

Growth, Governance & Reform in MENA

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PricewaterhouseCoopers Middle East GP
Meeting

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Growth, Governance & Reform in MENA: Agenda

- Challenges Facing the MENA countries
- Role & Importance of Governance:
 - Public Governance
 - Corporate Governance
- An Agenda for Reform
- A Call for Action: What You Can Do

The MENA Countries face numerous challenges

- Political, Strategic
- Demography and labour force
- Macro-economic environment
- Structural reforms
- Governance

Searching for Growth in Road Maps?

- MENA developments & outlook dominated by political & security concerns & uncertainty
 - September 11, 2001 & aftermath
 - War on Iraq & consequences
- Road maps for economic policy reforms ?
 - Domestic economic reforms
 - International integration

Global Growth Prospects: Assessment as of September 8, 2003 (annual percentage real GDP growth rates)

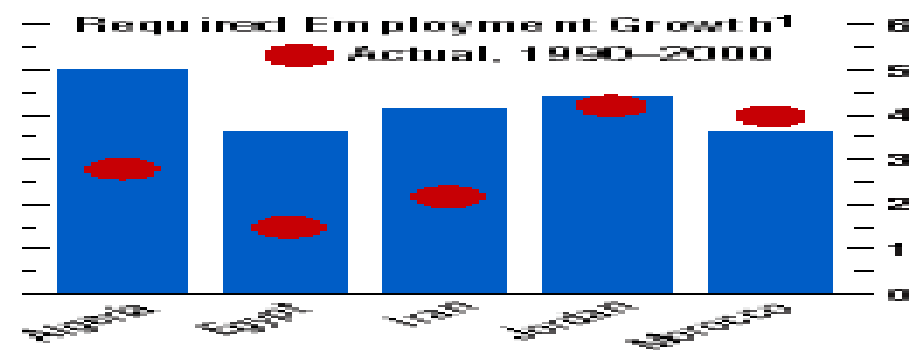
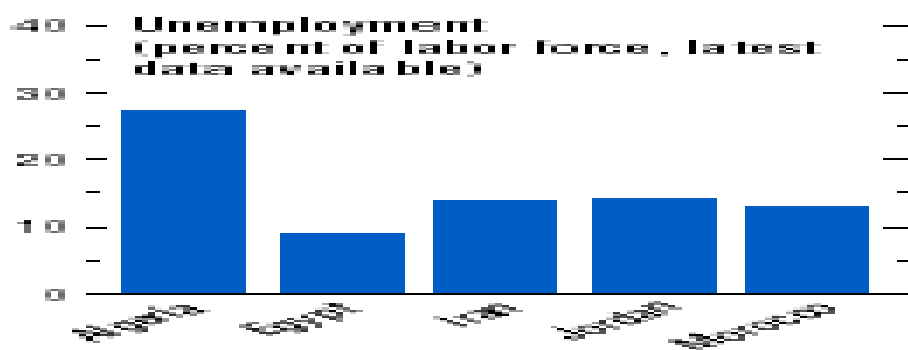
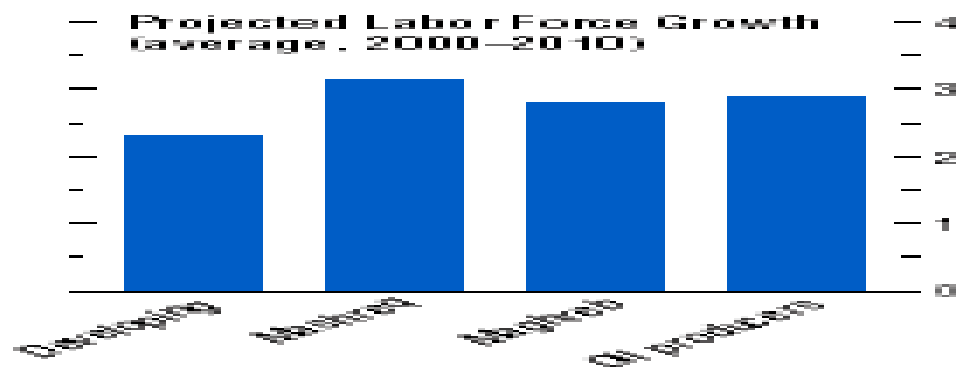
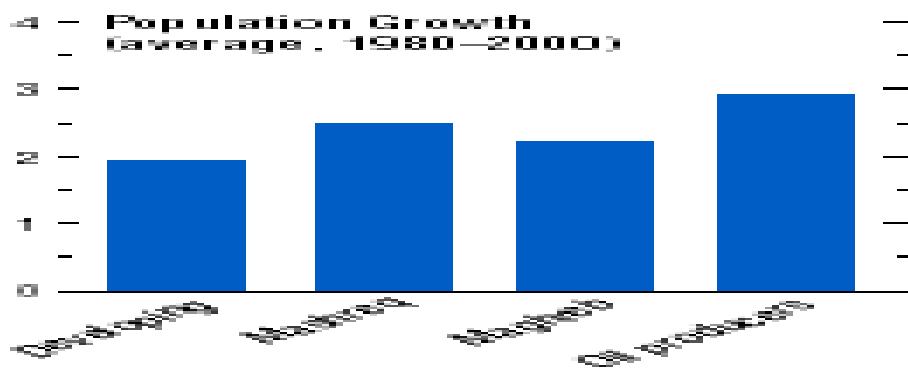
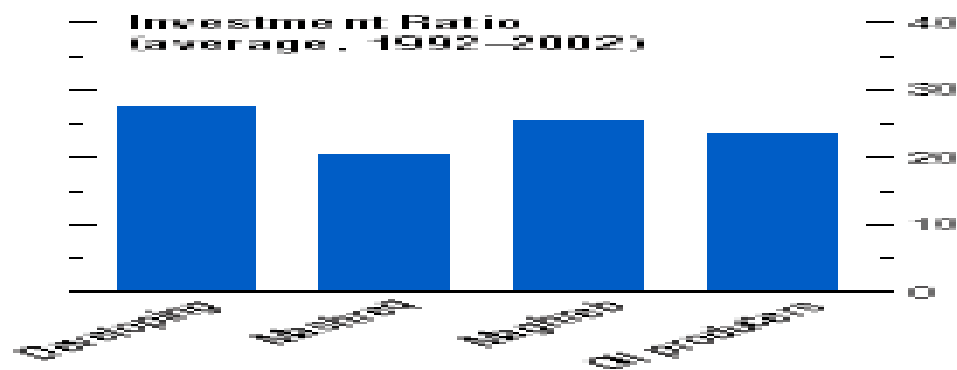
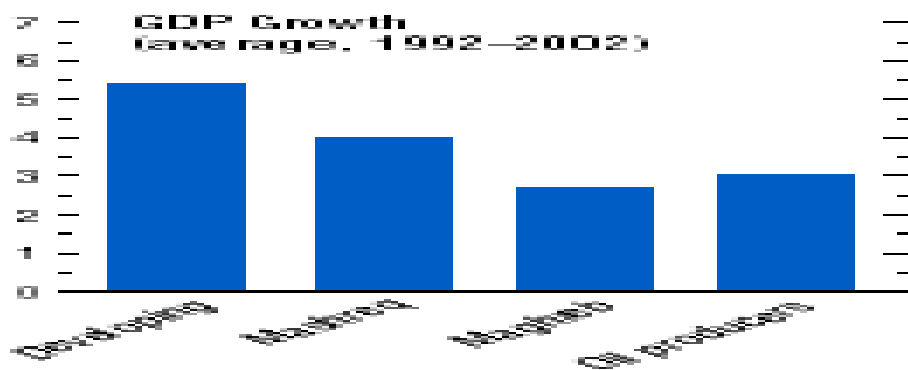
Country or region	Year over year			Q4 to Q4		
	2002	2003	2004	2002	2003	2004
Industrial countries	1¾	1½	3	2½	2	3
United States	2½	2½	4	3	3½	3¾
Japan	¼	1½	2	2½	2	2
Western Europe	1	¾	2	1½	¾	2¼
United Kingdom	2	1¾	2¼	2¼	1½	2½
Euro area	¾	½	1¾	1¼	½	2¼
Germany	¼	0	1½	¾	¼	1¾
France	1¼	¾	1¾	1½	½	2¼
Italy	½	½	1¾	1	½	2¼
Developing and transition countries	4	3¾	5½	4	4	5½
Asia	6½	5½	7			
China	8	7¼	7¾			
India	5½	6	6½			
Others	4¾	3	6			
Latin America	-1½	1	4			
Argentina	-11	5	5			
Brazil	1½	1	4			
Mexico	1	1¼	4½			
Central and Eastern Europe	4¾	4¼	4½			
Middle East	1½	0	3			
Africa	3	2½	3½			
World (WEO weights)	2¾	2½	4¼	3¼	3	4¼

Arab Countries: Post-Iraq Challenges I

- Effects of war on Iraq must be analyzed and understood in the context of the multiple challenges facing the countries of the region
- Demographic time bomb or 'blessing'?
 - High population and labor force growth rates: need 100 million new jobs by 2010
- Stagnating or falling per-capita real incomes
- Volatile economic growth rates
- Aging, inadequate infrastructure: need \$20 billion annually
- Deteriorating environment

Figure 1.15. Middle East and North Africa: Managing the Demographic Transition

In coming years, a key challenge will be to raise GDP growth and employment across the region to absorb the rapidly growing labor force and reduce high unemployment.



Sources: World Bank, *World Development Indicators*, 2002; and IMF staff estimates.

Arab Countries: Post-Iraq Challenges II

- Limited production and export diversification
- Limited regional and international integration in trade and investment
- Limited capital markets integration
- Large and growing 'digital divide'
- Dealing with political-security aftermath of September 11 and new barriers to trade, financial, investment and human flows

Globalisation is a major challenge

- **Competition between countries, both macro and micro**
 - Investment
 - Human capital
 - Technological innovations
 - Regulatory frameworks
- **Limited International Economic Integration**
 - MENA has 7.7% world population but produces only 4.3% world GDP, 0.8% of internet users
 - Limited trade integration
 - 1.6% of total FDI- \$2,645 million in 2001
 - 3.6% of aggregate Net Resource Flows in 2001
- **Challenge of competitiveness regime**
 - Intellectual property protection to boost innovation
 - Compliance with international codes, norms and standards
 - New legislation and institutions to enter WTO and to adopt reforms

**OVERALL CHALLENGES
OF GLOBALISATIONS...**

**... ARE ALSO
CHALLENGES FOR
MENA COUNTRIES**

Arab Countries: Post-Iraq Challenges III

- Failure of 'good governance' and institutional development
- Dominant role of the State in production
- Ineffective macroeconomic and financial policies
- Brain drain and capital flight

Arab Countries: Post-Iraq Challenges IV

- Vulnerabilities:
 - Conflicts and instability
 - Energy markets & prices: terms of trade shocks
 - Climatic conditions and shocks
 - Pro-cyclical fiscal policies
 - Fixed exchange rate policies
- Conflicts and instability leading to
 - Lower domestic investment & FDI
 - Slow growth of international trade & job creation
 - Brain drain

'New Institutional Economics' & "Good Governance"

- Empirical evidence suggests that well performing institutions, enabling legal infrastructure, regulatory regimes and enforcement, "good governance" are major contributors to economic growth & prosperity and democracy
- "Good governance" is required by both government and business in MENA & Lebanon
- Good CG essential in MENA & Lebanon to compensate for *weak overall (i.e. public) governance*

MENA Governance Issues

- Substantial natural resource wealth has not resulted in prosperity or economic growth
 - The region is ‘wealthy’ in natural resources, but poor in economic performance
- Governance issues along with wars, violence and insecurity have been retarding factors
- ***“At the root of MENA’s growth gap is its governance gap. Indeed, simulations find that if MENA had matched the average quality of administration in the public sector for a group of good-performing Southeast Asian countries (Indonesia, Malaysia, the Philippines, Singapore, and Thailand), its growth rates would have been higher by about one percentage point a year. The development gap is reflected in this growth gap: if the region had grown as fast as Hungary, Malaysia, and other top performers over the past decade and a half, average incomes would be twice what they are today—twice!”***
 - WB Better Governance for Development in MENA, September 2003

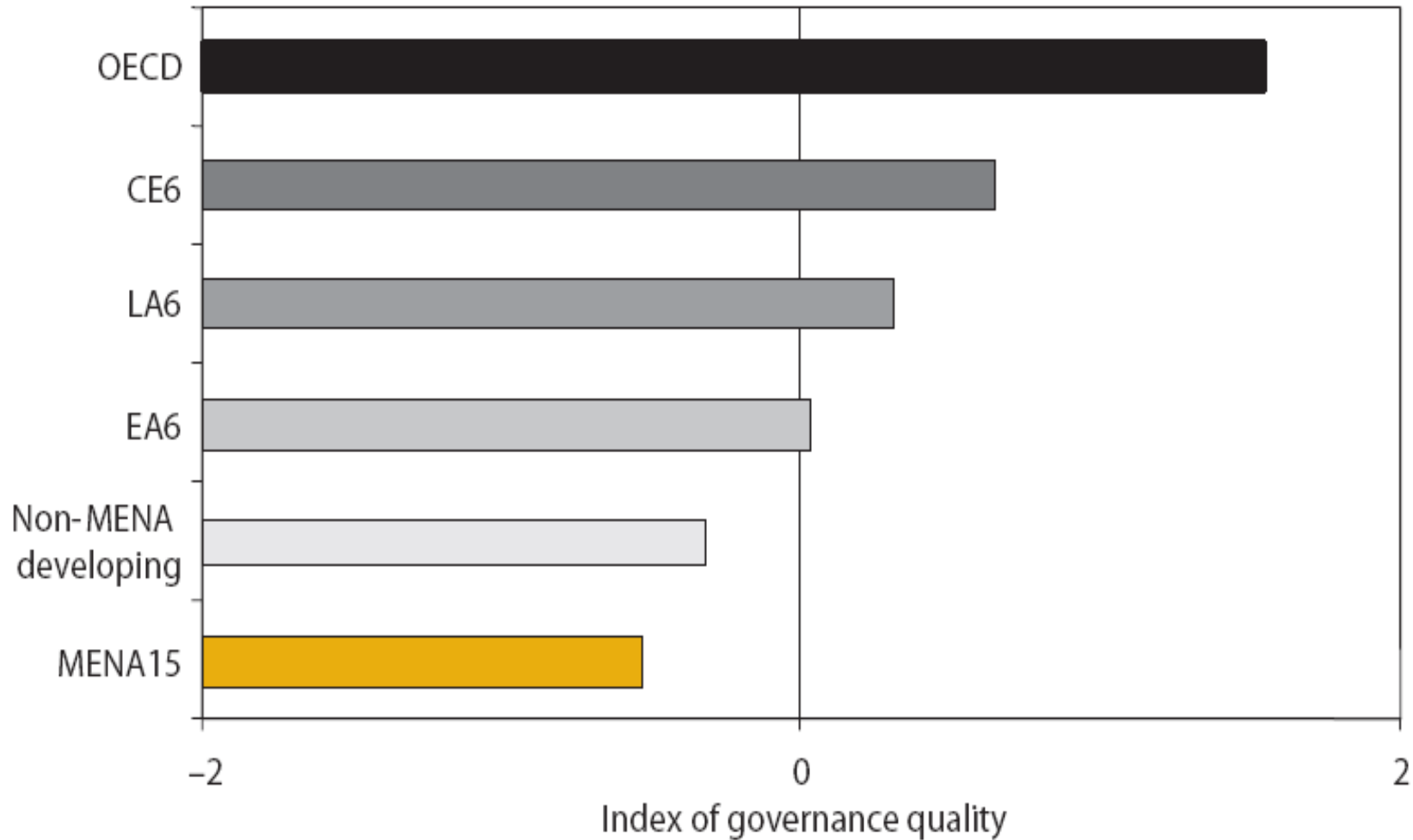
Dimensions of Good Governance (Source: World Bank)

- Voice and accountability
- Political stability; No violence or conflict
- Government effectiveness
- Regulatory quality
- Rule of law
- Control of corruption



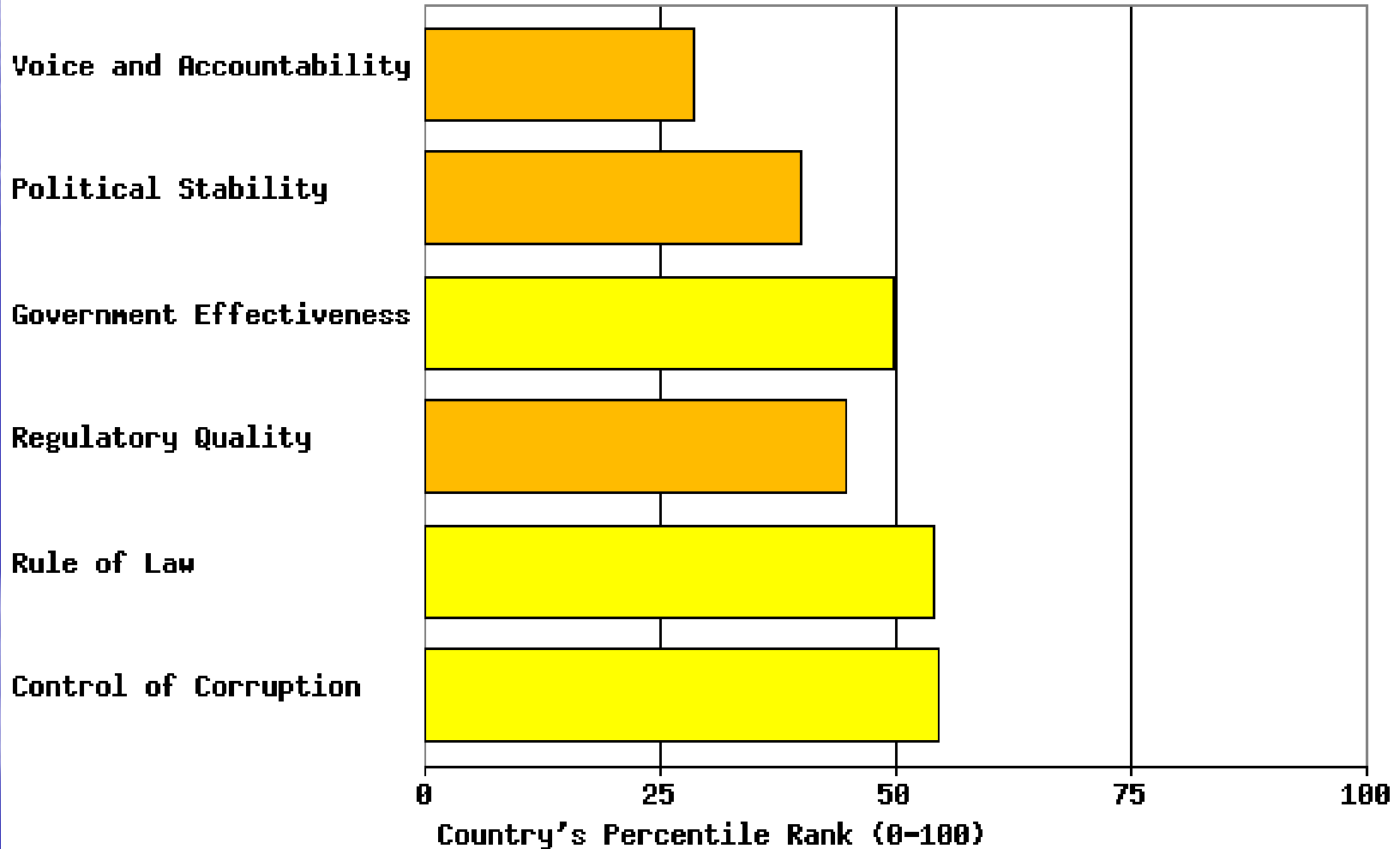
MENA Governance Gap

Compared with Other Regions, MENA Shows a Clear Governance Gap



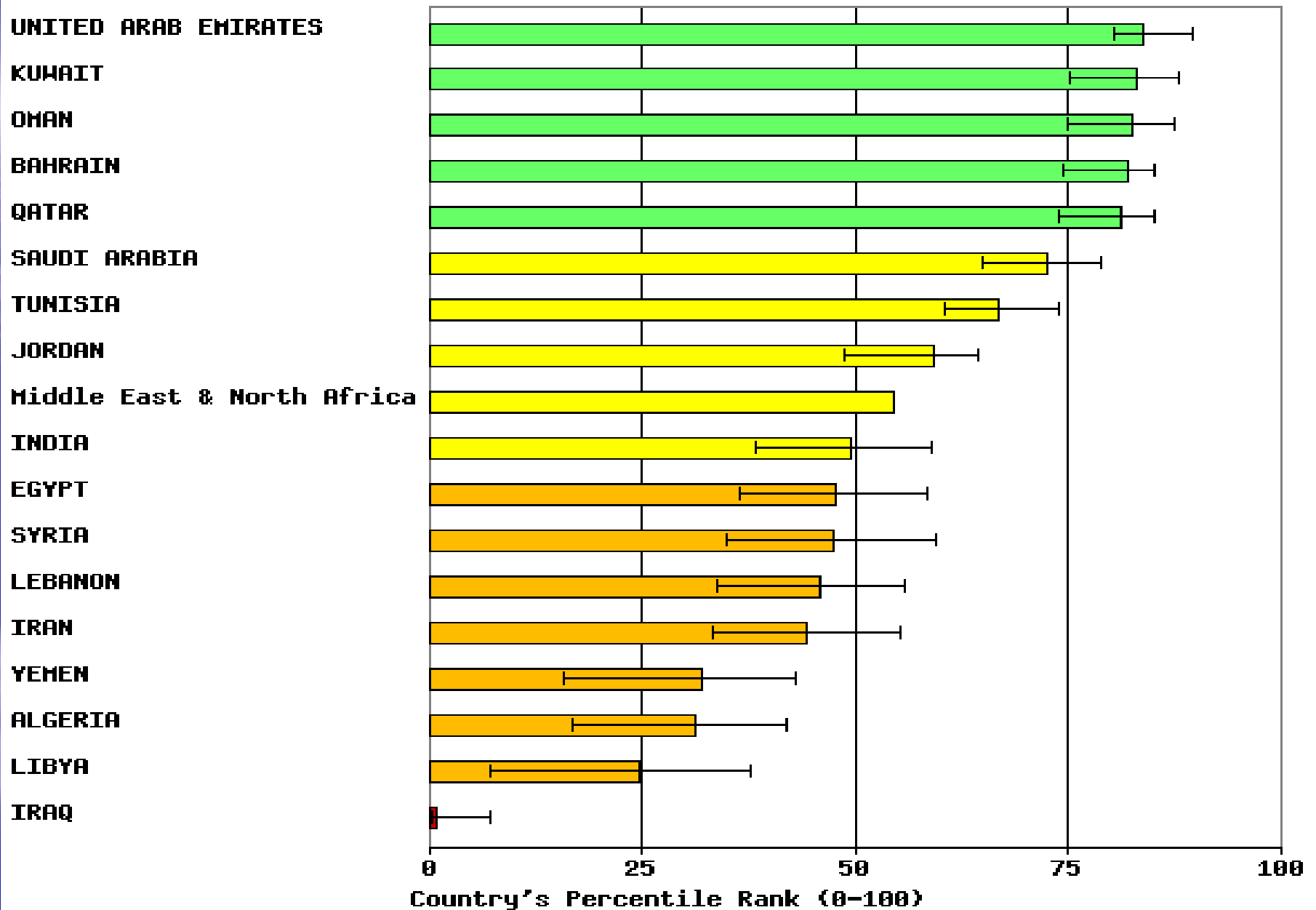
MENA Governance Indicators

Middle East & North Africa - Regional Average (2002)

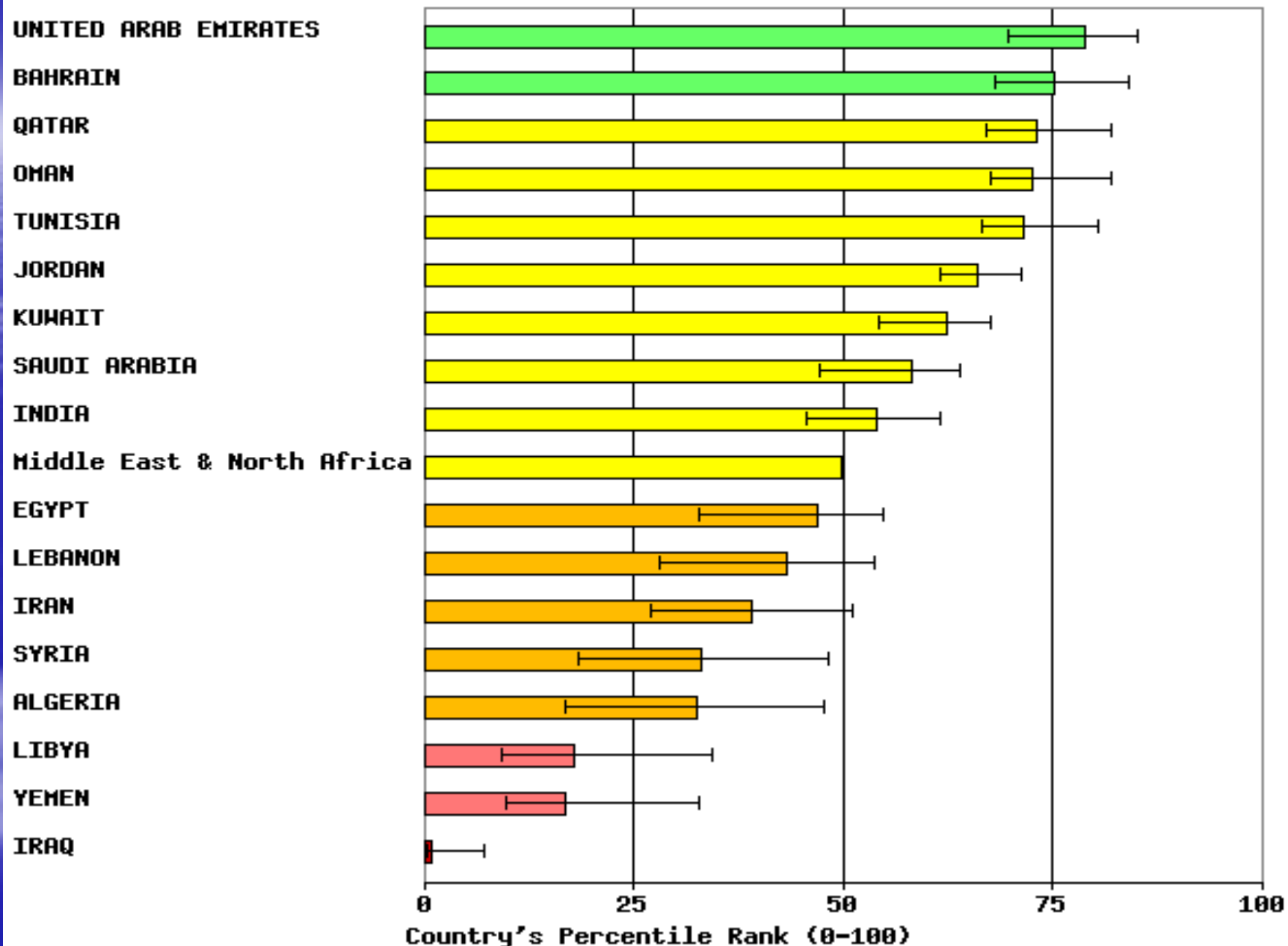


Source: D. Kaufmann, A. Kraay and M. Mastruzzi, 2003: Governance Matters III: Governance Indicators for 1996-2002 (<http://www.worldbank.org/ubi/governance/pubs/govmatters3.html>)

Control of Corruption (World, 2002)

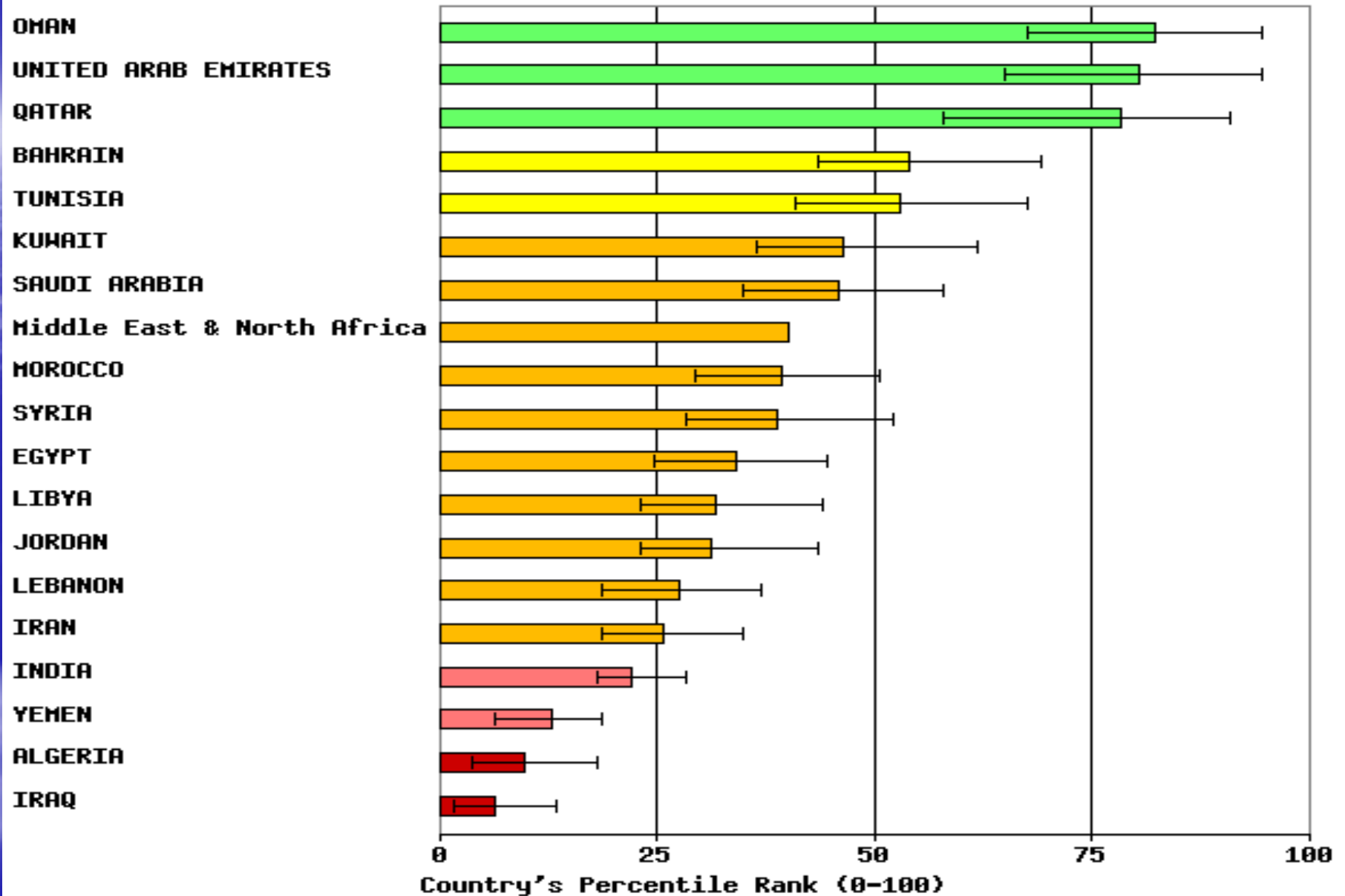


Government Effectiveness (World, 2002)



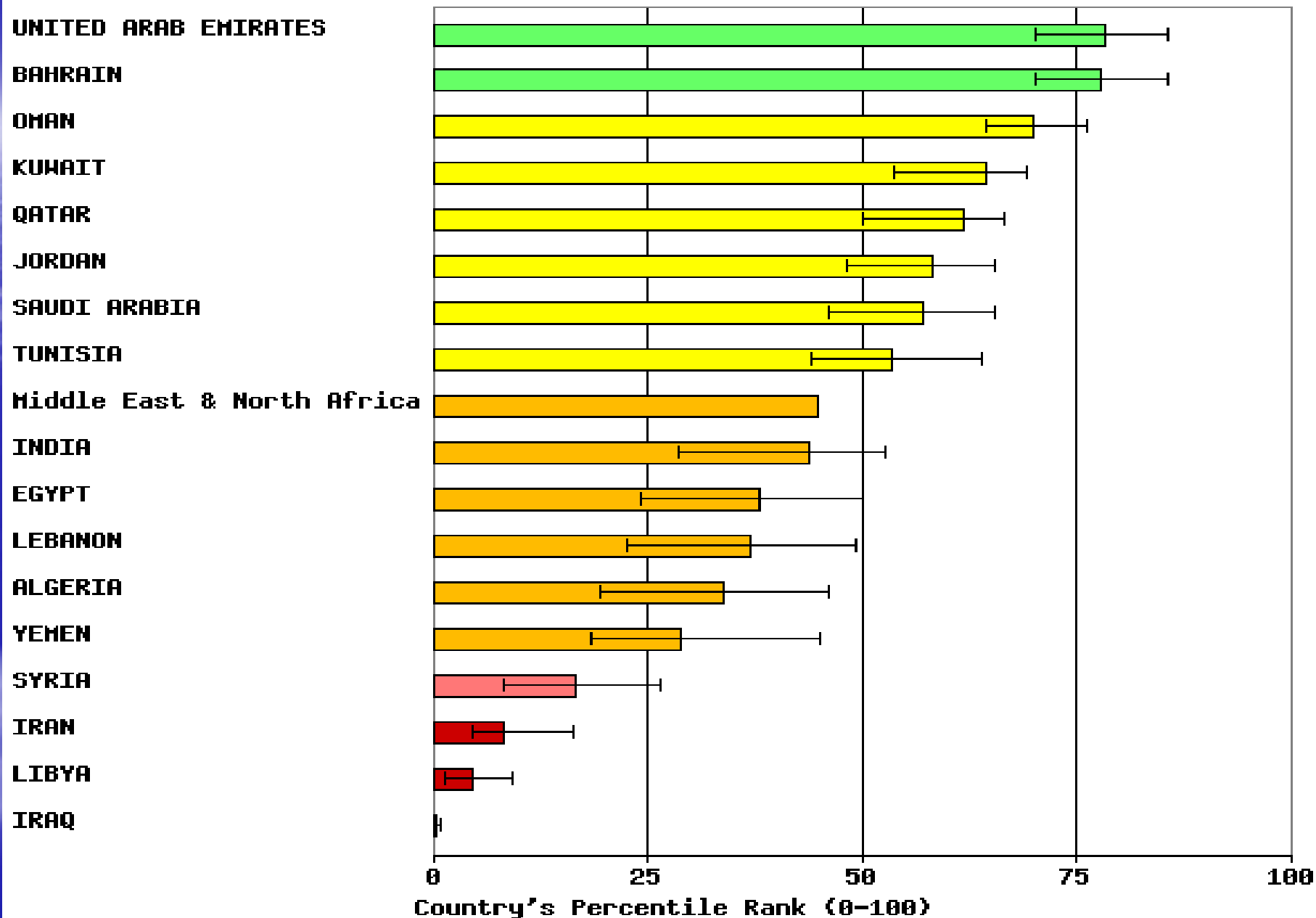
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Political Stability (World, 2002)

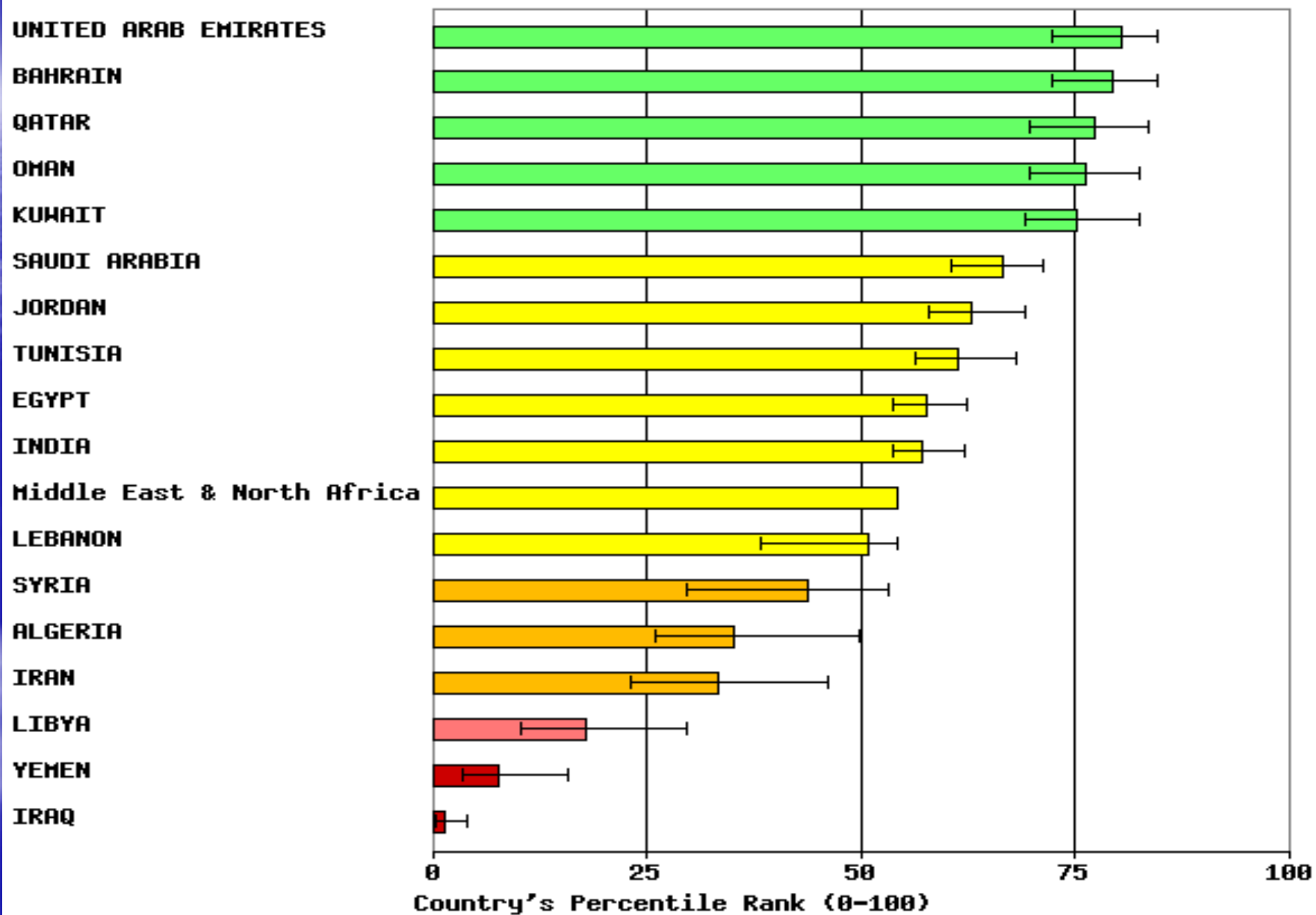


Source: D. Kaufmann, A. Kraay and M. Mastruzzi, 2003: Governance Matters III: Governance Indicators for 1996-2002 (<http://www.worldbank.org/wbi/governance/pubs/goumatters3.html>)

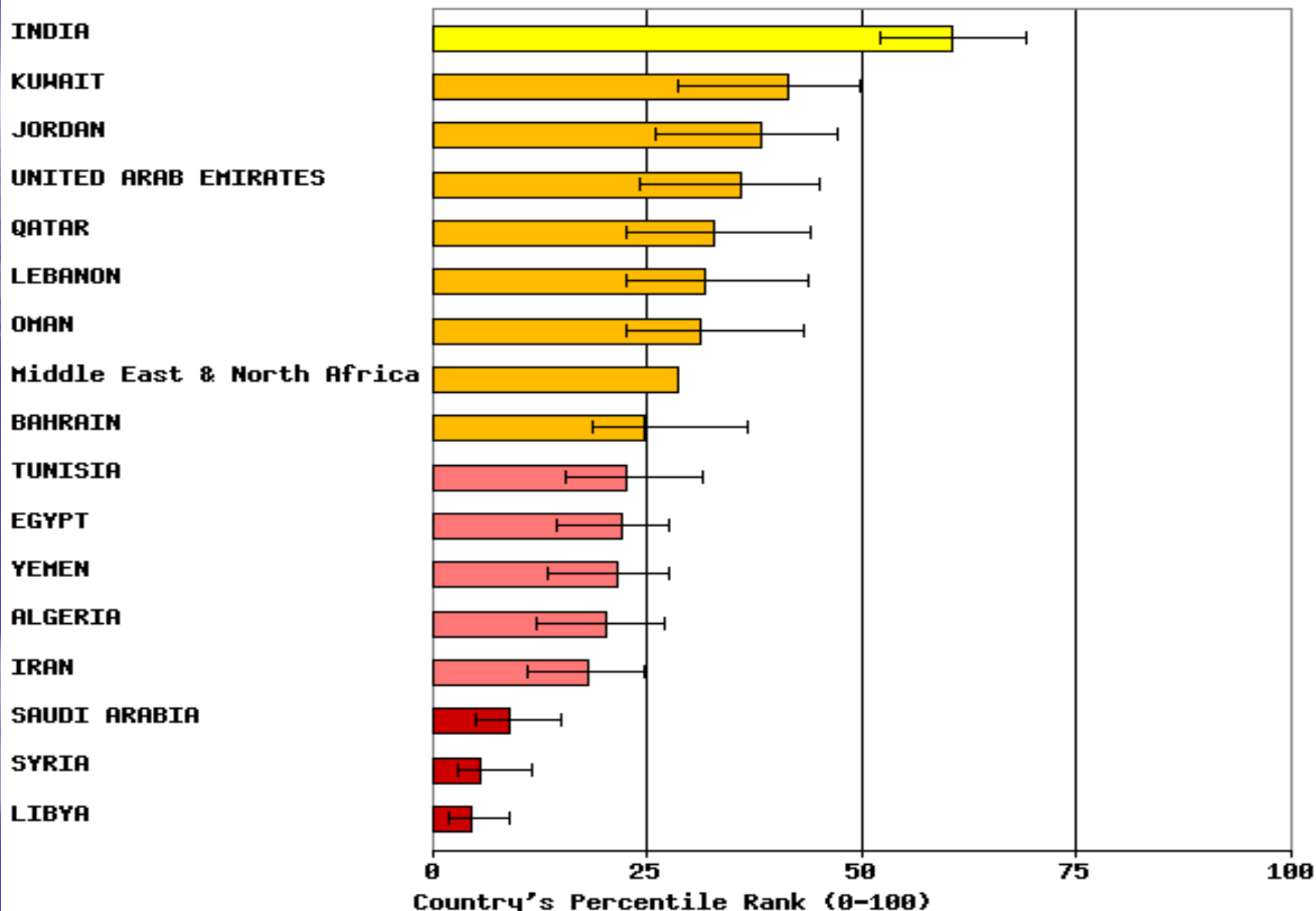
Regulatory Quality (World, 2002)



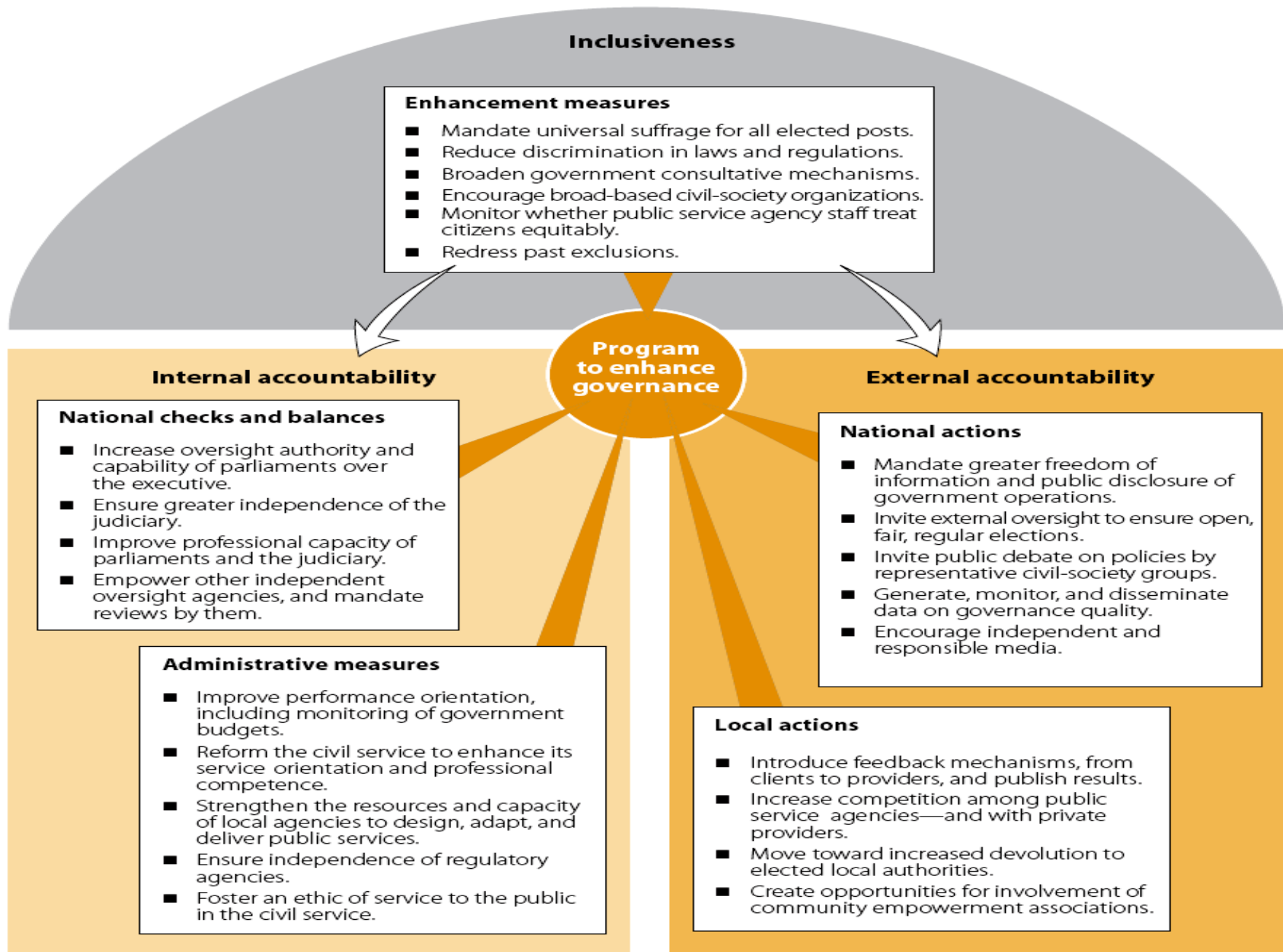
Rule of Law (World, 2002)



Voice and Accountability (World, 2002)



A Program to Enhance Governance



E-Government *is* a tool for economic & social development, democracy & good governance

e-Government has big potential...

- Can address both traditional and new challenges
- Can benefit all constituents
 - Citizens
 - Private sector
 - Governments
- To empower constituents, reform institutions and increase efficiency and transparency

...governments need to act to overcome obstacles.

- E-readiness divide
 - Missing basic infrastructure and corporate environment
- E-legal divide
 - Required legal environment supporting development of e-strategies
- Act on national and regional recommendations

E-Government needs to be an integral part of national e-strategies

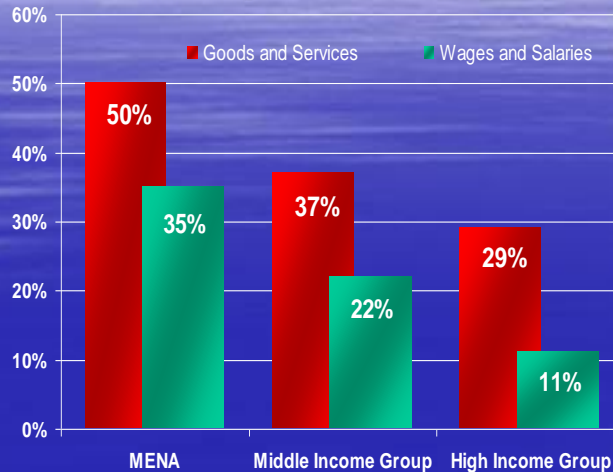
Public Sector has been a drag on growth & Modernisation in the MENA countries

- Large public sectors
- Highly centralised governments
- Complex regulatory structures & regulations, 'red tape', are negatively impacting private sector activity
- Absence of institutional reform & modernization
- Limited attention to promoting voice and competition

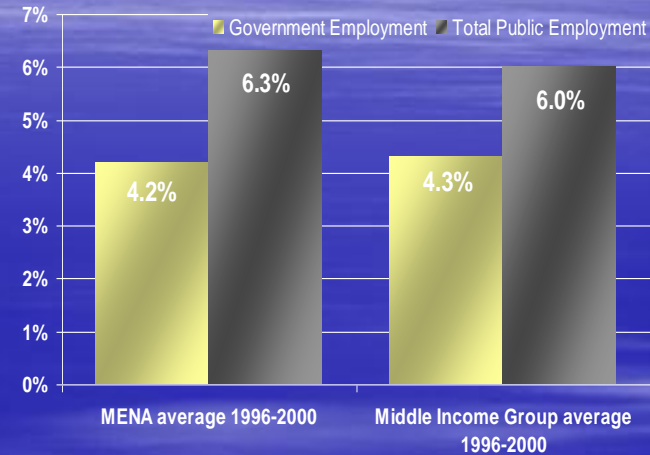
Large public sectors, expensive employees

- High expenditure (50% of government expenditure) on Goods and Services
- Substantial benefits could be derived from greater efficiency and transparency in e-procurement
- High wage bill - representing 34% of government expenditures compared to 23% for middle income groups
- Significant reduction in costs and overall saving in resources

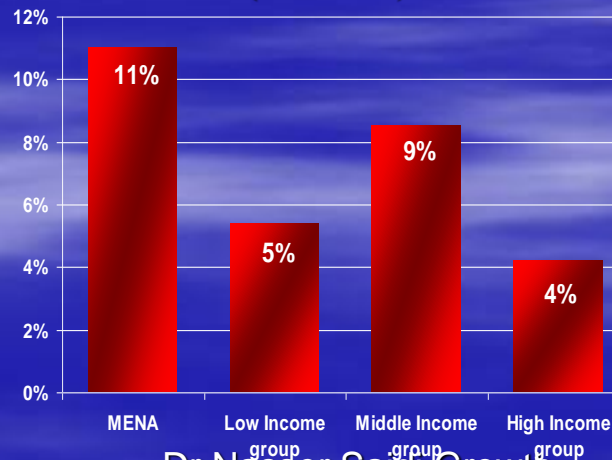
Central Gov't Expenditures as % of Total Gov't Expenditures (1999)



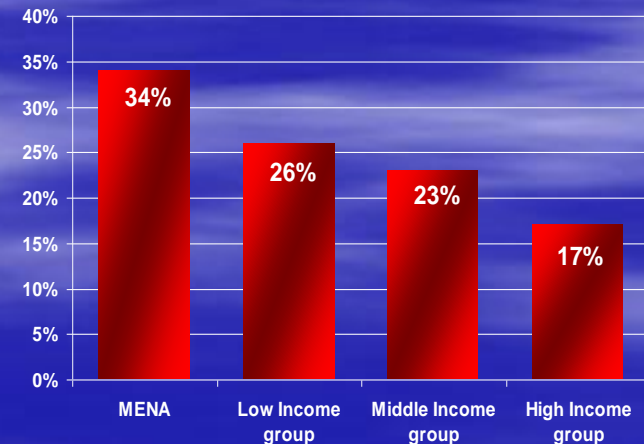
Government and Total Public Employment (% of Population)



Total Central Gov't Wage Bill as a % of GDP (1996-2000)



Total Central Gov't Wage Bill as a % of Gov't Expenditures (1996-2000)



Building democracy through technology

e-Democracy

**Good
Governance**

**Participation &
Representation
Gains**

Effective Political Markets

Information for Political Decisions

Media, Information & Communication Technology



- More transparency
- More government accountability
- More participatory democracy

**... ICT facilitates the transition from passive information access
to active participation and voice**

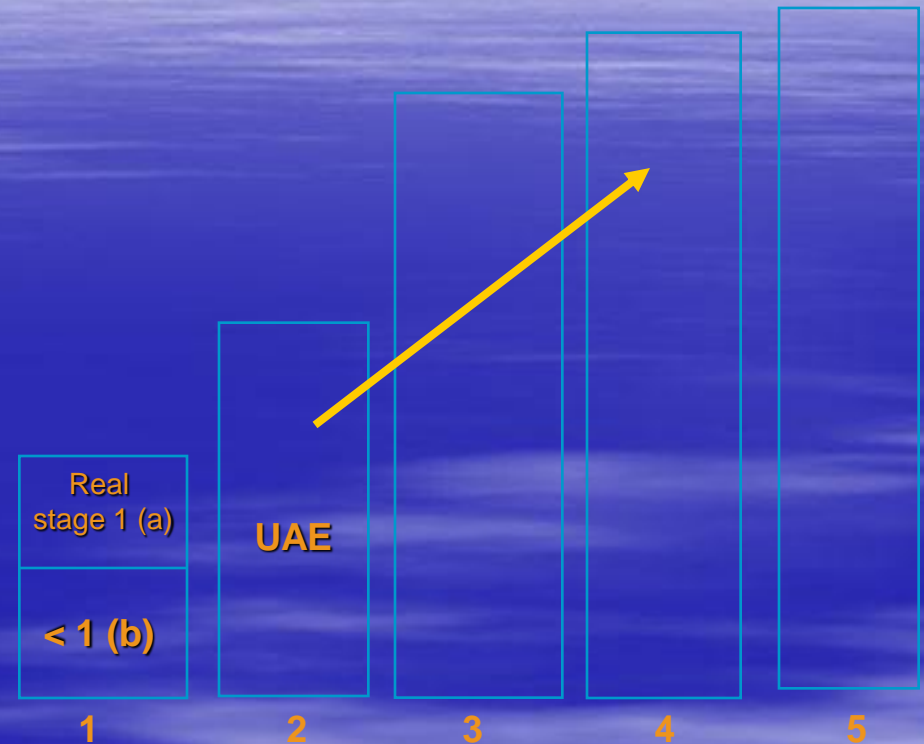
Challenges facing successful implementation of e-government in MENA

- E-leadership
 - *Is the leadership and strategic thinking ready?*
- Access, connectivity, and network readiness
 - *Is the technological infrastructure ready?*
- E-business climate
 - *Is the institutional infrastructure ready?*
- E-human capital
 - *Is the population e-aware and e-literate?*
- Trust, information security, and privacy
 - *Is the legal infrastructure ready?*
 - *Are secure systems and procedures available?*

Stages of E-Government

Path of e-Government model follows 5 stages

- Stage 1: Basic site
- Stage 2: E-publishing
- Stage 3: Interactive
- Stage 4: Transactional
- Stage 5: Integrated e-Government



(a): Algeria, Egypt, Jordan, Kuwait, Lebanon, Palestine, Saudi Arabia

(b): Yemen, Iran, Oman, Qatar, Syria

MENA countries are still at an early stage in the journey.

Regional and National E-Strategies

REGIONAL

NATIONAL

- ICT Infrastructure
 - Euro-Mediterranean Net
- Legal and Regulatory Infrastructure
 - New Lex Electronica
- E-Readiness
 - General Digital Certificate
- Regional/ International Initiatives
 - Arab States Program for Information Society
 - Global Digital Initiative
 - E-Government for Development

- ICT Strategy
 - National e-Strategy (including committees and institutes)
- Regulatory and policy environment
 - Tax breaks / subsidies for ICT
 - Incubators
- ICT Infrastructure
 - Broadband networks
 - Fast and secure ICT networks
- E-Human capital
 - Institutionalism of e-learning
 - Advancement of education in ICT

Good Corporate Governance in MENA: Focus on SMEs & Family Businesses

- Majority of business & corporations in MENA are SMEs & family-owned
 - Lebanon: >85% of industrial companies have less than 10 employees
- Deal with 'dualistic' nature of MENA economies: SOE's dominate many economies
- Need to develop relevant *incentive-compatible mechanisms for compliance with CGG principles*
- Need to reduce compliance costs
- Provide incentives for adoption & implementation of CG Principles

Core Principles for Good Governance in Family Businesses in Lebanon & MENA

- Change attitudes towards value of effective, transparent & accountable corporate governance: role of media, Parliaments, SRO's, business organizations & associations
- Develop & adopt core principles for family businesses and SMEs
- Amend laws to:
 - Increase protection of minority shareholders
 - Separate management from ownership
 - Reform Law on Bankruptcy & Insolvency
 - Develop Securities Law

Family business & Governance

The patriarch of an established successful family-owned business died and went to Heaven. At the gates to heaven, the patriarch asked God when there would be a family-owned business that was governed efficiently and in compliance with the rules on corporate governance.

God thought for a moment and then replied, "not in my lifetime".

CG & Investor Protection: Performance in Emerging Markets

- Better CG highly correlated with better operating performance and market valuation of companies
- Cross-country differences in laws & enforcement affect ownership structure, dividend payouts, availability & cost of external finance and market valuations
- Firm level CG provisions & practices matter even **more** in countries with weak shareholder rights and weak legal environments

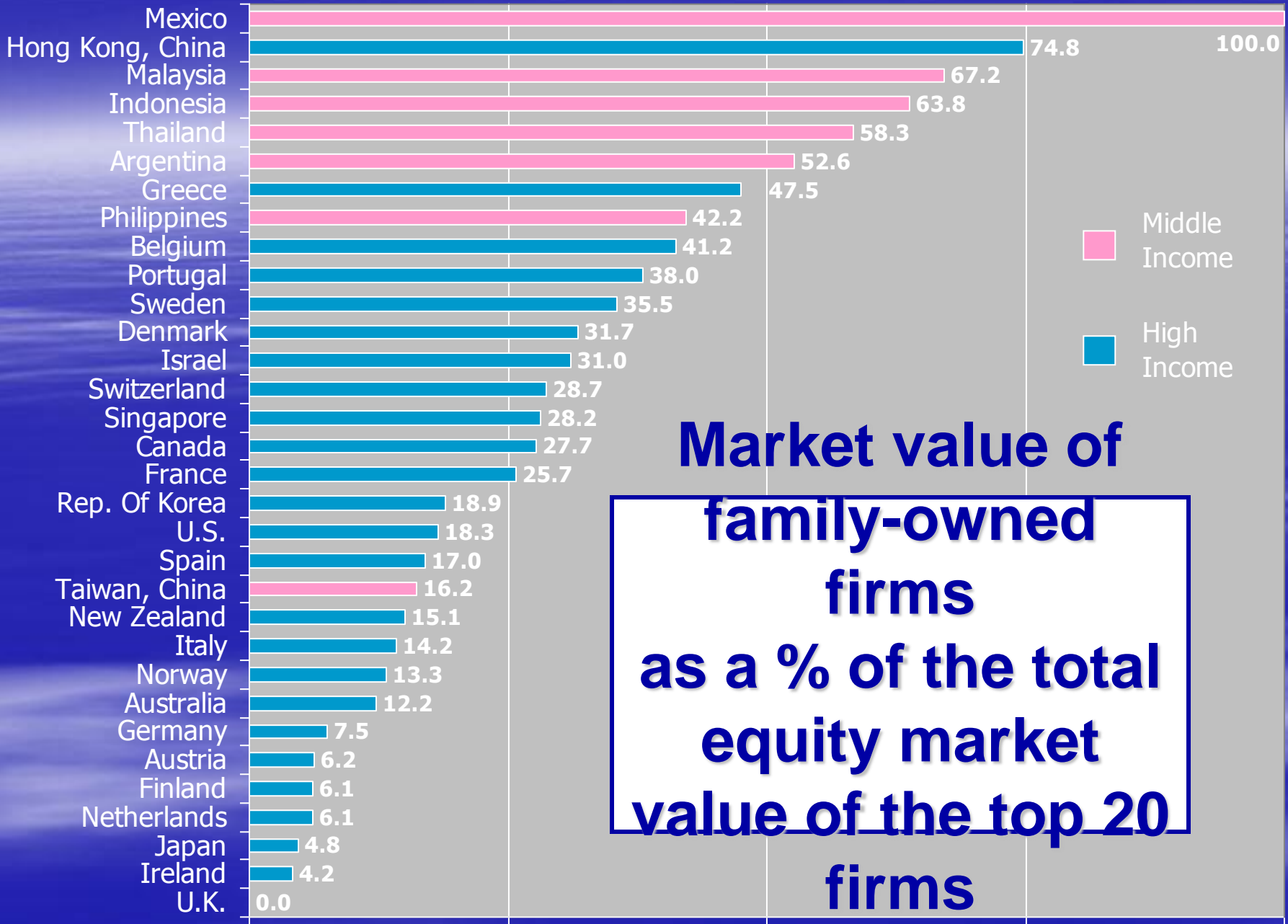
http://www1.worldbank.org/finance/assets/images/Litan_Pomerleano_Sundararajan--finsec_gov-ch01.pdf (See WB Institute papers)

Issues Facing Family Business

- Succession: who will succeed? How to ensure survival and continuity?
- Separation of ownership and management: trade-off
- Separation: allows specialization in mobilizing capital (shareholders/creditors) and efficient resource use (management)
- Large v/s minority shareholders

Families and Finance in Lebanon & MENA

- Families/entrepreneurs should actively promote development of financial markets:
 - Reduce risk through diversification and divestment of family assets
 - Exit strategy: solution to successor problem and equity in family inheritance
- Capital Markets Development should be a priority for MENA countries



Market value of family-owned firms as a % of the total equity market value of the top 20 firms

Financial Stability & Soundness Standards

- **Macroeconomic Policy and Data Transparency**
- **Institutional and Market Infrastructure**
- **Financial Regulation and Supervision**

Macroeconomic Policy and Data Transparency

- Monetary and Financial Policy Transparency
 - Code of Good Practices on Transparency in Monetary and Financial Policies IMF
- Fiscal Transparency
 - Code of Good Practices in Fiscal Transparency IMF
- Data Dissemination
 - General Data Dissemination System IMF
- Data Compilation

Institutional and Market Infrastructure

- Insolvency & bankruptcy World Bank
- Corporate Governance
 - Principles of Corporate Governance OECD
- Accounting
 - International Accounting Standards (IAS)
- Auditing
 - International Standards on Auditing (ISA)
- Payment and Settlement
 - Core Principles for Systemically Important Payment Systems BIS
 - Recommendations for Securities Settlement Systems CPSS/IOSCO
- Market Integrity
 - Forty Recommendations + 8 Special Recommendations Against Terrorist Financing of the FATF
- Market Functioning

Financial Regulation and Supervision

Banking Supervision

- Core Principles for Effective Banking Supervision BCBS

- Securities Regulation

- Objectives and Principles of Securities Regulation IOSCO

- Insurance Regulation

- Insurance Core Principles IAIS

- Financial Conglomerate Supervision

Recommendations & Proposals I

- Change attitudes: highlight high value of effective, transparent & accountable public & corporate governance
- CG practices matter more in Lebanon due to weak overall governance, protection of minority shareholder rights, legal & judicial systems
- Standardize Accounting and Auditing Practices

Recommendations & Proposals II

- Families/Entrepreneurs should contribute to development & well-functioning of financial markets
- Reforms:
 - Amend Laws to protect investors and minority shareholders
 - Introduce separation between Board and Management
 - Modernize & Reform Insolvency & Bankruptcy Law
 - Introduce a comprehensive Capital Markets Law
- Appoint a Commission to develop set of Core Principles for Good Corporate Governance

Guidelines for transparency and corporate governance in MENA

Proposal of a Draft Code of Corporate Governance
(based on Cadbury report) :

1. Minority shareholder protection
2. Responsibilities of the Board of Directors
3. Accounting and auditing
4. Transparency of Ownership and Control
5. Regulatory Environment

1. Minority shareholder protection

1. Protect the rights of minority shareholders:
 1. Right to vote on important matters
 2. Right to buyback shares
 3. Right to formally present an issue to the board of directors
2. Treat foreign shareholders equally with domestic shareholders: non-discrimination principle

2. Responsibilities of the Board of Directors

- A majority of board members should be independent from management
- Boards should establish various subcommittees
- All material information should be publicly disclosed – Transparency
- Develop an investor relations program that fully informs all shareholders of corporate activities

3. Accounting and auditing

- Firms should conform to accounting and auditing practices and standards i.e. comply with IAS or U.S. GAAP.
- Audit committee should have a majority of independent directors, who should be able to read and understand fundamental financial statements
- All communications between the committee and external auditors should be without the company management present

4. Transparency of Ownership and Control

- Who controls a company?
 - Who has significant ownership?
 - Firms should disclose accurate, adequate, and timely information so as to allow investors to make informed decisions about acquisitions, ownership obligations and rights, and the sales of shares
- **Establish 'Companies House' that would centralize information on companies**

5. Regulatory Environment

- Credible and transparent regulatory environment
- Regulatory environment must not be perceived to be under control or influence of any particular interest group
- Regulators should be independent from industry and from political parties

Good Governance Strategy for MENA countries [1]

- Adopt and monitor progress in implementing 12 Financial Soundness Codes & Standards
- Adopt Cadbury Report principles for SMEs and FOEs
- Adopt OECD CG for listed companies
- Right to Know & Right to Tell: seek to enact a 'Freedom of Information Act'
- Use banking & financial sector to enforce CG

Good Governance Strategy for MENA countries [2]

- Develop **Central Credit Organizations** to report on sources and uses of credit (bank, non-bank & supplier credit): more and improved credit information leads to lower borrowing costs, improves access to credit, develops credit rating system, improves 'good standing', encourages investment and facilitates access to export markets
- ∴ Need to Reward Good Governance**

Good Governance Strategy for MENA countries [3]

- Set-up national ‘**Companies House**’ to implement centralized financial reporting and disclosure of corporate actions
- Encourage set-up of local rating agencies to ease compliance with Basel II standards
- Set-up Working Group on MENA CG
- Develop incentives for disclosure and CG:
 - Set-up national websites of good CG companies
 - OECD-WB to set-up a gateway that would provide a Network for good CG complying companies

Regional CG Cooperation: elements of an Action Plan [1]

- *Regional* dialogue on CG is important: expand participating countries & organizations
- Build on the substantial economic, financial, banking and other reforms undertaken by some countries: reinforce reform agenda

Regional CG Cooperation: elements of an Action Plan [2]

- Set-up and develop an **Institute of Directors**
- Focus on Developing the capital markets
- Establish a CG-Working Group for the MENA region: objective is to improve investment climate for the region
- Establish a website for CG for the countries of the region to enhance networking potential and disseminate information
- Adopt the Financial Soundness Standards as a framework for action on Public and Corporate Governance for the region

What You Can Do:

- You are part of an elite, you are stakeholders & agents for change: you must build the future
- Be active: create Foundations, NGOs, Associations
- Focus on e-Government as a Tool for Good Public Governance
- Focus on a Regional Action Plan for Corporate Governance

Growth, Governance & Reform in MENA

Thank you

Q & A

Nasser Saidi