</sup> Without a corresponding rise in private sector employment, this trend could have only one predictable result: job creation further lagging behind the swelling labor force.

### Constrained Private Sector

The state-centered economic model dominating in MENA has severely stunted the private sector. On average, the private sector accounts for less than 50 percent of the region's GDP and remains concentrated in a small number of large firms benefiting from governmental protection. In contrast, a large number of small, informal enterprises provide much of the

employment but remain constrained by the lack of access to credit, markets, and legal rights.<sup>25</sup>

### Spot markets vs. market economy

MENA holds rich traditions of commerce that stretch back thousands of years to ancient trade routes and bustling bazaars. Spot markets follow some of the principles of market economy (e.g., competition, laws of supply and demand). But they are fundamentally different: they have no reliable third-party enforcement, suffer from limited information flow, and lack modern financing institutions such as banks or stock markets. In contrast, advanced markets are complex systems of rules and regulations that enable impersonal exchanges on a much larger and more efficient scale.

Conducting business in most of MENA is challenging, especially in areas such as starting a business, protecting investors, and enforcing contracts. According to the most recent Doing Business indicators, MENA's three most populous states – Egypt, Iran, and Algeria – rank 126th, 135th, and 125th, respectively, out of the 178 evaluated countries. The Gulf States rank the highest in the region due to their more advanced business infrastructure, which facilitates oil trade, but their performance on starting a business (crucial to job creation) is less than impressive. It is also important to keep in mind that this ranking is based on laws on the books, not actual policy implementation. The GCC's relatively high marks need to be considered in context.

The costs of complying with regulations remain significant for new firms. Obtaining starting capital is quite a challenge, too, since public banks

that dominate the region’s financial system favor SOEs, larger firms, and offshore enterprises rather than smaller ventures.<sup>26</sup> Other strategic services important for the private sector, such as telecommunications and transportation, continue to remain squarely under state control.

The constraints to private sector growth are deeply rooted in the region’s corporatist legacy, with the state as the most important player in the economy rather than an impartial arm’s-length regulator. Large firms with connections to state officials are able to manipulate the rules to their advantage. Smaller firms face an unequal playing field and must operate informally or resort to bribes. In fact, the informal sector is where significant numbers of the region’s citizens make their living.

In Egypt, for example, the ILO places the share of informal non-agricultural workers at 55 percent. Other estimates are much higher (figure 9). The 1996 government survey revealed that 82 percent of Egyptian entrepreneurs worked in the informal sector, which employed 8.2 million workers – more than the formal private sector (6.8 million) and the government (5.9 million); over 90 percent of extralegal firms were run as sole proprietorships with fewer than five workers.<sup>27</sup> Hernando de Soto’s groundbreaking work has further shed light on informality in Egypt. While conducting research there in the late 1990s, de Soto discovered that 92 percent of city dwellers and 83 percent of the rural population lived in housing to which they had no formal property title. He calculated that this dead capital held by the poor is worth some \$240 billion – 55 times the sum of all foreign investment on record, including the Suez Canal and the Aswan Dam.<sup>28</sup>

The primary explanation for the pervasiveness of informality in MENA lies in the inadequacy of institutions guaranteeing private property rights and

**Figure 8. Select Doing Business Indicators for MENA**

Economy	Ease of doing business	Starting a business	Protecting investors	Enforcing contracts
Saudi Arabia	23	36	50	136
Kuwait	40	121	19	99
Oman	49	107	64	110
United Arab Emirates	68	158	107	144
Jordan	80	133	107	128
Lebanon	85	132	83	121
Tunisia	88	68	147	80
Yemen	113	175	122	41
West Bank/Gaza	117	166	33	125
Algeria	125	131	64	117
Egypt	126	55	83	145
Morocco	129	51	158	114
Iran	135	77	158	57
Syria	137	169	107	171
Iraq	141	164	107	150
Djibouti	146	165	173	159

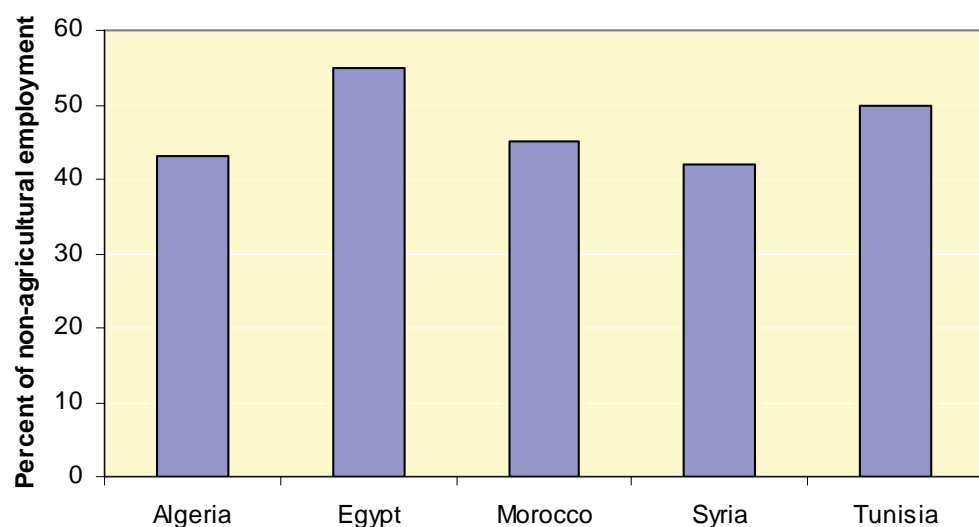
Source: Doing Business 2008, World Bank

enabling legal entrepreneurship, conditions largely inaccessible to the poor. As a result, two very distinct economic systems coexist, literally, side by side. But informality in MENA has spread far beyond micro- and small enterprises. Most MENA countries have protective labor regulations enforced in the public sector but not in the private sector. A tacit understanding emerged between governments and larger businesses that labor laws would not be strictly enforced for new workers. Hence, unionized older employees get to preserve their perks (e.g., employment contracts, insurance) while unregulated jobs created within formal businesses swell the ranks of informal laborers.<sup>29</sup>

“If you’re a large multinational and you want to register your foreign branch in Lebanon, it takes you about a month and a half to do that. If you want to get a construction permit with all the clearances in Egypt to set up a factory, you need to get approvals from about 15 government entities.”

– Frank Sader, Senior Operations Officer in the Private Enterprise Partnership for MENA, IFC office in Cairo  
(Source: CIPE interview)

**Figure 9. Informal Sector in Select MENA Countries, 1994-2000**



Source: ILO 2002

## The Challenge of Reform

The World Bank estimates that MENA needs sustained annual GDP growth rates of 6 to 7 percent in order to accommodate new labor force entrants. Growth *did* accelerate after 2000 from the low 1996-1999 average of 3.6 percent, but this oil-related boom is disproportionately benefiting the oil-rich labor-importing Gulf States (figure 10). In labor-abundant countries, where creating new jobs matters most, growth has remained volatile or has even slowed down. Changing that paradigm and sustaining high growth rates throughout MENA in order to absorb new labor force entrants is the region's top priority. But policy "band-aids" used in the past are no longer sufficient.

### Migration as a Substitute for Reform

Migration has traditionally been MENA's way to relieve labor pressures, but it is not a viable answer to the region's current unemployment crisis. For one, rural-urban migration is reaching its capacity. Only Egypt and Yemen remain predominantly rural, but by 2020 about 70 percent of the region's population will be urban;<sup>30</sup> moving more rural laborers to overcrowded cities would create more problems than it would solve.

Intra-regional migration from labor-exporting to labor-scarce countries is not the remedy, either. In the past, it helped to manage growing MENA populations: between 1975 and 1985, the imported workforce (from other MENA countries) in the Gulf almost quadrupled from 1.1 million to 4.1 million.<sup>31</sup> But lower oil revenues in the 1980s decreased the demand for labor and many countries began to use cheaper workers from Asia. The current surge in oil prices is not

reversing this trend, and even if peak emigration levels from MENA could be restored, it would still account for a small portion of the needed jobs. Additionally, Western Europe, the key destination for migration outside of MENA, is no longer as welcoming as it used to be. High unemployment rates there curtailed the demand for guest workers, while recent EU expansion to Central Europe opened up a more accessible labor pool.

### Incomplete and Insufficient Past Reforms

Unable to neutralize the economic slowdown through migration, MENA countries tried structural adjustment in the 1990s with support from international financial institutions. However, their uniform policy prescriptions failed to take into consideration unique social and political country contexts, and did not address the underlying institutional causes of the region's economic problems. Instead, governments that early on had experimented with political openings to garner popular support for market-oriented reforms soon started to perceive these actors as a threat to their rule.<sup>32</sup> Any benefits that partial economic liberalization produced were captured by state officials and their cronies and the incentives for reform soon diminished with recovering oil prices.

MENA today remains weakly integrated into the global economy, and its poor physical infrastructure, crippled by public-sector monopolies, makes it hard to reap the benefits of globalization. Arab countries' trade represented only 4 percent of world trade in 2005, and exports accounted for 5.5 percent of the global total (with fuels comprising 90 percent of MENA exports<sup>33</sup>). The level of intra-industry trade remains low as well, suggesting little cross-border movement of the components necessary for generating local employment through participation in global value chains.<sup>34</sup> This is largely due to wages inflated by the public sector, which negate MENA's competitive advantage as a low-cost producer.

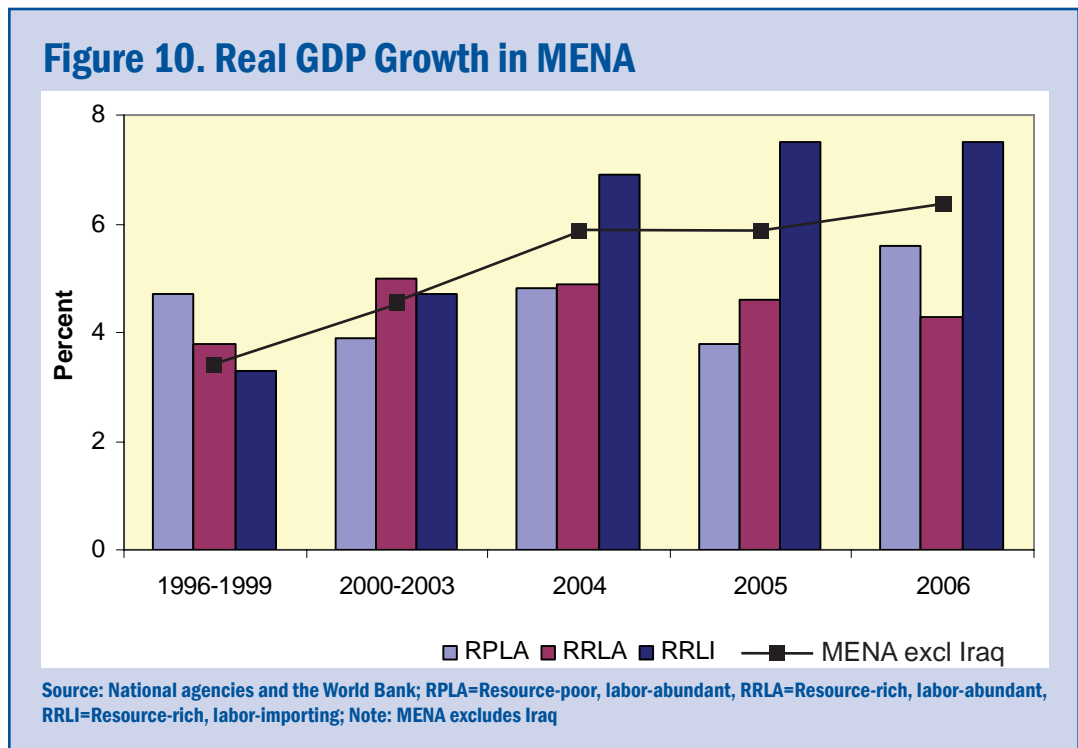
The region also attracts only a small share of global investment. In 2006, MENA received close to \$60 billion in net FDI flows, or about 4.6 percent of the global total, while the United States, with a comparable population, attracted over \$175 billion.<sup>35</sup> FDI in MENA remains centered on the energy sector, testifying more to investors' irresistible attraction to the "black gold" than to a particularly friendly business climate. In fact, a large part of the recent investment surge is the product of intra-regional petrodollar recycling, given that investors from outside the region are more wary of the risks associated with the authoritarian nature of local regimes.

**Reliance on State Solutions**

MENA countries increasingly recognize that in order to sustain growth and generate jobs they must expand private sector activity. But rather than targeting the institutional root causes, they have largely focused on various state-sponsored active labor market policies.

They include public works, microfinance and lending programs meant to promote self-employment, and labor force nationalization policies involving quotas and subsidies for hiring nationals and increased restrictions on work permits for expatriate workers.

Since unemployment is most acute among the educated youth population, it is unlikely that manual labor under public works will satisfy their ambitions and salary requirements, and significant non-wage labor costs are a disincentive for employers to turn such temporary jobs into permanent positions.



Similarly, as long as barriers to doing business persist, micro-lending programs have little hope of making a significant contribution to reducing unemployment and instead run the risk of skewing market incentives and crowding out unsubsidized entrepreneurs. Finally, labor force nationalization (most common in the GCC states where the public sector share of employment among nationals is least sustainable) is likely to diminish the competitiveness of firms by limiting their employment flexibility, obliging them to employ frequently less-skilled workers, and adding extra wage and administrative costs.<sup>37</sup>

Even though these policies can temporarily boost employment numbers, they cannot create enough quality jobs corresponding to the ambitions of MENA's young population, and they do not address the underlying structural causes of unemployment. More meaningful reforms require moving away from the state monopoly on political and economic power toward a system in which the state creates an enabling environment for the private sector to lead economic growth.

### Limited Progress of Reforms

Some positive examples of reform are already visible. In 2008, Egypt was named the world's top reformer by the Doing Business ranking with improvements in five of the 10 studied areas, ascending in the aggregate ranking from the 152nd place in 2007 to 126th in 2008. Reforms included cutting the minimum capital required to start a business, halving start-up time and cost, reducing the cost of dealing with licenses and registering property, and launching one-stop shops at the country's ports to facilitate trade.<sup>38</sup> Reforms have also progressed in Morocco in the area of human rights, corruption, and greater freedom of the press, and Morocco has even established a chapter of Transparency International.<sup>39</sup>

But more remains to be done, especially to complement economic reforms with political change. Egypt received deteriorating marks in the 2008 *Freedom in the World* survey because of increasing suppression of political dissent after the 2005 presidential elections. Morocco's reforms were also introduced top-down, lack implementation, and were not accompanied by measures that would meaningfully change the distribution of power or the monarchy's control over the economy.

### The Opportunity for Reform

In-depth reforms are difficult because, ultimately, they would redefine MENA's long-standing social contract and could threaten established elites. Until now, MENA leaders preferred not to "rock the boat," instead choosing to preserve the unsustainable status quo with only superficial changes, described by Steven Heydemann as "authoritarian upgrading."<sup>40</sup>

Today, however, this stability may be threatened more by not reforming.

At the same time, the opportunity to form broad social coalitions interested in the success of institutional reform has never been greater. The region's demographic transition makes reform a necessity, yet it also creates a unique one-time opportunity for greater prosperity.

Market economies that empower broader segments of the private sector are capable of meeting the region's demographic challenge, but creating them will require strengthening the application of good governance principles. Since those principles underpin not only market economies but also democratic order, incorporating them into how MENA economies are run will necessarily entail greater openness in the political realm.

### Environment Needed for the Private Sector to Lead Growth

For the private sector to become an active, credible, and informed participant in reforms, improvements are needed in the following areas:

- **Building market institutions.** To a large extent, MENA's current problems are derived from the institutional weaknesses that make it hard to move away from the failing welfare state model. Reforms need to establish functioning market economies based on sound governance and the equal opportunity to participate.
- **Developing political institutions.** MENA countries should foster the institutions of participatory governance. The need to strengthen the capacity of political parties to develop

"In the MENA region, the critical issue is not the availability of finance. There is more than one trillion dollars worth owned by domestic investors, which is invested outside the region. The main issue is the investment climate, sound and effective regulatory environment, a good corporate governance environment, and contract enforcement."

– Fouad Shaker, Secretary General of the Union of Arab Banks

(Source: Speech at the Regional Corporate Governance Forum, Amman, Jordan, January 2005)

economically sound policies is especially important, since today they remain weak, face ascending Islamist and militant groups, and symbolize the overall weakness of democracy in the region.

- **Strengthening the rule of law.** In order to be effective, both markets and democracies must be backed by rule of law. As long as MENA governments choose economic winners and losers and do not apply laws equally to everyone, the rule of law cannot flourish.
- **Empowering women and youth.** Closing MENA's governance gap will require the inclusion of marginalized segments of society. This cannot be achieved unless barriers limiting women's access to political and economic opportunities are reduced and young people receive an education that shapes an entrepreneurial culture and democratic values.
- **Creating space for the private sector.** MENA needs to limit the scope of its public sector and the level of governmental involvement in the economy. If informality is to be reduced and the private sector is to become the engine of sustainable growth and job creation, burdensome regulations on doing business should be reformed.
- **Improving access to information.** In MENA, information flow is limited and fragmented, contributing to opacity in business and policymaking. Information asymmetries between the government and society need to be reduced to ensure greater transparency and accountability of the political and economic systems.
- **Enabling private sector input.** Good economic policymaking depends on the inclusion of grassroots-level perspectives. Independent associations form the lifeblood of the pluralism necessary for healthy interest representation and checks on authority. Engaging MENA's voluntary business associations in an open policy debate serves the dual purpose of improving economic policies and democratic governance.

"I don't think we in the development community serve countries well by naively spouting the need for reform without recognizing the considerable difficulty institutional reform entails. Institutional reform is deeply political – it affects the balance of power between actors in society, and challenges the entrenched practices and economic privilege that some have enjoyed for generations. (...) The international experience with implementing and sustaining institutional reform points to virtuous circles: building those coalitions within the economy which need quality institutions, thus building the demand on institutions to respond. Successful institutional reforms are characterized by demand for change across the board, not just change instituted at the top."

– *Mustapha Nabli,*

*Chief Economist for MENA, The World Bank*

(Source: Keynote Address at the IMF/AMF High-Level Seminar on Institutions and Economic Growth in the Arab Countries, Abu Dhabi, United Arab Emirates, December 2006)

- **Combating corruption.** Corruption limits social trust in the economy and the political process. MENA governments and societies need to engage in a substantive dialogue on the costs of corruption, making the fight against unethical practices the top priority of reforms. Greater transparency in the relationship between the region's governments and businesses is needed, and better corporate governance can be a useful way to improve the conduct of business.

## The Future of Economic Reform in MENA

High growth figures derived from oil exports will not suffice to create millions of needed jobs unless the underlying structures of MENA's economies and governance are reformed. Given the immensity of the employment challenge and the fact that past reforms have been limited, as Marcus Noland and Howard Pack observed, "it is not difficult to envision the region caught in a downward spiral where impoverishment, discontent, militancy, and repression feed upon one another. Yet this is not the only possible future. If the region's employment challenge can be successfully addressed, its demographics could be turned from a potential liability to a valuable asset."<sup>41</sup> In order to capture this opportunity, reforms need to be broader-based and must incorporate both free market *and* democratic governance components.

As a first step, various parts of civil society – including private sector organizations – need to become involved in the public debate on reforms. This is already happening in many places, as illustrated by CIPE’s work with the Egyptian Business Association, the Center for Private Sector Development, the Lebanese Transparency Association, the Arab Institute of Business Leaders, the Yemen Polling Center, and many other organizations in the region.

Recognizing, as Dani Rodrik did, that the secret of economic growth lies in country-specific institutional innovations that come out of local knowledge and experimentation,<sup>42</sup> these organizations strive to represent grassroots voices of diverse entrepreneurs in order to seek local solutions. These organizations involve broad segments of the private sector in the design and implementation of economic reforms. They engage in a democratic, public-private dialogue on policy issues with the understanding that successful economic reforms require political will. Finally, their successes inspire confidence that similar initiatives can be successful elsewhere and that the broader private sector can help drive positive change throughout the region.

**“The public sector is obviously incapable of offering the needed job opportunities and the growth levels required to absorb the unemployed and new entrants to the work force. The logical alternative is to turn to the private sector and create an environment that facilitates its growth.”**

**– Ibrahim Akoum,  
Financial Markets  
Division Chief at the  
Arab Monetary Fund**  
(Source: “It’s Better Institutions, Middle East!” Economic Reform Feature Service, CIPE, 31 May 2006)

United Arab Emirates (based on the World Bank’s *MENA 2007 Economic Developments and Prospects*). Due to the lack of a universally accepted definition of the region and limited data availability, references to MENA in this paper may encompass a smaller group of countries as defined by the reference source.

<sup>6</sup> See Sufyan Alissa, “The Challenge of Economic Reform in the Arab World,” Carnegie Papers, 2007; and Hazem Bablawi and Giacomo Luciani, eds., *The Rentier State* (London: Croom Helm, 1987).

<sup>7</sup> United Nations Population Fund, *State of World Population 2002, People, Poverty and Possibilities: Making Development Work for the Poor* (New York: UNPFA, 2002), 21.

<sup>8</sup> See Larry Diamond and Leonardo Morlino, “Quality of Democracy: An Overview,” *Journal of Democracy* 15, no. 4 (October 2004), 20–31.

<sup>9</sup> Jason DeParle, “Emirates making peace with migrant workers,” *International Herald Tribune*, 5 August 2007.

<sup>10</sup> Eva Bellin, “The Political-Economic Conundrum: The Affinity of Economic and Political Reform in the Middle East and North Africa,” Carnegie Papers, Middle East Series, No. 53 (November 2004), 13–14.

<sup>11</sup> Tarik M. Yousef, “Development, Growth and Policy Reform in the Middle East and North Africa since 1950,” *Journal of Economic Perspectives* 18, no. 3 (Summer 2004), 92.

<sup>12</sup> World Bank, *Better Governance for Development in the Middle East and North Africa: Enhancing Inclusiveness and Accountability* (Washington, D.C.: World Bank, 2003), 56.

<sup>13</sup> World Bank, *Better Governance for Development*, 152.

<sup>14</sup> World Bank, *Unlocking the Employment Potential*, 1.

<sup>15</sup> James Zogby, *Attitudes of Arabs: An In-Depth Look at Social and Political Concerns of Arabs*, (Washington, D.C.: Arab American Institute/Zogby International/Young Arab Leaders, December 2005). Surveyed 3,900 Arabs from Morocco, Egypt, Saudi Arabia, United Arab Emirates, Lebanon, and Jordan.

<sup>16</sup> International Labor Organization, *Global Employment Trends* (Geneva: ILO, January 2008), 41. Due to limited availability of data and different methods of calculation, some alternative sources list Sub-Saharan Africa as having the highest unemployment in the world ahead of MENA.

<sup>17</sup> Nader Kabbani and Ekta Kothari, “Youth Employment in the MENA Region: A Situational Assessment,” World Bank Social Protection Discussion Paper, No. 0534 (September 2005), 5.

<sup>18</sup> ILO, 17 and 20.

<sup>19</sup> Robert J. Barro and Jong-Wha Lee, “International Data on Educational Attainment: Updates and Implications,” Harvard University, CID Working Paper, No. 42 (April 2000), 26.

<sup>20</sup> Salvatore Schiavo-Campo, Giulio de Tommaso, and Amitabha Mukherjee, “Government Employment and Pay in Global Perspective: A Selective Synthesis of International Facts, Policies and Experience.” World Bank Policy Research Working Paper, No. 1771 (May 1997), 9.

## Notes

<sup>1</sup> World Bank, *Middle East and North Africa Region 2007 Economic Developments and Prospects: Job Creation in an Era of High Growth* (Washington, D.C.: World Bank, 2007), 1, 29.

<sup>2</sup> World Bank, *Unlocking the Employment Potential in the Middle East and North Africa: Toward a New Social Contract* (Washington: D.C.: World Bank, 2003), 1.

<sup>3</sup> United Nations Development Programme, *Arab Human Development Report 2004: Towards Freedom in the Arab World* (New York: UNDP, 2005), 19.

<sup>4</sup> World Bank, *World Development Report (WDR) 2007: Development and the Next Generation*, Regional Highlights, Middle East & North Africa.

<sup>5</sup> MENA includes the following: Resource-poor, labor-abundant (RPLA): Djibouti, Egypt, Jordan, Lebanon, Morocco, Tunisia, West Bank and Gaza; Resource-rich, labor-abundant (RRLA): Algeria, Iran, Iraq, Syria, Yemen; Resource-rich, labor-importing (RRLI): Bahrain, Kuwait, Libya, Oman, Qatar, Saudi Arabia,

- <sup>21</sup> World Bank, *Middle East and North Africa 2005 Economic Developments and Prospects: Oil Booms and Revenue Management*, (Washington, D.C.: World Bank, 2005), 55; 2000 data or closest available year.
- <sup>22</sup> Christopher A. Pissarides and Marie Ange Venganzones-Varoudakis, "Labor Markets and Economic Growth in the MENA region," in Jeffrey B. Nugent and Hashem M. Pesaran, eds., *Explaining Growth in the Middle East* (Amsterdam and Oxford: North Holland/Elsevier, 2006), 149.
- <sup>23</sup> Elizabeth Ruppert Bulmer, "The Public Sector as Dominant Employer in MENA" (Washington, D.C.: World Bank, 2002).
- <sup>24</sup> World Bank, *Unlocking the Employment Potential*, 110.
- <sup>25</sup> World Bank, "Private Sector in MENA" (Washington, D.C., September 2004), available at [http://lnweb18.worldbank.org/mna/mena.nsf/Attachments/Private+Sector-Brief-ENG/\\$File/PRIVATE-ENG+2004AM.pdf](http://lnweb18.worldbank.org/mna/mena.nsf/Attachments/Private+Sector-Brief-ENG/$File/PRIVATE-ENG+2004AM.pdf).
- <sup>26</sup> Yousef, 105.
- <sup>27</sup> Ahmed Galal, "Potential Winners and Losers from Business Formalization," World Bank Development Outreach (November 2003), available at <http://www1.worldbank.org/devoutreach/nov03/textonly.asp?id=287#figure1>.
- <sup>28</sup> Hernando de Soto, *The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else* (New York: Basic Books, 2000), 5, 33.
- <sup>29</sup> World Bank, *Unlocking the Employment Potential*, 106.
- <sup>30</sup> Kabbani et al., 23.
- <sup>31</sup> Sara Johansson de Silva and Carlos Silva-Jáuregui, "Migration and Trade in MENA: Problems or Solutions?" World Bank Discussion Paper (October 2004), 10.
- <sup>32</sup> Yousef, 110.
- <sup>33</sup> Computations by Sufian Alissa, based on the data from League of Arab States, Arab Fund for Economic and Social Development, Arab Monetary Fund, and Organization of Arab Petroleum Exporting Countries, Joint Arab Economic Report 2006, September 2006.
- <sup>34</sup> Marcus Noland and Howard Pack, *The Arab Economies in a Changing World* (Washington, D.C.: Peterson Institute for International Economics, April 2007), 103.
- <sup>35</sup> MENA as defined in note 5; calculations based on the 2007 World Investment Report, UNCTAD.
- <sup>36</sup> Marcus Noland and Howard Pack, "Globalization with Arab Characteristics," Yale Global, 17 October 2007, available at <http://yaleglobal.yale.edu/display.article?id=9838>.
- <sup>37</sup> World Bank, *Unlocking the Employment Potential*, 155–163.
- <sup>38</sup> Doing Business 2008, available at <http://www.doingbusiness.org/Reformers/MENA.aspx>.
- <sup>39</sup> Marina Ottaway and Meredith Riley, "Morocco: From Top-down Reform to Democratic Transition?" Carnegie Papers, Middle East Series, No. 71 (September 2006), 8.
- <sup>40</sup> Steven Heydemann, "Upgrading Authoritarianism in the Arab World," The Saban Center for Middle East Policy at The Brookings Institution, Analysis Paper No. 13 (October 2007).
- <sup>41</sup> Noland and Pack, *The Arab Economies*, 13, 313.
- <sup>42</sup> Dani Rodrik, "How to Make the Trade Regime Work for Development," Harvard University, February 2004.