

# STRUCTURAL REFORM PROGRESS FOR LONG-TERM GROWTH

## 3.1 INTRODUCTION

3.1 Strong oil revenues and oil-related wealth, along with the ongoing European recovery provide the momentum for continuing robust growth outcomes in the MENA region over the short term. Over the longer term, however, MENA's growth prospects will be shaped by many other factors. Among oil producers, the permanence of the oil price shock and the fiscal management of the windfall revenues will greatly influence long run revenue streams growth prospects. As a result, many of the resource rich and labor importing economies of the Gulf, in particular, are pursuing a variety of strategies to utilize current oil savings to build up longer-term revenue streams outside of oil, with central banks and the rest of the banking systems accumulating significant foreign assets.

3.2 However, beyond oil wealth management, one of the region's fundamental development challenges – creating sustainable employment for its work force – will require the region to undergo major structural changes to provide strong engines for employment growth. While employment growth has been strong in recent years, MENA has still a long way to go to reach more desired levels of employment ratios and female participation rates, as well as to improve the productivity of its jobs. Understanding the progress that has been made in implementing this structural reform agenda, then, is an important aspect of gauging the region's long-run growth and employment prospects.

3.3 Over the past six years, MENA countries have exhibited progress in moving forward their structural reform programs. In the context of a proliferation of regional and bilateral trade agreements, MENA economies have significantly reduced tariffs and non-tariff barriers to imports, and over the past six years, the region ranks on average in 62<sup>nd</sup> percentile worldwide with regard to tariff reform.<sup>1</sup> But the path to creating an environment conducive to trade remains far from complete. Outside the GCC, tariff protection remains excessive. Tariffs average 17 percent among resource rich and labor abundant economies, and tariffs are even higher among resource poor countries, particularly in Tunisia and Morocco, where the current simple average

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<sup>1</sup> See Appendix B for methodology behind structural reform indicators.

tariff is above 26 percent for both countries, and where the heavy tariff protection of the domestic market has changed only slightly in the course of the past 10 years. Moreover, significant barriers to developing a strong trading sector exist in the form of cumbersome import and export clearing processes.

3.4 Improving the competitiveness of the region's trade sector also depends upon greater progress in liberalizing backbone services critical to trade. While there has been recent progress in liberalizing a few key services, liberalization is often stop and go, and the process remains far from complete. In many countries, key sectors remain closed to competition, either through ownership restrictions or other regulatory practices.

3.5 Over the last few years, MENA economies have undertaken measures to improve the environment for business, focusing on liberalization of key services in the economy, across-the-board business and regulatory policy reform, and targeted interventions to promote specific sectors. The more generalized industrial upgrading in the *mise à niveau* programs in Morocco and Tunisia, for example, have moved to programs targeted toward specific sectoral upgrading. These targeted interventions are also apparent throughout the GCC countries, which have worked to develop key service centers by creating international legal and business infrastructure separate from the rest of the country.

3.6 Despite some improvements in a few countries, progress in business and regulatory reform has been below average, and outside of the GCC countries (which have fairly developed business infrastructure and generally favorable business policies), the region continues to suffer from significant impediments to conducting business, especially in key areas such as starting a business, protecting investors, and contract enforcement. Taken as a whole, in a worldwide ordering of countries based on the overall business climate, MENA countries rank in the 44<sup>th</sup> percentile worldwide with respect to the climate for doing business -- behind all other regions worldwide but Sub-Saharan Africa and South Asia.

3.7 Many of the MENA region's development challenges related to governance challenges, but over the past years, MENA countries have taken significant steps to begin to address significant deficiencies in governance. Many of these efforts have focused on reforming public administration, both to improve efficiency in the delivery of quality public services and to create fiscal savings. MENA's historical models of state-run development have translated into large

civil services, and civil service reform has been a key element of the public sector reform programs in a few countries in the region, including in Jordan, Morocco, and Egypt.

3.8 But additional to efforts to improve public sector efficiency, several countries have taken important steps to open up the political space and allow for greater accountability in public policy and to strengthen inclusiveness in public policy, an area in which MENA continues to rank near the bottom worldwide. Over the past 6 years the region has taken considerable steps forward in toward reducing this governance gap. Between 2000 and 2006, MENA countries ranked on average in the 63<sup>rd</sup> percentile with regard to improving the mechanisms for government accountability, higher than almost all other regions of the world, with particularly strong efforts among resource poor countries and resource rich labor importing countries.

3.9 While the recent oil boom has greatly benefited the oil producing economies of the region in terms of higher growth and revenues, an important concern has been the potential impact this oil boom might have on the continuing structural reform effort. Though information is scant, there is some indication that the incentives for sweeping improvements in public sector management have diminished with rising oil prices. Although *resource poor* countries made strong progress in administrative reform, many of the region's oil economies failed to demonstrate significant efforts to improve public sector management.

3.10 In the area of enhancing public sector accountability, however, a significant divergence between MENA's labor abundant oil economies and labor importing oil economies is notable. Since 2003, many of the *resource rich and labor importing* economies of the GCC have begun to exhibit strong efforts into improving government accountability. In parallel with their efforts toward more prudent management of the oil windfall and stronger economic ties with the world, GCC countries such as Oman, Qatar, Saudi Arabia, and the United Arab Emirates have also taken significant steps forward in the sphere of enhancing the inclusiveness and accountability of government. It is a significant and encouraging sign that these efforts have taken place despite rising oil prices. MENA's labor abundant oil economies, on the other hand, have generally not moved forward with improving public sector accountability since 2003. Creating more inclusive and representative governance structures is influenced by far more than rising oil prices, but given the importance of this area of reform for the overall reform agenda, the significant backsliding by a few countries represents a large concern for the broader reform agenda, and thus longer run growth prospects.

## 3.2 MEASURING STRUCTURAL REFORM

3.11 Beginning with the first MENA Economic Developments and Prospects report (2005), evaluating the region's longer-run growth prospects has in part relied on assessing the region's progress with policy and institutional reform. Utilizing a range of available indicators, structural reform indices were constructed in three distinct areas of reform: *trade and outward orientation*, *business and regulatory reform*, and *governance*, broadly corresponding to the key areas of transition required from the region to create more open, private sector-driven and diversified economies.

3.12 These indices have developed as new information has become available which strengthens our true knowledge of both the current reform status and structural reform in each country. With these structural reform measures, this year's MENA Economic Developments and Prospects report highlights where the MENA region stands with regard to the rest of the world in terms of economic policies and structures, and evaluates the region's recent progress in terms of its transition to more open and private-sector oriented economies. Because many economic reforms take time to result in measurable development outcomes, along with structural reform indices, we also discuss the region's more recent efforts and emerging trends.

3.13 The chapter proceeds as follows: In section 3.3, the region's progress with trade reform over the period 2000-2006 is examined, highlighting the trade initiatives undertaken, evaluating progress in lowering trade barriers, and discussing the issue service sector liberalization. In section 3.4, progress on improving the business climate is discussed, highlighting the region's recent efforts at liberalization and measuring progress in improving the business environment between 2003-2006, based on a range of business climate indicators. In section 3.5, the issue of service sector liberalization is highlighted, and the potential gains from liberalization of both financial services and infrastructure services are estimated. In section 3.6, we highlight the region's progress with governance reform, both in improving the quality of administration and in improving government accountability. Finally, in section 3.7, we conclude the analysis with comparison of the region's pace of structural reform prior to and following the start of the oil price boom.

### 3.3 OUTWARD ORIENTATION IN MENA

3.14 The relationship between openness to international trade and income growth is almost axiomatic.<sup>2</sup> A vast empirical literature supports the view that economies with greater openness to international trade experience higher rates of economic growth, as a result of both higher investment levels and sustained gains in productivity.<sup>3</sup>

3.15 But in addition to growth gains, greater openness also can motivate the overall reform agenda, by building *virtuous circles* of structural and institutional reform. Opening economies to greater trade and competition expands the role of non-rent dependent export sectors. These more productive and efficient segments of the economy need better policies and institutions to compete, thus building the demand on policies and institutions to respond. For example, Mexico's trade liberalization through NAFTA induced business associations to lobby the government for reductions in the regulatory burden to help them compete.<sup>4</sup> Trade doesn't just raise the demand for other reforms, it also raises the *marginal product* of other reforms, in that better infrastructure, telephones, roads, and ports translate into better performance of the export sector.<sup>5</sup> And greater openness and trade also expose the work force to the need for new skills and knowledge, creating another effective coalition for reform, with this workforce demanding the skills and services needed to compete in this economic setting.

3.16 MENA countries entered the new millennium at a significant deficit with respect to most other regions of the world in terms of its integration into the world economy. The World Bank's flagship report on trade and investment<sup>6</sup> highlights many aspect of this deficit. While most regions of the world saw rising trade over the last two decades, trade in MENA declined, with trade/GDP falling from an average of 100 percent in 1980 to about 60 percent by 2000. Non-oil trade had failed to grow, with the share of non-oil trade/GDP falling from about 53 percent in the early 1980s to 43 percent by 2000.<sup>7</sup> Regional exports remained dominated by oil, with oil and petroleum product exports accounting for 81 percent of regional exports in 2000 (down only

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<sup>2</sup> See for example: Sachs, Jeffrey and A. Warner (1995), Frankel, Jeffrey and David Romer (1999), Dollar, David and Aart Kraay (2001).

<sup>3</sup> Although there has been criticism of the evidence of the relationship between openness to trade and growth (see for example, Rodríguez, Francisco and Dani Rodrik (1999), a broader interpretation suggests only that certain conditions are necessary for these gains from trade to be realized.

<sup>4</sup> Kikiri, Kenyon, and Palmade (2006).

<sup>5</sup> Berg and Krueger (2002).

<sup>6</sup> World Bank (2003a).

<sup>7</sup> World Bank (2003a).

slightly from 84 percent in 1990, and 95 percent in 1980). Only a few countries had established growing non-oil export sectors.

3.17 Similarly, the region had failed to attract more than a negligible share of the world's foreign direct investment. In the year 2000, while MENA accounted for five percent of the world's population and even two and a half percent of world income, its share of the world's foreign direct investment was a mere 0.3 percent.<sup>8</sup>

3.18 Myriad factors affect the level of trade in a country. Trade is influenced not only by formal trade policies (tariff and non-tariff policy, exchange rate policy, and policies affecting costs behind the border), but many external policies and structures affecting the overall climate for conducting an exporting or importing business. Political and institutional considerations also play a large role.

3.19 But to be sure, MENA's ability to expand trade has been disadvantaged by a legacy of protectionist trade and exchange rate policies. As a result, at the start of the new millennium, the region maintained the highest level of tariff protection in the world outside of South Asia, with simple average tariffs in MENA averaging almost 19 percent. It also heavily utilized quantitative import restrictions, with more than 23 percent of tariff lines subject to core non-tariff barriers (NTBs)<sup>9</sup> (Table 3.1).

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<sup>8</sup> World Bank staff estimates from country data.

<sup>9</sup> Core NTBs include price control measures (such as antidumping and countervailing duties) and quantity control measures such as import licenses and quotas.

**Table 3.1 Average tariff and non-tariff protection in MENA, 2000\***

Country/region	Simple average tariff	Non-tariff barrier coverage <sup>a</sup>
Algeria	24.0	17.5
Bahrain	7.9	4.4
Djibouti	31.0	..
Egypt, Arab Republic of	21.4	28.7
Iran	41.1	39.1 <sup>b</sup>
Jordan	23.1	48.6
Kuwait	3.6	..
Lebanon	10.7	24.1
Libya	17.0	..
Morocco	30.5	9.1
Oman	5.7	13.1
Saudi Arabia	12.0	15.4
Syria	21.0	..
Tunisia	29.1	33.1
Yemen	12.8	..
<b>Regional averages (unweighted)</b>		
Sub-Saharan Africa	15.8	4.7
East Asia and Pacific	10.7	19.6
Europe and Central Asia	9.5	9.5
Latin America and Caribbean	13.4	30.0
South Asia	17.6	13.6
High Income/OECD	4.3	25.7
<b>MENA</b>	<b>19.4</b>	<b>23.3</b>
<i>Resource poor</i>	<i>24.3</i>	<i>28.7</i>
<i>Resource rich labor abundant</i>	<i>24.7</i>	<i>28.3</i>
<i>Resource rich labor importing</i>	<i>9.2</i>	<i>11.0</i>
World	13.6	17.6

*Sources:* Tariff data: UNCTAD TRAINS database; Non-tariff barrier data: World Bank Development Economics Group online data and statistics, "Frequency coverage ratio of non-tariff barriers by country," available online at <http://intranet.worldbank.org/WBSITE/INTRANET/UNITS/DEC/INTRES/0..contentMDK:21051044~menuPK:476639~pagePK:64161873~piPK:64161126~theSitePK:469233.00.html>. *Notes:* \* or closest year available. a) Non-tariff barrier coverage refers to the proportion of tariff lines that have at least one core non-tariff barrier (quantitative restriction). b) Proportion of tariff lines requiring license from Ministry of Industry (from World Bank, 2001. *Iran: Trade and Foreign Exchange Policies in Iran: Reform Agenda, Economic Implications, and Impact on the Poor*. Washington, DC: World Bank.).

3.20 Technical barriers to trade, customs and administrative procedures, and costly and inefficient backbone services (such as transport, logistics, ICT services and finance) have further raised the overall costs (and disincentives) to trade. And problems in the overall business climate (discussed further in section 3.4) have added to the region's poor trade outcomes.

### **3.3.1 *Recent developments in trade reform***

3.21 Over the past several years, the region has embarked on reforms to liberalize their trade regimes and remove the many existing impediments to greater trade. At the start of the decade, only half of the countries in the region (Bahrain, Djibouti, Egypt, Kuwait, Morocco, Qatar, Tunisia, and the United Arab Emirates) were members of the World Trade Organization (WTO), but over the past seven years, three more countries have acceded to the WTO (Jordan, Oman, Saudi Arabia), and Algeria is in the final stages of meeting the conditions of accession.

3.22 In line with worldwide trends, bilateral and regional trade agreements have proliferated MENA. Dominant among these were the Association Agreements with the European Union (EU) signed by most of the labor-abundant countries in MENA. Resource poor economies were among the first to ratify the Agreements, which establishes tariff free trade in industrial goods between the EU and countries of the Southern Mediterranean, and both Tunisia (1998) and the Palestinian Authority (1997, on an interim basis) entered 2000 with agreements already in force. Since then, all of the other resource poor economies but Djibouti have signed and put into force EU Association Agreements (Morocco (in force 2000), Jordan (2002), Lebanon (2002), Egypt (2004)), and both Algeria and Syria have signed agreements which remain to be put into force. Beyond cooperation in trade in goods, several MENA countries have designed action plans in the context of a broader European Neighborhood policy (ENP), which allows for an agenda of political, economic and institutional reforms in exchange for greater integration into European programs and networks, increased financial assistance, and enhanced market access. Unlike countries which were part of the EU enlargement, the European Neighborhood policy action plans are selective, and MENA countries with EU Association Agreements in force can choose to harmonize norms and standards on a piece-meal basis, depending upon their own approaches for integration with the EU (Box 3.1). To date, ENP action plans have been agreed upon by Jordan, Morocco, the Palestinian Authority, and Tunisia, and both Lebanon and Egypt are expected to complete the design on their action plans over 2007.

3.23 Beyond the Association Agreements with MENA's largest trading partner, MENA countries have also entered bilateral trade agreements with other major trading partners, including the United States. In addition to free trade agreements (FTAs) signed between the United States and Jordan and Morocco, several GCC countries have signed (Bahrain, Oman) or are pursuing (United Arab Emirates) FTAs with the US (table 3.2), in the process throwing off course a

multilateral EU-GCC free trade agreement, which was envisaged as one of the major outcomes of the GCC customs union entered into in early 2003. GCC economies have aimed to strengthen economic ties with emerging countries in Asia, particularly China and India, through Free Trade Agreements (both in the process of being finalized).

### **Box 3.1 Morocco's "Open Sky Agreement" and the European Neighborhood Policy**

Morocco's air transport market, dominated by Royal Air Maroc (60 percent of passenger traffic as of 2004) has undergone dramatic opening initiatives over the past two years. In December 2005, within the context of the ENP, Morocco signed an "open sky" agreement with the EU, its largest trading partner (nearly three-quarters of Morocco's trade is with the EU and the bulk of tourists flocking to Morocco are Europeans). This agreement represents the first concrete example of implementation of the ENP. It means a significant regulatory approximation in exchange for a stake in the EU internal market. Upon a satisfactory evaluation of regulatory standards and compliance with EU aviation safety standards, Moroccan air carriers can fly to and through any airports in Europe if they depart from Morocco. Reciprocally, EU airlines departing from Europe are entitled to operate with no restriction between Europe and Morocco.

Comparable reforms implemented in other countries illustrate the possible benefits that Morocco can gain from amplified competition. The introduction of competition in Europe has been followed by a substantial reduction in airfares. Fares between London and Dublin, for instance, were down by half immediately after liberalization of this route. Similar effects were found in other Latin countries, including Mexico, where an increase in cross-border air traffic went hand in hand with a sharp decline in fares on competitive routes. Studies have found that fares on routes having two competitors are lower by 8 percent on average than the case of a monopoly.

Only a short time has elapsed since the EU-Morocco "open sky agreement" went into effect on January 1, 2006, and it is early to gauge its economic benefits. There are, however, indications that airfares went down and overall air traffic has expanded since January 2006. Morocco has become the only non-EU Mediterranean country host to a low cost carrier, Ryanair. The latter has opened routes to and from three airports in Morocco: Fez (Frankfurt, London, and Marseille), Oujda (to Marseille) and Marrakesh (Frankfurt, London, and Marseille) and anecdotal evidence suggest that prices have significantly gone down on those routes.

**Table 3.2 U.S.-Middle East Free Trade Efforts, 2006 [update]**

Country	Free trade agreement	Trade and investment framework agreement	Bilateral investment treaty	World Trade Organization	Generalized system of preferences
Jordan	X	X	X	X	X
Morocco	X	X	X	X	X
Oman	X	X		X	X
Bahrain	X	X	X	X	Not eligible
United Arab Emirates	Negotiating	X		X	Not eligible
Egypt		X	X	X	X
Tunisia		X	X	X	X
Kuwait		X		X	Not eligible
Qatar		X		X	Not eligible
Saudi Arabia		X		X	Not eligible
Algeria		X		Negotiating accession	X
Iraq		X		Negotiating accession	X
Yemen		X		Negotiating accession	X
Lebanon		X		Negotiating accession	X
Iran				Negotiating accession	Not eligible
Libya				Negotiating accession	Not eligible
Syria					Not eligible

Source: US Trade Representative [www.ustr.gov](http://www.ustr.gov).

Note: The Palestinian Authority participates in the US-Israel FTA.

3.25 MENA countries also enacted intra-regional trade agreements as a means to heighten regional trade and intensify economic cooperation, including the Pan-Arab Free Trade Agreement (PAFTA), grouping 17 Arab countries, and the Agadir Agreement (signed by Morocco, Jordan, Tunisia and Egypt), which allows for cross rules of origin among the four with regard to the EU.

3.26 In part due to these agreements, MENA countries made significant progress over the last seven years in tariff reduction and rationalization, with resource poor economies leading the movement. Jordan undertook sizable commitments in trade reform since 2000, partly through the process of membership to the World Trade Organization (WTO) in 2000 and the implementation of a Free Trade Agreement with the United States in 2001, with tariffs reduced by about half from an average of 23 percent in 2000 down to less than 12 percent by 2005. Trade liberalization was also a key element of Lebanon's structural reform agenda, and between 2000 and 2005, the

simple average tariff was cut by almost half from 10.7 percent to 5.4 percent. And significant trade liberalization took place with Egypt's broad-based trade reform in the summer and fall of 2004, resulting in a reduction in the number of tariff bands, an annulment of import fees and surcharges incompatible with the GATT, and a reduction of tariffs on over 700 import items, including clothing, textiles, IT, and machinery and equipment used in the textile sector. As a result, tariffs declined from an average of over 21 percent in 2000 to just over 9 percent.

3.27 Most of the resource rich and labor abundant economies also undertook trade liberalization efforts. Early in the decade, Iran reduced the number of tariff bands to 13 and cut the unweighted average tariffs by about half, from about 41 percent to 22 percent. But this progress slowed, and recently tariffs on some goods have been sharply increased in order to support domestic production. Algeria undertook large reductions in the maximum tariff rates and rationalization of the tax and tariff structure. Since 2000, the number of tariff rates was reduced to four (0, 5, 15, and 30 percent), although the average tariff remains high at 18.7 percent (down from 24 percent in 2000). Other import taxes, such as the *redevances douanières*, were replaced by a small fee and the customs tax was eliminated. Among the resource rich and labor abundant group, the most significant tariff reform was adopted in Yemen, where widespread smuggling of imported goods, combined with the desire to harmonize tariff rates with the GCC, prompted the government to lower import tariff rates over 2005, reducing the number of bands from four to three, with two thirds of the commodities attracting only a 5 percent tariff rate. After these changes, the unweighted average tariff rate fell to 7 percent, the second lowest (after Lebanon) average tariff outside the GCC in MENA.

3.28 GCC economies have maintained more open trade policies right from the outset, but since 2000, there has been further tariff liberalization by Saudi Arabia, which lowered customs duties to align with the other GCC customs union countries. In December 2005, Saudi Arabia was admitted to the World Trade Organization, and in the process of meeting WTO requirements, many remaining protective trade policies were revised, particularly in the areas of import licensing, customs valuation and fees, standards and technical regulations, and legislation for intellectual property rights and patent registration.

### 3.3.2 *Quantifying progress with trade reform*

3.29 Trade policy is multi-dimensional, reflected in a variety of policy actions which, together or separately, impact the ability and incentives for firms to conduct trade. To analyze MENA's current trade policy status relative to other countries worldwide, a composite index was constructed, utilizing several trade policy-related indicators, including: the simple average tariff, the proportion of tariff lines subject to non ad-valorem duties, the average time required to comply with import-clearing procedures, and the average time required to comply with export-clearing procedures.<sup>10</sup> MENA's recent *progress* with trade policy reform relative to other countries was evaluated based upon its progress in reducing average tariffs between 2000-2006.<sup>11</sup>

3.30 On the trade reform front, MENA countries have demonstrated strong progress over the last few years in lowering tariff barriers. Relative to the world, tariff reform by MENA since 2000 ranks on average in the top 62<sup>nd</sup> percentile of countries worldwide, higher than any other region but Europe and Central Asia<sup>12</sup>. The region's resource poor countries have made the most significant progress (on average, ranking in the 69<sup>th</sup> percentile worldwide), led by Egypt, Jordan and Lebanon, but several of the region's resource rich countries also made strong strides in lowering tariffs, particularly Saudi Arabia and Yemen (Table 3.3).

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<sup>10</sup> See Appendix B for description of methodology behind structural reform indicators.

<sup>11</sup> Tariff information is the only data widely available for 2000, the initial period of comparison. Doing Business indicators on behind the border constraints to trade only became available in 2005.

<sup>12</sup> Structural reform indices are presented based on a country's percentile rank within a worldwide cumulative frequency distribution. Running from 0-100, higher numbers indicate better policies or stronger progress.

**Table 3.3 Structural Reform Progress: Trade Reform**

Country/Region	Current Trade Policy 2006 <sup>a</sup>	Trade policy reform progress 2000-2006 <sup>b</sup>
Algeria	68	63
Bahrain	..	76
Djibouti	17	47
Egypt, Republic of	60	100
Iran, Islamic Republic of	16	67
Jordan	44	94
Kuwait	69	54
Lebanon	50	80
Libya	..	9
Morocco	52	50
Oman	51	43
Saudi Arabia	64	88
Syria	2	32
Tunisia	53	42
United Arab Emirates	75	..
Yemen	63	82
<b>Regional averages (unweighted)</b>		
MENA	49	62
Resource poor	46	69
Resource rich labor abundant (RRLA)	37	61
Resource rich labor importing (RRLI)	65	54
East Asia and the Pacific	53	40
Europe and Central Asia	50	64
Latin America and the Caribbean	64	57
High-income OECD	84	61
South Asia	28	41
Sub-Saharan Africa	26	22
World	50	50

*Source:* See Appendix B. *Notes:* a\ Current trade policy status reflects country's current placement in a worldwide ordering of countries, based on four major categories of trade policy indicators available in 2006, expressed as a cumulative frequency distribution, with "100" reflecting the country (countries) with the most open trade policies and "0" reflecting the country (countries) with the most closed trade policies. b\ Reform progress reflects the improvement in a country's rank between 2000 and 2006 in a worldwide ordering of countries, based on the simple average tariff (the only trade policy indicator widely available in 2000) expressed as a cumulative frequency distribution, with 100 reflecting the country (countries) that exhibited the greatest improvement in rank and 0 reflecting the country (countries) that exhibited the greatest deterioration in rank.

3.31 At the same time, though the region has begun to move strongly on tariff reform, the task of creating an environment conducive for trade remains far from complete. Tariff protection remains excessive, averaging 13.1 percent, higher than all other regions but South Asia and Sub-Saharan Africa, and far higher than the world average of 9.8 percent. Tariffs are particularly high among resource poor countries, where the average tariff applied to goods averages 18.4 percent. In both Tunisia and Morocco, the current simple average tariff is above 26 percent, and the heavy tariff protection of the domestic market has changed only slightly in the course of the past 10 years.

3.32 Relative to the rest of the world, MENA economies rank on average in the 42<sup>nd</sup> percentile worldwide with regard to tariff protection, behind all regions of the world but South Asia and Sub-Saharan Africa (see Table 3.4). Imports are also hindered through the continued use of non ad-valorem (NAV) duties (specific duties or taxes based on volume, rather than the value of the import). About 0.8 percent of tariff lines carry such duties in MENA, higher than all other regions but Europe and Central Asia and high income countries, but the ad-valorem equivalent of these NAV duties is unclear.

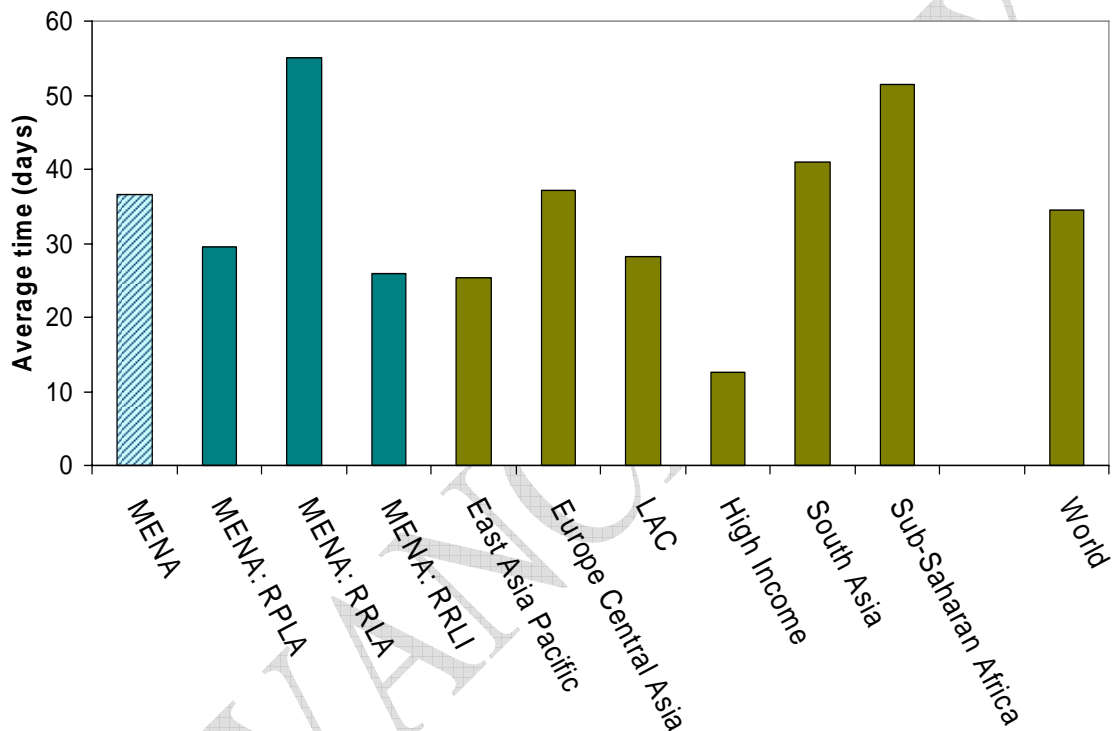
**Table 3.4 Tariffs and duties in MENA, 2006**

Country/Region	Average tariff <sup>a</sup>	Percentile rank <sup>b</sup>	Non ad-valorem duties (% of tariff lines)	Percentile rank <sup>b</sup>
Algeria	18.7	7	0.0	88
Bahrain	5.1	72	1.0	31
Djibouti	31.0	0	2.7	22
Egypt	9.1	48	0.2	54
Iran	22.1	4	0.5	39
Jordan	11.8	33	0.3	46
Kuwait	3.6	92	1.3	28
Lebanon	5.4	69	0.5	39
Libya	17.0	13	2.2	23
Morocco	26.2	2	0.0	88
Oman	5.0	74	1.0	31
Qatar	5.0	74	1.0	31
Saudi Arabia	4.8	75	1.3	28
Syria	19.6	5	0.5	39
Tunisia	26.9	1	0.0	88
United Arab Emirates	4.8	75	0.5	39
Yemen	7.0	62	0.0	88
<b>Regional averages (unweighted)</b>				
<b>MENA</b>	<b>13.1</b>	<b>42</b>	<b>0.8</b>	<b>47</b>
Resource poor	18.4	25	0.6	56
Resource rich labor abundant	16.9	20	0.3	63
Resource rich labor importing	6.5	68	1.2	30
East Asia and Pacific	7.3	59	0.5	56
Europe and Central Asia	6.8	66	3.4	36
Latin America and Caribbean	9.5	45	0.3	69
High Income OECD	4.2	88	5.6	16
South Asia	15.0	22	0.4	60
Sub-Saharan Africa	13.7	27	0.7	62
World <sup>d</sup>	9.8	50	1.8	50

Source: Average tariffs and ad-valorem duties from WTO International Trade Statistics. Notes: a) Simple average tariffs based on MFN applied rates; b) For any country, percentile rank reflects the proportion of countries worldwide with a higher tariff/ higher non ad-valorem duty.

3.33 Beyond tariffs and duties, clearing processes for trade remain burdensome, particularly with regard to importing. Import-clearing processes are especially cumbersome among resource rich and labor abundant economies, which on average rank in the bottom third of countries worldwide with regard to the time associated with complying with import procedures (see Figure 3.1).

**Figure 3.1: Average time required to complete import-clearing procedures in MENA**



Source: Staff estimates from World Bank *Doing Business* indicators. Notes: MENA RPLA (resource-poor, labor-abundant) economies include Djibouti, Egypt, Jordan, Lebanon, Morocco, Tunisia, and the West Bank and Gaza; MENA RRLA (resource-rich, labor-abundant) economies include Algeria, Iran, Iraq, Syria and Yemen; MENA RRLI (resource-rich, labor-importing) economies include Kuwait, Libya, Oman, Saudi Arabia, and the United Arab Emirates.

3.34 And although MENA’s export-clearing processes are less burdensome, the time required for completing export procedures are particularly high in several countries (Iraq, Syria, and Yemen). In Syria, the time required for export-clearing averages 40 days, about 45% higher than the world average, with particularly great time burdens for preparing export documents.

3.35 A composite index of trade policy, factoring in tariffs, non ad-valorem duties, and time required for trade clearing processes, indicates that the MENA region ranks on average in the 49<sup>th</sup> percentile with regard to the trade facilitation, behind the average of countries of East Asia and

the Pacific, Latin America and the Caribbean, and high income countries (and about on par with Europe and Central Asia). While the region's resource rich and labor importing countries of the GCC have fairly open trade regimes (on average ranking in the 65<sup>th</sup> percentile worldwide), elsewhere the region continues to maintain significant import barriers in the form of high tariffs and duties, and suffers from lengthy procedures for engaging in trade. MENA's resource rich and labor abundant countries are among the least trade easy in the world, on average ranking in the 37<sup>th</sup> percentile worldwide, only higher than the average for South Asia or Sub-Saharan Africa (Table 3.3).

### ***Increasing the gains from trade through service sector liberalization***

3.36 Lowering barriers should allow for greater trade to emerge in MENA, but the effects of trade on growth are not uniform across the world. And in the MENA region, the effects of trade on growth have been found to be considerably weaker than for other countries.<sup>13</sup> One key reason is the lack of services liberalization.

3.37 The competitiveness of a country's trade sector is heavily dependent upon access to a wide range of services at world prices. Backbone services, such as transport, utilities, finance and insurance and communications are central to the global competitiveness of firms. An efficient financial sector ensures that investments can take place where they will have the highest returns. An efficient communications sector lowers the costs of information dissemination, raising efficiency of firms engaged in trade. An efficient transport sector contributes to the efficient distribution of goods within countries, raising the ability for firms to participate in global trade<sup>14</sup>.

3.38 In MENA, there has been recent progress in liberalizing a few key services (detailed in Section 3.5). However, the process remains far from complete. In many countries, key sectors remain closed to competition, either through ownership restrictions or regulatory practices. This lack of entry has kept the quality of these services low and the cost high, undermining industrial exporters from moving further up the value-chain. Manufactured exports in MENA are generally

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<sup>13</sup> See Makdisi, Fattah and Limam, 2005. "Determinants of growth in the MENA Countries: Growth performance in MENA and issues that need further examination." Global Development Network working paper. World Bank.

<sup>14</sup> Sekkkat, Khalid. 2002. "Trade, FDI, and backbone services in the MENA Region." Middle East and North Africa Trade Policy working papers; World Bank; available online at <http://Inweb18.worldbank.org/mna/mena.nsf/Sectors/MNSEDE6AA04E04245D74185256C4600644C1A?OpenDocument>.

low value-added and technologically unsophisticated, with few countries' industrial sectors moving up the value chain. In Morocco, for example, resource-based industries account for 51% of the country's total manufacturing value added (MVA), while advanced medium- and high-technology industries only account for 25%. The food, tobacco and clothing sectors alone account for 40% of the country's MVA, employing 51% of all manufacturing workers. Morocco's industrial structure has barely evolved towards higher value-added and technology-intensive sectors in the last 15 years<sup>15</sup>.

3.39 Removing these barriers to competition in services will remove the internal constraints to greater competitiveness and economic efficiency, increasing MENA's gains from trade liberalization. But the traditional framework for liberalization of services is on a bilateral or reciprocal basis. The economic relationships covered by the EU Association Agreements, for example, exclude trade in services (along with agriculture), which substantially limits their potential economic impact. Nor does the PAFTA cover trade in services. To achieve greater gains from trade liberalization, liberalizing trade in services and removing the regulatory barriers to investment needs to become a key priority.

### **3.4 BUSINESS AND REGULATORY REFORM**

3.40 The challenge of creating sufficient job opportunities for MENA's rapidly growing labor force is immense. As noted in chapter 2, with diminished employment opportunities in the public sector and reduced migration, the most important engine for rapid and sustainable job growth in MENA into the future will need to be the private sector. Providing a business environment in which a dynamic and competitive private sector can thrive in MENA is a multi-dimensional endeavor.

3.41 Businesses depend upon mechanisms that provide for macroeconomic stability, critical for affecting the certainty of investors' decisions. They depend on trade and exchange rate policies which do not undermine competitiveness. And, they require a regulatory environment that promotes competition, supports efficient resource allocation, and protects property rights. A strong legal environment which effectively enforces and administers commercial laws, as well as efficient financial institutions which can mobilize and make available resources for entrepreneurs

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<sup>15</sup> Oxford Analytica. Friday, October 6, 2006. "Morocco: Stability masks manufacturing woes."

to start new businesses and for existing businesses to grow and expand are also important for bolstering a good investment climate.

### ***3.4.1 Recent developments in business and regulatory reform***

3.42 Over the last several years, almost every country in the region has undertaken various steps to improve the environment for business. Reform has centered on three key areas: liberalization of specific services in the economy to competition, across-the-board business and regulatory policy reform, and targeted interventions to promote growth in specific sectors.

3.43 MENA's recent liberalization of services has centered primarily around a few key areas, including telecommunications, transport and banking (discussed further in section 3.5). In addition to opening key services to competition, the region has taken some steps to reduce the regulatory obstacles to doing business. Supporting a liberalization push in banking, a number of countries have shored up the regulatory environment for the financial sector. In Morocco, specific measures to improve financial intermediation include standardizing the minimum data required to process loan applications, helping banks to develop their practice of internal rating systems, and merging existing information on credit risk into a privately managed centralized database to all credit institutions.<sup>16</sup> In addition, banking laws have been revised to improve supervision of non-bank institutions. In an effort to reduce non-performing loans, Tunisia has taken first steps to improve credit appraisal, raise provisioning rules, and sanction banks with insufficient provisioning or capital. Algeria's key actions include modernization of the payment system, as well as the introduction of performance contracts in public banks and the publication of explicit subsidies to commercial banks in the 2006 budget law. Iran has worked to develop a risk-based regulatory and supervisory framework for banking and has worked on the measures needed to modernize payment systems, but progress has been slow. Libya launched a series of measures to support financial system reform, aimed primarily at restructuring state-owned banks and adjusting ownership structures to include or increase private participation. Bahrain's reforms initiated in 2004 include establishing a consumer credit rating agency and drawing up new regulations for insurance companies and trust funds. Bahrain has also made notable progress in developing Islamic lending instruments aimed at rolling over conventional domestic debt and diversifying financial instruments. The regulatory framework of the financial sector in the UAE also witnessed some improvements, with major steps taken to control money laundering,

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<sup>16</sup> IMF (2006).

including the passing of anti-laundering laws, improving the rules and regulations dealing with the informal money transfer system, improving banking supervision and enhancing the payments system.

3.44 In addition to reforms aimed at the financial sector, regulatory reforms have centered on a few key areas. One is improving bankruptcy laws, which in Egypt were revised to allow voluntary liquidation, which should significantly ease business closure procedures. The cabinet recently approved a draft law to establish economic courts with specialized judges and special provisions for appeals within 30 days. The courts will have jurisdiction over matters related to the central bank and the financial and monetary system, the capital market law, stocks, house financing, intellectual property rights, competition, consumer protection, insurance, the provisions of the commercial law concerning bankruptcy, and disputes over commercial contracts worth more than LE 10 million (US\$1.7 million). Another key area was reducing the capital requirements and registration process for starting a business, which has been a key part of the business reform agendas in Tunisia and Jordan. Labor laws have also featured prominently in the region, in an effort to improve (national) employment outcomes, most significant among these a new labor code in Morocco, which significantly clarifies employment relations. GCC employment laws, on the other hand, have primarily focused on national employment targets (quotas) to increase the employment of the domestic workforce.

3.45 In addition to across the board reform, MENA countries have relied on interventions targeted to specific sectors in an effort to “launch” private sector growth. In Morocco and Tunisia, these targeted efforts follow more generalized reforms under the *mise à niveau* programs aimed at industrial upgrading. Early on over the 2000s, Morocco’s reform efforts included fiscal measures, simplified investment and procurement procedures, and an improved institutional framework governing the private sector, while Tunisia’s concentrated primarily on providing technical assistance, training, subsidies and infrastructure improvements.

3.46 But both countries have moved on from the generalized *mise à niveau* platforms to more specific sectoral upgrading. Morocco launched its Emergence Program (begun in 2005), focusing on overhauling eight main sectors, including modernizing the textile sector to adapt to the

dismantling of the MFA,<sup>17</sup> and consolidating the sectors of electronic components, information technology; automotive manufacturing parts, aeronautics, and artisan products. Authorities are implementing a broad range of incentives that include tax exonerations, subsidies for training, and development of four offshore free trade zone. And Tunisia moved on to a five year program targeted at industrial innovation in SMEs, with general privileges extended for investments in selected economic activities and for exporting.

3.47 Reforms aimed to promote key sectors is a strategy also highly visible in GCC countries as well. A majority of the GCC economies have worked to develop service centers, creating international legal and business infrastructure separate from the rest of the country, to establish themselves as regional service hubs, including in financial services (particularly Bahrain, Qatar, and UAE), tourism (UAE and Oman), technology (recently, Kuwait) and even regional education and health services (Qatar's latest development push).

#### **3.4.2 *Quantifying progress with business and regulatory reform***

3.48 MENA's business climate was evaluated in two ways. First, the business climate in 2006 was evaluated based on current information in eight areas important for doing business: (1) ease of starting a business; (2) ease of closing a business; (3) ease of hiring and firing; (4) ease of enforcing contracts; (5) ease of registering property; (6) ease of paying taxes; (7) degree to which investors are protected; and (8) ease of dealing with licenses. In each of these areas, a variety of available indicators related to that sphere were utilized (often including the time, cost and number of procedures required for fulfilling a certain business obligation). Based on these eight areas, a composite index of the business climate was calculated.<sup>18</sup>

3.49 In addition to evaluating the current business environment, recent reform of the business climate was evaluated based on progress made along four different fronts (four areas for which information was available in both 2003 and 2006): (1) starting a business; (2) closing a business; (3) hiring and firing; and, (4) enforcing contracts. From these data, a business and regulatory

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<sup>17</sup> In January 2005, the World Trade Organization Multifiber Agreement (MFA) on textile and clothing expired. The agreement had allowed privileged access to European markets for a few MENA economies – Egypt, Morocco, Tunisia and the United Arab Emirates – in textile and clothing products.

<sup>18</sup> The categories included for this year's business climate index differ from last year's, with the addition of information on protecting investors, and with the removal of last year's indicators for access to credit. The results of these changes, however, are large, and thus the business climate index for 2005 has been recomputed and is included in Appendix B (along with a fuller description of the methodology behind all structural reform indices).

reform progress index was calculated, reflecting the improvement between 2003 and 2006 along these fronts. A fuller description of the methodology underlying the business climate index and the business policy reform index can be found in Appendix B.

3.50 On the recent reform front, the MENA region has made below average progress over the last three years in improving the business climate, relative to the world. On average, MENA countries rank in the 40<sup>th</sup> percentile with regard to business and regulatory reform between 2003-2006, behind all other regions but South Asia (Table 3.5).

3.51 Within the region, resource poor countries have demonstrated stronger progress in business climate reform, on average ranking in the 54<sup>th</sup> percentile worldwide, led by reform efforts in Morocco and Egypt. Morocco's progress with reform primarily reflects improvements in the ease of starting a business. In addition to significant declines in both the number of procedures (from 11 to 6) and the average time (from 36 to 12 days) required to start a business, the average minimum capital requirement associated with starting a business fell by more than 90 percent, from an average of 761% of income per capita to a mere 67%. Elsewhere, Egypt's progress in business and regulatory reform primarily reflects reductions in the time and number of procedures associated with starting a business, but also relative improvement worldwide in contract enforcement – less a reflection of Egypt's efforts than a reflection of general rise in the time, procedures and costs associated with enforcing contracts.

**Table 3.5 Structural reform progress: business and regulatory reform\***

Country/Region	Current business environment 2006 <sup>a</sup>	Reform progress, 2003-2006 <sup>b</sup>
Algeria	36	37
Djibouti	9	..
Egypt	2	59
Iran	26	2
Iraq	33	..
Jordan	59	41
Kuwait	77	16
Lebanon	40	46
Morocco	38	76
Oman	79	27
Saudi Arabia	76	75
Syria	33	52
Tunisia	55	40
United Arab Emirates	54	20
West Bank and Gaza	22	..
Yemen	66	26
<b>Regional averages (unweighted)</b>		
<b>MENA</b>	<b>44</b>	<b>40</b>
Resource poor	31	54
Resource rich labor abundant	39	29
Resource rich labor importing	71	34
East Asia and the Pacific	64	46
Europe and Central Asia	55	59
Latin America and the Caribbean	47	54
High-income OECD	84	49
South Asia	40	24
Sub-Saharan Africa	27	51
World	50	50

*Source:* See Appendix B. *Notes:* \* Current business environment and reform progress indices are not comparable to last year's MEDP report. For 2005 index values, see Appendix B. a\ Current business environment reflects country's current placement in a worldwide ordering of countries, based on eight major categories of business environment indicators available for 2006, expressed as a cumulative frequency distribution, with 100 reflecting the country (countries) with the most friendly business policies worldwide and 0 representing the country (countries) with the most unfriendly business policies worldwide. b\ Reform progress reflects the improvement in a country's rank between 2003 and 2006 in a worldwide ordering of countries, based on four major categories of business and regulatory reform policies available in 2003 and 2006, expressed as a cumulative frequency distribution, with 100 reflecting the country (countries) that exhibited the greatest improvement in rank and 0 reflecting the country (countries) that exhibited the greater deterioration.

3.52 However, it must be noted that despite recent efforts in business climate reform, the overall state of the business environment in MENA is poor. Although the GCC economies have fairly developed business infrastructure and generally favorable business policies, MENA's resource rich and labor abundant and resource poor countries are among the least business

friendly in the world, with burdensome and costly procedures and practices that thwart business development.

3.53 In resource poor economies, only a few countries such as Jordan and Tunisia have the regulatory policies and infrastructure which are fairly conducive for attracting and maintaining investment. The majority have significant impediments to conducting business, especially in the areas of starting a business, protecting investors, and contract enforcement (in sales disputes). On average, resource poor businesses must comply with an average of 41 different procedures during the process of dispute settlement and the total time required averages about 2 years,<sup>19</sup> higher than all other regions of the world but South Asia (Figure 3.2).

3.54 Firing restrictions among resource poor countries are substantial, where firing for redundancy is either illegal (Egypt) or subject to numerous procedures and approvals. Worker hours are also subject to various rigidities, with restrictions on the number of working days, night work and weekend work. And licensing procedures associated with business are extensive and costly.

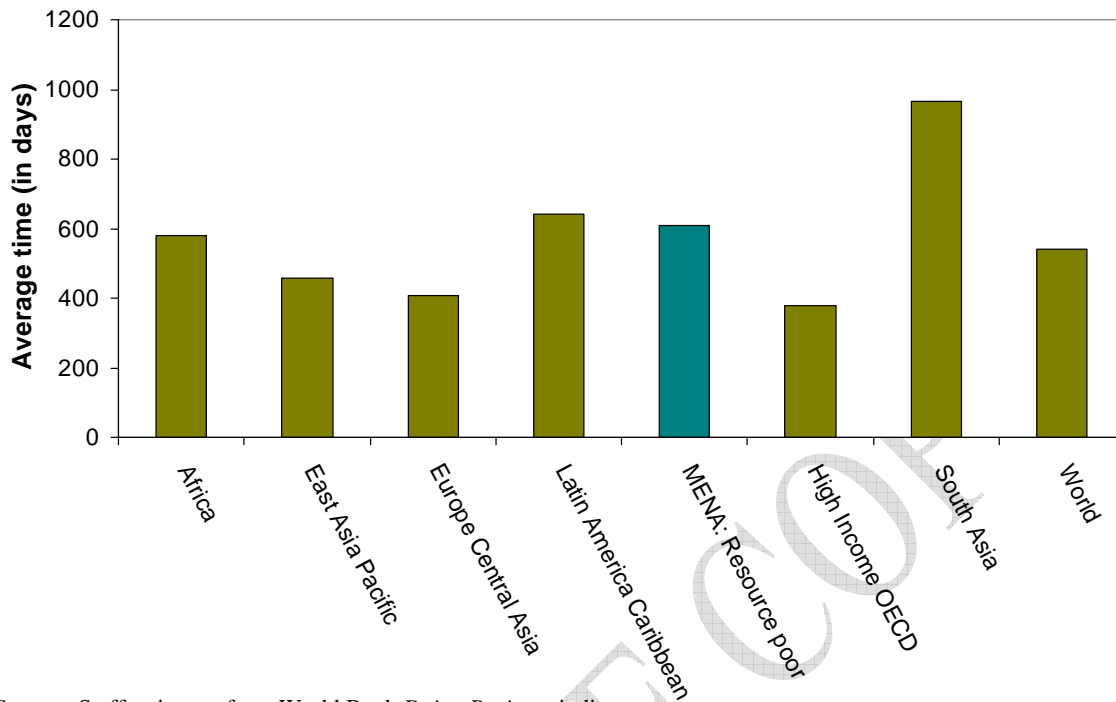
3.55 Two countries which have especially large challenges in improving the business climate are Egypt and Iran, among the most populated countries of the region. In Egypt, in every sphere of the business climate, the country ranks in the bottom third in a worldwide ordering of countries based on those characteristics.<sup>20</sup> Almost all aspects of doing business suffer from major obstacles, but the problems are especially severe in contract enforcement (where the total time required for dispute settlement can average almost three years, about twice the world average), as well as dealing with licenses. And in Iran, although some features of the business climate are well developed, a few key areas are exceptionally problematic, resulting in a seriously weak overall business climate. One of these areas is in dealing with licenses, where it averages almost \$19,000 for the regulatory procedures to build a warehouse, and where the approval for an electrical connection alone can average a year.

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<sup>19</sup> Unweighted average of countries represented.

<sup>20</sup> See Appendix Tables B3.1-B3.3 for individual business climate indices by category.

**Figure 3.2 Average time required for contract enforcement in MENA**



Source: Staff estimates from World Bank *Doing Business* indicators.

3.56 Taken as a whole, in a worldwide ordering of countries based on the overall business climate, taking into account numerous indicators across a number of key business areas, MENA countries rank in the 44<sup>th</sup> percentile worldwide with respect to the climate for doing business -- behind every other region of the world but South Asia and Sub-Saharan Africa (Table 3.5).

### **3.5 LIBERALIZING KEY SERVICES**

3.57 Service sector liberalization – opening essential services within the economy to domestic and foreign competition – constitutes a separate and fundamental element for fully realizing the benefits from both trade policy reform and business and regulatory reform. Backbone services such as information technology, communications, financial services, transport, and distribution, play a key role in the development of integrated supply chains in the economy, improving overall productivity and the gains from other reforms.

3.58 MENA has made recent progress in liberalizing a few key services, but the process remains far from complete. In many countries, key sectors remain closed or semi-closed to competition, either through ownership restrictions or regulatory practices. Moreover, liberalization in the region has been a stop and go process, as countries face the political

difficulties of implementing bold reform. Many promising efforts at liberalization have been tempered as opposition surfaces (including Algeria, whose ground-breaking hydrocarbon law passed in 2005 allowing majority private sector ownership for the first time in the hydrocarbon sector and separated regulatory powers from production received a setback over 2006 with an amendment reinstating a predominant role for the state-owned oil company Sonatrach). And while competition has been introduced in many sectors, there remain large numbers of sectors with significant restrictions to investment. Often the number of firms has been fixed by regulation and there remain limits to foreign participation.

3.59 To better understand where MENA countries stand with regard to this important area of reform, this section assesses service sector reform in MENA, drawing upon indicators which the European Bank for Investment and Development indicators commonly uses to measure progress in service sectors reform in transition economies (see Box 3.2 and Appendix C for methodology behind EBRD service sector liberalization indices). Although these indicators are only available until 2004, they nonetheless provide a useful picture of both where the MENA region stands relative to other regions and (relatively) recent progress with reform. In addition, we assess the potential impact of service sector reforms on the growth performance of MENA countries.

3.60 Broadly, the service sector comprises infrastructure services (including telecommunications and information technology, transport, energy, and water) and financial services. They also represent key inputs for the production of other goods and services. Telecommunications services are crucial for the international diffusion of information and knowledge. Ensuring access to modern networking technology is a vehicle that allows the economy to diversify by utilizing information technologies to export labor-intensive services<sup>21</sup>.

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<sup>21</sup> Good examples are the call centers that are proliferating in Tunisia and Morocco. Efficient producer services and the development of e-commerce (Internet) are of great importance in expanding export earnings.

### Box 3.2 The EBRD Services Reform Indices

The European Bank for Reconstruction and Development indices range from 1 (little progress) to 4.3 (most advanced implementation of reform agenda) and has been compiled on an annual basis for the 1990-2004 period.

The overall index for *Service Sector Reform* is the simple average of the Infrastructure and Finance indices:

**Finance** = average of the following two banking and non-banking reform indicators:

(i) *Banking and interest rate liberalization*: 4.3 = full convergence of banking laws and regulations with BIS standards, provision of full set of competitive banking services.

(ii) *Securities markets and non-bank financial institutions*: 4.3 = full convergence of securities laws and regulations with IOSCO standards, fully developed non-bank intermediation.

**Infrastructure** = average of the following five infrastructure reform indicators:

(i) *Electric power*: 4.3 = Tariffs cost-reflective and provide adequate incentive for efficiency improvements. Large-scale private sector involvement in the sector. Fully liberalized access with well-functioning arrangements for network access and full competition in generation.

(ii) *Railways*: 4.3 = separation of infrastructure from operations and freight from passenger operations. Full divestment and transfer of asset ownership implemented or planned, including infrastructure and rolling stock. Rail regulator established and access pricing implemented.

(iii) *Roads*: 4.3 = fully decentralized road administration. Commercialized road maintenance operations competitively awarded to private companies. Road user charges reflect the full costs of road use and associated factors, such as congestion, accidents and pollution. Widespread private sector participation in all aspects of road provision. Full public consultation on new road projects.

(iv) *Telecommunications*: 4.3 = effective regulation through and independent entity. Coherent regulatory and institutional framework to deal with tariffs, interconnection rules, licensing, concession fees and spectrum allocation. Consumer ombudsman function.

(v) *Water and waste water*: 4.3 = water utilities fully decentralized and commercialized. Fully autonomous regulator exists with complete authority to review and enforce tariff levels and quality standards. Widespread private sector participation via service/management/lease contracts. High-powered incentives, full concessions and/or divestiture of water and waste-water services in major urban areas.

3.61 Efficient transport services ensure that goods and people arrive in foreign countries in a timely manner. In places where it is expensive to ship goods abroad and service delays are frequent, transportation can become a prohibitive barrier to trade or can bias the geographic composition of exports and preclude countries from participating in the global production sharing that increasingly characterizes international trade. For tourism—a key service export in Maghreb—good transportation and telecommunications infrastructure are also key for the sector growth.

3.62 Access to financial services—working capital, export credit, insurance—is critical if firms are to obtain and fulfill orders from abroad; the existence of markets for foreign exchange, forward contracts, options, and other derivatives can reduce exporters’ risk exposure.

3.63 The service sector reforms discussed in this section cover a mix of deregulation (dismantling barriers to entry and the promotion of competition) and improved regulation (putting in place an appropriate legal environment, strengthening regulatory agencies, increasing their independence, etc.). The policy challenge is to achieve a balance between effective regulation and increasing the contestability of markets.<sup>22</sup> Reforming backbone services sectors can play an important role in fostering deeper economic integration. First, service sector reforms can support Maghreb’s integration with global production networks. The cost and quality of key backbone services are important determinants of multinational firms’ decisions to locate production facilities in a country. Second, these reforms will also increase domestic firms’ productivity and competitiveness because they reduce the costs of producing and trading goods and services. Third, these reforms, by improving the efficiency of key backbone services, facilitate the development of new exports with time-sensitive delivery schedules, such as exports of electronic components and exports of ICT-enabled services<sup>23</sup>.

### ***3.5.1 Progress in service sector reforms***

3.64 Liberalization of specific services of the economy has started to gain momentum in MENA, but overall progress of service sector reforms in the MENA region has been modest. Figure 3.3 plots the region’s progress with service sector reform according to the broadest indicator of service sector liberalization (including financial services, transport, telecommunications, power and water), based on the EBRD overall service sector reform index. This broad index – in addition to the underlying category indices -- ranges from 1 to 4.3 (with 4.3 indicating best practice) and spans the period 1990-2004 (See Appendix C for methodological details<sup>24</sup>). Despite progress over the last few years, MENA’s overall progress with service sector

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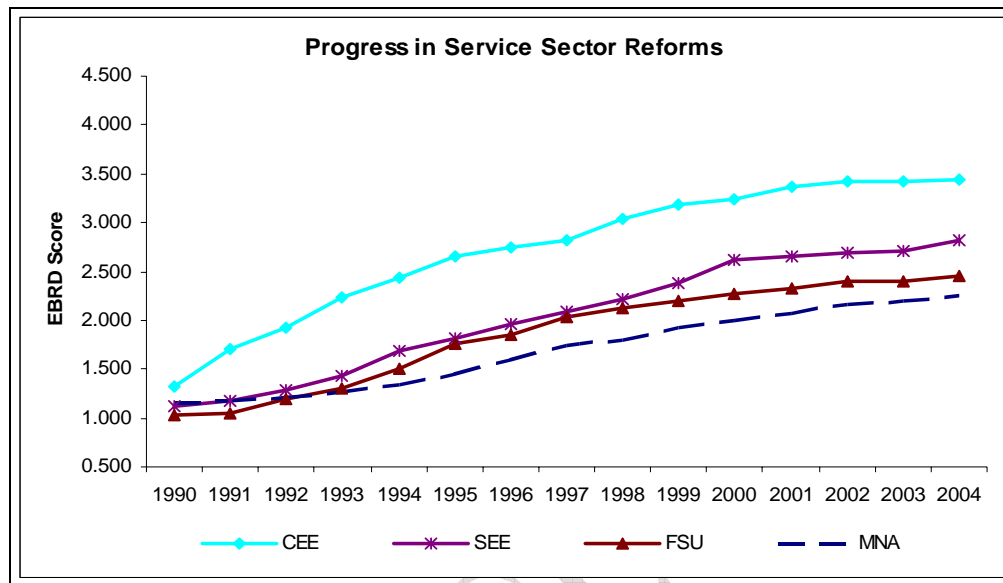
<sup>22</sup> Hoekman (2005).

<sup>23</sup> ICT-enabled services encompass a broad range of activities made possible by advances in telecommunications and the spread of the internet. These services are increasingly provided in offshore locations in emerging markets and include: (i) data conversion and digitization (i.e. medical transcriptions); (ii) voice center operations (offshore reservation centers, call centers, and telemarketing; and (iii) outsourcing back-office and professional and administrative services.

<sup>24</sup> Given data restriction, for the quantitative analysis of the service liberalization section we cover only six countries in MENA: Algeria, Egypt, Jordan, Lebanon, Morocco and Tunisia.

reform falls well below that of other economies in transition, although in a few areas the region has demonstrated considerable progress (discussed below).

**Figure 3.3 . Progress in Service Sector Reforms**

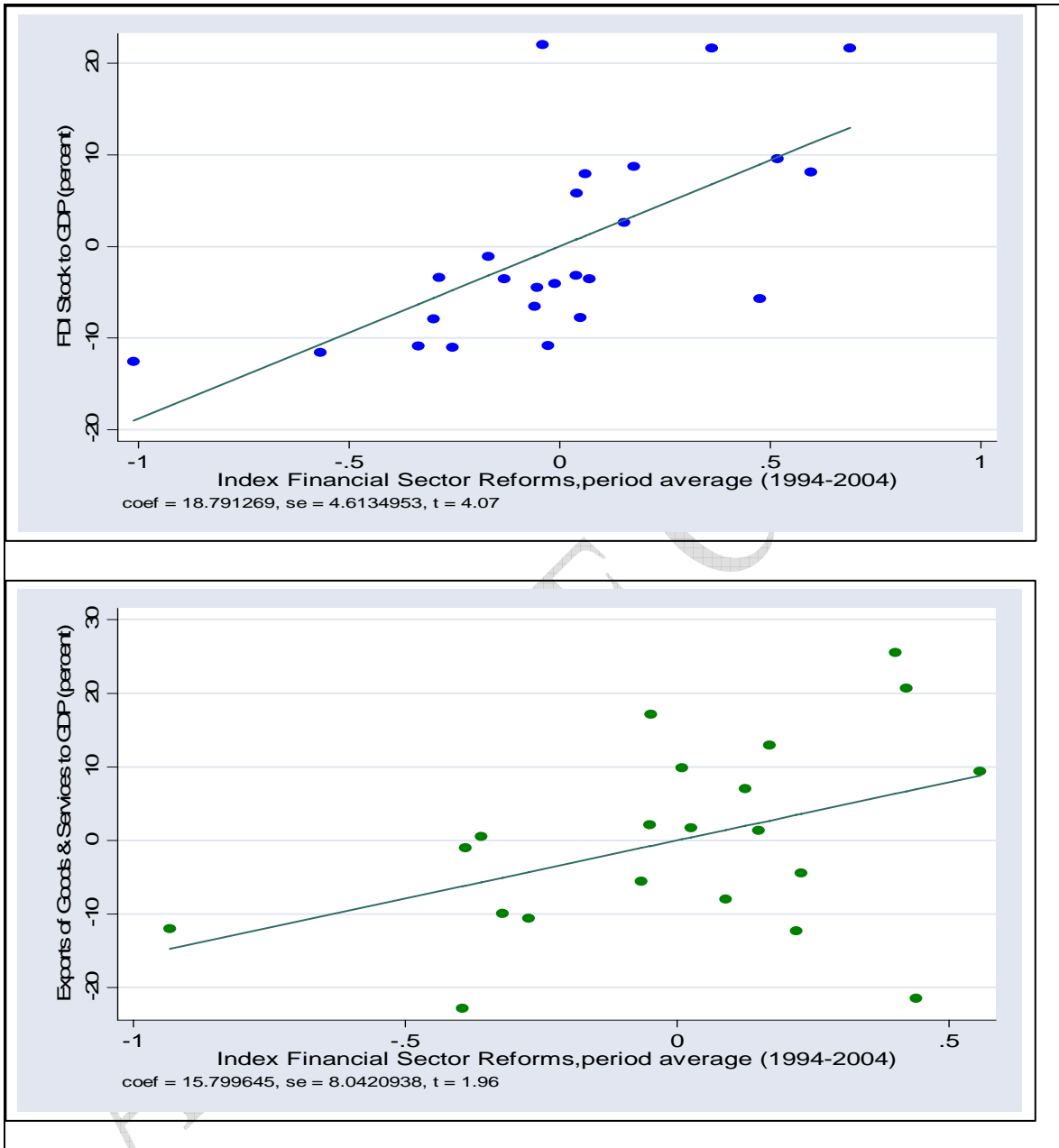


Source: World Bank staff estimates. Note: MNA= Morocco, Algeria, Tunisia, Egypt, Jordan and Egypt. SEE= Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Macedonia, Romania and Serbia & Montenegro. CEE = Poland, Hungary, Czech Republic, Slovak Republic and Slovenia. FSU= Estonia, Latvia, Lithuania, Russia, Ukraine, Belarus, Moldova, Armenia, Azerbaijan, Georgia, Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan.

### *Financial sector reforms*

3.65 Financial sector reforms spur trade and FDI flows. Financial sector reforms aimed at increasing competition and market contestability in the sector are associated with higher flows of trade and FDI, even after controlling for income levels (Figure 3.4). Empirical research has found that integration of financial markets and trade in goods and services tend to go together (Levine, 2001). Financial services are themselves subject to international trade and investment, and it has been found that trade and FDI also improve the quality and reduces the cost of financial services. The presence of foreign banks, for example, can exert competitive pressure on local banks leading to a significant decline in their overhead costs following the entry of foreign banks. In addition, foreign banks often bring new products and may stimulate improvements in domestic supervision and regulation. However, ultimately the link between trade, FDI and financial sector performance is affected by the quality of the regulatory framework (Honohan and Klingebiel 2000).

**Figure 3.4 Financial sector reforms are associated with more trade and FDI**

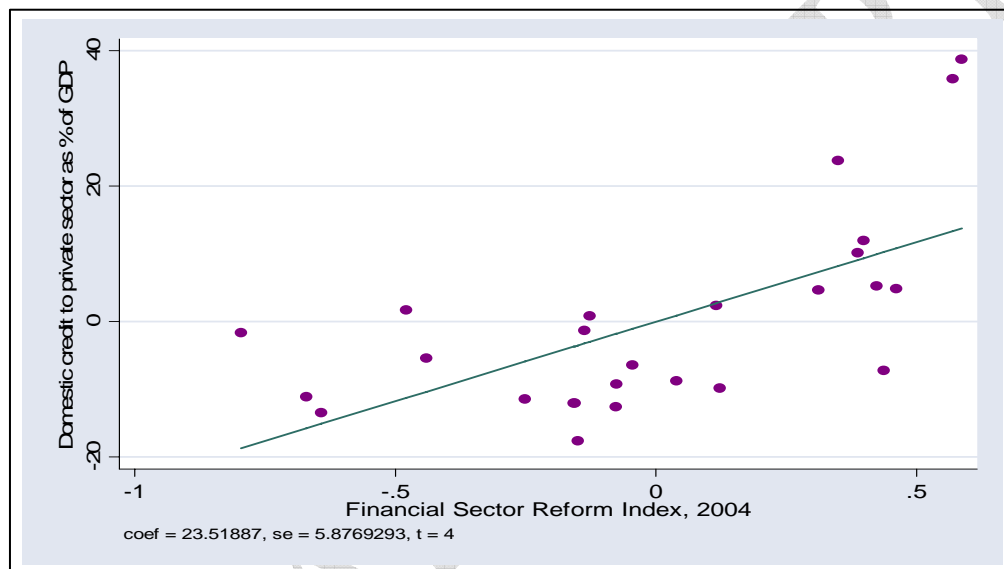


Source: World Bank staff estimates.

3.66 Financial sector reforms are also associated with greater access to credit. Financial sector reforms aimed at increasing competition and market contestability in the sector are associated with higher shares of domestic credit by the banking sector, after controlling for income levels (Figure 3.5).

3.67 For the MENA region, financial services constitute an area in greatest need of further liberalization. A major factor inhibiting greater domestic investment in the MENA region is lack of access to credit by firms, a problem highlighted in last year's MENA Economic Developments and Prospects report.<sup>25</sup> Investment Climate Assessments undertaken by the World Bank indicate that a low proportion of firms in the MENA region have access to finance, with more than three quarters of funding for investment being sourced from retained earnings, and only 12 percent from the banking sector (lower than any other region of the world).

**Figure 3.5 Financial sector reforms and access to credit**



Source: World Bank staff estimates.

3.68 Although many factors lie at the heart of the structural disconnect between the plentiful financial resources in the region and the scarcity of external financing for businesses, one of the key factors has been the high level of public sector ownership of banks, which has both impacted the direction of credit in MENA, as well as the operating efficiency and the ability of the banking sector to conduct robust risk analysis. The degree of state ownership is especially high in the resource rich and labor abundant economies of Algeria, Iran, Syria, and Libya, but state ownership is also high in several of the resource poor economies like Egypt, Morocco and Tunisia.

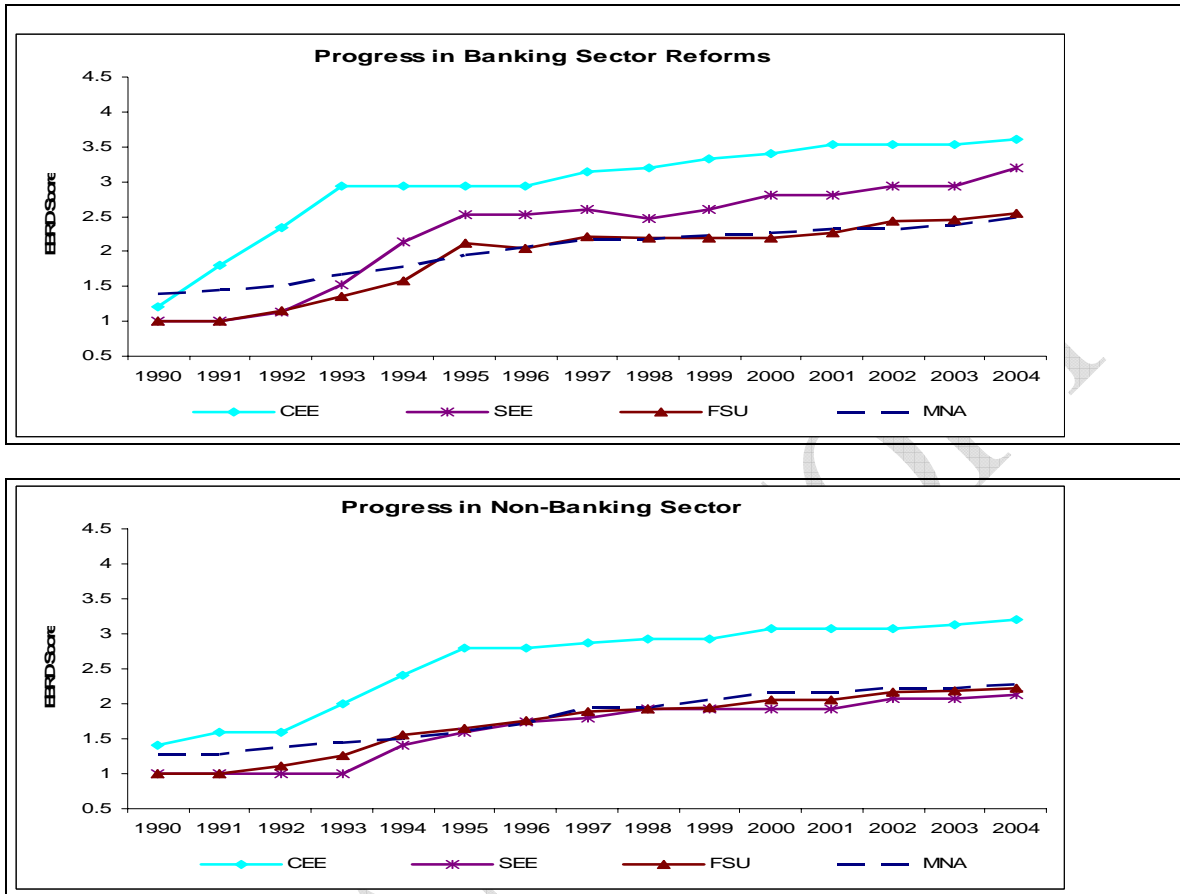
<sup>25</sup> MENA Economic Developments and Prospects (2006).

3.69 Over the last few years, many MENA economies have taken steps to open their banking sectors to greater private sector participation, granting licenses to private banks and changing foreign ownership restrictions. While these changes are only nascent, they nonetheless signal a broad change in policy by the region. Much of the recent efforts have come from those countries with the highest degree of state intervention and ownership in the sector. In Algeria, two new private banks were established in 2006. Iran opened the door to private sector participation, although the impact is relatively small to date. Licenses have been issued to four private banks, but together these command a very small share of the market. Syria, whose banking sector was monopolized by the state-owned Commercial Bank of Syria, overturned its 49% maximum foreign ownership requirement in 2005, which allowed for a new bank to be established, and foreign Islamic banks are also entering the market. And in Egypt, majority stakes in one of the four main state-owned banks, the Bank of Alexandria (with 7-8 percent of total banking deposits), was sold over 2006. This major privatization was only one component of a broad range of actions initiated in 2004 to restructure the financial sector, including the sale of joint venture banks and investment houses, and the restructuring of private sector nonperforming loans.

3.70 However, while some MENA countries have made significant progress in liberalizing the financial sector, the region still lags behind international standards in ensuring market competition and contestability in the sector (Figure 3.6).

3.71 One of the main drivers of deeper regional integration in both the accession countries of Central and Eastern Europe and more recently the Western Balkans has been foreign direct investment by European banks. If the MENA countries want to emulate these successful precedents, the privatization of remaining state-owned banks and financial services companies (e.g. insurances, stock market) would be the main policy lever.

**Figure 3.6 Progress in Financial Sector Reforms**



Source: World Bank staff estimates.

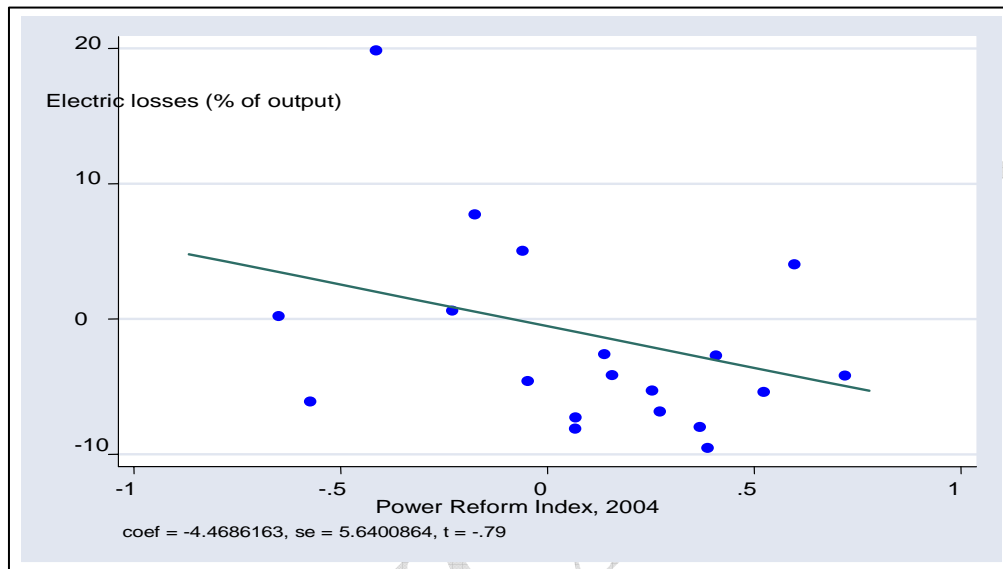
**Infrastructure sector reforms**

3.72 This section focuses on the following infrastructure sectors: transport (roads and railways); telecommunications; power and water. Three types of reforms are particularly important in increasing the efficiency of provision of regulated infrastructure services<sup>26</sup>: (i) allowing entry of new domestic and foreign providers; (ii), where feasible, opening the domestic market to imports of such services; and (iii) the establishment of an independent regulator.

<sup>26</sup> Reforms may and often do include privatization, but this variable is captured in the overall investment climate reform index discussed in the earlier section of the chapter. Even if incumbent providers remain state-owned, if regulators permit entry of new providers in the market, such competition can be expected to yield efficiency gains in the industry overall.

3.73 Power sector reforms are associated with better quality of electricity services. Progress in power sector reforms aimed at improving competition and market contestability in the sector are positively correlated with lower electric transmission and distribution losses (as a share of total electrical output), after controlling for income levels (Figure 3.7)

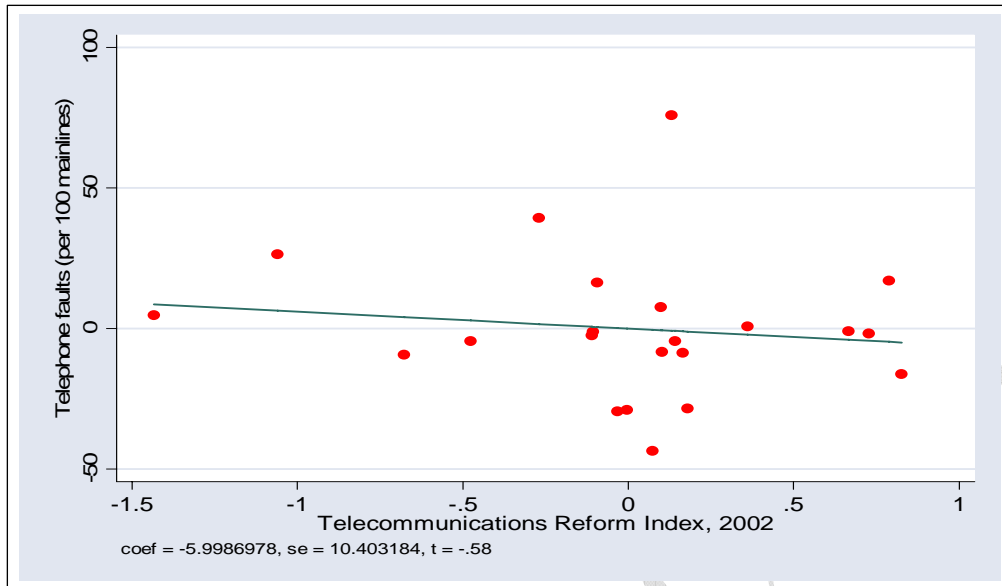
**Figure 3.7 Power Sector Reforms and Electric Losses (in percent of output)**



Source: World Bank staff estimates.

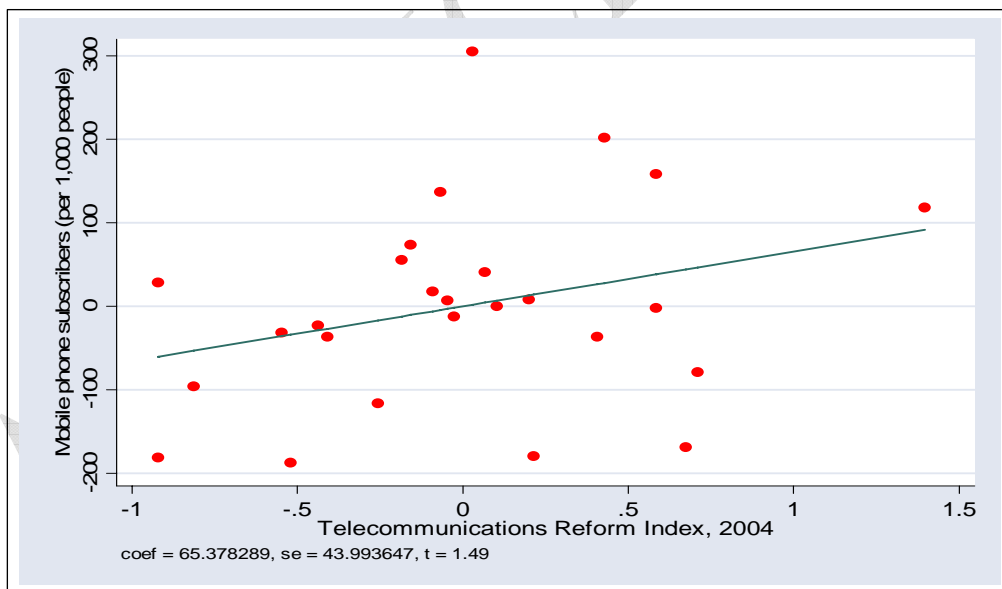
3.74 Telecommunication sector reforms are associated with better access and quality of telecom services. Fink et al (2003) found that privatization, competition and the introduction of independent regulators had a positive impact on telephone penetration and productivity in the telecommunications sector. The study also found that countries that introduced the full package of reforms did systematically better than those that confined themselves to partial reforms. Telecommunication sector reforms aimed at improving competition and market contestability are associated with lower telephone faults (per 100 main lines), after controlling for income (Figure 3.8). These reforms are also associated with higher number of mobile subscribers (per 1,000 habitants), also after controlling for income levels (Figure 3.9).

**Figure 3.8 Telecommunication reforms and telephone faults (per 100 main lines)**



Source: World Bank staff estimates.

**Figure 3.9 Telecommunication reforms and mobile phone subscribers (per 1,000 people)**



Source: World Bank staff estimates.

3.75 Poor transport infrastructure are reflected in higher direct transport costs and longer time of delivery leading to higher domestic production and trading costs. An improvement in a country's infrastructure can make a big difference to the costs of trading. It has estimated that a 10 percent increase in transport costs may reduce trade volume by more than 20 percent (Limao

and Venables, 1999), and that the decline in transport costs accounts for 8 percent of average world growth since 1945 (Baier and Bergstrand, 2001). Better infrastructure for sea, land and air transport are associated with higher volumes of trade. A recent study shows that doubling the number of paved airports per square kilometers of territory in a country boosts imports by 14 percent. Trading with an exporting country with twice as many airports increases bilateral trade by a further 15 percent. Doubling the kilometers of paved roads per 100-square kilometers is estimated to increase trade by 13 percent (Nordas and Piermartini, 2004).

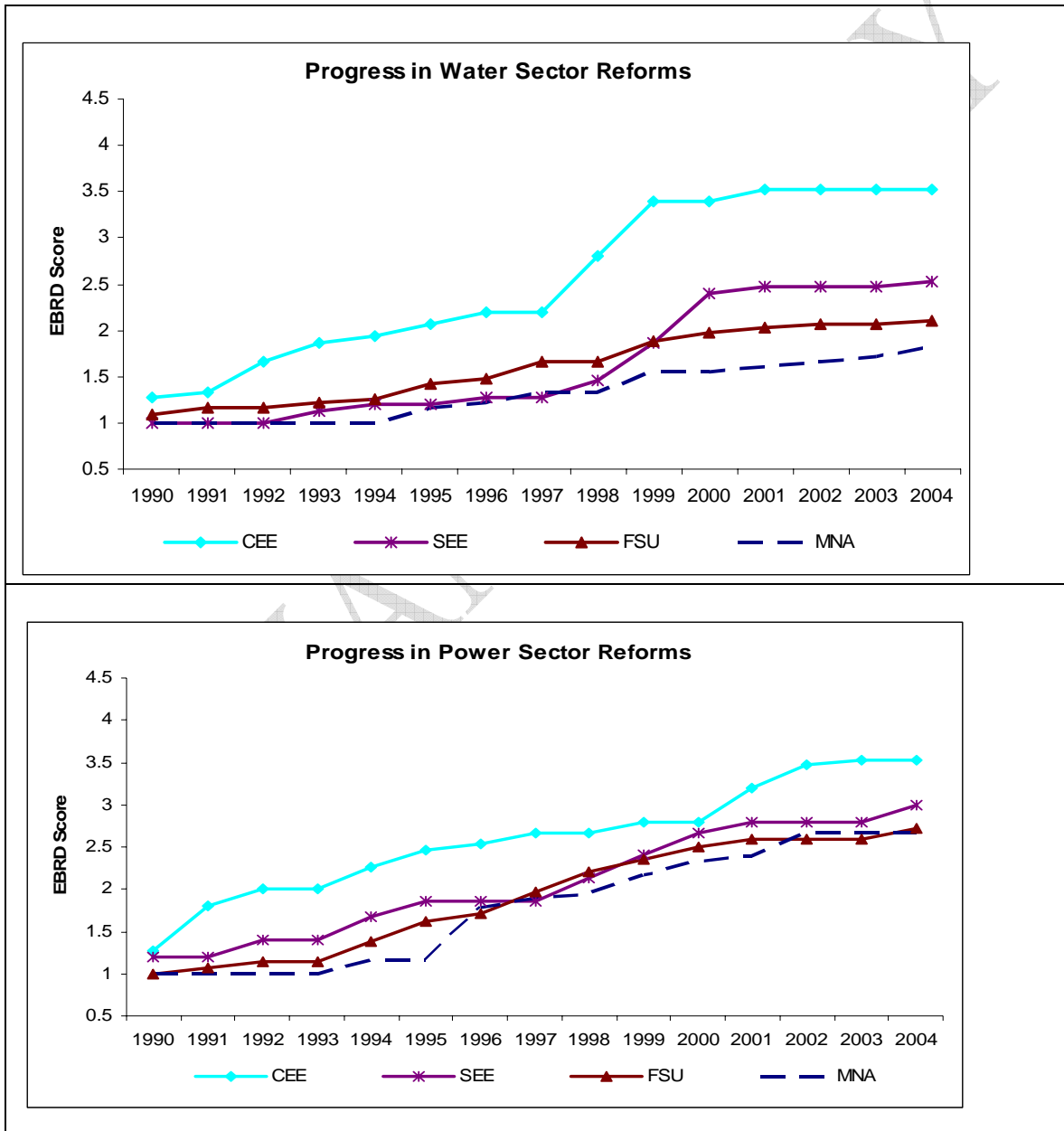
3.76 With a few exceptions MENA countries have made less progress in liberalizing infrastructure services than many other emerging economies (Figure 3.10). Implementing and sustaining reform has tended to be more difficult in some sectors than others. In telecommunications, where prices before liberalization were often high – and in port and airport transport, which are generally export-oriented services- there have been fewer difficulties in initiating reforms. In the electricity and water sectors, on the other hand, where prices are generally far below cost, the progress has been much slower, as policy-makers must balance the need for efficiency improvements with expected price increases. Tunisia and Algeria have approached service reform in the infrastructure sector in a piecemeal fashion. As a result, privatization has been slower than in other parts of the world and barriers to entry often remain forbidding for investors.

3.77 Telecommunications reform has received the most effort within the region, with Jordan, Egypt, Morocco, Algeria, and Tunisia all having opened the telecommunications sector to foreign competition, and with partial privatization of the national telephone companies in Bahrain, Qatar, Saudi Arabia, the UAE and Oman (though not open to foreign ownership). Competition in mobile telecommunications exists in Egypt, Morocco, Tunisia, Algeria, Jordan, and Kuwait, and most recently Bahrain and Saudi Arabia.

3.78 Outside telecommunications, progress with infrastructure liberalization has been mixed, with relatively strong liberalization efforts among a few, including Morocco (air transport, oil and gas exploration, audio visual communications, and with planned liberalization of electricity), Jordan (phosphates, air transport, and with planned liberalization of electricity generation), Bahrain (electricity, petrochemicals, and planned liberalizations of water and postal services), and Oman (power, water, ports, and oil). Egypt has liberalized air transport. Iran opened the door for private sector participation in most major industries, including power generation, water, postal

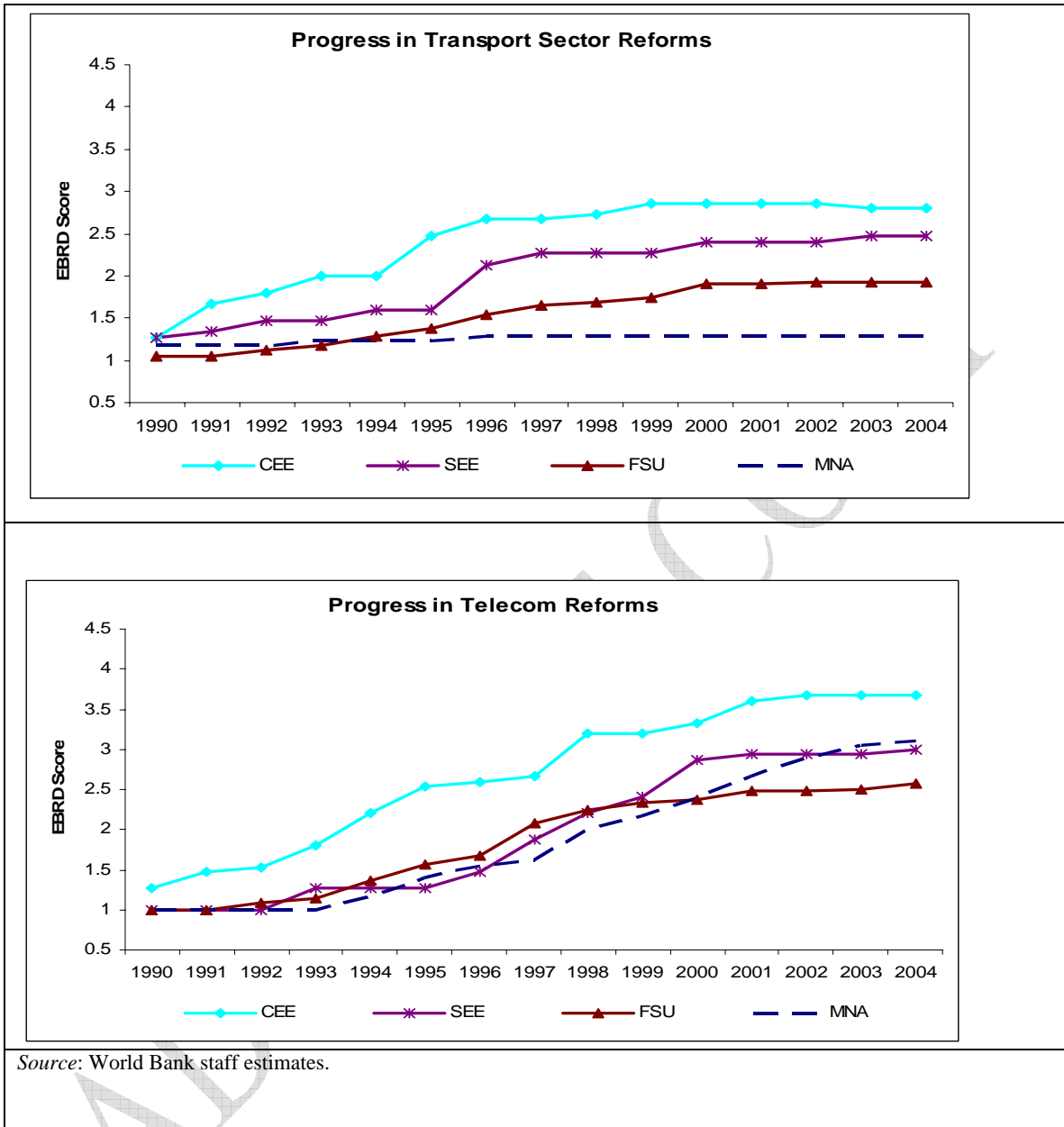
service, railways, airlines and ship building, although the actual privatization process has moved slowly and access to these sectors still pending. Elsewhere, almost all of the GCC countries have converted to private power, and there have been piecemeal efforts at liberalization in other sectors (Saudi Arabia in air transport, Qatar in some air services and water, and in the UAE in tourism and air transport).

**Figure 3.10 Progress in Infrastructure Reforms, 1990-2004**



Source: World Bank staff estimates.

Figure 3.10 Continued



### 3.5.2 Economic impact of service sector reforms

3.79 Drawing on time-series data for a panel of 30 countries (6 MENA countries and 24 transition economies) covering the 1990-2004 period, we estimate the impact of service sector reforms on per capita income growth, trade and FDI in MENA countries (see World Bank, 2006 for details). The magnitude of the impact of these reforms varies across countries. Below we report the average impact for the MENA countries under analysis:

3.80 ***Impact on per-capita income growth.*** One-unit point increase in the service sector reform index is associated with an average increase in annual real GDP growth per capita of about 2 percentage points in MENA countries, holding inflation and the change in investment-to-GDP constant.

3.81 ***Impact on FDI.*** One-unit point increase in the service sector reform index is associated with an average increase in FDI stock of about 8 percentage points, holding inflation and the change in investment-to-GDP constant.

3.82 ***Impact on per-capita export growth.*** One-unit point increase in the service sector reform index is associated with an average increase in annual export growth of about 1 percentage points, holding inflation and the change in investment-to-GDP constant.

3.83 Thus, the potential impact of greater liberalization of services in MENA economies, in terms of export growth, FDI and overall growth, is considerable. It is interesting to note that the economic gains of service sector reforms has tended to be consistently higher for Maghreb countries (Algeria, Morocco and Tunisia) than for Mashreq countries (Egypt, Lebanon, Jordan). One possible explanation is that the Maghreb countries, with the exception of Tunisia, have made less progress in reforming the service sectors than their Mashreq neighbors.

### **3.6 GOVERNANCE REFORM**

3.84 At the heart of many of the economic challenges facing the MENA region are governance issues. The World Bank outlined some of the key governance challenges facing MENA in its flagship report on governance.<sup>27</sup> Parallel to the economic reforms the region faces, it must strengthen the incentives, mechanisms, and capacities for public institutions, both to improve economic policies and to force the broad social consensus needed to successfully enact reform. Policy reform can help to build coalitions who expect and demand good institutions. But there needs to be some feedback mechanisms in place for these expectations and demands to be heard and met.

3.85 MENA's governance challenges relate to two different but complementary spheres. First, they face the challenge of modernizing governance structures and operations for more

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<sup>27</sup> World Bank. (2003b).

efficient public sector management. That task involves administrative reform of the public sector to enhance the efficiency of the bureaucracy, to improve mechanisms of internal accountability, and to reduce corruption. Second, the MENA region faces the more difficult challenge of increasing public sector accountability. This governance challenge requires improving transparency in governance mechanisms and enhancing contestability in government policies.

### ***3.6.1 Developments in governance reform***

3.86 Over the past years, MENA countries have taken significant steps to begin to address the region's significant deficiencies in governance. Many of these efforts have focused on reforming public administration, both to improve efficiency in the delivery of quality public services and to create fiscal savings. MENA's historical models of state-run development have translated into large civil services, which has been a key element of the public sector reform programs in a few countries in the region, including in Jordan and Morocco. Morocco's early retirement program aided the departure of 8% of the central government civil personnel within a year of its launch. The implementation of the early retirement scheme and the continued no-new-net hiring policy reduced the wage bill by 1.4 percent of GDP in 2006, to 12.2 percent of GDP.<sup>28</sup>

3.87 In 2006, Egypt also launched a system for early retirement of public sector employees, which allows for retirement for employees with minimum years of service, regardless of whether their position is threatened. Previously, retirement was possible only at 60 years of age, with special packages offered only to those working for companies due to be divested. And in Yemen, major reengineering efforts are underway to improve efficiency of administrative processes in key ministries and agencies, and encompassing over two thirds of total public employment, through the implementation of the National Wage Strategy. Improving public sector efficiency has also centered around upgrading modernizing the organization structure of the public sector.

3.88 But additional to efforts to improve public sector efficiency, several countries have taken important steps to open up the political space and allow for greater accountability in public policy and to strengthen inclusiveness in public policy. Many of these efforts have come from the GCC. In 2001, Bahrain became a constitutional monarchy with a bicameral parliament, full suffrage was granted to all citizens (male and female), and an independent judiciary was created. The government has more recently introduced a proposal to strengthen women's legal rights,

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<sup>28</sup> IMF (November 2006).

particularly in cases dealing with child custody, inheritance, and divorce, and shift jurisdiction over family affairs from Islamic to civil courts. Although the bill is still being blocked by conservative forces in the parliament, reformists are battling the issue. Saudi Arabia held its first nationwide elections in February 2005 to elect municipal councils. It also has made changes – albeit small – to improve the status of women, including giving women the right to obtain personal ID cards, and improving the employment opportunities in the public sector. Qatar has introduced new legislation granting more freedoms and permitting demonstrations, labor union formation, and public meetings. And in Oman, a consultative parliament was established in 2003, enabling all eligible adults to vote. Political rights have been extended to women, and starting in 2004, a number of key appointments of women to ministerial and ambassadorial posts have occurred.

3.89 Elsewhere, a major achievement in enhancing accountability occurred with Morocco's adoption of the Law on Political Parties, which helps consolidate the credibility and efficiency of political parties and institutions. And in the area of transparency, after a half century of state monopoly, Morocco's audiovisual sector was liberalized, allowing for greater access to wider and diversified sources of information.

### ***3.6.2 Quantifying progress in governance reform***

3.90 MENA's reform progress was evaluated across two broad spheres of governance: governance related to the quality of public administration, and governance related to public sector accountability. For each sphere, two structural reform indices were created, measuring both the current status of a country relative to the rest of the world in terms of that sphere of governance, as well as the country's recent progress with reform.

3.91 Public sector accountability in 2006 was evaluated based on current information in a variety of key accountability areas, including political rights, civil liberties, freedom of the press, and various measures of executive recruitment and participation processes. Quality of public administration in 2006 was evaluated based on current information on several areas of public sector capacity, including corruption, bureaucratic quality; property rights, regulation, and various

regulatory processes for business. For both areas of governance, reform progress was measured over the period 2000-2006.<sup>29</sup>

3.92 In the area of improving the quality of public administration, MENA countries have made strong advances over the last six years, ranking on average in the 57<sup>th</sup> percentile worldwide, higher than all other regions of the world. Resource poor countries, which on average rank fairly high relative to other developing regions in terms of public sector efficiency, also demonstrated strong advancements since 2000 (and average in the 85<sup>th</sup> percentile with regard to improvement in the quality of administration measure between 2000-2006), with efforts centered on improving procedural requirements for business. Public administration quality among resource rich countries varies dramatically between generally more efficient public sectors of the GCC and the substantially less efficient public administration of the labor abundant economies and Libya (without Libya, resource rich and labor importing economies would rank in the 64<sup>th</sup> percentile, on average, with regard to the quality of public administration). Over the last several years, a few of the GCC countries have exhibited further progress in areas of reducing corruption, and as a group the labor importing economies rank in the 53<sup>rd</sup> percentile with regard to recent reform efforts. Resource rich and labor abundant economies, however, have not kept pace with worldwide progress with public administration reform, ranking on average in the bottom third worldwide with respect to improvements in the mechanisms for quality public service delivery (Table 3.6).

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<sup>29</sup> See Appendix B4 for description of the methodology behind governance indicators.

**Table 3.6 Quality of Public Administration in 2006 and Quality of Public Administration Reform 2000-2006**

Country/region	QUALITY OF ADMINISTRATION INDEX: CURRENT STATUS (Percentile Rank)	QUALITY OF ADMINISTRATION REFORM INDEX (Percentile Rank)
Algeria	38	15
Bahrain	79	75
Egypt	52	97
Iran	17	12
Jordan	65	82
Kuwait	64	58
Libya	2	13
Morocco	69	91
Oman	67	78
Qatar	53	87
Saudi Arabia	54	77
Syria	20	72
Tunisia	63	69
United Arab Emirates	65	8
Yemen	20	27
<i>Regional Averages (unweighted)</i>		
<b>MENA</b>	<b>49</b>	<b>57</b>
Resource poor	62	85
Resource rich labor abundant	24	32
Resource rich labor importing	53	53
East Asia and Pacific	43	42
Europe and Central Asia	47	54
Latin America and Caribbean	47	40
High Income OECD	90	49
South Asia	48	56
Sub-Saharan Africa	33	54
World	50	50

*Source:* See Appendix B for methodology behind governance indices. Current status reflects country's current placement in a worldwide ordering of countries, based on a variety of indicators of quality of public administration, expressed as a point in the worldwide cumulative frequency distribution, with 100 reflecting the country (countries) with the best/most efficient public administration worldwide and 0 reflecting the country (countries) with the weakest/most inefficient public administration worldwide. Reform progress reflects the improvement in a country's worldwide ranking between 2000 and 2006 in a worldwide ordering of countries based on quality of public administration, with 100 reflecting the country (countries) that exhibited the greatest improvement in rank worldwide, and 0 reflecting the country (countries) that exhibited the greatest deterioration.

3.93 Along with improvements in public administration efficiency, MENA has demonstrated significant progress over the last several years in improving the mechanisms for greater government accountability. The gap between MENA countries and the rest of the world in terms of accountable and inclusive institutions is large. On average, based on a range of measures, MENA countries rank on average in the bottom 20<sup>th</sup> percentile with regard to public sector accountability in a worldwide ranking of economies. And only one country – Jordan, ranks

above the bottom third<sup>30</sup> (Table 3.7). But an encouraging and important development has been the recent inroads that MENA countries have made toward reducing this governance gap. Between 2000 and 2006, MENA countries ranked on average in the 63<sup>rd</sup> percentile with regard to improving the mechanisms for government accountability, higher than all other regions of the world. Strongest improvements have come from resource rich and labor importing countries, which on average rank in the 73<sup>rd</sup> percentile with regard to public accountability reform (led by Bahrain and Oman, but with progress throughout the GCC). But resource poor countries, led by Morocco, have also made inroads.

**Table 3.7 Public Sector Accountability 2006 and Public Sector Accountability Reform 2000-2006**

Country/region	PUBLIC SECTOR ACCOUNTABILITY INDEX: CURRENT STATUS Percentile Rank <sup>a</sup>	PUBLIC SECTOR ACCOUNTABILITY REFORM INDEX Percentile Rank <sup>a</sup>
Algeria	28	68
Bahrain	27	96
Egypt	23	73
Iran	21	6
Jordan	34	62
Kuwait	30	63
Libya	0	43
Morocco	32	78
Oman	17	89
Qatar	15	75
Saudi Arabia	6	75
Syria	6	54
Tunisia	22	37
United Arab Emirates	20	84
Yemen	18	48
<i>Regional Averages (unweighted)</i>		
<b>MENA</b>	<b>20</b>	<b>63</b>
Resource poor	28	63
Resource rich labor abundant	18	44
Resource rich labor importing	16	73
East Asia and Pacific	41	44
Europe and Central Asia	52	56
Latin America and Caribbean	57	42
High Income OECD	91	47
South Asia	37	31
Sub-Saharan Africa	36	52
World	50	50

*Source:* See Appendix B for methodology behind governance indices. Current status reflects country's current placement in a worldwide ordering of countries, based on a variety of indicators of public sector accountability, expressed as a point in the worldwide cumulative frequency distribution, with 100 reflecting the country (countries) with the best/most accountable governance structures worldwide and 0 reflecting the country (countries) with the weakest/least accountable governance structures worldwide. Reform progress reflects the improvement in a country's worldwide ranking between 2000 and 2006 in a worldwide ordering of countries based on public sector accountability, with 100 reflecting the country (countries) that exhibited the greatest improvement in rank worldwide, and 0 reflecting the country (countries) that exhibited the greatest deterioration.

<sup>30</sup> And Jordan is only marginally above the bottom third.

### 3.7 REFORM AND THE OIL BOOM

3.94 While the recent oil boom has greatly benefited the oil producing economies of the region in terms of higher growth and revenues, an important concern has been the potential impact this oil boom might have on the continuing structural reform effort. Historically, the region relied on oil and oil-related revenues to delay implementing a deeper economic reform agenda, with the substantial revenues from oil permitting many to postpone difficult but important reforms that were taking place worldwide. Indeed, it was only in the mid-1990s, well after the collapse of oil prices in the mid 1980s, that most of the countries in the region began the long and complex process to move toward more market-driven, open, and diversified economies.

3.95 With the current oil boom, a natural question is whether the region's structural reform effort will slow. Answering the question, however, is difficult. Structural reform takes place in distinct stages and actions. Examining one period of reform versus another may yield results which are less a reflection of changes in reform effort rather than simply reform sequencing. Reform is also a reflection of need, and countries might demonstrate a lower reform effort in one particular area because less reform is needed. Moreover, our information on structural reform is limited to just a few short years, and only in the area of governance reform is information available both prior to and after 2003.

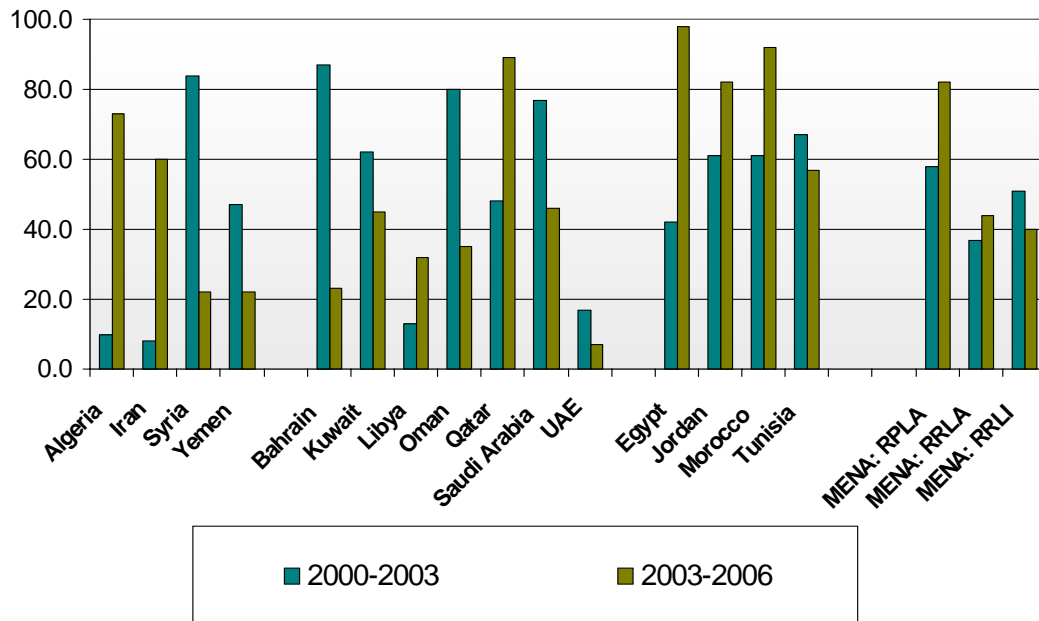
3.96 But there are some generalities about reform in MENA which can nonetheless yield important insights. In the area of public administration reform, there is some evidence that, outside of the resource poor countries (facing higher oil import bills and oil subsidies), the incentives for sweeping improvements in public sector management have diminished with rising oil prices. On the whole, oil economies backed off from improvements in the quality of public sector administration after 2003, even where modest progress had been occurring previously (Figure 3.11). In only a few countries (Algeria, Iran, and Qatar) was the reform effort heightened following the start of the oil boom (in both Algeria and Iran, however, this "heightened" effort since 2003 more accurately reflects the modest containment of a significant downward slide since 2000). Interestingly, resource poor countries, facing higher oil import bills, have universally demonstrated a significant improvement in measures of quality of public sector administration since the start of the rise in oil prices.

3.97 In the area of enhancing public sector accountability, however, a significant divergence between labor abundant and labor importing oil economies is notable. Between 2000-2003, efforts at improving public sector accountability were mixed. Only a few of the early reformers in the area – Oman and Bahrain, but also Iran – made significant strides in opening up the public space and increasing mechanisms for greater voice in governance, but most of the oil countries (and non-oil countries) remained inactive in improving mechanisms for greater accountability.

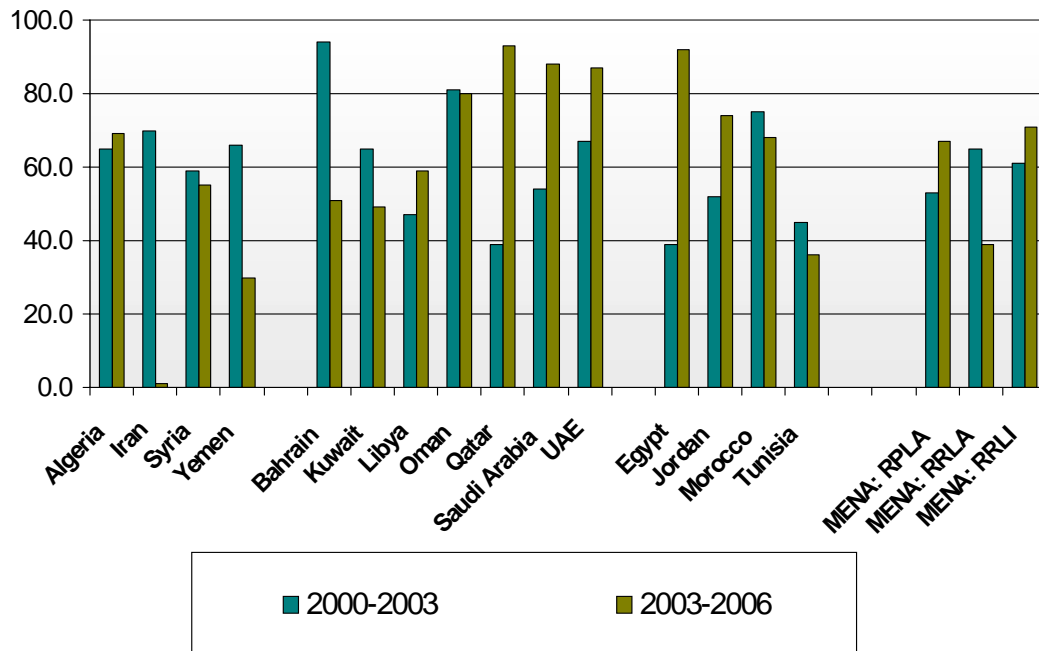
3.98 Since 2003, however, many of the resource rich and labor importing economies of the GCC have begun to exhibit strong efforts into improving government accountability. In parallel with their efforts toward more prudent management of the oil windfall and stronger economic ties with the world, GCC countries such as Oman, Qatar, Saudi Arabia, and the United Arab Emirates have also taken significant steps forward in the sphere of enhancing the inclusiveness and accountability of government. It is a significant and encouraging sign that these efforts have taken place despite rising oil prices.

3.99 MENA's labor abundant oil economies, on the other hand, have generally not moved forward with improving public sector accountability since 2003 (Algeria is an exception). Undoubtedly, creating more inclusive and representative governance structures is influenced by far more than rising oil prices. However, given the importance of this area of reform for the overall reform agenda, the significant backsliding by a few countries (especially Iran) represents a large concern for the broader reform agenda, and thus longer run growth prospects.

**Figure 3.11: Governance reform since the oil boom**  
**Panel A: Quality of public sector administration reform**



**Panel B: Public sector accountability reform**



Source: See Annex B for methodology behind governance reform measures. Note: Worldwide average reform for any period = 50 (50<sup>th</sup> percentile).