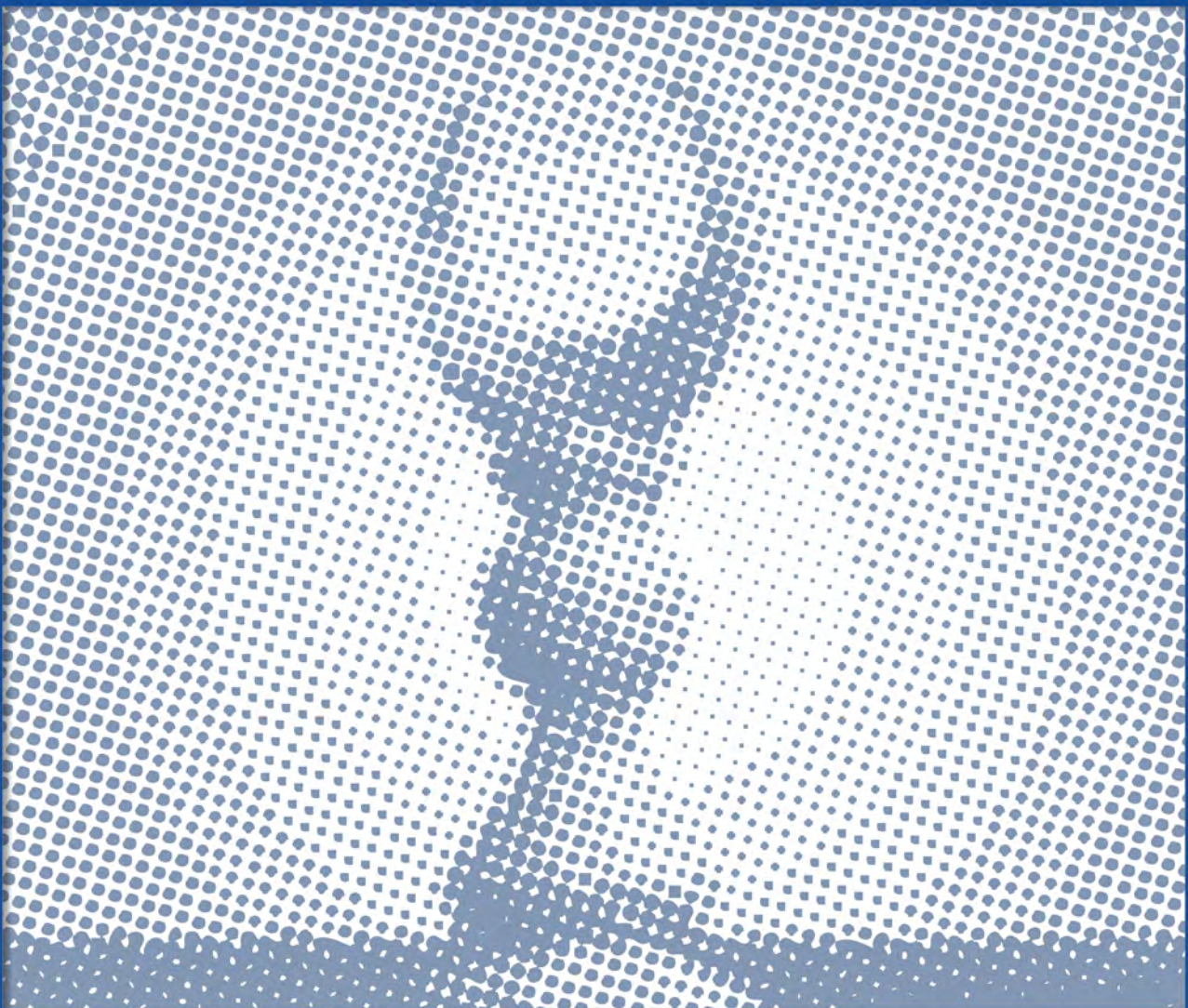


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Barcelona Euromed Forum What Economic Governance for Arab Transitions?





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What Economic Governance
for Arab Transitions?

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DOCUMENTSIEMed.

Published by the European Institute of the Mediterranean
Coordination: Javier Albarracín
Layout: Núria Esparza
ISSN: 978-843-383864

June 2012

The IEMed is a think tank for the identification and interpretation of the challenges in the Euro-Mediterranean area and for the preparation of proposals to confront them. It offers spaces for reflection and debate as well as advice and assistance to cultural and cooperation projects in the Mediterranean. Moreover, it promotes the participation of civil society in the Euro-Mediterranean space through several networks and in collaboration with entities from the social, economic and cultural worlds.

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Project funded
by the European Union



EURO MED

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Presentation

Presentation

Andreu Bassols. Director General, European Institute of the Mediterranean (IEMed), Spain

Since the beginning of the uprisings in the Arab world much emphasis has been placed on the political dimension and the social and media aspects of the revolts, but the very significant economic consequences have received little attention.

The new rulers in the region will need to introduce not only major political and social reforms but also engage an open debate on the economic policies to address the most pressing economic dysfunctions inherited from the former regimes.

The IEMed organized the international conference called “What Economic Governance for Arab Transitions?” on 15th and 16th December 2011 at Pedralbes Palace, in Barcelona, to assess the economic causes and consequences of the uprisings in the MENA region.

This report summarises the speeches and presentations made during this conference that brought together policymakers, high-level researchers, and experts from Arab countries, the European Union, international financial institutions, central banks and think tanks.

The objective of the seminar was to provide a platform of dialogue between its participants to discuss the economic policies that Arab Mediterranean countries will need to implement to address the emerging economic and social needs of the region.

With this conference, the IEMed has laid the foundations for a more substantial work within the Institute and with a network of experts, to pursue a thorough and much needed analysis on the economic transition processes in the Southern Mediterranean.

There was consensus among participants that some countries risk serious destabilisation and its emerging democracies may turn unsustainable, if there is no a more equitable growth that results in a reduction of the poverty rates and development gaps between regions. This will require sound economic policies and sufficient external political and financial support.



Introductory Remarks

Introductory Remarks

Olivier de Laroussilhe. Head of Unit, Trade Relations with Euromed and the Middle East, DG Trade, European Commission

Thank you for inviting the European Commission to explain where we are with these countries. We have indeed done quite a bit of homework since the Arab Spring started. What I propose is to explain to you what challenges we see coming out of this Arab Spring and what reaction and programmes we have tried to put in place for them.

The Arab Spring has clearly highlighted some shortcomings in the region, regarding in particular public governance and the labour market, but at the same time it may be an opportunity to improve governance. Clearly the fall of authoritarian regimes can lift some blockings. I think of the heavy hands of certain families on economic assets. From the economic point of view, there are also a lot of uncertainties emerging from the elections; we have to deal with that too.

On our side too, this has been a stimulating situation because Member States and the EU have had to try to think about what we can do. We had the feeling that we had to do more and the Member States were prepared to go beyond their red lines and to be more proactive, particularly in the area of market access and the area of mobility, which is one of the strong requests of the Southern Countries. Member States reacted very quickly. In March 2011, the European Council called for a new partnership with the region and asked the Commission to devise new means to foster trade and investment in the region. So we had an order and we had to fill it.

A word on the challenges as we see them: to summarise, I would be tempted to say the challenge is employment, employment and employment. And, of course, it is a simplification, but I think this was a key to the upheavals. And I would tend to concur with the French researcher Bertrand Badie, who says that “economic progress and the establishment of a middle class likely to support change will be critical to democracy in the region.”¹ This is the model that was followed in India, Brazil and Turkey. This is why unemployment is really one of the main challenges. Adding to the challenge is the timeframe, as the new President of Tunisia, Moncef Marzouki, put it: “We are both in the urgency and in the long term ...”² Indeed, we have to address quickly this unemployment question, but we also have to change the modes of governance in the long term.

How do you encourage job creation? Of course it is not easy to find a quick fix in this area. Job creation requires more flexible labour markets, better governance, more loan facilities for business start-ups, more market access, and more investment. A lot of the work has to be done internally, but the outsiders can also offer some help. Improving governance

1. “La seule voie d'espoir se trouve dans le chemin suivi par les puissances émergentes, Turquie, Brésil, Inde, qui ont réussi peu à peu à se doter d'une démocratie grâce à leurs performances économiques, grâce à la naissance d'une véritable classe moyenne qui se reconnaissait dans les vertus d'un tel régime ...”, “Les sociétés prennent leur revanche en Tunisie, Égypte et Libye”, *Le Monde*, 24th February 2011.

2. Arielle Thedrel, “Moncef Marzouki, un président à poigne pour la Tunisie », *Le Figaro.fr*, 12th December 2011.

in the business sector is one of the key challenges and it has been an important issue in our discussions with these countries. In this direction, we think they need to improve the record regarding corruption – which was also one of the causes for social upheavals –, as well as the record on the stability of the legal framework.

Another challenge is to reduce the public sector's influence on the economy, as in many countries the public sector is crowding out financial and labour resources that could be used by the private sector. I am not talking about public spending that is often misallocated in these countries. Another challenge is interregional trade. It is clear that the poor performance of the region in GDP growth compared to Southeast Asia or Latin America is partly due to the lack of international and regional integration, so more regional and more international integration has to take place. These countries have to integrate in the world production chain. And they have to go up the value added ladder because they have to find employment for educated people too.

Regarding the EU response, we already have strong relations with these countries; we have free trade agreements with all the countries of the region, (except Syria and Libya, for different reasons). These simple free trade agreements, which cover essentially trade in goods, are being complemented with a number of additional negotiations. We are in the process of extending these agreements to services, which is clearly one of the main areas of job creation and growth in the current economies. We also want to extend market access in agriculture. The EU is the leading trading partner and one of the leading investors in the region, so obviously we did not start from scratch. Our reflection was about how we can build on this and how we can do more to improve the economic situation and help job creation and investment in the region.

The EU approach was expressed very recently in two policy documents. One, in March 2011, was a communication by the Commission and the external representatives, which included both political and economic short-term measures. The other was in May 2011 and was a more long-term approach. The communications promised increased financial assistance, enhanced mobility – which is new because this is a strong requirement by the countries and Member States were rather reluctant to make concessions on this – and a very important offer of direct access to the EU market. The idea was that we have to offer more market access to provide outlets for these economies and to help them create jobs. The approach announced was the so-called “more for more”, which means we do not grant concessions without reciprocity, in terms of reforms rather than advantages. Hence, the concessions that will be made will be on an incentive-based approach as they will have to show progress. Everything will be done on a voluntary basis. Countries that are not interested will not be obliged to go along with our proposals.

In these two communications there was a political element, which was support for democracy, for building an independent judiciary system, a free press, a dynamic civil society and so on. The second point was mobility partnerships, where we offer the possibility of visa facilitations for business people, for people who are doing service work, in exchange for a common monitoring and a common commitment against illegal immigration. Negotiations in this direction have already started with Tunisia and Morocco;

they could start with Egypt whenever possible. This policy addresses one of the key requests of these countries who say “we want more mobility, more facilitation.” The third point, which for us is important, is inclusive economic growth and development.

We placed an offer on the table, regarding trade and investment. Trade is an instrument for development: it can bring technology, investments, jobs and economic growth provided the sufficient conditions and particular rules are there. We offered a comprehensive strategy of integration for these countries into the EU market, and the Member States decided yesterday (14th December 2011) on mandates of negotiation, which the Commission has prepared, for what we call “deep and comprehensive free trade agreements.” These agreements will be presented to the ambassadors of the four countries that we have in mind; that is, Tunisia, Morocco, Jordan and possibly Egypt.

What is on offer is a comprehensive strategy of trade integration into the EU market, with two aspects: more market access (negotiations on agriculture, services, etc.) and regulatory convergence. Because when you trade, what is most at stake is not customs duties (they are very low, and with some countries like Tunisia they have been completely removed) but the so-called “behind the border issues,” such as regulations, standards, intellectual property rules, etc. We proposed that these countries, on a voluntary basis and following their own agenda, adapt their rules to the EU standards. The agreements will have strong regulatory components, covering public procurement, competition, intellectual property, food regulations and SPS standards. We will also suggest negotiating mutual recognition of industrial certification agreements, something that some partners have already started preparing. These agreements will mean that selected industrial products from the third country will enter the EU without any certification check on a reciprocal basis. That constitutes a very powerful instrument to foster trade. On their side that will require strong political commitment, a lot of work, but it is an offer that will be worth considering because clearly, in the end, they will be part of the EU market and that will certainly help develop their economy.

The preparation of these negotiations will be very important. The Commission will assess during a thorough scoping exercise the commitment of each partner on a case-by-case basis to implement far-reaching regulatory approximation and their level of ambition in the future negotiations. These economic/trade assessment will go in parallel with political assessments on progress of democracy. The decision by EU Member States to actually launch the negotiations will be conditional on the positive results of both assessments.

This liberalisation of trade processes would be supported by additional technical assistance to help upgrade their regulation. Moreover, this will be a very good incentive for better governance because when you have to open and change your public procurement rules it means less corruption, more transparency and more competition. Consequently, governance rules have to be changed. When you adopt competition rules, monopolistic markets are prevented, which introduces true competition. That is why I said this will require a lot of political will and a lot of hard work.

The EU has been very active in the Deauville Partnership, which made 38 billion dollars available for the region, in particular for Tunisia, Egypt, Morocco and Jordan. One of the

decisions taken very early by the Member States is to raise the ceiling of the European Investment Bank's external mandate whereby the bank can now provide close to six billion euros over the three years to the region in loans. Another idea that is close to completion is that the European Bank of Reconstruction and Development (EBRD), which has been so instrumental in the transition of Eastern Europe, will have its mandate extended to the Mediterranean region and they will be able to provide annually up to 2.5 billion euros to support the establishment and extension of business and the financing of infrastructures.

Regarding EU technical assistance, per se, the EU added 1.2 billion to the 5.7 billion, so that is close to 7 billion, already budgeted for the neighbourhood in the period 2011-2013. And let me mention some new technical assistance instruments that we have recently introduced. Let me mention two new TA instruments that were recently introduced to help the region: the €350 million umbrella programme Support for Partnership Reform and Inclusive Growth (SPRING) that will make available support to partner countries showing sustained commitment to, and progress in democratic reforms. A new €20 million SME investment scheme called SANAD targets SMEs in the Middle East and Northern Africa region, in particular the business segment which is too small for banks, but too large for microfinance.

And, finally, we are moving forward in developing a new investment security scheme for the Mediterranean jointly with the OECD and the World Bank Multilateral Investment Guarantee Agency. Now we have to see, along with the countries, the level of interest in and commitment to pursuing this programme.

Lino Cardarelli. Senior Deputy Secretary General, Secretariat of the Union for the Mediterranean (UfM)

Thank you for the invitation. I am here to substitute Secretary General Youssef Amrani, who unfortunately could not be here. Andreu Bassols said in his presentation that one important word is “ambition.” In the present circumstances, if we do not have ambition, I think that we will not do what has to be done. In my opinion, ambition is what drives human beings to be committed to getting to where they want to go. We all know that the Arab Spring is an important change, a change over total discontinuity. We know that Arab Springs demand investments, and we have heard now the reports that the European Commission is devoting to that. But, in my opinion, what is very important are governance and good ambitious management to drive the change.

Transition. At the end of the day, the Arab Spring has sent a clear message: the old model has died and we have the responsibility to work on a new one, which is not yet defined. Understanding of the transition then, in my opinion, is crucial. Ambition and transition. I am not an expert and I am sure other people here will contribute several very important experiences. But I did not want just to be an expert; I wanted to be involved and to understand what transition means. When I was at school, I consulted the *Webster English Dictionary*, which defined it as “an extraordinarily complicated process which at first is not fully understood, but after a period of intensive research certain features become gradually clearer as the process proceeds through a series of stages.” In business, transition is the change from one significant condition to another. So it seems clear when we are in a transition period but, in my opinion, we should also detect why and from where the transition comes. We have to take action; we have to understand what is going on and where we are. The lessons that can be learnt from similar situations of transition could be another good exercise. But we have to be careful, we know that transition is a tense period of change and we will have winners and losers. And when we read the story afterwards, we have to have clear that the story is written by the winners, not by the losers.

The transition, the process of discontinuity, which is connected, is very serious. It deeply impacts on a country, its institutions and the history that has brought the country to where is just before the start of the transition. It will impact on millions of people, men, women and children, including the next generation.

I do not think economic transition can be separated from transition in general, which is often caused by extraordinary events followed by big changes throughout the society of the country. It is well-known that there has never been a difficult situation of any nature whose outcome is different from expected.

How does transition start? What has been the hidden vision and purposes that have brought a group of men to start an action of discontinuity which is at the basis of the new cycle of the defined transition? A couple of questions that I am sure will be answered over the next two days. What is the result of the transition that we have in mind? Who are the

allies and who is against the possible change that we intend to achieve and manage? Is it a top-down or a bottom-up process? These are some questions, thoughts, emotions that come to my mind from two different historical situations that I have experienced firsthand: the Eastern European countries' economic transitions in the 1980s (as the CEO of a bank involved in Eastern Europe reconstruction) and the Iraqi reconstruction and transition process following the 2003 war (as member of the Coalition Provisional Authority team coordinator).

I would like to talk about the lessons of these two transition processes in terms of governance. It is essential to learn the right lesson rather than the easiest side, even if there is always the desire to reach a simple bureaucratic conclusion, as George W. Bush did in May 2003 saying: "Mission accomplished." However, when we started the Iraqi reconstruction, whether the physical or the non-physical project, we had in mind a model of governance that turned out to be wrong. I remember that when the reconstruction was delayed because of bombing, looting and sabotage, it was a difficult period where the original expectations collapsed, along with the idea of reconstruction. And, just to draw attention to the reality of the reconstruction that we had to manage, we put a large poster on top of Saddam's palace, which was the headquarters of the CPA, which said, "Iraqi reconstruction. Not only bricks and mortar." By doing this, I wanted to draw people's attention to what the Iraqi reconstruction meant.

Which of the lessons learnt can I bring to your attention? First of all, be ready for the worst, the unpredictable scenario. Only by working on the ground it has been possible to discover that the studies, seriously conducted by the World Bank, the Brookings Institution, the Rand Corporation, the Pentagon and the Department of State contained suggestions and conclusions that turned to be very different from the reality, from the model of governance we had in mind at the beginning. Next, strengthen the security forces as soon as possible by improving hierarchical structure and discipline. Security is always not a problem, but the problem. And the point is to give leadership responsibility to the local authorities, as they know the environment better and can take unpopular measures.

Regarding to Arab economic transitions, I think that first of all we have to move from an import oriented model towards an export and investment driven economy. We cannot have those countries dependent on imports. Between 60 to 70% of goods and services used in this region are imported. Strong currencies should stay there, and South to South exchange trade should be reinforced. Moreover, there should be a move from a non-diversified economy model towards a diversified one in which the largest employment generators have to be placed at the core of the economic strategies in the country, and, finally, great attention to a performing educational system. Education is key: it is the basic infrastructure of the region, in order to provide the right jobs for the right economic model for the needed company which has to invest there.

Other areas are of great importance. One is governance, the second is governance, and the third is governance. First, governance as an equivalent of the rule of law. The rule of law must be the focal point in the economic strategy and an essential guarantee for a fair

competitive economy. Keywords related to that: transparency, local participation, involvement of young people. Second, governance as an equivalent of sound administration at all levels. What are the keywords? Inclusion, civil society, guarantee, local actors, coordination. Clearly, if we allocate real responsibility we can, of course, manage transparency. Finally, governance as an equivalent of human beings. I just mentioned that education is key in this region; the right education, technical education, and training. We need the right education with lower training costs, otherwise we have to train people who are not prepared for what they are supposed to do, and of course that is too costly. And then there is the link between schools, universities and the private sector. So this is the new emerging paradigm on which we are working. As you know, the Union for the Mediterranean is the technical arm at the service of political ambition and we try to fulfil this ambition, within the framework of the European Commission, and the financial support of the European Investment Bank and the other financial institutions that will join our efforts.

I just want to add another important point: partnership. Partnership because we cannot, in this complex world, go alone, we need a proper organisation and we are working with the United Nations, the OECD, the Arab League and the Deauville Partnership just to promote regional governance.

I am sure over these two days I will learn, and I might change my emotional views. So that is what my experience has shown me and I wanted to draw your attention to the fact that the process of transition is very complicated, so we have to move fast, solidly and ambitiously, but, at the same time, very carefully.

Senén Florensa. Secretary General for Foreign Affairs, Government of Catalonia; President of the Executive Committee, European Institute of the Mediterranean (IEMed), Spain

It is a real pleasure to be with you this afternoon. I would like to thank the institute for the job that they are doing. I want to say how grateful we are, in the Government of Catalonia, for the organisation of this seminar. I think it is a very important moment, as has been said by all the previous speakers, because we are at a crucial point. And it is a very important occasion that we bring together around the table the representatives of the European Commission, the Union for the Mediterranean, the European Investment Bank, the European Bank for Reconstruction and Development, the OECD, the Carnegie Institute, among others. I think that expectations are very high, so our challenge is to live up to them.

The Government of Catalonia has always been a strong supporter of the Euromed Process and Euro-Mediterranean policies, because we are in the Mediterranean and we are strong believers that the future of the Euro-Mediterranean area depends on how we can build together a unified area – and not only economically speaking – where people, ideas, goods and services, investments and job creation can move freely. The objective, as was stated right at the beginning of the Barcelona Process in 1995, is to build around the Mediterranean this area of peace and security, of shared economic progress and of dialogue and understanding among the peoples of the Mediterranean. So this is always our motto; we have always believed in that.

In 1989, this was the reason why the Catalan Government, under the leadership at that moment of President Jordi Pujol, created the then Catalan Institute for the Mediterranean. It was in 1995, on the occasion of the 1st Euromed Ministerial meeting that launched the Barcelona Process, that the IEMed was asked by the European Commission and the European Presidency to organise the major Euromed Civil Forum. That Forum took place along with the ministerial meeting just to underline that this process, later to be called the Barcelona Process, could not be carried out by governments alone, but with the participation of all levels of administration and, especially, all levels of civil society were needed. This is why that first Euromed Civil Forum was organised, to show very vividly, visually, that everyone's contribution was needed for that purpose.

So we were there and, of course, we have always supported all Euromed policies, and when the occasion came to take a step forward with the creation of the Union for the Mediterranean, of course we were there and we offered these premises, the Pedralbes Palace, to be the home of the Secretariat of the Union for the Mediterranean. I think it is necessary to keep on pushing for that process in order to respond to the very fast development of the situation in the Southern and Eastern Mediterranean.

And this is why, for example, with the President of the Government of Catalonia, Artur Mas, we have paid three visits in the last three months to the European institutions in Brussels to spread the message that the Mediterranean is extremely important for Europe. Therefore, there has to be a centred European approach which focuses on the region. For

this purpose, the role of the Union for the Mediterranean is crucial. Of course, the commercial policy of the European Union is competence of the Commission and has to be dealt with by the Commission itself, but the majority of the cooperation projects should be carried out by this common instrument that we have created altogether (the European institutions, the Member Countries and our Mediterranean Partner Countries).

Of course, this adds a lot of difficulties, because it is not the same to settle bilateral agreements with each one of the countries as to discuss an issue with forty-three countries, plus the European Commission, plus even the Arab League and some other observers. However, these issues should be approached with increasing frequency through the Secretariat of the Union for the Mediterranean.

I would like to make a comment on the current situation, on how we see it, because it is now very different from what it used to be. We used to start any seminar like this by saying, "Well, there is a big gap between the Northern and Southern Mediterranean. In the North, everything is good and going very well – a happy world – and in the South there are a lot of problems." Now there are a lot of problems in the North: the economic crisis, financial crisis, real estate crisis, and so on. We do not even know whether in the future we will be able to sustain the welfare state we have built over the last fifty years. And in the South there is a lot of hope: for democratisation, for a new participation of the people, a new way of governance in the overall political governance of the countries. They have not been spared by the financial crisis, but there is great hope because the people of these countries have had enough courage to go on the streets and take history into their own hands. Now a very complicated path lies ahead. And this is the reason for this seminar.

A good thing to do is to learn, as Lino Cardarelli said before, from experience. There are all kinds of experiences and all of them are different and therefore there is no pattern that can be applied mechanically to a new situation or to another country. But from one experience and then another we can gather advice that might be helpful; and this is why it is a good idea to put around a table different approaches to the issues.

What is absolutely true is that expectations are very high, although the process is going to be very different from one country to another. Some will go through a process of reform, and are already doing so, as in the case of Morocco and, probably, Jordan. Others have gone through a revolutionary process; they have managed to overthrow the previous system. That is the case of Tunisia and Egypt. The transition process in Egypt is a big issue because Egypt is the centre of gravity of the Arab world in all respects: demographically, culturally, historically, and so it has a lot of consequences internally and throughout the region.

Some other countries will have other kinds of revolutions, provoked by the resistance of the old regimes. The reminder of what happened in Iraq is extremely important. I only hope that we are going to do things differently in Mediterranean affairs because for many years during the Barcelona Process people told us we are not succeeding in establishing democratic systems in the Southern and Eastern Mediterranean. And we responded by explaining that European policies are soft power and soft power has the disadvantage of

being soft, but when you try to apply hard power then you get some consequences which might make the situation much worse, as was mainly the case in Iraq. Finally, the Barcelona Process has helped to some degree to produce democratic regimes.

Now everything else remains to be built and the transitions are not going to be easy, but we will try to help them, using this soft power whenever possible. There are exceptions, as in Libya, where the international community reacted to put an end to the massacre.

Altogether, the instruments that should be used to support the transitions are those of the Euromed policies: that is, soft policies of spreading progress and inclusive development beyond the borders of the European Union. We must also offer our neighbours the opportunity to participate in economic integration (of goods, services, investments) and mobility of people. Time is very short and we have to react as quickly as possible and not just quickly but well, because expectations are very high.

Some of the speakers here today will talk about the experiences of other transitions. What has now been experienced in the Arab world is not unique in the world. Rather, it is the continuation of this wave of democratisation. In the 1990s, it was in Eastern Europe, in the 1970s and 1980s in Southern Europe. So we see more or less the same thing at different stages in time.

A final word to welcome you again to Barcelona. I just want you to be inspired by Barcelona. This Process has borne the name of Barcelona for many years. And now we are facing a completely new stage, we do not even call it a Process anymore, although it is a continuation of one. So may your stay in Barcelona inspire all of us to shed some light on the complicated years that lie ahead and to respond to the great expectations of all the countries around the area.

the 1990s, the number of people in the UK who are employed in the public sector has increased from 10.5 million to 12.5 million (12.5% of the population).

There are a number of reasons for this increase. One is that the public sector has become a more important part of the economy. The public sector has become a more important part of the economy. The public sector has become a more important part of the economy.

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Best Practices: Lessons from Previous Economic Transitions

Best Practices: Lessons from Previous Economic Transitions

Alfredo Pastor. Former Secretary of State for Economic Affairs, Ministry of Economy and Treasury, Spain

We are now going to discuss previous experiences of transitions, and I was asked to say a little about the Spanish transition. I am grateful to the Institute for inviting me to this conference. It has given me an occasion to think back to what the Spanish transition was, because it looks to us like it is something that happened a very long time ago.

A former teacher of mine used to say that historians were divided into two classes: the Lumpers and the Splitters. The Lumpers thought that you had to analyse all events in the same way because, in fact, all crises, all wars and so on were pretty much the same. The Splitters thought the opposite: you had to analyse them singly because they were in fact very different from each other. If you think about transitions you have to side with the Splitters in the sense that the specific features have a greater weight than the common features.

The Spanish transition has widely been perceived as a success. The reason is probably that people, knowing Spain, were prepared for the worst. But the worst certainly did not happen. Nevertheless, it was not a very smooth process. I will first give you the reasons why the transition was a relative success, and what, in my view, were the two or three main difficulties that we had to face.

The reasons why the transition was a relative success were, first, that in fact what we call the transition, the period that started with the death of Franco in November 1975, was just one more stage in a long process of a return to political normalcy. Spain had been a normally governed state since the last quarter of the 19th century. We had had our first constitutional monarchy, then a republic, and so on and so forth. Of course, we had had this Civil War, which did not come out of the blue. But, after 1939, we started the very slow return to political normalcy. Second, it was a predictable process because it was intimately linked with Franco. No one expected that when Franco died things would continue as they used to be. The third reason, a very important one, is that the final stage of that process was known. We knew exactly where we were going to go. We were going to integrate a solidly democratic Europe, which was not the case in 1945. In 1945, Europe was pink, especially Southern Europe. Not red, but certainly not blue. In 1975, there was no question about what Western Europe was, and we were going in that direction. We were not contemplating any other alternative.

Another important reason is that economic integration, to a very large extent, had already been achieved before the political transition started. Our economic transition began around 1959 with the Stabilisation Plan. We had the first World Bank mission in 1961, following which we caught up very quickly with the rest of Europe. In 1975, our GDP per capita was 80% of the European Market average. So the middle class was there already, which is a very important factor. Even though the political transition started under

unfavourable economic circumstances, Spain was already a middle-income economy at that time.

Finally, we had a lot of outside help that essentially took the form of advice. This very discreet help came principally from Germany, both the Adenauer Foundation and the Ebert Foundation. The Conservatives and the Social Democrats helped us a lot.

Yet the process, as you know, was not as smooth as one might have thought. In 1981 we had a serious scare. But there was one factor of cohesion and that was the King. In other countries the factor of cohesion is the army. That was not the case in Spain. Just to simplify, we could not trust the army at that time and, in fact, a lot of what happened in 1981 was brought about by the army.

What were the sources of conflict? If you have to summarise them in one word, it was the settling of accounts. Lots of accounts, real and imagined, had to be settled on the political and economic fronts. And that, of course, was a very difficult part of the transition.

On the political front, quite a few people thought that the Franco dictatorship was not such a bad regime after all. Some of them owed their livelihood to that regime, some liked it for ideological reasons, while others just thought that was something they knew, and they preferred it to something they did not know. I was in Madrid on the day that Franco died and there were queues of people standing in line in the street for hours just to see him. That has not been the case, if I remember rightly, in the countries of the Arab Spring. But it was the case in Spain. On the other hand, we had something to our credit: the actors, people who had been someone in the Franco regime, just disappeared. No one tried to cling to power; they just went away. Some of them were very old, some of them were retired, some of them had already died, but essentially those who were still in power just left it to the next actors and the element of continuity was the King. The King had been prepared by Franco, so he was still sworn to the old regime. But he started the new regime. It was of course an artificial continuity, but it worked. If you looked at it rigorously it was just hot air, but it was very useful hot air. It provided the formal continuity needed. There were very few questions of legitimacy in that transition. In the settling of political accounts the decision was taken to have this sort of clean slate policy: don't ask, don't tell. There was no witch-hunt, nothing like that after the transition. But that did not satisfy everybody. Some people thought that we should have taken things more seriously, and in recent years we have had a process of revision of all the accounts. We also have to remember that the "bad part" of Franco's regime was immediately after the Civil War, between 1939 and 1949, and that was already very far away when Franco died in 1975.

The second part of settling accounts, which is probably more interesting in this context, is the economic aspect. After Franco died, everybody was a creditor. Everybody thought that somebody owed him something but, unfortunately, there were no debtors. The debtors had disappeared. It was a country of creditors. Everybody had claims. I think Adam Michnik said that revolutions –and I think this can be applied to transitions – have two phases: the first is the fight for freedom, and that brings out the best in human nature; the second is the fight for power, and that brings out the worst in human nature. There was a little bit of that in Spain. The first phase was a phase of liberation, which to some

extent was an artificial one because at that time Spain was pretty much a free country. There was one thing that you could not do and that was to try and go for Franco's place. Everything else was more or less allowed. Ordinary life was a free life; there were no constraints on people's behaviour. With the transition, people thought that the repression had ended and that with democracy a lot of forces were liberated. This is true, but those forces are not necessarily productive forces. They are not the forces of hard work, sustained effort and discipline but forces of disruption. And that is something that has to be taken into account.

In 1975, our GDP per capita was 80% of the European average. In 1985, it was 70%. In a period of very slow growth of the European economy we had dropped 10 points. The main cushion for this economic crisis was public enterprise. We had a lot of public enterprises and those were more or less instructed to lose as much money as they had to, but to maintain employment. So lots of public enterprises which used to be profitable in 1975 were losing a lot of money by 1985, which meant they had to be restructured. It was a very painful process, but it was ten years later. So this cushioning of the impact through public enterprises was just kicking the can down the street. But in some cases, in a transition process, you have to kick the can down the street. That is, if you want to carry out reforms, fine, but the sequence is important. Not only is it important but sometimes it is the only thing that is important. If you take a first wrong step there is no second step. You have to allow yourself cushions.

The last thing I would like to say is that it is a very long process. The problem is the management of expectations. People expect a lot of things from the transition process and, in fact, they get very little in material terms. In the case of Spain, in political terms, they got elections, parties and so on, and that was important. However, they did not earn an immense amount of freedom because freedom was already there. In economic terms, you do not get very much because, after all, things have to be produced by work, through infrastructure and decent services, and that does not just grow on trees. You have to work for it. Economic achievement in the first phase tends to be pretty bad. You have to allow for that, you have to realise that people will get frustrated and you have to be able to manage that sort of frustration.

To deliver things takes a very long time and you have to convince people that this is what has to be done, because otherwise you generate frustration and, of course, frustration is a very great danger for a transition process. Results, but not quick results.

Samir Radwan. Former Minister of Finance, Egypt

The Egyptian Spring is continuing, as you know very well. We have wave after wave, and it is promising to continue even further into 2012. I would like to organise my thoughts into three points. The first point is what has happened; the second is the management of the transition; and the third concerns where we go from here.

The first aspect is the 25th of January Revolution. If one reflects on the genesis of that revolution, you see that young people were rejecting a development paradigm at a national, regional and global level. These young people were born under President Mubarak. For thirty years they were watching the situation and the message became very clear to them: that they were marginalised and therefore resorted to a virtual world – Facebook, Twitter and so on – and created their own world and their own dreams. As they told me several times, they first started with very modest demands and when these demands were accepted they went for higher and higher stakes. This is the situation right now. What was this rejection? They do not express it very coherently, but one could discern a rejection of a development model in Egypt, resulting in increasing unemployment. Official unemployment figures are 11-12% nationwide, and for young people it is almost double at 25%. So, one out of every four young people does not see a hope of finding a place in the labour market.

If they do find a place, it is either in the public sector of government (which represents 6.2 million people or 25% of the Egyptian labour force) or in the so-called informal sector. The remuneration for these forms of employment is very low, hence the issue of poverty and income distribution became an extremely important issue for those young people. Poverty in Egypt affects 40% of the population: 20% are properly poor, and another 20% are near-poor, in the sense that at any shock like inflation or a food crisis would take them below the poverty line. There was flagrant inequality everywhere and that is why the model was rejected at a national level.

At the regional level, they know that they live in a region that is extremely rich: oil-producing countries have substantial income. But the only access to that regional wealth was through migration to the Gulf Cooperation Countries or through subcontracting.

At the global level, my friend Mohamed Al-Aryan summed it up the other day by saying: “We had a situation of privatising massive gains and socialising massive losses.” Those who made the gains were the private sector, while the population at large footed the bill. That model is being questioned now.

When revolution came, I was Minister of Finance and we had to deal with the situation. Available time was very short – like now – and sources of finance were also being eroded. The budget deficit was about 9% of GDP, there were increasing claims, especially from public sector employees, and revenue was going down because of the stoppage of production and exports. Manufacturing exports fell by 40% in the early months of the revolution. Luckily, other incomes, like remittances, increased during that period, and the Suez Canal continued to pay, as usual, the 5.5 billion dollars a year. But, as a result of this

situation, there was a decline in growth rates. Growth, which was 7% before the global crisis, and 5% even at the height of the 2008 crisis, is now down to 1.9%.

The revolution, and the slowdown of productive activity – because these young people are extremely sensitive if you insinuate that you are blaming the revolution for the decline in growth – has provoked a decline in tourism of 1 billion dollars a month, 40% of exports (that means 40 billion pounds), and 3% of GDP over last year. And this will continue. There was also a decline in FDI flows. Those represented almost 10% of GDP before the revolution, and now they have gone down. The result is a decline in the international reserves from 36 billion to 20.1 billion in a few months and a pressure on the pound. I must say I was fortunate, as the Minister of Finance, to have the collaboration of my Central Bank colleagues. They managed the alignment of fiscal and monetary policy very well. It made things easier.

However, facing that dire situation required an assertive reaction, and it came exactly at a time when the budget for this fiscal year had to be drawn up. We spent night after night, with our colleagues from the IMF and the World Bank, producing the budget. With this budget we wanted to provide some rewards for those people who were demonstrating in the street, right or wrong. The idea was to go some way towards social justice, as it was central to the revolution. One of the dilemmas was that we did not want to increase public sector employment. Egypt already has one of the highest public sector to population ratios. There is one bureaucrat for every twelve Egyptians. At the same time, these people were protesting at the Ministry of Finance and other places. Finally, the idea we came up with was to introduce a minimum wage. The latest revision was in 1984 and it was fixed at 35 Egyptian pounds a month (5.8 US dollars). We revised it to 700 pounds. That was on that front.

The second front was to stimulate the economy. Because what has happened as a result of that scene I have described is that many of the leading private sector people were either in jail or escaped abroad. And the others were frightened. So I had to lean back on my Keynesian education and use public investment as seed money to attract private investment again. The idea was to push some 40 billion Egyptian pounds in a stimulus package of infrastructure and private-public partnership. The result of this whole thing was a budget that had a deficit of 12% of GDP; admittedly high. But we also knew our way out of it, with the Central Bank, the IFM and the World Bank. And the way out was at two levels. One, of course, was that we needed extra resources, hence the famous request to the World Bank and the IMF to borrow some 5.2 billion dollars. Another was to go to the Arab countries, especially the oil-producing countries, to make up for part of this resource deficit.

I must say the international offers were fantastic, the emotions were fantastic. But what we have got until now through the Central Bank is precious little, if I am not mistaken. We went to the G8 Summit of Deauville, in France in May 2011, and the reception was out of this world. Mr. Obama told me: “We are following what you are doing, you are doing very well, we are with you, and you cannot fail.” So I went home thinking: “That’s it, this will have to bloom tomorrow.” But nothing has come. And that is why I very much like the

proposal of the European Commission that Olivier de Laroussilhe has presented to us, and I hope we can go a bit further with this integration between Europe and those four countries. Except that he has said: “and possibly Egypt.” And I understand why he introduced this “possibly.” I can assure you Egypt has its own ethos, its own logic, it plods along, but it gets there in the end. But that is another story we could discuss.

So what can we do with this situation? Of course, we are waiting for the elections, but the attitude of “wait and see,” is not going to help in the Southern Mediterranean. I think engagement is a better strategy to help these countries out, to hasten the process of transition. Somebody told me that “it took eighteen years after the Russian Revolution and twenty years after the French Revolution.” That’s true, but now it is a totally different ballgame and we can curtail the transition time. We need to work out a modality of managing the transition based on help between North and South. And I fully agree with Tony Blair that the era of foreign aid is over. It is over, and I’m glad it is over. I never believed in that type of foreign aid; that you get aid and you lay back and do nothing else. So I think we are in an era of technical assistance, of capacity building in these countries, of transferring knowledge, of lessons, of experience that will help to create this brave new world we are hoping for.

Ioannis Kaltsas. Head of the Trust Funds and Policy Division, EIB Operations outside Europe, European Investment Bank (EIB)³

I would like to thank the IEMed for the invitation, as well as the speakers that spoke very nicely about the EIB. To reassure you, I am not going to speak about the EIB and all the wonderful things that we are going to do over the next three years, the partnerships we have set up or the wonderful projects that we are going to finance because this will be boring. I was asked to do something bolder, to go through the EIB and IFI experience of transitions and, from my personal point of view, to come up with some simple conclusions about how this could be related with the evolutions currently in the Mediterranean Partner Countries.

I think it is important to be on the same level of understanding about our assessment before the revolutions. I disagree with some of the things that were said in the first panel about GDP stagnation, lack of trade and FDI attractiveness, which painted a negative picture for the Mediterranean Partner Countries before the revolutions. If you look at the evaluation reports from the IFIs, they certainly do not correspond to this. All of us, all IFIs, were very proud, in 2009, of our achievements in the Mediterranean Partner Countries. I went back to my first speech in my current position, which I gave in Barcelona in the framework of the Mediterranean Week and clearly declared that “finally it seems that the Mediterranean Partner Countries are catching up their convergence with Europe.” Indeed, from 2009, these countries, on average, grew more than 4%. And there was not only growth – because this was also said and I think it is a mistake –, but also considerable productivity gains and, as Keynesian economics was mentioned, productivity is much more important than growth. In the case of Tunisia, Morocco, Egypt and Jordan, these productivity gains were due to the fact that there was a fast penetration of information technology.

With respect to FDI attractiveness, I can personally testify that while working as an EIB operational expert in industry during the year 2001-2006 political risk was not really a big issue. Nobody was worried – not the investors, not the IFIs, not the European governments, and not the international organisations – about the investment climate. They were willing to take a lot of political risk and bank a lot on the economic and social stability of these countries. This was also reflected – as my colleague from the African Development Bank knows quite well – five years ago, when we had tremendous difficulties lending because the banks were very willing to take risks, sometimes crazy risks, in these countries because they were assuming a climate of political stability.

Why did we not see what was happening? We could see the statistics coming out of these countries. First of all, we could see an unbalanced transfer equation in Euromed trade, between Europe and the Mediterranean Partner Countries. We could see that the reduction in the poverty rate was not as fast as the increase in the rate of GDP. And these clearly meant that inequality is going up. So not all of the people in these countries

3. The speaker has been invited at personal capacity and his views do not necessarily reflect those of the European Investment Bank.

are able to get equal access to this growing pie, and this creates frustration and desperation.

Other statistics, which were put alongside the great achievements of these countries, could make us even more puzzled. I remember the quote “little girls die more frequently than boys in rural areas in some of the Mediterranean Partner Countries.” How can we be proud of our achievements in these countries if this is so?

But eventually things caught up, and most people today believe that the reason was the international financial crisis and the food crisis. That pushed the population a little. Actually, in one of the World Bank reports I found a very interesting example that I never knew, which shows that history repeats itself. Thirty-five years ago, Egypt’s Tahrir Square, the IFIs – the Bretton Woods Institution in this case – suggested that to make the Egyptian economy competitive in terms of food prices what you had to do was to reduce food and staple subsidies. The consequence was food prices went up, people went to Tahrir Square, they burned down a number of hotels, and riots forced President Sadat at that time to increase subsidies and reduce food prices. This is actually what Ben Ali did in Tunisia just two weeks after the revolution broke out. But it was not enough.

I share a lot of the thinking of the previous speakers about the exclusion of young people from the decision-making of these countries. When we were going to these countries we were only meeting old people, at all levels of the hierarchy, while we know that in these countries the bulk of the population consists of people under forty years old. I found that it is not by accident that the new Moroccan constitution includes a specific provision for representation of young people under forty. Maybe soon we could see a similar quota for women.

But there is something that the IFIs should be proud of, because not everything that we did was wrong. What I think we did right in these countries, helping this process, was the creation of the middle class. Because it is true that in rural areas the poverty was exaggerated, the inequalities were more rampant, but the revolution came from the urban areas. And let’s face it, the revolution came from the small – or bigger, depending on the country – middle class.

I would like to go back very quickly to the other historical examples: Greece, Spain, Portugal and Eastern Europe. In all these cases there was always a mixture of a political and economic transition; and it is difficult to distinguish one from the other. In Greece in the 1970s and the 1980s, our big fear was the same as we heard previously in Spain. When in my house the lights were going off because of the disruptions in the electricity supply in rural areas, my father immediately considered the possibility that we were having a military coup. Things have changed a lot, and this is thanks to Europe. The difference of these transitions with the Mediterranean Partner Countries is that there is no clear political direction. In Greece, in Spain, in Portugal, we wanted democracy; we wanted to be part of Europe. The same for the Eastern European countries, they wanted democracy, they wanted to change to a capitalist economy. In the Mediterranean Partner Countries this direction has not yet been set. And what is striking, if you see these evaluation reports from the IFIs, is that the political objectives are the first to be set. If you do not set the

correct political objectives it is very difficult to achieve the economic and social objectives.

The second striking thing is that the different parties in the former European transitions – the EU, Greece, Spain, Poland, the Czech Republic and Bulgaria – were in full agreement about the process. There was unanimity in Europe about what Greece should do, and there was an agreement also in public opinion and the political leadership. Today, this is lacking in the Mediterranean Partner Countries. Some also claim that it is also lacking in European countries. Europe has difficulties in agreeing, and this makes this process more painful for the Mediterranean Partner Countries.

The last and most important point is that during the first years of previous transitions, Europe was offering a lot of money. There were big packages. And now this is not the case in the Mediterranean Partner Countries, partly due to the international financial crisis that particularly affects European countries. However, one of the striking things is that the money itself, on many occasions, is thought to have harmed the transition process, or to have derailed it. All the free money coming from the European Union towards Greece has changed the mentality of the country. When I was a small child, the bribery of a public servant was socially unacceptable. But when the packages of money came from the EU, and the biggest concern was how to absorb this money within the country, then people started to be more “flexible” about whether, for some big projects, they could use more of the free money that came from Europe. Free money very abruptly changed the work ethics and consumption patterns. And this, as we can see today, has harmed more than helped the economy in some respects. So one lesson that we can perhaps take to the Mediterranean Partner Countries is that, instead of declaring huge amounts, maybe this “more for more” – or “less for less” – declaration of Europe should be translated to “better for more.” If we do not do better, we will repeat the mistakes of the past.

Torbjörn Becker. Director, Stockholm Institute of Transition Economics (SITE), Sweden

First, let me thank the organisers for inviting the Stockholm Institute of Transition Economics to be part of this conference. I just wanted to tell you that some of my colleagues have put together a report called “Transition All Over”, talking about the transition experience in Eastern Europe and the former Soviet Union and the comparisons we can make with the current transition that we are seeing in the Arab world. I cannot really comment on the previous two presentations, so I would just like to add a few notes from the experience we had in Eastern Europe and the former Soviet Union.

I think one thing that has come up here, which I do think we need to stress, is that transition takes a long time. It took Eastern Europe countries at least ten or fifteen years just to return to the GDP per capita levels that they saw before the transition started. The market structures and institutional factors of the Arab countries are different, but I think it is quite dangerous to think that we can manage and get this transition process over in a year or two. That establishes the wrong expectations for all the parties involved.

And when you look at the former communist countries, you can see that they took two very different routes. You have a number of countries that really went the route of democracy, closer EU integration and quite successful economic development. But, as you all know, a few of these countries took quite a different route. They became quite autocratic, they have not really benefited from any kind of EU integration process. And their economic development, unless they happen to have oil resources or gas resources, have not at all been at the same level as, for example, the Baltic countries, the Czech Republic or Poland.

The start of this process, either with shock therapy or a revolution, is just the start of the race. Sustainability is going to be the key for successful long-term development. When it comes to sustainability, I want to highlight two things. The first is related to public goods provisioning. If people feel that there is a ruling elite that basically grabs the resources that the country has at its disposal and does not share this with the general population and income distribution is not looking good, then it is really going to be hard to sustain support for this kind of transition. It is also going to be hard to sustain it fiscally in the long term. I think a lot of countries in this region can probably expect to receive a fair amount of donor support over the next couple of years, even if they may not have seen it yet, but I think in the longer term they will all have to rely on generating tax revenues. And you can only do that in a sustainable manner if you have the support of the people that are going to pay these taxes. And I think we have seen quite a few countries that have failed to convince the population that it is actually a good thing to pay taxes, because you get some valuable public goods. So this is a very important issue for sustainability.

The other challenge in many of the countries in the region is natural resources management for sustainability. In a lot of countries, including the former Soviet Union, abundance of natural resources can become an obstacle to development and building good institutions. For long-term sustainability it is extremely important that countries

themselves, with the support of donors, think carefully about setting up transparent institutions that manage resource wealth. The worst-case scenario that I can see is if countries from the rest of the world race to this region in the hope of securing as much of the natural resources as possible in the near future. And countries fail to deliver the public goods and the general goods that can be given to the population at large from these natural resources.

Let me just finish on a few notes about the EU. I think the real lesson in Eastern Europe and the CIS (Commonwealth of Independent States) countries was that the EU was the number one external anchor. Without the EU, I do not see how many of the reform processes that we have witnessed, some of the success stories that we have seen, would really have come about. At the same time, I think the EU and the West probably made a few mistakes here and there in the former Soviet Union. In Russia, for example, there was quite a lot of donor support when you look at it from a financial viewpoint, but I do not think the Russians felt that the EU and the US were always partners in their development. Russians sometimes had a sense that the West was coming there and dictating the terms, and telling them that “we won the war, you lost the war.” This kind of mentality did not really help to build trust between Russia and the West in those years. I think we should be very careful not to repeat a similar scenario with the Arab countries, so that we can really be viewed as partners in this development process; a good external anchor that does not try to come there and dictate to these countries what they should be doing. And, again, it is really important that the EU and Western support goes towards building sustainable local institutions that can take care of the reform process, not only for a year or two but for ten, fifteen and twenty years going forward.

Luc de Wulf. Former Professor, American University of Beirut; Former Staff, International Monetary Fund (IMF) and World Bank (WB); Fellow, Center for Social and Economic Research (CASE), Poland

First of all, I thank the IEMed for inviting CASE. It is a pleasure and an honour. CASE is a Polish think tank that has recently done a lot of work on trade and investment in the Mediterranean and the Middle East. Based on this research there are a few findings that I believe will interest this conference. The theme of the conference is basically "Governance Matters", and we have done a lot in the last four or five years, mostly with funds from the European Commission, to analyse and to document this theme. The most recent research that I was involved in was planned in 2009, launched in 2010, with as title "Prospective Analysis for the Euro-Med 2030" or MEDPRO for short. You can imagine the amazement and the puzzlement within our team of researchers when the Arab Spring, the Arab Summer, the Arab Fall and the Arab Winter succeeded each other. And the discussion was: "Is this a blip in the trend or is it a change in trend?" Well, I was very happy to see a study that Caroline Freund, Chief Economist of the World Bank and speaker in this conference, carried with her colleagues, which looked at forty countries that recently engaged in a successful transition and what impact this transition had on growth and investment several years later. This analysis basically informed us that after a successful transition was initiated, GDP growth had recovered in three years; investment took a few years longer. Drawing in this findings and looking at the Euro-Med prospects for 2030, we tend to consider 2011 a blip if the transitions are successful. Our research will focus on the factors that could assist in making the transition a success. In Egypt and Tunisia, industrial production is already what it was at the end of last year. So there is hope despite the crisis. The ongoing European financial crisis certainly does at the moment not help to move to sustainable growth in the Mediterranean region. With the region exporting 60% of its exports to the EU, the European crisis is really holding back the Mediterranean countries.

We also undertook a study on governance and fiscal policy issues. Briefly, based on regression analysis and panel studies, we showed that the percentage of public expenditure on education and health by itself has no great impact on education and health outcomes (literacy rate, mortality). Thus confirming the findings of studies carried out for other regions. But when we combined the level of spending on education and health with a governance index, then it became very clear that in countries with good governance these spending had a favourable impact on health and education outcomes. So, public spending on education and health, without good governance, is a lost cause. It creates a lot of jobs for teachers and health professionals and producers of textbooks and pharmaceuticals, but to achieve good outcomes you need good governance.

Another study carried out by Khalid Sekkat, from the University of Brussels, in the context of our work for the European Commission (MEDPRO), related governance indicators to investment and to trade developments. Again, countries with good governance attract FDI in larger volumes and lead to greater levels of exports. The volumes of investment matter

but so does quality. If there is good governance, the public investment crowds in private investment and stimulates growth. With good governance investment and FDI are much more growth-promoting. The reverse is true when governance indicators are poor, as investment tends to become self-serving, and procurement processes dysfunctional.

There is a wealth of literature arguing that well-managed trade is growth-inducing, particularly when accompanying measures are taken. What are the major impediments for growth, for trade? In the Mediterranean region, despite some exceptions, tariffs are being reduced/eliminated through international and regional trade agreements, and are on their way out. Non-tariff measures on the other hand are prevailing and thriving. The MEDPRO project undertook an analysis for the EC's Research Directorate General measuring the ad valorem equivalent of non-trade barriers. What does that mean? Measuring tariffs is not easy because the database is very deficient but it can be done and disputes on the obtained results are minor when the methodology used is understood. But obtaining the tariff-equivalent of the non-tariff measures is an exercise that has emerged only in the last ten or so years. The numbers the MEDPRO project arrived at suggest that the ad valorem equivalent of non-tariff measures for Algeria is 35%, for Morocco it is 28%, and for Jordan it is 33%. In fact, these non-tariff measures for all the countries included in the study are much greater trade inhibitions than the tariffs themselves. Therefore, I applaud the new initiative of the European Commission, mentioned earlier today by Mr. Olivier de Laroussilhe, to negotiate with a few Mediterranean countries with the purpose of obtaining a commitment to reduce/eliminate selected non-tariff measures. Countries committed to this building down of non-tariff measures will qualify to EC support. This process will require improved governance the selected countries, a willingness to stand up against vested interests. Again we go back to the importance of good governance.

How good are Mediterranean countries at trading? The World Bank has recently published data on trade logistics and trade performance indicators, such as the time it takes to cross the border, the cost of tracking a container and so on. When using these data to rank countries, it is clear that Middle Eastern countries stand out as inefficient. Turkey, Tunisia, and Israel are somehow decent performers, but the other countries are way out on the tail end of the ranking. We went one step further within the European MEDPRO project, using a gravity model which indicates the export and import performance of a subset of Middle Eastern countries under various scenarios with respect to reducing the non-tariff barriers. In an optimistic scenario, we would have all the Middle Eastern countries perform at the average level of trade logistic performance of the region, as not all countries can be expected to achieve the levels of the best performer. Hence we moved the trade logistics indicators of the poor performers up a couple of notches. For this we used the ad valorem tariff equivalent of the non-tariff measures, mentioned earlier. The result of reducing the non-tariff measures would mean that Algeria's exports to the EU would increase by 85% (from a very low level indeed), Morocco's would increase by 65%, Egypt's by 50%. Of course, if they become more competitive vis-à-vis the EU, they would also become more competitive vis-à-vis the faster growing regions like Brazil, the United States, China and so on. So there is a tremendous potential for trade expansion by improving trade logistics. And if you believe that export growth is good for

the country as it stimulates employment and production efficiency, the reduction of non-tariff barriers should receive more attention in future discussions and trade negotiations that it has had so far. The deeper and more comprehensive trade integration negotiations between the EU and some Mediterranean countries are on their way, and the intended support for these policies is the right way to go. We also estimated, using these gravity models, what the South-South rate of trade expansion would be. Again, similar magnitudes of trade expansion were obtained. These orders of magnitude are not precise because such simulations are not a physical science, but they indicate that a deeper integration would be very promising for trade expansion.

Now let me dwell for a minute on ambition and engagement, issues mentioned earlier today by Lino Cardarelli and Samir Radwan. In the afore mentioned MEDPRO project a CASE colleague carried out a study on Turkish customs unions with the EU, where he tackled in great detail in non-tariff trade barriers. Turkey spends hundreds of millions of dollars on customs reform, product standardisation improvements, investing in quality laboratories, conformity assessment and agreements, etc. Much of this was financed with EC support. This was an example of deep integration between the EU and Turkey. I made a presentation ten days ago at a CASE conference in Warsaw on the European Union 2030. I advocated that it may be a very worthwhile idea to broaden the EU-Turkey Customs Union and apply it to the Mediterranean region. This idea has been discussed in several academic papers and in several other forums, so maybe it is worth keeping it on the table. Promoting the deep and comprehensive trade integration that the European Commission is now starting with a few countries, could benefit from keeping this customs union idea in mind when moving to the operational stage of the initiative.



Institutional Economic Reforms

Institutional Economic Reforms

Pilar L'Hotellerie-Fallois.⁴ Deputy General Director of International Affairs, Banco de España, Spain

What I want to do today is to review some aspects of the financial systems and the design and implementation of monetary policy regimes by central banks in non-European Mediterranean countries in order to assess the ideal scope of changes in these areas. But before entering the specifics of financial systems and monetary regimes, allow me to make some comments on the economic performance of the region over the last few years.

The world economy registered a very expansionary period between 2000 and 2007, and this expansion was also beneficial to Southern and Eastern Mediterranean countries. We showed average growth rates between 4 and 5%. The average for the region, including Turkey, was 4.8%, which in absolute terms can be considered a very good result, a very high growth rate. However, when we compare this growth with that registered in the whole group of emerging and developing countries – if I may use this group as a benchmark –, the figure appears to be less impressive. In fact, Mediterranean countries grew around 2% below the average of emerging and developing countries and more than 3.5%, for example, below emerging and developing Asia. During the world financial crisis of the years 2008-2009 and due to the generally limited integration of the region into the global financial markets, the weakening of economic activity in the region was moderate and no country entered into recession, with the exception of Turkey and Libya. And the region also enjoyed a rather intense recovery in 2010. At present, the economic disruptions associated with the political transitions are imposing a heavy toll in terms of growth in the short term in many Mediterranean countries. External conditions are not favourable, especially in the European Union, which is the most relevant partner for Mediterranean countries and, as a result, a sharp deceleration of economic growth will be registered in 2011 and 2012. In fact, according to IMF figures, when a comparison is made between the average projected growth in these two years, 2011-2012, and the average growth during the expansionary period 2000-2007, only Morocco will grow at similar rates, 4.6%. By contrast, for example, Libya, Syria, Jordan or Egypt will grow more than 3 points below the expansionary phase average.

Hence, I think the present context can generally be defined as characterised by slow economic growth, both in absolute terms and in comparison with recent historical perspectives, and this will make it more difficult to manage successful transitions in Arab Mediterranean countries. This difficulty is reinforced by the high expectations of economic improvement that citizens in these countries have for the new setting. Even if in the short term the negative effects of the Arab Spring on economic activity are short-lived, as expected, getting back to pre-crisis rates of growth will not be enough. One of the lessons that can be drawn from the Arab Spring is that the region needs higher growth,

4. The author wants to thank Luis Orgaz and Pedro del Rio for their help in preparing these comments. An edited version of this speech has been published by Real Instituto Elcano, *Challenges for the Financial Systems and the Monetary Policy Regimes in Southern Mediterranean Countries after the Crisis*, "ARI", No. 13, 2012.

comparable to that attained in other emerging and developing countries, and at least enough to prevent further increases in the already high unemployment rates in the region.

There is a second and even more important lesson: the region needs a more inclusive kind of growth, one whose benefits can be spread among citizens and that will allow for improved living conditions and more work opportunities. An essential ingredient to achieve this higher, more inclusive, growth is a new economic reformist agenda, agreed between all of the relevant actors in Arab Mediterranean societies. Of course, in a reformist agenda that will end up reinforcing growth, economic governance is very, very important. Economic governance entails, first of all, the functioning of public institutions, which are direct providers of many goods and services to people. More importantly, economic governance defines the framework in which the private sector operates the business climate as we usually call it. And in this regard, most countries in the region rank particularly low. Economic governance and the way in which rules and regulations are applied also affects how the benefits of economic activity are redistributed among the population. So there is no doubt about the relevance of governance and the need for an ample set of reforms in the Arab Mediterranean countries.

But before touching on issues of monetary policy regimes, which is the aspect of economic governance that I want to address today, let me review some of the key characteristics of the financial systems of the Arab Mediterranean countries and also give some hints about possible improvements in that area, which is intimately related to monetary policy.

The first key feature of financial systems in the region is their limited integration into global financial markets, as I was saying before. This can be seen, for example, in the low level of foreign bank lending, which is much lower in terms of GDP than foreign bank lending in Latin America or developing Europe. The region's banking systems have an overall reduced reliance on foreign funding, which is matched by a loan-to-deposit ratio that in no case goes above 100%. Another dimension of the internationalisation of the financial system is the direct presence of foreign banks, and this is also not very significant in the region, as the share of foreign banks in bank assets is low, with the exception of countries such as Lebanon, Egypt and Morocco, where it reaches 20%.

A second key feature of the financial systems in the region is their limited development, particularly with reference to the level of financing of the private sector. Capital markets play a marginal role, with corporate bond markets still in a nascent stage in most cases. In some countries, stock markets registered buoyant activity in the pre-crisis year, but data on issuance of new shares, the listing of new companies or market liquidity reveal that the stock markets' role in the financing of new investments is generally limited. Accordingly, banks play a very predominant role in the financial sectors of the region and are the main channel of financing these economies.

However, there are strong differences between countries. It is a very heterogeneous region. For example, Lebanon has by far the biggest and most developed banking sector and the rest of those fourteen countries, like Algeria, Libya or Syria, are lagging behind. Banks appear to have a bias to hold liquid assets of government debt rather than lending

to the private sector. And within the private sector, credit to households has shown a growing trend at the expense of credit to the corporate sector. Many private companies in the region have to rely exclusively on retained earnings to finance their investment, and this can mean loss of business opportunities and, on aggregate, lower growth. Furthermore, a risk of the present situation, in which public deficits have grown as a result of the economic slowdown and the increases in public expenditure related to the Arab Spring, is that the increased financing requirements of the public sector may crowd out and reduce financing to the private sector. There is also evidence of a high loan concentration in the region. For example, the exposure of banks to their twenty principal clients in terms of capital is higher than in any other region in the world. The interconnectedness between large, and often family-owned, conglomerates and the pre-eminence of public companies explains this very high level of credit concentration. On the other hand, access to financial services for the population is low, and studies indicate that small- and medium-sized companies find it hard to obtain credit.

From a policy perspective, there are several ways to increase the competition of the banking sector in the region and improve the intermediation role in the private sector. Among these, for example, would be the entry of new domestic and foreign players, or improving the disclosed information or improving the legal frameworks that protect minority shareholders. Policy should also pursue the development and strengthening of the corporate debt market to complement the options for financing productive activity. Of course, the development of local currency bond markets is a long-term task that involves a sequence of structural changes and with macroeconomic stability being a prerequisite, including low and stable inflation. The establishment of a robust market infrastructure, including creditor rights and sound regulatory and supervisory systems, is also needed, and a well-developed local market for public debt that provides a benchmark and strategies to broaden the domestic and foreign investor base can also help to consolidate this source of finance for local firms.

In any case, I have to say that Arab Mediterranean banks are generally well-capitalised and have good profitability, which are two very positive features that have to be emphasised from a financial stability perspective. The main problem of the banking sector in this regard is the legacy of a large stock of non-performing loans. Although some countries have managed to reduce the structurally high levels of NPLs, they still account for more than 15% of loans in countries like Algeria or Egypt, and in some cases the levels of provisions are low. Asset quality is really a concern, as the present economic slowdown can add pressures in this field, and efforts have been made in recent years to control this problem, speeding the procedures, for example, for realising collateral or injecting capital into a state company so that they will be able to repay their loans. But there is still need for further improvement. More generally speaking, there is still scope to make further progress in strengthening the capacities of bank supervisors, which in the case of Arab Mediterranean countries are mainly the central banks. In this regard, complete compliance with the Basel Principles for Governance, Resources and Operational Independence is paramount, as well as complying with the Basel Capital Framework.

So let me turn now to monetary policy frameworks. It is well-known that there are no conclusive theoretical or empirical arguments to choose one monetary or exchange rate regime as optimal over another regime. The best framework for each country depends on

its own peculiarities and, for historical, political and economic reasons, in the Eastern and Southern Mediterranean region most countries follow what we call a managed or fixed-exchange-rate regime, while floating exchange rates have been, until very recently, the exception. Just in the case of Turkey, for example, there is an inflation-targeting framework with floating exchange rate. For the same historical and political reasons, most of these exchange rate regimes are oriented towards the dollar, although the euro has been gaining relevance due to the trading of some of these countries. For example, Morocco and Tunisia obviously have very important trade links with Europe. Also, in order to keep the fixed exchange rates, most of these countries have maintained controls on capital movements and have intervened heavily in foreign exchange markets.

Well, this broad picture has been subject to slow changes in recent years, and somehow countries in the region have modified their monetary policy regimes, introducing greater exchange rate flexibility and capital account liberalisation. Some of them, like Tunisia or Mauritania, moved from a fixed exchange rate to a managed floating exchange rate regime. Others, like Egypt, widened the fluctuations against the anchor currency, and they have also modernised their monetary policy instruments and have strengthened the independence and transparency of their central banks. But while fixed exchange rate regimes have yielded substantial benefits in terms of monetary policy credibility, price stability and disciplinary effects on other policies, they have also faced important challenges in recent years as a result of increased inflationary pressures. It has been so mainly due to commodity prices, but also due to buoyant domestic demand in a world that is more global and in which they receive more capital flows. So in some sense these countries have been confronted with what we call, in Central Bank argot, the “Impossible Trinity,” which states that you cannot have, at the same time, a fixed exchange rate, free capital flows, and independent monetary policy.

In this context, managing the fixed exchange rate in some of these countries and controlling inflation has been increasingly more difficult and, as a result some countries, such as Egypt, Morocco and Tunisia, are planning to adopt, or at least were planning to adopt, inflation-targeting regimes with more flexible exchange rates, in order to focus on domestic policy objectives. This shift toward more flexible exchange rates and the eventual adoption of inflation targeting is in line with the trend that we have observed first in advanced economies and later in emerging markets over the last few decades. In the case of emerging countries, the currency crisis that we saw very often in the mid-1990s led many of them to the practical abandonment of exchange rate targets in favour of more flexible currency regimes. In this context, the search for a nominal anchor, led by the adoption of inflation targeting, which had already been successfully tried in advanced economies, was a framework adopted by a growing number of emerging market economies.

Latin American experiences are a case in point here. Many countries in the Latin American region switched from exchange rate targeting to inflation targeting between 1999 and 2001-2002, and we now have five inflation-targeting countries in Latin America: Brazil, Chile, Colombia, Mexico and Peru. Some of them have abandoned the exchange rate due to speculative attacks. For example, Mexico did so after the Tequila Crisis. But others

did so pre-emptively, for example Chile and Colombia. In many ways, inflation targeting has been very successful in Latin America, as is reflected in the reduction of inflation to low single digit rates in recent years, despite some challenging periods and exchange rate depreciations. It is important to highlight that inflation targeting in Latin America has always also kept an eye on the evolution of the exchange rate. In contrast to advanced economies, they have also significantly increased the international reserves and implemented other macro prudential measures to stem financial excesses, including capital controls. These elements, capital controls, the building of reserves, which were conceived as temporary devices in the transition period to the new regime, have been very useful for preserving financial stability during the crisis, and have become more permanent elements of inflation-targeting frameworks in Latin America, in what has come to be known as “Inflation Targeting Plus” (IT+).

More generally, empirical studies have shown that the adoption of inflation targeting can bring considerable gains to emerging markets, not only in terms of this inflation, but also of anchoring expectation and ensuring central bank independence and accountability. However, it must be clear that adopting an inflation target is not a panacea, and the soundness of other economic policies and rigorous and financial supervision are essential to maintain economic and financial stability. Indeed, I think one interesting aspect found in the empirical literature is that inflation-targeting central banks in emerging market economies tend to miss their targets by far more than in advanced economies. One of the reasons for this can be due to the impact of external shocks, often exacerbated by capital inflows.

The experience of Turkey, for example, in the Mediterranean region, is an example of difficulties and limitations of the inflation-targeting approach. This economy was hit by a series of external shocks that prevented inflation from staying within the announced targets. It is a useful reminder that in a challenging global atmosphere, the conduct of monetary policy becomes more difficult and it must be supported by a broader set of sound economic policies. Moreover, the adoption of inflation targeting is quite demanding in terms of economic, institutional and technical aspects. Without entering into the theoretical requirements or criteria of adopting inflation targeting, there are a number of critical elements that must be put in place, to a sufficient extent at least, for a successful adoption of this kind of monetary policy regime: central bank independence, fiscal soundness, deep and stable financial systems, a well-functioning monetary policy transmission mechanism, and technical capacities. Of course, some of these factors are not specific to inflation targeting but are also very important ingredients of any monetary policy regime.

In particular, I want to stress that the development of financial systems and markets is crucial to support the transition to a monetary policy regime based on inflation targeting. Deep and stable financial markets, as well as a sufficiently developed set of monetary policy instruments, are needed for the appropriate functioning of the transmission mechanism, which means that central bank policy rates are effectively transmitted to the financial conditions of households and firms and affect their saving and investment decisions. I think that countries in the Mediterranean region planning to adopt inflation

targeting have made important advances in some of these areas, but a number of impediments still remain, and I think this requires transiting to exchange rate regimes, to inflation-targeting regimes, in a gradual sequence.

Finally, I would like to make a couple of remarks taking into account that the inflation-targeting framework is also subject to reconsideration. It is not a fixed framework for monetary policy but it is also subject to reconsideration in the aftermath of the global financial crisis. On the one hand, the possibility of separating financial stability and price stability objectives, which is at the basis of strict application of inflation targeting, has been put into question. Central banks have been called to rethink their exclusive focus on inflation and the failures to account adequately for financial sector risks. The recent world financial crisis has made it clear that financial stability is of vital importance and that supervision at the micro level of each individual bank has to be completed with a macro approach to detect and prevent the building of systemic risks. There is no doubt that central banks have to be involved in this new macro prudential approach, although the precise way in which this involvement should take place is still under discussion. In the Mediterranean countries, as in the rest of the world, due consideration for financial stability matters and how to better integrate, institutionally, this macro prudential function is going to be essential.

The pre-crisis consensus view that monetary policy should only react to asset price shocks if they affect inflation prospects has been broken. Now it is widely accepted that central banks should at least lean against the wind of asset price bubbles. So we are probably heading towards a future in which central bankers have to optimise the use of different policy tools to achieve multiple objectives and all this argues for a flexible and wider inflation-targeting regime that takes all of these issues into consideration.

Another lesson from the crisis is that central banks should be more aware of the spill-over effects that their actions have on other countries, as well as the repercussions of central banks' actions on the actions taken by other central banks in their own economies. You may remember the so-called "currency war" one year ago, which originated because non-conventional monetary policy in the US was supposed to cause strong capital inflows into emerging market economies and commodity markets and this threatened the achievement of their policy objectives. In fact, cross-border effects can be very important and can very much complicate the management of monetary policy, and this raises the need for international coordination of policies and means that central banks, especially those that are big and located in systemic countries, should internalise the effects of their policies.

I think that the challenges in the transition to a more advanced policy regime are important in all regions and all countries, and experiences in other countries can be of use. But, obviously, because the international and global framework is changing, new issues will arise that will have to be tackled for the first time.

Rania A. Al Mashat. Assistant Sub-Governor and Head of Monetary Policy Department, Central Bank, Egypt

Before I discuss what the panel is designed to address, namely “strengthening institutional capacity”, I would like to highlight the challenges that faced the Central Bank of Egypt (CBE) during the revolution and describe the measures undertaken to mitigate them. Most of these challenges were also echoed in the Tunisian case. I know that Governor Nabli was supposed to be here, so many of the challenges that both central banks faced are worth highlighting.

Before I talk about the 1st quarter of 2011, I want to take us back to the 4th quarter of 2010 because it is important to characterize the initial conditions at the outset of the revolution. Egypt entered the revolution with a very comfortable cushion, a by-product of monetary and fiscal reforms implemented since 2004, which provided support to the central bank and the government over the past fifteen months. In the fourth quarter of 2010, we were complaining about two things: first, structural surplus liquidity in the banking sector, and capital inflows which were too much for us to handle. At that time, I actually visited the European Central Bank (ECB) to discuss the sorts of instruments the ECB introduced when faced with the same market developments, basically structural liquidity and capital inflows. Moreover, the fourth quarter of 2010 was when the IMF and other institutions took an unconventional stance and started talking about the possibility of imposing capital controls. So this is really where we were at the time. We entered January with a lot of liquidity in the banking sector, as well as a very comfortable cushion of international reserves.

On the 25th January, the first Tahrir gathering took place. We had a monetary policy committee on the 27th. Everything was normal on the 25th, 26th and 27th. The 28th was really when the revolution started, in my opinion. This was followed by the closure of the banking system for a week. For any central bank, political uncertainty is its biggest enemy, and to us it was unclear how the security situation was going to evolve and the possible repercussions were not fully foreseeable.

The banking sector was shut down for a week on the back of the deteriorating security situation and the damage that happened to the ATMs. It is important to bear in mind that Egypt is a very much cash-based economy where not everyone has access to credit cards. This implied that once banks were open, queues of people in front of banks for cash withdrawals was expected to withdraw cash. Hence, for the CBE the first order of business was to ensure that banks had enough cash in their vaults. And when I say banks, it is not just banks in Cairo, but all over Egypt. In the absence of any police, how do you get this legal tender to the different branches? We used military tanks to take the cash to the airport, and then helicopters to basically take the cash from the airport to the governorates around Egypt. The public sector banks played a very important role in basically availing their branches, even for other banks that were closed during this period. This was a very important experience during the revolution and it was key for the central bank to be pre-emptive to face excessive cash withdrawals because if a citizen goes to a bank and asks for 1,000 pounds and only gets 50, this could definitely trigger a bank run.

When you look at the statistics you find that currency and circulation in the month of February 2011 was the highest in Egypt's history: 22 billion Egyptian pounds. Part of it, of course, came back because people were not sure when this was going to end. Everyone was basically hoarding as much cash as possible, not knowing whether or not banks were going to be closed again. So that was the first challenge, and thankfully it went very smoothly. I remember going to the bank on that Sunday once we opened – the central bank is downtown – and I could see queues in front of the banks. That was on Sunday. On Monday, the queues were shorter and on Tuesday there were no more queues. So that, again, was to instil confidence that the central bank was capable and able to meet the people's needs. It is very important to tame people's expectations in these very critical moments.

The second point was extremely challenging and actually annoying to a large extent: you are closed for a week and then every investment bank around the world is giving projections on the Egyptian pound. The estimates ranged between 20 and 40 devaluation. There was a race among economists to try and guess the level for the Egyptian pound. In 2004, as part of the reform programme, we introduced a foreign exchange market for the first time in Egypt's history. And the central bank had faced many shocks between 2004 and now. There was a terrorist attack in July 2005; there were regional stock market crises in the summer of 2006; there was the global financial crisis in 2008, and along with these different crises the key objective of the central bank was to ensure that the foreign exchange market continued to function in an efficient and orderly manner such that people's foreign exchange needs was always met and that foreigners can come in and take their cash out. Egypt had not previously imposed capital controls, and it was very important for us to maintain that and ensure that the market itself functioned in a very smooth manner.

With all this fear that the pound was going to lose value, and so on, as a central bank we had to consider the public's reaction once the markets open. We had two clients: first, the domestic clients, and then international clients. As a central bank – very keen on making sure that our relationship with foreign investors continues beyond the revolution –, we did not impose any capital controls on investors who wanted to basically take their cash and leave, either from treasury bills or from treasury bonds. The stock market was closed for other reasons. We were actually opposed, as a central bank, to its closure. We felt it was a very bad move, but again that was the decision taken by the stock exchange. So at first we did not impose any capital controls on foreign investors. However, we did impose restrictions on Egyptians. This was again to tame expectations and give people the opportunity to test the market. This was very important. So we imposed limits on how much cash you can withdraw per day: 50,000 Egyptian pounds per day (10,000 US dollars per day) from your account. And these were considered temporary measures for two purposes: we wanted people to test the markets, so you go to the bank, withdraw your cash, and change from dollars to pounds. You test the market, you are comfortable, things are fine and therefore, as a central bank, you basically tame this panic that could have taken place.

The other reason why we imposed these controls is because there were so many legal cases against people in the old regime. This led us to limit the transfers of cash until the legal and judicial system basically resolved these issues. There were so many people on this list; we had to freeze their accounts. So that was the second challenge that we had to face, trying

to tame people's expectations with respect to this panic and knowing the forecasts or predictions of what would happen to the exchange rate.

The third point, which was very important, was capital leaving the banking sector. All the surplus liquidity that we were trying to get rid of suddenly slowly started to exit the sector. We had a very similar situation to what happened after the global financial crisis in Europe, where you had interbank rates increasing. And as a central bank what we did was to open a repo facility in March which was basically a way to allow banks to transact with each other to bring back the interbank rate to where the central bank wants it, or to the operational target.

These are the three key challenges that the central bank faced right after the revolution. Of course, the capital outflows that we witnessed led to a drop in the foreign exchange reserves. However, it is important to put some context to this, our discussion with the IMF on a possible program had started in March 2011. As a central bank, we knew that we were drawing down reserves, but we had reassurances from the G8 Deauville Summit in 2011, and from the IMF, so for us it was all temporary – and by knowing it was all temporary, we managed. We knew that there was going to be this lifeline coming, seed money, which would be put in by the IMF. With this vote of confidence, investors would come back in. So in terms of the CBE's information set, if you ask if we were time consistent or not, these were the parameters we were working with at the time. Therefore, the drawdown in reserves to us was seen as a temporary solution because in the near future we were going to receive a needed influx of foreign exchange again.

It is important to also underscore that this was a period of crisis management. Far from tranquil times where fundamentals take center stage. Each and every day there is new information on the table, and as a central bank we have to be extremely pragmatic trying to weigh all the tradeoffs and using our best judgement to make a decision. Maybe history will say it is not correct but this is the best we can do given the situation. For example, some had been arguing that the Egyptian pound is overvalued, and if the pound were to depreciate tourism would increase again. Our response was that "Even if the pound depreciates by 50, would tourism increase in Egypt today?" Tourism had dropped on the back of the deteriorating security situation.

Going back to today's panel. When I think of inclusiveness, it is not just that the marginalised get opportunities. It is that everyone has a chair at the table and is involved in the discussion. And the top-bottom approach that was there before is not going to work; and the bottom-up is also not going to work on its own. This is going to be learning by doing. It will take time. We have discussed the fact that transitions take time. Nonetheless, there was something else mentioned in this discussion, which is that government institutions provide public goods, and a central bank also provides public goods. The public good that the central bank provides is the stability of the financial system. It provides the overseeing of the banking sector and a stable monetary system. This is how we should see the role of the central bank after the transition or during the transition.

I am going to summarise to some extent how I see this role, in five points. Number one, there needs to be a choice of a nominal anchor. Pilar L'Hotellerie-Fallois mentioned

inflation targeting and experiences from other countries, such as Turkey or Brazil. The one thing that is very important is that these countries moved to inflation targeting after a crisis. When I went to Egypt in 2005, the idea was to actually implement inflation targeting in a couple of years. And we introduced many reforms both operational and institutional as well as strengthened capacity building within the central bank, but it is very important that inflation targeting does not start and end at the central bank. It is a holistic process. You need the fiscal authority to be on board, you need competition policy to be on board and you need agricultural policy to be on board when 40% of your CPI is basically food. So you need to invest, not just in what you do as a central bank, but also macroeconomic management has to be more coordinated. This is extremely important.

Between price stability and inflation targeting, I would prefer price stability because inflation targeting can take on different forms: it could be a point target, it could be a band. I remember that we had a coordinating council for monetary policy in Egypt, where we had an implicit target set collectively between the government and the central bank, and this target was supposed to be confidential and not announced. And then, suddenly, the Prime Minister decided one day to announce it in the press. So we had everyone calling the central bank: "So is this the inflation target that you have?" What are you supposed to do? The Prime Minister had said it. So I said, "You know, even if it was, he did not mention a horizon, so it can be the target for five years or even ten years." So basically his statement was void of substance just because the horizon was not mentioned. So again, there needed to be a choice of a nominal anchor.

Achieving price stability is extremely important. We want to increase employment and we want to have more investments. An investor needs to have certainty, to have a horizon whereby the investment decision or the consumption decision become clearer. The idea that you are able to reduce the uncertainty related to relative prices and help, promote and support investment decisions is extremely critical. And if it was critical and important before, it is even more critical and important now. There are many efficiency and economic gains that come from having a framework that is basically well-known and advertised, and price stability is definitely important. Another issue that is mentioned over and over again is that Egypt needs a minimum wage. What does a minimum wage mean without knowing what the inflation rate is going to be in the next twelve months? There has to be this tie-in, because certain concepts are mentioned as an absolute. Would 1,000 pounds be enough? Would 2,000 pounds be enough? Maybe not, if my inflation rate every year is 20%. So, again, that is where the price stability comes on board. When I say the top-bottom and bottom-top, you need to have buy-in from people. So this price stability mandate is not just something that the central bank decides on, but where everyone basically agrees to see it as an important objective.

Something else which is also very important going forward is that we need to avoid time inconsistency from the central bank side. The central bank should not have at its discretion the choice to basically increase or follow expansionary policy, to increase employment in the short term, at the expense of longer-term price stability and employment gains. So this is very important. And how you basically avoid this time inconsistency is by institutionalising this commitment. How do we institutionalise the

commitment? Today, in different countries, we are discussing the Constitution and all its different elements. Maybe the Constitution should have central bank independence explicitly mentioned. Again, when we talk about the institutional commitment, we always wonder if the central bank should have goal independence, instrument independence or both. In a situation where employment is very important, where we need to discuss not just the growth rate but the quality of growth to ensure that everyone gets part of the pie, I believe that the government should have goal-setting powers. For example, the government sets your GDP target. And the central bank has its instrument independence to achieve that goal. Remember that the government is supposed to be an elected government, representing the different people, so when they come up with a growth rate or with an economic plan it is one that takes into account what the people have voted on or accepted.

When you institutionalise what needs to be done, the central bank cannot goof around. The public can basically exercise control on what the central bank does, evaluate what it does, and therefore this commitment to a target or to a mandate or to price stability becomes extremely important. In addition, institutionalising the commitment would also help us mitigate time inconsistency. You would not be at leisure as the central bank to basically decide today that employment is more important than price stability and so forth.

Something else which has been lacking in the past, and I think is very much in line with governance, is accountability. You can have the institutional commitment but without the accountability and without the mechanisms by which you hold government responsible – or the central bank for that matter – is basically futile. And again, this is learning by doing and it is a process. If I take our colleagues in Greece for example, they have been a democracy for a very long time, but the government goofed around and look at where they are today. There is no guarantee that the process is going to be easy or that it will deliver, but we have to start somewhere and a way of basically institutionalising this accountability is to have periodic reporting systems. Part of our IMF programme was to finally publish our inflation report. And I think it is very important. It creates this awareness among the public about what inflation is, and where the sources of inflation are. I always tell the governor that if we publish our inflation report we create jobs because everyone is going to hire an economist to basically try to decipher what messages the central bank is giving. So actually that is one way I think of doing it: it is a job-creating tactic from the central bank.

The other could be testifying in Parliament. We need to get the parliamentarians to understand what sort of work we are carrying out. Something very similar to what we see the Chairman of the Federal Reserve doing in the United States. When you are transparent, you actually align people's objectives to where you want to be as a central bank. I believe very much in central banking. The word "ambition" has been mentioned in the discussion. I believe that the region has it, and I talk about the Central Bank of Egypt. We have a lot of resources. We have excellent people who are able to do things with their own hands. We have fantastic relationships with other central banks around the world. For example, our forecasting model was done in collaboration with our Czech colleagues, and we are actually presenting that soon at the IMF with modellers from the research

department. There is plenty that has been accomplished. We need to build on that. We need to build on that in a more consistent manner. We are not reinventing the wheel. Central banking is out there; experiences in Turkey and Latin America are vast. I am very hopeful that maybe, going forward, some of the things that impaired us in the past – particularly when it came to seeing eye-to-eye with the different departments in government to stand on a common ground – will cease to exist. For example, we had an economic committee meeting in the cabinet last week, and the point I was making is that each ministry has its own objective. That does not work. We need to have a social planner that basically aligns these different objectives. A goal like price stability, for example, is important since meeting a certain inflation target for minimum wage and meeting it ensures that enough products are available in the market. The eradication of monopolistic practices is also important since it is these practices which push prices up. I think that having a clarified objective for the central bank is not just good for the central bank; it is very good for macroeconomic management. This is very much needed in the period ahead to try and overcome lots of the problems we mentioned, particularly unemployment, poverty, inflation and encouraging investments, which are very much needed. Whether they are private investments, domestic investments or foreign investments, investors will only come when the macroeconomic environment is stable and predictable. And that I think rests on the shoulders, not just of the central bank, but of the government as a whole, and in the end maybe the democratic process itself could actually bring this to the fore and push us forward.

So to sum up I believe the central bank's contribution during the transition should be (1) choosing and communicating the nominal anchor; (2) avoiding the time inconsistency problem; (3) ensuring the existence of the institutional commitment; and (4) ensuring the modalities of accountability are put in place.

Gülsüm Yazganarikan. General Director of Economic Research, Under-secretariat, Turkish Treasury, Turkey

I would like to talk about our experience, the Turkish experience, of the reform process. When we look at the successful reform efforts of most countries we see that they started from some political or economic instability. We can say that there are push and pull factors for the reform process. Push factors are political and economic instability, and pull factors could be the membership process of the European Union or IMF-backed programmes. When we talk about the push factors, in the Turkish case, we had experienced some volatility in the financial markets; we had high inflation rates, volatile growth rates, high public sector debt and deficits. These factors accumulated and they resulted in a crisis. Economic instability feeds political instability, and vice versa. Coalition governments or multiparty governments in Turkey are short-lived. So it is very important to have a majority government to have a successful reform process. As I already mentioned, as pull factors we can include the EU membership process. Turkey is in an EU membership process and, in order to fulfil the membership requirements, you have to have a well-functioning market economy and you have to have the capacity to cope with competitive pressures. And these requirements mean that you have to change your system, your institutions, and your mechanisms in the economy. So these are the main roads to our reform efforts.

In 2001, Turkey experienced a financial crisis. The interest rate increased, the exchange rate devaluated significantly, and after that crisis we established a comprehensive reform programme, backed by the IMF. The main ingredients of the programme were that we establish fiscal discipline, central bank independence and some structural reforms. These structural reforms covered public sector reforms, financial market reforms and private sector reforms.

Thanks to fiscal discipline, we decreased our budget deficit significantly. We reduced our expenditures, we settled our wages according to targeted inflation and there was a new law bringing transparency, accountability and control to the system. The state economic enterprises were very inefficient before 2000 and we have now reformed most of the state economic enterprises through privatisation. When we come to the monetary policy side, the central bank was made independent and free to choose their policy instruments. The central bank set an inflation-targeting policy, which set implicit targeting. We had implicit targeting between 2002 and 2005, and then we explicitly announced our inflation rates after 2006. The target is set within a band of plus and minus 2%. If inflation realisation falls outside the band, the central bank must write a letter to the government and explain the reason why it has fallen outside the band, and this is made public.

There was a committee at the central bank, made up of the Governor, Vice-Governor and two board members, who determined the policy instruments. The target is set with the government and the central bank. They announce their programmes, the central bank reports to the public, and the summary of committee meetings can be shared with the

public. The main policy of the central bank is to settle price stability, with the policy rate being the main instrument. But now the central bank is, at the same time, focusing on financial stability, because after the global crisis, the abundant capital in the market flowed mainly to emerging countries. Emerging countries faced with a high appreciation and balance sheet structures should be watched carefully. Therefore, this threatened financial stability in the country so the central bank changed the policies. Now the central bank is using policy rates and also other monetary policy tools, such as required reserve ratios and interest rate corridors.

After the crisis, our central bank became independent and we changed our exchange rate regime. It is now flexible and I think it is also important to cushion the fluctuations in the market. So we have had a significant financial sector reform. In 2001, our crisis resulted from a weak banking sector. After 2001, there were reforms in the three sectors. The state banks, for example, were capitalised. Government provided bonds to those banks, and some of the private banks were taken under savings insurance and deposit funds, and in some way nationalised. Eight private banks were nationalised and they were dissolved by sales or mergers and termination of their activities. So after 2001 we cleared the bad banks. There were no weak banks in the system. So the banking system became strong. We also established a banking regulation and supervision agency and this agency watches over the banking system very carefully. Since 2002, we have had a strong banking system and, in 2009, when we had the global crisis, Turkey's banking system was not affected. I think Turkey was the only country that was not affected by the financial crisis. When we look at the position of the banking system among the emerging countries, we can see that Turkey is one of the strongest, because of the supervision facilities. We followed our financial system very, very closely. This is very important in order to prevent the systemic risk that could take place in this environment.

The financial system became strong and the public sector deficit declined significantly. Public sector deficit was around 12% in 2001 and now it has come down to 1% or 2%. Public debt stock was around 70% and now it is around 30%. So, the inflation rate declined significantly – because with a majority government, markets trusted our programme – and public deficit and debt declined because interest rates decreased. We have improved the private sector role, we privatised most of the state economic enterprises and we improved our investment environment by changing certain laws.

To summarise, I would say that autonomous institutions are very important. The role of the government should be minimised but the government should play the role of controlling the market. Transparency and accountability are also very important and we should carefully watch the leverage ratios of the sectors, especially foreign currency and fixed debt stock. In addition, the balance sheet positions of the sectors are also an important aspect to take into account.

Alexander Böhmer. Head of MENA Programme, MENA-OECD Investment Programme

We have new scenarios for governance reforms and institutional public management reforms in the region. The OECD through its MENA-OECD initiative has been working for a number of years on these reforms. I would like to simply make a few points which might also be interesting for the discussion. We have a new scenario with three changes. First of all, this is very welcomed, as we can address issues very openly now. This was not always the case. We do not need to talk about transparency; we can talk about anti-corruption policies. Secondly, the cycles of governance reforms will be shorter. We will have democratically elected governments who have a shorter time frame for instigating reforms and this gives a new political economy background to our reform initiatives. And thirdly more stakeholders have to be involved. The Parliament plays a serious role now, and so will businesses associations. Trade organisations, labour organisations – as we have seen in Egypt – will particularly play an important role now in defining the institutional environment of governance reforms.

It was mentioned before that, although growth rates in the MENA countries were good until 2008 – investment flows had enhanced greatly – there was still, if compared to other countries, not a high level of private investment in the region. The private sector responded less to a relatively stable macroeconomic environment and relatively advanced business climate. Countries like Morocco had started to reform their business climate already in the 1980s. So the big miracle was always: what makes investors hesitant to go and invest? What makes businesses hesitant to really start operating in the region, as they did in other regions? If you look into the governance-related benchmarks, the normal business climate, you will see that three of the Deauville four countries – Turkey, Malaysia and so on – are not doing so badly in comparison to other countries, so that did not seem to be the answer.

Over the years, we have conducted a number of more comprehensive business climate assessments and governance assessments with a number of countries in the region and we always ended with key findings. The first and foremost was the reason why private investment is still relatively low. The reason why businesses are not reacting to policy reforms as they do in other comparable countries has a lot to do with the unpredictability and lack of transparency of the environment. Now this sounds very broad as a finding, but it is very specific. It means that licensing for foreign investors as well as for domestic investors is very unpredictable. It means that tax inspectors have a lot of discretion to do their work. It means that portfolio investors, who invest in companies operating in the region but hold only a minority share, have no protection of their investment. It obviously means that intellectual property rights, and contract enforcement in general, is an important issue. So a lot of institutional governance factors lead to this hesitation at the end of the day, and this was a major outcome from a number of surveys we conducted.

Now, what does that mean for the future governance reform agenda in which many institutions, from the World Bank to the UNDP, the EIB, the OECD and others are involved? We would probably recommend that it is very important to consider private

sector development and investment attraction as management of public institutions. And it is also important to focus on a number of key public-private interface issues. One of the key findings of our survey in Morocco was that the number one obstacle for businesses is the judiciary system. The reform of the judiciary system in my own country is taking a generation. It will take some time for countries in the region to do that. Measures should be taken to embark on it, but for an immediate impact, given the fact that reform cycles have to be a bit shorter now, we recommend focusing on a number of key public-private interface issues. The one most related to what has been presented here is the collateral regulation: the introduction of collateral law, the stabilisation of creditor rights, which gives investors the feeling that investments made can be recovered, even in cases of insolvency.

Another area we are working on is public procurement reform. Let's be realistic: the state will continue to play a major role in MENA economies, so a lot of business activity at the end of the day results from public state tenders. Inspection reform is also important. Tax administration in Egypt had started a big reform under the previous government, with one of the targets being to reform the tax inspections, which was a major cause for companies to stay in informality. That is a very important reform measure on the public-private interface.

Third, onerous licensing requirements. Obviously this is one of the key issues that come up in company surveys. Licensing requirements may fulfil every single available public interest and the public purpose, but the totality of them can be stifling for companies, particularly if they are related to transparency issues. Countries like Egypt have addressed these issues by setting up one-stop-shop, where officials from different licensing authorities come together and have real licensing authority. An enterprise can get its clearance in a day or two. But it also has customs border administration simplification processes, and the work that the OECD is doing on regulatory reform can be very useful here. We have a number of projects on these issues in these countries.

Finally, contract enforcement. Contract enforcement reform requires, at the end of the day, a reform of the judiciary system. That is a long-term issue. Short-term measures can be the installation of commercial courts. We have supported that in a number of countries. In a way, you are creating a kind of "n-class" in the judiciary system where well-trained judges, trained in modern commercial law, can administer commercial law cases in a faster way than the overall system. That in itself removes a big worry from the business community which is that contracts cannot be enforced.

I will end with the market openness topics, particularly highlighting the role of competition policy, which should now be at the forefront of public-private interface reforms in MENA. We have a nucleus of very nascent competition authorities in the region. The Egyptian Competition Authority has been set up, only in the last few years, and has started to operate and generate cases only recently. The OECD Competition Committee has conducted a review of the competition situation and has come up with a lot of recommendations here. This is also a big legitimacy topic for new leaders and reformists in the country. The cartels and the clientele which also came from big businesses was a

major cause for the Arab Spring. And addressing this in a functional and transparent way through enactment of competition policy would be a key recommendation.

To sum up, it is a big chance to really work, openly and directly, on governance reform issues. However, the targets and projects should not be overambitious. There are many new economic policy factors which have to be taken into account now, and that requires focus.



Macroeconomic Policy Reforms

Macroeconomic Policy Reforms

Marcos Bonturi. Deputy Director of Global Relations, Expert in the MENA region, OECD

First of all, I want to say that the changes that are going on in the region fill all of us with humility. I think that should really be our first approach. We have to be humble. Humble to understand the challenges that they are facing, humble in admiration of the courage that many people in the region have shown. This has generated enormous good will from the international community and we want to put it into something very specific in supporting the transitions in the region.

Each transition is different. Transitions in other parts of the world ten years ago, twenty years ago, or thirty years ago, were very different but, of course, there are lessons that can be learnt from the mistakes that we made, as well as the things that were done well. One thing to keep in mind when we think of the Arab transitions is that they have their work cut out for them because they are experiencing transitions in the middle of a major worldwide economic crisis. That does not help, so let us also keep that in mind when we talk about the transition. Our role is to provide advice and I think when we do so it is also very good to remember that advice is just that. The people in the region know what is best for the region. They will have to make their decisions; they have to find their own path of reforms. And our role is to show the possible consequences, from experience, of the different decisions that they themselves will have to make.

I think there is a consensus that should link all the different policy areas: reforms in one policy area reinforce the reforms in another area. We mentioned the economic and social areas but we did not mention the environment much. This is also something to keep in mind alongside the political issues and how political legitimacy reinforces economic reforms. So we can have a positive effect on each other. This linkage is very much recognised in the context of the G8 Deauville Partnership, for instance, which created a two track approach. One is led by the ministers of finance, which is called the financial track or economic track. The second is the political or governance track, which is led by the ministers of foreign affairs. So this whole linkage between the different policy areas is very much recognised by the international community.

I am not going to speak much about the macro. I think we had a very prominent discussion just before this one. I will only say a couple of very minor obvious things, but they need to be said. No country has succeeded in developing over the long term without macro-stability. Some of the short-term solutions can be very costly in the long term so this is something to keep very much in mind. But let me focus on a couple of other points. First, let's concentrate on the social area. I do not think we have discussed this enough. Arab societies are among the most unequal in the world; that is the starting point. There is an obvious need to achieve more inclusive, and thus sustainable, growth. There was a mention here of the European social model and a fully-fledged social safety net; again that is one model. Maybe it is realistic to think of something that countries in the region can aspire to in the medium to long-term future, but it is not going to happen overnight.

There are, however, some interesting experiences of very successful, cost-effective, very well-targeted social policies in different parts of the world. And here, on social policies, it is interesting to see that the best practices do not generally come from the wealthiest countries, they come from other parts of the world. On social policies, we have, for example, the Latin American experience with conditional cash transfers. The programmes like *Oportunidades* in Mexico or *Bolsa familia* in Brazil are now being repeated in Sub-Saharan Africa. It is, again, for us, a very interesting experience that the countries in the region can perhaps look at the pros and cons. But those are programmes that are targeted at households and with very small stipends, conditional on action by the families in keeping the children at school or having medical check-ups and vaccinations and so on. But this is perhaps one thing we should look at; very, very efficient, very, very cost-effective. Most of those programmes cost less than 1% of GDP and have a huge social impact. Beyond the social impact, they are also having a huge economic impact in creating a critical mass of consumers that then help generate jobs and so on. Again, just an idea on social policies that one should consider.

Moreover, related to social policies, we have the issue of subsidies. Many countries in the region maintain subsidies, be they on food, fuel or some public services. That is something that, of course, has a huge impact on the budget in the region and perhaps the region would be well-advised to look at examples like Indonesia. Indonesia is one country that had a huge subsidy on fuel and it dismantled it and replaced it with a very well poverty-targeted set of subsidies. Basically, if you subsidise fuel you are subsidising the people who consume lots of fuel, who are generally not the poor. So by subsidising fuel wholesale you are generally not targeting your social policies very well, something that perhaps should be changed. There is a budget impact but the social impact must also be manageable.

The only policy, of course, that leads to a permanent reduction of inequalities is education. If you think of the fact that in the region you have huge unemployment, but more importantly the fact that you have huge unemployment of skilled workers, perhaps there is something wrong; that there is a certain mismatch of the skills that are being produced in the education system and what is being demanded by the job market. This is something experienced in many, many countries on skills and education. We have been working very closely with the World Bank in Egypt on education, but again there are many, many areas. The OECD has a programme called PISA. The best-performing education system in the world was Shanghai. It was not Finland, it was not Korea: it was Shanghai. And they came from really far behind and now they are the best-performing system. There are lots of lessons that can be learnt.

Next, there is the issue of labour markets. It is very important to see how they function, whether they are a factor for reducing inequalities or increasing inequalities, and of protecting workers in the formal sector but leaving out those in the informal sector. This is something that perhaps countries in the region can also look at. There are lots of experiences from other parts of the world.

Last but not least, on the issue of social policy, the role of the tax systems. Tax systems in the region have not been a major factor in reducing inequalities. And that is perhaps

something people in the region can examine: how to implement better tax systems, not only the design of the taxes but also the issue of tax administration.

I am not going to go very deeply into the issue of private sector development and investment because this was discussed in the session just before us. But I will just say a couple of things. Trade opening is, of course, good in itself, but when countries start approaching different partners they should think of trying to be as polygamous as possible. They will not have to choose, there are no choices, you can trade freely with everybody and I think they will be well-advised to have as many partners as possible. And some partners, of course, are more obvious than others and more complementary than others. However, it should not be a problem for them that they are trading with everybody. They should also try to use the opportunities to open their markets to your exports. I think that is obvious, but it needs to be said.

We talked a lot about business climate and I do not want to go into that, but there is one area I want to talk about in the private sector that perhaps you have not discussed very much. This is the issue of entrepreneurship and how it leads to innovation. This is the main source of productivity growth. The only permanent source of productivity growth is if you have a society that innovates: a society that creates firms, a society that nurtures its SMEs. And we have heard little about SMEs, so perhaps the panellists can say a few words about that: how to foster innovation and how to create the good conditions to help the private sector to innovate.

On the environment, I just want to touch upon one issue that is very important in the region, which is the issue of water management. This is an area where there is quite a bit of waste and inefficiency. It is very much linked to the concentration of power in the past and there is quite a bit of hope that perhaps with a more democratic system water management will become more democratic and more efficient. And I think there are lots of countries that have great experience in this area that can help us think about how to improve this. On water, the issue of multilevel governance is essential. What is the role of the national government? What is the role of the region, the cities and so on? So all this has to be considered.

Let me move on to the issue of governance, more on the political side. It has been said that we need an efficient public sector. And the role of the public administration in the region – let's be realistic – is essential. This is really what is going to make or break the transitions. The international community needs to support the public sectors in the region, to play a constructive role in a market-based economy. We will have to move from the role of the public sector of basically over-regulating and over-controlling the economy, to the role of traffic police. And I think that we have to think of how to create the right capacities in the public sector.

The issue of procurement is essential to have the capacity to run the public private partnerships (PPPs). We need PPPs if we really want to build infrastructure in the region. There are a number of guidelines that exist and quite a bit of experience, but countries need to get used to it, public administration needs to get used to drawing up those PPPs. The delivery of public services, of course, the regulatory role of the public sector, the

supervisory role and the enforcement role also need to be looked at. We do have a programme: we are carrying out public administration reform on a country by country basis. And we have just undertaken one for Greece where we have identified a number of gaps and this is something we can easily do for countries in the region.

In terms of the political pillar, the issue of rule of law is essential in showing that the transition is sustainable. Indeed, we can now talk very clearly about the fight against corruption. I just want to point out that corruption is not a monopoly of the MENA region; corruption is a problem everywhere. Everybody from every culture can be corrupt and the key here is to put the right systems in place so you can prevent corruption, detect it and eventually punish any misconduct. Just to give you an example, not very long ago – I would say less than ten years ago – some types of corruption were totally legal in many countries in Europe; not only were they legal, they were tax deductible. You could go abroad, you could bribe a foreign official – as long as it was a foreign official and not a national official – and you could claim this as a legitimate business expense. So again let's just put this in very relative terms. Nobody is giving lessons to anybody, but this is a matter of putting the right systems in place so we can tackle this problem.

Last but not least, the issue of the participation of civil societies in the political system – again this is key –, and the issue of the protection of minorities. There is quite a bit of experience in many countries in the context of democratisation and I think that is also something that countries in the region can take a look at: the kind of experience people have. And we must not forget the issue of gender as it is not talked about enough. Not fully utilising the skills and the potential of women in society is a major waste. So there is a huge economic cost for discriminating against women. And we all understand the context in the region but if there is anything we could do to help, it would be to show people in the region that it is in their interest, their economic interest, but also their broader interest, for women to participate fully in society. And I think that we will be doing them a great service.

Tarik Yousef. Chief Executive Officer of Silatech, Qatar; Non-Resident Senior Fellow, Brookings Institution, USA

I believe the arrival of the Arab Spring is arguably not only the most significant political event from the perspective of civil rights and human dignity and broader questions of social peace and political transformation, but it is also probably the most important event in the region from the perspective of economic governance and economic development. Many of you here have been party to debates in the region. Debates on policy reform, economic reform, fiscal reform in the last ten years, where a widely shared conclusion has emerged, and it runs as follows: reforms in the past twenty or twenty-five years in the region have been largely ineffective; they have always been partial, hesitant, incomplete and prone to reversals because they were top-down. There was no political liberalisation and political reform to go along with economic reform. Hence, reform programmes tended to be short-sighted, elitist and to fall prey to short-term calculations. If that is the case, then the arrival of the Arab Spring, by heralding a new era of political reform, might in fact be unleashing the dynamics of economic reforms on the ground.

I think the Arab Spring is not only a reality but in fact it might be a necessity for engaging in exactly this discussion on economic governance. What we did not spend a lot of time on, and I think we have all been caught off-guard by, is the need to think through the dynamics of this process once it is unleashed. It is easy to say political liberalisation and political reform will help empower, legitimise and support economic reform, but how do you organise the actual sequencing? How do you organise the actual agenda, especially with questions of long-term, global parameters and, a lot of internal political parameters that are largely uncertain and difficult to predict? That is the core challenge of this agenda. It is not necessarily only where we want to be five or ten years from now, but how we get there, how we manage the short term and how various actors play their respective roles in this. I would say this is where, in fact, issues of timing matter, issues of ideology matter, issues of political actors matter and the external world's readiness to engage also matters.

One way, for example, of putting some specific content in each of these is to ask: What if the Arab Spring had actually taken place in 1989? Would things have been easier? Would the outside world have been ready to engage with a different capacity and a different level of commitment? Would it have been easier to forge a consensus around some of the political and economic issues, the vision for the medium and long term, than it is right now? Would it have been easier to incorporate the Islamic parties in the political process without undermining the readiness, the capacity and the engagement of various actors in this transition? I would say the answer to all of this is possibly yes. We are at a moment where in fact the previous conventional wisdom on what ought to be done, or how it ought to be done, has to a significant degree been shaken. We are in a political space internally where we did not necessarily foresee the kind of interests that are emerging and the coalitions that are forming, and we do not know their interest or willingness to work together and how easy that will be. One demonstration of this, for example, is the very strong showing by the Salafist party in Egypt recently. It caught all

of us off guard, nothing that we could have seen before, and it does complicate the political calculus. And so I would say the fact that the Arab Spring is happening in 2011, as opposed to 1989, possibly gives rise to a level of uncertainty and does require us to go back to the drawing board, in a way that may not have happened if this had occurred twenty years ago.

Nonetheless, I am willing to go out on a limb and suggest that, in fact, if we were to get the political side of this transition right, if these dynamics prove to be enabling and reinforcing of an atmosphere of social peace and participation, the economic transition programme and the agenda for the region within a three to five year horizon is going to revolve around four challenges.

First, the issue of opportunities for young people. This is a challenge that has evolved over the past twenty years but that does not necessarily make it easier. We think we have figured out to some extent the broad contours of what is required, whether issues related to employment, skills development, entrepreneurship or SMEs, but it is also about values, norms and expectations, and it is about a host of other institutional challenges associated with how youth respond to economic opportunities and policy change. This is certainly about a lot more than just simply employment. It is about a host of other issues, including civic engagement and political participation, which are at the core of empowering young people.

A second area, and I would argue that it is actually more complicated now than it was just ten years ago, is the need for governance reforms. What a number of countries are actually going to be engaging in is a project for building a modern state: legacy state institutions that are highly interventionist and redistributive have to be transformed. Rigid institutions that cannot cope with reform and are unable to adjust to change have to be reconfigured. And close connections between ruling elites and networks of patronage have to be broken within this process. I think it is clear to most of us that this is going to require fiscal reform, civil service reform and a host of issues that have been pending and long-standing. But some of the newer issues that have emerged and have to be harmonised with the building of a modern state include the broader agenda for social equity, economic justice, and equality.

How do you do this in the middle of current conditions and with a view to creating a long-term vision for building a modern state that achieves all of this. Some of the issues have to do with the process of policy making in this regard; others have to do with control of corruption – pandemic corruption, systematic corruption –, the effectiveness of state institutions; and it has to do with the quality of data, information and access and the transparency of the process. This, as a project in itself, is worthy of being the focus, the cornerstone of any new government that comes into power and wants to provide a long-term vision for modernisation. I do not think it is as easy as one would like it to assume, but it will probably condition much more what is likely to emerge than many of the other issues that have been discussed today.

The third challenge, maybe the most difficult because of the politics around it, is how you involve and integrate the private sector in this reform agenda. If you think creating

opportunities for young people is one cornerstone and building a modern state is another, then reviving the private sector – while admittedly a need and an area that many of us would have taken for granted just twelve months ago – is possibly going to be the most politically sensitive item to deal with. This is all about politics. It is about how the private sector is going to react, what kind of private sector is going to emerge. Will this be a private sector that again seeks to capture the process of reform or will it be one that is willing to engage in setting up new rules in the game? Throughout the region, one sees how the debate around the private sector has become decidedly negative and exclusionist. Even the term “private sector” has become a term that people shy away from just to avoid any association with the last two decades. Then how do you bring the private sector in? How do you incentivise it? How do you introduce greater competition and limit the opportunities for state capture?

When Daniel Kaufmann used to lecture us in the 1990s on state capture in the transition countries, it was not easy to relate the discussion to the Arab world, partly because we always took it for granted that the private sector in the Arab world tended to be more dependent on the state, more reliant on state patronage and, in fact, more vulnerable to the state. I would say that in the past decade and at this particular moment of transition in some countries, we are seeing symptoms of state capture à la Eastern Europe, whereby previously connected and empowered private sector interests are seeking to capture, to set the new rules to protect their interests. So this would be one area in which I would say the role of the private sector need not be in conflict with building a modern state; rather, it should be incorporated within it.

Last but not least, I think the new regional global agenda ought to be a part of the discussion. This is no longer about providing aid or financial assistance or financial resources; it is about trying to find an alternative to what took place elsewhere in the world, where regional neighbours and external partners can anchor reform. How can the world help unlock the reform process? Can external partners help lock-in processes of reform by opening up markets, providing access and supporting SME development?

The new regional-global agenda has to be cognisant of the realities in the world economy as well as the limited anchoring and conditionality mechanisms. We are in a second-best world, where you can influence without dictating but where you need to be credible to have a seat around the table. This regional-global agenda is not only the outside world's responsibility. The new elites in the region also have to take charge and take the initiative. They have to articulate what they want, they have to reach out, they have to be willing to learn from the experiences of others and perhaps adapt that to local circumstances.

And I will go back to my only comment yesterday when I said that there are new actors in the political and economic space that are emerging in the Arab world. They have to have a seat around this table because they might have most of the seats that will dictate policy and outcomes, not just in Egypt but in Tunisia, in Libya and in Morocco, among other countries. How to incorporate them, how to give them that space, how to give them their autonomy, and how to engage with them, is going to be one of the challenges in any dialogue we have with them. I would just state that in my own brief experience engaging

with a number of these actors in the countries I have mentioned, that dialogue has not always been that easy. It is not straightforward; you do not always agree and certainly do not share the same visions. Discovering that common space will be one of the biggest challenges for all of us moving forward at this exciting moment in this region's history.

Mohammad Pournik. Poverty Practice Leader for Arab States, United Nations Development Programme (UNDP)

I will talk about political and economic considerations, because I think one of the main problems that we have faced – I am talking as somebody with at least eight years of trying in two Arab countries to push certain reform agendas with government machineries – is not understanding the dynamics that are at work. The problems are not simply economic; they relate fundamentally to power relationships: the role of the state and where the state gets its legitimacy and authority. And until we understand that, I do not think we are going to move forward and change things. You cannot solve problems with the same thinking that created them.

A lot of the questions about the role of the extensive public sector, about whether it should be there or not, have been raised. The real problem is the way things are done. For me, the problem is not the size of the public sector, but what the public sector does. The problem is not the six million Egyptians who are working for the government, it is what it is that they are doing and what they are not doing. We have huge shortages in many areas of public service, despite having large numbers of workers. Within ministries of education, in country after country, you have too many people doing office work and too few people actually teaching. We have a major problem with the way the resources are allocated. So you have a lot of money spent on “buildings”, and this is something that I have had to face. I remember we talked with our own planning commission where, whenever you talked about a project, somebody wanted a building. Why did they want a building? Because this was the only way they could cream some money off it. You could not easily cream money off salaries. They build buildings but then do not provide enough for operations and maintenance.

Another problem is power relationships. This is why a lot of our work on public sector reform has come to nothing. A lot of the work done by the UNDP and by IFIs on public sector reform has seen millions of dollars spent with no result. So we really need to review the way we do things. The fact that we have had the Arab Spring shows that the Arab streets have realised that: that there was no way that they could change things as long as the regimes continued because the problem was the regimes themselves, and hence could not be solved by tinkering at the margins. If we accept that the problem is not tinkering at the margins, then the political element becomes the primary element: namely the relationship between the state and citizens and how the economy operates within this context.

In a healthy political setup, you have a state that depends on its citizens for survival, you have a state that imposes taxes and provides services, and there are systems of mutual accountability between the state and citizen. In this region, the norm is that it is the citizen who depends on the state. The state, either through direct access to income from natural resources, or political rents or revenues from a fixed asset, is able to generate sufficient money to stay in power. And it engages in the politics of patronage. This is why public sectors, rather than being there to provide services, are there to pay off people who

support the regime or keep elites safe. So when you have this kind of public sector, why would you waste your time and effort on public sector reform? The role of the public sector is not to provide health or education; it is to pay off people that provide political support or to keep them quiet. So this is why the primary emphasis has to be on having in place a new social contract of mutual accountability between the state and the citizen. Unless we get that, I think all our discussions will be academic and not really attack the core issues.

How do you get a relationship of mutual accountability? You have to get that by really engaging in a meaningful debate about what the role of the state should be. And such a debate is often uncomfortable because the ruling dogma is that somehow the state is a necessary evil. So it has to be cut down to the smallest possible size and allow the private sector to do whatever it wants. And you can find examples where this approach works. Somalia effectively has no state and the private sector seems to flourish, at least in some sectors, and it is working well. So you could find evidence to support the argument that the state is a necessary evil which we should reduce. But the fact is that in this region you have no way of avoiding a major role for the state because the state does control a lot of resources and, by virtue of controlling those resources, it is important that the state uses its assets to actually provides support for the growth of the private sector.

How can you support the growth of the private sector if you do not have a genuine private sector? In the discussion about the problems faced by the private sector, the issue is that in this region, in most countries, I am not sure if what goes by the name of private sector is genuinely a private sector. What you have is a certain politically well-connected set of companies or individuals who, through relations with the state, generate high revenues. And this is fundamentally the main reason why we have a very low rate of investment. Without investment you cannot have jobs. If you want investment you need to have a private sector that is based on the rules of the market, where you make a profit if you are efficient and produce good quality products that can be offered at a reasonable price.

So the next thing we need to do is make sure that the rules of the game are changed, that there is popular participation in defining the rules and the enforcement of those rules. We have no effective, functioning, consumer protection laws or effective implementation of laws with regard to labour rights. So neither labour nor consumers have any rights. How can you have a functioning private sector if those who are the main producers do not have any rights and those who are the main consumers do not either? Hopefully in a post-Arab Spring environment we will have the growth of civil society, so there will be an increasing number of consumer rights advocates, there will be an emergence of genuinely free trade unions, the emergence of genuine employers' associations rather than employers' associations that are politically controlled. Then you can have meaningful social dialogue, in the course of which, how the pie is divided is agreed, and there are open discussions of trade-offs.

How do you divide what you have? You do it by having rules in place to decide on what happens when as a result of a policy choice some people lose. We have no system for that. So effectively the losers have no recourse. And those who gain do not have to share

whatever they gain with anybody else. That is very peculiar. In any normal society you have a system for this.

And because of a fundamentally problematic structure, even things which are positive do not seem to lead to positive results here. We have looked at the extent of trade opening in the region. The share of trade in GDP has gone up substantially over the past ten or fifteen years, but we do not see any benefits emerging from that because the region has not been able to integrate into the global value chain in a proper sense. We have simply opened up the economy to increased imports, which are partly responsible for adding to the unemployment problem.

Productivity growth has been mentioned. How can you have productivity growth if the economy is dominated by non-traded goods? If you look at the structure of the economies in most Arab countries, a huge share of GDP comes from minerals, which do not employ large numbers. But they produce substantial rents which are divided by the state and lead to the emergence of a non-traded service sector where you have very low productivity. The sector that actually produces productivity growth is the productive sector. And we find that the productive sectors have suffered throughout the region, and this is not purely an economic problem.

Water management issues are definitely a problem. For example, in Yemen the main reason why they could not raise the price of diesel was because those farmers are politically very strong and therefore demand access to cheap diesel. This allowed them to deplete the water resources, which means that in a few years time there will be nothing left. There is no economic solution to this problem. You need to change the power game. So long as those who rule the country are in debt to those who produce that, this problem will continue.

Torek Farhadi. Programme Coordinator, Enhancing Arab Capacity for Trade (EnACT), International Trade Centre (ITC)

Having travelled in the Middle East for the last ten years, and almost monthly since the Arab Spring, I would say that the Arab Spring plays out differently from country to country. In Egypt, after the overthrow of President Mubarak, after the revolution, the element of continuity has really been the army. So on the surface, one could say that despite the spectaculars of the revolution, it just amounted to the pushing out of President Mubarak and some of his team, but then the rest of the actors in power are still the same: the army, which still has great control of the economy. In the case of Egypt, I happen to think that in the short run, the army having control of part of the economy is an element of stability and continuity.

The army is part of the economic model of the country. Attempting to change that overnight would lead to massive layoffs at army owned economic operations. Primary goods and prices would go up and it would result in the price of bread going up and the price of most staples Egyptians buy. It would lead to major instability.

Obviously, in a different setting this set up does stifle competition in the private sector. But today I think what we need in Egypt is stability over this period that will continue for three to four years of uncertainty.

We wanted elections, we have elections. We wanted peaceful elections, we had peaceful elections. Yes, now the Islamists are in Parliament but this has come out of a democratic process. Now what's important is that we have to open communication channels to the new elected leaders. We have to realise that for the most part, these new leaders have no experience of governance, they have never been in political office before. They need our help!

Before the revolution, on every mission, I got to know two new people from the ruling elite so I ended up with a lot of friends from there. But since the revolution, the ruling elite has been shrinking. When I go to the ministries they are not there anymore. So now, to get the pulse of the country, I thought I should know some friends from Tahrir Square. Then I went and found friends from Tahrir Square, and now I know that they are frustrated as well, because they are not part of the political mainstream. The people who have been voted in are the people who were not in Tahrir Square! In fact, during the last demonstrations, the Islamists did not come to Tahrir Square! They said: "We want peaceful elections." So, we had the ruling elite pre-revolution, then we shortly had the young people who came out in Tahrir Square and pushed out the Mubarak regime using media such as Facebook, but now the power is sliding in the hands of yet another group: those who were elected in Parliament.

I was just reading *The New York Times* three days ago about Shaaban Darwish, a Salafi sheik. The Salafis have 20% of the vote, may be more, so they are going to be in Parliament. In the article, the sheik was talking about the ruling elites saying "they didn't come to our streets, they didn't live in our villages, they didn't work in our hamlets, didn't

wear our clothes, didn't eat our bread, didn't drink our polluted water, didn't live in the sewage we live in and didn't experience the life of misery and hardship of the people." So there is basically a gap now, there is a cleavage between the people who are going to be in the Parliament voted in by democratic elections, and they are going to penetrate the corridors of power and those who used to be the ruling elite, which is now shrinking. So there is a risk that government capacity might suffer as the former bureaucrats are leaving.

However, we need to keep engaged. We need to keep engaged because as part of this engagement we have a chance to build new bridges. Not because we have money. It is clear; right now donors do not have money. Basically, we need to have an engagement between civilisations, an engagement between ideologies. We need to share our values, we need to talk to the new parliamentarians, we need to give them the space and listen to them because their ideas are very different. But there is also a chance that we might agree with them on a few things, if we patiently engage them. So the bottom line is in the next two to three years we are going to deal in this region with new actors, generally weak governments issued from parliamentary coalitions. You can see the case of Morocco: the Islamists won, but not enough. They had to bring some other parties into their coalition, so they will not get their way with the laws because they do not have enough representation. At the same time, this could make for uneasy coalitions here and there. As a result, the governments are going to be weak and are going to change often. But isn't this the democratic process? We have to let it unfold.

Meanwhile, It would be good to establish relationships with federations in the private sector and civil society, because those eventually will not go away, they are a constant in the spectrum. And if we develop relationships with them we can influence change by bringing them universal options. The private sector is always very influential in these countries. Whether they are corrupt or not, they will be connected and they will have an influence on what the governments do. They will be influencing the parliamentarians, who in turn will be influencing what weak governments do. Ministers would be at the very mercy of parliamentarians. Ministers could change; they could be called upon to explain what they are doing. Parliamentarians will send their friends to ministries and say: "Please, appoint this person in your parallel structures". There were old parallel structures before and there will be new parallel structures which will appear now! So our approach of bringing best practices at the root business federation's level is not so bad of an idea. An example is gender. It is at the business level that we have to prove that equality between women and men is good business. It is good for business and it is good for society. Same goes for equal access to education and vocational training.

I am just going to wrap up my comments, but these are some of the ideas that I wanted to contribute. We need to communicate in a new language that everyone understands, whether they are parliamentarians, Islamists, technocrats or ruling elites, you cannot save an economy without a modern competitive structure; you cannot replace anything without investment in your private sector, its' human resources in an inclusive way. Forget the government, although they are six and a half million public servants, they are not going to change the destiny of Egypt, or for that matter any other of these countries. The private sector is going to change this destiny, because if it becomes competitive there will be a power house.

Then there is the big potential in these countries. The youth. How to harness this potential? If we can mobilise this youth with education which really prepares them for employment in the private sector, with vocational training, with entrepreneurship guidance and why not, seed financing, then we could unleash the real potential of the region. Women and men. We need to foster incentives for the private sector. Give them the space to operate in a modern way, in a competitive way, in a level playing field which didn't exist during the previous regimes. There are some other things that we will not be able to control, such as corruption, but I think it has always been there and the private sector knows how to deal with it if we keep advocating for a climate of transparency.

Maria Ortiz. Associate Programme Management Officer, ESCWA/ECRI

We need to keep in mind that governance reform does not always mean transition to democracy. We need to think about the governance reforms that we are putting in place that are going to facilitate a transition to democracy, if that is the model that we want to follow, as the Arab voice has cried aloud.

Good governance is not a freestanding phenomenon, but it is in an endogenous relationship with participation. I think 2011 really is the year where a lot of people, including all of us, had to start to question our preconceived notions of governance in the Middle East. At this point in time, the Arab citizens and their representatives are renegotiating their social contract. And, what has been brought to our attention – by “our” I mean the international community – is that they very much believe that the state and the citizens are in this two-way relationship. Citizens are not passive anymore. They are both on an equal footing in terms of the process of accountability. So citizens in the Arab world are claiming their rights to remain vigilant, engaged and demand better services⁵ from their leaders. As we saw in Iraq, engagement does not only mean voting. It also means that people have a meaningful participation in policy making and decision making.

We have talked about transparency and accountability and I think that is the specific case of the Middle East. Although it is not a phenomenon that only happens in the Middle East, transparency becomes very, very important in fighting rent-seeking and corruption. We all know here that rent-seeking has very negative consequences for governance. Once governments do not need to extract taxes and they can buy loyalty and grease patronage networks, it is very, very hard to build the transparent bureaucracy or to have an informed civil society. While rent-seeking has been the status quo in the Arab world, it does not need to be its destiny. A lot of people talk about the oil curse, and there is a natural resources curse, but I do not think that is the problem. The problem is a poor institutional framework and lack of transparency. When the Arab social contract is being renegotiated it is very important to give bargaining power back to citizens so they can advocate a more transparent state. This means removing the purse from the rent-dependant state by readjusting our indicators to measure real economic standing, such as adjusted net national income instead of GDP, developing human resources in institutions or demanding the inclusion of all national assets in national budgets.

Corruption can take many different forms from one country to another, and stopping the local modus operandi and the political dynamics is a crucial step to establishing sound anticorruption measures. Failing to comprehend the context in which corruption occurs only exacerbates the problem and does not tackle its root causes.

Thinking about how we are going to create this governance reform, a couple of my colleagues have pointed out the importance of creating flexible and inclusive mechanisms capable of adapting, while resisting, outside pressures and opportunistic agendas. There

⁵ By services, it is meant basic public services such as education, health, water, security, etc.

is also the concept of respect for human rights and basic freedoms, as well as an end to the culture of impunity that has to remain at the forefront of this debate.

In terms of institutional reform, it should be emphasised that we have to build on what is already there because there are errors of trying to just clean up the house and starting from scratch. That was the case, again, in Iraq, when there was what people called the “de-Bathisation” of the Iraqi institutions, which created a huge vacuum in terms of knowledge, institutional knowledge, and it also created a sort of witch-hunt. And I think that is something that should be avoided.

ESCWA recently released a study where we looked at governance indicators. We created a composite indicator, which was done mainly in fourteen countries in the Middle East. This study pointed out that the Arab region not only underperformed in comparison to regions with similar income levels, but governance indicators had also remained stagnant for many years. And when we took a closer look at what this meant we saw that the main areas of underperformance were formal democratic institutions and civil liberty indicators. So economic policy indicators were also somewhat poor in comparison to other regions, but corruption, military involvement and bureaucratic quality were actually, on average, on a par with other developing countries. So it is important when we are talking about governance to know which areas we need to tackle.

This is something that I really like because, visually, governance is like a cup and it needs to be filled. And either we fill it with legitimate, transparent and inclusive mechanisms or opportunistic groups are going to emerge. So we have this opportunity but we have to seize it. And I think that this is particularly true in this region because the democratisation and reform process can easily fail in the face of loyalties, rivalries, sectarian divides and personal interest. Governance is a very political process and it should be treated as such. So I would caution against approaching governance reform as a technical issue, a “How-to-Guide”, or trying to replicate. Good governance means that government practices are locally owned and reflect national views and aspirations. And it also means that all parties are included: citizens and officials, allies and non-allies, mainstream and ideology-based groups, and also non-state actors. That is a component that we have not really touched upon and they are big players. Governance strategies are not fixed; they need to be flexible, they need to offer an opportunity for integration and improvement and they also need to be developed with long-term vision and in a coordinated way between different actors.

Finally, I would like to say that governance requires a multilevel and holistic approach to address challenges at a local, national, regional and international level. And strengthening regional cooperation mechanisms that have the express purpose of impacting upon the quality of governance will also increase the chances of a smoother transition for this region.



Socioeconomic Policy Reforms

Socioeconomic Policy Reforms

Paolo Lembo. Officer in Charge, Regional Center for Arab States, United Nations Development Programme (UNDP), Egypt

Inclusive growth is probably one of the most used terms and expressions that I have heard this morning. I counted; it was used thirteen times by six different speakers here. Inclusive growth suggests that this “growth” really succeeds in reaching the largest possible volume of citizens, irrespective of their religious belief, ethnic identity, political affiliation, cultural profile, language, and also spatial distribution, irrespective of where they are in the region, and so on. And I heard this morning almost every single speaker underline the fact that inclusive growth and inclusive governance cannot be dissociated. And it is relevant to say that an inclusive political system is a necessary precondition to create a proper environment for inclusive growth.

This is exactly what did not happen, or happened rarely and accidentally, in certain regions where the state is not held accountable to the population at large, but is held accountable to small groups who share power. So the question is how we really insert this concept of inclusive growth into a new dimension of inclusive governance. We need to understand that it is best to secure mechanisms for the rotation of political power and for the proper exercise of public overseeing of state action. The creation of a proper legislative architecture is one of the issues that has very rarely benefited from a process of inclusive growth, probably also due to the predominance of rent-based political economies in the region, which do not suppose mechanisms of accountable governance, precisely because these are friend-based economic systems. And that probably is why it becomes impossible to define the real economic performance of a country on the basis of analysis of GDP growth. For instance, the countries that have lately seen a clear growth in GDP are also where the biggest inequalities occurred and where the gap between the poor and the rich has been widened. So where you have sky-rocketing GDP growth in many countries, you have pockets of poverty that have been deepening.

Although we all know that no reliable, comprehensive and, above all, statistically accurate data about wealth distribution exists in the Arab region, we do have an assortment of well-documented or anecdotal evidence that could cause plenty of anxiety in us in having the perception that this is one of the fundamental objectives that we should achieve while dealing with socioeconomic reform. And it is enough just to go outside Cairo, to the outskirts of the city, to realize that there is this exponential growth of extremely luxurious gated-residential communities, with sky-rocketing prices for houses, and the enduring and visibly worsening existence of large slums – all while the country’s resources are being depleted. We will also discuss the issue of the reform which is taking place in many of the countries of the regions with the reduction in both food and fuel subsidies in places like Yemen, Syria, and lately in Jordan as well.

Moreover, we have also witnessed how, on such occasions, reforms have had a less than positive impact, such as in Yemen. We really are going to reassess how we can better

define a proper system of retargeting and recalibrating these subsidies and also make them more sustainable. We are also aware that these kinds of processes can also be bitterly unpopular and so they need to be part of a larger reform plan, which can also succeed in properly communicating the benefit of the operation at large; that in the end when you reform subsidies, the poor are not the ones that are going to lose. So you have to create a proper political space to engage the people that are going to be the object and make sure you find an exclusive global economic context in which the process takes place.

Finally, the issue of inclusiveness, of policy reform design. This means how, in the whole process of social economic reform, you can create an atmosphere in which you take into account the various groups that are going to be affected by this process and prepare, design, formulate, implement and explain the political mechanisms that the government has put into place to deal with the interest of the losers from different reforms; and find a way to direct some of the benefit obtained by the gainers in the state for an eventual final distribution to the losers. We have observed that, lately, many of these reforms in the socioeconomic sector in a number of Arab countries either have had no mechanism to deal with losers and gainers from reforms or have had very weak mechanisms that in the end contributed to erasing the positive impact of the reform. Potentially, if they had had a better and more intimate relation, it could have been better digested, better understood and eventually better supported.

The last issue that we will discuss is the issue of tax policies. This is a non-issue for the simple reason that many countries did not need or were not particularly concerned about raising taxes, as much of the public revenue would not come from taxes, but from the countries' resources. The notion of collecting taxes will also pose some challenges. But as rents are inevitably doomed to decrease and create political constituencies in order to procure a buy-in, given the need to start preparing a system based on taxation and to push for this agenda, it is a very significant trajectory in order to reform the social economic policy architecture that should underpin the next phase of this transformational change that characterised the Arab Spring.

Roby Nathanson. Former Head Office, Economic and Social Planning, Prime Minister's Office; General Director of MACRO, Center for Political Economics, Israel

I have a really difficult challenge here: how to introduce Israel's socioeconomic situation into this very important debate on the Arab awakening. It goes without saying, of course, that these cases have a different angle and perspective, but I will try to draw some parallelisms in what I am going to say because we are still living in a global world, in a global economy; and in many fields we are also facing similar challenges vis-à-vis trends in the global economy. One of these is the fact that during the summer of 2011 we also had an awakening in Israel, with social unrest, and the question is why it happened and why it happened everywhere at more or less the same time, whether in Spain, America, the Arab countries or Israel. So there could be some common denominators that might answer this question.

From the historical point of view, the state of Israel has undergone a number of social revolutions. During the period of the establishment of the state, the hegemony of the labour movement assigned great importance to the value of labour. Israeli society was perceived at that time as a society of workers. It was understood that there should not be large gaps in income distribution and that workers should not be poverty stricken. There was a period of liberalisation by the end of the 1960s. Following that liberalisation of the economic system, Israel experienced very substantial economic growth. This economic liberalism already caused an increase in social gaps during that period.

This was the first uprising and the banner of social distress was also driven by the population of North African emigrants. The Black Panther protest movement succeeded in penetrating the public consciousness in light of the prosperity that widened the social gaps and the erosion of the liberal movement's hegemony. Therefore, socioeconomic issues became dominant in public discourse at the beginning of the 1970s. If you follow Israeli history, when in 1977 Begin won the election and broke the hegemony of the liberal movement at the time, this was because of social distress and not for political reasons following the Yom Kippur War of 1973. This was the reason for the deep and extensive political change in Israel at the time. The segregation of various sectors of society and unfair distribution of income were the reasons for that change. So from the beginning of the protest movement until the mid-1980s, public expenditure grew, as did the state budget deficit. Three other things increased in size: the proportion of public consumption over GDP, because this was the way to face social demands, the size of the balance of payments deficit and the huge foreign debt. This process was accompanied by an ongoing rise in inflation from a level of 40/50% to 150% at the beginning of the 1980s, to 100% in the middle of the decade.

When the national unity government was established in 1984, it became possible to implement an economic stabilisation programme, which put an end to this hyperinflationary process following the expansion of the budget in order to cope with social protests. Thus, the formation of a political consensus led to inflation-fighting measures and changes in the structure of the economy. The social protest movement

ended during that period, but fundamentally the problems of Israeli society and the income gap and distribution of income were not solved. From the mid-1980s, public policy was dominated by three objectives: limiting government intervention in the economy, changing the system of transfer payments and subsidies, and modifying the taxation system. The recent movement of summer 2011 shares many similarities with the 1970s. The housing issue, for example, was central in the 1970s and now it is also a very important issue as part of the protests. We must learn from those lessons shared between the 1970s and the present situation, and ask ourselves how we can find solutions to the present crisis.

The economic stabilisation programme of July 1985 was a turning point in Israeli socioeconomic policy. The Israeli economy was typified by centralised dominance in the economy under the ownership of the Histadrut (Federation of Labour) and the government. Domestic industry was protected by trade barriers and lack of competitiveness with international markets. All those measures were eased by the more neoliberal approach of the economic policy since 1985, which consisted of cutting back the share of public consumption and limiting governmental intervention in the fields of media, energy, transportation, infrastructures and financial markets. And here we also have a warning that the reduction of governmental possession and intervention in the market and privatisation does not necessarily mean that the economy will be less centralised. It means that you actually pass from governmental ownership to private ownership, which has been the Israeli case, but it does not necessarily mean that you will have a more sophisticated and competitive market, but a centralised economy as well. However, this time it is owned by private people and not by the government or public institutions. And if in any of your countries you consider going the way of privatisation, you should at least look at our case and perhaps you can also learn some lessons about that.

So cutting transfer payments such as child and old age allowances – we still have a welfare system in Israel, which is comparable to the welfare systems in central Europe – and also cutting spending on education, health and housing, decreasing direct taxation of the middle and upper classes and corporate income taxes, is accompanied by increasing indirect taxes. This has a very negative income effect because, by reducing direct taxes, you actually give up the mechanism of using the tax system in order to ensure better income distribution. And increasing indirect taxes is, of course, regressive and also generates more disparity and negative income distribution effects. Israel also exposed itself to international competition by reducing taxes, customs and quotas for a long list of products and services. Many sectors still benefit from protection, mostly the agricultural sector, but most of the sectors and traditional sectors in the Israeli economy actually disappeared because of this liberalisation of trade conditions; for example, the textile sector.

And then we have a period where the Ministry of Finance actually controls and carries out the policy over the years in a highly centralised system, where they not only intervene in financial issues but also introduce very sharp, structural reforms in many sectors of the economy. On the other hand, we have to realise that from the Israeli point of view we have very weighty items in the budget expenditure. One is still the 30% debt servicing,

due to the debts that we had during the 1970s, and another is the 17% defence expenditure, which compared to any other developed or even emerging economy is a huge amount and a burden on budget expenditures.

In addition, there is a very strict fiscal rule, introduced in 1985, which limits government expenditure, leaving very little room for socioeconomic policies in the budget. Therefore, there is no other choice but to compromise priorities within the budget constraints without actually increasing it. This includes the need, if we want, to change priorities and to address the social issue of the re-examination, from my point of view, of defence spending and outlets of the settlements hidden in many of the budget items. Such a discourse on priorities has never taken place and, as a result, governmental policies have caused ongoing erosion of the social system, both because of the very strict neoliberal conservative fiscal approach and the lack of any debate on prioritisation of budget expenditures, mostly regarding the defence settlement issue, something I will refer to as well.

On the other hand, in the macroeconomic policy context, current economic policy has impressive results, even compared with the international field. In the course of the last decade, GDP has grown by about 41% in fixed price, GDP per capita has grown by 16%, and foreign debt has shrunk to 80% of GDP and to about 14% of GDP in 2010. In the course of 2010, a surplus of 6.3 billion dollars was achieved in the country's balance of payments, which was a unique result for Israel. We see that the Israeli economy has developed the ability to cope successfully with acute economic crises, such as the world financial crisis of 2008. The impact of the crisis on the Israeli economy was minimal and the economy rebounded quickly to an average growth rate of 4.5% a year, without any real harm to the labour market. So this has a lot to do with what was also mentioned before, that social unrest, protest and awakening actually has little to do with macroeconomic performance. In the case of Israel and, as far as I have understood, of Northern African countries, there has been, more or less, a pretty good macroeconomic performance during the last year. So, from my point of view, this is not the source of the unrest.

On the one hand, we have a very impressive macroeconomic performance, and the economic policy succeeded in achieving stability, yet it had a very high social price. Over the last five years, civil public expenditure, excluding defence, has fallen by 6% in proportion to GDP. This expenditure on civil targets is 34.9% of GDP and is lower now than the OECD average. As a consequence, about 20% of Israeli households live below the poverty line and after transfer payments this is double the average of OECD countries. Of course, I have to mention that poverty is more strongly represented in the Arab-Israeli sector, where households living below the poverty line is close to 40%, and in the orthodox sector, both sectors having high percentages of poverty. This is also followed by a reduction in health expenditure, among the lowest in terms of public expenditure on health after the United States, according to the OECD. And, of course, the increasing financial burden on the population is also a result of taxation policy, as I described before. The indirect taxes/direct taxes ratio in Israel is very high by OECD-country standards. As a consequence of these policies, which have achieved quite significant stability in

economic terms, the percentage of the population at risk of poverty was 26% in 2001 and rose to 30% in 2007.

I will keep my conclusions very short and tell you that we have, first of all, a big problem regarding the trade-off between the stability priority and the socioeconomic priority. The second thing is a highly centralised economic system, which is all in the hands of a few companies. Sixteen companies in Israel hold 50% of GDP; this is just as an example to address what was said here about inclusion as the target of a new economic policy or the reason for the unrest and awakening in Israel and elsewhere. I can tell you that on the 3rd September, 400,000 people protested in Israel against social injustice, which was the main issue of the demonstration. A committee headed by Professor Trachtenberg was appointed to find out what the reasons for the unrest were and what the solutions might be. And the reasons were very similar to what we heard here: rising economic needs and lack of purchasing power to make a decent life, to achieve a decent education, health or even housing. There is a feeling that growth and achievement in the macroeconomic field is not equally shared by all sectors of the economy. And a third thing, which has a lot to do with the inclusion aspect, is the alienation of large sectors of the population and young people from the political system. They feel that the government does not care about what they need and that they are totally disconnected from the real needs of wide sectors of the population.

Finally, I will mention two things: one is that we have to prioritise and maintain the debate regarding what our first priorities are, mostly regarding the settlement issue and the defence issue. The settlement issue is a huge burden on Israeli society, which has never been put on the agenda but must be if we want to transfer resources from one place to another without undermining stability. Only in the last decade, 18 billion dollars were invested in those settlements and this is a huge amount of money that could easily have been transferred for the purpose of resolving social issues and many of society's social needs. So, at the end of the day, what we are facing now is a need to solve, of course, our overall situation vis-à-vis the Palestinians and the peace process with neighbouring countries. And what the social movement in the last summer succeeded in doing was to put the socioeconomic issue on the agenda in such a way that this could also be a sign of change in course, because in the end this is the only way to generate social change, as was the case with the protests in the 1970s. Hopefully, this situation will also change the hegemony of the present administration in Israel.

Jacob Kolster. Regional Director, Egypt, Libya and Tunisia, African Development Bank (ADB)

Did we all get it wrong until January and February 2011? And are we getting it right now? I am not sure. I would say that one divide could be: are we basically facing a sort of macroeconomic crisis in the Arab world, or are we facing the possible beginnings of a new paradigm? Where you stand in that analysis would decisively determine how you address the challenges you are facing today.

I want to quote from the *Human Development Report*, where it refers to “the human development miracle in North Africa.” That was 2010! I know there was a lot of other context to that report and the UN system was definitely not alone in having that perception. I think many of the institutions around the table actually, by and large, subscribed to that notion. Or, if there were diverging views, they were minimised at the time, relegated to footnotes because we all knew that there was no way we were going to travel into Tunis and raise the debate on governance, human rights and other things. With the regime in Tunis there was no way they would have allowed it.

The Arab world had an inclusive, limited growth. Actually, following independence and through the 1980s, the Arab world was one of the most equitable regions on the globe. What we have seen is an increasing inequity and inequality, which has happened over the past twenty to thirty years. And I would say that is where the accumulation of frustration and discontent has emanated. You saw the unemployment – again the state had failed to provide jobs to well-educated youths –, which was an increasing issue in all North African and most Arab countries, where today you have a high unemployment rate among academics. An economist like myself in Tunisia is more likely to be unemployed than to be employed. You have up to a 50% unemployment rate for social scientists. You have inequality and you have inequity. You have regional disparities that have been growing over the past ten to twenty years. You have Gini coefficients in Tunisia that have actually been growing over the past ten years. You have had a declining level and quality of public services, in virtually all the countries that we are talking about, for the reasons that Rania A. Al Mashat and Minister Radwan explained to us earlier. You have equity, a certain social comfort, but do not ask any questions; you are not part of the political process. When one side of that bargain fell through, in some countries conspicuous, if not predatory, corruption became very visible. I lived in Tunisia and at that time it was getting to that point or had been at that point for a long time.

Now, this is where it will all go wrong. I would say that with what is happening now, during the transition, it is very important to realise that there is no longer one shoe that fits all. This is a number of countries that are doing the best they can but they are moving in very different directions.

There are new bargains being struck, there are new contracts being established, some of them above the table and others below, I am afraid to say. They are happening as we speak. Libya is a case in point. It is an exciting opportunity. I believe for the first time in four or five decades you might actually have the possibility of something decisively

positive in Libya, but there are bargains being struck right now, including with the benevolent partners from the Northern Mediterranean. I think it is very clear that nearly twelve months into upheaval and revolution, frustrations are mounting in all the countries we are talking about. The social demands are still there, and they remain unmet. The agenda might not be dominated in the short term by the need to satisfy these demands. We might all forget what the underlying drivers are and I think that would be a great pity.

My third point of intervention will be on the challenges in the short term. I believe it is easy to say it is getting all the things right that we got wrong in the past. That is almost a tautology and it is way too easily said. It is part of the illusion we all have that North Africa and the Middle East were doing well from a growth perspective. Actually, not that well. Over the last five or ten years, per capita growth on average has been around half a percent in real terms and that is not in coefficients that have been going up. When you have had a growing inequality and distribution, it means more and more people living on less and less. That needs to be corrected. There are two dimensions of distribution of growth: the stronger growth is one of the other illusions that I believe we have had about North Africa and the Middle East. Let's for a moment shunt aside the oil producing countries because they are an exception, but the non-oil producing and the non-oil net exporting countries – their sophistication, their level of industrialisation, and so on – has not been nearly as good as most of us believed. Sophistication of exports and in GDP terms have actually in some cases declined over the past ten years. The underlying dynamics is that growth has not been fast enough in real and per capita terms.

Inclusive growth is the new fad in development. “More and better jobs” – which is easy to say – is a whole range of structural policies that range from education, vocational training, not only the quality of education but also the direction of education. It is about skills for those who go out in the markets, about investments, about technological advancement, and so on. There is a whole range of policies. It is not easy, but that is part of what it will take to bring about inclusive growth. It is better-targeted public transfers.

I am not going to go into the details of subsidy policies because I think it is a whole agenda. It is part of the social contract; subsidies, fuel subsidies and food subsidies are part of it, but governments cannot address these issues, particularly now in a socioeconomic crisis. I would say it is exactly now that you should address it, but with smartphones, with the ability to actually target subsidies to exactly the people you want the subsidies to go to. This is the moment to do it. Then you come down from a 10% deficit to 6%. You do not need the IMF. Health and education is an area where you really need to invest in; in order to enable people to be part of the growth process you need to focus on those areas, otherwise there is no way they will be an inclusive part of the growth process. You need better public services. The Arab world, or North Africa, usually had relatively good public services. They kept taking on public labour in the public sector that eventually did not produce but was paid.

Managing the short term is my fourth area. We had some wonderful real-life lessons explained to us by the former Spanish Secretary of State, Alfredo Pastor, about the Spanish transition, and I really enjoyed them. Expectations are the single most politically

important challenge, because there are no jobs right now, there is no extra revenue to pass around and it is going to take some time. But credible signals are needed that those of us who are now there to govern and manage mean business and are serious. That might actually enable people to strike a short-term deal to say: "Okay, I'll sacrifice my social demands until you get the time to do the right thing." I think there are some guiding principles on which we would all agree. Some of them have already been said: do no harm, do not permanently contract in the public sector another half a million people. It is going to saddle you with an extra structural problem to address tomorrow.

I think that the restoration of confidence is absolutely critical, both inside and outside, among domestic and foreign investors. What are some of the most important elements in restoring confidence? I believe, not just because I am Danish but because this is what I have seen in Egypt and elsewhere, it is about access to information and transparency. And I am not necessarily talking about the political process, but the economic and socioeconomic process. Transparency needs to take place in government, and other institutions, such as the Central Bank. And as somebody said earlier, avoiding capture is absolutely critical. In a tumultuous process like this one, capture is very real; the possibility of capture is very real. There is possible capture from all sides, and I am not referring to religious capture here, I am actually referring to good old economic interests that can easily capture the process for good.

There is the national level: you need political justice, you need political participation, you need social dignity and you need economic inclusiveness. I do not think there is any way around this. At the regional level, my recommendation to you as Europeans working for an international institution is to open your eyes, look at the realities as they are and what they are. When I look up North I see a continent that is busy trying to figure out whether they want to be together or not, busy trying to fend off a possible implosion. I look to the west and I see good old America busy trying to sort out where they are on the Earth and how they can deal with their own problems. So keep that reality in mind.

I think it is important that there is a regional contract. Many of the countries are suffering from migrant labour being kicked out of the rest of the region. You are suffering now, whereas remittances went up in the first months of 2011 for some of the countries but are starting to come down because migrant workers have been part of the political adjustment process in the region. Part of that compact should be: "Well, you do not want employers, transfer some financing to us." As I said yesterday, China and perhaps Russia are the only parts of the world right now that are accumulating foreign exchange. And I think it is reasonable for you to look to the oil producing part of the region for a new deal. I think it is the moment for regional integration, not just for economies of scale, because actually I think there might be limited room to exploit, but for a better bargain vis-à-vis the rest of the world.

And then there is the international level. There are some realpolitik that are playing in this region and I think if we keep dodging that issue we are going to get it all wrong. We need to realize that the IFIs cannot be looked at through a vacuum. What are the IFIs? They are institutions that are owned by nations. And who are the nations that have the biggest

share of capital in the biggest IFIs? Well, we know them. And what is their political stake in the region? We know that too. And eventually that is going to create a certain level of tension: we have an Islamic wave of political influence in a region that has been dominated by a set of geopolitics. Let's not close our eyes to that. One of the extremely important experiences was that there was an extremely strong anchor outside their own transition process; in that case, the European Union. Turkey experienced it, as did the Eastern European countries and some of the former Soviet Union countries. If the European Union can give something similar to the countries in question, or other regions or other supra-entities of the world, it would be extremely helpful to anchor the process of transition.

Ibrahim Saif. Senior Associate, Carnegie Middle East Center, Lebanon

Since yesterday we have been hearing some generalisations and about some issues that I think we all agree on, whether diagnosing, whether we got it wrong or right or whether we are getting it right now, and the issues concerning the inclusiveness of the growth, equity and other concerns. I wanted to take on some of the issues and add to this list that, issues very much related to Middle Eastern countries.

First is the issue of identity in some of the countries. Identity is probably not that big a question in Egypt, but until recently we have seen the divide that has taken place and the incidents that took place at Maspero reminded us of what kind of problem we are facing. Identity is an issue that would emerge in a country like Libya, where they are forming a government, and Tarik Youssef can tell us how difficult it is to reach a balance in order to at least keep those new actors satisfied. Now with the states running out of resources, what new balance will emerge? And it is under this new balance or new equilibrium that I want to take this further.

One issue that we have been discussing but have not dwelled on is the security apparatus in the Arab countries. This is probably, after the central banks, the most well-established and best-run institution. In the case of Egypt, I think that in this newly released document, "Silmi Document"⁶ they identified what they really want to protect, to what extent they can go on with this democratic process, how long this can be sustained, what can be done, what the new balance will be, and the form it will take. This is the new apparatus. I think this dichotomy of losers and winners can be found in terms of security, which was not playing alone in this field but alongside the business sector, civil society organisations, such as labour unions, and independent media, among others. Now we are witnessing their emergence. Look at the number of strikes that have been taking place in these countries over the last six or eight months: there are thousands in Egypt, Jordan, Syria and even in Tunisia. So how can we strengthen this process within the civil society organisations and assure their independence? We never visited a country without having a meeting with the representative of the labour unions, the professional unions, the workers, but were they really independent? Actually, were they really elected in a fair way? We know that they were selected and appointed. This is where we are witnessing, not at the macro level but rather a micro level, an emergence of these new social forces.

Now let's talk about social equity and inclusiveness. What kind of taxation or tax system would that imply? We have representatives from the World Bank and IMF: would they be happy to adopt or advocate progressive taxation in Arab countries? To my knowledge, that was not the case: a flat tax, VAT or indirect taxes were always suggested, not progressive income taxes, similar to those in Denmark, Sweden, Germany or other European countries. This is an area where now, if you really want to change the balance and increase the government resources, a lot of debate is going

6. http://www.memri.org/report/en/print5826.htm#_edn4.

to take place and yet we are not witnessing this. Towards the end, I will spend two minutes talking about the Islamic agenda, which is what we have been questioning. At least on taxation they are actually unanimous, they are all advocating progressive taxation in the Arab countries. Whether they are going to do it, we do not know.

Another issue: since yesterday we have actually been talking about income distribution and income inequality in Arab countries. Comparing Gini coefficients in Middle Eastern and Latin American countries with other countries, I do not see a staggering difference that would really suggest that income distribution or income inequality is the sole or one of the important factors, because it is almost identical between Chile and Tunisia, close to that of Egypt and close to that of Jordan. I was trying to argue that income distribution is something that we can rely on for understanding what is happening. But actually I failed, at least based on the data available. I think the question is how wealth has been accumulated in Arab countries and how it has been accumulated in other countries.

Here we come to my next point on the private sector. In the case of Egypt, in the case of other countries, we have both crony capitalism and a crony private sector. So the danger is that when you generalise about the private sector you can easily miss the full picture. Now it is not just about apples and oranges, it is actually the fact that those independent, genuine, entrepreneurs will actually be scared because of the labelling of the private sector. In the case of Egypt, for example, I think the government somehow tolerated the attack on the private sector, to the extent that again the private sector became something that you really do not want to be associated with.

The other point is about corruption and how flagrant it is. Because of their failure to deliver on health, education and other areas during this transitional period there is much talk about corruption, as if by dealing with this issue of corruption, the rest of the economy and the rest of the problems will be sorted out, which I think is short-sighted. It will definitely help; but it is not all about corruption and it is not going to be the panacea.

I want to talk about two more points: about health and education and the issue of subsidies. I have the notion that these Arab countries are subsidy-states, not welfare states. Subsidy-states are all about allocating subsidies, not even distributing subsidies; allocating subsidies subject to political allegiance. This is changing and in Egypt, for example, subsidies are about double what is publicly spent on education and health. Whether that figure is correct or not, it is worrying. It may even be much more. And it is quite well known. If we are talking about short-term policies that would have an immediate impact on me, I would worry. I have never met an economist in Egypt, including the Islamists, not in favour of revising the subsidies because they are known to be at least 50 or 60% (there are various estimates of the target). So why is this not taking place even during this transition? It is a sensitive issue but I think with some awareness it can be raised.

And, lastly, I want to talk for one minute about a study that I am conducting with a colleague from Jordan on the economic agenda of Islamists in Morocco, Tunisia,

Jordan and Egypt. I was under the impression that they do not have a programme or, at least, they do not have an economic programme. To my surprise, I found that they are even going as far as talking actively about market policy. They really have some loopholes, but they have some detailed programmes that are advocating the pillars that we have been talking about: inclusive growth, respect for ownership and others. Now they are not talking about the tools to do it and how they are going to do it but at least we know the general direction from where they are coming.

Hassan Hakimian. Director, London Middle East Institute, SOAS, University of London, United Kingdom

As 2011 comes to a close, it is very tempting to think back and describe this year as the year of tumultuous upheavals in the Middle East, the so-called Arab Spring. I have some problems with that description, but I will come back to it. Reflecting back on the past twelve months, I would rather think of this year as the year of the trials and tribulations of democracy. And it is not just the Middle East, although it is going through some very interesting, exciting and also worrisome transformations, but also Europe that has been affected by such tumult. As we know, it is difficult when watching video footage from events out on the streets in Greece, in France or elsewhere not to relate them with the Arab world. Or the very serious riots in the first week of August in London we witnessed some serious street clashes. There is a lot of soul-searching going on around the world and that is not just limited to the Middle East.

Now permit me to take exception to the question that Jacob Kolster asked: "What went wrong?" In my opinion, that is not the right question to ask. What went wrong in the Middle East? It was not that we had these revolutions, what went wrong was that they were so delayed. Anybody who knows the region intimately enough would have expected that the old order was not sustainable. Nobody can claim we can accurately forecast the time and the place where such ruptures may occur, but they would have expected the old order to reach its natural limits and conclusion at some point in time. What I think was surprising was the speed of the contagion; that with such speed the fire flared up in one little place, then caught on not only in the rest of that country but also travelled elsewhere. So I think asking what went wrong misses the point and I think this in a way also reflects what worries me as the background to these discussions, and it seems that we may be trying to prescribe blueprints that help us avoid revolutions.

This is probably the wrong approach. It reminds me of macroeconomists, suffering perhaps from the irrational exuberance of the long boom period of the last sixteen years, who were inclined to think that "the business cycle was over". The political cycle will never be over; I do not even think we can abolish it. If we are searching for inclusive growth as a blueprint so that we can introduce social insurance mechanisms to allow the elite to avoid revolutions, we may be disappointed. Which country has completely avoided political upheavals? Of course, there are different degrees. When you think about Syria, do you ask what went wrong? You know it was already wrong. The fact that change did not come earlier is what was wrong, not the fact that people wanted real change. And I think this is where a measure of indirect identification with the ancient regimes' elite is self-evident. We were advising them – when I say "we" I mean the international agencies including development agencies, funders and donors – in the expectation that when they implemented our advice then everything would be fine. And of course it was not, and many of us in the universities were not surprised that these blueprints did not work.

Inclusive growth means a lot of things to a lot of people. I think growth is very important. My own country, Iran, which went through a revolutionary transformation thirty-two years

ago, largely neglected the importance of growth. Inclusiveness is also very important. Now, how to wed these two is the real challenge. And, in a way, in development economics you are back to the old dichotomy: redistribution with growth and equity versus growth. I think the real question is what sort of policies can actually bring these two dimensions together.

I want to end my remarks by reflecting on the political economy of what has happened, not just the economic dimensions. And here we have to remember that what has started is a process of revolutionary transformation. Revolutions bring with them an immense and potentially constructive process, but they also bring with them an immense and potentially destructive process. I know this again from what we witnessed in Iran, which brought down a very strong, well-entrenched, western-backed monarchy, but what replaced it exhibits precisely the contradictory nature of a revolutionary process. Who expected the so-called revolution in Egypt to yield results in one week or even one year? This is a process that has just opened the Pandora's Box. And this is where both fear and hope have to be understood alongside the apparent division between the pessimists and the optimists. But in reality, revolutions offer both: the possibility of massive destruction and the possibility of construction. Some of us veer towards optimism in this respect and some of us veer towards pessimism.

Taking a leaf from the Iranian revolution, the current upheaval reminds me of the euphoria associated with large numbers of people demanding change on the streets. Actually, the Iranian revolution was even more mass-based than any demonstrations and mass movements that we have seen in the Arab countries in the last year. We had three to five million people out in the streets. That euphoria was real, and I agree with your comments that we must respect the wish of the people when they are out queuing from the early hours of the morning to exercise their newly-found right to vote. That is absolutely exhilarating. But, looking beyond that, where is this going? We are entitled to ask and we ought to ask the tough questions. Look at where the Iranian revolution went! As I said that was a mass revolution, the Islamists did talk about transparency back then, they did talk about inclusiveness. They talked about the private sector. And this is where the IMF endorsing the future as judged by the manifestos of the Islamists worries me. I think we should judge actors, players, parties and leaders by what they have to offer in real terms, not just by their manifesto and by their promises.

Fernando Perpiñá-Robert. Ambassador of Spain

I will begin with an anecdote. At the end of the Spanish dictatorship regime, it seems that the President of the United States was very worried about the future of Spain after Franco's death. So he asked General Vernon Walters to go to Madrid, ask for an audience with the court and try, in a very diplomatic way, to find out what would happen after his death. So poor General Walters went to the residence of Franco – already at a very advanced age –, and tried in this diplomatic way to ask him about the future of Spain. And he said: "Look, my General. You know very well that the President of the United States thinks that you are one of the most experienced people in the future of Europe. You have fought against the communists, you know everything." And then Franco stopped him and said, "You probably want to know what is going to happen in Spain when I die." And General Walters then said: "From a General to a General, yes." And Franco, who did not want a transition to democracy in Spain, said: "Nothing is going to happen in Spain because we have a middle class."

So I think he was right, although not from his point of view. He was right that the middle class in Spain was one of the main factors in allowing a very successful transition. There are other conditions; one of them is social peace. And this was guaranteed through the so-called *Pactos de la Moncloa* (Moncloa Pacts). And then there is a third and very important reason. I think that for Spain it was extremely positive to have a close and favourable relationship with our political environment. Our political environment is Europe and I think, therefore, in the Arab transition to democracy Europe is also the environment. And I think that means two responsibilities: from the European point of view, a responsibility to pay close attention to the special characteristics of the transitions in the Arab world. And from the Arab world, the will to be helped and the will to accept such help, that there is some common ground. There are some common values from the economic view, from the social view and from the human rights point of view, which must be accepted by both of us. This is not uniformity – there is no need for uniformity –, but I think this common sensibility is necessary.



The Role of European and International Finance Institutions

The Role of European and International Finance Institutions

Josep Piqué. Former Minister of Industry and Foreign Affairs, Spain

We are discussing how to approach economic governance in Arab countries in the midst of these transition processes. Over the two days, the Spanish political transition after General Franco's dictatorship has been evoked, along with its parallelisms from an economic point of view.

It is now a commonplace to affirm that the Spanish transition was possible because of the responsibility of all political forces and the desire for consensus and reconciliation. But it was also because, at the same time, economic problems were confronted in the understanding that, if they are not solved, political transitions become unfeasible. This involves stabilising the situation from the macroeconomic point of view. It also means carrying out reforms and institutionalising, also from the economic point of view, those instruments which are necessary to provide trust, credibility and security. In the specific case of Spain, there were pacts between all the political forces in Parliament, the so-called *Pactos de la Moncloa* (Moncloa Pacts), in which a series of agreements were made aimed at calming the economy to do everything necessary in the political field. Therefore, this meant agreements between the social agents, trade unions and businesspeople. It meant something that, at that time, was revolutionary; that is, linking salaries to the future inflation forecast rather than past inflation. The role of central banks – the Bank of Spain – was anticipated. And something was done that, in my view, was absolutely instrumental: fiscal reform. It is not possible to consolidate a democracy without taxes being paid by a majority of people. I attach strategic importance to the decision made to undertake, along with a new democratic Constitution, a fiscal reform in which all citizens and economic agents accepted that they had to contribute, from the point of view of taxes, to the common effort.

We are discussing the Arab world, North Africa and the Mediterranean. Historically, the Mediterranean world has existed because there was trade. This was so in Antiquity, at the time of Phoenicians and Greeks, and, in the end, the words *trade* and *Mediterranean* have become almost one. In contrast, I must say that, today, in the whole of world trade, commercial exchanges between the Northern and Southern Mediterranean hardly reach 2% of the world total. Thus, we are faced with a challenge and an opportunity which we undoubtedly need to embrace.

From the European perspective, we cannot forget that in the South there are more than 200 million people with a GDP per capita of around 7,500 dollars, which is more than the GDP per capita of the emerging Asian countries. Thus, they have a not inconsiderable purchasing parity power and, in the last fifteen years, have experienced GDP growth higher than the growth experienced in the same period by all Latin American or Eastern European countries.

Thus, I believe that we are faced with an extraordinary opportunity. There is a joint political partnership and commitment instrument, which is the Union for the Mediterranean. But I think that there are challenges that we must deal with that affect economic governance in

the midst of this new political situation we are experiencing: trade liberalisation, the removal of non-tariff burdens, legal security for foreign investment, and political stability, which, from my point of view, is linked to democratic institutionalisation.

Democratic processes are necessarily good in themselves and, therefore, we must accept their outcomes, even if we do not like them. It is true that these outcomes may be worrying, but they open up a dynamic and a process. We must get used to the fact that political stability must not be linked to political authoritarianism, as we Europeans have *wrongly* believed, but rather to the free expression of the democratic will of citizens.

In my opinion, this is one of the basic reflections on everything that is happening, and here the Arab countries, which are opening promising processes full of expectations, have a responsibility. I am quite aware that we must differentiate and that it is not the same to talk about Tunisia, Egypt, Libya or Morocco, even if we do not talk about Algeria, or that we are very concerned about what is going on in Syria and have great expectations of Jordan.

But I should also add a personal concern which, I think, can be shared by many. Europe has so many and such serious problems that it can make a terrible mistake; that is, not paying enough attention to what is happening and not understanding that this can be as strategic as many other things, for its own future, for its own economic stability and for its own political stability. You must have noticed how in the last European councils there was no talk about foreign policy, because we have quite enough with discussing whether we support the euro or not, whether we are capable of overcoming the crisis of sovereign debts or what we do with countries with a more distant attitude towards the process, such as the United Kingdom. But I believe that Europe would make a profound mistake if it did not take into account, for its economic and political future and from a stability and security perspective, what may happen in the Arab countries.

In this context, the economy has a fundamental role and multilateral financial institutions have a basic role, because we are talking about encouraging economic growth and about fostering projects that have a strategic component from the point of view of infrastructures, industrial development and technological innovation. And there are multilateral institutions in different fields that may have a basic role.

Today, we are lucky to have some of them on this roundtable; I would say the most important. Let me tell you that as former Minister of Foreign Affairs, I feel a great frustration because, at the time, we tried to create a specific investment bank, like the EIB or the EBRD, for the Mediterranean area. It was not possible for several reasons. A financial facility was created, which is working reasonably well. But in any case the existing instruments (EIB, EBRD, IFIs and World Bank) are powerful enough to help us shed some light on what we can do for the political stability and the democratic institutionalisation of the Southern Countries. They can also help the Northern Countries see that, beyond our problems, we must think in the medium and long term. Finally, they can show us how we can develop cooperation instruments between Europe and the Southern Mediterranean Countries from a structural and sectoral point of view. Even the possibility of launching a kind of Marshall Plan, as in its time the United States implemented after the Second World War for the reconstructions of the European economies.

Ratna Sahay. Deputy Director of Middle East and Central Asia Department, International Monetary Fund (IMF)

I am first going to talk about the lessons from the past for the IFIs – what we do right and what we do not or have not done right –, and not only in the transition economies. The second part will consider what the IFIs can do, while the third will cover the key messages that I would like to give to the MENA region and to us, the international financial institutions.

One area where I think the IMF and others who have taken the same stance have been right is in ensuring macroeconomic stability. It is great to think about inclusive growth but if you do not have macro stability you cannot even get to inclusive growth. And sometimes macro stability goes in the same direction as inclusive growth: for example, when you have huge fiscal deficits, because of generalised subsidies, which benefit everybody, they actually benefit the rich a lot more than the poor. That is one area where macro stability and inclusive growth go in the same direction. Another area where macro stability and inclusive growth follow the same direction is when you have high inflation. Inflation hurts the poor a lot more than anybody else. But even when they might seemingly contradict each other, if you do not have macro stability you are not going to be able to sustain everything that goes into building inclusive growth. So I want to emphasise this point, which is a message we need to keep giving because that is what is going to lay a solid foundation both for growth and prosperity.

So where did we get it wrong? Macro stability may be a necessary condition, but it is not sufficient without the component of inclusive growth. Because if you just ensure low inflation and fiscal surpluses and you do nothing about inequality and poverty, it is going to backfire, and we have seen that. And here I want to make a comparison very much with Latin America. Latin America liberalised in the 1990s and they had high growth rates. And I know we have gone back and forth on whether growth was high or low in the Middle East, but actually growth was reasonably high when Tunisia, Egypt and Jordan liberalised. The growth rates were around 5-7%. In Latin America, even though they had high growth, there were many backlashes because the growth model simply did not deliver on the social side. So what is similar is that even though there was liberalisation and growth here, few were benefiting from the fruits of these reforms. So what Chile, Brazil and Uruguay began to do, which they call the “Second Generation Reforms”, was to focus much more on social policy and improved access to equal opportunities. And that has obviously been paying off, as we see, in Latin America. Now they are in the “Third Generation” of reforms, which is focusing on regulation, along with the rest of the world. But let me just say that this backlash is something we can see in advanced countries too. So one lesson is that we really need to focus a lot more on how the benefits of growth are being distributed.

A third lesson, and this is very much in contrast with the transition economies, is that the IFIs definitely suffer from a stigma. It may not be as much in Libya because Libya has not had IMF programmes. But in many parts of the MENA region, we are not seen as

institutions that are in any way supportive of the poor, the people on the streets. We have been accused – rightly or wrongly, and often wrongly – of having supported the autocratic regimes. The fact is that we work with any government in power. That is our job. But that is how we are seen. So we need to find a way to demystify ourselves and explain who we are and what we do in a much better way. And I think we have also evolved. So the package we bring is a lot more sensitised to the local conditions, because we have learned from the past. So that is another lesson and a job that needs to be done.

That brings me to the second point: what can we do? And let me focus on the IMF. I think there are three things that we can do: we can give policy advice, provide technical assistance, which helps in institution building, and provide financing. In terms of policy advice, I think we still have to keep our emphasis on addressing the macroeconomic imbalances that exist in many countries today. There are several countries that have very high debt levels. They have very high fiscal deficits and, in some of them, inflation is very high. So that is a job that we just need to keep on doing, helping these countries address them. On fiscal deficits, there is one key item that needs to be established and that is the huge level of subsidies that exist in many of these countries. This region has the highest subsidies. Some countries, like the oil exporting countries, can probably afford it. By afford it, I mean not efficiency-wise, not equity-wise, but just financially; they have the resources. But most of them simply cannot afford it. Just to give you an illustration, in Egypt about 10% of GDP is fiscal deficit. That is almost exactly what the level of subsidies is. So that is something I do not think can wait any longer. But the Egyptians themselves understand this and want to do something about it.

The second issue is the question of inclusive growth: I really think we have to help build socially-targeted safety nets. And this, of course, is not necessarily our direct area at the IMF, but it is where it is absolutely imperative that the IFIs work with each other because it is their area of expertise; for example, the World Bank and maybe some other IFIs. Even if the countries want to get rid of their generalised subsidies, they need to have targeted safety nets in place for these reforms to succeed. The lesson from Iran was fascinating to me. Before removing the subsidies, they established checking accounts, and they managed to do it for I think about 85-90% of the population. They deposited identical cash transfers for every household. So that took care of the inequality in one fell swoop. Of course, now they are struggling with how to improve the productivity of the industrial sector, which is highly inefficient and very dependent on oil, but there are ways of doing it, and there are lessons from other countries.

The third issue is on unemployment. It is true that unemployment actually did come down during the high growth period. The problem is that the growth of the labour force is extremely high. That is a huge issue. And if that is the case then clearly these countries need much higher levels of growth and they also need to have growth that is a lot more oriented towards employment generation. There are many issues which I will not dwell on, but just to mention one: the type of education in these countries needs to be reformed.

A fourth area: trade integration. The fact is, if you look at the MENA oil importers, their exports as a share of world exports is only 2.5% of GDP. It is very small. To give you a

perspective: emerging Asia is about 30% of GDP, a big contrast. This is both an opportunity, because it is so low – if you do a little, you will grow – but it is also a challenge. This trade can grow, not just with the rest of the world – and maybe they should reach out to the emerging Asian world because they are growing more – but especially trade with each other, within the region.

And, finally, on the policy advice side, I think we have to keep emphasising much greater transparency in governance and all the things that create a competitive environment. Access to finance is critical; equalising the opportunity of small and medium sized enterprises. Again, let me just give you some examples: the share of micro credit loans in total bank credit in the MENA region is less than 1%. It is not great in other parts of the world, but even in Sub-Saharan Africa and Latin America it is 5-10%. I think this is very important if you want the small sized enterprises to benefit.

Second issue: on paper you will see that for a firm it takes on average 15-20 days to get a license in these countries. But if you ask these firms how long it actually takes, the answer is 60-90 days. So there is a disconnection between what is on paper and practice.

And the final example: Syria. There is private activity, of course, but the state banks completely dominate. They have 80% of the assets, and they give out 75% of the loans, including to the private sector. But, of course, this is used very much to benefit the regime and their friends, who may be in the private sector.

So there is much to be done, and not just by the IMF, in helping this region provide much better access to opportunities, to finance, to creating a better environment, and to helping improve governance overall.

A second aspect for the IFIs to do is to facilitate institution building. We have so much expertise. And why do we have it? We have it because we have been working in different parts of the world; we have learned lessons from what works, and what does not work. This expertise comes from countries where it has worked, although there are also lessons to be learned from where it has not worked. And we have good networks too. So I think this is an area where we have to keep providing technical assistance. But, of course, this technical assistance should not be provided blindly. It is easy to ask for technical assistance and not do anything about it. I think we need to have much better governance vis-à-vis ourselves. So that is an area of improvement needed for us.

That brings me to the final point on what we can do, and that is financing. Unlike the Marshall Plan, unfortunately, even if we thought it was a good idea, I do not think it is coming. I do not think it is feasible. It is not the right time because traditional donor countries are themselves extremely cash-strapped and the global environment is extremely weak. That is a reality that everybody has to face. I still think that there is a lot we can do, even by providing small amounts of financing. If we all join forces, the needs are not overly great on the financing side because a lot of countries are either rich themselves, like Libya, or they get some help from their regional partners, the Gulf States. But one thing that we keep hearing, including from the Gulf States, is that they want some governance if they want to give money. And that is where our role comes in, sending

the right signals by providing some financing, to show that we are serious, which also brings much needed confidence for the private sector, both domestic and foreign. So there is a whole reform package that can be put together with the governments themselves, with the people, with our help and with some bilaterals – especially in the region – who can help. The IMF has also recently introduced new instruments of financing, which recognises that there will be transition governments, that they have needs, where you cannot impose too many conditions. I will give you a couple of examples. There is the so-called Exogenous Shock Facility. This consists of a very rapid financing income when there is a shock that hits because oil prices or commodity prices go up and hurt the countries. There is another new one that was just approved last month called the Rapid Credit Instrument, which is, again, to bridge the gap for a temporary period. They do not include too many conditions but then, of course, the amounts involved are not big either. So my bottom line on financing is that the IMF has committed to providing about 35 billion dollars to different countries together, and we would very much welcome and urge our IFI partners to also join forces when we think that the conditions are right to help a country.

And this brings me to the final point about the key messages. There is both fear and hope in the region. I want to focus on hope. I would say, first of all, capitalise on your strengths. The MENA region has many strengths. There is a young and dynamic population. Take advantage of the population, which is a dividend. They have a privileged geographic position. Take advantage of the low transportation costs and the low trade integration that you have. Finally, take advantage of the help that the IFIs and bilaterals can offer. The message to ourselves and the bilaterals: I think it is absolutely critical to support economic transformations that are home-grown. They have to be home-grown. If they are not home-grown we are just not going to succeed. We have seen it repeatedly fail many times. And, in that context, I think we have to work with them. If we demand and welcome democracy and elections, we have to respect the results of the elections, we have to work with whoever comes to power and we have to give them a chance.

Second, there is this Deauville Partnership and there is already scepticism setting in from the people in the region. They ask: "There's a lot of talk, where is the meat?" I think we have to provide real help. By real help I mean market access. If you look at the past trade agreements, the EU agreements, this region did not really get that much benefit. There have been a lot of non-tariff barriers. Quality was a very key word which hindered trade. Provide credit guarantees. Provide concessional lending. And I would even dare to say provide access to labour markets.

Finally, the third message to IFIs and bilaterals is to engage in outreach. In the current environment of transition governments that are not yet fully democratically elected and legitimate, it is important to be more inclusive and engage much more broadly than before with civil society and emerging political parties. But, as I stated earlier, I think outreach is also needed to correct the misperceptions of the IFIs to overcome the stigma that exists against us.

Caroline Freund. Chief Economist of Middle East and North Africa Region, World Bank (WB)

I will divide my comments into three parts. I am going to talk a bit about transitions and what they mean, the role for outsiders, and then employment in the region, which is a key issue.

To start by talking about transitions, one thing we have done is to pull together data on about fifty successful transitions. These are countries that jumped from autocracies to democracies and managed to sustain them for seven years. Then there are nearly forty unsuccessful ones that jumped and went back, or did not quite manage to jump all the way. And we looked at some of the things that happened. And one of the things is that there is a temporary cost to growth; because of uncertainty, investment tends to decline. Surveys now show 70% of investors in the Middle East and North Africa are waiting on the sidelines. And what we see is that growth tends to decline, but it is a matter of one or two years. And just to give some examples: in Turkey, the growth cost was just 2-3 percentage points in one year and a little the next year when they transitioned. In Indonesia and the Philippines, it was a lot more: they lost about 13 percentage points in growth, but then growth resumed. The other thing we have seen in these successful transitions is that if you compare the post-period – not including the first years of loss – and the pre-period, growth is actually higher. So this transition does force better governance and we see a better percentage point gain in the decade after the transition compared to the decade prior to the transition. So there are some gains.

We also looked at what increases the probability of having a transition. The results are kind of interesting and they speak very much to what we have seen. One is the age of the dictator, not the years in power, which was not significant, but the fact that these old guys are ready to go. A little more political freedom, a less severe autocracy, actually increases the chance. Unfortunately, for some of the countries in the region, oil makes it less likely to be successful. We also looked at the likelihood of having a successful transition, as opposed to one of these failed transitions. One thing that we can mention is access to information. Whether we measured cell phone or Internet usage, more and better information makes you much more likely to be successful.

The second thing I wanted to talk about is the role of outsiders. First, ultimately right now it is going to be the countries themselves that matter, so outsiders are playing a purely supporting role. We were asked to discuss the Marshall Plan kind of concept, but it is not clear that this is really about money. The Marshall Plan came after a devastating war. In the MENA region there is a lot of money being spent on subsidies; in many cases, it is just a matter of readjusting to use that money more effectively. It is about carrying out regulatory reforms. Some countries carried out tremendous reforms on the doing-business indicators, but the implementation was not there.

The World Bank strategy right now is based around four pillars, which are governance, jobs led by private sector growth, economic and social inclusion and sustainable growth. The other thing the IFIs can do is to provide data information. As I mentioned, successful

transitions had better access to information, and one thing that is missing in this region is some of the diagnostics we have seen in other regions. If we cannot diagnose the current problem, we cannot necessarily apply the best solution. In Tunisia, we have seen an increased openness to data. We are working with the authorities on the firm censuses to look at which firms create jobs, and we have actually done the analysis on this. What we find is it is actually very similar to what you see in the US: that it is young firms and large firms, so it is not the standard small-firm argument you hear. It is actually young firms, many of which are small, but age matters much more than size. So I think getting data out there is important, as is dissemination. In the past we probably spent too much time disseminating reports asked for by governments for governments. We need to disseminate to the public to help get the right information out, so people can understand who is benefiting from subsidies or other issues and help get the debate on the street. For instance, in the Africa region, the World Bank has started sending text messages to people in the form of a quiz that makes it interesting and in that way it gets information to the people.

The final thing I wanted to talk about is employment. One of the interesting things is that it is not just a MENA issue. And, actually, since this is a Mediterranean conference, I looked at unemployment of all countries with a coastline on the Mediterranean, and it is 12.5%. Youth unemployment, on average, is 26%. The Euromed region has an unemployment rate of 13.5% and youth unemployment of 28%. The MENA/MED has unemployment of 10.5% and youth unemployment of 24%, slightly better than the Euromed. In this regard, competitiveness is the key figure, and there is one price in an economy that really reflects their competitiveness, and it is the exchange rate. The exchange rate can be adjusted through wages and prices or through devaluations. But these countries have in common a fixed exchange rate or an exchange rate tied to the euro. It is just something to think about: that all the reforms we can carry out, in trying to open to trade and so on, may not be effective if the exchange rate is misaligned. If you look at the Morocco-US Free Trade Agreement, what you see is US exports increasing to Morocco but Moroccan exports to the US are quite flat. So it did not have the bang, and part of that might be that you need a more competitive exchange rate. These are complementary reforms seeking macro stability. With the subsidies they have, it is very hard to move on to other things. But macro stability and getting prices right is crucial to moving forward.

Regarding the interventions of the World Bank and other IFIs, I think we really have to think about what the distortions are. For example, when investing in power plants we have to think about the distortions in place; or when financing SMEs we must think about why firms are not growing. In short, we must think more holistically about the necessary reforms.

Erik Berglöf. Chief Economist and Special Adviser for the President, European Bank for Reconstruction and Development (EBRD)

The EBRD is completely new to this region. We were asked by the G8, as part of the Deauville Partnership, to extend our activities from Europe – we were basically in Eastern Europe, Southeast Europe and the former Soviet Union, including Mongolia – to, in the first case, North Africa, but also Jordan and possibly more countries later. As we prepare to start investing, we have been looking back at the experience in Central and Eastern Europe. We have also been assessing our own role in the transition process. As with the other IFIs, this role was very much conditioned by the context in individual countries – by initial conditions and by overall policies pursued. Most importantly, we have analysed how we need to do things differently in our new region.

I am going to divide my talk into two parts: first, I will try to put the lessons from the European transition into some context, and then analyse the lessons from that experience for the countries in North Africa and the Middle East.

The transition experience in Europe is extremely diverse. There are failures and there are successes, and we need to learn from both. In terms of successes, Central Europe has since 1989 achieved a remarkable institutional transformation. I do not think that you can show any other example in history of similar progress in genuine transition over such a short period of time. Moreover, the trade reorientation has been exceptional, probably the most dramatic in peacetime. What explained those successes and why it did not happen all over the region, because it did not? A large number of countries in the region are “stuck in transit.” This is familiar from all over the developing world. Countries start reforms and then get stuck. The reform process is captured by vested interests with a stake in the status quo.

Looking at which countries managed to break out of such transition traps is a very important exercise. One overriding factor – and I think this is something that we need to take very seriously and it came up in the previous debate – is the anchor of the European Union. Basically, that is what I meant by initial conditions. The countries that really had prospects of joining the European Union managed to do so, despite the very strong initial output decline in the region. And despite very different approaches to the transition, of privatisation, of restructuring the banking system, of building capital markets and so on, the real convergence we have seen has been driven by the strength of this EU anchor. And countries that have had explosions in corruption after the transition started managed through this process to break out of the cycle. Poland is a very good example of that.

Needless to say, the historical experience and culture of the countries in North Africa and the Middle East differ fundamentally from those of countries in emerging Europe. The idea of “Back to Europe” can never have a similar meaning or appeal in the MENA region. The likelihood of these countries ever being offered the prospect of membership in the European must be viewed as very slim and in any case beyond the horizon of any policymaking today. At the same time, the economic logic of these countries adopting

standards and integrating with the European Union is very strong. Offering meaningful prospects for access to the single market would provide a sense of direction for the transition process in the MENA countries.

What are then the key lessons from the Eastern European transition? One is that it is absolutely crucial to transform the role of the state, allowing the private sector to develop but giving the state the tools and the effectiveness to support that development. That is possibly the most important lesson. Other important lessons include the importance of the social aspects of reform, compensating losers to the extent feasible, and using the need to sequence reforms to build constituencies for future reform. That is something that countries that were successful were good at.

When I look at the North Africa region today, what is really relevant is not looking at the situation in 1989, but really looking at the countries in 2011. And it is very important to have this perspective because these countries are not starting from scratch. In other words, there is a transition history, so things that did not mean much to countries in 1989 mean something today. For example, privatisation: if you come to use the term “privatisation” today in Ukraine it means something. To many the term is associated with insider deals, with extensive corruption and so on, and we need to take that into account when making policy recommendations. The fact that there is a transition history also means that much has been done. We do not need to build a financial system from scratch. There are banks; they may be more or less good at what they are doing, they may have more or less bad portfolios, but they can be used as vehicles, and that is very important for an institution like the EBRD.

The negative side of the transition history, of course, is that there are fewer easy wins. Something that was extremely popular and very important in pushing the transition agenda in Eastern Europe was the possibility of privatising small shops, small sized enterprises and so on. Those kinds of reforms have already been done. Not to mention the differences between these regions in terms of demographics of social constraints, of human capital and the difficult match between human capital and what the needs of the market are. The religious dimension is also different.

When looking at the needs of the MENA region what is called for is not a Marshall Plan. It would in fact have counterproductive effects. What is needed is not a macro plan where you are putting capital into already existing and well-functioning institutions with human capital that is well-adjusted to the markets, like the situation after World War II. What we need is something that is micro-driven, something that is targeted at creating an investment climate that generates growth.

The IFIs also should not interfere with local politics. Instead we should be part of supporting the outside anchors, and we should create conditions for these countries to exploit the benefits of these outside anchors.

Despite the difficult business environment I am optimistic. There is a wonderful book that most of you probably have seen: it is by Abhijit Banerjee and Esther Duflo called *Poor Economics*, which explores this issue. It says that even in the worst institutional environments you can make progress if you do it in the right way; if you really try to target

the failures. For example, even in thoroughly corrupt systems you can improve voting procedures so as to more adequately reflect the vote of the poor and studies have shown that this is then reflected in actual political decisions. There are things that you can do even in very poor environments; we should not despair over the political economy.

What then can the EBRD specifically do? First of all, one thing that came out of the crisis, and which is incredibly important for us as a newcomer to the region, is the cooperation with other IFIs. We are trying to coordinate our efforts in different parts of the world where we overlap. We need the support of the World Bank and we need the support of the IMF to be able to create an environment where we can work. This is something that has improved a lot.

When we talk about supporting development for individual projects, what can we do and what will we do in these countries? A lot is going to be focused on job creation. It is a very different world from the one that we went into in Eastern Europe, where most people were basically employed, but in activities providing little value, sometimes even destroying value. We need now to focus on how we can create jobs and we can do that through reaching SMEs, but we should not forget about the large companies – research shows that they often are more important in creating lasting, sustainable jobs. We need to work to make these companies more competitive globally and we are going to do this, again through specific investment, working with both domestic and international investors.

We are also going to focus on municipal infrastructure, investing water and energy efficiency, and creating transparency around these activities, particularly around procurement. In addition, we are looking at a lot of ways in which we can work again with the other IFIs, improving the governance environment, including corporate governance, and facilitate the entry of new companies. The discrepancy, which you find when you look at the rules on the books and the actual environment for these companies, is absolutely critical to address.

Finally, let me end on another note of optimism, not only about North Africa and the Middle East, but also the rest of the transition world. We talked about the lessons of Eastern Europe for the MENA region, but it is also interesting to see how the lessons from the countries of the Arab uprisings are taken to the countries in transition elsewhere. It is absolutely fascinating if you follow what is going on in Russia right now: the demonstrations in Moscow, the response from the leadership and so on, which is very much inspired by what happened in North Africa. And this goes not only for Moscow or Astana in Kazakhstan. It goes way beyond that. It goes for China and Hanoi. This is incredibly important for the world and in all these discussions about how we can try to instil lessons into this part of the world we should also see the incredible benefits for the world as a whole.

Debora Revoltella. Chief Economist, European Investment Bank (EIB)

I would like to limit my presentation to a couple of points, commenting (1) the complexity of the challenges for the region, (2) the role of Europe and IFIs supporting the transformation process.

The Complexity of the Challenges

The Arab Spring has opened the door to huge opportunities for people in the Mediterranean region, but also to multiple challenges. The political challenge, the economic challenge and the social challenge are all strict priorities and need to be addressed in a very integrated way. Short term oriented measures, addressing macroeconomic, political and social stability must combine with efforts to gain medium term objectives and pose the right bases for their achievement. A path of sustainable inclusive growth is the medium term goal.

In this context, expectations of the population are important drivers and constraints. The people and the young people in particular emerging from the revolution have high expectations for the future and this poses an incredible additional challenge to the new political force. This new political force has to come into power, to legitimate itself, to change the way in which governance is done, and then be much more inclusive in the way of doing politics, of managing economic resources. At the same time, they need to be quick in delivering. Failure to do so would substantially endanger the whole process.

To face those challenges, countries need comprehensive and well designed transformation strategies. The international community and IFIs can be facilitators of the transformation process, but countries, need to set the direction and feel a strong ownership for their own transformation strategies.

The Role of Europe and IFIs in the Process

From the European point of view, we are in a tough position. The context is very different from what happened in 1989, when the transition in Central-Eastern Europe started. At that time, Europe was really the benchmark. There was a natural process of political, economic and social convergence, in which Europe was in a position to attract those countries toward the EU standards. Today the situation is different. Countries in the Mediterranean are not exclusively looking at Europe but also looking politically, economically and socially towards other examples. And Europe is a less shiny example to follow, from a political and economic point of view. We have an economic and institutional crisis inside the EU and we are fighting to find a common solution that will solve the internal problem and, at the same time, we have ended up with strong fiscal corrections in some countries, which are necessary but which will also have some social impact on Europe itself. But as Europeans we are working through our own readjustments and our success will be a stimulus for others to follow, as well as work as a catalyst for attraction.

From a European perspective, despite internal challenges, it remains crucial to play a strong role in the MENA region because it is a unique historical opportunity and we are living in the same Mediterranean area; and because there are economic and social benefits for the Mediterranean area overall, both South and North, from deeper economic and trade integration.

Having said that, what can we do? We are working together with the Deauville Partnership. This is not a massive and macro Marshall Plan, which would not be feasible in the current circumstances. But we are aiming at more inclusion of the region in global dynamics. Economic integration through increased trade and foreign direct investment (FDI) is key to support the countries of the region in their own transformation phase. Clearly this is not all, and internal structural reforms will remain the key driver of transformation. My institution in particular, the EIB, is looking at the business opportunities and private sector development.

The EIB has a consolidated presence in the region. It is a project-based institution, the bank of Europe, a bank which has a mandate to carry out long-term investment to support growth in Europe and outside the EU (90% of activities are in EU countries and 10% outside EU countries). We have been massively present in the region for many years through the FEMIP, which is a special structure dedicated particularly to the development of local markets. We have a platform for investment of some 13 billion euros, which account for roughly 2% of the regional GDP and, as an example, last year we invested 2.5 billion euros in Mediterranean countries.

We are going to continue what we are doing: continue to work on project-based programmes and push for private sector development, for structural development and for long-term investment projects in the region. We are looking at sectors such as energy, water and transport. We have fairly strong expertise in the European market on PPP, and what we are doing is to extend our expertise to also cover the Mediterranean and look at the legal and institutional preconditions that need to be in place in order to grow more with this kind of project. The other activities are related to financial sector funding, actually lending to small and medium sized enterprises. From this point of view, one of the things that we are looking at in more depth is the banking sector: whether the banking sector really needs long-term funding, or if it is liquid enough, has enough resources or needs more credit guarantee schemes, which would allow it to lend in an easier way to small and medium sized enterprises.



**Conclusions:
What Prospects for Economic
and Democratic Transitions?**

Conclusions: What Prospects for Economic and Democratic Transitions?

Samir Radwan. Former Minister of Finance, Egypt

It has been a very rich debate: let me take a few minutes to point out the most important messages I have taken from this conference.

The first is that the most important challenge for the Arab Spring countries is the management of the transition. And that is where we were all groping with various ideas, drawing on our vast experience around this table to guide this transition, with expressions of hopes and fears and a wealth of information about the research that has been done. That raises three major issues. Issue number one is how to promote inclusive growth, and how to design and put into action a kind of growth regime that takes job creation as its objective. In a very interesting seminar we had with Lord Robert Skidelsky, Keynes' biographer, someone said that "what we really need is a bit of Keynes and a bit of Schumpeter's creative destruction, because the private sector is very important in regenerating this growth." That serves as a good starting point.

So far, the source of growth in the region has been consumption. And in a country like Egypt, while the expectation is 1.9% GDP growth this year, consumption accounts for 4.9%. Investment is taking a secondary position. If we want to employ the young people who come to the labour market every year, investment has to be between 22% and 25% of GDP. Now it is on average 15% to 17%. So that is a challenge that we have to confront. How do we do this? The answer is probably that the public sector has to take the lead in stimulating investment, thus crowding in private investment, which has suffered quite a lot during this transition. Therefore, I think the more our multilateral partners can help these countries in designing a stimulus package which regenerates investment and raises savings, the better for these countries.

But that does not absolve our regional and global partners. In the first session, we had a discussion about the role of Europe. There are two points here. Point number one is that any rebound of growth in the region will depend very much on growth rebounding in the Eurozone and in the United States. The Eurozone for us is very important; 40% of our trade is with the Eurozone. Then we come to the whole issue of the quality of this growth. The trick here is how to deal with the problem of growth redistribution. I did a little study before the revolution about this issue and I found that if the structure remains the same, distribution will remain the same. If 42% of your labour force are illiterate and have no access to skilled jobs, and therefore higher pay, forget the whole story. And that leads us to the whole issue of training, skills and education.

The second thing is that growth, employment and poverty are a nexus we cannot approach separately. We have to see the linkage between them in designing policies. And here comes the discussion about the SMEs, which has been very much present in

this conference. But we really need to stop talking about SMEs and start doing something about it. And in my position as Minister of Finance I tricked the Central Bank into giving me a bank, Banque du Caire, which I was going to put in charge of financing SMEs. A breakthrough has to be made; entrepreneurship has to take up its position.

In reference to fiscal policies, what I picked up from this conference is the appreciation of everybody around the table about the dilemmas that these transition countries face. They want to satisfy what we call rising expectations but at the same time they do not have the resources. Could external resources foot the bill? In Egypt, we tried to compensate with the IMF and the World Bank because, given the situation, domestic resources were not sufficient. I agreed with Tony Blair when he said that the days of traditional aid are over. What I want is transfer of experience, technical cooperation, resources that are transferred from places like the EU or the IMF.

The second issue is regulation and the execution of policies. I think it was perverse in our discussions. How do you guard against the new regimes by falling back into the mistakes of the old regime? The free economy is a regulated economy. Not regulated in a coercive manner, as it is not the role of the state to suffocate everybody with laws, but I think regulations in the modern sense are extremely important. However, in Egypt, the larger part of corruption is legalised. So, the trick is – in any institution – how to close the legal system loopholes that make it possible to get away with corruption.

My final remark relates to the rise of political Islam. It is a very real issue in the region. The programmes of the Islamic parties are very vague, especially when it comes to things like taxation. The largest part of the Muslim Brotherhood's economic programme is based on Islamic charity (zakat). President al-Bashir of Sudan, backed by the Muslim Brotherhood, removed taxes and established the zakat. At the end of the year there were no salaries, the pot was empty and they had to abandon zakat immediately. So I think we have to put these parties to the test as far as serious economic policies are concerned. At the same time, I think Europe and IFIs have a role to play supporting secular forces and secular policies.

My final word is on integration, which is a real issue. If we have emerged from this meeting with something specific, it is deepening integration between Europe and these countries.

Tarik Yousef. Chief Executive Officer of Silatech, Qatar; Non- Resident Senior Fellow, Brookings Institution, USA

I think most of the issues have been amply covered by Samir Radwan. I would like to reflect here on an issue raised by Erik Berglöf (EBRD), who reminded us of an interesting new book, *Poor Economics* by Abhijit Banerjee and Esther Duflo, which addresses micro interventions as opposed to typical macro interventions. One of the premises in this book is that you can, even in a rather imperfect world, engage in micro interventions that might be effective and deliver results. This might seem like a very obvious fact but I do not think it is, especially at this moment in the region when we are thinking about grand proposals for reform. For example, just a couple of weeks ago there was a regional conference where a Marshall Plan for the transition countries in the Arab world was discussed. Some went out on a limb and even tried to do some back-of-the-envelope calculations to come up with the cost of a big Marshall Plan. In contrast, I find it more appealing to approach the transition issues from a micro perspective. Many people in the region do not necessarily fully appreciate why these micro interventions or micro reforms matter and why they might in many cases be the only thing we can or should do. Now, I have an interest in this, partly because I work in a foundation which is in the micro arena and is an institution that wants to invest in SMEs, microfinance projects and the skills development area. I came to this micro area, thinking that there will be a lot of actors, that every large country in the Arab world will have lots of incubators for entrepreneurship and lots of SME funds; and that they will all be in competition to grab companies, start them, and make them grow and be successful. And that there will be a lot of centres of excellence that promote that kind of skills formation and mind set change. However, and this is one of the most surprising and perhaps frightening realizations, these interventions in the SME space, for example, are few and far in between and their impact is rarely monitored or assessed. We have many more experts on the region but very few practitioners where it matters the most. As a result, if we are going to be tempted to go down this path of thinking about micro interventions, I think a lot of experiments will go wrong and the final results may not necessarily get us to where we want to go.

The SME funds that we are helping to establish are not particularly big in size. And the expected employment impact is typically very small. Even the proposed two billion dollars that Europe might pour into the SME area in Egypt is going to have very modest results on job creation. Hence, while micro approaches might have a lot of potential prospects, and the money might be there, implementing such reforms will not be easy. Unless we multiply the micro interventions or multiply the actors in them we may not affect the magnitude of the problem. We are talking about hundreds of thousands, if not millions, of jobs every year and we want to create employment through modalities that we do not understand very well.

Just a case in point: you can count on maybe one or two hands the number of SME fund managers who are competent, have a track record and that you would want to trust with millions of dollars in our part of the world. Try to invest billions, think of the number of

fund managers that you need to find, what you would require of them. It is perhaps a call for us to think through this micro area more, and to invest in it as much as we have done over the years in the macro space. But I think I have learnt a lot personally and I am certainly going back to Qatar with a lot of food for thought and a lot of input into my own work.

Jordi Pujol. Former President, Government of Catalonia, Spain

First, I must say that in fact today we Europeans do not have great authority for telling you what economic governance for Arab transitions should be because we are not governing very well in our European Union. But I actually experienced the Spanish transition directly and I will tell you about this.

In order to understand the Spanish transition, we must start from the past, in 1854. At that time, Gross Domestic Product was not calculated but there were similar calculations. And if we look at the evolution of Spanish income and GDP from 1854 to 1960, Spain was moving backwards. Not in absolute terms, but in relative terms. In comparison to France, Italy, Germany, Holland, the United Kingdom or the United States, it was going backwards. In fact, it suffered from a long decline. Spain had been a country in decline since the 17th century. And it was moving backwards economically and socially. It was not the sick man of Europe, as was said about Turkey, but it was a country that did not advance enough. We had civil wars, dictatorships, instability, poverty, territorial unbalance, and so on. And the last civil war, which was very devastating, lasted from 1936 to 1939. There was the dictatorship of General Franco and for the first twenty years of his regime the country was economically very bad. Along with the dictatorship, there was poverty and underdevelopment. Moreover, Spain was a closed country which did not want to know anything about Europe. It was also an economically closed, autarkic, country. It was not a modern country, and was highly conservative in all senses: politically, socially and religiously.

By 1959-1960, however, during the dictatorship, a desire for change emerged. This is how a new policy began following the World Bank's slogans of economic governance. The option taken was economic growth and opening towards Europe. It was a limited opening because, as it was a dictatorship, it could not apply for membership of the EU. But a very intense trade and tourism policy was developed because they involved major economic profits but also because mass tourism also obliged the Spanish population to open up or helped them to become familiar with other things, with other worlds. And all this bore fruit.

For fifteen years, from 1960 to 1975, which marks the end of the dictatorship, Spain experienced a great economic growth and began to gain ground among the neighbouring Europeans. This resulted in a rapid creation of the middle class. Spain was a country with a small middle class. In Catalonia, which enjoyed a mainly industrial economic development and greater opening towards Europe, there was a middle class. The same goes for the Basque Country. But in the rest of the country it was only present in some areas. And democracy hardly takes root and prospers in a country in which there are only rich people and poor people. In other words, if there is no important middle class sector, democracy can hardly consolidate. Moreover, a certain opening of the regime took place through many social events. Thus, when 1975 came, the country was much better prepared for democracy and more open towards Europe.

In order for you to understand the importance I attach to this fact, I would like to emphasise that the same government which began this policy in 1959-1960 sent me to jail for three years as I was against the regime. Thus, when I praise this policy, I do so because, objectively, it had a decisive influence on the future democracy.

In 1975, when General Franco died, there was some disorientation. The most conservative sector, supporters of the dictatorship, realised that in that context it was meaningless, and there was a certain opening from within the Francoist regime itself. A new man, from the regime but young, was appointed, President Adolfo Suárez, who would lead the transformation. And the transition process began, with the political parties and the trade unions still prohibited, but with greater freedom of action.

And then two highly important events happened. A committee was created, called the Committee of the Nine, with representatives from all the existing illegal political parties. This Committee met with President Suárez to jointly define how to undertake the transition (for instance, the type of electoral law, the legalisation of the parties, etc.).

The elections took place on 15th June 1977, almost two years after the death of General Franco. They were won by the governmental party, Unión de Centro Democrático (UCD), but without an absolute majority. The economic situation was at that time very difficult. Inflation was around 26%, with the risk of increasing. The government had to adopt a series of unpopular measures. And the opposition led by the Socialists had a poorly collaborative attitude. Thus, the government could not carry out the measures. Our Catalan nationalist party, despite disagreeing with the UCD on other issues, voted with them for the economic measures because we considered that otherwise the country would collapse. These things are necessary in times of transition.

The second fact was that, after some time, President Suárez summoned all parties to jointly agree the economic, fiscal and social bases of the country. They were called *Pactos de la Moncloa* (Moncloa Pacts.) And this yielded good results. There were other elections and we applied for membership of the EU and NATO, and so on.

Moreover, I would like to emphasise that there was a moment when the trade unions adopted a more aggressive posture in their demands and somehow put the transition in danger. But soon after, it should be noted that the trade unions matured quite quickly and understood that they could not have everything in such a short period of time.

As for the Church, bearing in mind the importance that religion has in many Arab countries, this problem existed here, although less intensely. But, of course, the issue of the Church could have been somewhat dangerous and there was some confrontation that in certain aspects still exists. However, I must say that the Church had a positive attitude. Cardinal Tarancón, the Head of the Spanish Church, probably by his own decision and the influence of the Vatican, issued a call to support the transition and accept the ecclesiastic institution's loss of privileges.

Finally, the army was also a problem. There was a moment when the army became nervous and attempted a coup. But, as it failed, it was a ridiculous coup. And, of course, a ridiculous coup is an anti-coup and it finally turned against them. Since then, the army

has remained quite neutralised. Curiously, today the Spanish army has become one of the most valued state institutions because it has made a very clear move towards democracy and mainly carries out pacification actions. Something which was very useful for the army is that we became members of NATO and that greatly contributed to the modernisation of the army.

Programme

Barcelona Euromed Forum Programme What Economic Governance for Arab Transitions?

Barcelona, 15th and 16th December 2012 - Palau de Pedralbes

15th December

3.30 pm – 4 pm Accreditations

4 pm – 4.30 pm **Welcome address**

Andreu Bassols, Director General, European Institute of the Mediterranean (IEMed), Spain

4.30 pm – 5 pm **Inaugural plenary session**

Senén Florensa, General Secretary for Foreign Affairs, Government of Catalonia; President of the Executive Committee, European Institute of the Mediterranean (IEMed), Spain

Lino Cardarelli, Senior Deputy Secretary General, Secretariat of the Union for the Mediterranean (UfM)

Olivier de Laroussilhe, Head of Unit, Trade Relations with Euromed and the Middle East, DG Trade, European Commission

5 pm – 6 pm **Best practices: lessons from previous economic transitions**

President:

Alfredo Pastor, Former Secretary of State for Economic Affairs, Ministry of Economy and Treasury, Spain

Speakers:

Samir Radwan, Former Minister of Finance, Egypt

Ioannis Kaltsas, Head of the Trust Funds and Policy Division, EIB Operations outside Europe, European Investment Bank (EIB)

First comments:

Torbjörn Becker, Director, Stockholm Institute of Transition Economics (SITE), Sweden

Luc de Wulf, Former Professor, American University of Beirut; Former Staff, International Monetary Fund (IMF) and World Bank (WB); Fellow, Center for Social and Economic Research (CASE), Poland

6 pm – 6.30 pm Debate

16th December

9 am – 10 am **Institutional reform**

Institutional capacity building. Recommendations for the development of professionalized institutions: agency for property registration, anticorruption agency, financial institutions and treasury reform. Judiciary reform. Re-definition of the Central Bank's role. Public Administration reform.

President:

Andreu Bassols, Director General, European Institute of the Mediterranean (IEMed), Spain

Speakers:

Pilar L'Hotellerie-Fallois, Deputy General Director of International Affairs, Banco de España, Spain

Rania A. Al Mashat, Assistant Sub-Governor and Head of Monetary Policy Department, Central Bank, Egypt

First comments:

Gülsüm Yazganarikan, General Director of Economic Research, Undersecretariat, Turkish Treasury, Turkey

Alexander Böhmer, Head of MENA Programme, MENA-OECD Investment Programme

10 am – 10.30 am Debate

10.30 am – 11.30 am **Macroeconomic policy reforms**

Overcoming crony capitalism: new institutions to ensure free competition. Labour market reform. Access to finance for SMEs. Good governance: transparency and accountability. Implementing private public partnership correctly. What role for the national economic representatives of the private sector?

President:

Marcos Bonturi, Deputy Director of Global Relations, Expert in MENA region, OECD

Speakers:

Mohammad Pournik, Poverty Practice Leader for Arab States, United Nations Development Programme (UNDP)

Tarik Yousef, Chief Executive Officer of Silatech, Qatar; Non-Resident Senior Fellow, Brookings Institution, USA

First comments:

Torek Farhadi, Programme Coordinator, Enhancing Arab Capacity for Trade (EnACT), Office of the Executive Director, International Trade Centre (ITC)

Maria Ortiz, Associate Programme Management Officer, ESCWA/ECRI

11.30 am – 12 noon Debate

12.00 noon – 12.30 pm Coffee break

12.30 pm – 1.30 pm **Socioeconomic policy reforms**

Inclusive growth. Redistribution of wealth. Subsidies reform. Need to create a welfare social network. Inclusiveness of policy reforms design. Reform and universal implementation of tax policies. Employability policies.

President:

Paolo Lembo, Officer in Charge, Regional Center for Arab States, United Nations Development Programme (UNDP), Egypt

Speakers:

Jacob Kolster, Regional Director, Egypt, Libya and Tunisia, African Development Bank (ADB)

Roby Nathanson, Former Head Office, Economic and Social Planning, Prime Minister's Office; General Director of MACRO, Center for Political Economics, Israel

First comments:

Ibrahim Saif, Senior Associate, Carnegie Middle East Center, Lebanon

Hassan Hakimian, Director, London Middle East Institute, SOAS, University of London, United Kingdom

Fernando Perpiñá-Robert, Ambassador of Spain

1.30 pm – 2 pm Debate

2 pm – 3.30 pm Lunch

3.30 pm – 4.30 pm **Final plenary session: general discussions**

The role of European and international institutions

A "Marshall Plan" for the Mediterranean? What role for the international financial institutions? What role for the European Union? What are the consequences of the sovereign debt crisis on European involvement in the transition processes? Development of new cooperation instruments of the European Union, both structural and sectoral facilities.

President:

Josep Piqué, Former Minister of Industry and Foreign Affairs, Spain

Speakers:

Ratna Sahay, Deputy Director of Middle East and Central Asia Department, International Monetary Fund (IMF)

Caroline Freund, Chief Economist of Middle East and North Africa Region, World Bank (WB)

Erik Berglöv, Chief Economist and Special Adviser for the President, European Bank for Reconstruction and Development (EBRD)

Debora Revoltella, Chief Economist, European Investment Bank (EIB)

4.30 pm – 5 pm Debate

5 pm – 6.30 pm **Closing session: What prospects for economic and democratic transitions?**

Introduction:

Senén Florensa, General Secretary for Foreign Affairs, Government of Catalonia; President of the Executive Committee, European Institute of the Mediterranean (IEMed), Spain

Conclusions:

Samir Radwan, Former Minister of Finance, Egypt

Tarik Yousef, Chief Executive Officer of Silatech, Qatar; Non-Resident Senior Fellow, Brookings Institution, USA

Closing intervention:

Jordi Pujol, Former President, Government of Catalonia, Spain

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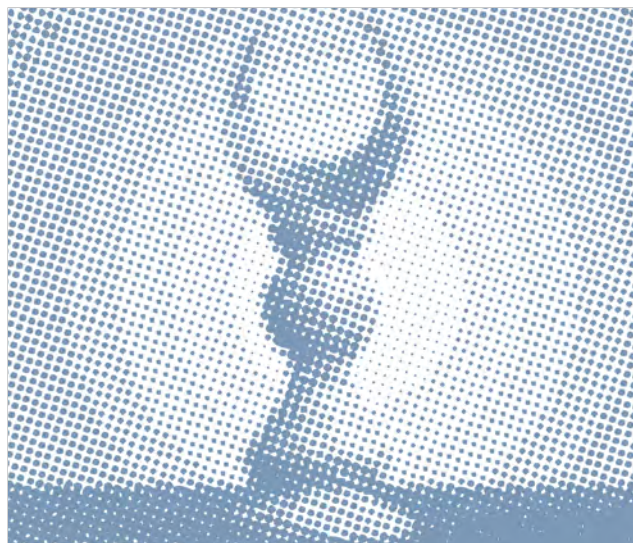
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In 2011, we witnessed the beginning of a historic process of uprisings by peoples of the Arab world demanding democratic reforms in the political, social and economic domains. In the economic field, the demands for the implementation of a more inclusive development model imply a better distribution of economic growth in societies. In this respect, urgent reforms should be endorsed on the institutional, macroeconomic and socioeconomic front.

This report summarises the speeches and presentations made during the two-day international conference called "What Economic Governance for Arab Transitions?" organised by the IEMed and held on 15th and 16th December 2011 in Barcelona. This conference brought together policymakers, high-level researchers, European Union and international financial institutions, representatives of central banks and think tanks to assess the economic causes and consequences of the uprisings in the MENA region. The objective was to provide a platform of dialogue for its participants to discuss the economic policies that Arab Mediterranean countries will have to implement to address the emerging economic and social needs of the region.



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