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Understanding and Responding to Aspirations For Dignity

Facets of Exclusion across the Region

Arab countries have been grouped into various subsets, depending on the purpose at hand. Here, with a view to discussing common constraints and opportunities, we divide them into three major groups, with a proviso that sets apart some of the conflict-affected countries. The groups are high GDP per capita oil-rich countries, middle-income countries and LDCs. High levels of per capita GDP and low levels of income poverty characterize the first group, made up of GCC member countries plus Libya. This group features a large presence of expatriates (that in some cases far outnumber the national populations) and rapidly improving values of HDI since 1970. The oil sector has dominated development in this group of countries, and the resultant substantial oil revenues have allowed the adoption of a welfare state approach for the national population. Common problems related to fragile environments and the excessive use of energy has afflicted growth; each dollar of GDP was associated with the use of 16000 BTU of energy, against 6500 BTU for the average Arab MIC country and an average of 8900 BTU in energy-intensive North America.⁶⁰ The Arab region clearly needs to get ready for a post-oil boom period, as even the most well endowed countries are expected to cease exporting oil within a generation. Most have the luxury of not having to contemplate transformative change in the immediate future, as they can afford to offset political and social exclusion by providing the entire population with access to basic social services and a minimum level of income.

Building on our earlier analysis of the development process in the Arab region, in the following pages we offer an understanding of the dynamics of exclusion in the less endowed parts of the region.

Processes of exclusion in middle income countries

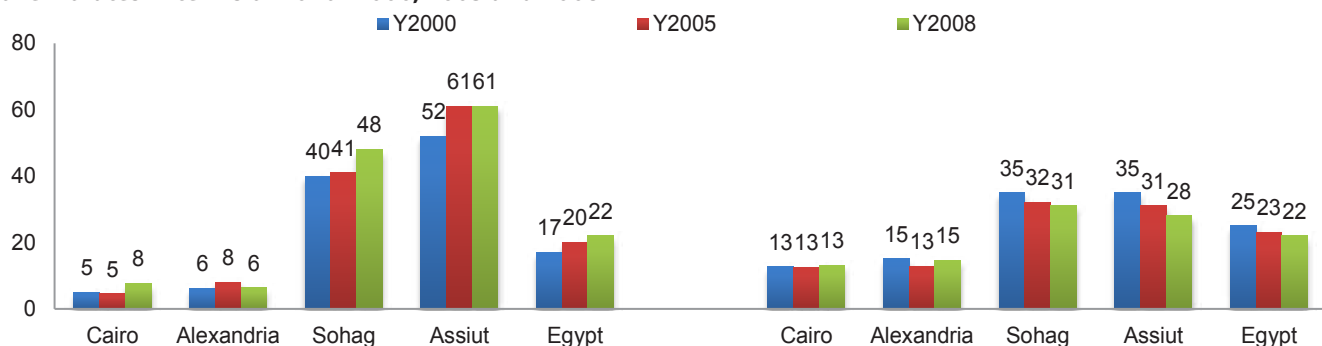
Middle income countries, despite having achieved substantial progress on a range of human development indicators, have not managed to promote inclusive development. Rather, their mostly rentier-based character has tended to marginalize most population groups from decision making processes and participation in the mainstream of economic activities.

The country case studies undertaken as background for this report clearly demonstrate the results of exclusionary processes in the case of Egypt, the most populous Arab country, with very high disparities between richer and poorer governorates in terms of both human and income poverty. While differences have decreased with respect to income poverty, they still remain alarmingly high, with differences of more than 60 percentage points in terms of income poverty between the richest and poorest governorates. Differences in human poverty, despite marginal reductions, remain at around 25 percentage points, with maximum and minimum rates, respectively, at 61% and 35%.

Conventional measures of income inequality, such as the Gini coefficient, do not reflect the wide disparity in wealth and access to social services of which every Egyptian is conscious. Figure 39 shows how huge disparities in income and human poverty continue to persist in Egypt as a major MIC.



Figure 39: Egypt income poverty (P0) (Left) and human poverty (Right) for Cairo, Alexandria and bottom two governorates in terms of P0 for 2000, 2005 and 2008



Source: Authors' estimates based on data from El-Laithy, 2011.

Exclusion in Egypt is multifaceted, with intersecting social, economic, cultural, and political dynamics that have incited rage and undermined dignity. Social exclusion is attributed to inequitable access to health, education, and social protection. Economic exclusion results from many factors, including reduced opportunities to find decent jobs and for SMEs to engage in innovative and productive activities. The dominant role played by politically well-connected businesses who benefit from monopoly rents in the economy has subverted the course of economic development, creating a situation where increases in GDP at the aggregate level have been accompanied by declines in the real income of many people and undermined food security and environmental sustainability. In addition, environmental fragility continues to render people's livelihoods vulnerable. Finally, political exclusion leaves civil and political liberties unprotected, encourages weak participatory mechanisms, and impedes accountability and access to justice and information.

Box 8 offers a simplified presentation of the exclusionary processes at work in Egypt, as a guide to a better understanding of social dynamics, which have to change for Egyptian youth to realize their dreams for a life of dignity, as expressed in the slogan, "We want jobs without nepotism."

Arab states focused attention primarily on urban trading centres, neglecting agriculture and the rural sector. The state kept urban areas pacified as part of the traditional Arab social contract by providing them with subsidized imported food. The neglect of rural areas weakened the ability of emerging or existing powers, such as nomadic tribes or feudal landlords, to challenge the central government. The end result was a consistent decline in the share of agriculture in GDP. This dynamic, combined with only marginal declines in the rural population, explains the increase in rural poverty in many countries, notably in Egypt, in the period up to 2009.

The exclusionary processes at work also explain persistent regional disparities, with divergences in poverty rates across regions increasing in Egypt and Syria and only declining marginally in Tunisia. This is the result of a development process that favours certain growth poles with limited economic linkages among the regions, or redistributive policies by way of public investment. Politically-motivated neglect of certain regions in some countries due to their association with opposition movements has aggravated this pattern of unequal development.

The growth process has not been inclusive, with most economic activity concentrated in the hands of a small, politically well-connected business elite that derives its profits from monopoly control over markets and government contracts. There is no incentive to develop a competitive, productive economy that will sustain a youthful and increasingly well-educated labour force. Unemployment rates remain the highest in the world as more and more working-age people continue to look for work in vain. The few available jobs are typically not in the high productivity, high wage bracket. Efforts to reduce poverty move at a very slow pace.



Box

8

A schematic understanding of exclusionary processes in the Arab region

Nothing exemplifies the multiple exclusion and the ensuing feeling of rage in Egypt better than the situation of an Egyptian young man or woman living in one of the slums inside greater Cairo. Educated and out of school, hoping that a university degree will be a ticket to a reasonably good and respectable living away from the poverty line, the young Egyptian faces a job market that is not producing enough jobs in the formal sector, where those that exist are not subject to transparent and competitive hiring processes. Faced with this prospect, the young Egyptian resorts to the informal undeclared labour sector to earn a living. After all, the dream of marrying a good partner and starting a family is never too far away, but requires financial means. In the informal sector, jobs are insecure, income is vulnerable and social protection and/or some sort of health insurance in case of illness or other risks is non-existent. If this young Egyptian is coming from the countryside, where agricultural production has been declining over the years, the only hope to live in Cairo materializes in a slum area. In the slum, the poor infrastructure of social services (including clean water and sanitation) and human insecurity increase this person's sense of exclusion.

For this young Egyptian, opportunities to engage politically or to express concerns and needs are limited. Until recently, there was a district office for the ruling political party, but it was the very source of the poor policy making that lead to this person's exclusion in the first place. Hopes to receive rights through this party were illusory. Other political parties likely did not have a district presence, or had structures that did not provide public space for a young Egyptian to voice opinions on policy. Civil Society organizations would come and go depending on their funding situation for projects; the media would come through one of the popular TV shows to project exclusion, embarrass a governor or a minister and at best, bring some short-lived nominal improvement.

Any relief in such context would have been cosmetic. The root causes of this multiple exclusion in Egypt were to be found in a political regime that badly managed the economy and natural resources. In the economy, growth was driven by monopolies of business families in close relation to the ruling elite. Water, the main Egyptian natural resource, was squandered in an agricultural sector that literally sucked 80% of it without providing food security. The government's reliance on food subsidies to protect the poor was ineffective because it was biased towards the middle class and because of leakage in distribution due to corruption. In addition, energy subsidies were squandered through ill-conceived energy intensive activities that were biased against the poor.

Source: El-Mikawy, Noha

The rentier mentality of ruling elites further hampers efforts to reduce poverty and income inequality through a tendency for maximal extraction of revenue from the natural resource base, or environmental mining. This is reflected in declining per capita levels of water availability and percentage of land area covered by forests. Declining agricultural productivity as a whole finds culprits in a lack of investment in research and extension services, and a decline in soil fertility, coupled with declining and less predictable rainfall in the context of largely rain-fed agriculture. Egypt and Sudan have access to the Nile River, so their agriculture is not exclusively rain-fed, but Egypt, despite access to Nile waters, has plunged below the water scarcity level. Mismanagement of a fragile environment has kept population groups that directly depend on natural resources, most notably farmers and pastoralists, in a precarious condition that has not allowed them to escape the poverty trap.

The problem of exclusion could have been addressed, if not corrected over time, through inclusive participation mechanisms that would have given the young Egyptian a chance to articulate interests into collective proposals for policy change. Instead, weak political parties, professional associations, and labour unions—as well as a lack of organization in the informal sector—forced young Egyptians into despair. In the years leading up to January 25, 2011, slum dwellers organized small demonstrations and blocked main roads, including the circular roads that connect the rich to their gated communities in the desert and the northern coast.

The call for revolt in the Egyptian Spring resonated with countless others, because this multidimensional exclusionary process is not confined to a specific group, but affects people in rural areas, the urban lower middle class, as well as the poor.

In Morocco's case, we are aware of the dualistic pattern of development going back to the colonial period, where most development focused on the plains and coastal areas that were considered to make up "useful Morocco," while the interior regions were left to their own devices as "useless Morocco."⁶¹ Unfortunately, post-independence governments



continued the same policy, as evidenced, for example, by the focus of all agricultural investment on the irrigated sector that was controlled by a small elite of landowners of vast estates. Meanwhile, the traditional rain-fed agricultural areas, where the majority of the rural population lived, had to cope with overpopulation as the rural population doubled, while land productivity remained unchanged. In 2002, the total value of cereals produced in Morocco, which covers almost the entire production of rain-fed areas, came to only 14 billion dirhams, or less than the value of smuggled goods from just two points.⁶² Against this backdrop, it is easy to understand why rural income and human poverty rates have remained stubbornly high.

Population groups that used to make up the backbone of Moroccan society have, over time, been excluded from the development process and forced into precarious livelihoods. There is documented evidence that politically well-connected individuals made huge profits from trade in land that was to be covered by irrigation projects. For example, three individuals bought 40% of the land in the Sous-Massa region before a dam was built in the area.⁶³ In the name of modernity, traditional rights over what are called collective lands in Morocco have been undermined as far back as the colonial era. As a result, the state and public institutions can effectively dispossess traditional usufruct rights of farmers and pastoralists without compensation. Phosphate companies have used this system to push the traditional populations of mining regions off their lands, and by doing so they destroyed the livelihood systems of pastoralists in particular.

Due to political interference in the economy and the preponderance of rent-seeking behaviour by businessmen, the economy of MICs has been unable to take advantage of the substantial increase in the working-age population from around 40% in 1968 to between 50% and 58% in 2008. Instead, as noted earlier, we see a stagnation of labour force participation at rates well below world averages, particularly for women, combined with unemployment rates that are substantially higher than global averages.

In a closed political system controlled by a political and economic elite, there is no incentive to push a social justice agenda. Despite the fact that most middle-income countries can be classified as diversified economies, with Algeria and Iraq being the exceptions, their public finances show high dependence on royalties, indirect taxes, and external assistance. Morocco may represent a special case with a relatively high share of taxes in government revenues. The states did not push the taxation agenda, as they were not ready to give the citizen a say in how public funds are allocated. In addition, the lax taxation system allowed elites to avoid taxes and protected them from public scrutiny of their finances. A tax system would normally follow a social justice agenda by taking from those who can pay and spending on those who need state support, but taxation without representation leads to rebellion and is not sustainable. No wonder the Arab countries have chosen to forego taxes as part of the social contract that has underpinned political exclusion for the majority. The absence of redistributive justice explains the higher-than-expected levels of human poverty we observe in the region, based on a comparison with other countries with similar GDP per capita levels. The lack of effective regulatory mechanisms and pervasive patron-client relationships further undermine the efficiency of public investments. At the same time, the absence of a rule-based market discourages productive private investment.

Processes of exclusion in least developed countries

The patterns of exclusionary development are much clearer in Arab LDCs by virtue of stronger interaction between the social, political, and economic spheres. Socioeconomic development processes have been subverted through state-instigated malformation of tribal affiliations, breaking traditional symbiotic relationships among different population groups. Public expenditures have been used to underpin patron-client relationships, rendering public investments ineffective. By undermining public provision of basic services and productive infrastructure, misuse of public resources has led to the polarization of society, with a small rich elite living among a sea of abject human poverty.

This pattern of exclusionary development has already led to the disintegration of the Somali state and the separation of South Sudan and continues to fuel conflict in North Sudan and Yemen. In Sudan, British colonialists put in place a process



of exclusive development to grow cotton needed for their mills that only benefited a small part of the Nile basin and left the rest of the country in a state of backwardness by limiting external contacts. This policy, which unfortunately was not effectively reversed in the post-independence period, contributed to the eventual separation of the southern part of the country in 2011.⁶⁴

The productive base of LDCs is still heavily dominated by the agricultural sector, despite oil revenues becoming increasingly important in both Sudan and Yemen since 1990. A struggle over who gets access to an increasingly limited supply of arable land and good-quality pastures has marked the evolution of these countries. By removing customary usufruct rights to land and pastures in the name of establishing a modern system of land management, ruling elites have excluded the majority from traditionally sanctioned systems of access to resources and have forced an ever-larger number of people into more and more marginal areas. The well-documented demise of Arab nomadic populations in Sudan, Somalia, and Djibouti is witness to this process.

The documentation shows that public resources were used to create modern irrigated agriculture, whether in Sudan or Yemen. Politically connected elites, however, have appropriated the benefits. Records also attest to the degradation of soil in Sudan due to the leasing of large tracts of land to political elites on nominal fees, who in turn lease the land to farmers at much higher rents on short leases. The Tahama irrigation initiative in water-scarce Yemen substantially increased the availability of irrigated land, but control remained in the hands of a few well-connected elites.

Large scale use of formally banned tube wells fuelled by subsidized diesel in Yemen has led to the dispossession of small farmers, as land became more valuable by virtue of being irrigated. This process generated substantial revenue for landowners of vast estates, but depleted scarce water resources. At the same time, incomes of smaller farmers were reduced as they were pushed onto increasingly marginal lands. This process is evinced by household budget surveys in Yemen, which show no statistically significant reduction in rural poverty between 1998 and 2006, while urban poverty declined appreciably in the same period.

The above exclusionary processes have generated and sustained many years of conflict in a number of countries and risk blowing into open conflict in Yemen. The threat or reality of conflict has adversely affected private investments in these countries, except in extractive industries.

The combination of exclusionary processes with limited resources has meant that the majority of the population in LDCs is subjugated to conditions of abject poverty. Widespread poverty in rural areas clearly demonstrates the failure of the development process. Poverty has limited the domestic market and has negatively affected the productive capacity of a large segment of the population that suffers from malnutrition and poor health. The countries have been frozen in a vicious cycle of low income, investment, and productivity.

The limited revenue base of the state and the importance attached to spending money to keep ruling elites in power has meant that these countries have not invested heavily in improving their productive and social infrastructure. As a result, transport and communication networks are underdeveloped and health and education facilities are of limited reach and poor quality. The LDCs have not managed to make substantial progress in attaining the MDGs, and most likely none of the goals will be achieved by 2015. The precarious nature of social peace and intermittent internal strife and conflict has even, at times, caused reversals of the limited gains obtained.

Insufficient and inefficient public interventions on basic social services have caused human poverty to mirror income poverty, with persistently high incidence of both at the national and sub-national levels. This is particularly evident in a country like Yemen, where one observes an increase in disparities on both income and human poverty among governorates, with the gap between richer and poorer widening on both accounts. Rural areas suffer from higher levels of human poverty due to poor infrastructure and wider prevalence of social norms that limit access of local populations to social services, even in the rare cases where such services are offered.⁶⁵



Due to mismanagement of land and water resources, Arab LDCs, which traditionally have been self-sufficient in food, with Sudan even considered at one point the bread basket of the Arab World, have become increasingly dependent on food imports. The resultant environmental decline has been particularly disastrous for nomadic populations, because it decimated their herds following years of consecutive droughts.

In addition, consolidating exclusionary forms of decision making has tended to reinforce traditional, male-dominated behaviours not only at the national level, but also in the community and in the private sphere, where women are effectively excluded from the decision-making process. As a result, all Arab LDCs do poorly on specific gender MDG targets, such as high maternal mortality rates, as well as major gender disparities in terms of access to economic opportunities and political representation. Conditions of conflict have further marginalized women by reaffirming the traditional role of men as warriors and by reinforcing male-dominated tribal structures. The lack of women's empowerment, through their exclusion from control of environmental assets and household income, perpetuates the status quo of women and hinders the attainment of MDGs in general.

The accentuation of income disparities due to the processes discussed above has prevented the growth of a large domestic market, rendering local economies incapable of creating significant numbers of jobs in the industrial sector. The process has also prevented the emergence of a well-educated and healthy work force. In addition, falling childhood mortality rates, thanks to better control of communicable childhood diseases, created rapidly growing populations and by default ever-rising unemployment and underemployment, particularly among youth and women. The rise in the numbers of unemployed and working poor translates into stagnant, generalized rural poverty that risks undermining social stability and reducing effective demand. In turn, this sustains the vicious cycle of jobless growth, leading to higher unemployment that lowers growth by further reducing demand and exacerbating social instability.

The end result of non-inclusive development has been significantly higher general unemployment rates than the regional average of 10%, with the alarmingly high rate of 18% among women.⁶⁶ The above is likely to underestimate the true extent of unemployment, as official figures are typically estimated, without the benefit of labour market information systems. In addition, many of the poor cannot afford to be unemployed but are engaged in low productivity part-time jobs that fail to provide them with a living wage.



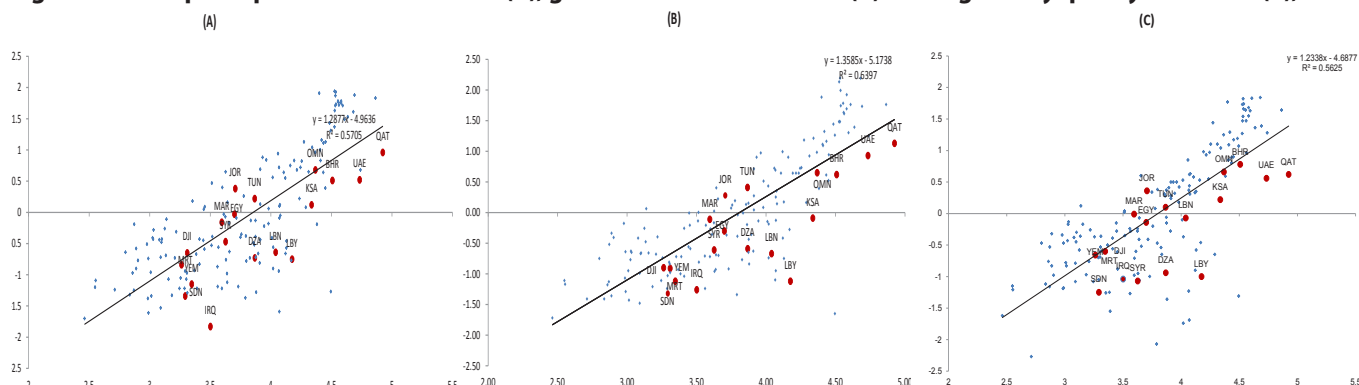
Governance Deficits Perpetuating Exclusion

Our analysis of development challenges in the previous sections illustrates the failure of the region to translate its material wealth into commensurate improvements in human wellbeing, which are in large part due to deeply entrenched governance failures. Increased impunity of political, economic, and administrative elites, in the context of constrained freedoms and weakened accountability mechanisms, has undermined equitable and inclusive economic growth. Joseph Stiglitz, Nobel laureate, declared the Tunisian revolution to be “proof of the need for fair play and voice, without which growth will not be enough for sustainable development.”⁶⁷

Two governance deficits have delayed equitable human development in the Arab region: one in state capacity and accountability, and one in societies’ empowerment. Hours of public debate following the Arab Spring indicate that the people are seeking: 1) enhanced legitimate leadership through free and fair elections in an environment of freedom of expression and organization; 2) responsive policies of inclusion and equity that are informed by inclusive partnerships between state and society; 3) effective anti-corruption mechanisms and social monitoring of public policies made possible by access to information; and 4) an independent judiciary.

Development is not only about wealth creation, but also about wealth distribution and participation. Persistent poverty is the result of policy choices and not of inadvertent technical failures. To effectively address poverty, states have to assume a leadership role in expanding capabilities and freedoms and empowering people. This is a democratic governance agenda that requires paying particular attention to respecting people’s rights and guaranteeing their dignity.⁶⁸

Figure 40: GDP per capita versus rule of law (A), government effectiveness (B) and regulatory quality estimates (C), 2009



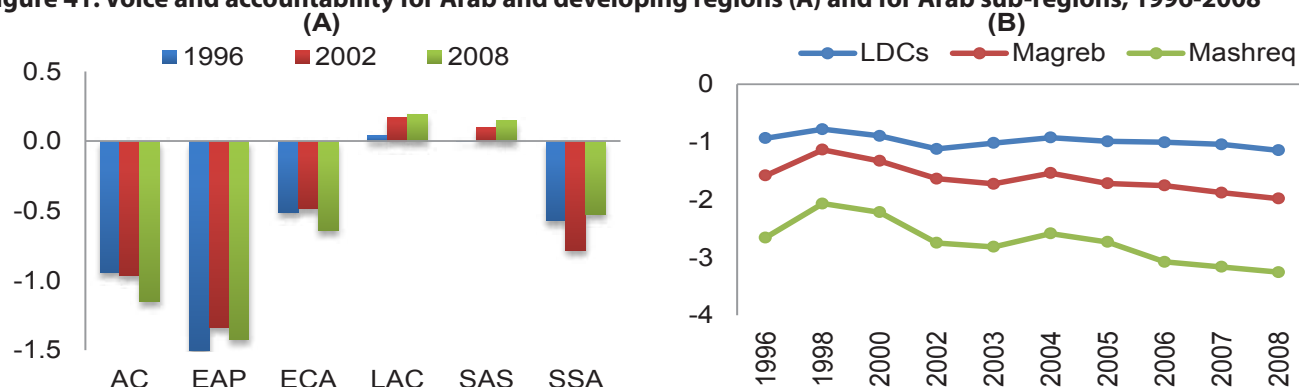
Source: WDI online datasets.

Note: Arab Countries included are Algeria, Bahrain, Djibouti, Egypt, Iraq, Jordan, Lebanon, Libya, Mauritania, Morocco, Oman, Qatar, Saudi Arabia, Sudan, Syria, Tunisia, UAE and Yemen.

Figure no. (40) indicates that some particular elements of democratic governance are known to have a strong, positive correlation with economic performance measured by GDP per capita, namely effective government, quality of regulations, and rule of law. This global trend is also manifest in the Arab states region. These elements of democratic governance correlate positively with economic performance in all three sub-groupings of the Arab region. The “very high” and “high” ranking Arab countries in terms of GDP per capita tend to have consistently higher indicators for rule of law, effective government, and quality of regulations, while middle income countries and LDCs score lower on these indicators. However, it is also clear that the correlation between governance elements and GDP per capita levels in the Arab countries is lower than for other countries. Most importantly, it is evident that the majority of Arab countries lag behind in governance indicators when compared other countries with similar in GDP per capita values. In other words, as Arab countries fail to translate their wealth into gains in governance. There is no doubt that this dichotomy between material wealth on one hand, and human development and good governance on the other hand is one of the most distinguishing features and products of the Arab rentier economies.



Figure 41: Voice and accountability for Arab and developing regions (A) and for Arab sub-regions, 1996-2008



Source: Authors' estimates based on WDI online data-sets.

Note: Arab Countries included in figure 41 (A) are Djibouti, Mauritania, Yemen, Morocco, Tunisia, Egypt, Jordan and Syria. For figure 41 (B) include the same countries as figure 41 (A) but grouped as LDCs (Djibouti, Mauritania and Yemen), Maghreb (Morocco and Tunisia) and Mashreq (Egypt, Jordan and Syria).

Beyond GDP as a measure of economic progress, there is also equity and cohesion. There is considerable agreement on the elements of democratic governance that help to address issues of equity and social cohesion. Inclusive participation offers the opportunity for course correction through improved and responsive regulations; painful course correction is mediated through the participation of organizations for social conflict management and collective bargaining. All of that increases not only participation but also accountability. Both participation and accountability are fundamental to creating constituencies for social justice and to fostering national dialogue and consensus on policy options. Two important dimensions of democratic governance needed for equitable development, therefore, are participation and accountability of government to its people. Both dimensions, captured in a single index in figure 36, register consistently low scores and deterioration since 1998.

Table 8: Open Budget Index (OBI) for the Arab countries, 2006-2010

2010 OBI rank	Country	Open Budget Index		
		2006	2008	2010
1	Jordan	50	53	50
2	Egypt	18	43	49
3	Lebanon	N/A	32	32
4	Morocco	19	28	28
5	Yemen	N/A	10	25
6	Saudi Arabia	N/A	1	1
7	Algeria	28	N/A	1
8	Iraq	N/A	N/A	0

Source: International Budget Partnership Survey.

Note: 1) OBI scores 81-100 = Extensive information/ OBI scores 61-80 = Significant/ OBI scores 41-60 = Some/ OBI scores 21-40 = Minimal / OBI scores 0-20 = Scant or no information. 2) All scores in the OBI 2010 are rounded to the nearest whole number, which, in the case of countries scoring slightly above zero, may not reflect that these countries do provide some, albeit extremely limited, budget information. This is the case for Iraq which had an OBI 2010 score of 0.4.

Voice and accountability deficits have an immediate adverse effect on people's lives. Despite substantial investments in health and education across the Arab region, as reflected in the background paper of this report on human development, there is considerable evidence at the country level to indicate inequality of access to quality services in education, health, water, and sanitation. This partly reflects an endemic structural disparity between rural and urban areas and partly a dynamic of social exclusion within urban areas (e.g. of slum dwellers and migrant workers). Contributing to inequalities in service delivery is weak participation in and accountability of the budget process, both nationally and at the local level (table 8).



Structural drivers of exclusion

As noted in the background paper on governance deficits in Arab countries, six structural drivers of exclusion can readily be identified.

First, there is the role of a rentier economy and a weak tax base. Rentier-based Arab economies, in which there is a concentration of political and economic power, perpetuate the coexistence in the region of a low average HDI (compared to the global average and to other developing regions) and low participation and accountability. The predominance of rentier revenue as the basis of most Arab economies, both rich and poor, weakens incentives for participation and accountability. The fact that Arab regimes—with few exceptions—rely on oil revenue and remittances (and in some instances on international aid) and less so on direct and indirect tax revenues, perpetuates their ability to promise political and economic reforms, while remaining unaccountable for delivery of their promises and much less accountable to the poor and marginalized.⁶⁹

Second, a disempowered local government is a strong driver of exclusion. Despite some legal commitment to decentralize power in several Arab countries (e.g. Egypt, Iraq, Lebanon, and Morocco), diffusion of political and financial control is still weak, with the possible exception of Morocco. Administrative decentralization is the main feature of local government, coupled often with the marginalization of local societal forces from the process of keeping local governments accountable, due to the weakness of local electoral processes and thus of locally elected councils.⁷⁰

Third, legal disempowerment propagates exclusion. In many Arab countries, restrictive NGO laws, often only allowing charitable organizations connected to the ruling elite, have hampered civic engagement in advocacy of collective rights. Advocacy NGOs that work to defend human rights are often restrained, with the exception of national human rights institutions. Against these odds, however, civic engagement is on the rise, including in several cases of litigation.⁷¹ In fact, a network of civil society advocates of social, economic and political rights is building up in the region.

The missing constituency for social justice is a fourth important structural driver of exclusion. One missing constituency for social justice is the labour movement, which has been weakened through decades of economic liberalization and privatization, as well as restrictions on labour union formation and operation. For those working in the informal sector, social exclusion due to lack of social protection policies compounds their economic exclusion and their inability to organize themselves and engage in collective bargaining.⁷² The other potential constituency for social change, namely the middle class, has been weakened through economic liberalization policies. It has had its income eroded over time and its ability to participate in the political arena curtailed. Declining quality of education has further weakened the ability of the middle class to spearhead movements for social justice. Furthermore, education in the region does not include civic and human rights education as a core message. A critical mass of the middle class has problems translating its dreams or frustrations into rights-based agendas.⁷³

Fifth, the business class, through its changing role, has arguably fostered exclusion in Arab countries. The business class in the Arab region has seen its character radically transformed in the period since 1970, due to the dynamics of its relationship with the ruling political elite and the implications of economic liberalization policies on its strategic interests. While business communities have been increasing, large numbers of politically connected new entrants into the group have undermined their cohesion. With variations, the business community in the Arab region has favoured liberalization of national economies but refrained from fostering or demanding democratization. The business class of the Arab region was weakened as a force for democratic and inclusive development. The deindustrialization process that reinforced the supremacy of the trading elite over industrial capital exacerbated this process. The trading elites did not feel compelled to advocate for stable policies, social peace, and an accountable governance structure, as they could benefit from the anarchy that prevailed, thanks to the lack of checks and balances on the executive branch. Furthermore, economic liberalization invariably resulted in concentrating power and wealth in the hands of the few.⁷⁴



Last, but by no means least, security and oppression are powerful structural forces that perpetuate exclusion in Arab countries. Stability has been associated with oppressive police and military presence rather than being buttressed by laws and inclusive development. This manifests itself in the irony of having conflict-affected countries, such as Palestine and Lebanon, scoring higher on democracy than “stable” countries in the region. The democratic space available in these conflict-affected countries, however, has been constrained, in the case of Palestine by continuous oppressive police and military presence of an occupying power.

In the region, stability, furthermore, has become synonymous with stability of incumbent ruling elites.⁷⁵ In the name of national security and stability, legislative institutions have not scrutinized high military expenditures, leaving little room for expenditures on basic social services, and reducing resources available for local and regional economic development and to disaster risk management and environmental sustainability.⁷⁶

An oppressive model of stability has been equally adopted and condoned by external forces. Putting security before development, several regional and international powers have accepted the oppressive regimes in the region because of geostrategic alliances that protected their national interests.⁷⁷

Institutional drivers of exclusion⁷⁸

First, there is the legacy of “formalistic governance reform.” Elites who are more interested in stability than in deep reform adopted palliative improvements in governance for show. The spectacle led to anger and defiance. Elections are a case in point: Arab countries regularly run local and national elections and, though commendable, the quality of the electoral process has deficits in practice, in electoral professionalism, especially in election management bodies, and in openness and competitiveness. Arab civil society and the judiciary have reacted strongly to these deficits. In fact, some argue that the badly rigged elections of 2010 in Egypt became the last nail in the coffin of the old regime. Mollifying reform for appearances’ sake also applies to corruption and gender, where, despite legal provisions to redress corrupt and gender-based practices continue unpunished. With the ongoing Arab awakening, formalistic governance reform is unlikely to continue to pacify the Arab street.

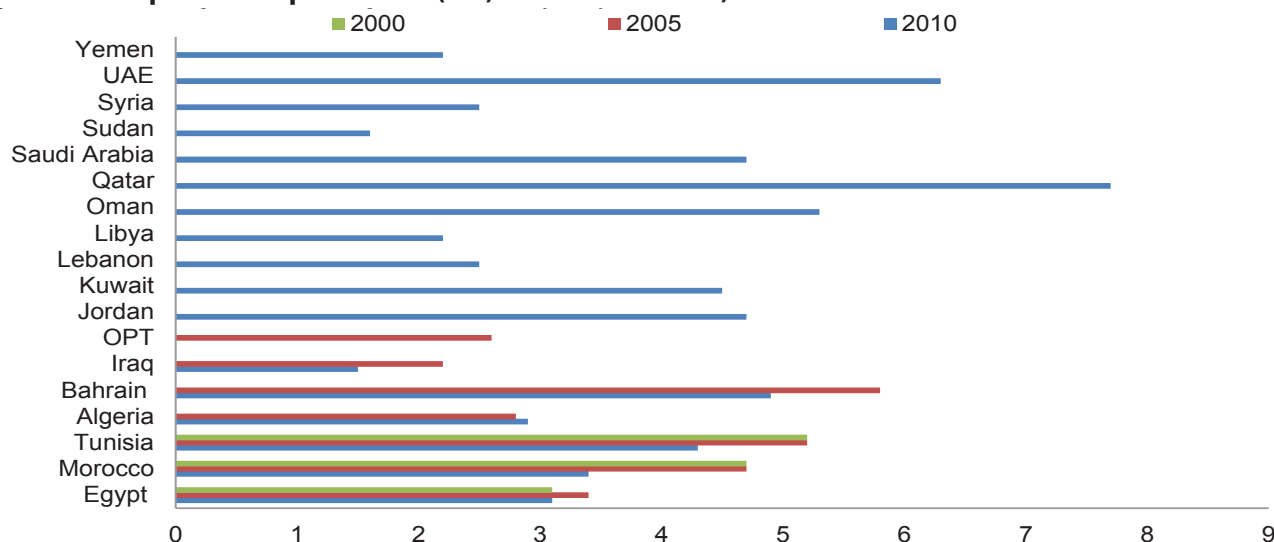
Second, when it comes to corruption, governance failure is deep and complex. Corruption has been identified in several Arab countries as a major hurdle to investment and business (Egypt, Libya, Algeria, Jordan, Morocco, and Lebanon). In the World Economic Forum survey, countries with a high frequency of complaints about inefficient government are spread across North Africa, the Mashreq, and some of the oil-rich Arab countries. Bureaucracy is also frequently cited among the hurdles to doing business and can be an impediment to effective action in dealing with corruption.

What renders the situation explosive in the Arab region is the combination of corruption with high levels of regional economic inequality within countries and high levels of nepotism that deprive vulnerable groups of jobs and services. Political loyalty networks give impunity to the corrupt and weaken judicial independence. Closed public space and weak oversight from parliaments (which have often been implicated in serious corruption cases) ended up eating into the legitimacy of incumbent regimes, including legislatures.

In that context, societal pressure to combat corruption is increasing in the Arab region through, for example, human rights-based advocacy, supported by legal activism in high profile cases, especially in the past five years. Web-based movements such as Shayfenkum and other CSOs against corruption or for the protection of consumers are also good examples. Anti-corruption mechanisms have been increasing in number, and so have some pioneering attempts to measure and monitor corruption in the Arab region (Egypt and Palestine).



Figure 42: Corruption Perception Index (CPI) for Arab countries, 2000-2010

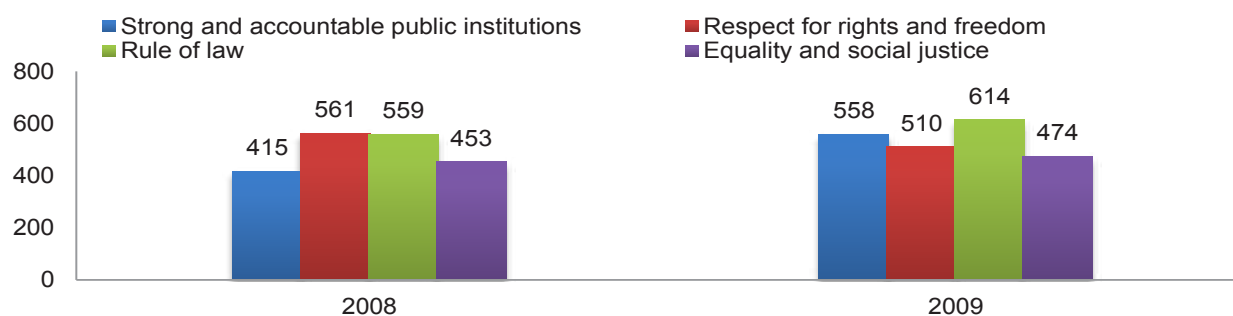


Source: Transparency International.
Note: score 10 = good; blanks=missing data

The picture on corruption as a governance failure is not complete without a look at a third important institutional driver of exclusion, namely the rule of law. Oddly, the rule of law index in the Arab Democracy Index of 2010 shows improved scores for most Arab countries, except for Yemen and Palestine. This is a commendable result, though the authors of the ADI warn against excessive optimism, since the scores are a reflection of technical improvements in measurement as much as they may reflect substantive improvement in governance. Several Arab countries have witnessed intense public anger that has accumulated over the years against the police. The uneasy relationship between police and people has become a defining feature of both the Tunisian and the Egyptian transitions.

This has been attributed to the belief that the police are protectors of the regime and not the people. Anti-terror laws, emergency laws and security concerns in general continue to provide pretexts for detention without trial, torture, and military trials of civilians.

Figure 43: Arab Democracy Index indicators, 2008 and 2009



Source: Arab Reform Initiative and The Palestinian Centre for Policy and Survey Research, http://www.arab-reform.net/IMG/pdf/annual_rep_010_english.pdf

Rule of law is not an abstract institutional construct. The issue is often about the “law” as much as it is about its rule. Several Arab countries have national laws that significantly fall short of signed and ratified international conventions. Anecdotal evidence indicates that the legal profession in the region has not yet started to reference international conventions in order to put pressure on the national frameworks to align with countries’ commitments. The past five years, however, have seen increased public interest litigation to raise awareness of how laws are in violation of social, economic, and cultural rights as well as civil and political rights.



Fourth, there is the judiciary. Judicial independence is the last line of defence and is pivotal for the effectiveness of accountability tools, especially when those who are to be held accountable are either politically or economically powerful, or both. The World Competitiveness Index of the World Economic Forum, which ranks 14 Arab countries among 139 countries worldwide, in 2010 registered three Arab countries in the upper 1/3 on lack of judicial independence (relative to the rest of the sample). Two of those three Arab countries ranked in the upper 1/3 on favouritism of decision by government officials (i.e. high favouritism relative to others in the sample).

Table 9: Ranking of the judicial independence and government favouritism components of the Global Competitiveness Index, 2010

Institutions	Country rank/139							
	Algeria	Bahrain	Egypt	Jordan	Kuwait	Lebanon	Libya	Morocco
Judicial Independence	112	34	63	48	36	113	95	79
Favouritism in decisions of government officials	82	42	95	44	47	136	122	52

Source: WEF

Several Arab countries have anchored the independence of the judiciary in their constitutions. However, two sets of factors have negatively impacted the fulfilment of this constitutional principle. One is contextual and has to do with political systems; the other is institutional and has to do with internal safeguards of judicial independence.

The crisis of participation is a fifth driver of institutional exclusion. When elections take place in the region (see annex table 34), turn out is weak because elections have lost their meaning and function as channels of participation and accountability. They have become a non-credible option, due to the weakness of political parties and the sluggish professionalism of electoral management bodies. In several countries, elections have become terrain for tribal and family networks to assert their power and distribute the spoils of economic rent among themselves and their followers, often at the expense of wide participation and accountability. Participation between elections is also weak and characterized by constant push and pull. Arab states have, for instance, restricted freedom of expression and association through constitutional and legislative means. This has hampered the formation of institutions and processes of social conflict management and collective bargaining.

Institutional reforms in the latest election rounds in Tunisia and Egypt, where turnout has registered a significant increase, attest to the importance of institutional incentives to free participation. In both countries, electoral systems and electoral management bodies introduced new rules in the context of the Arab Spring; these new rules enhanced people's trust and confidence and thus their turnout.

The sixth institutional factor of exclusion is the limited access to information, which undermines effective participation. Arab regimes have limited broadband infrastructure and interrupted or strongly monitored Internet connections to limit criticism. Beyond Internet-based social media, free access to public information is often regulated through a freedom of information act such as the one Jordan has and that both Yemen and Egypt have been trying to draft. More open public space and free flow of information will guarantee correction of planning and regulate errors, as well as induce more competitive procurement and accountable provision of services.



Finally, local governance is a powerful institutional driver of exclusion in most Arab countries. The Tunisian revolution, ignited by a young man who was forced to work as a street vendor in one of the deprived regions of the country, brought the troubles of local governance to the fore. The Tunisian call for the dissolution of all local councils and the removal of local governors underlines the deep distrust of local government and the serious rift between people and their local government.

In general, the state of local governance in the Arab world shows problematic exclusion and strong centralization. Exclusionary dynamics for women and for the young are particularly alarming at the local level. In Yemen, for instance, the number of female candidates taking part in local elections was reportedly very low.⁷⁹ The same is true of local elections in Lebanon, Iraq, and Egypt. This is partly due to weak women's representation inside political parties or on political party lists of candidates, especially at the local level. However, more and more young people are participating in public debate, making use of high-tech communication tools and social networking sites such as Facebook and Twitter. It is still early to tell how much this new era of social media will encourage participation in local area development, deepen citizen participation in local planning, and keep local governments accountable for equitable service delivery.



Towards an Accountable, Capable State with More Inclusive Participation

Lessons learned from political and economic transformation in other countries

The burden of multiple exclusion (social, economic, and political) in the Arab region has resulted in popular outrage that provoked the “Arab Spring.” This is a historic phase of transition that may or may not result in transformation. Transitions are the periods during which established regimes (rulers, structures, and processes) are dismantled and new ones are constructed. The newly constructed ones may live up to people’s aspirations or may not.

The variety of transitional pathways is evident in the multiplicity of processes and outcomes to be found in Southern Europe, Latin America, Asia, Africa, and Eastern Europe. Each country is specific in its transition and in its domestic, regional, and global context. We cannot automatically replicate any of the transitional pathways, but we can learn lessons that will inform an understanding of transitions and expectations to achieve change.

Transitions are protracted processes

If there is any lesson to be learned from other transitions, it is that they are often protracted. If one takes the first free and fair elections to parliament after years of authoritarian or autocratic rule as an important milestone, one realizes that in Europe (both Southern and Eastern) transitions have varied from four to seven months in Greece, East Germany, Romania, Bulgaria, and Czechoslovakia, while transitions towards the same milestone have taken one year to eighteen months in Portugal, Spain, Poland, and Hungary.⁸⁰ A similar observation is possible about transitions away from authoritarian rule in South America. If the duration of the transition is to be measured in terms of its ability to produce free and fair elections followed by resilient democratic institutions that withstand risks of break down into military or civilian authoritarian rule, then the four big countries of Mexico, Brazil, Argentina, and Chile have seen transitions that stretched over several years.

One could look at the case of Mexico as a gradual transition over 70 years. Long and sometimes violent, the road started with a revolution (1910), went on to a new constitution (1917), the assassination of the first president elect (1929), and the election of the first civilian president (1946), and arrived at a critical junction with the beginning of mass protests against lack of political liberalization in the 1950s. It was not until 1977 that the opening of the party system allowed for more than the one party rule of the PRI (the Institutional Revolutionary Party). Internal party feuds and the PRI’s flagrant electoral fraud in the mid-1980s were signs of its demise. PRI started to lose control of municipal elections in the 1990s, but its loss of an absolute majority in parliament did not occur until 1997, thanks in part to an independent electoral management body created in 1990. Only in 2000 did the PRI lose its first presidential elections in seven decades.

Transitions are uncertain by nature

Transitions are naturally uncertain, as O’Donnell and Schmitter asserted in 1986. Whether the transition starts with a total rupture with the past (East Germany in the 1990s) or with a negotiated change by elements of the authoritarian regime allowing some political liberalization (Argentina 1969-73), the process is in constant flux as forces outside the regime (opposition) and the liberalizing elements of a regime constantly try to outdo and outsmart each other.⁸¹ There is no guarantee that transitions will succeed in propelling societies forward on the road to democratic and economic transformation. Between 1900 and 1970, two-thirds of South American transitions relapsed into autocracy within three to five years.⁸²



Chile is another case in point. A coup by Pinochet ended Chile's long tradition of constitutional government. Society resented being under military rule for well over a decade. Despite Pinochet's often successful macroeconomic policies, economic transformation bypassed many poor and middle-class families. In 1982, an economic collapse led to massive social protests, and the opposition pressed the armed forces to negotiate an immediate transition in 1983. However, only limited political concessions were obtained. Two years later, eleven groups, including prominent conservatives, signed the National Accord for a Return to Full Democracy, but the accord collapsed as most of the conservatives backed Pinochet. Until 1988, opposition leaders continued to demand free and open elections. The state of emergency was finally lifted in August 1988, and in October Chileans held a plebiscite on whether Pinochet's term should be extended to 1997. 55% of the electorate voted no.

Transitions are the work of both elites and masses

Many observers of transitions have considered them the work of elites, especially the so-called soft liners of incumbent ruling elites (O'Donnell 1979a and Huntington 1984, Whitehead 1986, Stepan 1988). Experience tells us, however, that no transition takes place without pressure from societal forces; the fundamental role of labour unions in Europe (and in Tunisia), of peasant groups, church groups, and neighbourhood associations in South America cannot be denied (Therborn 1977 and Stephens 1987).

Brazil is yet another example. The transition from the mid-1960s to the mid-1980s saw the country move out of military rule via massive demonstrations. The result was a democratically elected civilian president coming from the ranks of the opposition. Brazil's military rule maintained significant institutions typical of liberal democracy. It also embarked upon economic liberalization. Both features helped create the total rupture with the past. Though the opposition had difficulties voicing its opinions between 1969 and 1974, it became increasingly independent after 1974, as the military allowed for competitive elections hoping to boost its own legitimacy, given the backdrop of unpopular economic liberalization. Popular movements surged between 1977 and 1980. A severe recession began in 1980. Numerous associations and local movements emerged and demonstrated across the country. In the 1982 elections, the opposition won most of the major states' governor seats, accounting for 60% of Brazil's population and 74% of the country's GDP. In three-and-a-half months there were hundreds of demonstrations across the country demanding presidential elections. The government managed to fend off the calls for direct elections by instituting an electoral college, in which congressional delegates and state assembly members voted for the president. However, massive public demonstrations helped split the government party and achieve the desired goal: a civilian elected president.⁸³

While societal mass mobilization is important in triggering transitions, social forces are less influential in shaping the consolidation of institutions. What influences the latter are elite decisions and compromises and negotiated elite pacts that determine the nature of institutions and the rules of the game. Reflecting on the role of social forces during the transitions of the 1980s and 1990s in Europe and South America, P. Schmitter reminds us that negotiated elite pacts outnumber revolutionary transitions. The downside of this observation is that in pacts between elites of the opposition and the old regimes, which outnumber revolutionary changes, privileges are locked-in, making distributive policies, especially of wealth and assets, harder to achieve (P. Schmitter, 2010).

Transitions that succeed are based on commitment

Some political scientists consider democracy an unintended outcome of acts of compromise by non-democrats (Rustow 1970, Huntington 1984). Others have wondered about the challenge of getting democracy from the hands of non-democrats (G. Salame 1994) and have drawn lessons that confirm the need for commitment to democratic rule—otherwise transitions cannot consolidate democracy (Dahl 1971, Lijphart 1977). Commenting on 25 years of transitions and consolidations, P. Schmitter asserts that disappointment in democracy and its



institutions increased over time, yet there has been no sign of desire for another form of government and few signs of support for avowedly autocratic leaders. The challenge is to continue to encourage commitment to a constant process of deepening democracy without succumbing to cynicism.

Transitions tend to focus in the immediate phase on political change

The experiences of nine southern and eastern European countries indicate that transitions tend to focus on four key milestones that consume most actors' attention and energy: (i) elections, (ii) electoral systems, (iii) electoral management bodies, and (iv) constitutions.

In all nine countries, elections were held within four to eighteen months of the transition as a signal of rupture with the old discredited regime and as a means to ensure the legitimacy of the new one. Quick elections also constitute a concrete step on the roadmap of democratization and focus attention on the electoral campaign. Given the fact that quick elections give little time for political parties to organize and campaign, especially as most of them are often too new on the scene and too weak, almost all of the nine European cases chose to have an element of proportional representation to allow for the inclusion of diverse political parties and views. Given the history of fraudulent elections in those nine cases, almost all opted for an independent electoral management body to guarantee genuinely free and fair elections. Those bodies were composed of independent figures and/or political party representatives.

All nine countries managed to produce a new constitution within one to two years as a cornerstone of the transformation in power relations. Experience varied on the constitution-making process, with some opting for amendments to existing constitutions (Czechoslovakia, Poland, Hungary), others scrapping the old constitutions and writing new ones (Romania, Bulgaria, Portugal) and a few adopting changes to existing constitutions before writing a new one (Greece and Spain). Most of the nine European countries surveyed charged parliaments with this task (Greece, Spain, Hungary, Poland, Czechoslovakia), while Portugal made it the responsibility of a constituent assembly and a few allowed a combined parliament and constituent assembly forum to do the job (Bulgaria and Romania).⁸⁴

Socioeconomic outcomes of transitions

The Latin American & Caribbean and European experiences show that the ultimate socioeconomic outcome of transitions could be minimal, with no change in the distribution of wealth and assets. Most transitions so far have witnessed a lag between the time of political liberalization and the institution of socioeconomic policies that ensure distributive social justice.⁸⁵

There are different explanations for transitions that produce political transformations but not socioeconomic ones. One is related to the direction of causality between political and economic transformations. In the 1960s and 1970s, many analysts argued that political development does not drive economic development; it is rather a derivative of economic development.⁸⁶ Income and literacy levels and urbanization were considered necessary preludes to political development and not the other way around. This was echoed by dependency and bureaucratic authoritarianism literature in South America, which also considered a country's position in the global system of production (G. Frank, I. Wallerstein) as determining of its political system and not the other way around.

A second explanation for the lag of social justice behind political liberalization has to do with the coalitions that lead such transitions. Transitions are usually induced by societies that are discontented with the concentration of power and wealth caused by years of impunity. When alerted to possible transformation in power and wealth



relations, those in power or in possession of economic privileges will do everything they can to subvert change. The success of those leading the call for change lies in their ability to calm the fears of those who benefited from the status quo. In many instances, elements of the old regime coalesce with some of the opponents to produce a centrist alliance that chooses not to push for revolutionary redistributive policies.

The existing economic development model at the time of a democratic transition provides the third explanation for the lag in social justice behind political liberalization. The general observation is based on the Latin American experience and should be kept in mind, as transitions in these countries were mostly after import substitution industrialization had run its course. They also happened after the years of the oil boom (1970s), which resulted in avid borrowing that ended in recession in the 1980s. Enthusiasm for policies that enhanced distribution and social justice was not there. Eastern European democratic transitions were actually marked by an increase in inequality and social and economic exclusion after years of communism.

A new social contract

The contestation movement in the region asks for deeper democratic practices, building on the twin pillars of an accountable and capable state and a society that is empowered through inclusive participation. The cry for dignity calls for a development agenda that affirms the centrality of human development and poverty reduction. This will likely require more comprehensive state-led action to enlarge investment in public assets and direct private sector activity towards accelerated decent job creation. Whether the state or public-private partnerships create the required public productive infrastructure depends on the particular country's circumstances.

The greatest imperative is that states be held accountable by the citizens and honour their civic, political, social, economic, and cultural rights in a progressive manner. This is the only way multiple dynamics of exclusion can be reversed.

Building constituencies for a new social contract

One of the fundamental reasons for the current contestation movement in the Arab region is concern about governance failures. Of particular relevance to prospects for growth and investment is rampant corruption and a justice system that has proven itself incapable of upholding the rule of law in a consistent manner.

Deepening democratic governance is a necessary prerequisite for a new social contract that binds state and society in the context of inclusive, transparent and accountable governance to support social and economic inclusion in an environmentally sustainable development model. There is a need for constituencies for socially and economically inclusive policies in the form of strong political parties, independent professional associations, and labour unions. These will have to be empowered through freedom of information acts and more open budgeting processes. Currently, public life is reduced to the national level and monopolized by dominant elites in one ruling party. With increased freedom of expression and organization at the local level, democratic governance processes will build and nurture organizational, managerial, and political calibre for national politics. Inclusive participation will make government more accountable and less prone to capture by elites.

The revival of Arab economies is contingent upon governance reforms. Well-functioning mechanisms that oversee the actions of the executive branch are particularly critical. Citizens demand a system that allows them to seek redress if their rights are violated or public assets misappropriated. To that end, judicial systems must be given full autonomy from the executive branch and be provided with the requisite means to rule expeditiously on cases brought before them. Long-term investment will only begin to flow to sectors other than natural resources when investors are convinced that they can seek enforcement of contracts.



Some key governance prerequisites for implementing a new social contract

The same measures that will help build social and political constituencies for social inclusion will also support the development of institutions that will manage social conflict.⁸⁷ The Arab Spring has demonstrated beyond any doubt that Arab society suffered from weak or non-existent institutional arrangements that could absorb and manage mounting anger and relative deprivation. Building political parties with social bases and independent professional associations and labour unions that engage their respective constituencies will provide the state and society with institutional channels for conflict management.

Furthermore, with political and fiscal decentralization, local governance will provide communities the mechanisms and processes necessary to ensure equitable delivery of services. Most importantly, inclusive participation and accountability at the local level will create fertile ground for new leadership that can practice pluralist politics and develop management at the base.

All of the above will require the strengthening of judicial independence as the foundation for protection of fundamental rights (civil, political, social, economic, and cultural). Careful attention should be paid to the relationship between the judiciary and the police, and to the role of the army as guardian of national sovereignty, not of individuals in power.

A new development model, anchored in a rights-based social contract, can set in motion a virtuous cycle of mutually reinforcing political, social, and economic inclusion processes. It can open up public space for participation and strengthen accountability mechanisms.

A new development vision can enable the region to use its considerable finances and human resources more efficiently and effectively, by shifting away from temporary solutions to long-term policies that promote sustainable and equitable development. To respond to the demand of youth in the region for dignity, freedom, and social justice, the Arab world needs to adopt a development model that enlarges the choices open to citizens as active agents. This requires moving from the non-developmental, oil-led growth model to a developmental state model that emphasizes productive sector performance, addresses poverty, reduces inequality and creates decent jobs.

This new vision will have to put the human being at the centre of the development debate and find ways to use the abundant natural wealth of the region to assure freedom from want and fear.

The poor development outcomes in the region have been largely caused by inefficient use of substantial financial resources, due to unaccountable and non-responsive governance structures, underpinned by the politics of patronage. In order for this to change, the state has to become accountable to the population, and at the same time hold citizens accountable for their obligations to respect a rule-based socioeconomic system. A new social contract of mutual accountability would improve efficiency in the use of public resources, enhance equity, and foster transformational growth. It would also facilitate more tax revenues by promoting a culture of responsible citizenship, fostering broad-based growth, which in turn increases the resources available for redistribution and sustainable service provision.

The young revolutionaries in Egypt and Tunisia have already demonstrated aspirations for such a contract, asking for a more accountable government while they take upon themselves their rightful civic responsibility as citizens. This was manifested in both countries by the emergence of popular neighbourhood watch committees in the course of the revolutions to fill the gap left by the sudden disappearance of the police from the streets. There is heated debate ongoing in both countries about the exact contours of this new social contract, including a desire to have it enshrined in the new or amended constitutions.



The constitutions of a revitalized Arab region should clearly spell out the developmental role of the state and enshrine the right to development for all citizens. Furthermore, they should provide the means to hold states accountable by stipulating the right to information and open discussion.

Inclusive political and economic systems

A developmental Arab region would actively promote balanced development through macro-economic policies that target decent and productive employment. The state would balance economic growth and social development through the use of state resources and influence to tackle poverty and expand economic opportunities.

Arab states have been intervening in the economy, but unfortunately, rent-seeking behaviour, as opposed to promotion of the public good, has driven their interventions. Changing the nature and motive of their interventions in the market is contingent upon their transformation into developmental states, as a result of democratic transformations in which the state becomes subservient to, and an expression of, popular will. The reformed states can then be expected to intervene in the economy with the objective of creating a genuinely level playing field, by correcting market failures and promoting social cohesion through human-centred economic development and income redistribution.

The Arab developmental state would engage in deliberate guidance of national economic development by mobilizing resources and directing them toward the realization of common goals. It would place priority on an inclusive market that provides the population at large with the desired opportunity to lead a productive life in dignity.

A developmental state would be one capable of directing and supporting economic development through building a strong public service, creating equal access to investment opportunities for all investors, supporting small business development, using state owned enterprises effectively, and driving strategic investment initiatives. The state would keep the economy competitive and close to the leading edge in the global development of knowledge and technology. It would dedicate its resources to further human development, rather than engaging in the politics of patronage.

Given the rampant rent-seeking reputation of the state and private sector in the region, state-led macroeconomic management has to be carefully calibrated to block elites from appropriating well-intentioned programmes. The best guarantee against such practices would be to deepen democracy, through revisiting the current institutional frameworks. There is no substitute for effective participation of all citizens in setting public policy through strengthened mutual accountability of state and citizens.

Another important guarantee of inclusive development is the institution of mechanisms and processes of legal empowerment of the poor so as to enable them to break through poverty traps and disrupt exclusionary dynamics. In order to do so, the poor must be able to rely on a respected and protected legal identity, a space to organize themselves and a collective voice to influence the enforcement of laws, policy, and regulatory decisions. Granting civil space to the poor is crucial for their growth into right holders and stakeholders in policymaking. Participatory governance in this agenda is about bringing legal solutions closer to the reality of those excluded in the Arab region, chiefly the most vulnerable of the Arab poor. Facilitating participatory governance is crucial to legal empowerment in at least three dimensions: (1) to understand and to take into account the complex and diverse realities of poor communities, (2) to refine and enhance the normative and judicial decisions of the state, and (3) to ensure equitable delivery of services.



To sum up, in the medium term, the Arab region has to adopt a new development model that moves beyond neoliberal orthodoxy to target poverty reduction and the MDGs. This model would be anchored in diversified economic growth that emphasizes decent and productive employment generation and poverty reduction within a sustainable development approach. Business as usual is no longer possible, as the region is reaching the limits of what its fragile environment will bear and can only avert a major water and eventually energy crisis by radically reorienting its development track along a more socially and environmentally sustainable path. The days of aiming for short-term economic gains at the expense of future generations are over.

Shift to employment-led growth

International best practices and experiences suggest that to realize inclusive growth, the Arab region would need to ensure: a) a concentration of growth in economic sectors that can directly benefit the poor, b) an enabling environment that promotes their employment and real incomes, and c) enhancement of their basic human capabilities. While rapid growth is essential for poverty reduction, it has to be equity-based and human-centred. In this context, reform of social institutions, such as the system of land holding and conflict resolution mechanisms, towards more equitability is a central prerequisite for success.

The centrepiece of the new development vision for a transformed Arab region must be a sustainable pattern of spatially balanced economic growth focused on employment. Nothing short of this radical departure from the past will enable the region to provide the Bouazizis⁸⁸ of this world the chance to live in dignity and provide for their families in their hitherto neglected home regions. Employment needs to be targeted as a macroeconomic variable.⁸⁹ The focus on real variables, such as employment, can complement the more conventional macroeconomic focus on nominal variables such as inflation.⁹⁰ A diagnostic process that draws on realistic and evidence-based employment growth scenarios can be used to set realistic employment targets.

To be effective, the employment targets defined at the macro level need to be translated into targeted employment objectives for specific sectors and incorporated into local development and territorial strategies, particularly in regions with high unemployment rates. As indicated earlier in this report, there is also need for a complementary focus on the poor who are trapped in the informal, unreported labour sector, as well as more short-term measures to address the significant numbers of underemployed and the working poor.⁹¹ The experience of national-level employment guarantee programmes in countries such as India suggests that employment guarantees can be useful supplements to existing livelihood activities and can contribute to asset/service provision to stimulate additional employment opportunities.

The inclusive growth agenda can respond to the needs of the large number of working poor and informal sector workers by including measures to increase their productivity and incomes. Simply generating jobs to absorb the openly unemployed is not enough. This adds to the enormity of the task at hand.

Macroeconomic policies

Such an employment-led growth process calls for a substantial role of and initiative on the part of the state. This would require dispelling fears of crowding out private investment, which has long been a central pillar of the discredited old model of development. This process would help to identify the potential, scope, and role of public investment as a complement to private investment. This would include investments that can more effectively mitigate risks relating to investing in new areas, or in activities where the payback period is relatively long—i.e. public investment can help to crowd in private investment. (Box 9 on the 2011 South African employment plan is a case in point.) The role of the state in promoting decent employment opportunities is critical for the wellbeing of the poor.



Box

9

Inclusive growth strategies: Key features of the 2011 South African employment plan

- 1. Short-term employment schemes:** This includes the expansion of the Community Works Programme to up to a million positions by 2013/14.
- 2. Infrastructure and public investments:** The systematic selection, planning and monitoring of large projects. This intervention will systematically improve the capacity of state agencies to deliver infrastructure and improve inter-agency coordination.
- 3. Unblocking investments in major projects:** A small, high level inter-agency team will focus on unblocking private-sector projects with a substantial impact on employment investment. Measures will include tougher action to address practices that limit the entry of new enterprises.
- 4. Interventions to improve competitiveness and expand the productive sectors:** This will include Industrial Policy Action Plan (IPAP) by prioritizing actions that expand the productive sectors of the economy, reduce the costs of communication, transport, electricity, construction, and food and strengthen the Competition Act.
- 5. Enterprise development and promotion of small businesses:** Interventions include scaling up small business incubation programmes and use of the BBEE Codes to encourage private sector support, improve small business funding, and expand micro-finance.
- 6. Rural Development:** Scaling up existing rural programmes aimed at expanding agricultural production by small scale farmers, extending core infrastructure to rural areas, increasing jobs and revitalizing rural towns. Targets will be set for investment in rural infrastructure.
- 7. Greening the economy:** Power Purchase Agreements involving 1000MW of renewable energy by 2013 should be in place with a target of 3800MW by 2016 with local procurement of technologies. Scale-up financial support to achieve the targeted million solar water heaters installed by 2014.
- 8. Public Sector Training:** All Government Departments are to spend at least 1% of payroll costs to develop skills with regular reports on progress through the Department of Higher Education and Training (DHET).
- 9. Local procurement:** Identify an initial list of products that can be designated for local procurement by the end of September 2011. Firm action to combat corruption in tender processes by establishing a high level team to consider complaints about tender delays or abuses that negatively impact on jobs, cost-effectiveness or economic development.

Source: 7th space INTERACTIVE

http://7thspace.com/headlines/390510/south_africa_statement_on_the_cabinet_lekgotla_26___28_july_2011_pretoria.html

Moreover, the state can also use taxation and transfer payments to reduce income inequalities by taking advantage of the great potential that exists for pro-poor macro policies, given the low tax receipts and generally low levels of public debt in the region. Even consumption taxes, which tend to affect the poor proportionately more, can have an inequality-reducing impact if the revenues raised are used to provide quality services to the poor.

Planning and budgeting processes

Many Arab countries have produced vision documents, but these have mostly been academic exercises with little genuine popular participation. For the most part, they have been inspirational and not evidence-based—that is, they have neither taken into account the difficult choices ahead nor considered constraints. The shift to a new, deliberative development process requires clearer articulation of longer-term visions around which whole societies can coalesce (note Malaysia and its Vision 2020 as a case where a vision was translated into economic transformation).

Such shared vision can provide the foundation on which medium term plans and annual budgets are produced. UNDP has amassed a lot of experience supporting vision exercises in Sub-Saharan Africa through participatory production of National Long Term Perspective Studies.⁹² These exercises have been used to bring about national consensus in post-conflict contexts. They are most useful as settings for structured debates about the kind of society people aspire to have as a follow-up to the contestation movement in the Arab region. The consensus that results from such an inclusive and participatory process would foster real stability underpinned by social cohesion, not the imposed stability that has so far been the distinguishing feature of the Arab region.

A healthy social dialogue and a well-articulated longer-term development vision can mitigate the risk of frequent changes in policies that have been the norm in the region. As alluded to above, growth-employment scenarios can be used to identify the types of policies that are likely to be needed for different rates and kinds of growth in order to facilitate a social dialogue on the policy choices involved.⁹³ As such, they can provide a solid foundation on which a socially cohesive approach for the way forward can be initiated.



Participatory and accountable processes for use of public resources

Improved planning mechanisms normally include a consultative process that brings together the private sector and regional/provincial authorities to maximize synergy between public and private sectors and addresses regional disparities. This approach responds to the conclusions of the growth commission about the “need for long planning horizon and strong, sustained commitment to inclusive growth, underpinned by stable, honest and effective government.”⁹⁴

Additionally and notably, a clear link between the planning and budgeting processes must be established to ensure that plans are developed within a realistic framework and are used as guides in the budgeting process. The region is home to too many plans that are simply developed as a routine, with no clear agenda for mobilizing the required resources toward their realization. Unfortunately, annual budgeting processes in the region mostly pay formal attention to the plan. Sectoral budget allocations, in many cases, result from a bargaining process in which the ministers with greater political clout get all the resources they need, while others do not even have enough resources to pay for their operational expenses.

Weak traditions of accountability and transparency result in budgets that are not meaningfully discussed within parliaments. The budgets of many countries are so opaque that it is difficult to know how much is allocated to each objective. Open budget processes can ensure more effective use of public resources and encourage more meaningful popular oversight.

Creating fiscal space

A study by Rodriguez and Moreno (2006) finds that in 109 economies the sustainability of fiscal expansions depends on the type of expenditures. If the development payback is sufficiently high, then deficit-financed public investments are compatible with fiscal sustainability and an expanded share of government in the national economy. Clearly, the sustainability of a fiscal expansion depends on the purposes for which the expansion is undertaken. As Rodriguez and Moreno (2006) have shown empirically, whether such investments happen in defence spending or education, for instance, is critical from the perspective of fiscal sustainability (not just welfare maximization).

The above means that when making decisions regarding the approval of an increase in expenditure that raises the fiscal deficit, the authorities concerned need to carefully evaluate the total social and economic payback of the associated investment over a longer time horizon. Thus, in addition to looking at the eventual revenue stream of the project, if it has a commercial side to it, one needs to look at the extent to which the expenditure increase contributes to progress towards developmental benchmarks such as MDGs, compared to other interventions of similar cost.

Rather than adopting a target for the overall budget deficit, as is the norm, we suggest an approach that differentiates between current expenditures and development ones. Such a fiscal rule will ensure that fiscal restraint does not discourage growth in the aggregate public capital stock (the corresponding on-budget flow variable being gross public sector capital formation). On this count, the current budget deficit/surplus would be a logical indicator to choose.

We therefore argue that a zero current deficit rule is an important long-term policy target for fiscal responsibility in a long-term fiscal framework. While some allowances may be made for current deficits during a development transformation with external grant financing making up the shortfall, the long-term fiscal framework must plan for all such expenditures to be financed entirely out of current revenues. This is a non-negotiable requirement for a prudent long-term fiscal policy.



In this context, we would argue that it is important to strictly follow the present definition of what items can be treated as current (or recurrent) expenditures in the economic classification of public expenditures. Even though it is clear that current expenditures on health and education bring about long-term gains and are therefore qualitatively different from items such as defence expenditures, they would still be treated as current expenditures. This is to ensure that they can be provided on a continuous basis, no matter what. However, within current expenditures, basic social services and recurrent support to productive sectors should clearly be shielded against cuts to the extent possible, given their high social benefits and developmental impact.

Even capital expenditures, which can be funded through deficit financing, have to meet certain strict criteria to ensure that they do not compromise long-run fiscal sustainability. The macroeconomic analysis that supports capital expenditures would need to specify the future impact of the development transformation on the revenue base and the savings rate to enable fiscal policy makers to assess the longrun fiscal sustainability of the suggested course of action. The long-run sustainability rules would not contradict short-term rules of fiscal solvency and absorption capacity issues. However, long-run development, with its transformative potential, should not be held hostage to rigid short-term fiscal constraints, such as a preset low limit to the overall budget deficit, inclusive of development expenditures.

In the short run, countries embarking on development transformations that require a permanent increase in public investment need to assess the desirability of the fiscal expansion by weighing the possible short-run macroeconomic implications such as moderate rise in inflation and fiscal deficits against the expected long-term benefits. Furthermore, in countries where the scaling up of investments is initially financed by ODA, a strategy to exit from aid becomes operationally necessary to secure long-term fiscal sustainability.

The above discussion is based on a definition of fiscal space as “concrete policy actions to enhance domestic resource mobilization and the reforms necessary to secure the enabling governance, institutional, and economic environment for these policy actions to become effective.”⁹⁵ The focus on domestic resource mobilization in this definition underscores the ultimate dependence of the sustainability and solvency of an economy on (a) the extent to which domestic resources can finance public expenditures and (b) the relationship between the political economy context and mobilization of fiscal space in a sustainable manner.

We argue for zero current budget deficit in the long run in order to maintain financial prudence, while funding badly needed public investments to bring about structural transformation. There is no need to impose the same condition in the short-term, as even the IMF is beginning to admit, for at least some of its richer member countries. Given the kind of radical transformation needed in the region, we have to have substantial public investment to create the productive infrastructure and required supportive operating environment for the private sector to prosper. This will require a radically different profile of public expenditures from the current one. Based on comparative experience, a revitalized Arab region has to focus on increasing the effectiveness of education expenditures and reducing military and security spending if it is to have sustainable fiscal deficits.

Differentiated approaches to expanding fiscal space

As indicated earlier, considerable scope exists for fiscal reform to underpin a healthy social contract and reduce current vulnerability of government revenues to external shocks. There is sufficient fiscal space for well-targeted public developmental expenditures to lay the foundation for a positive structural transformation of the region's economies. The realization of this potential is contingent upon implementation of a set of policies to raise more resources through taxation and switch expenditures away from costly and ineffective subsidy programmes and military expenditures. With the right mix of policy choices and proper oversight mechanisms, most countries can increase public investment by at least 2 percentage points of GDP. The scope for additional investment can be



expanded substantially through regional action (explored in further detail below) whereby major oil-rich countries, which do not have a fiscal space problem, invest some of their oil income within the region.

LDCs are, however, in a precarious situation, whether oil-rich or not. Given the huge need for scaling up of public investments in all LDCs, which would require very high investment-to-GDP ratios to realize, all of them require ODA in order to overcome their development challenges. Their low level of GDP per capita limits the potential contribution of taxation to revenues, while their infrastructural limitations necessitate substantial public investment. This, of course, does not negate the need for Yemen and Sudan to review their expenditures and to minimize wasteful outflows on fuel subsidies and military hardware. There is also scope for increasing tax revenues, at least to levels that are obtained in other countries with similar GDP per capita levels.

For oil-poor countries, which are the group that needs to engage in deficit financing, assessments of the link between inflation and fiscal deficits in the region do not confirm the accepted dogma that fiscal deficits cause inflation. The fiscal space for middle-income diversified economies (Egypt, Syria, and Morocco) and upper-middle-income ones (Jordan, Lebanon, and Tunisia) will have to be managed with care. Tourism, transfers, and remittances play an important role in cushioning these economies. The latter group is, of course, in a more comfortable zone by virtue of the smaller population and higher level of developmental achievement. In that respect, the fiscal space constraint is considerably less binding than for the former group (although Lebanon's high debt-to-GDP ratio places it as a distinct outlier).

Syria, Morocco, and Egypt have income levels that are too high for an aid-dependent development strategy (which in any case is not advisable), while at the same time they are still too poor to rely on traditional measures, such as expenditure switching. Egypt and Syria are in a particularly difficult situation, given the latter's reliance on declining oil revenues and the former's relatively constrained space for increasing internal debt financing. For these countries, the solution to the fiscal problem will be contingent on their ability to find the right set of policies that would maximize fiscal space by increasing tax revenues and reducing wasteful expenditures so as to further diversify their economic base. For example, the high cost of fuel subsidies in Egypt, coupled with the findings from many recent World Bank studies regarding their inefficient targeting of the poor, makes a strong case for a radical change in policy. The difficulty, of course, would be to implement this policy adjustment in such a way as to minimize the negative impact on the poor (for example, by shifting to natural gas to support public transportation systems). Egypt can also explore options for at least a partial write down of external debt contracted and appropriated by the previous regime.

On the revenue side, the move to a new social contract of mutual accountability of state and citizens opens up the scope for raising taxes. While subjects of states that are run exclusively by elites have every reason to avoid any taxes imposed on them, citizens who freely choose their leaders and can hold them accountable would find it difficult to condone tax evasion.

Do we dare tackle fuel subsidies?

Governments in the region have sought to mitigate the impact of food and fuel prices through subsidies. In many instances, these subsidies have grown to significant levels. For oil and gas products subsidies, they also have the potential to lock countries into inefficient energy paths. Removing or redirecting fuel subsidies and refining the manner in which food subsidies are provided can both release resources for removing structural bottlenecks to growth and help reverse the worsening nutritional status of the population. Fuel subsidies have already been reduced by a number of countries, including Tunisia, Jordan, and Syria. Syria and Jordan, in particular, have both reduced the scope of their fuel subsidy programmes in the latter part of 2000s, largely driven by budgetary necessity as the increasing fiscal cost of the subsidies became unbearable (Refer to Box 10 for more detail on the major features of the Syrian subsidy reduction programme and its results).



Box

10

Rationale for and benefits of reducing fuel subsidies in Syria

- Syria was forced to reduce fuel subsidies in 2008, due to their rising cost which had previously covered diesel for transport, the heating and power industry, and heavy fuel for manufacturing industry. The cost of these subsidies reached US\$ 7 billion by 2008. This was happening at a time when the government had problems even in financing current expenditures, let alone undertaking the transformational investments needed as part of the 10th five year plan.
- The rising gap between local and international prices increased smuggling to about 1 million tons a year, almost 15 per cent of Syria's total consumption. Artificially low prices caused excess demand and consumption and encouraged energy-intensive manufacturing and services activities which would eventually have to close when prices could no longer be subsidized.
- The subsidies were also inequitable, with the top 10 per cent of income earners benefitting 52 times more in absolute terms -than the lowest 10 per cent of the population, as revealed by household consumption surveys of 2004 and 2007.
- The government had to pay the price of not having dealt with the issue in a planned manner by being forced to increase heating diesel prices by 260 per cent on June 1st 2008. In order to soften the impact of the increase on key economic sectors and the poor, the government planned to set up an export support fund, a social aid fund, an agricultural support fund and an industrial support fund to channel back 50% of the savings generated.
- Impact of subsidy reduction: the budget deficit dropped to less than 2 per cent of GDP in 2009 and public investments increased by 10 per cent and 12 per cent respectively in 2009 and 2010.
- The promised compensatory measures proved hard to establish and difficult to manage. Citizens were victims of wrangling between sector ministries and finance. The process of building and operating those new mechanisms was slow, over politicized, and tactical rather than strategic. Despite all its failings, Syrian families received \$1 billion worth of coupons for subsidized products in 2008-2009, which was replaced by an unconditional cash transfer of the same amount in 2010.
- Smuggling also went down substantially, saving Syria \$2 billion of refined oil product imports.
- The feared inflationary impact of subsidy removal failed to materialize due to falling international food prices in the second half of 2008 and prudent monetary policy measures internally.

Source: Office of the Deputy Prime Minister, State Planning Commission and the Central Bureau of Statistic

Other countries can refer to the experience of these countries in order to avoid making the same mistakes and to ensure a more smooth and beneficial implementation of the policy. A shift from conventional sources of energy to sustainable energy can also be used to promote more environmentally sustainable development and to foster investment in sustainable energy options, including wind and solar power (especially given the plentiful sunshine in the region).

With fuel subsidies accounting for as much as 15% of GDP in countries like Yemen, leaving them alone is not an option in the medium term. No matter how politically unpopular, steps have to be taken to remove them, and the sooner such measures are taken the better. The longer one delays dealing with this problem, the more entrenched the current energy-intensive pattern of production becomes and the higher the eventual cost of course correction will be. While all efforts at removing fuel subsidies have had their detractors and none have been without difficulties, we cannot afford to continue to spend twice as much or more of what we spend to educate our children simply to fund our appetite for an energy-intensive lifestyle.

Inclusive and competitive markets

An inclusive market would require that the poor have access to credit on reasonable terms, as well as providing SMEs with the required governmental support services, including access to public contracts. To this end, financial sectors need to be reformed so that they move away from the current practice of only providing short-term credit to mostly well connected individuals and companies, largely for trading purposes. There are additional prerequisites for equipping smaller firms against high fixed costs of entry into export markets, on a national, regional, and global scale. As eloquently put by Professor Chang, "The state could share risk with exporters through schemes like loan guarantees for exporters and insurance for payment defaults."⁹⁶



Tailored responses to country characteristics

Response to the employment challenge in MICs is contingent upon moving up the value chain to higher productive activities that can capitalize on an increasingly educated labour force. To do this, Arab countries need to catch up with technological leaders in order to achieve levels of productivity and competitiveness that will allow them to be effective participants in the global economy and reap benefits from globalization. With the dawn of more open political systems in the region, economies too can become genuinely knowledge based by providing scope for unrestricted pursuit of knowledge. Arab countries can adopt policies that expand indigenous technological capacities through knowledge-based assets that will lead to increased investment, productivity, and growth.

For the LDCs, the employment and poverty challenge is strongly linked to the need for a major transformation of the agricultural sector, where the majority of the population makes its living. There is an absolute need to increase labour productivity if we want income levels to rise and decent income-earning opportunities to be created. This does not preclude expansion of cultivated areas in countries like Sudan, where water supply is plentiful.

In order for the region's economies to transform into modern, vibrant ones, the productivity of the industrial sector and agricultural and service sectors should be increased. Intensified globalization imposes a greater sense of urgency for Arab countries to initiate reforms that expand indigenous technological capacities and competitive advantages in higher value-added goods and services. This will require some degree of state intervention to support domestic firms during the transition to higher levels of competitiveness. There are various mechanisms (including subsidies and technological support) for this, which need to be carefully considered, based on contextual nuances.



Supportive Sectoral and Local Level Initiatives

Macroeconomic policies alone cannot deal with the myriad problems that have built up over the years. The shift from a macroeconomic framework focused on growth and price stability to one that clearly elevates employment to the centre stage of the policy arena needs to be supplemented by specific sector and programmatic interventions.

Industrial policy

Industrial policy is needed to ensure that countries move beyond their static comparative advantages through time-bound support and direction, to activities that can contribute to transforming the economy and creating dynamic development pathways for job creation. Industrial policies include a wide variety of elements that are traditionally divided into six subsets: 1) trade policies, 2) investment policies, 3) science and technology policies, 4) policies aimed at promoting micro-, small-, and medium-size enterprises, 5) human resource training and upgrading policies, and 6) regional development policies.

An active industrial policy will provide carefully targeted public support to enable the private sector to deal with imperfections that exist in the market mechanism. It will help build up research, development and marketing capacities that firms need to effectively compete by engaging in high value-added activities and/or by excelling in niche areas. Growth not only entails a broad structural transformation of the economy from agriculture to manufacturing and services, but it also involves the development of niche areas of excellence in manufacturing and/or services over time. Governments in high growth countries were not market purists; they had deliberate industrial policies and intervened in the market using different policy instruments at different times.

In the current, more open, and fiercely competitive global trading environment, selective industrial policy instruments need to be identified. Instead of being designed to circumvent market outcomes, they would need to foster innovation in value-added services and niche investments in the relevant countries. The state would also have to redress market failures through the provision of public goods, performance-based long-term development financing, and government intervention to stimulate the supply of goods and competencies with positive externalities.⁹⁷ The world's leading regional jet manufacturer, Embraer, flourished via such careful government intervention, including a combination of government procurement, tariff protection, and subsidies.⁹⁸ (See Box 11).

Box

11

Brazilian aircraft: active state support in a post-WTO World

Programme description

The Government of Brazil launched its PROEX scheme to overcome the financing handicap faced by the Brazilian aircraft manufacturer, Embraer, in competing for international contracts. Under the scheme, the lending bank charges its normal interest rate for the transaction, and receives payment from two sources: the purchaser, and the Government of Brazil. Of the total interest rate payments, the Government of Brazil pays 3.8 percentage points, and the purchaser pays the rest. In this way, the total effective cost of purchasing an Embraer aircraft is reduced.

Canada took Brazil to WTO over the case and the two countries were engaged in a lengthy litigation process. All through the process, however, Brazil continued to subsidize the exports of Embraer aircraft. It no doubt experienced tremendous pressure throughout the dispute and was required to change its PROEX program. But it did so gradually, carefully testing the limits of the restriction in repeated appearances before a tribunal and moving its measure to a threshold point where it could be considered permissible.

Programme results

As a result Embraer managed to break into the lucrative and high technology aircraft market, winning contracts for the sale of some 350 aircraft (for a total of some US\$ 7 billion) to companies in Europe and the US.

This case also shows that when a country has a program that it considers valuable, it can defend it and it can also make sure not to over conform to the apparent restriction. As it emerges from the evidence of the case, Brazil, a founding member of the WTO, not only did not cut its export subsidy program. It doubled it. And then it made sure to make its case for why it should be permissible, modifying it little by little until it passed muster. Brazil has combined a strategy to promote market access for its exports with domestic measures to promote economic sectors it considers valuable.

This experience shows that in a post-WTO world, states can take an active role in the promotion of their domestic industries and their economic future.

Source: Santos, 2006. http://www.cebrap.org.br/v1/upload/pdf/LANDS_Alvaro_Santos.pdf



The Latin American experience

The East Asian industrialization and the later Latin American rediscovery of industrial policy in the 1990s were driven by the understanding that 1) in the modern world, competitive advantages are, to a large extent, created, or in other words, they emerge from factors that are themselves the result of the development process, and can be shaped by economic agents (both private and public) and not simply from the availability of natural resources or unskilled labour; 2) the effort to create a more competitive economy must be approached in an integrated manner because competitiveness is not merely the product of the enterprises' individual actions, but also the result of the sector and global settings that provide a framework for those actions; and 3) the efforts to promote competition and overcome the constraints to free-factor mobility must be complemented with active sector policies aimed at surmounting the obstacles to higher productivity levels. Sector policies and actions would enable the different productive sectors to integrate more effectively into the new development model with strategic plans directed at removing institutional or regulatory restraints, redefining the scope of credit and export-promotion policies, designing strategies of industrial reconversion, inducing processes of technological transfer and innovation, and generating a greater integration of production chains to increase productivity. Success of such a vision is contingent upon combined public and private actions on the basis of dialogue and negotiation.

The success of this new wave of industrial policy in Latin America & the Caribbean is instructive in that despite political economy risks of the elite capturing incentives, the subsidies provided by open economy industrial policies were often gradually reduced. Countries such as Brazil promoted development banks to ensure that private businesses were able to access the required long-term credit to engage in productive activities. In Chile, public investments fostering R&D and infrastructure were critical for the development of its dynamic fruit and salmon clusters. Active industrial policy promoted ten years into the Pinochet regime also contributed to reversing the process of de-industrialization set in motion by free market policies followed by the regime in its initial years. These policies helped to double Chile's non-traditional exports between 1990 and 1995.

The Arab region can also learn from the Latin American experience with import substitution industrialization (ISI), which was more nuanced and more consistently followed than the similar Arab experience. Gabriel Palma's (2003) analysis for LAC is thus a *propos* for this region: "As ISI became more mature, it inevitably required continuous re-adjustments and changes. The crucial problem was that Latin America's capitalist and political elites, rather than making the required effort, opted for relatively minor modifications to prolong ISI for as long as possible. Eventually, a combination of domestic and international factors made the change to a different development path practically inescapable."⁹⁹ As Palma argues, there is need for constant recalibration of industrial policies to ensure that incentives for productive investments and increased efficiency are not transformed into rents. Reversing the region's policy and initiating a new forward-looking focus on diversification of productive capacities will involve not only a focus on innovative policy and financing modalities, but also a proactive focus on economic governance and identification of more nuanced niche areas within sectors and services, as opposed to a broad, sector-level focus *per se*.

What can LDCs focus on?

The Arab LDCs, with the majority of their populations living off the land and a very small manufacturing base, have to start from the basics. The majority of their population depends on agriculture and has a relatively low level of income. At present, they import farm implements that may not be adequate to their particular conditions. Farmers suffer huge post-harvest losses due to the inadequacy of food processing facilities. Their consumer goods needs are met through cheap imports from Asia. An indigenous industry can address their problems with agricultural activities (farming implements), post-harvest handling of produce (food processing), and simple consumer goods to meet basic consumption needs.



The limited road and rail infrastructure in LDCs tends to fragment the limited local market further by not allowing local producers to achieve economies of scale. Therefore, as a first step in an integrated approach to industrial development, the state has to enter into partnerships with local communities, regional/provincial authorities, and the private sector in order to improve internal communications, develop infrastructure and services, and stimulate demand. As indicated by the UNCTAD LDC Report (2006), “The sustained development of productive capacities occurs when there is a virtuous process of cumulative causation in which the development of productive capacities and the growth of demand reinforce each other.”¹⁰⁰ In this context, the social and economic policies that are being proposed for the inclusive structural transformation of the region’s economy will have mutually reinforcing effects: a focus on poverty reduction and social protection within the framework of inclusive growth can, in fact, contribute to a “feedback mechanism supporting the momentum of growth as productive employment opportunities expand.”

In terms of supply-side policies to facilitate the required supportive services in an efficient manner, LDCs can benefit from the establishment of well-functioning industrial zones in partnership with the private sector and sub-national authorities. There have been many unsuccessful attempts to establish such zones in many countries, but they failed because of a non-supportive operating environment, including limited private sector involvement. In countries where such industrial parks already exist in an embryonic form, they can be made functional with limited additional funding and an appropriate set of incentive structures.

As part of the complementary sectoral policies, local production of appropriate agricultural tools can be promoted. The standard tools available are not easily useable by an increasingly female agricultural labour force. Local production of agricultural implements must be initiated with state support in order to provide the required tools to women farmers.

Furthermore, LDCs can take advantage of provisions of WTO agreements that exempt them from limits imposed on direct support to industry. In cases where they are still engaged in negotiations to join WTO, they can insist on lengthier interim arrangements to allow their infant industries some room to grow. There is clearly more policy room to manoeuvre than one normally counts on. There is no need to be apologetic about subsidizing agriculture, as agricultural subsidies are a mainstay of economic policies in most countries and are even allowed by WTO rules. Unfortunately, the current levels of tariffs and increasing restrictions of policy space impede the ability of the Arab region to develop a dynamic comparative advantage in the global market in significant ways.¹⁰¹ Regional integration offers LDCs, who stand little chance at penetrating the global market alone, an opportunity to successfully integrate into the global hierarchy of production.¹⁰²

What about middle-income countries?

Middle-income countries already have some industrial infrastructure. In addition, their economies are better served by transport and communications networks. Due to higher per capita income levels, the industrial base is also likely to be partially dependent on servicing the local market. Given low levels of productivity and relatively high labour costs, however, these countries are increasingly incapable of competing against imports from more efficient Asian producers. High levels of income inequality also mean that the local market is segmented into a mass market for cheap, undifferentiated goods where cost is the most important consideration, and a luxury goods market where international brands have a foothold.

A more egalitarian income distribution, promoted through a more socially responsible fiscal policy, as discussed elsewhere in this report, can help create the required local market base for an industrial renaissance. The long-term solution for the manufacturing sector, though, rests in moving up the value chain to produce differentiated goods with a high technological content. To facilitate this move, Arab MICs would have to actively support research and development activities, as well as packaging and advertising support services. The quality of university, technical,



and vocational training would also have to improve in order to produce the highly qualified labour needed in such industries. All the same, such activities are unlikely to generate a huge number of jobs. Support must be provided concurrently to the large number of informal units engaged in various manufacturing activities to enable them to increase their productivity.

A knowledge-based economy is going to have a major focus on providing advisory services and sophisticated services. This will be discussed later, in the role of services.

Agricultural development policies

Agriculture continues to be a major source of employment, even in MICs, and has huge potential for contributing to poverty reduction, especially in the more impoverished rural areas.

The first Development Challenges Report recommended addressing the underlying causes of food insecurity by increasing agricultural production based on a four-pronged approach. The suggested strategy would: a) secure access to productive land and credit, b) target price support benefits, c) include more effective participation of women in on-and-off farm activities and d) manage water resources efficiently.

It is also strategically important to expand non-farm, labour-intensive activities within rural areas to ensure economic diversification. The magnitude and types of taxation regimes employed by the state can have powerful impacts on the systems of production and distribution in an economy.¹⁰³ For example, progressive land taxes can induce landowners of vast estates to sell part of their land, reducing the concentration of land in the hands of the wealthy. On the other hand, fiscal incentives can militate against excessive parcelization of small holdings due to inheritance, which risks making small-scale agriculture non-competitive. Changes in statutory laws to strengthen women's entitlements and claims are similarly important to foster a more equitable society. Improved research and data collection can also be crucial, given that it will allow the government to develop better informed policies and farmers to make better informed decisions. Encouraging agro-industries can increase productivity of labour in rural areas and improve economic efficiency.

The region has substantial scope to encourage the financial sector to expand its lending operations to rural areas. Inspiration can be drawn from countries such as India, where agriculture and small-scale industries have benefited from the stipulation that all banks lend at least 40% of their net credit to the 'priority sector'.

It would also be prudent to establish an Arab Food Security Fund to provide immediate food relief for those in dire need. To improve food security, the region needs to invest heavily to improve water availability, conservation, yield and distribution for all uses. Specifically, there is need to invest in greater desalination capacity, drip and other types of efficient irrigation systems, and reforms in water governance to promote equitable access to water resources. More indigenous R & D through greater public and private investment in agricultural R & D is critical for overcoming the technical limitations to increased production in the arid and semi-arid zones typical of the region.

Arab countries have to create the required margin to address the food security challenge. Enacting macroeconomic policies that would increase the fiscal space available for financing investment in agriculture and rural development would be a good first step. Adopting appropriate medium- to long-term environmental, agricultural and rural development policy objectives is also crucial, so as not to exacerbate an already acute water shortage problem and avoid further damage to a fragile environment. Any policy would also have to take into account the likely impact of climate change for its sustainability.



While increasing income and purchasing power of the poor remains the best way to combat food insecurity, improved social safety nets and increased climate change-compliant agricultural productivity can also enhance food security.¹⁰⁴ Improved education can reduce over-dependence on wheat and cereal for caloric intake, thus reducing dependence on imports and improving nutrition and health.

A second major means of enhancing food security is the expansion of public and private investments in agricultural productivity and climate change adaptation. While expansion of farmland is unlikely, owing to scarcity of land and water resources, there is considerable scope for increasing crop yields. Investments in drought resistant crops and improved water conservation can help farmers adapt to shifting climates, while investments in energy efficiency and renewable energy applications, reuse of agricultural waste, methane capture through biogas systems, enhancing soil carbon, and expanding agro-forestry can provide a new source of finance, as the post-2012 climate regime increases focus on access of the poor to carbon markets and a further alignment of carbon credits with the MDGs. A green economy approach supports a shift to ecologically sound methods to increase yields and address social equity. It can engage small and marginal farms; farms with greater acreage will benefit in part from higher prices for their produce, while investments into small farm productivity can have an impact on reducing poverty and increasing food security. Broader measures include crop diversification, production of high-value organic produce for urban markets, reduction of persistent organic pollutants (POPs) from fertilizer and pesticides, and replenishment of soil nutrients, which are being bleached at historic rates.¹⁰⁵

Water is a key element for enhanced food security. There is need for major investments to make water use in irrigation efficient, since it already accounts for the highest percent of water use in most Arab countries.¹⁰⁶ This is especially true given that groundwater reserves are in serious decline in many countries and competition for water is increasing in urban and industrial centres. Substantial water savings can be achieved by investing in water recovery and reuse, along with possibilities for investments into industrial wastewater treatment and reuse and low-carbon means of seawater desalination.

Agro-ecology has also been highlighted as a mode of food production that can support improved productivity in an environmentally friendly manner. Agro-ecology “seeks ways to enhance agricultural systems by mimicking natural processes,”¹⁰⁷ as a way to improve the resilience and sustainability of food systems.¹⁰⁸ Resource-conserving, non-polluting approaches to food production are seen more and more as a means of de-coupling crop yields from expensive energy, water and fertilizer inputs and of increasing yields without jeopardizing long-term quality and viability of progressively scarce soil and water resources.

Agriculture as the linchpin of development in LDCs

In the case of LDCs, a major focus of government action and support has to be on improving labour and land productivity in agriculture. Even the industrial policy suggested for these countries would focus on supporting the primary sector.

Agriculture typically receives minimal allocations in public budgets, and as a result research into more appropriate varieties and farming techniques is not taking place. Moreover, even limited knowledge of innovations is not conveyed to farmers because of outdated and underfunded extension services. Clearly, a more equitable distribution of public resources would call for increased allocations to agriculture in the national budget and institutional reform in existing farmer support services.

Without improvements in supportive institutional frameworks, small farmers cannot be provided with expanded micro-finance services and joint marketing mechanisms to increase the price received for their produce and provide access to affordable inputs. Organizations representing farmers would ideally have a greater say in discussions of national policy choices.



Food subsidies that typically enlarge food imports can be recast so that they promote better nutritional balance and provide an outlet for local producers by moving away from imported staples to baskets of locally produced food. Subsidies that lead to increased food production have been found to be most effective in dealing with the dual problems of rural poverty and food insecurity (see Box 12). Improved rural infrastructure would further assist the growth of the sector by reducing transport costs and losses suffered in the process.

Box

12

Effective production subsidies: Example of the Farm Input Subsidy Program (FISP) in Malawi

The FISP was implemented in 2005 in all districts by the Ministry of Agriculture and Food Security, and is mainly funded from the national budget. It aims to improve national and household-level food security by increasing the use of inorganic fertilizers among resource-poor households by targeting poor and vulnerable smallholder farmers, through a system of vouchers or coupons for seeds and fertilizers for maize and tobacco. Support to tobacco was discontinued during the 2009-2010 season.

The main emphasis of the programme has been on maize, under which each beneficiary household receives two fertilizer coupons for one 50kg bag of basal and one 50kg bag of urea, as well as a maize seed coupon. Around 1.6 million farming households have been targeted in recent years. Priority has been given to vulnerable groups, which include households that are headed by either a child or a woman, although targeting has been inefficient at times.

Some of the major positive impacts of the programme have been:

- The achievement of self-sufficiency in national maize production, with a 26% to 60% increase in production following the implementation of the input subsidy programme.
- Greater village maize availability and prevention of food shortages, despite the high prices following the 2007/8 agricultural season.
- A decrease in the proportion of households reporting a major shock from high food prices from 79% to 20% between 2004 and 2007.
- Substantial protection from the impact of highly volatile maize prices through fixed prices.
- Significant increases in nominal wage rates from 2005/6, greater than the later maize price rises.
- Increases in real incomes of up to 100% among poor beneficiary households, compared to increases of up to 20% for poor non-beneficiary households.
- Considerable fall in poverty incidence estimates from 52% in 2004/5 to 40% in 2007/8 and 2008/9 (NSO 2010)

The FISP programme has contributed substantially to the achievement of food security in Malawi. The FISP experience has demonstrated that political, technical and budgetary commitment to implementing large-scale and fundamentally appropriate programmes can substantially improve the welfare of poor and vulnerable households and can contribute to longer-term processes of broad-based, inclusive development and economic growth.

The costs of sustaining the input subsidy, however, substantially exceeded the budgeted expenditures. The cost of the programme rose from 2.1% of GDP or 6% of the national budget in 2005/6, to 6.6% and 16%, respectively, in 2008/9.

Source: Chirwa and Dorward, 2011.

Can MICs continue to ignore agriculture?

For MICs, agricultural policies would take a supportive role to industrial policies, as well as serve as a major tool in a more targeted response to pockets of high poverty in rural areas. Syria's experience in the period since independence shows the benefits of paying attention to agriculture in order to achieve food security and reduce rural poverty (See box 13). It is worth mentioning that this vision is contradicted by other analysis of the Syrian experience in that period.

The key concern is to maximize productivity of land and labour by moving to higher value crops, whether for local consumption or exports. This may even mean further reducing the production of food staples. Food variety is particularly important for achieving a balanced diet in these countries, and to that end, increased local production of dairy products, fruits, and vegetables would be important. Such countries also have the required infrastructure for promoting production of high value organic produce for the international market. This option might also prove to be attractive to the more advanced regions of LDCs.



Promotion of non-farm rural activities is particularly important in MICs as part of a larger land use management strategy. These countries are already suffering from excessive rates of urbanization and concentration of all services and amenities in cities. It is critical that a broader rural development strategy be developed to slow down the rate of urbanization in big cities and make it practical for educated people to stay and work in more rural settings with the development of secondary towns and cities. Improved telecommunications and road transport can allow semi-rural and peri-urban populations to engage in home-based service activities, thanks to the spread of information technology. Provision of information technology services itself can play a major role in non-conventional, relatively higher-value activities.

Box

13

Syria: Lessons learned from the post-1958 rural development experience

Several lessons can be learned from Syria post-1958 agricultural development experience, particularly the period from 1960-1980 to guide us in outlining future suggestions for Arab countries (including Syria itself). As noted by Ghonemy (2005), this “golden age” of Syrian agriculture was triggered by:

- (1) redistributing land-property rights in favour of the landless and poor tenants, protecting leaseholders and setting minimum wage rates;
- (2) the upsurge in public investment in three giant projects for labour-intensive irrigation and land development of nearly 740,000 ha. (Sud al-Forat, Al-Roston Dam and Asharna-Al-Ghab project;
- (3) pro-farmers pricing system which included production inputs subsidies, combined with a substantial investment in human capital.

The rural economy’s successful performance in the 1960s and 1970s was thus manifested in the triangle of (a) redistribution and secure land tenure rights; (b) considerable public investment; and (c) equity-driven pricing. The result on human development was remarkable. Notable achievements in well-being were realized between 1960 and 1980; longevity increased by 28%, and child mortality rates and adult illiteracy decreased by 76% and 40%, respectively. Indeed, this is another reason why extreme poverty in Syria is still only half that which prevails in Egypt, despite the similarity of income per capita in both countries.

In recent years however Syria’s agricultural model has witnessed major setbacks as a result of successive droughts since 1999 and the impact of rising oil revenues on reducing the urgency of local food production.

Source: Ghonemy 2005.

Competitive service activities and effective social protection

The service sector has been much maligned in the region due to its concentration in low value-added activities of a non-traded nature. However, the service sector, even when it is essentially of a non-traded nature, can have a major role in supporting industrial and agricultural transformation strategies.

Services and LDCs

In LDCs, providing reasonable access to financial services to rural populations can be most revolutionary. There are many successful examples that can serve as lessons, such as provision of banking services by retail traders or expanding access to post offices. Provision of such services, allowing for direct deposit of benefits to beneficiary accounts maintained in rural banking outlets, can reduce the transaction costs of social protection measures and avoid the risks of elite capture. It can also allow for speedier settlement of state payments in cases of public procurement of agricultural products. Such systems are known to have increased savings as well. Given the low rates of savings in the Arab region, this side benefit is of significant value.

LDCs can benefit from the multi-faceted role of services in their linkages, forward and backward, with other sectors in the economy. For example, many LDCs have huge untapped tourism potential that can be harnessed to provide maximum benefit to rural populations through the promotion of ecotourism. The growth of tourism can then serve to increase market opportunities for artisanal production.



Can services support transformation in MICs?

Middle-income countries can benefit even more from expanding competitive service activities by encouraging further growth of medical, financial and consulting services, specialized higher education, cultural products, and tourism. Some Arab countries are already engaged in a subset of such activities and can show the way to others in terms of what works and what to avoid.

Medical tourism provides an excellent source of jobs for surplus doctors, nurses and technicians in country after country. It also provides a platform on which other services can be offered—for instance, financial services targeting foreign retirees who may spend long periods in a country due to affordable, long-term medical care services. Medical tourism can also provide the required revenue base on which medical research can be expanded, allowing the concerned countries to move into cutting-edge medical research.

The growth of a modern agricultural and industrial sector depends on available, supportive consulting and financial services, as well as marketing. The simultaneous development of both can maximize synergies and provide a critical minimum market base for the concerned service sectors to operate until they succeed in breaking into global markets.

Social protection and the quest for decent jobs

As argued earlier, the evolution of the job market in the Arab region has been accompanied by a decline in the quality of jobs on offer. Increased numbers of jobs do not provide any social protection and are often undertaken in dangerous or denigrating conditions. The global response to this has been to push for decent jobs and to prepare a social protection floor initiative with substantive support from the UN system.

Many businesses complain about the added cost of social protection measures and might opt for more capital-intensive methods of production if they see their labour costs rise. At the same time, the Arab street's cry for dignity is inconsistent with degrading work conditions. Social protection that is publicly provided or subsidized is one option, and the promotion of higher-value activities that can support the payment of decent wages is another.

Win-win situations can be created through public and private partnerships that spread the financial burden of social upgrading and skill development. The state can help ensure better technical qualifications for workers, with a view to increasing their productivity. Private industry will have greater incentives to recruit these more productive workers and to cover the cost of their participation in national social protection plans. Tunisia has been experimenting with various schemes to encourage firms to take on new workers by covering at least part of the cost of new recruits for an initial period. One of the most important programmes of this kind is the SIVP (Stage d'Initiation à la Vie Professionnelle) programme, which has been in operation since 1987. Despite its shortcomings, the programme has managed to get over one third of the covered workers into regular employment. Post-revolutionary governments can learn from such programmes and adapt them to their particular circumstances, given the rising numbers of young people who have not managed to find a job following several years of job search.

Improved quality and relevance of public education

The first Development Challenges Report detailed the failures of the educational system in the Arab region and asked for a radical overhaul of the system. Though the current report did not cover this particular issue as a theme, individual country cases highlight the negative influence obsolete educational systems have had in keeping income and human poverty high in the region.



There are many important areas that require attention, particularly preschool education, which is not yet generalized by the public sector even in some of the higher middle-income countries, let alone the LDCs. For the MICs, the challenge is more with adjusting postsecondary education to provide the needed balance between specialists and technicians.

The MICs also have to pay attention to improving the quality and relevance of research undertaken by universities and specialized institutions in order to become serious producers of quality knowledge. This would underpin their move to knowledge-based economies and provide jobs for the more educated.

Maintaining social infrastructure as expenditures to improve productive assets

The quality and relevance of public health and education services are critical for improving the key resource available to Arab economies: their young people. Expenditures incurred in providing these services clearly complement developmental expenditures and might require special treatment when reviewing current expenditures.

Providing quality social services is a necessary condition for meaningful poverty reduction. The freedom from debilitating health conditions as well as equal access to adequate and quality education is vital for breaking the cycle of poverty of the poor who only have their labour power to offer.

An improvement in delivery of social services can also directly assist with creating employment through longer-term jobs for the more educated by raising teacher/pupil ratios in public education and medical professional/patient ratios in public health care facilities.

Promoting popular participation in the management and funding of public education and health services can sustain improved social services. Stronger links between educational establishments and the private sector will ensure more job relevance and a better educational experience.

Public health services can take into account cost effectiveness in terms of number of potential lives saved as a result of different interventions. Such an approach would mean priority funding for immunization and primary health care in poorer countries and referral services in richer countries. There are examples of adapting the delivery options to local conditions, which allow for increased employment without necessarily incurring increased costs. LDCs can explore use of community health workers as the primary contact point for the general population, while MICs can explore options for sub-contracting the delivery of health services to the private sector through public health insurance plans that pay for services rendered by private sector providers.

Greening the economy and creating jobs in the process

The growth process of the Arab region, with a highly energy-intensive development model, has led to some of the highest per capita carbon emission levels in the developing world. It has been estimated that the region has experienced an 88% CO₂ emission growth between 1990 and 2004, three times higher than the world average, despite hosting only 5% of the world's total emissions of greenhouse gases. As oil reserves decline, countries across the region are intensifying efforts to diversify their economies beyond oil exports, through rapid urban-industrial expansion meant to create new growth and jobs for a burgeoning youth population. There is clearly an urgent need to change the development path by opting for a green economy.

The Arab region can reorient its expertise in the energy sector and take advantage of its substantial solar radiation and wind resources to develop into a leader of clean energy technology and finance. The Arab region has huge potential for integrating energy efficiency into new buildings that are multiplying at a fast rate, thanks to a sustained period of high growth since 1999. Many countries and private sector leaders are now engaged in compliance with international



green building standards, such as the Leadership in Environment, Energy and Design (LEED) standard. Pivotal are the new green construction efforts to reduce the carbon footprint of buildings, save energy costs, and help achieve national goals of conserving energy resources. Particular progress in green construction has been marked in Egypt, Mauritania, Morocco, and UAE, while Saudi Arabia is also increasingly engaged in the process.

Furthermore, Arab countries can save oil resources for export through transition towards a high-tech knowledge economy, creating new jobs for youth by developing their huge potential of solar and wind power. Currently merely 7% of energy needs are met from renewable energies, so the potential for growth in this area is considerable. Appropriate policies and regulatory frameworks can integrate clean energy technology and competitiveness approaches across sectors. Multi-stakeholder processes are needed to facilitate public and private partnerships for finance and technology development and transfer.

The largest example of solar technology use is in Morocco, where 160,000 solar home systems have been installed, covering 8% of rural households with 16-megawatt (MW) capacity. Stand-alone smaller-scale applications are also becoming prevalent across the region, such as water pumping, telecommunications, and remote lighting. Other examples are found in Algeria, where a National Action Plan has been released to increase clean energy contribution to 5% of local energy demand by 2017, aiming for 20% by 2030; in Tunisia, where the National Energy Programme seeks to achieve 40% of energy from renewable resources by 2030; in Morocco, with its goal of 20% renewable energy share by 2012; in Jordan, with a target of 10% renewable share by 2020; and in Egypt, where great attention has been placed in recent years on solar and wind power, with a goal of 20% renewable energy by 2020.

Renewable energy opportunities are also on the rise in the GCC member countries. The United Arab Emirates plan to establish Masdar City as a model of the future for low-carbon emission, while the country has made progress in developing CDM initiatives for mobilizing foreign investments into new, clean energy, including a new large-scale solar power facility.

A pan-Arab solar network stretching across the deserts could capitalize on the region's world-leading levels of solar radiation. A private initiative led by EU investors, the Desertec project, would generate 550 gigawatts (GW) of electricity up to 2050 and would service demand within Arab region and export markets in the EU by 2025.¹⁰⁹ Initial solar capacity would be hosted across North Africa, from Morocco to Egypt, with possible expansion to the GCC, catalyzed by a proposed contribution of \$5 billion from the new Clean Technology Fund managed by the African Development Bank (AfDB), whose clean energy investment strategy focuses on energy security, energy access for the poor, and carbon emission reduction.



Regional Integration

Active regional integration can strongly facilitate transformative economic change in the region. Not only will regional cooperation bridge the funding gap for required investments in MICs and LDCs, it will also allow all producers in the region to take advantage of huge economies of scale.

The experience of Europe and East Asia & the Pacific demonstrates that regional integration matters fundamentally for competitiveness, growth and income convergence in an increasingly competitive global arena. Intra-Arab economic integration can substantially raise regional trade and create a large market that allows efficient specialization and economies of scale in industrial activities that would otherwise be constrained.

The Arab region can learn much from the experience of the ASEAN regional integration initiative in Asia, which has managed to attract additional Foreign Direct Investment (FDI) into regional production chains, as well as coordinate much needed technical and financial assistance across the region. As a result of regional collaboration, the ASEAN group have become major actors in global trade. The Arab region can similarly effectively participate in the global economy if governments tap the growth potential that enhanced regional integration can generate. Regional markets would complement national markets, allowing firms to benefit from economies of scale necessary to achieve globally competitive cost structures that allow them to expand production and consequently increase job opportunities.

BOX

14

Financing for development in the context of the “Arab Spring”: Opportunities and Challenges

The outcome document of the International Conference on Financing for Development that took place in Monterrey, Mexico during 18-22 March 2002, known as the “Monterrey Consensus”, was based on a global deal, described by some as a “Grand Bargain”. The “Grand Bargain” embodied in the Monterrey Consensus reflected a new spirit of partnership, where developing countries would exert maximum effort domestically to put their houses in order through good governance and sound economic policies, while developed countries would exert maximum effort to create an international environment supportive of the development efforts of developing countries. The record since 2002 suggests that developing countries have been much more forthcoming in fulfilling their part of the bargain than developed countries.

The Arab Spring poses new challenges to the Arab region at this critical historical juncture, with the initial and turbulent systemic transition period. However, it also opens wide opportunities to implement the Monterrey Consensus in the medium and long run that could take it to a new level of hope for countries of the region at all levels; national, regional and global. The promise of a new social contract and a “Developmental state” model opens the door for a new, vibrant, responsible, and competitive business community that contributes to the mobilization of domestic resources in a more equitable environment. The promise of Arab economic integration takes regional prospects and ambitions to a higher level as the new development model is geared towards more accountability to the people and for the people of the region. This could lead to a large and deep regional market of 350 million consumers that would deepen investment and trade ties, leading to prosperity and capital accumulation to solve debt problems and decrease reliance on outside assistance. All these positive potential outcomes would lead to enhanced status of the region vis-à-vis the global economy, increasing the bargaining power of the region with the rest of the world and opening the doors for a much wider mix of policy alternatives within a much wider and expanded policy space. This latter outcome is at the heart of solving the central problem relating to systemic issues, having to do with the struggle to enhance the voice and representation of developing countries in global economic decision-making.

Source: UNDESA (Department of Economic and Social Affairs) FFDO (Financing for Development Office)

Furthermore, integration can promote regional food security and bring about shared prosperity, peace, and security through joint action. Such collaboration, by enabling and fostering a strong and proactive common position, would provide the region more leverage in international commitments negotiations to secure more favourable and equitable development outcomes. This would allow Arab countries, especially those less privileged and less wealthy, a better chance to renegotiate the terms of their integration into the global economy so as to open up their economies gradually, in line with the development of their productive forces and competitiveness. Moreover, free movement of labour and capital within an Arab economic union would allow the combination of the financial wealth of major oil-rich countries with the land and human capital of poorer countries to mutual benefit.



Thus far, the region has only made timid attempts at regional economic integration, unlike other regions of similar income per capita levels, like Latin America & Caribbean and East Asia & Pacific. The success of such regional groupings as the ASEAN in Asia and MERCOSUR in Latin America & Caribbean illustrate the opportunity the region has lost by not insisting more forcefully on regional integration.

How can regional cooperation be expedited?

A recent report by the World Bank¹¹⁰ suggests a practical approach to promoting greater Arab economic integration in the context of a Pan-Arab Free Trade Area. This consists of (1) completing the free movement of goods within the Pan-Arab Free Trade Area, notably by eliminating unnecessary non-tariff barriers; (2) implementing a regional initiative to liberalize the service trade, including identifying a number of pilot service sectors for early regional liberalization; and (3) strengthening the rules and discipline applicable to regional trade and other policies of common interest.

It is unfortunate that the Sharm el-Sheikh Arab Socioeconomic Summit only paid lip service to Arab economic integration and did not agree on any concrete measures for moving ahead with the implementation of the 2009 Kuwait Summit Declaration on economic integration. The leaders merely agreed to strive to establish an Arab common market by 2020 without a detailed timeline or procedure for follow up. As also argued by the World Bank, Arab governments can accelerate the free flow of trade in services within the region by developing a regional strategy for trade in services integration, establishing forums to address knowledge gaps and facilitate the political economy of reform, conducting regional Regulatory Services Audits, and negotiating a pan-Arab agreement in services.

To pave the way for the liberalization of trade in services, a number of pilot service sectors could be identified for early regional liberalization. Key candidate sectors include: (1) trade facilitation & transport, given the importance of facilitating trade in key corridors and improving trade facilitation and logistics services inside the Arab region, including customs and border agencies; (2) banking & finance, to immediately promote banking sector competition, encourage further access to credit and intra-Arab investment and facilitate capital movement among Arab countries; and (3) information & communication, in order to enhance the competitive potential of the sector. There is also considerable potential for increasing intra-Arab tourism by simply revising visa requirements. For example, Syria, since 1955, has not demanded visas from nationals of any other Arab country, and there is visa-free travel within the Maghreb Union of Libya, Tunisia, Algeria, and Morocco and within the GCC.

Five areas in which Arab integration may be useful in the years to come are:

1. **Surging LAS capacity in electoral cycle support:** The Arab League may want to establish a core group of experts on technical electoral assistance to work with national electoral commissions on various aspects of election support, including a core group of Arab monitoring experts on elections to work with civil society actors.
2. **A LAS-led institutional building initiative:** Learning from the IGAD initiative to mobilize civil servants from African countries to help build the civil service and public administration in South Sudan, the LAS can consider an Arab Initiative for Institution Building. This would be highly relevant in Libya and later in other countries. There are sustained long-term benefits to having Egyptian and Tunisian or Jordanian and Lebanese experts in law, constitution making, or public administration work with nationals and internationals in Libya in a concerted and scalable manner. This requires an initiative with long-term agreements for secondments and return of expatriate nationals.



3. A LAS decision-support database, including governance, socioeconomic, and environmental indicators: Proceed to put into practice the already agreed holistic capacity to combine socioeconomic, crisis, environment, and governance assessment capacity for future trend and scenario building inside the LAS.
4. Operationalizing the Arab Human Rights and Anti-Corruption Charters: These Arab Charters need to be operationalized. Learning from the African experience with peer review mechanisms, the LAS can consider different strategies for the operationalizing of a review mechanism based on the Arab Human Rights Charter.
5. Arab Fund for LDCs: Along the lines of the EU regional structural funds, the Arab League may want to devise a similar fund in support of less developed regions of the Arab world that works to improve physical infrastructure, job creation, and targeted social services. It is important in this context to set up mechanisms to follow up on implementation of existing Arab Development Summit commitments on establishing various funds.

Good neighborhood effect

The Arab region needs a good neighbourhood effect like the European Copenhagen principles for accession and the African Peer Review Mechanism. In 2008, at a meeting in Riyadh, the League of Arab States called for joint cooperation to address high poverty and unemployment rates, among other common challenges, through Resolution 3653. Following that resolution, LAS convened the first Arab Economic and Social Development Summit in Kuwait in January 2009. The concluding declaration of the Summit, entitled “Elevating the Standard of Living for Arab Citizens,” gave priority to private sector and civil society participation in social and economic growth, among other objectives. Stressing that the Arab world is still facing local and international challenges that affect its security, sovereignty, and social development, this first Arab Development Summit reaffirmed the commitment of the region to achieve the MDGs and to activate policies and programmes to, among other things, reduce poverty and unemployment, improve social equality, empower youth and women, raise women’s participation in economic, political and social life, and invigorate the role of civil society.¹¹¹

In the past two decades, the Arab region has witnessed a number of declarations for democracy and human rights (Sanaa, Alexandria, and Tunisia in 2004). If acted upon, these could give a good push to a new social contract in the region. The Arab League needs to follow up on the Arab Human Rights Charter of May 2004, ratified by 10 Arab countries so far. Though it falls short of aspirations, it is important to note that this is the first attempt at setting regional standards for governance.

Another attempt at joint action is the Arab Anti-Corruption Charter, recently passed but not yet ratified. The Arab region may benefit from specific charters or conventions that set standards for access to information, as advocated by the Arab Freedom of Information Network,¹¹² for free, fair and credible elections, and for rights-based private-sector-led investments. Within the region, discussions over the design of an Arab League Action Plan on Climate Change have prioritized the elaboration of national climate policies as a means of ensuring coherence among country approaches.

Affirming commitments and setting standards are good starting points, but are not enough. It is necessary to monitor efforts to meet those commitments and standards. The African continent has pioneered a process of peer review, called the African Peer Review Mechanism (APRM) that has developed a systematized framework for assessing economic, social, and political reform and has encouraged a civil society partnership with governments for conducting the assessments. Though few reports in the countries that have completed the APRM process have been circulating openly and few action plans are being rigorously implemented, the Arab region may benefit from the APRM experience by encouraging a regional assessment of governance reform efforts in partnership with civil society.¹¹³



What Can Be Done Now?

The “Arab Spring” that led to political transformation in Egypt, Libya, Tunisia, and Yemen now has to move beyond what it is against and define what it is for. The social justice agenda that has been dormant for so long under dictatorial regimes cannot be held back for long. At the same time, there is a danger of populist politics taking hold if there is not sufficient attention to having an informed debate about trade-offs in social and economic policies. In addition, design of short-term interventions has to take into account existing institutional weaknesses and political realities. This section contains proposals that aim to address such short-term concerns alongside some longer-term ones.

Building constituencies for immediate action

The global experience of democratic transitions in placing the social justice agenda on the back burner in the initial period, in the interest of maintaining the largest possible support constituency, does not bode well for a frontal attack on social justice issues. Given the demands expressed by the Arab street in the contestation movement, social demands cannot be ignored for long without putting the revolutions in danger. In addition, in both Tunisia and Egypt, the democratic transition has been accompanied by a slowing of economic growth to a crawl due to the negative impact of insecurity and uncertainty on private investment and tourist flows. At the same time, the spike in food and energy prices increases the cost of maintaining food and fuel prices at pre-revolution levels. The weakened ability of the state to collect revenues, now that it is no longer feared, risks undermining the ability of the government to raise revenues. The state is being asked to do more precisely at the moment it is least able to do so.

The Arab Spring may produce immediate political transformation. This political agenda would result in procedural improvements to ensure free and fair elections and reduce the monopoly of power through regular rotation of political parties or incumbent presidents.

We are already witnessing in Tunisia and Egypt a move towards writing new constitutions and fixing laws that affect political life, allowing for more inclusive public space for political contestation after years of one-party domination and one-man rule. Morocco and Jordan are quietly changing rules of political contestation (electoral and political party laws, including some constitutional amendments).

The ability of the ensuing democratic regimes to adopt immediate social justice policies, as mentioned above, is less certain. The current economic crunch, coupled with capital flight and the fluctuating nature of most sources of rentier revenue in the region (whether oil or other natural or geopolitical assets), will most probably make economic policy makers focus first on re-starting the economy to regain pre-Arab Spring growth rates. While interim governments try to find the resources to start huge public works, the persisting populist demands for better wages, more secure contracts, better and cheaper housing, etc. will continue to put pressure on state budgets. Ministers of finance in interim governments, who often suffer from risk-averse psychology, may not want to venture into politically risky choices. They may find themselves forced to meet populist demands by increasing borrowing from abroad, domestically, or by other inflationary means. In any case, the budget deficit may well increase to unsustainable levels.



The interim governments will need to build a social and political constituency on which they can rely for political support that paves the way for a social justice agenda in the long term. In the short term, the working class is ready to march behind policies that improve their wages and contractual conditions. The result will be advocacy of populist spending that is not sustainable. Another possible political and social constituency is the middle class. The middle class in most Arab countries is traumatized by decades of economic and social impoverishment. Furthermore, the middle class was politically marginalized. Weak political parties (other than former ruling parties) and controlled professional associations deprived the middle class of channels of expression and articulation of interests.

Consequently, a social and political constituency to reset economic policies on a social inclusion track will be hard to mobilize in the short term. This is particularly difficult given the obvious lack of strong political parties with a social justice agenda in the Arab region. However, new social movements, especially those based on social networks and the Internet, new independent labour unions, and new political parties are on the rise. This bodes well for the future. However, as other transitions have taught us, the landscape of social and political actors could remain in constant flux for a while. The risk is that counterrevolutionary forces may reorganize and use electoral processes to come back to power.

Economic and social policy

A better understanding of unemployment dynamics

Successful policy interventions have to be based on solid evidence. A lack of updated data on job seekers complicates a rigorous understanding of employment dynamics in the region, in LDCs and lower-middle-income countries. These countries also face a funding constraint that limits the regularity and depth of labour market surveys that are carried out. The data on employment trends and dynamics are based on estimates. Even in the higher-middle-income countries with functioning employment offices, the information collected is limited and does not provide a solid base for understanding employment dynamics. It is even less suited to provide the desired response, follow-up, and monitoring support in the event that employment-focused programmes are launched.

There is an urgent need for growth-employment diagnostic studies that will carefully evaluate policy options and trade-offs for expanding employment in the context of different growth trajectories. The studies would also assess the ability of sectors that have been providing the bulk of jobs to date to continue to contribute to employment creation in the future. In countries like Tunisia, this work is already being attempted in the context of coming up with regional employment plans in selected governorates. Based on this assessment, the authorities can carry out cost-benefit assessments of different mixes of interventions on demand and supply factors to inform a public debate about development choices. The assessments should, of course, pay particular heed to binding environmental and foreign exchange constraints and suggest ways that these can be relaxed.

The UN system would be well placed to assist interested countries in carrying out such diagnostics, building on the work already done within the region and globally. The Arab League can also assist in the process by adopting common standards and facilitating inter-country exchanges.



Supporting local producers: imaginative use of government procurement

The current wave of contestation has unleashed a newfound pride in being Egyptian, Tunisian, etc, on which a movement to support local producers can be mounted. Limitations imposed on WTO member countries notwithstanding, there are imaginative ways in which the state can use public procurement policies to promote local industry and “green” the economy. Governments can formulate the terms and conditions of offers, and tenders such as to provide incentives for local content development and capacities by, for example insisting on local after-sales support services or use of components that are more likely to be found locally, such as a particular kind of wood. In any event, the procurement market of the countries going through transformative change is not so major or lucrative as to lead to major trading blocks to lodge complaints against what may be perceived as non-authorized favouring of local suppliers.

Public procurement can also be used to incentivize procurement from local farmers within the context of enhancing food security. For example, Brazil has implemented a Food Acquisition Programme (Programa de Adquisição de Alimentos, PAA), as a pillar of its Zero Hunger programme. The PAA has promoted the purchase of food from family farmers by exempting it from public bidding processes at prices compatible with those prevailing in regional markets.¹¹⁴ (See Box 15.)

BOX

15

Brazil's programme for purchase of food from family farmers (PAA)

Programme Description

Under Brazil's Food Acquisition Programme (Programa de Adquisição de Alimentos, PAA) launched in 2003, the government directly purchases various agricultural products exclusively from family farmers at market prices to create public food stocks to regulate prices and provide high quality products to institutions dealing with food-insecure populations. Its twofold objectives are to “guarantee access to food in the proper quantity, quality and regularity according to the needs of the population living in food and nutritional insecurity, as well as to promote social inclusion in rural areas by strengthening family agriculture” (MDS).

Programme Results

- *Direct monetary benefits:* Beneficiary farmers received three times the income of non-beneficiaries as a result of marketing produce through the PAA. Purchases made by the PAA altered the relationship between producers and intermediaries in established markets and helped improve conditions for non-beneficiaries.
- The programme provided alternatives to traditional marketing channels, helped minimize the power of middlemen and ensured that farmers received fair prices. By providing a market for products that previously had no clear market opportunities, the programme raised income and market participation levels; beneficiary farmers also diversified their production and increased the use of various inputs such as improved seeds, fertilizers and the use of irrigation equipment.
- *Additional benefits:* At least 20% of farmers adopted new milking techniques in response to requirements of the PAA. The number of milk coolers installed in the region rose by 40% and the use of tractors, fodder, trucks, and computers grew by 15%, 17%, 27%, and 35%, respectively. 26% of farmers said they acquired new livestock that were genetically superior to those they previously owned. There were also improvements in nutritional outcomes for the most vulnerable populations who were receiving milk under the programme.

N.B. The approach of offering local market opportunities to farmers in public procurement plans is also present in Brazil's National School Feeding Programme (PNAE). A law approved in 2010 stipulates that, of the total financial resources transferred by the federal government to states and municipalities under the programme, at least 30% must be used to buy food directly from farmers, mainly at the local level. This amounts to about US\$500 million. PNAE has a significant scope, since it provides a daily meal to about a quarter of the country's population. The initiative offers another market-access option for these farmers and seeks to stimulate economic development of their communities.

Analysis suggests that, particularly in poor areas that are far from urban centres and where infrastructure facilities are poor, such public programmes can play a valuable role by ensuring predictable demand for the products of family farmers and by stimulating economic and social investments, as described above. The demand-side stimulus (through public procurement at predictable prices) can also help to increase the impact of more traditional supply-side policies (e.g. credit, insurance and technical assistance).

Source: Souza and Chmielewska, 2011.



States can also offer in-kind increases in the pay packages of civil servants, with which they are provided the opportunity to buy particular locally-produced commodities where substantial excess capacity exists. Even if the extra expenditure is financed through the banking sector, it need not lead to any inflation, as the extra demand is likely to create the supply to respond to it. This way, not only will the civil servants see their incomes approach a living wage, but in addition, jobs will be saved in the private sector and private investment will be encouraged. Currently, for example, many Arab governments provide substantial subsidies on largely imported grain, which does not even produce a balanced diet. While it may not be politically feasible to revamp the system in the short term, measures can be taken to supplement it by providing targeted school feeding programmes, for instance. This can help inject some life into anaemic agricultural sectors by including the promotion of community gardens and livestock programmes, and encourage local food processing activities to ensure that food reaches the intended beneficiaries in a fit state for final consumption with minimal post-harvest losses.

Can a real exchange rate undervaluation help?

The assessment of challenges faced in structural transformation, and particularly what has happened to the manufacturing sector, indicates that an overvaluation of exchange rate, which is normally associated with natural resource rents, is in part responsible for the excessive growth of the non-traded service sector.

In Arab countries that are highly dependent on food imports, increases in the price of imported food raises national inflation rates. The IMF has actually been pushing for an overvaluation of exchange rates in some countries, notably Yemen, as an anti-inflationary measure.¹¹⁵ However, as such overvaluation tends to depress the prospects for the traded sector (and this is where the highest opportunities for increased productivity, and hence income, exist) such a policy might actually end up increasing poverty by decreasing the income of the poor.¹¹⁶

While it will be difficult to sell politically, it makes sense for Arab countries to explore options for bringing about a real exchange rate undervaluation in order to counteract the Dutch Disease, at least in the interim period, while capacities for effectively implementing carefully crafted industrial policies are built up. Of course, the success of such a strategy is contingent upon careful management of monetary policy so that a formal devaluation does not translate into generalized inflation, which might actually lead to further overvaluation of the effective exchange rate. Such a policy would have the benefit of providing blanket support to all entities involved in the production of traded goods, and as such it will not be counter to WTO engagements. This should not detract from a longer-term objective to move from real exchange rate undervaluation-led growth to innovative and skill intensive growth, especially in countries like Tunisia that already have a reasonably mature manufacturing sector.

Complementary action to support productive activities

While building up the capacity of state institutions to administer a carefully thought out industrial policy, there is scope for a) higher public investment in infrastructure through a revised macroeconomic framework that allows for it, and b) easing access of private firms to affordable, long-term credit. Access to long-term credit can be expanded through the creation or strengthening of development banks by identifying incentives to shift bank lending away from support of more short-term and speculative real estate investments and consumption loans towards longer-term productive investment. The experience of Brazil's National Bank for Economic and Social Development (BNDES) may be of interest in this regard (see Box 16).¹¹⁷



Creation of public productive and social infrastructure

In order to lay the foundation for the eventual implementation of a long-term industrial and agricultural growth strategy, the state can launch an immediate programme of infrastructure upgrading to deal with the urgent need for jobs and affordable housing in the current economic junction.

Such a programme would deal with major bottlenecks to private sector growth in terms of transport, power and communication networks, as well as dealing with urgent social demands for affordable housing. The implementation of such an investment programme using labour-intensive methods would create jobs in the immediate term and save foreign exchange on imports of machinery needed if capital-intensive methods are used. This is in line with the findings of the growth commission that public and private investment, funded from national savings, lays the foundations for sustained growth. This is exactly what was done by East Asian countries, who managed to crowd in private investment by building the needed productive infrastructure through public action.

The infrastructure to be supported in LDCs is mostly in the form of feeder roads, small rural clinics, and rural water supply networks. These are closely linked to the desired improvement in an agriculture-dominated economy. Infrastructure projects can be implemented using community-based mechanisms to design and monitor them, thus overcoming weaknesses in official monitoring and evaluation mechanisms.

The LDCs might also want to study the feasibility of adopting some version of the national employment guarantee plan operational in India, in order to provide a minimal level of income to their largely rural poor population.

The MICs would have to focus on infrastructure that opens up the more deprived regions and links them to main industrial and tourist sites. Infrastructure development is likely to be more in the nature of highways and improved rail networks. The MICs can ensure that such projects provide large-scale employment to unskilled groups by stipulating certain minimum labour content in the contracts for such jobs.

It is possible for any country to easily allocate up to 1% of GDP through deficit financing to mount well-articulated public works programmes that actually increase the productive potential of the country without any inflationary impact. A programme of this magnitude may create jobs for a critical mass of unemployed persons to make a dent on the unemployment problem in the immediate term. It will not, however, directly create long-term jobs and will be of very limited use in dealing with the thorny issue of graduate job seekers.

In Egypt's case, one can mount a public works programme for some \$1.5 billion which, at an average cost of \$5 per job created per day, can create 300 million work days, sufficient to provide 3 million people with part time work for 100 days a year. For Tunisia, the comfortable level of funding would be around \$400 million which, at an average cost of \$8 per job created per day, can create 50 million work days, sufficient to provide half a million people with part time work for 100 days a year—a remarkable achievement by any standard.

In addition to creating new assets, public works programmes can be used in countries undergoing transformative change to improve maintenance on existing facilities. Typically, such activities have the advantage of not requiring much in the way of auxiliary equipment, allowing for greater employment generation per dollar expenditure. The payback on such interventions is also unusually high, as these prevent decay in existing facilities, some of which have been built at considerable expense. Such activities can also be more evenly spread throughout the country to avoid possible charges of favouritism, which can plague regular public works programmes.



Box 16

Brazil's National Bank for Social and Economic Development (BNDES)

Description:

The National Bank for Social and Economic Development offers several financial support mechanisms to Brazilian companies of all sizes as well as public administration entities, enabling investments in all economic sectors. In any supporting undertaking, from the analysis phase up to the monitoring, the BNDES emphasizes three factors it considers strategic: innovation, local development and socio-environmental development. The BNDES pays special attention to international trade by financing mechanisms for exports of Brazilian products and services. Consideration is also given to increasing the international presence of Brazilian companies. The bank's operations cover most economic activity sectors. Some of the sectoral projects that BNDES supports are:

Cattle-Raising and Agriculture: Among other projects eligible for funding are beef cattle production, establishing or recovering pastures and costs and cultivation treatment until the first harvest of crops.

Trade, Services and Tourism: Special financing conditions are offered to projects focused on modernizing the infrastructure of education, health, social welfare and tourism.

Results achieved:

The Bank played a fundamental role in Brazilian import-substitution policies during the 1970s, culminating in the most complete industrial sector in Latin America. The Bank encouraged investments in new industrial segments, including information technology and microelectronics.

During the 1980s, the Bank encouraged Brazilian companies to compete with imported products on the domestic market, as well as stimulating exports. In the 1990s, it was responsible for the administrative, financial and technical support of the Brazilian Privatization Program, assisting in the sale of large state-owned Brazilian companies, which began in 1991.

In the 1990s, the BNDES emphasized its role in regional decentralization with heavier investment in less developed regions in Brazil, as well as support for exports of micro, small and medium-sized companies. In the 2000s, the bank moved to more systematic support for cultural activities, financing all phases of the artistic production chain. The BNDES today is an active and modern institution that continues to pioneer new boundaries, including establishing an international presence in 2009.

Source: Brazilian Development Bank (BNDES). http://www.bndes.gov.br/SiteBNDES/bndes/bndes_en/

The state can also engage in large-scale programmes that provide a minimum amount of predictable part-time work opportunities and facilitate support to schools (e.g. teachers' aides) and health facilities (e.g. community health workers and home based care as in South Africa's Community Work Programme). These programmes can assist by increasing the quality and reach of public health and education services in the immediate term. In the longer term, reforms of public health and education services and upgrading the skills of personnel engaged in these sectors can do away with the need for such additional capacity. More likely, some of the people recruited on these work opportunities may develop the necessary skills to be absorbed into a post-reform social service delivery structure.

Part-time public works programme jobs can also be created in a number of other areas—e.g. early childhood care and other social services, food security through community gardens, etc.—as well as major public awareness campaigns (e.g. adult literacy). The plans can include workers trained in advocacy and outreach who could animate debates on issues, such as the inefficiency and poor targeting of current subsidy programmes, to lay the foundation for their eventual removal. Such plans can use social motivators that would animate public debates among the population at large to actually build a constituency for the removal of subsidies. The social animators can be provided with some minimal allowances.

Interventions to support the working poor

The country case studies commissioned as background papers for this report highlight the issue of the working poor, particularly in LDCs, where they do not have the luxury of remaining unemployed. Even in MICs, an increasing



number of people, like Mohammed Bouazizi, find themselves marginalized in low-productivity occupations in the informal economy.

There have been many successful community-based approaches, piloted in countries at different levels of development, to increase the income of the working poor that can be replicated. These initiatives include productive inclusion, such as Brazil's PAA, as well as marketing cooperatives that assure small producers of higher and more consistent prices for their produce, on the model of the Amul Milk Cooperative in India. They also cover the work of such world-renowned NGOs as BRAC in Bangladesh, whereby poor peasants are provided with training and needed support services, including access to credit and marketing, to engage in more remunerative activities.

The self-help group concept has been supported by UNDP, among others, in a number of countries, including India, with great results. This approach assembles poor people in a given village who support each other through a group savings-based credit programme. The programme also provides technical training and links the organized communities to government services. This move allows the poor to improve their income-earning opportunities by taking maximum advantage of available support services.

Such community-based approaches to improving the incomes of the working poor can be initiated in the immediate aftermath of democratic transitions, given their additional benefit for developing social capital and promoting participation in decision-making processes. They also provide an opportunity in terms of socially useful jobs to a team of social animators that will support the programmes.

Are peripheral regions destined for a life of misery?

The problem of sub-national disparities in the region, and the role the resultant sense of grievance had in igniting the protest movement in Tunisia, has been highlighted in this report. Clearly, if democracy is to take root and national cohesion be strengthened, post-revolutionary Tunisia and Egypt do not have the luxury of leaving behind the deprived remote regions.

The problem of regional disparities is not limited to Arab countries. The European Union has a special programme for assisting the deprived regions of its member countries to overcome their economic backwardness. Within Arab countries, Morocco and Algeria have attempted to deal with the problem and engaged in interesting regional development initiatives. Post-revolutionary Tunisia has even created a Ministry of Local and Regional Development to focus on the issue.

It is critical to immediately start dealing with the problem of regional disparities in the initial phase of the democratic transition, given that this is a major cause of discontent. The first requirement is to have a thorough understanding of the dynamics of regional development, on which a response plan can be articulated. To that end, local governance and local economic development issues have to be addressed as a matter of priority. The requirements for successful decentralization efforts also have to be defined by first electing local bodies and giving them a role in the management of local development issues. Bringing the government closer to the people will help to overcome traditional mistrust of authority and can lay the foundation for eventual attempts at increased domestic taxation.

In Tunisia, there is already a push for greater attention to local development with a new Ministry of Local Development in the transitional post-revolutionary government. Similar moves can be supported with measures aimed at



strengthening grass roots democracy, by promoting bottom-up planning at the village level. The government of Tunisia and UNDP are already initiating action on this front, which is expected to produce lessons for replication.

Post-transition fiscal arrangements

The margin of manoeuvre for governments aiming to push through transformative change is initially constrained by pre-existing patterns of expenditure, which may be very difficult to alter in the short term. Staff costs typically account for a major share of current public expenditures, and since they consist of salaries and benefits of staff already on the payroll, not much can be done about them. Discretionary spending is limited to the minimal budgets most entities have for operations and maintenance, which, again, can only be cut at the risk of seeing capital assets deteriorate faster. Military and security expenditures cannot be cut in the short term due to the need to defend a reform-minded government against internal and external threats. There might be some room for minor adjustments to the budget for subsidies by marginally adjusting the prices charged for the subsidized items. However, even this move is unlikely to generate much revenue under the current conditions, where recent increases in the market price of food and fuel, as the typical subsidized items, mean that the existing budget projections are likely to be an underestimate. At best, an adjustment in prices can keep the expenditure within the allocated budget.

After a successful contestation movement, possibilities for raising revenues in the short term are limited due to the recessionary impact of radical changes in governments. In the immediate aftermath of a revolutionary change, there is no escape from increased levels of budget deficit. The suggested programmes of building public infrastructure in particular are likely to further add to the deficit. The question is how to define a safe level of budget deficit that does not create long-term problems for the country. Here is where the nature of interventions to be funded assumes critical importance. So long as the suggested interventions can remove production bottlenecks faced by the local economy in a reasonably short time, they need not be inflationary, as they would be creating the supply needed to respond to the increased level of demand. Withstanding populist pressures for across-the-board pay increases for civil servants and the like thus becomes very important in the short term.

There is not much possibility to effectively raise receipts against direct taxation in the short term, due to institutional weaknesses and the need to allow time for the culture of responsible citizenship to emerge. Import duties and fees, however, can be increased to the extent compatible with each country's international obligations. In addition, such revenues would have the advantage of promoting local production by increasing the relative cost of imported items.

Governance reforms

With regard to governance, a distinction has to be made between immediate and long-term reforms or steps to be taken. In the long run, two major mechanisms must be enhanced and secured in place: enhancing accountability and transparency, and justice and the rule of law. Meanwhile, societies in transition must diligently work in the short run to address four major issues. These are constitution building, elections, political participation, and transitional justice.



Enhancing accountability and transparency

The economic measures needed for immediate action will be easier to sell if coupled with strong signs of readiness to stand up to all forms of corruption. Useful actions include (1) openness about what happened in the past (the role of anti-corruption transitional commissions), (2) immediate action to strengthen and empower anti-corruption mechanisms, and (3) direct measures to strengthen the judicial system to deal with sector-specific corruption cases. A professional, unbiased media with standards on investigative journalism will help guide public opinion away from populism.

One further governance intervention that can accompany tough economic measures is the immediate opening of budget processes and laws that ensure access to information.¹¹⁸ This will increase popular ownership of the fiscal choices and lead to meaningful support of and engagement with the populace at large in reshaping public finances.

Justice and rule of law

A rupture with past corruption protected by incumbent political elites is necessary to underpin a successful transition. Arab outrage with the lack of integrity can be calmed through transitional institutional arrangements that investigate and try past abuses, embezzlement of public funds, and violations of human rights. This requires that the role of the judiciary and its respected position in the Arab mind be closely monitored. Tunisia and Egypt are manifesting two alternative ways in the short term: in Tunisia, a transitional commission addresses corruption, while in Egypt, the courts are handling the matter.

A complete change in mindset away from concern with the security of an incumbent elite to the security of all people will also help make economic reforms easier to accept. The model of oppressive stability has shown its limits, if not its bankruptcy. A change in how the security sector is governed can be initiated in the immediate term via new mandates that emphasize the professionalism, political neutrality and civilian control of this sector.

Constitution Building

Transitions to democracy require a new social contract, the governing document of which is the constitution. Previous transition experiences show that measures adopted vary from one country to another: while some completely revoke the old constitution, others introduce amendments that conform to the character of the new phase. This is very much influenced by the transition's style, whether the transition represented a complete break with the past or, alternatively, if it was the product of a negotiation process. In Brazil, for example, a congress was elected first and commissioned to write up a new constitution, which was later approved, while in Chile, the opposition negotiated with the regime to amend the constitution. South Africa's old constitution remained until negotiations with the apartheid regime ended. Argentina on the other hand, only changed its constitution ten years after the inception of the democratic reform phase. In Tunisia, the revolution revoked the constitution, after which a higher national commission was set up and commissioned to prepare for elections of a national constituent assembly to write up the constitution.

However different these experiences are, the lessons learned from these countries concerning constitution building indicate the importance of reaching consensus on fundamental problems to ensure that the constitution appropriately reflects and protects the interests and rights of all social groups. Furthermore, the process of writing the constitution should be characterized by the inclusion of all political groups, economic factions, and religious loyalties as well as racial and ethnic affiliations so that the constitution becomes expressive of all and owned by all without exception. South Africa offers an excellent model in this respect.



Box

17

The process of constitution making

A distinction should be made between constitution drafting, which is a legal and technical act and constitution making, which is the result of political dialogues and compromises. Constitution making is a complex and multi-dimensional venture. It involves various processes and stages, with multiple actors consulting with one another to reach a consensus on the nature of the constitution. The makers of the constitution need to decide on the procedures to be followed during the making of the constitution. They also need to deliberate on relevant matters like the nature of the political institutions that will be set up, such as the judiciary and federal and regional governments. The whole process may be a guided roadmap and a sequence of events to be accomplished within a certain time-frame, and the time frame may be ridged or flexible.

Source: The Constituent Assemblies and Process of Making Constitution, IDEA October 2007:1

Elections

One of the pressing issues relevant to governance and transition is that of elections. The organization of the first free and fair election, the expansion of participation and of political parties' rights, and reaching agreement with political forces of the old regime are all difficult challenges of democratic transition. However, though difficult, country experiences have exemplified different measures.

Brazil focused on the procedural matters related to the voting system, the means of regulating the electoral process and its integrity. Both Chile and Argentina made successful attempts to set up a large alliance among forces that supported democracy. Both Indonesia and Chile encouraged participation by women and youth. Tunisia recently dissolved the ruling party, deprived its members from exercising their political rights, and decided to allocate 50% of the parliamentary seats to women. South Africa and Mexico were adamant about ensuring representation of minorities. Mexico provided a unique example in public financing of 90% of the budgets of political parties; 30% of public finance was evenly distributed to all parties, while the remaining 70% was distributed to each party according to its share of seats in the last congress. Parties' ability to have access to the media was limited except through the government media, so as to ensure equality between the parties.

In addition, the first post-transition elections indicate that there are several lessons to be learned to ensure fair, competitive and clean elections, including the need to have clear rules and procedures for elections, having interpretation and legal action against violations entrusted to the Court of Cassation for Electoral Affairs, establishing an independent electoral management body that is powerful and enjoys the trust of the people, ensuring equal opportunities for competition between the parties, in terms of funding and access to the media, and requiring loyalty to democracy from the parties. An independent electoral management commission should work on drafting rules organizing the election process, compiling and updating valid electoral lists and ensuring their regular revision, ensuring fairness and integrity of election campaigns, and monitoring and evaluation of elections, among other things. Setting up a specialized court to consider election-related cases is another option that countries may pursue.

From a sociological perspective, given the demographic structure of Arab countries, the involvement of youth in the election process as candidates, observers of election integrity, and as voters appears to be imperative and conducive to political stability. Furthermore, inclusion of excluded and marginalized groups, such as the poor and rural youth, must be taken into account. Urging youth to become politically active and engaging them in the transition phase can secure the continuation of the democratic transition into the future. Stressing the importance of looking at elections from a gendered perspective should not be understated, given the growing political conservatism in most Arab countries.



Political Participation

Ensuring political participation by all social, economic, and political entities, including anti-democratic forces, may be essential as national unity is necessary for successful transition and the prevention of return to dictatorship. As such, large-scale coalitions or alliances for democracy should be made and party alliances that can win a parliamentary majority should be encouraged. This should be accompanied by support for party institutional structures and support for democratic values at all levels of community and society. Furthermore, freedom of the press should be ensured and given high priority, including equal access to mass media by political parties.

The motives of transitions and revolutions are often socioeconomic, not only political. In the Egyptian and Tunisian cases, the masses were concerned as much with clean and democratic government as with better living conditions and less corruption. This may pose urgent challenges for political parties in the Arab region. The first of these challenges is the need for parties to stress social justice, as political democracy has to be linked to people's standard of living. A popular democracy that achieves social justice is vital. Otherwise, transition may lead to military or religious fascism, seeking an absolute and just ruler, capable of providing them with decent living—a state where democracy is not a priority.

Transitional Justice

Successful transition to democracy involves the achievement of two goals, which sometimes seem conflicting and even contradictory, namely:

1. Achieving justice for the crimes of human rights violations committed during the dictatorship;
2. Moving forward to build a future.

These goals are linked to the question of the extent to which one should insist on punishing those who committed crimes against human rights. The answer depends on the circumstances of each country, and there is no standard recipe for the time required to achieve justice during the period of transition to democracy, as exemplified in transition processes across Latin America, Africa, and Asia. Furthermore, the negotiation process with the old regime is often difficult.

While people may disagree on the past, they do not have the luxury to disagree on the present and the future. Reconciliation is a goal that cannot be avoided, if a nation is to be unified in its view of the future without excluding any party. A nation that is divided against itself without the ability or willingness to tolerate risks can expose the emerging democracy to danger. However, democracy without justice may not be effective and the speed in applying justice is a tough challenge that requires both courage and clarity.

As such, the notion and mechanisms of transitional justice, which are governed by the conditions of the country and the history and type of violations, must be considered during the period of transition. In this respect, the dramatically different experiences of previous countries such as South Africa and Chile provide some food for thought. Various mechanisms and tools of transitional justice need to be selected with sensitivity to country context. These measures include legal frameworks for truth and reconciliation commissions, judicial and non-judicial processes of truth seeking, punishment, amnesty, and reparations. At the same time, due attention must be paid to long-term institutional reforms and symbolic measures for collective memory to ensure that violations are never repeated in the future.