

Public Policy & Private initiative : towards a new partnership

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*Governance and accountability inside the Public Sector and the Private Sector
and in their new partnership*

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(Comment on the main paper of Mrs. Nehmat SHAFIK)

Introduction : Globalization challenges for the Arab economies

The theme of the changing roles of the Public and the Private Sector in the Arab countries constitute today a fundamental issue that has to be addressed boldly if these countries are to be able to face global competition without social and political disruption on one hand and secure at the same time the foundations of a sustainable development. The lessons of the last thirty years indicate clearly that the path of development followed by a number of Arab and Middle Eastern economies was far from being sustainable and might be considered as one of the causes of Arab domestic tensions and civil violence as well as wars, as the Gulf War.

The development strategy based on maximizing export of raw materials and energy or derived products has created a high dependency on international markets for such products. Arab economic growth rates have fluctuated widely according to the prices of energy and other raw materials. It is to be noticed that countries like Morocco, Tunisia and Egypt have made substantial progresses in implementing structural adjustment policies and opening their economies to global competition.

However, on the whole MENA region has lagged in comparison to other regions of the developing world mainly Eastern Asia and Latin America. In spite of the huge oil and mineral wealth and the large amounts of Public investments in infrastructures, heavy industries and fertilizers and petro-chemicals, the Arab economies are very marginal in the global economy. Aggregate GDP is less than the GDP of Spain and total Arab exports (including oil & gas) is less than the exports of a single small industrialized country like the Netherlands. Emerging Financial markets in Egypt, Jordan, Tunis, Morocco and Lebanon are still lacking deepening and have not yet reached developments achieved recently in countries like the Philippines or Malaysia.

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Public and Private Sector are still entrenched in a strong tradition of exploiting rent situations (transport, tourism, export of raw material or workers, protected domestic market, etc...)¹. The relations between the Private Sector and the State are characterized by a lack of transparency and the absence of vision on how to face both the challenge of globalization and that of domestic social issues in need of bold measures to prevent more exclusion of the low income groups from the advantages of globalization.

This is why there is a need to identify different issues involved in the changing roles of the Public and the Private Sector in the MENA countries. Why we fully agree on the general theme of smaller but much "smarter and efficient government that can guide private action to serve the public good" ², our feeling is that reaching this main goal requires additional efforts to what is envisaged usually and that concentrates almost exclusively our curtailing Public Sector activities. If privatization of Public enterprises and the opening of traditional Public services supplying tradable and non tradable goods to Private enterprises together with accelerating the changing role of the State in production from a "player" to a "regulator" and a referee" is highly desirable, other issues have to be confronted if the structural adjustment efforts and the new partnership between the Public and the Private Sector are to be successful.

These issues are related to both the Public Sector and the Private Sector.

I. Introducing Governance and Accountability in both the Public and the Private Sectors and in the relations between the State and the Private Sector

a) Fighting corruption and raising the expertise level of the Public Sector

Most States in the Middle East are characterized by too large and underpaid bureaucracy. For different historical reasons, States and Public entities have been the main source of employment for University graduates and even for students completing secondary education. With the exception of the rich oil exporting countries of the Arabian Peninsula where Public Sector salaries are equivalent or higher than Private Sector salaries, civil servants and ministers receive a very low level of compensation. In many countries, the civil servant who resist corruption

¹ See N. SHAFIK, *Rents, Reform and Economie Malaise in the Middle East and North Africa*, The World Bank, September 1996, and G. CORM, *Le développement économique dans la région méditerranéenne : approche historique et problématique*, Council of Europe, Conférence méditerranéenne sur la population, les migrations et le développement, Palma de Majorque, Octobre 1996.

² N. SHAFIC, *Public Policy and Private Initiative : Towards new partnership in the Middle East and North Africa*, The World Bank, March 1977, p.13.

has to seek an additional occupation to make a decent living for his family. In such countries, salaries of ordinary civil servants could be as low as the equivalent of \$ 50 to \$ 100 and minister's salaries would not be higher than \$ 500 to \$ 1000.

This situation create a very favourable environment for the development of corruption whereby ordinary citizens have to pay "under the table" bonus to be able to proceed with their administrative formalities and whereby the Private Sector can exercise a pervasive influence on the higher strata of the local bureaucracy to obtain specific advantages or protection or to escape taxes or other regulations (environment and pollution, urban planning, health regulations, etc...).

In certain countries, members of the Government are themselves prosperous businessmen or contractors continuing to run their various companies while being key cabinet members, preparing laws and issuing regulations. This type of partnership between the State and the Private Sector is unhealthy and inadequate as was recently very well exposed in the Harvard Business Review³. The author of this article explains very clearly why someone who has made a personal fortune will not necessarily know how to make an entire nation prosperous and that the specific logic of a corporation and its behaviour and strategies can not be the same as the macro-economic logic of a State.

These inadequate types of partnerships between the Public and the Private Sector, either built on visible or invisible corruption or on businessmen running governments, have to be phased out if we want to see a fundamental change in both the behaviour of the Private Sector and the Public Sector and the nature of their relationship. This will not be an easy task as rent culture is deeply entrenched in the relations between Public and Private Sector and as corruption has been on the rise in many countries due to the very low level of civil servants salaries. The International Monetary Fund has recently studied the economic distortions that corruption creates in an economy⁴ and there is an increasing trend in the world for more efficient fight against corruption (petty corruption or high level corruption). Corruption is not only immoral; it is also preventing an economy to take full advantage of free market principles and becoming fully competitive.

When calling for a change in the role of the State and a new partnership between the State and the Private sector whereby the State will become the regulator and the referee, then the fight against corruption must be put on the agenda as a high priority.

³ See P. KRUGMAN, *A country is not a Company*, Harvard Business Review, January-February, 1996.

⁴ See P. MAURO, *Why Worry about Corruption?*, IMF, Economic Issues, n° 6, February 1997.

If the State is to perform efficiently its role as regulator, general rules for governance and accountability has to be introduced at all levels of the State bureaucracy.

To this effect, it will be necessary to reduce drastically the size of the bureaucracy through adequate compensation packages paid to the big number of redundant civil servants that should be asked to leave the Civil Service. But to perform efficiently its new role, the State will have to introduce new blood in the civil service by recruiting people with the proper level of expertise and paying to them competitive level of salaries. Asking for the services of private consulting firms to begun with is an acceptable idea, but this should not prevent the various ministries of developing their own capabilities so that they could monitor the quality of the work of hired consultants and, at a later stage, be in a position to produce adequate regulations without depending on the Private Sector.

b) *The new responsibilities of the Private Sector*

Rules of governance and accountability should also be introduced for the Private Sector. The bribing firm should be as strongly punished as the corrupted civil servant or the Government executive granting undue advantage or exemption to a private company or an individual. In addition, private sector firms should stop avoiding tax payments by all means.

Income tax evasion is a plague affecting all the Arab countries and any new and sound partnership between the State and the Private Sector will entail introducing income tax where it does not exist, enlarging the scope of the tax elsewhere to include all incomes and suppressing so many loopholes, creating an efficient and honest Tax Administration, punishing harshly tax evasion. The Private Sector in the Arab World has a tendency to prefer to pay "transaction costs" rather than paying even a reasonable amount of taxes and low paid tax officials tend to harass Private firms or prosperous professionals in order to get a bribe.

Part of a new partnership should be concluded around this income tax issue. The Private Sector will have to pay a fair share of Public expenditures that provide them with infrastructures and security and social stability; the State will have to raise the standards of its Tax Administration, simplify tax legislation and regulations. Any tax exemption to the private sector should be linked to performance criteria in terms of employment, creative manpower, training, R & D capability⁵.

⁵ See G. CORM, *L'ajustement structurel du secteur privé dans le monde arabe*, The Economy of Peace in the Middle East, L. BLIN and Ph. FARGUES ed., Maisonneuve et Larose, Paris, 1995.

In most Arab countries, Investments Codes are granting too many exemptions in activities that do not entail specific entrepreneurial risks. Exemptions should be targeted to inducing the private sector into more competitive and efficient production organization, into opening and enlarging the equity of companies which two often are family based, into entering in R & D in new industries. In fact, in most Arab countries the private family groups are risk adverse and looking for very high return on equity that have been made possible by the high level of protection and tax exemptions or oligopolistic situations or situations linked to the oil boom or to unhealthy relation with the State and Public entities (overbilling in contracting or supplying the Public Sector with overpriced goods).

In fact the Private Sector has to become acquainted with the culture and environment of real competition, technology and organizational build-up. The new partnership will have to be built upon an understanding between the State and the Private Sector that the cosy world of rents and protected domestic market is over and that it is high time that both members of the partnership have to restructure and retool to face the world of globalization and competition.

However, this partnership will also have to face many domestic social challenges.

II. The social issue and the sustainable development approach

Globalization and liberalization will not be able to produce automatically a sustainable development. As Paul Kennedy remarks : *"Such a vision of a prosperous and harmonious world economic order, founded upon laissez-faire, twenty-four-hour-a-day trading, and all-pervasive television, seems breathtakingly naive in the light of this planet's demographic, environmental, and regional problems. Cheering references to the way in which the "discriminating consumer" can nowadays buy a Mont Blanc pen or a Vuitton suitcase without regard to that product's country of origin recall Jevons's enthusiasm a century ago about the easy purchase of Argentine beef and Chinese tea. In both cases, there is a failure to recognize that newer technologies may not benefit all, that the vast majority of the world's population may not be able to purchase the goods in question, and that profound changes both in economic production and in communications can bring disadvantages as well as advantages in their wake."*⁶

Many countries in the MENA region are facing immense social challenges. 50 millions people are illiterate and this number is expected to increase in the next few years to 60 millions. The number of poor is also on the increase. Annual average rural GDP per person in the Arab World is \$ 272, according to the last

⁶ Paul KENNEDY, *Preparing for the twenty-first Century*, Vintage Books, February 1994. (p. 53).

Arab Joint Economic Report for 1996, a very low figure indeed. Contrary to World Bank estimates, UNDP estimates that the percentage of Arab population living below the poverty level of \$ 317 per annum is around 17% against an estimate of 5,6% by the World Bank⁷.

In addition, the level of unemployment is quite high fluctuating between 15% to 25% according to countries and the number of new comers on the labour markets is on the increase in all the region.

This is why any policy designed to improve the capacity of both the Public and the Private Sector to face more efficiently globalization and adapt to it will have, at the same time, to face the domestic social issues to arrive at laying the foundations of a sustainable development. It is not only a question of adapting to globalization with a human face, it is the need to promote a sustainable development to be able to face successfully the challenges of globalization.

In this respect, the experience of some of the East Asian countries, recently described in an-depth study of the World Bank, is of great value. The Arab countries have undertake in the paste substantial physical investments in infrastructures and some industries, but although they have also spent on health and education, their investments in human capital have not yielded adequate results. Poverty in the rural areas, unemployment, the persistence of high rate of illiteracy, mainly in the female population, and the failure to accumulate knowledge and expertise in the field of new strategic industries are clear indication of dramatic failures that will have to be corrected by future policies.

A new social pact is in fact desirable in many MENA countries to secure political stability and a large consensus upon which new policies could be developed without endangering the domestic stability. The fight against illiteracy and unemployment should become much more efficient. Costly untargeted subsidies should be eliminated to be replaced by tailored measures to assist directly those social groups and those rural areas or urban slums that are living in very poor conditions.

The State can not at this stage stop being a "player" in these fields to become only a regulator as should be the case in productive sectors, but there is certainly room for a bigger Private sector role in supplying efficient health and educational services under the control of the State. The Private Sector will also have to become much more active in creating employment, training manpower, undertaking industrial R & D in association with Universities and Official Research Centre.

⁷ See *Preventing and eradicating poverty*, Report on the experts' meeting on poverty alleviation and sustainable livelihoods in the Arab States, UNDP, Damascus, 28-29 February 1996.

On the other hand, the stimulation of financial markets should not be exclusively concentrated on deepening markets through the Stock exchanges and more desirable privatization of Public Sector companies. It should also mean that financial resources are made available to the informal sector, the women, the young graduates to enlarge the number of small firms and supporting their expansion that could generate substantial additional employment opportunities. New banking skills will have to be developed to process such small loans either through the existing banking system or through creating specialized funds and institutions catering for the financial needs of such people as have been developed elsewhere in Asia.

All these measures will be a key both to meeting the globalization challenges and to put domestic development in a sustainable foundations. Without them, the opening of the economies of the MENA region might produce more unemployment and more social imbalances adding to political instability factors.

Conclusion : Towards a partnership within the framework of a new social consensus to face the challenges

There is no doubt that a new partnership has to be developed between the State and the Private Sector in the MENA region. However, to be successful this partnership should clearly have both parties to underwrite specific commitments within the framework of a new social consensus on how to face the globalization challenges through sound and sustainable development policies. Emphasis up to now have been put on commitment from the State to reduce its size, to privatize its productive assets, to encourage Private enterprise, within the framework of Structural Adjustment policies.

A real and efficient partnership requires , however, that the Private Sector would move away from a rent situation with few productive efforts to a different world whereby it will invest in R & D, train workers and employees, upgrade its organizations, comply with business ethics, implement adequate and transparent accounting procedures, accept to pay a reasonable level of income tax and abstain from trying to influence the State through corruption to get undue advantages or exemptions from rules and regulations. As the Public Sector will have to become much smaller, it will be the Private Sector that will have to become much more active in creating new jobs, in training manpower, in contributing to eradicate illiteracy and poverty so that the overall productivity of the economy will be higher and competition within the global economy could be sustained without losing jobs and increasing domestic social strains.

These are the main issues involved in the necessary changing roles of the Public and the Private Sector in the MENA countries and the basic ingredients for a new partnership between the two sectors so that the region could put an end to its marginalization in the global economy and to its domestic social and political tensions.