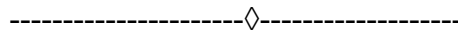




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## Workshop 6

### **The role of the private sector in promoting economic and political reform**

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## **Workshop Description**

Experts' views of the capabilities and the potential role of the private sector in promoting economic and political reform in the Arab countries are sharply divergent. Some view the private sector as being still primarily subordinated to the government and depending on government expenditure or other forms of government protection to be able to achieve profit in business. Accordingly, the emphasis is laid on the lack of international competitiveness except in sectors, such as petrochemicals, which are formally privatized but in fact still closely controlled by government; on the lack of transparency and openness to international investment; on excessive dependence on government contracts or other business opportunities essentially influenced by government decisions and initiatives.

A contrasting view has emphasized that the private sector has come a long way since its beginnings in the 1970s or earlier, and has now acquired capabilities that it did not have in the past. Therefore, while the picture of a business sector subservient to the government might have been correct 30 or 40 years ago, it no longer represents reality today. Many genuinely private business groups have greatly increased their financial capabilities also through international investment, and are increasingly engaging in business that caters to open and fairly competitive markets. The declared strategy of the Arab governments to increasingly rely on the private sector, while not always implemented to the point of divesting or reducing government holdings in key enterprises, nevertheless is opening further opportunities for private sector investment and growth, progressively tilting the balance in the equation.

This proposal aims at conducting original research that might throw light on the capabilities and attitudes of the private sector, opening the door to a more sophisticated understanding of its evolving reality.

The proposed research plan is divided in two parts: the first part aims at evaluating the private sector capabilities and degree of dependence on government spending or protection; the second part aims at discussing the actual and potential role of the private sector in promoting economic and political reform.

### **1. Private sector capabilities and degree of dependence on the government.**

The first part of the research will entail collecting and evaluating evidence on key parameters to measure private sector dependence on, or independence from the government. We propose to articulate research in four main tasks:

a. Estimate total domestically vs internationally invested capital, and domestically vs internationally generated profits

A crucially important reason why the private sector is believed to have progressively become less dependent on governmental support is that a growing share of private investment has been directed outside of its country of origin, and wealth has been accumulated internationally even more rapidly than nationally. GCC investors have engaged in financial investment in the major international markets, and real estate investment in countries outside the GCC; as well as cross direct investment in other GCC countries or other Arab countries or, finally, the rest of the world. Arab entrepreneurs from outside the GCC frequently made their fortune by starting business activities in the GCC countries or in the US/Europe. In all cases, international investment escapes from the direct control, but also cannot benefit from special government support, being normally outside of the government's jurisdiction.

In parallel with the expansion of investment and wealth accumulated internationally, the origin of private sector profits has changed. It is important to estimate whether today's major business groups realize their profits primarily in the domestic economy or internationally, and the extent to which their prosperity depends on the prosperity of the domestic economy, or is rather tied to global prosperity and, at least to some extent, de-linked from economic conditions at home.

b. Estimate turnover with government and government entities vs open market based

For some private companies government procurement remains a fundamentally important source of business and profit, but for many others the business is conducted primarily with private customers, be they final consumers or other business enterprises. Surely, the purchasing power of final consumers is also essentially influenced by government spending, and in this sense it might be true that the well being of the Arab economies still is substantially influenced by government expenditure. However, the significance and implications of being directly dependent on government business is entirely different from catering to a market whose overall purchasing power is influenced by government expenditure, but individual purchase decisions are made privately and without government interference.

The modalities of government procurement are also of relevance. We propose to explore the extent to which more transparent and competitive procedures have been adopted in procurement by the government and other major government-controlled agencies or companies, in order to estimate the extent to which direct access to this market still is a source of extra profit.

c. Estimate concentration/competition

The degree of competitiveness of key markets is very important in determining whether business may be said to stand on its own feet or be dependent on government support. Government can support specific businesses either through procurement, or by creating conditions of limited competition or outright monopoly to facilitate extra profit – i.e. create positions of rent. Competition can come from openness to international trade and investment, or from a multiplicity of domestic actors competing for the same customer, or both. It is the superficial impression of the proponent that the competitiveness of the Arab economies has significantly increased on both counts, and today there are relatively few “protected” niches in which private players can prosper undisturbed by competitors. Indeed, it is increasingly the case that also government-controlled corporations are being exposed to competition, or forced to become more competitive because their market increasingly lies abroad.

d. Evolution of corporate structures and corporate governance

The corporate structure of the business sector is also evolving, from being organized primarily as informal family-owned conglomerates (business groups) to being increasingly organized as formal, publicly-held corporations in which the founding families may maintain a dominant ownership, but management and ownership are increasingly separate. The extent to which this process is actually unfolding needs to be investigated; are the well known-cases of this tendency just isolated exceptions, or do they constitute the dominant trend?

The reorganization of business enterprises is extremely important inasmuch it opens the door to more aggressive management of assets, i.e. divestment, acquisitions and mergers. Formal companies will tend to critically assess their assets, and exit areas in which their profits are below par, to concentrate in areas where they can do better. In this process of critical evaluation of corporate assets, corporate governance is also likely to improve, because management will pay attention to the transparency of results as a prerequisite of rational decision making.

This is but one motivation behind the attention that has recently been devoted to improved corporate governance. The increasing importance of financial intermediaries and the desire to tap the equity market for growth by way of listing in the regional stock markets will inevitably bring about pressure to improve corporate governance and transparency.

**2. Actual and potential role of the private sector in promoting economic and political reform.**

Political science literature has frequently asserted a link between a thriving and competitive private sector and economic and political reform. This link can exist at two levels: because business openly and expressly articulates a reform agenda and calls on the government to engage in it; or because, even in the absence of open calls for reform, the business sector engages in behaviour that encourages/precipitates reform.

Accordingly, we propose to divide our discussion in this second part in two main areas: participation and contests.

a. Participation

Participation refers to the formulation of opinions or proposals for policy initiatives in the economic or political sphere, constituting a partial or widely-encompassing program of reform.

The following aspects are proposed for research:

i. Private sector representation in state institutions

Private business entrepreneurs or members of business families are represented in government, in Parliament or Majlis ash-Shura, in major public agencies. We will investigate the extent to which these business leaders or members of business families have supported economic or political reform in their statements, vote or through other action, including the fulfilment of their mandate as managers of public agencies.

ii. Private sector representative institutions notably CCIs

Institutions have been established to represent the private sector. These are primarily, but not exclusively, the Chambers of Commerce and Industry. Attention should be devoted also to groupings such as specific sector associations or more or less informal associations of business leaders at the national or regional level, which may be promoting a reform agenda through the organisation of debates or the publication of reports.

iii. Private sector and policy research

The establishment and support to policy research is another frequent tool for the private sector to influence the policy debate. Whether policy research is carried out indigenously, through the establishment of research centres and think tanks independent of the government; or through such institutions existing abroad; the study will aim at

summarizing and evaluating the message that is generated from private actors and directed to holders of political power.

iv. Private sector and social responsibility

The private sector also increasingly engages in activities directed at meeting its perceived social responsibility. Corporations engage in supporting training, community development and other benevolent activities. The nature and importance of these activities will be surveyed and analyzed in view of understanding their overall potential significance for economic and political reform.

v. Private sector and education

Specifically, the private sector has been playing a growing role in the provision of education. The launching of educational enterprises is done sometimes as primarily benevolent activity, sometimes for profit. The difficulty that government authorities have encountered in reforming curricula and education methods - notwithstanding the fact that these are widely recognized as indispensable to guarantee long-term employment perspectives to young national entrants into the work force - has led to greater reliance on private sector initiative. In view of the central role of education in the political system, the characteristics of private sector initiatives in education, their profile, curricula, teaching methods etc. acquire considerable significance as tools for promoting economic and political reform, and will be analyzed in this light.

vi. Private sector and media/public sphere

The private sector also has invested in the media and in this way contributes to the development and shape of the public sphere in the Arab countries. The relevant media include not only traditional press and TV, but also the publishing business (books are important) at the more traditional extreme and internet-based platforms at the opposite, advanced ICT extreme. This is important because, while much of the press and TV is either directly government controlled, or controlled by individuals with very close ties to political power, when it comes to other forms of communications the role of genuinely private actors appears to be much greater.

b. Contests:

The importance of contests derives from the fact that, while the private business community may be quite conservative in its ideas and timid when it comes to advocating reform; nevertheless the progressive development of private enterprise in a competitive environment will inevitably generate conflicts of interest – contests – that the government will find increasingly difficult to mediate on the basis of traditional patron/client approaches. The natural dynamics of private sector development will necessitate the adoption of more formal rules of engagement and market regulations, which will limit the government's room for arbitrary decision making.

We identify three main areas for research:

i. Major government tenders/transparency

As competition heats up, and the number of potential bidders is increased - also thanks to the impact of WTO and closer relations within the GCC and with other Arab countries - major government tenders, including new utilities concessions or floating of government-owned assets, will have to be conducted in a more transparent and reliable fashion. We propose to survey the introduction of more advanced procurement methods, such as e procurement; and review the more important cases of privatizations and issuance of concessions (e.g. mobile telephones) to discuss the extent to which more formal and transparent rules are being adopted and adhered to.

ii. Other major market contests notably stock market

Government procurement and tenders are not the only relevant market for contest. Other markets also should be considered, notably the stock market and implications of boom (bubbles) and bust on income distribution and economic development. The greater the importance of the stock market and the wider the participation of small investors in it, the more important becomes for political authority to perform the role of regulator and enforce rules and transparency – rather than merely agent for the allocation and distribution of the oil rent. This transformation will, with time, increase the legitimacy and influence of successful private enterprise and lead to calls for greater transparency of

government expenditure, decision making and investment policies. The influence that the government may have on the fortunes of individual companies or group of companies is likely to become increasingly evident, and provide an opportunity for questioning government policy or administrative behaviour. The aftermath to the bursting of the 2003-6 stock market bubble has already provided abundant evidence to this phenomenon.

iii. Inter-Arab competition for investment – at the broad governance level as well as specific initiatives

Arab governments are ever more actively competing for attracting investment from other Arab countries as well as from the rest of the world, through improved governance, streamlined rules, more sophisticated judiciary and effective contract enforcement, and friendly investment environment. Such competition is especially intense within the GCC. Governments compete also through specific and targeted initiatives, such as the various free zones or “cities”, often imitating and in direct competition with each other. Considering the geographic closeness of urban centres especially along the Gulf coast, and the ease of travel between them – which is bound to improve with the implementation of some road and rail projects currently under consideration – the competition for attracting factories, logistical facilities or company headquarters can only intensify. Already now, the private entrepreneurs in the Arab are clearly playing governments against each other through their investment decisions, and are, in a sense, “voting with their feet”.

This phenomenon is further reinforced through the increasing importance attributed in the media to international benchmarking of various aspects of government activity, or scoring of government services outcomes, or rating of financial performance and creditworthiness. Through these private sector controlled tools, governments in the region have come under constant scrutiny and a degree of accountability is increasingly enforced.

Paper proposals for this workshop should aim at offering original material relevant to one or more of the points illustrated above. We are especially looking for case studies,

preferably papers covering two or three case studies from different countries, allowing for comparative analysis. We expect that the condition, capabilities and behaviour of the private sector will be very much different in different countries. Case studies may be based on material from the press, company sources, interviews or the like. If sufficient statistical information is available – which is unlikely to be the case, statistical analysis would also be relevant.