The Political Economy of Reform: Mobilizing Alliances for Change

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An Examination of the Myriad Factors Underlying Reform

The development community has seen a shift in the focus on economic reform. Initially, the goal was to define the appropriate elements of policy reform – to identify the obstacles to higher growth and improved living standards and to design a policy reform program to address these obstacles. Increasingly, however, we are appreciating the importance of myriad factors *underlying* policy reform. Emerging analysis on the subject touches on the issue with terms like the institutional capacity for reform and the political economy of reform. And what is clear from the analysis is that economic policy reform is far from a straightforward undertaking. It is a deeply political issue. It affects the balance of power between actors in society; at its core, it involves finding the economic rents that have built up over the years and cutting them back; it attacks the economic privilege that some have enjoyed for generations. And thus it is no surprise that carrying forward comprehensive economic reform is a profoundly difficult task.

The MENA region (Middle East and North Africa) has been no exception. The region's reform effort has been characterized by great promise and subsequent disappointment. Starting in the mid 1980s, a few countries embarked on ambitious macroeconomic stabilization and structural reform programs. There were high hopes about the region's prospects when almost every other country in the region began to follow suit. But observing the subsequent slowdown in the pace of reforms, the reversal of some of them and the inability to tackle deeper and more fundamental arrangements inhibiting growth has certainly confirmed the importance of understanding these forces behind policy reform.

This is a Particularly Important Period for the Region: What does an Economic Boom Mean for Reform?

First, however, it is important to acknowledge what is at stake for the region in terms of reform. This is an interesting time for the region. By all accounts, MENA has been in an economic boom. Over the last two years, growth in MENA has averaged more than 5.6% a year, the strongest growth in a decade. On a per capita basis, MENA's 3.5% growth per capita was the highest recorded growth performance since the mid-1970s. We have seen stock markets in the region booming. We have even seen a noticeable reduction in unemployment in a few countries. And perhaps most importantly, oil prices are expected to remain buoyant well into the decade.

So the first question is what does this mean for reform? Does it diminish the need for economic reform? Are we looking at a new growth trajectory in which major development challenges, including employment creation, are going to be attainable so long as oil prices remain relatively elevated? On this, I think it is clear that the answer is no.

To begin with, even the growth acceleration we have seen in the region has not been broad-based, with only a few of the oil exporters realizing significantly higher growth since the 1990s. The region has changed and the traditional transmission channels of an oil boom to the non-oil economies have greatly diminished since the 1970s. Labour remittances, aid, and investment flows are all significantly lower than in previous oil booms. So only a few countries will see advanced growth prospects based on the current oil market forecasts. Higher growth will depend on more than oil.

Moreover, the region has enormous challenges ahead in the labour market, with some 100 million new jobs needed to absorb the coming labour market entrants and the currently unemployed over the next two decades. Simply keeping pace with new labour force entrants implies sustaining economic growth rates of between 6-7% per year for the next two decades, and we have already seen growth level off below that. In the past year, economic growth has moderated to 5.2%, having peaked at over 6% growth in 2003 as a result of both spiralling prices and a large ramp-up in production. Even short-term forecasts for growth, while strong, at 4.9% and 4.3% in 2005-2006, suggest rates of growth insufficient to address a mushrooming problem of unemployment.

It is clear, the development objectives for the region have not changed and the path for meeting those objectives has not changed because of the recent oil price increase. To achieve sustainable levels of growth for the types of job creation needed in the region requires comprehensive reform of the economic structures driving growth.

Reform Progress has been Uneven: Start and Stop

How is the region faring on the structural reform front? We are all familiar with the history of reform in the region, where following the collapse in oil prices and facing high debt, deteriorating budget deficits and a lack of growth, a few countries – Morocco, Tunisia, and Jordan, and subsequently Egypt – adopted programs aimed at restoring macroeconomic balances and promoting the private sector as an engine for growth. By the late 1980s and early 1990s, most other countries in the region had followed suit, adopting some form of economic stabilization.

The question is where does the reform effort stand today? On the macroeconomic stabilization front, the region has achieved a lot. Debt renegotiations and write-offs have helped reduce the very large and unsustainable debt burdens and have helped achieve improvements in the fiscal deficits. Continuing macroeconomic stabilization efforts have helped to contain inflation to about 3 percent between 2000 and 2003, down from an average of twelve percent in 1991.[1] Over the same period, fiscal balances have moved from deficits averaging about 4% of GDP in 1990 to surplus positions by 2000, and total external debt has declined from an average of 40 percent of gross national income in 1990 down to 28 percent in 2002,[2] with the largest declines achieved in Egypt, Morocco, Yemen, and Jordan. These achievements have largely been sustained when one looks at the standard indicators of macroeconomic stability. But we should keep in mind that that are many risks which may make this stability unsustainable because of the many contingent liabilities which have been building up in many countries. These are related to the accumulating implicit debts from many sources such as the pension systems, the banking sectors, the public enterprises and a variety of explicit and implicit government guarantees.

In terms of accompanying structural reforms, the results have been more mixed. A few early reformers have implemented more intensive reforms toward market-oriented, private sector led economies, signing Euro-Mediterranean agreements, implementing tax reform, and undertaking trade and financial sector liberalization. Others have pursued reform more sporadically and slowly. Still others have made more modest progress, but by and large, the pace and intensity of the reform effort has been weak.

If you look at some of the standard indicators of market-orientation or private sector development, the region remains well below potential:

- On the trade side, and despite some strong progress with trade liberalization among a few countries, average tariffs remain well above those of other developing regions. Weighted average tariffs average 15% in MENA, higher than in East Asia (9.4), Europe and Central Asia (7.0), Latin America (10.6), and even Africa (13.0).
- Non-oil exports account for only 8% of GDP, compared with an average of 27% among low and middle income economies. Only one country in the region – Tunisia – has exceeded that level.
- FDI inflows to the region average a third of the average levels achieved worldwide, averaging less than 1 percent of GDP (0.7%), compared with almost 3 percent in East Asia, and two-and a half percent achieved in Europe and Central Asia, Latin America, and even Sub-Saharan Africa.
- The private sector remains underdeveloped, both in terms of contribution to output and in terms of contribution to employment creation. The public sector accounts for 33% of employment in the region, well above that of East Asia (9%, excluding China) and Latin America (13%).
- And, examining a broad range of indicators of doing business, the MENA countries continue to have significant barriers to entry and obstacles to doing business. Overall, the MENA region countries rank below every other region of the world but Sub-Saharan Africa in terms of the ease of doing business.[3]

Why Hasn't the Region Been Able to Achieve More?

So, what has prevented a more intensive reform effort? Two fundamental factors stand out.

Oil

The first has been the ability to continue to rely on oil and strategic aid to delay implementing a deeper economic reform agenda, which has permitted Arab governments to adopt limited reforms and postpone the fundamental reforms needed for higher growth and employment creation.

So it must be acknowledged that the current climate of high oil prices presents the region a real challenge in terms of moving forward on reform. The history of economic reform movements suggests that deep economic reforms are often most successful and most sustained when countries have faced virtual economic crisis. Often reform is only adopted "once the possibilities of throwing money at the problem are foreclosed."

To their credit, in this current oil boom, many oil economies, including Saudi Arabia and Algeria, are wisely utilizing windfall revenues to retire debt, and there are signs that the region is showing relatively higher prudence with oil windfalls than in past booms. However, there is much more the region could be doing to take advantage of the current favourable economic environment to press forward with more difficult reforms needed to unleash stronger economic growth.

Coalitions

But the second and assuredly more important factor behind why reforms have stagnated has been the lack of

[1] Inflation figures for Algeria, Bahrain, Egypt, Iran, Jordan, Kuwait, Morocco, Oman, Qatar, Saudi Arabia, Syria, Tunisia, and Yemen.
[2] Weighted average of external debt/GNI for Algeria, Egypt, Jordan, Lebanon, Morocco, Syria, Tunisia, Yemen, Kuwait, Oman, and Saudi Arabia.
[3] Based upon a composite index of indicators found in the World Bank *Doing Business* database, measured in 2003.

EUMEDIS PROGRAMME

(Euro-Mediterranean Information Society Initiative)

In February 1999, the European Commission approved a regional initiative within the framework of the MEDA programme, which had the main objective of developing an Information Society in the Euro-Mediterranean region, specifically to bridge the digital and technological gap between the north and the south of the Mediterranean. The EUMEDIS initiative, with a total budget of 65 million euros, is a pilot project to demonstrate the concrete advantages that ICTs can offer to the priority sectors of the Euro-Mediterranean Association.

The main objective of this initiative is to contribute to the development and qualitative improvement of the Euro-Mediterranean Information Society, thereby promoting economic development and an improvement in quality of life. It is an attempt to achieve a harmonious development of ICTs and an update of technologies and new electronic platforms, with the aim of extending their use in MED countries.

The EUMEDIS programme comprises 21 pilot projects and more than 300 associates or *partners* distributed amongst 9 MEDA countries (Morocco, Algeria, Tunisia, Egypt, Israel, Jordan, the Palestine Authority, Syria and Turkey). These projects are divided into 5 sectors of intervention:

1. Health and medical assistance
2. Electronic trade
3. Tourism and cultural heritage
4. Industry, trade and development of small and medium enterprises
5. Education

During 2004 the EUMEDIS programme has obtained a number of concrete results, including two projects completed: one project in the health sector and another in the industry and trade sector.

EMISPHER (*Euro-Mediterranean Internet-Satellite Platform for Health, Education and Research*)

1. This project, led by the most important hospital in Germany (the Charité Hospital in Berlin), has installed the equipment required for satellite communication in 10 hospitals in MED countries, with the aim of sharing the diagnosis of serious diseases, to carry out surgical operations in real time (*telemedicine*) and to teach specialized long-distance courses.
2. The success of this project has convinced partners to continue with two new projects: The Mediterranean Virtual University and the Mediterranean Virtual Hospital.

E-MED TEX-NET (*Cluster for the Development of a Euro-Mediterranean Partnership Network in the Textile Clothing Sector*).

1. This project, led by the Parisian Chamber of Commerce, responds to the needs of the sector, since they coincide with its total liberalization, within the framework of the World Trade Organization (WTO) agreements signed in January 2005.
2. The aim is to create an online portal with three services: *Business intelligence* (information on markets, consumer tendencies, national and international laws and regulations, etc), *Business contact and trade* (forum where firms can get directly in touch) and *Business benchmarking/improvement* (each operator can administer in real-time its firm's *benchmarking*, which includes the setting up of a system for online training).

For further information, see: www.eumedis.net

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coalitions emerging to press the government for deeper reforms and better policy choices.

Structural reform depends on both a perceived need for change and the ability of alliances to develop the capacity to press for those changes. These coalitions for change can emerge from many different places. The private sector can come together and press for changes to enhance profits. Or they may emerge from labour unions or from consumers. These traditional advocates for reform, they are not present in MENA. The private sector is greatly underdeveloped. Private sector activity is concentrated in a small number of large firms that have benefited from protective policies, along with a number of small enterprises, which account for much of employment but have little access to formal finance, markets, or government support programs. Large scale industries do not press for change because they benefit from the status quo, manipulating Government policy for their own gain – the so called "state capture" of government regulation. It ranges from persistent awarding of large public sector contracts to few well-connected groups, to actual change in laws and regulations that lower the costs or increase the profitability of such groups.

Trade unions, which could also be an effective vehicle for change, are tightly controlled in MENA region and without real independence from the political system. As a result, they have not been effective in organizing the labour force to press for reforms.

More generally, the problem of lack of coalitions for change in MENA region is not the underdevelopment of the private sector or the lack of independent trade unions. There are innumerable other groups which could press for reforms. But the greater problem is that MENA's governance systems directly hinder any groups from effectively uniting for change.

To unite for change, groups need certain central rights. They need access to information to formulate choices, they need the ability to mobilize and they need the ability to contest policies that are poor. But these rights are not present in the region. Government information is not accessible by the public. Freedom of the press is carefully monitored and circumscribed in most countries. There are restrictions on civil society. There are restrictions on freedom of association. And the ability to contest government policies is weak.

In a nutshell, we are talking about fundamental weaknesses in governance, both in terms of inclusiveness and public accountability. Inclusiveness reflects the notion that everyone who has a stake in development and wants to participate in governance processes can and on an equal basis with all others. Accountability reflects the notion that governance processes are known and can be contested.

In the MENA region, weaknesses in inclusiveness are reflected not only in differential business opportunities, with large or privileged firms being awarded contracts or favourable legislation, but in rural dwellers having fewer public services, gender inequalities in voice and participation, in nepotism, tribal affinity, patronage or money determining who gets public services and who does not. Weaknesses in accountability are reflected in limited access to government information, limited freedom of the press, restrictions on civil society, and most importantly, a virtual void of opportunity to contest policies.

It is a combination of entrenched interests and uncertainties from those who benefit from the status quo, combined with lack of information and an inability to mobilize and contest for better policies by those who would benefit from reform that prevents deeper reform from taking place.

We can not talk about mobilizing alliances for change without acknowledging that a critical element of moving structural reform forward is addressing this enormous governance challenge. Though the region has had some success with implementing broad, top-down reforms, these have largely run their course, and deeper economic reform cannot proceed without reform of the incentive structure in which reforms are embedded. This is not a separate agenda that can be pursued at its own pace. Addressing the governance weaknesses in the region is a critical cog in the overall machine of economic reform – and the process cannot be moved farther along without fixing that cog.