

EBERHARD-KARLS UNIVERSITÄT TÜBINGEN

INSTITUT FÜR POLITIKWISSENSCHAFT

# PATRIMONIAL CAPITALISM

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Economic Reform and Economic Order  
in the Arab World

Inauguraldissertation

zur Erlangung des Grades eines  
Doktors der Politikwissenschaft

vorgelegt von  
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Tübingen, den 26.04.2004

## **Urheberschafts-Erklärung**

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<p>Note on Translation and Transliteration</p>
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**Transliteration:**

The spelling of Arabic words follows closely the style of the *International Journal of Middle East Studies*, publication of the Middle East Studies Association (MESA) of North America.

Deviations were allowed for in the case of proper names whose bearers spell themselves differently (e.g., on business cards or in publications) and in the case of Company Names or commonly known *nomina loci* such as ‘Cairo’ (instead of ‘al-Qahira’).

**Translations:**

Quotations from Texts written in languages other than English have been translated by the author into English in order to facilitate reading – except when an authorized translation was at hand or existed. Specific or crucial terms remain, in some instances, in their original language in case this helps in understanding. However, the translation is then given in brackets.

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# List of Abbreviations

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ADMA-OPCO	Abu Dhabi Maritime Oil Operations Company
ADNOC	Abu Dhabi National Oil Company
ADSE	Abu Dhabi Stock Exchange
ADWEA	Abu Dhabi Water and Electricity Authority
AD	Algerian Dinar
AED	Arab Emirates Dirham
AFM	Amman Financial Market
AMF	Arab Monetary Fund (Abu Dhabi)
API	Allocative Power Index
APSI	Agence pour la Promotion, le Soutien et le Suivi des Investissements (Private Sector Investment Office, Algeria, in 2001 renamed ANDI [= Agence nationale de Développement des Investissements])
ARE	Arab Republic of Egypt
ASEZ(A)	Aqaba Special Economic Zone (Authority); (Jordan)
b/d	barrel per day (1 barrel = ca. 159 litres)
B(O)O(T)	build, (own), operate, (transfer) (= scheme for attraction of private investment)
CAPMAS	Central Authority for Public Mobilization and Statistics (Egypt)
CBJ	Central Bank of Jordan
CEDEJ	Centre d'Etudes et de Documentation Economique et Juridique, (French Research Center in Cairo)
CERMOC	Centre d'Etudes et de Recherche sur le Moyen Orient Contemporain, (French Research Centers in Beirut & Amman)
CMA	Capital Markets Authority (Egypt)
CNEP	Caisse nationale d'épargne et de prévoyance (National Savings and Housing Bank, Algeria)
CNES	Conseil National Economique et Social (semi-independent research centre and government-advising think-tank in Algeria)
CPI	Consumer Price Index
CSS	Center of Strategic Studies (at the University of Jordan in Amman)
DFM	Dubai Financial Market
DUBAL	Dubai Aluminum Company (world's second largest smelter)
ECC	Economic Consultative Council (Jordan)
ECES	Egyptian Center of Economic Studies (semi-dependent think-tank in Cairo)
EFF	Extended Fund Facility (type of IMF credit)
EIA	US Dept. of Energy, Energy Information Administration
EIB	European Investment Bank
EIU	The Economist Intelligence Unit (London)
EPE	Entreprises publiques économiques (larger public enterprises in Algeria)
EPL	Entreprises publiques locales économiques (smaller public enterprises in Algeria)
ERF	Economic Research Forum for the Arab Countries, Iran and Turkey (internationally and nationally supported, semi-independent research center and think-tank in Cairo)
EU	European Union
FCE	Forum des Chefs d'Entreprises (Algerian business association founded in 2000).
FDI	Foreign Direct Investment
FIS	Front Islamique du Salut (Islamic Salvation Front)

GAFI	General Authority For Investment (Egypt)
GDP	Gross Domestic Product
GIA	Groupe Islamique Armé (Algeria)
GNP	Gross National Product
GTZ	Gesellschaft für Technische Zusammenarbeit
HDI /-R	Human Development Index / - Report
HKJ	Hashemite Kingdom of Jordan
IMF	International Monetary Fund
ISI	Import Substitutionalizing Industrialization
JD	Jordanian Dinar
JEDCO	Jordan Export Development Corporation (public sector entity)
JIB	Jordan Investment Board (formerly known as the Investment Promotion Corporation)
LE	Egyptian Pound
MEED	Middle East Economic Digest
MEFT	Ministry of the Economy and Foreign Trade (until 2001 in Egypt)
MoF	Ministry of Finance
MoP	Ministry of Planning
NAFTAL	Entreprise Nationale de Commercialisation et de Distribution de Produits Pétroliers (Algeria)
NAFTEC	Entreprise Nationale de Raffinage des Produits Pétroliers (Algeria)
NBE	National Bank of Egypt
NDP	National Democratic Party (ruling party in Egypt)
NGO	Non-Governmental Organization
NIE	New Institutional Economics
NIS	Newly Independent States (former members of the Soviet Union)
NPE	New Political Economy
OAPEC	Organization of Arab Petroleum Exporting Countries
OECD	Organization for Economic Cooperation and Development (Paris)
OPEC	Organization of Petroleum Exporting Countries
PCSU	Privatization Cooperation Support Unit (Egypt; subcontractor of USAID in charge of monitoring Egypt's privatization program)
PEO	Public Enterprise Office (Egypt)
QIZ	Qualifying Industrial Zone (in Jordan; special economic zone where cooperation with Israeli firms is advocated; products gain duty- and quota-free access to the US market)
RADP	République Algérienne Démocratique et Populaire
REACH-Initiative	Initiative by Jordanian IT-entrepreneurs
SFD	Social Fund for Development (Egypt)
SOE	State-Owned Enterprise
SONATRACH	Société Nationale pour le Transport et la Commercialisation des Hydrocarbures (Algeria)
SONELGAZ	Société Nationale d'Electricité et de Gaz (Algeria)
UAE	United Arab Emirates
UGTA	Union Générale des Travailleurs d'Algérie (Algeria's Trade Union Federation)
UNDP	United Nations Development Programme
UNIDO	United Nations Industrial Development Organization
UJRC	Urdun Jadid Research Center (New Jordan Research Center, Amman)
USAID	United States Agency for International Development
WTO	World Trade Organization



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‘We all think we know crony capitalism  
- but nobody knows how to study it’

Roger Owen

(in his Keynote Speech to the First World Conference of Middle East Studies [WOCMES],  
Mainz, Germany, 8-13 Sept. 2002)

## Who Should Read What?

Nobody likes reading books from page one to the end – and in most cases, this is not necessary either. Books have a tendency to deal with many issues one is not interested in; the challenge is then to find those passages that might be important or interesting for oneself. Since this one moves along the edges of various disciplines, I feel fairness obliges me to reduce that challenge for the reader. Nobody will understand the book who does not read Chapter (11). This is held as short as possible and contains the concept, or model, I suggest, in a brief form. More could be said in this chapter, but I have refrained from doing so in order to be concise. Depending on what you are interested in, you might wish to look at different chapters of this study.

To start with, *development practitioners, diplomats, and politicians* or those who consult them will not be interested in the entirety of methodological chapters, nor in all of the chapters on individual countries. But be sure not to miss the argument - which you will not get unless you look into Chapters (3) and (11). Of interest should also be Chapter (13) since this is where reflections on policy recommendation are suggested that might be of practical value.

For *economists with a primarily academic interest*, it might be worth looking into Chapters 2 (methods and connections between economics and other social sciences), 3 (on economic orders), 10 (the summary of empirical findings in the Arab world), 11 (the concept suggested) and 12 (applicability of the proposed concept beyond the Arab countries).

*Political scientists with a specialization on the MENA region* will either want to read about ‘their’ countries, i.e. the individual country in which they take a specific interest (Chapters 6 through 9), or more generally (Chapter 10). However, Chapter 11 (the model) is a must for anybody.

*Social scientists* – sociologists, political scientists or economists – who are *primarily interested in methodology or comparative approaches* and who might not be familiar with the Middle East nor wish to become so should read Chapters 2 (methods), 3 (theoretically on how I perceive the question of economic orders), 4 (which cases and issue areas, and why), 11 (the model I propose) and 12 (applicability of the concept without respect to geographical regions).

In case you feel you belong to *none of the above* groups but still happen to have this book in your hands, do at least read this introduction and cast an eye into Chapter 11. This is the essence. Otherwise, you might find the bibliography useful for finding some reference you never needed but which you might still use because you know for sure that all of your readers will be flabbergasted seeing you cite such a bizarre title. Alternatively, cite this book.

# 0. Introduction

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## What Is This Book About?

### The Context: What and Why?

This book is about economic orders and their development – a rather academic and theoretical issue one might think. However, the impetus to embark on the present study came from an empirical observation that seems strange: Throughout the past decades, Third World countries have implemented liberal economic reforms in order to overcome developmental problems. Billions of dollars have been spent in each of these countries in all corners of the world, from the Far East and South Asia to the former Soviet Union, from Africa to Latin America. There must thus be an extremely strong, if not universal, belief that implementing such reforms is vital and necessary among the concerned countries' elites as well as among the decision-makers in the Western industrial states for such an agenda to be designed, co-ordinated and implemented. Governments of the industrialized nations have supported policies of economic reform and structural adjustment around the globe, on bilateral tracks, but even more so on the international level through the *International Monetary Fund* (IMF) and the *World Bank Group* as well as through other multi-lateral institutions such as the *Organisation for Economic Co-operation and Development* (OECD) and a number of regional Development Banks.

At the outset, severe economic crises that had hit Third World countries to various extents and at different times, and a huge debt-burden were the trigger for economic reform. In most cases, however, economic stabilization and austerity policies were followed by reforms that involved deep changes to the institutional, legal and regulatory frameworks within which economic processes in those countries take place. The very structure of the economies, it was recognized, would have to be adjusted to a changed international environment and a globalizing world economy so that the countries concerned could economically survive. Often, this implies not only 'adjustments' within existing economic systems to changed environments and circumstances, but indeed a *systemic transition* from one *type* of economic order to another, as is most obvious in the case of the Central Eastern and Eastern European 'transition countries', including Russia. It is probably not exaggerated to state that, in terms of international co-operation and in terms of the financial resources spent throughout the world, these efforts of structural adjustment are unprecedented in the

history of human life, an immense effort for the sake of economic development. Thus, the relevance of the context in which this study is set is beyond debate.

Considering this context, the only possible assumption, on a most basic level, is: If such efforts have been taking place for more than two decades, some *broad trend* should by now be recognizable: How did structural economic adjustment influence the path of development of the implementing countries? While ‘final results’ may, admittedly, not be expected from something that is still in process in various parts of the world, two decades should be time enough for first characteristics to surface. Of course, it is impossible to empirically assess the impact of structural adjustment on economic development for all developing regions. Here, the Arab world is singled out for examination. Economically, this region provides a wide variety of ‘systems’ or orders as regards the legal and institutional frameworks, the countries’ respective levels of development as measured in per capita income, and of economic structures in terms of the weight of economic sectors and their respective contribution to the generation of the *gross domestic product* (GDP). By choosing four individual cases for in-depth examination, this study claims to be representative for the region as a whole (see Chapter 4).

## The Puzzle

The Arab world is one of those Third World regions that, with remarkable delay in comparison to others, experienced and still experiences liberal economic adjustment policies of the kind described above. There is no Arab country that has come to an end in reforming its economy; independently of the depth or pace of reform; as will be shown, the adjustment processes are continuing throughout the region. This is convenient for researchers since it allows them ‘live’ observation, but it is inconvenient because it seems hardly possible to find ‘concluding remarks’.

A first glance at the Middle East and North Africa demonstrates that structural adjustment has taken place to various degrees and with some difference in timing, sequencing and *tempo* in virtually every Arab country since the late 1980s. What is amazing, however, is that even a brief look at economic development in the Arab world shows: There is no such broad trend as mentioned above: After two decades of economic reform in Arab countries, no general tendency can be recognized as concerns prospects for development. In fact, it seems that economic development takes place or not according to some unknown logic that works according to laws independent of the economic policies of reform that have been implemented. As the empirical part of this analysis will demonstrate, some states have enjoyed high growth rates, others have not. Some states have witnessed both. Some economies have performed better during the 1990s than during the 1980s, some have not. Some have been considered ‘successful’ in their efforts at reform, others not. Some have,

within a few years only, been considered to be both ‘successes’ and ‘failures’ by the major international donor organizations. If ever there is a common denominator, it would most likely be that those who designed and implemented structural economic reform in the Arab world have come to find out: ‘Somehow, it did not work out the way we thought it would’ – a statement by one expatriate of the developmental business community in Jordan, but applicable to every country in the region that underwent liberal economic reform. How come?

For none of the Arab economies, any answer to the question of how exactly structural economic changes have influenced overall economic development on a long-term basis can be given. Regarding the region as a whole, the desired effects of structural adjustment, namely to spur development in a similarly structural way as has been the character of adjustment, cannot be proven. Considering the magnitude of efforts undertaken by national governments, international organisations, multi-lateral agencies and governments from outside the region, mainly from the Western hemisphere, this is a most striking fact. The *broad trend* mentioned above, the trajectory that should have become apparent after two decades of liberal reform, seems hard to trace; it may, in fact, not exist at all. It is one of the tasks of this study to demonstrate this empirically for the Arab world.

The most basic, hardly ever contested and common assumption that policies are based on and which most of the academic literature on development in the Arab countries are based on is that rentier economies (or even socialist systems) are being liberalized to become market economies. However, despite thousands of policy papers, sectoral and country assessments and evaluations that have been written and conducted for years by hundreds of experts, the incredible and startling, yet simple fact is: The logic of structural reform in the Arab world, or rather: the question of long-term developmental impacts of structural adjustment, remains unknown. Even worse: if the results and impacts of systemic changes to the economic orders are unclear, economic policy-making with the aim of generating sustainable economic development is extremely difficult (as the reader will realize, I am trying to avoid the term ‘erratic’) and cannot be said to be anything else than a highly hazardous enterprise. The present book aims at eliminating at least some of these uncertainties, and, I hope, some of the more essential ones that have all too long been neglected. It will deconstruct the almost consensual assumption of a ‘market transition’ mentioned above, and suggest an alternative framework for the analysis of economic policy reform in the Arab world instead. This theoretical approach is designed in a way that should also allow us, on a qualitative level, to draw conclusions about future development prospects of the Arab economies emerging from structural adjustment, as well as reflections on possible policy recommendations and possible shifts in the priorities of the major development co-operation agencies.

## The Implications

How can ‘sound’ policies be designed when it is not known what the content of ‘sound’ actually is? True, we do have some idea about certain aspects and local causalities that are at work in the context of liberal economic reform. For instance, welfare losses caused by corruption are likely to be reduced if an efficient system of accountability, transparency and effective mechanisms of sanctions are introduced. Unemployment will most likely rise, at least temporarily, if former state owned enterprises (SOE) are privatized. Differential rents are likely to decrease in case structural heterogeneity is reduced and a greater degree of economic independence from the mineral resources sector is reached. However, there is a second range of questions that awaits us once we accept these first answers: How is it possible to introduce transparent processes and accountability where corruption seems endemic? Are the said rises in unemployment a permanent or a temporary result of privatization? What does this depend on? Can it be economically desirable at all to reduce dependence on the oil sector when this is where countries have their comparative advantages?

In order not to raise too high expectations, it must be said that the aim here is not to find answers to all of these questions, and the hundred others of equal relevance that are not mentioned here. Rather, I try to present a political-economic model that helps to better understand the ways the Arab economies perform, and to understand the directions in which they change. Only with a better and more comprehensive understanding of the principle ways along which today’s economies in the Arab region work, I would maintain, there is a possibility to reach conclusions that, in their turn, allow for a coherent assessment of the political needs and deeds that should be sought for.

Yet, the overall inter-relation of structural adjustment and economic development is of course far too complex to be expressed in simple terms or any ‘master formula’. Therefore, there is a need to go beyond economic policies and day-to-day politics, to climb the step unto a more conceptual level, painstaking as this process may be. The fundamental questions to be addressed – and answered – are: *What economic orders are changed in what ways by structural adjustment, and what kinds of economic orders emerge from such systemic changes?* While these are purely theoretical questions, it is evident that without answering them, our understanding of what is currently being done by ‘structural adjustment’ will remain deficient, and so will the policies that are designed and implemented. Answering these conceptual and most basic questions is thus of primary practical importance – not only (and, from my own personal view, not even primarily) for decision-makers within and without the Arab world, but for the hundreds of millions of people in their everyday life. In this very basic sense, I admit that it is in fact an emancipatory approach that I am pursuing here.



## Methodological Background: How Can Answers Be Found?

Economic orders are one part of the complex fabric of human societies that determine the characteristics of a specific area of human interaction on a macro- and micro-societal level. Of course, I am speaking about the production, exchange and distribution of goods and services. But apart from goods and services, economies produce relations between human beings with everything that involves. To understand this fact and take it into account is not of lesser, but rather greater importance than applying econometric models in order to understand the functioning of economic actions and transactions. As such, like any other sphere of human action and interaction, economic interaction is at the heart of social science, since it is the human being with its interests, preferences, and strategies that shapes the economic behaviour of human beings towards other humans. The market-place is not a neutral sphere where supply and demand, and thus the price only, matters. Far more, it is, like in any other issue area of politics, the relative distribution of resources and power that determines bargaining positions and economic outcomes. Thus, when talking about structural adjustment and its results, we are talking about a genuinely *political* issue and genuinely *political* conflicts over positions, resources, their distribution, and – ultimately – power as the heart of politics. Since these characteristics of human interaction are first and fundamental prerequisites of understanding economic processes, any analytical approach that neglects them will inevitably fail to produce reliable results.

## The Results

The results of this study suggest that many (though not all) of the former statist, rentierist economies in the Arab world are thoroughly being transformed into economic systems that are different in type from the former. This is so because many of the Arab rentier economies were no longer viable in a world of rapid globalization and a structurally decreasing oil price. Some of the oil-rich economies can afford to maintain the rentierist mode of development for the foreseeable future while the non-oil economies had to rely on ‘early’ (for this region) adjustment. Ultimately, however, all the Arab world will be integrated into a world economy that grants Third World systems an ever decreasing leeway to pursue their own national economic priorities or ideologies, but rather face the challenge of global economic integration without any real alternative.

In essence, what is presented here is the conceptualization of a type of capitalism that seems to apply today to most of the Arab world. However, the aim pursued here is not limited to the Arab world. Rather, as is outlined in Chapter (12), what is called ‘patrimonial capitalism’ here can most probably be found in other developing regions as well.

I will then, in part two, sketch out the path of development four selected Arab economies have been taking since the late 1980s. Secondly, the state of their economic performance after more than a decade of reforms is analyzed in order to evaluate overall developmental prospects for the economies chosen as cases. The goal of this empirical part is not to prove or verify the viability of the model of patrimonial capitalism in the strict sense of model-testing. However, it should be helpful in providing some indicative evidence to *support* the model presented.

Part three then outlines the analytical concept of what I call ‘patrimonial capitalism’, its constituting elements, the conditions of its existence and survival, as well as its relations with and differences to the ‘Western’ type of capitalism that is much more familiar to the reader from neoclassical readings. It examines some of the implications that this type of capitalism brings about for the concerned countries’ future economic prospects, for their possible survival in an ever more globalized world, and for the formulation of donor strategies and the policies pursued by the states’ incumbent regimes.

The core argument can be depicted in three steps: (1) somehow, the Arab economies all have become capitalist, but at the same time, they all failed to behave as analysts would expect capitalist systems to do. (2) There are three interrelated reasons for this: First, the financial crises of the state that hit the whole region in the late 1980s; second, the subsequent collapse of state-led growth ideologies in the Arab republics; and third, the selective implementation of liberalization policies in both monarchies and republics affected by the crises of the 1980s. (3) These factors explain the emergence of a variant of capitalism that is qualitatively different from Western-style market economies: Patrimonial capitalism.

To assume that the historical, economic and political experience of the Arab countries had no repercussions on the development of their economic systems would be naive. In this sense, the paper seeks to explain the differences that have become apparent in the course of the past decade between market economies and patrimonial capitalism. The aim is thus a conceptual one. The fact that economic liberalization as pursued in the Arab states brings about non-market orders leads to quite different conclusions from those we reach when we assume that liberalization is a universal and uniform process that leads to liberal market economies everywhere on earth. Therefore, the findings are bound to be not only of theoretical, but also of practical relevance.

Economics, political economy, and political science rarely deal with such systemic considerations on economic systems; thus, part I of the book, the analytical framework, is not primarily meant to be an overview of methodological literature, but is exploring new ground in order to be able, later on in part III, to suggest a – preliminary – framework for analyzing and comparing economic systems in the region (and beyond) beyond the dichotomy of capitalism vs. socialism. While the rentierist type of non-market economies that has dominated the Arab world since the early 1970s survives on much of the Gulf peninsula, recent years have seen patrimonial capitalism emerge as a different type of non-market

economic order in the Maghreb and Mashriq regions alike. Finally, the book inquires into the characteristics as well as the developmental potential of patrimonial capitalism and thereby analytically distinguishes it from both market economies and rentier economies.

In the following paragraphs, I give a short overview on the organization of the book for the reader with a more explicitly academic interest: What are the variables (independent, intervening, dependent), how are they interconnected and what are they needed for, what underlying assumptions are guiding the analysis, and in what way do I proceed in the following chapters?

In order to enter these basic methodological considerations, let me get back to the initial empirical observation that the Arab world's economic performance lags greatly behind what had been expected as outcomes from one and a half decades of structural adjustment. "Why has it not worked out the way we thought it would?" is the question that is asked by Arab and Western politicians alike, by development practitioners and their bi- and multi-lateral agencies, as well as by the international financial institutions when it comes to judging the results of economic reform and structural adjustment programs in the Middle East and North Africa. Along with questions about the (im-)possibilities of political regime change, this probably represents the most intriguing puzzle with regard to the Arab world since the late 1980s, and it is the one that will be answered in this book. The ready-made recipes of liberal and structural economic change as prescribed by the Bretton-Woods institutions and by Western donors since the late 1980s, and as embraced by Arab governments to a greater or lesser extent, have structurally altered the Arab economic systems, but they have not altered economic outcomes in terms of the development prospects of this world region in an equally structural way. In other words: The seeds of structural adjustment that the Bretton-Woods institutions and others had sowed in order to grow market economies did not dry up in desert sands, but the plants that are growing today look significantly different from what had been expected as crops.

In yet another picture, the problem I address here is, in essence, a very simple one: Before prescribing a recipe, a thorough and reliable diagnosis has to be made – a diagnosis that, in the case of the underlying causes for weak or, at best, wobbling Arab economic performance is still lacking. It is this diagnosis (Chapter 10) that is the main aim of the book, whereas only preliminary reflections on possible ingredients of a remedy can be advanced here (in Chapter 13). The diagnosis in itself, however, shows that the medicine which has been prescribed to date can not bring about the desired overall recovery of the 'patient', that is bringing Arab and other Third World countries on a track of sustainable development for the long run.

In countless discussions, policy-makers, diplomats, development-practitioners and academics with practical experience in the region usually refer to the importance of issues such as corruption, to what has fashionably come to be called 'good governance', to the role of crony capitalists, to inapt institutions and legal settings, and the like. All of these issues are,

to be sure, pertinent and point in the right direction in that they hint at the importance of socio-political factors in the explanation of economic outcomes, but a coherent frame to analyze and explain them in an integrated fashion as the results of structural adjustment policies is missing.

Here is how I proceed: The central assumption of the book is that political-institutional arrangements and systemic socio-political settings may not necessarily *determine* economic outcomes, but they certainly *shape* them decisively. Therefore, an analysis of these independent variables should help us in explaining concrete economic outcomes. As time passes, however, variables tend to change or assume values different from the initial ones, and intervening variables tend to pop up.

In our case, the *independent variable* is the different types of socio-political systems and their respective economic orders in the Arab Middle East and North Africa as they had existed before economic reform during the 1970s and 1980s. Here, the most important observation to start with is that pre-reform Arab political and economic systems differ enormously in most important respects: demography, size, geographic location, geo-strategic importance and, as a result, the level of influence external actors can wield in their political and economic affairs, types of political regime, ideological orientation, the level these countries are endowed with extractable natural resources, economic potential, economic structure and relative importance of economic sectors. The one factor that is common to all of them and that, in fact, makes them comparable is the mode of societal organization which is predominantly informal, personalist, strictly hierarchical, and characterized by the pervasive existence and importance of patronage networks and clientelism throughout the region. All Arab countries display neo-patrimonial *social* forms of organization that are often, but not always matched by equally neo-patrimonial forms of personal *political* rule (Algeria and Lebanon are the exceptions). The research design and case selection thus follows a most-different-cases logic of comparison, with only one of the examined variables as a common denominator (cf. Sartori 1970, 1991). The Arab states have roughly been classified here into four groups according to their political (republican vs. monarchical) and economic (resource-rich vs. resource-poor) bases prior to structural economic reform (i.e., the early 1980s), and from each group, one case is chosen for closer inspection in Chapters (6) through (9). Obviously, it is not possible to conduct an in-depth examination of each case as would be feasible in a single-case study. Chapters (6) to (9) thus serve illustrative purposes rather than constitute hard tests. On the other hand, four countries is a rather small number in order to claim to be representative for the region as a whole. Therefore, a justification of case selection is imperative for the reliability of results, as is the question of what issue areas to look at.<sup>1</sup>

The *intervening variables* here are economic crisis and the subsequent implementation of economic reform and structural adjustment programs (SAPs). To be sure: Not all the Arab states were forced to embark on SAPs; the traditional oil-rentier states of the Gulf peninsula

such as Saudi-Arabia, Bahrain, Oman or the United Arab Emirates, too, were hit by the region-wide economic crisis during the second half of the 1980s, but due to the abundance of exportable mineral resources they were able to avoid succumbing to externally designed reform programs. This group of states is needed for comparison with their less well-endowed sister countries, but does not in itself represent a testing case for the effects of structural adjustment. However, it does represent an important category of cases since they can serve to examine the course of development without the influence of one intervening variable. Thus, the degree to which the intervening variables (economic crisis and – in many, but not in all cases – structural adjustment) impacted upon the course of the Arab economies depends on the level of natural resources they possess: The greater the level of resources in a given countries, the lesser the degree and depth of economic reform have been (cf. Beck and Schlumberger 1999).

The second step is to look at what the results of structural economic reform look like. Our *dependent variable*, therefore, is the *type of post-reform economic order*. It makes sense to look at economic orders as a dependent variable because different types of economic orders have different prospects for development (see Chapter 13 for details). Empirically, it can be observed that policy reforms in specific issue areas sometimes do, but sometimes don't trigger the desired or expected output changes and performance effects that were assumed by the reformers, depending on the structural, political, institutional and economic environment in which they are set. The macro-systemic level is therefore of decisive importance for viable statements on overall developmental prospects. Hence, a correct assessment of the structural pillars of an economy is essential also for reliable prognosis on future prospects as well as for any suggestions on how to enhance them.

According to the general logic of most-different-cases comparisons, we should expect multiple and diverse pathways and outcomes of processes of economic reform that have now lasted for more than fifteen years. As figure (0.1) below demonstrates, the outcomes of structural reform as regards the newly emerging economic orders in the Arab world do not confirm this assumption. This finding can only be explained by a variable that is common to at least all those cases that display similar post-reform results. I argue here that it is the predominant mode of societal and socio-political organization that has perpetuated itself despite structural economic change and despite the fact that structural adjustment policies always have a profound impact on the existing social fabric in any given society.

Socio-political arrangements as well as institutional settings, however, are crucial for the realization of economic potential (see Chapter 2); sustainable development can not be achieved unless policies and reform strategies take into account the socio-political soil upon which they fall. One major point demonstrated in the present book is that economic reform programs as formulated by Western and international organizations and implemented by Arab governments have hardly ever acknowledged that fact.

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<sup>1</sup> The full explanation of this four-fold matrix, as well as the justification of the cases selected from each

Since it is not an economic, but a socio-political variable that has been found to be of paramount importance in the outcomes of structural economic reform, I call the type of economic order that has emerged in a number of cases in the Arab world through structural economic reform *patrimonial capitalism*.<sup>2</sup> The term implies both that structural change from a rentier type of economic organization towards capitalism has taken place, but that – contrary to our assumptions – it have not been Western-style market economies that have been created in the Arab world. This is not to say that all Arab economies have changed in type or that all of their traits had significantly changed. However, I do maintain that it seems more useful today to look at the economies concerned through the lens of the model I present in order to think about further reform strategies. In Chapter (11), steps towards a definition of this type of economic order are presented.

In order to avoid misinterpretations, it seems important to stress that the evolution of patrimonial capitalism is, as I argue in Chapter (12), not unique to the Middle East, but has also emerged as a pattern of structural economic change elsewhere in the world such as in Eastern Europe or in the Far East. The line of argumentation I pursue here is therefore neither culturalist nor built upon assumptions of Middle Eastern exceptionalism, but strongly holds that economic development in the Arab world is comparable to developments elsewhere in the world. In fact, one of the central aims of this book to present a concept that should be able to ‘travel’, that is: to be applicable to other areas. Developmental prospects for these new economic systems that evolve today in a large number of Arab countries are discussed and tentatively assessed in Chapter (13), before reflections on possible strategies to address their weaknesses are made.

Although it might look somewhat banal, figure (0.1) below might help as a visualization of the core argument of the book. Note that no change in the type of economic *order* occurred in those cases where structural adjustment could be avoided. This does not mean that no important economic changes had taken place in these cases or that their long-term prospects for welfare and economic development had not altered at all over the past one and a half decades. However, it was not SAPs that have impacted on these economies, and it is not the typological question of orders which is at stake in such cases.

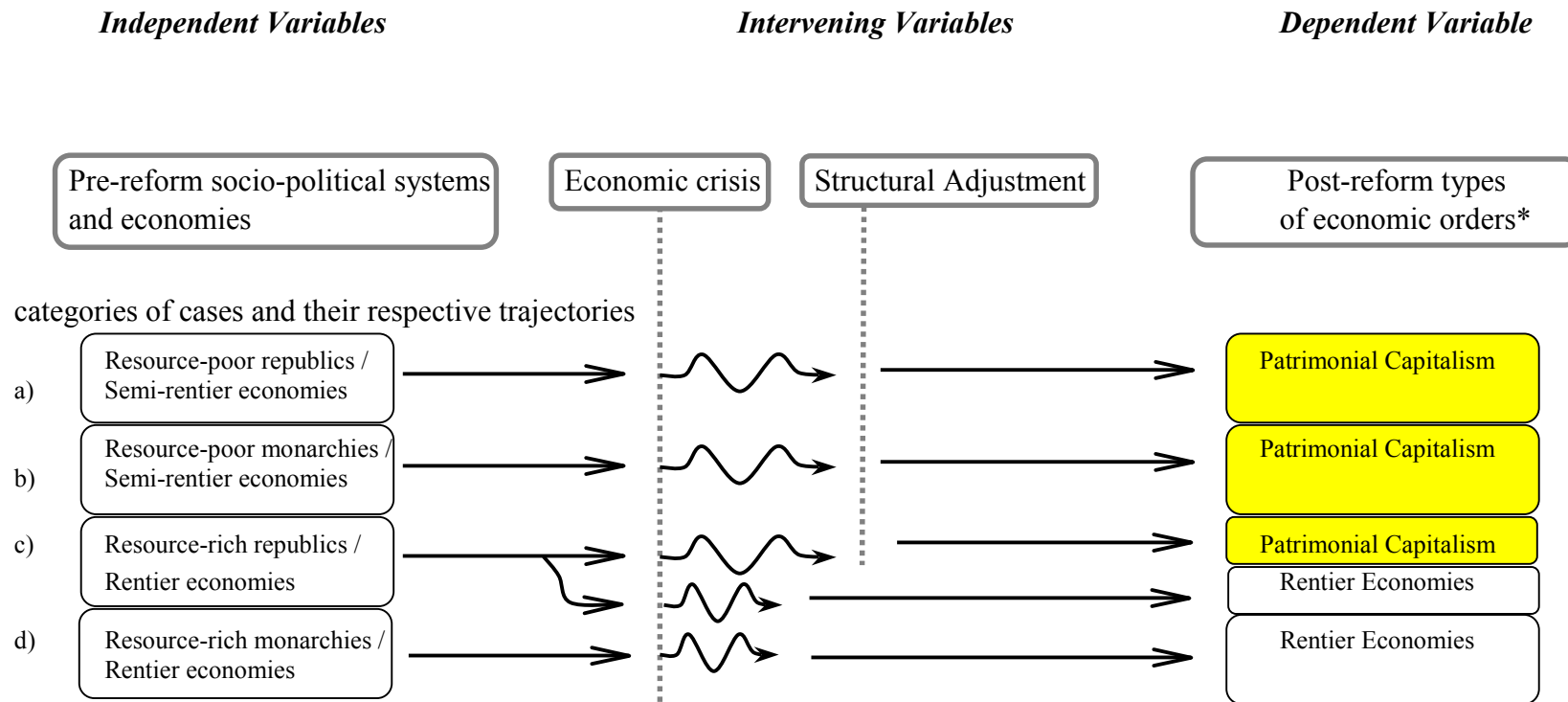
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category and the issue areas to be examined, can be found in Chapter (4).

<sup>2</sup> I have first used the term in this sense in a paper on “Socio-Political Obstacles to Economic Reform in the Middle East: The Syrian Case”, presented to the 4<sup>th</sup> annual conference of the *German Middle East Studies Association* (DAVO), in December 1997, Hamburg, Germany. I re-adopted it in a revised and expanded meaning in a background paper prepared for the 7<sup>th</sup> annual conference of the *Economic Research Forum on the Arab World, Iran and Turkey* (ERF), October 2000, Amman, Jordan, and in a 2002 contribution on “Transition



Figure 0.1: PROCEDURE OF ANALYSIS: STRUCTURAL ECONOMIC CHANGE IN THE ARAB WORLD, 1980s – 2000s



\* as an indicator for long-term economic performance prospect



As can be seen, categories (a) and (b) are the relatively resource-poor countries, while (c) and (d) represent their resource-rich sisters. In both (a;b) and (c;d), we find traditional monarchies as well as (formerly socialist) republics. If political-institutional arrangements impact on economic performance (and maybe also on economic policies), we should expect this difference to be reflected in the outcomes of structural adjustment processes. However, the findings presented in Chapter (10) indicate that this is true only to a very limited extent. Another observation becomes clear in figure (0.1): While, among the oil-rich countries, all group (d) countries were able to avoid structural adjustment altogether, this holds true only for some of the countries in group (c) which is split between those countries that underwent structural adjustment in the course of the 1990s on the one hand, and those that did not on the other. Why some of them did and others did not is discussed in Chapter (10) which can be regarded as a summary of the empirical Part (II) of the book.

While the design of this book and its goals seems rather of theoretical interest at first glance, it should also be clear from what has been said by now that the results entail important practical implications: Dozens, if not hundreds of millions of people in the Arab world are dependent, for their better or worse, on the soundness of economic policies initiated by their governments. Numerous bi- and multi-lateral institutions and international organizations have advised these latter ones in policy-design and –implementation. The present study should therefore be of interest not only to those involved in development practice or policy-making, nor to only those who take an interest in theoretical questions or those who are specialized in Arab affairs. In a sense, it is hoped that its relevance to all those economists, political scientists, and development practitioners and politicians who are involved in questions concerning economic development, institutions, developmental policies and political economy in non-Western countries.

# Part I

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## Analytical Frame: What, Why, and How?

# Chapter 1

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## Where We Are, and Where to Go To: The Study of Economic Reform in the Arab Middle East

Despite its geo-strategic importance at the crossroads between Asia, Africa and Europe, despite its economic importance as the world's most abundant reservoir of hydrocarbons, and despite its political relevance as one of the most prominent areas of virulent conflict in the international system, the Arab Middle East attracts a lesser number of scholars of the modern social sciences than other developing regions. After the creation of the *Organization of Petroleum Exporting Countries* (OPEC) and the 'oil price revolution' of 1973/-74, heightened consciousness about economic and political structures of the Middle Eastern sub-system took hold in the West, mainly in the USA where a number of university departments and research centers were either newly founded or expanded. However, in the academic community, the Middle East has always played a subordinate role in the disciplines of international relations, comparative politics, political economy, and economics, when compared to the Far East, to Latin America, or to Eastern Europe. One of the reasons for this phenomenon certainly lies in the fact that economically, the circuits of petro-dollars that still shape the overall picture of the region have long been sketched out, and not much news had been heralded between the 1970s and the late 1980s. On the political side as well, Arab countries have not been appealing to students of comparative politics because of their seemingly eternal pattern of 'oriental despotism' (Wittvogel 1957) that had been ascribed to the Arab world for decades.

Since the late 1980s, however, a new and undeniable dynamic has changed the face of virtually all Middle Eastern countries and their economies to an extent that an imaginary visitor who had last seen the region in the early 1980s would hardly recognize the countries today, and this is, at least in part, reflected in the fact that scholarly interest in the region rose – albeit not to any level that would equal the interest economists take in South East Asia or Latin America – and that the subject of economic reform, along with its political implications and repercussions, clearly dominates the literature that has been published since the second half of the 1980s.

Hit by a severe region-wide economic crisis in the second half of the 1980s, every single country in the Arab world has been forced to reflect on and re-design its economic strategies and policies ever since. With a view to other developing regions, of course, this is

nothing new: The powerful global trend towards structural economic change had finally reached the Arab world – several decades later than East and South East Asia, over a decade later than Latin America, and round-about the same time as Eastern Europe and Central Asia. However, while economic consolidation was progressing quickly in Central Eastern Europe and several former Warsaw Pact countries are now integrated into an enlarged European Union, the Arab Middle East still struggled with the Bretton Woods institutions about policy-implementation, about conditions, about amounts of loans and aid and about the proper timing and sequencing of policies. What is worse: There is still no developmental take-off in sight (cf. Henry & Springborg 2001 [Chap. 2]; Kingston 2002; Schlumberger 2002d)

Some countries, such as Jordan or Tunisia, have seemingly embraced the recommendations by the international financial institutions wholeheartedly, trying to cook according to their recipes as closely as possible, and have been hailed by donor institutions as success stories in return – remaining structural economic problems notwithstanding (see Schlumberger 2000b; Pfeifer 1999a; 1999; Murphy 2001; Bellin 2002). Some other countries, like Egypt, have been half-way accompanied through structural adjustment by the international institutions, but then even chose to end such close cooperation with the IMF (Kienle 2001; Mikawy & Handoussa 2001; Weiss & Wurzel 1998). Yet others, such as Libya or Syria, have long been cautious enough not to entertain such relations at all (see Perthes 1995; Wils 1997; Niblock 2001; Vandewalle 1998). To them, their own government's sovereignty and freedom from imposed conditionality was more important than the institutions' expertise. The Arab Gulf states as a fourth group of countries are so well-endowed with natural resources that they never felt any need to structurally reshape their economies. To them, austerity policies in times of low world oil prices seemed enough for economic survival, even though in many cases they adopted at least parts of the Bretton Woods *rhetoric* of reform (e.g. Chaudhry 1997). Thus, both the depth and timing of economic reform as well as the respective relations with advising international organizations vary greatly from one Arab country to the next.

Together with the limited political liberalization some countries had temporarily experimented with and which caught the attention of numerous scholars, these processes of structural economic reform certainly represent the most important change to the picture of the Arab Middle East during the last decades of the twentieth century. But unlike the experiment of political liberalization (which has not occurred in all countries in the first place), structural *economic* adjustment in the Arab world can today be said to *have* had a long-term impact on the developmental course of the Arab world, on their economic structures, as well as on the socio-political fabric of the countries concerned.

Academic analysis of these processes of economic reform in the Middle East has been conducted mainly by representatives of two disciplines: Economists, assessing the ongoing dynamics of reform from within the discipline of economics proper, and political economists and political scientists on the other hand, who have written with a focus on the 'political

correlates' (Ayubi 1992), inter-relations, preconditions or consequences of economic reform policies, i.e. from a political economy perspective. Works of both currents taken together are numerous today, and it could be asked with good reason: 'Why yet another book on economic reform in the Middle East?'. The reason is simple: The literature that exists to date is fundamentally deficient in various respects and on various levels. A brief review of these two currents will help in identifying where exactly these deficiencies lie, and to what extent the present analysis might help in overcoming them.

## Economic Literature

Economic literature aiming at a more profound understanding of the economic crises in the Arab world rather than giving *ad-hoc* recommendations to Arab governments began to emerge at around the late 1980s / early 1990s. Ever since, a considerable *corpus* of literature on the subject has been published.

This body of economic literature can be distinguished on a first level according to its respective origins: First, there are the countless policy papers authored by analysts of the think tanks of international organizations such as the *OECD Development Centre* in Paris or the *World Bank Institute*, as well as from other major bi- and multilateral agencies that operate as distributors of development aid in the region (*USAID, GTZ, DANIDA*, etc.). Most of these are economic or technical papers that examine the extent of reforms necessary, their sensible timing and sequencing, and compare these exigencies with the real course of events within the Arab world, with new recommendations as conclusions. This literature often focuses specifically on certain economic sectors such as information and technology, agriculture, tourism, hydrocarbons, etc., or else on certain distinct aspects of structural adjustment and stabilization such as deficit financing, interest rate development, tax reform, trade liberalization, private sector development, the promotion of small and medium-sized enterprises (SME), public sector reform and privatization, and many others more. Thus, this is research that aims at providing concrete policy recommendations resulting from possibly detailed findings in one or two issue areas.

Second, there is a growing number of research papers and some edited volumes from research institutions within the Arab world. These, too, are often practically oriented and either explicitly or implicitly choose a policy-advising focus. The most prominent example without doubt is the *Economic Research Forum for the Arab Countries, Iran and Turkey* (ERF) in Cairo that is co-financed by the World-Bank and acknowledged by the Egyptian government, but others, like, for instance, the semi-governmental *Emirates Center for Strategic Studies and Research* (ECSSR), the *French Centres d'Etudes et de la Recherche sur le Moyen Orient* (CERMOC) in Beirut and Amman, the *Centre d'Etudes et de la Documentation Economique et Juridique* (CEDEJ) in Cairo do exist alongside other, more

country-specific institutions such as the *Egyptian Center for Economic Studies* (ECES), the *Centre for the Study of Developing Countries* at Cairo University in Gizeh, the *Center for Strategic Studies* (CSS) or the *Urdun Jadid Research Center* (UJRC) in Amman. Others yet are closely related to the state, as is, for example, the *Conseil National Economic et Social* (CNES) in Algiers, even though they do enjoy a certain amount of independence in their research activities as long as it is considered ‘technical’ by the ruling elites. Most of the output of these institutions is as specific as the one originating from the Western institutions mentioned above: single-case studies dominate, and often, these single-case studies are even restricted to sectoral analyses in one country.

Some of the locally published work reflects on the course of economic reform in a specific country. Such tasks are regularly assigned to the country’s most eminent economists who are often policy-makers or –advisors themselves, as has been the case on several occasions in Egypt and Jordan. This obviously poses problems as regards the independence of those who produce results and engage in research. Other papers try to provide comparisons, but in those cases, the fields compared are restricted to single issue areas or economic sectors.

Apart from these rather practical reports and papers, and the few edited volumes and books from within and outside the MENA region (e.g., Weiss and Wurzel 1998; Shafik 1998 and 1998b; Glasser 2001; Rivlin 2001), there are Arab and Western economists and political economists who have worked on the subject for many years and who have sought to contribute to a better understanding of the ongoing dynamics of economic change. Here too, however, it is remarkable that sectoral and single-issue studies that focus on one aspect of the reform process dominate the scene.

Two points are most amazing with regard to this economic literature on the Middle East over the past decades. First: Until today, there are hardly any comprehensive analyses that take any other theoretical background than neoclassical theory. In fact, despite the forceful critique that has recently been formulated by an increasing number of adherents to relatively new currents in economic theory and which stress the relevance of transaction costs, organization, property rights systems, contractual arrangements and their enforcement, and information (notably in the works by Eggertsson, Furubotn, Libecap, North, Weingast, and others), the neoclassical approach still enjoys considerable attraction when it comes to the study of developing regions, and contributions that are based on even slightly diverging theoretical backgrounds are still an exception.<sup>1</sup>

As to the study of Arab stabilization and structural adjustment, orthodox economics, including the assumptions of the general equilibrium model with all their acknowledged weaknesses, still serves as a hardly challenged paradigm in the Kuhnian sense (cf. Kuhn 1962). For the vast majority of economists who work on the Middle East, information is, by

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<sup>1</sup> See, for instance, the volume on *The New Institutional Economics and Third World Development* edited by Harris, J.; Hunter, J. and C.M. Lewis (1995) that even contains one case study on Egypt. However, this chapter

definition, symmetric and perfect on all sides, transacting is defined as being voluntary in all cases and, moreover and more importantly: as being costless; so is the measurement and enforcement of individual economic rights as well as the process of building institutions and organizations. Even externalities are often ‘defined away’. Symptomatic for the state of economic research on the Arab Middle East, there is only one book I know of that explicitly focuses on ‘*economic theory underlying adjustment policies in the Arab world*’ (Tahir 1997). Symptomatically again, there is no reference made in that volume to any theoretical literature other than what is referred to as the ‘Chicago school’ - let alone to alternative approaches that have developed over the past two or three decades in economic theory and that seek to alleviate some of the problems of the neoclassical model by integrating new partial findings in areas where basic assumptions of mainstream theory suffer from serious shortcomings. Likewise, Euchner (1995) recognizes that the state is necessary as a ‘visible hand’ and acknowledges that ‘a new “mixed-economy adjustment” [is] required’ (1995: 42). However, for him, too, ‘the “mixed-economy” merely corrects market-failure’ (ibid.: 43). As I will argue in the next chapter, these efforts to maintain a basically neoclassical approach in analyzing and designing economic policy reform in developing countries represents a major methodological deficiency – especially as regards possibilities of viable policy recommendations in non-market economies as they prevail today throughout the Arab world.

Second, there is an obvious lack of comparative studies. While the benefits of comparative methods in the social sciences are beyond doubt, it is surprising that the vast majority of authors seems to neglect this and rather focuses on either single-country studies or on single-sector analyses. What is needed, though, in order to discern any region-wide patterns in the course of economic policy reform in the Arab world, would be a comprehensive (in terms of issue areas) *and* comparative approach to the study of economic reform in this part of the globe. It is this lack in studies that present overviews and choose a genuinely comparative approach which is amazing. Unfortunately, most of the economic literature on reform in the MENA region remains as much piecemeal as the implementation of reforms themselves. What is missing is a truly comparative and comprehensive study that assesses similarities and differences in the outset, implementation, and with regard to the results of liberal economic change across the region. This, in turn, is a *desideratum* because only then will we be able to compare the outcomes of economic reform in the Arab world with those in other developing regions.

Third, there are some commercial rather than academic journals that report on news in this field (such as the *Middle East Economic Digest* and others). They mostly publish four to five-page reports the value of which lies in the topicality of information. What they do not provide, however, is in-depth analyses of policies and their impact on economic structures, institutions and the mechanisms according to which the Arab economies work, on politics, or

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is by an author who cannot be considered an expert on non-neoclassical economics. Another more general example, but with no mention of the Middle East, is by Dutt, Kim, and Singh (1994).

on society on a macro-level. They are extremely useful in order to gain a quick overview of the current state of any given economy, but they neither analyze liberal reforms as a process that by now has lasted for one and a half decades, nor do they provide much insight into the 'hows' and 'whys' of individual states' practices and the political reasons that lie behind their timing and sequencing of reform measures.

Despite the fact that the body of literature is large, therefore, one cannot but state its deficiency in various respects. While this seems strange at first sight, there are reasons for this state of affairs which make it less astonishing: That economists who work on the MENA region have, by and large, not seemed to take any specific interest in revealing structural socio-political patterns that underlie economic policy formulation is understandable since most economists working on the region tend to have a rather 'narrow' view of their discipline and strongly adhere to orthodox theory. Second, many of them live inside their Arab home countries where academic output is tightly controlled and where analytical work that takes into consideration socio-political backgrounds, let alone causes for meager performance is, to say the least, strongly discouraged. Some economists have successfully been co-opted by their governments and write for (semi-)governmental institutions and organizations so that their capacity to conduct research on the political determinants of economic processes is restricted by the structures within which they are established.

Third, there are Western economists who work on the subject of liberal economic reform and structural adjustment in the Arab world. Their primary focus is on quantitative methods as normally applied in economic research on industrialized countries. The problem is that data in a Middle Eastern context are mostly less reliable, and in any case not reliable enough to allow for significant results and practical value when they solely rely on quantitative methods that presuppose an exact, reliable and up-to-date data base. In many cases, such accurate information simply does not exist, and therefore, results can be quite misleading.

The quality of statistical data on the Arab countries is generally poor when compared even to other developing regions. Internet sources are hard to tap and, as a rule, not in line with international standards; in case they do exist, they are often outdated, insufficient, incomplete, or incompatible with international standards and units. Field research can help to some extent, since it allows scholars to access country-specific and otherwise unpublished or inaccessible material originating from international organizations (directly from their local offices - if such representations exist), from national government authorities, and from other institutions such as chambers of commerce and industry, statistical offices, local think-tanks, parliamentary committees, and the like.

Even when one engages in arduous field research, however, the quality of the existing data is in many cases highly dubious. The two main reasons are:

- Lack of commitment to transparency on behalf of the governments



Most if not all Arab governments find it useful not to disclose certain (and often vital) statistical data to the public and, at times, even to international organizations. The political necessity to adopt a secretive attitude towards certain fiscal chapters and transactions, to veil the origin and usage of certain types of funds such as oil revenues and others makes it extremely difficult and, in some cases, even impossible to carve out a clear picture of even the basic economic and financial developments.

- **Poor quality of statistical departments and lack of qualified personnel**

It should not be forgotten that most of the Arab world is to be counted among the developing world and is thus as much affected by the brain-drain phenomenon as other regions. Therefore, there is a general shortage of expertise in the collection, evaluation, compilation and timely publication of statistical data. Furthermore, the ‘Central Statistical Bureaus’ are mostly not independent entities, but part of the central governments and, as such, subject to both bureaucratic red-tape and political interference.

As a result of these observations, any information based on figures therefore continues to represent trends rather than accurate data, and the quality of the data that are available is often such that they inhibit any sensible application of quantitative methods. Yet, of course there is no way of avoiding the use of such data in a study on economic development. However, it must be stated clearly in this first chapter that any quantitative data has to be handled with greatest caution and, additionally, that in many cases, the application of quantitative methods such as regression analyses hardly makes much sense since the sets of data the researcher has to base his calculations on do not guarantee information accurate enough to allow for significant conclusions. A second consequence of this lack of reliable and standardized data is that comparisons are made extremely difficult. In many cases, data from one country are incompatible or even incomparable with those from another, which makes it hard to construct arguments based on comparative methods. The question is: What can or should we do instead? In the next chapter, I shall return to this question of how to achieve better or more reliable research results in an environment characterized by a structural lack of reliable data and by the fact that ‘the governments hesitate to unlock their economic secrets’ (Henry and Springborg 2001: 60).

In sum, literature originating from the discipline of economics proper that discusses economic reform in the Arab countries is rather rare when compared to the importance of the phenomenon and when compared to political science and political economy literature. In addition to that, it often tends to fall prey to one of the following fallacies: (a) lack of economically reliable research results due to the fact that scholars choose inadequate methods that do not match with the (poor) quality of available information, including ‘hard’ national and international data, (b) it is limited from the beginning either to single-issue or single-country studies, and (c) it is, when originating from the Arab world, often pre-determined by what is deemed politically desirable or acceptable for incumbent regimes.

However, this is but the smaller part of literature on the subject dealt with here. The larger body of literature on economic reform in the Arab world is written from a political economy perspective.

## Political Science and Political Economy Approaches

Political science contributions represent by far the more voluminous *corpus* from among the two strings of literature on the Arab world discussed in here. There has been a relatively large number of books that deals specifically with questions of liberal economic reform, often by discussing one country per chapter (see, inter alia, Hakimian & Moshaver 2001; Henry & Springborg 2001; Niblock & Murphy 1993; Harik & Sullivan 1992). However, such works are problematic insofar as they are often not truly comparative, even though they deal with different cases between the front and back covers of one book. What they generally lack is a common methodological framework of analysis for comparison that would allow at least the editors to *compare* cases instead of describing and analyzing each one of them as if no others existed. This is not to say that singled out analyses are necessarily of low quality – what is meant here is rather that they mostly lack any integrated approach that would allow scholars to draw cross-country conclusions. When concluding on the results, the successes or failures of economic reform, single-country experts then regularly risk to become trapped in parochialist judgements since they lack a comparative perspective, and they do so not only with regard to the international scene outside the Middle East, but often even as regards other countries within the region. Inter-regional comparisons which compare economic development in Middle Eastern with non-Middle Eastern cases (e.g., Waldner 1999), are still a rare exception. And even when they do exist, the subject of comparison is not structural adjustment policies and economic reform or economic orders, but economic development in a much more general and long-term sense (Waldner 1999), or somehow combined with questions political development, namely the famous old question of inter-marriage between democracy and market economy (Bellin 2002).

As in economic literature, single-case studies are much more numerous. In fact, case studies are abundant.<sup>2</sup> It is possible here to distinguish between an early body of literature that has, roughly, appeared from the late 1980s up to the mid 1990s. This earlier body tended to be descriptive, rather enthusiastic about the changes, and often normative in the sense that any

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<sup>2</sup> For most Arab countries, there are many – or at least: more than one reference that would deserve citation here (with the exception of the Gulf states, maybe). Suffice it to mention, as some important examples, Kienle (1994) and Perthes (1995) for Syria, Hinnebusch (2001) on Egypt and Syria; Kienle (2001), Qassem (1999) for Egypt, Brynen (2000) for Palestine, Tlemçani (1999), Werenfels (2002), and Dillman (1998) for Algeria, Murphy (2001) for Tunisia, Schlumberger (2002a) for Jordan, Dillman (2000a; 2000b) for the North African region, Lawson (2004) for the Gulf oil economies, Albrecht (2002) for Yemen, or Vandewalle (1999) for Libya. (Note that almost all authors mentioned here are political scientists by education, and none of them is an economist!).

economic change was seen as a positive sign that would help install functioning free market economies in the Arab countries.

This historically first part of the literature is important since these publications first assessed and described a then new phenomenon. They thus serve as a valuable reference for the early phases of reform processes while at the same time, they reflect a certain historical phase within this literature: euphoria about the reforms and a generally optimistic view on the economic and developmental prospects of the Arab countries clearly prevails in these works (Hopfinger 1996, Poelling 1994; many of the contributions in Harik and Sullivan 1992; some contributions to Niblock and Murphy 1993; Haggard and Kaufman 1992). This phenomenon is even more evident in the reports by the international financial institutions that had hailed the beginnings of structural adjustment in most Arab countries as ‘success stories’ early on. Maybe the most fascinating example for this string of literature is the 1995 book ‘Claiming the Future’ published by the World Bank, a little book that bears the funny sub-title ‘Choosing Prosperity for the Middle East and North Africa’ – as if the choice between poverty and prosperity was similar to the one between tea or coffee.<sup>3</sup>

Interestingly, however, both the literature on political liberalization and on economic liberalization and structural adjustment have taken similar directions over the 1990s: The early euphoria that saw democratization and market economies as some sort of a ‘natural’ development and the only possible outcome of both political and economic processes of change gave way to a much more sober attitude toward what ultimately the results of both dynamics might be (see, i.a., the more critical examples concerning political change *without* democratization: Kienle 1998; Hudson 1996; Schlumberger 2000a. On economic reform and its sobering, often non-market results: Schlumberger 2000b and 2002d; Henry & Springborg 2001). In view of actual developments that have taken place over the past, say, ten years or so, this second string of publications certainly has a more realistic outlook concerning future prospects for development.

Both ‘phases’ that literature has gone through have thus their specific merits, but they both of them are also deficient in various ways: The early contributions in so far as they fundamentally misinterpreted ongoing events and dynamics, the latter ones in that they somewhat corrected the wrong picture painted earlier, but did not manage to grasp on an analytical level what *was* actually going on if *not* democratization or the establishment of market economies. This newer part of literature, roughly published since the mid-1990s, rather stresses the shortcomings and perceived *deficiencies* of what was intended by the international financial institutions, but what did *not* happen during the checkered course of economic reform in the Arab world. In this sense, they are both normative, adopting as implicit goals Western standards and images of how an economy should be organized, and

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<sup>3</sup> See the contributions by Pfeifer, (1999a, 1999b) and Mitchell (1999) in *MERIP* for a critical discussion of such overly ‘optimistic’ judgements.

analytically deficient in that they state what went wrong, but less so what actually happened and where the Arab economies today stand. Outcomes are assessed only with regard to the initial goals, rather than independently of what Western donors and policy-makers would have *wished* to see. Typical areas of such ‘deficiencies’ include issues pertaining to governance, transparency, accountability, institutional change, public sector reform, privatization, the judicial system, the inequitable application of business laws or, in a wider sense, the rule of law, and the adverse social effects of adjustment.

What is remarkable in this context is that *economists* working on the Arab world hardly ever write about the issues just mentioned – with the notable exception of issues pertaining to social security (see Loewe 2000; Loewe 2002; Assaad and Rouchdy 1999). At the 2000 ERF-conference in Amman, for instance, not a single paper on governance or institutional reform was presented. This, of course, is the result of a combination of two factors: first, there are extremely few non-Arab economists who work on Arab economies. Second, as noted above, the political environment in the Arab world (where most Arab economists live and work) is, to put it that way, less than optimally conducive when it comes to analyzing governmental structures, power networks, and ‘deficiencies’, or rather peculiarities, in the behavior of political institutions as a possible cause for dismal economic performance. This hints to a basic dilemma that exists here: Most economists from within the Arab world either can not or – for political reasons – do not wish to focus on political factors that impact on economic performance and economic reform. Outside the Arab world, there are first of all very few scholars only who deal with economic questions regarding the Arab world at all, and many, if not most, of them are not economists, but political scientists (Alan Richards and John Waterbury [1996], Clement Henry [1996]; Henry and Springborg [2001], Steven Heydemann [1992], Bradford Dillman [1998], Volker Perthes [1995] or Eberhard Kienle [1994; 2001] are, for instance, among those few who deserve mention).

Thus, this overview reveals serious deficiencies in both currents of academic literature on economic reform in the Arab world. And the circumstances just mentioned might, as a matter of fact, represent the main reason why the subject has slowly but gradually lost much of its previous fascination among scholars. After the first, often descriptive and, subsequently, sometimes *prescriptive* assessments, it seemed impossible to acquire new insights into the nature of economic reform or, more specifically: into the variant of liberal reform under political premises that was implemented in the *Middle East and North Africa* (MENA) region. The question why even in those instances where the recipes of the IMF and the World Bank were followed, no economic success occurred remains unanswered, just like the maybe even more important question of how the results of structural economic reform in this part of the world can actually be grasped. While nobody doubts that significant change on various levels of the Arab economies did occur, nobody has, as of yet, presented any analytically sound suggestions as to what that change looks like and how it can be grasped on an economic systems level.

## Statistical Data, ‘Grey Literature’, and other Primary Sources

A third category of literature which has already been briefly hinted to above are ‘primary sources’. They originate from within the governments and administrations of the countries concerned, and from the administrations of donor organizations that represent the donor governments or multilateral organizations and their think-tanks. Such ‘literature’ is thus not always ‘academic’ in a strict sense of analysis without normative implications, but should rather be seen as political documents that, by and large, and with some remarkable exceptions (see, e.g., Kattermann 1997;1998), mirror the specific interests of the drafting parties who usually are actors actively involved in the game and thus are pursuing their own normative and institutional interests. However biased such sources may be, they nevertheless constitute an important reference in that they are first-hand accounts on what *has* been done (policy assessments), on what policies yielded which results in the opinion of the institution that formulated the respective document (effects of policies), and on what *should* be done in the view of the drafting party (policy prescriptions or recommendations). Even though their actual language might often seem overly diplomatic, these readings allow insights into actors’ preferences, interests, and perceived options and strategies. Their importance, therefore, is beyond doubt. Any attempt at assessing the dynamics of economic reform in the Arab world without consulting this part of the ‘literature’ must inevitably rely on guessing when it comes to the question of what actors think, what they perceive, what strategies they consider rational, and what, finally, they decide upon as policies.

While in themselves, such political reports and papers may not be considered an adequate basis for any serious analysis, they soon turn out to be invaluable when embedded in a viable theoretical concept or analytical frame. (This is why the remainder of this part (I) is devoted to the establishment of precisely such an analytical frame).

Studying Europe or almost any Latin American country, obtaining this kind of material does not pose great problems to the researcher: he or she would simply call the ministry or organization concerned, ask for their reports, be given what he or she needed for his or her research project, and write. Or, easier yet, he or she would simply download the relevant files from the institution’s internet websites. Even in the age of globalization, the Arab world remains very different in this respect since, as a rule, the regimes tend to be extremely ‘information-shy’ (Henry & Springborg 2001). State-provided information available on the internet is hardly ever up to date, and, as a general tendency, unreliable. Still today, field research is often the only possible way of accessing information; however, even this is hard (and often impossible) without knowledge of the language, the customs, and, most importantly, personal bonds of friendship or at least acquaintance between the researcher and those who can provide them. Thus, any researcher in this field will end up with a less than optimal collection of often unrelated pieces of information or insights only – unless he or she has a political task to fulfil for the respective government which then impedes him or her from

impartial academic analysis or from making publicly available the relevant documents and from publishing unbiased analyses.

The reason for this is, on the one hand, that processes of economic reform are always politically sensitive. Outcomes of policies affect the population at large as well as organized interest groups. Second, all Arab governments are non-democratic; this, in turn, partly explains that transparency in decision-making procedures and in policy-formulation and – implementation is often considered too risky for incumbent regimes.

Therefore, what has been done for the purpose of the present study was, mainly in the course of 2000 and 2001, to conduct possibly thorough field research within the four countries under consideration here. Secondly, more than two hundred conversations and interviews with businesspeople, journalists, lawyers, and officials from donor as well as recipient countries have been held, both inside and outside the Arab world where, at times, the atmosphere for conversations seemed more conducive to open exchange of views and conversation.

### Conclusion: What this Study Aims At

The above sections have shown that although a large *corpus* of literature on the subject of liberal economic reform in the Arab world has been published over the past fifteen years or so, the existing scholarly literature suffers from various deficiencies:

- (1) First and foremost, there are hardly any attempts to compare what happened in one case with what happened in any other case *and* to do so on a macro-level, looking at the general state of the reforms pursued and their respective results; in other words: there is an evident lack of comparison on the macro-level of analysis.
- (2) Second, there is no study to date that examines economic change in the Arab world on a systemic level, that is, on a level considering *types* of economic *orders*, thus reaching out into the field of the transformation of economic systems.
- (3) There are analyses of a political-economy origin on economic reform in the Arab world, but what they fail to do until this day is to assess the interrelations and find laws that explain the causal links between politics and economics, let alone economic performance. Those very few attempts that have been made in this regard seem more like an apology for not being able to trace such links than to carve them out in a methodically sound manner (an example is Pool 1993).
- (4) No study (that this author knows of) has ever compared the implementation of neoliberal reform in the Arab world and its outcomes with the proclaimed policy-goals of the institutions that promoted and often initiated structural adjustment in that region in a comparative and comprehensive fashion.

- (5) There is absolutely no literature that ventures to find out about the nature of ‘structurally adjusted’ Arab economies. It seems to be clear to everybody that structural adjustment did alter the Arab economies’ structure. It seems also clear that the resulting economies, though different than before, have not arrived at the point where international financial institutions and donors would have liked to see them arrive. Strangely, nobody has ever seriously asked where they actually *are*, what their state of being is, other than somewhere, but not at the point ‘we’ would have liked them to arrive, or somewhat ‘less’ than predicted. It is time for an assessment of the specific traits of the Arab post-reform economies, and this must be done independently of the normative frame of reference that had been set by the Washington Consensus.
- (6) There is hardly any literature that thoroughly examines the question of whether the ‘structurally adjusted’ economies that resulted from liberalization have viable prospects for sustainable development or not, and that asks what their developmental prospects actually look like.

These are the six most important deficiencies or gaps in today’s literature on structural adjustment and economic reform in the Arab world. I contend that all of them can be overcome with the present study. As is easily seen, these deficiencies matter to practitioners of development cooperation just as much as to political and economic theorists, and should therefore be of interest not only to regional specialists, but to economists and political scientists alike, no matter whether they work at universities or in development practice, as policy advisors in the field or at research institutions. Since the subject matter of the study is at the crossroads of a number of different, but interrelated disciplines, this book is hoped to constitute, in the various aspects of economic development it discusses, fruitful reading for all those involved in the disciplines of economics, economic and/or political theory, development cooperation, comparative politics, political sociology, political economy, and international relations.

## Chapter 2

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### Concepts and Interconnectedness: An Interdisciplinary Analytical Framework

The fact that this study covers a range of issues and interrelated aspects of politics, economics and developmental issues makes it imperative to carefully take account of exactly this inter-relatedness of various aspects and puzzles. They touch on at least four disciplines: Political Science, Economics, Political Economy and Sociology. The following chapter is devoted to the establishment and explanation of the interdisciplinary analytical framework this study uses, that is: the concepts relevant for the present analysis, as well as to the explanation *why* they are considered relevant and what context they stem from.

A review of concepts and methods will help in determining an integrative analytical framework that I wish to suggest as adequate for examining structural economic change in the Arab Middle East (and in other developing regions). Since the subject is as much political as it is economic, obviously, economics, political economy, and political science can reasonably be assumed to contribute to the establishment of such a framework and therefore have to be searched for their potential to provide concepts with significant explanatory power for the analysis. Furthermore, economic sociology and some other sociological concepts have contributed significantly to the understanding of economic exchange processes and, more yet, to the social settings within which they take place. The first section below is a quick historical review of the development of political economy from the earlier forms of economics that shall explain why I suggest to pursue a specific political-economy approach as the basis of analysis here. Then follows a brief outline of some political and sociological concepts that literature in political science and sociology has found to be the most valuable in explaining Middle Eastern societies and politics, including the establishment of rules and regulations for economic policies. A summarizing characterization of the methodology established here and an outline of the potential benefits of such an *integrated* approach vis-à-vis other possible avenues results in a number of preliminary hypotheses that conclude the chapter.

Since *grand theories* are today generally viewed as having failed to explain socio-economic change on a global level (see, e.g., Menzel 1992), and because less ambitious, medium-ranged approaches have generally been accepted to be of greater value in explaining the dynamics of economic development and socio-economic change, this chapter is important



in that it explains in what way such more modest approaches are combined here to reach the greatest possible explanatory capacity.

## The Historical Context: From Classical Economics to New Political Economy

‘What oeconomy is to the household, political economy is to the state’, wrote James Steuart in 1767. This marks one essential understanding of the older literature on political economy. As Levine (2001: 523f.) points out, the difference between economy and political economy established by Steuart entails a distinction on two levels. Most importantly, the *boundaries* of the *οικωσ* are determined by the family or the household, whereas the boundaries of modern economies are political. What makes an economy political in modern times, according to the early tradition of eighteenth century political economy, is the transgression of the boundaries of the household. The economic community is thus enlarged so that one might not even know the persons with whom economic interaction is necessary in order to satisfy one’s needs.<sup>4</sup>

The astonishing fact is that Levine uses ‘political’ throughout his text without ever even attempting to circumscribe, let alone define, what he want us to understand by that term. ‘Political’, to him as to many other economists, seems to constitute some suspicious domain of power that best be avoided since it prohibits itself from theoretical, let alone ‘scientific’ analysis – precisely because of the inconvenient and somewhat ‘dirty’ fact that it involves the exercise of power. This type of reluctance is often met with when economists try to distinguish their discipline from political science. But what is this power-shyness all about?

At the heart, I suspect that the acknowledgement of the existence and exercise of power in economic relations is an earthquake to the basic assumptions every student of economics is taught: That price is a matter of supply and demand, and that free-private-enterprise-competitive-market-systems are what every economic analysis and the corresponding theorems and the resulting quantitative methods are based upon. If one accepted the real-world observation that *any* economic outcome is at least to as large an extent determined by the relative distribution of resources available and, thus, the power of economic agents as well as the structures in which they operate, then it would be more than evident that economics is a genuinely social rather than a mathematical discipline (cf. the lucid contributions by Olson [1968; 1991: 1-3]).

Levine complains that modern political economy had questioned the ‘positive connection between development and capitalism’ in a first stage (ibid.: 531), and then even gone on to repudiate ‘the idea of development itself’ (2001: 532). ‘Development’ for him, it should be said, seems to mean something quite close to modernization theorists’ deterministic

and normative world-view according to which all processes of economic change are ultimately and automatically gearing the order toward democratic and liberal capitalist systems. Very much from the perspective of a conservative economist, he even states that ‘once political economy loses its anchor in an idea of development, [...] we can no longer ask if the resulting discourse is true or false’ (ibid.)! Now, methodologically it seems a very strange stance indeed (a view that is, by the way, epistemologically as well as logically easily falsifiable in itself) to state that verification or falsification of sentences can be reached only when dealing with the ‘right’ topics of analysis (that is: a political economy based on what he calls ‘the idea of development’ as opposed to the ‘idea of power’). Levine argues that

‘So far as political economy continues the older theme of interests, without connecting interests to the process of development, the contingency just referred to becomes the contingency of the clash of interests. This is also the contingency of the exercise of power in the pursuit of interest where those interests encounter the opposition of others. Thus, power and interest replace development as the integrating ideas of political economy, narrative replaces any notion that political economy might discern the hidden truth of interaction’ (ibid.).

This statement involves an obvious logical error. It is precisely the basic importance of power and its exercise that has been found to enable us to discern just that ‘hidden truth of interaction’. Now, I guess that this brief positioning of mine needs some justification.

Many efforts have been made – in the tradition of Anthony Downs’ famous *Economic Theory of Democracy* (1957) – by economists and political scientists alike, to establish economic models of politics (cf. also Kirsch [1974] as well as the more recent works of political scientists such as Shepsle [1991], Weingast [1991], and many others more). Usually they see the polity as a market where exchanges take place and where the principle of supply and demand as determinants of prices applies no less than in the economic realm. However, none of these efforts has made it into any sort of approach that could be considered commonly accepted among political scientists. Textbooks on comparative politics and political systems analysis sometimes do not even mention such efforts, and the reason is easy to understand: Neoclassical economic theory does not provide us with the analytical tools necessary for grasping social and political conflict and outcomes. The perception of politics as a liberal market where everything had its price, determined by supply and demand, seems erratic from a comparative politics point of view. Economists who thought of politics as markets were all Western-educated, mostly US-American scholars who had seen how politics worked in Western liberal democracies. And while there certainly are a number of analogies that can be drawn between democratic political competition, or rather contestation for power on the one hand and the working mechanisms of markets, this vision becomes quickly misleading when turning our eyes towards non-democratic polities. It seems, therefore, a lack of conscious overview on a global scale that is at the heart of the imagery of politics as markets. It also

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<sup>4</sup> On a second level, the distinction Levine asserts is about the *regulation* of the economy, but this is less central to the purpose of this study and therefore skipped here.

demonstrates that classical economic instruments are not adequate for an analysis of politics because they suffer from at least two inherent misperceptions of reality:

- (1) The idea of politics as an arena similar to markets, only with the difference that measurement is harder to achieve in numbers since *other* factors come into play (such as power), neglects the fact that in the economic sphere, too, human beings are interacting, bargaining, concluding contracts, and so forth. The outcomes of such processes are *always* subject to the relative ‘bargaining power’ the parties to an exchange possess, to the relative distribution of resources among them (which in turn influence their respective bargaining power), and, ultimately, to their ability to influence prices. Thus, the exercise of authority, power and influence is not restricted to politics, but occurs just as much in the ‘economic market’. It is worth noting here that this holds true not only for exchange situations that are characterized by the dominance of one party and subordination of the other, but also for the ideal constellation of voluntary relations between free and independent persons – a constellation that mainstream economics takes for granted in all exchange relations.
- (2) Furthermore, actors exchange within a framework of legal rules, regulations, governmental and non-governmental institutions and organizations, not to mention the role played by the international environment. This fixed institutional context on the polity-level is, again, the result of social relations and interactions, or, to put it that way, the outcome of ‘coagulated’ social conflicts. While the legal and institutional framework of an economy often minimizes actors’ uncertainty in that it provides stability, this setting itself is subject to change – change that is normally incremental, but that can be profound and far-reaching in times of crises, revolutions, or during the breakdown and transition of social systems. In all of these cases, however, such changes to the legal and institutional setting will, again, reflect the relative bargaining strength of individual or collective actors involved in negotiating the changes, the amount of resources they can command over, the information they can access – in short: their capacity to influence outcomes and attain their own goals even in the face of resistance.

Hence, it is both in a direct way, in the process of economic exchange proper, and in an indirect way through the legal and institutional framework within which exchange relations occur that the actors’ position vis-à-vis other actors plays a key role for the outcomes of economic processes. This position will always be determined to a large extent by the resources any one actor possesses.

Adopting the fundamental neoclassical assumptions that actors (a) are rational and (b) maximize utility, the relevant question in this context is about the capacity of actors to maximize their utility not only in a Pareto-optimizing way through free and voluntary exchange, but to achieve their aims in the more difficult situation when the other party or parties to the exchange are not better but worse off after exchange, that is, against resistance.

For neoclassical economists, this question is irrelevant since exchange is considered, by definition, to be voluntary, and therefore assumed to be *always* of benefit to *everybody* involved. In those cases where neoclassical theorists do acknowledge the existence of Pareto-inferior exchange situations or market failures,<sup>5</sup> they are seen as an exception to the rule and thus, again, of negligible importance. However, even the most casual look at the real world is sufficient to show that Pareto-inferior exchanges are probably as numerous as are Pareto-optimizing situations – and maybe even more frequent than the latter ones. Capital-labor relations are a structural issue that is often mentioned to demonstrate this argument in critical economic literature, but we need not repeat this. Take a look, for instance, at the row of false balances, starting with the US energy provider ENRON, that were presented by a number of large US firms in the course of 2002: These are clearly an example where only one party (a small number of individuals with privileged access to information) benefited while the majority of shareholders were worse off after, and where power (and asymmetrical information!) determined outcomes. In fact, due to their lack of information, the majority of small shareholders had probably not even a chance to decide whether or not they wanted to participate in an economic exchange: Even the most Chicago-based economist would hardly dare to call this a ‘voluntary interaction’.

More generally, parties to an exchange can be forced or perceive themselves to be forced into a Pareto-inferior exchange relation by financial needs, by state laws and regulations, by lack of information (as in the above example), which makes them enter such relations unknowingly (in which case they can no more be considered ‘independent’ since they depend at the least on accurate and timely information about the nature of the exchange), and by many other factors more. In fact, the question is at hand whether those voluntary relations between perfectly free and independent individuals with perfect information really are the rule, as classical economic theory has it – or rather the exception. This question becomes especially relevant, as will be shown below, in analyses not of Western free market economies, but in Third World economies where the regulatory legal and institutional framework that constrains the possibilities of exchange relations in various ways is even less conducive to Pareto-optimizing exchange (see also North 1990b).

In such a context, the flaws of neoclassical theory that are already apparent in the close-to-ideal market economies, are bound to lead to profoundly deficient results and, therefore, to fundamental misinterpretations and misconceptions of economic processes. Regarding these findings, methods like econometric modeling can safely be discarded as misleading or, at best, irrelevant when analyzing the dynamics of economic change in non-market economies with different, politically motivated and influenced relations between agents, and where voluntary exchange between well-informed agents is a rare exception (and where, in addition to everything else, the poor quality of available macro-economic data

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<sup>5</sup> The most famous such instance is the case of public goods where the social desirability is high and yet there is a lack of incentives for private agents to invest since the benefits are social rather than individual.

prohibits us from proceeding along quantitative methods for macro-studies anyway! Cf. Chapter [1] above). What we need instead for the analysis of economic change in a non-market environment is not an economic analysis of politics, but rather the opposite: a political analysis of economics.

If we accept the line of argumentation presented here, it is a power-oriented approach to political economy<sup>6</sup> that seems best suited for an analysis of economic processes in an environment where we have good reason to suspect that Pareto-optimizing exchange is the exception rather than the rule.<sup>7</sup> Neoclassical assumptions enter the approach pursued here only insofar as actors are still expected to be rational in their behavior, and to be utility maximizers. Apart from that, however, orthodox theory is excluded because of its well-known and above mentioned theoretical shortcomings.

In the sense used here, then, *political economy* has a different meaning than for John Caporaso and David Levine (1992: 86) who contend that ‘political economy sometimes refers us to the study of the limits of the market as an institution for want satisfaction and sometimes to an economic theory of politics’. Rather, the term political economy here, as in other writings of the *New Political Economy* (NPE) school, refers to the political foundations of economics or rather: to the socio-political factors underlying economic outcomes, if not to a political theory of economics that views markets as arenas of politics (cf. Fligstein 1993). Markets are no neutral or apolitical realm; it belongs to their most basic characteristics that they, as White (1993: 5) emphasizes, ‘embody political processes of conflict and co-operation and political relations of dominance and subordination.’

While it is certainly true that there are more than just difficulties in grasping the notions of power and its distribution and exertion with econometric models, nothing indicates that political economy must be or even *should* be restricted to analyzing the possible interconnections between capitalism and development in the rather dusty style of modernization theory as last heard of in the early 1960s (see, e.g., Lipset 1959). Quite the opposite: It is today commonly acknowledged that this kind of grand theories of development has failed to provide the answers that had been expected from them. They continue to suffer from empirical counter-evidence the existence of which has never been satisfactorily explained, and they negate the difference between correlation and causation.<sup>8</sup>

Levine (2001) in his – admittedly sophisticated – polemic against modern political economy thus places himself outside the analytical discourse that has taken place throughout the past half century among theorists of development, political economy and political science. Instead, he presents a fundamental misreading of modern political economy in a vain effort to

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<sup>6</sup> I use this term in analogy to Caporaso and Levine (1992: Ch. 7) who speak of ‘power-centered’ approaches to political economy’. However, the conclusions they draw about such power-centered approaches differs enormously from the views presented here.

<sup>7</sup> For a similarly power-centered approach, but with strong neo-Marxist overtones this author does not subscribe to, see White (1993).

<sup>8</sup> See Rustow (1970) for an early critique of this point.

re-affirm some of the errors of classical economics, to dismiss social science knowledge as ‘unscientific’ and to ignore roughly one hundred and fifty years of social science research. Consequently, this can hardly be the approach to choose here.<sup>9</sup>

To sum up this section, the following can be said: Historically, capitalism as a regime of (relatively) free markets implied peaceful situations and the accumulation of wealth for industrialized regions. For lesser industrialized regions, however, it is easy to demonstrate empirically that capitalism was associated with violent uprisings, wars, the exercise not only of power, but also of military and police force – for the protection of specific individual or group interests. In both cases, however, the liberal market was something that was instituted and maintained by politics and, in this respect, the two became – historically and empirically – virtually indistinguishable.

On a theoretical level, quite the opposite development took place simultaneously: The idea of a ‘self-regulating market’ became something that was sought to be studied separately by the nineteenth century. No such distinction can be found by writers prior to the end of the eighteenth century. In fact, this is where the modern discipline of economics as well as the separation of political and economic science seems to have taken its origin. It is the merit of New Political Economy (in the power-centered sense that Levine dismisses as ‘narrative’) to have re-combined both in order to allow for integrated analyses of political-economic processes, decisions, and outcomes, and to engage in further research about the link between the political and the economic. Thus, with respect to the goals of this study, it is precisely the power-centered branch of approaches of New Political Economy that promises to be useful for an analysis of economic policy reform – even more so in a geographical area where it is highly questionable whether anything that comes close to a ‘perfect’ market exists at all.

### Institutional Economics: Origins and Merits

As has been hinted to in the section above, an astonishing development took place in economic theory from the 1960s onwards: With the theoretical works of Léon Walras, Friedrich Hayek, Milton Friedman and several others, and with the writings of their *élèves*, the ultra-liberal approach which had later been cultivated mainly at the *School of Economics* of the University of Chicago reached the heights of an uncontested paradigm in a Kuhnian sense within the discipline of economics. In a somewhat distorted way, this approach entered the think-tanks of developmental institutions roughly a decade later and became known as ‘neoliberalism’. Originally based on classical economics, the practical developmental approach soon became de-based from its roots and provided easily understandable recipes for economic policies. Somewhat pointedly, the slogan was: Set the self-regulating forces of the

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<sup>9</sup> It is frankly admitted here that I react to Levine in an equally polemic style of argument – albeit, as I hope,

market free and protect them from any sort of state intervention, and the economy will produce optimal outcomes by itself.

Such seemingly self-explaining recipes of course neglected the existence of long-known instances of market failures, but they were nevertheless voluntarily adopted – at least rhetorically – in the Cold War days of a bi-polar world order by political decision-makers mainly in the United States, when the Soviet adversary was clearly identified. The poor performance of socialist economies helped in enhancing the popularity of neoliberalism among Western politicians in economic policy-making in the Western or, in neoliberal terminology, in the ‘free’ world. With the usual time-lag, ‘Reaganomics’ and ‘Thatcherism’ emerged as political corollaries of a thus popularized neoliberalism. It must be noted here that, as if that were natural, a strong dose of normativity had been added to this dichotomy of economic philosophies that cursed any form of state intervention in the economy as evil while the all-encompassing powers of the free market were hailed as the remedy to all economic and developmental problems.

Neoclassical theory had thus regressed from an analytical tool and concept to the largely normative contents of neoliberalism that were often used for affirmative political ends rather than for scientific purposes of explanation; by the mid-1980s, neoliberalism had become a political ideology rather than an economic theory. The liberal prescriptions that originally had been deducted from (neo-)classical theory became ends in themselves in the eyes of Western governments and developmental agencies. Issue areas such as trade liberalization, deregulation, or, maybe most importantly, privatization are examples for these tendencies: The firm belief in the superiority of the private sector was prominent among US administrations since the early 1980s at least, but with the adoption of the ‘Baker-Plan’ in 1985, the promotion of privatization abroad had become official US-policy – and ‘the IMF and the World Bank have duly encouraged privatization in Latin America and elsewhere since’ (J. Williamson 1990: 16). What had been neglected in such easily comprehensible and therefore politically attractive policy recommendations was that the assumed superiority of private sector efficiency is subject to various conditions.<sup>10</sup>

Along these lines, some economists began to feel that conventional economic wisdom had left aside a number of important variables that impact on the outcomes of economic processes, but could not or hardly be assessed in any quantitative manner: How does the role played by networks, institutions, and organizations – both public and private – affect the outcome of transactions? How do different constitutional and legal environments impact on economic performance? Might not different social structures that economic agents are embedded in, too, have a decisive influence on the results of economic processes? Hard to measure, up to the early 1990s such issues had either been entirely neglected or had, at best, been relegated to footnotes in mainstream economic literature, but not been approached

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based more on logical and methodologically verified principles than is Levine’s line of argumentation.

<sup>10</sup> I shall get back to this point in part three below.

systematically by economists engaging in studies on Middle Eastern development (and often enough on other developing regions, too, for that matter).

It was Douglass North who won considerable attention as one of the first economists for decades who dared address these problems in a comprehensive way in his *Institutions, Institutional Change, and Economic Performance* (1990b). In his book, he showed that institutions and institutional arrangements as well as their development over time significantly influence economic outcomes in any given economy. As such, this was not new: Classical economists like Adam Smith had, in their works, written on the importance of institutions, ‘law-givers’, and the like in an *en passant* fashion, as something almost self-understood. It is also well-known that Keynesianism had later relied on the role of the state’s regulating authority in the economy in order to overcome and avoid market failures. Third, there is a considerable row of neoclassical authors (see below) who, them too, elaborated on the significance of rules, laws, and institutions that would be needed in order for market systems to reach economically optimal performance.

Yet, it is in this special historical context that, during the seemingly uncontested reign of neoliberalism in the American political arena, various currents emerged in economic theory which reminded the discipline of some of their past achievements that had been buried under the paradigm of neoliberal political ideology and apparently been wiped out of the minds of many scholars. ‘*New Industrial Economics*’ (see, i.a., Tirole 1989), ‘*New Economics of Information*,’ ‘*Transaction Cost Economics*’ (O. Williamson 1990; 1984; 1979; North 1984; 1990a,b; Wallis and North 1986; De Alessi 1983a,b) and, most prominently, ‘*New Institutional Economics*’ (NIE)<sup>11</sup> entered the scene (most elaborate and comprehensive: North 1990b; 1991; 1993; 1997; Eggertsson 1990; Furubotn 1994; Richter 1994; cf. also Furubotn 1991; Hurwicz 1990; Hutchison 1984; Schweizer 1988).<sup>12</sup> There is no space here to discuss each of these (and other currents not mentioned here) in depth; however, what they have in common is their explicit focus on what neoclassical economics had summarized (and what

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<sup>11</sup> After various terms had been suggested to refer to this new current in economic theory, ‘New Institutional Economics’ has meanwhile become a generally accepted ‘umbrella’ under which the various trends and approaches focussing on transaction costs, organization, formal institutions and informal ‘constraints’ are gathered. Furubotn and Richter (1991) provide a good short introduction to what NIE encompasses, which general problems it focuses on, and from what perspectives. For a focus on the applicability to developmental questions see Nabli and Nugent (1989); for an application to Third World development and development theory, see Bardhan (1989) and Harris, Hunter & Lewis (1995).

<sup>12</sup> Of course, all of these currents are built on predecessors that were published – at least in some cases – long before these and other new approaches in economic theory became fashionable. To give but one example, Ronald Coase’s seminal essay on ‘The Nature of the Firm’ (1937) can be considered to be among the early origins of industrial organization. His second famous article, on ‘The Problem of Social Cost’ (1960), has long been neglected by mainstream economics, but most of the new literature on transaction costs is either explicitly or implicitly built upon his points of departure in that text. Two other eminent classical ones of thus re-discovered scholars must be mentioned here: Joan Robinson (1950 [1933]) for the Anglo-Saxon tradition, with her foundations of the origins and consequences of ‘imperfect competition’, and Walter Eucken (1990 [1952]) for the German-Austrian tradition of economists, with his lucid elaboration of the principles of a ‘competition economy’.



neoliberal economics then set aside for good) as ‘externalities’.<sup>13</sup> While all of these approaches are non-orthodox, one of them has received special attention, not least because its main proponent was awarded the Nobel Prize in economics for his model. Therefore, I will limit myself to discussing the possible impact which North’s version of NIE theory could have on the analysis of economic change in the Arab world (and beyond). In essence, what is new about North’s approach is the fundamental challenge it posed to orthodox theory that was so dominant in those days. But a challenge in how far?

In his earlier works on transaction costs, North had questioned the assumptions of the Walrasian general equilibrium model in that he showed production costs to not only consist of the inputs of production factors, but that the costs of transacting would have to be added to the overall costs (production costs = costs of transforming + transacting). Therefore, the net gain of an exchange of goods or services was lesser than assumed in orthodox economics, because the costs of the effort of exchanging were not taken into account in the standard neoclassical model. Together with Wallis, he was able to show that such costs are by no means negligible: In the American economy, they demonstrated, the cost of transactions rose to forty-five percent of national income (Wallis and North 1986). This in itself posed a serious challenge to neoclassical economics, or, as Thomas Kuhn would have put it: ‘normal’ economics.

Building on these findings, he constructed his theory of institutions. This goes one step beyond transaction cost economics in that it is based on the definition that the costs of transacting can be identified as the costs of measurement (the costs incurred by a party in search of exchange for gathering and processing information about the desirable attributes of the commodity or service to be exchanged) plus the costs of enforcement (the costs incurred in order to claim ownership to that commodity or service, that is: monitoring and policing in order to ensure the commodity or service is in fact as agreed upon by the exchanging parties). The ways and means of how measurement and enforcement is carried out, and thus, the mode in which transaction costs arise, then, is dependent on human behavior and, as a result in modern times, on societal organization. Therefore, his ‘theory is constructed from a theory of human behavior combined with a theory of the costs of transacting’ (North 1990b: 27).

However, this is only the starting point of his theory, the point, where things start to become interesting to economists and other social scientists alike: From here, he develops an original theory of the reasons for the existence, evolution and working mechanisms of institutions. While the origins of their existence, he holds, lies precisely in the fact that it is costly to exchange, that is, to measure, monitor and police, the larger part of his Noble prize

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<sup>13</sup> ‘Externalities’ can broadly be said to refer to ‘effects on third parties [parties that are not involved in an exchange or transaction, that is; O.S.] that are not transmitted through the price system and that arise as an incidental by-product of another person’s or firm’s activity’ (Rhoads 1985: 113). Obviously, this also involves problems of what is desirable socially and whether the market mechanism will produce socially Pareto-optimal results if externalities exist. Often, the presence of ‘externalities’ are those incidents where neoclassical thinkers usually admit market failures. Think of, for instance, environmental pollution caused by a firm, or of other public goods that are not produced to the socially optimal amount since the market in itself sets no or too little incentives for socially desirable levels of their production.

winning book is devoted to the question of how humans interact in order to *minimize* these costs, and, subsequently, to the question of why they do *not* interact – over time – in a way that the most efficient forms of institutional arrangements would survive as a result of the assumed evolutionary process. In brief, his puzzle could be reformulated in the question: ‘Why does there not seem to be any Darwinist evolution in modes of social organization and institution-building?’

What is important for the framework of this analysis is the fact that there was, for the first time, an economist who voiced, from *within* his own discipline, exactly that uneasiness which scholars from *all* social science disciplines had felt for a long time when faced with the assumptions of neoclassical economic theory. Knowing about the strongly political nature of economic processes and decision-making in the Arab world as explained above, these ‘new’ approaches seem to have an exceptionally great value in explaining the ongoing dynamics of change in the Middle East. While main-stream economics on the Arab world does not usually call into question the neo-classical approach, and a considerable number of economists even still adheres to the theoretically truncated neoliberal version, there are some few economists who are specialized in Middle Eastern affairs and who have today started to reflect on a possible applicability of institutional economics in explaining structural economic change (see, for instance, Handoussa 1995; to a rather limited extent: Chaudhry 1997).<sup>14</sup> Hence, institutional economics still remains largely to be discovered by economists as a possible instrument of furthering our understanding of economic change in the Arab world. Here, it is sufficient to bear in mind the possible benefits of such an approach: It points to the gaps, lacks, and omissions that come along with neoclassical economics and sets a quite different agenda for research. Factors to look at are not only the easily measurable macro-economic data, but also and even primarily the socio-political modes of organization through both formal institutions and informal constraints built on norms and values which, in turn, impact strongly on transaction costs.

Many critics from other social science disciplines discard the NIE immediately, with various (and often not convincing) justifications. It would, of course, be ignorant to assume that NIE had no methodological problems. (I shall get to the problems of applying institutional economics to an analysis of the Arab economies below). Still, I hold that NIE does provide a useful starting point for the analysis of economic change: It helps a great deal in demonstrating to the economist that conventional economics will not manage to provide us with reliable results for the analysis of economic reform in developing regions, and it pinpoints exactly to those areas that neoclassical theory (and even more so the neoliberal ideology) omits and which is all the more crucial when analyzing non-market economies and

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<sup>14</sup> Contrary to what their title implies, Mikawy and Handoussa (2001) can hardly be said to be based on *any* theoretical foundations, even though the contributions do examine formal governmental institutions (legislature, business associations and other interest groups, etc.), economic development, and the interrelations between both. Also, it seems that even those few applications of NIE to the Middle East and North African region tend to be somewhat popularized, or even truncated.

changes therein. Yet, in itself, it will not suffice to explain the interrelations between the economic and the political arenas, between the private and the public spheres, between the formal and the informal domain, and between individuals and various types of networks that all exist in the Arab world and shape Arab economic performance and development prospects. Yet, neither classical economics nor institutional economics alone provides concepts for grasping these phenomena analytically.

### Institutional Economics Revisited: Conceptual Flaws

The economist who agrees that conventional economics would not have led to these results will certainly ask at that point: If I make good use of NIE-based approaches, what do I need all those other concepts for, then? This view is justified insofar as I myself have started off with a pledge *for* institutional economics. It is not justified, however, for at least two reasons which lie mainly in the conceptual flaws of NIE itself.

- a) NIE sets an agenda which it cannot pursue satisfactorily because it lacks adequate analytical tools for inquiring into social and political organization.
- b) usage of term ‘institutions’ is misleading and blurs lines for distinguishing certain types of capitalism from others. This works against differentiation and makes distinct types seem the same while they are qualitatively different from one another, as is explained in Chapters (3) and (11) below.

While NIE, therefore, is considered as a viable point to start with, the problem is that institutional economics does not provide us with instruments to describe, analyze, and understand the way social and political norms, patterns of behaviour and political institutions such as a legal system or a polity work. *NIE in itself thus lacks the instruments to pursue the research agenda it establishes.* Furubotn and Richter (1991: 16), for instance, state that ‘in considering how shifts in the fundamental data of an economic system work themselves out, attention has to be given to the constitutional and legal system that is operative and, more directly, to the role of contractual agreements’. On this latter issue, again, they comment as follows: ‘It remains true [...] that the prevailing property rights structure must determine the content of the contracts entered into. More concretely, the rights structure currently existing sets limits on the specific bundles of rights that can be transferred via the exchange of goods and services’. This makes the legal system the determinant of contractual agreements – a finding that is so obvious that it would almost seem trivial even from a common sense point of view.

Research into structural economic change and systemic transformation, according to NIE, requires thus an analysis of the political system since this latter determines both the ‘constitutional’ context of the economy as well as the property rights structure and, via this, the nature and content of contractual agreements. Therefore, the *key* to a reliable analysis of

economic change, in the eyes of adherents to NIE *themselves*, is an accurate assessment of the polity, that is, the organizational and institutional structure of a given socio-political system. North (1997: 5) confirms this finding: ‘How effectively agreements are enforced’, he states, ‘is the single most important determinant of economic performance’. There is no debate that enforcement is performed in today’s world to a large extent by what NIE proponents call the ‘third party’, that is the state. Enforcement thus depends on the existing legal and institutional framework that is set by political actors who formulate policies.

Adopting this as a basis for analysis entails problems that conventional economics does not even perceive: A view on the political process in the Arab world (and in other parts of the developing world as well) demonstrates that politics is only partially a question of the ‘constitutional’ frame, the legal system or the institutional structure. A much more important feature yet, as has been explained in the above sections, are informal rules that are adhered to by the social and political actors. As North (1990: 40) emphasizes elsewhere and in general perspective, ‘even the most casual introspection suggests the pervasiveness of informal constraints’. This has been examined with regard to Western societies (for the USA: Ellickson 1986; Axelrod 1986) and to ‘primitive societies’ (e.g., Posner 1980; Bates 1989).

Arguably, however, much of the developing world today, including the Arab countries on which I focus below, neither consists of ‘primitive societies’ nor of Western-style ones. Yet, the predominance of informality is so much a feature of everyday life that nobody who has ever spent an even limited span of time in any Arab country would doubt it. In fact, a good deal of the existing sociological and political science literature has dealt extensively with the phenomenon of informality in both politics and society, and established analytical concepts to better grasp it. If we want to take a step ahead in our understanding of the causes (and remedies) for the continuously wobbling performance of Arab and other economies, this necessarily requires us to analyze much more thoroughly how the Arab countries’ systems of laws, regulations and – most importantly – their enforcement work (a genuinely political question). Secondly, it is necessary to examine what exactly the social norms and values are that influence individual economic behavior, how they work, and how exactly they impact on performance. Furthermore, we must gain a better understanding of the patterns of informal behavior that characterize Arab societies, and then identify the societal patterns of sanctioning deviations from such informal norms and values (a question for political sociology).

This is the agenda that the findings of institutional economic theory set. It has to be stated clearly that despite its obvious importance, none of these issues has ever been seriously tackled by economists specializing in Middle Eastern economics and development. They are, by definition and in the words of even institutional economists, beyond what economics can explain or even describe since the discipline, to begin with, lacks the vocabulary to assess social and political phenomena as soon as we dismiss the notion of ‘politics as markets’ as inadequate, as has been done above.

Realizing this, an examination of *formal* rules such as written laws or even a constitution, institutional enforcement mechanisms, and the like, is not enough to assess prospects for economic performance and development. Rather, the pervasive presence of informal social patterns of behavior imposes itself as a subject for the analysis of economic structures and processes.

Among the more elaborate major criticisms that have been advanced against NIE is that most currents in institutional economics ultimately seek to reconcile neoclassical economics with the empirical flaws that had been observed and which I have mentioned earlier in this chapter, and thus present but an ‘appendix’ to neoclassical theory. But it may be that the said flaws are so fundamental that conventional economics cannot provide an adequate *frame* to properly address them, however much we add to classical theory. Other social science disciplines, critics maintain, must – and can – ‘bridge the conceptual gap’ (Powers 1996) where economics fails to explain social and political phenomena that are relevant for economic outcomes. Concerning the target and geographical region of this study, it is the realm of non-Western social values, norms, and informal patterns of behavior that are not only, but also bequeathed inter-generationally (from one generation to the next). Since these are strictly socio-political or, respectively, socio-cultural norms and patterns of behavior, they inhibit themselves to economic analysis. There is no economic effort to analyze or even to simply describe the informal patterns of behavior such as *wasta-seeking* or *clientelism* and the prevalence of *patronage* in the Arab world (which I will address below). For this, we have to resort to other disciplines that may not provide us with ultimate answers, but have at least the one advantage over economics that they have succeeded in describing how these norms and patterns of behavior manifest themselves in Middle Eastern societies and polities, and how they function in a given socio-political system. This, however, is the realm of political science and political sociology which have inquired into the subject for several decades already, whereas economists specializing on the Middle East have – until this day – mostly neglected the presence of such factors and rather been clinging to neoclassical theory and economic modeling within the frame of ‘normal science’ in a Kuhnian sense.

Therefore, I argue, we have to apply an integrated approach such as the one sketched out above that combines institutional economic theory with approaches that have been developed political economy, political science and sociology. The approach suggested here thus takes as its basis the theoretical findings of NIE theory that transgress the structural deficiencies of neoclassical assumptions, but will now be complemented by political science and political sociology approaches. Such an approach, I contend, bears greater promise than any effort based exclusively on either political science or economic theory; it should enable us to reach at least qualitative results in a comprehensive analysis of what actually has been going on throughout the Arab world in the past fifteen years or so in terms of economic reform, even though a formalization of such an approach is a task that will probably require several years and most likely a significant number of scholars.

To be sure: this is not merely an extension of NIE theory to the analysis of politics. While most proponents of NIE, among them its most eminent representatives such as North, insist on the compatibility of NIE with neoclassical theory, the approach suggested here is less compatible with mainstream economic theory because the latter does not allow for the inclusion of political and societal patterns (be they formal or informal) as decisive factors for economic performance and development. By contrast, these elements are seen in this concept (as well as by the NIE) as vital elements for performance.<sup>15</sup>

Second, such an integrated approach necessitates special emphasis on the decisive distinction between formal rules and informal norms, values and patterns of behavior that dominate Arab social life. In this respect, it diverges significantly from institutional economics as elaborated by North, Eggertsson, Furubotn and many others. Although North admits that the two differ in some respect,<sup>16</sup> he does not seem to realize that this difference becomes most essential when investigating into the question of how given social and political structures impact on economic performance and development. Calling both formal institutions and informal norms, values and patterns of behavior by the same name results in a lack of differentiation of the diverging consequences both imply for performance. Unfortunately, this terminology has even been adopted by political scientists who seem to have forgotten that their own discipline had provided much sharper possibilities for differentiation decades ago. Nevertheless, this new fashion of giving up existing possibilities of important differentiation has to be firmly rejected. This problem may seem rather abstract at this stage, but it will be addressed in greater detail in Chapter (13) below on the relation between socio-political features of the Arab states and economic performance and developmental prospects of various economic orders.

## Political Science and Economic Sociology Concepts

There are several key arenas and methods in political science where basic economic ideas that have been fruitfully adopted and where, thus, political science has greatly benefited from the work of economists. What is remarkable, however, is that this process has not to date been a mutual one. While it is very obvious that a great deal (if not the majority) of the variables responsible for economic outcomes and for the analysis of economic policies are social or political ones, there still seems to be a wide-spread fear, especially among orthodox economists, to consider and apply methods and concepts that political science and political

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<sup>15</sup> From this perspective, it may even be that the efforts by the new institutionalists at integrating their findings into an orthodox approach are inconsistent in themselves. However, this would require a separate study and is clearly beyond the possibilities of this study.

<sup>16</sup> He acknowledges, for instance, that 'while formal rules can be changed overnight by the polity, informal constraints change very slowly' (North 1997: 1). I shall get back to this point in the conclusions.

sociology have developed over the past decades – often because of their apparent ‘inaccuracy’ or, more precisely: the difficulties inherent in the strife for *quantitative* operationalizations. The question is thus: Are such approaches simply useless for the analysis of economic policies, their implementation, and their outcomes? Or are they just not necessary? – Obviously, my standpoint towards such questions is a clear ‘no’. Why?

In a well-informed and remarkable article, Dani Rodrik presents an ‘economist’s perspective on the political economy of reform’ (1996: 11), where he outlines several of the key questions that arise in the context of economic policy reform: the reasons for the initiation and mode of implementation of reforms, the ‘different political-economy underpinnings’ of stabilization on the one hand and structural adjustment on the other, the (political and social) costs of reform, the ‘conflict between top-down versus participatory approaches, the conducive or adverse perception of foreign aid as help or hindrance for the implementation of adjustment measures, or about ‘the collective rationality of political institutions and behavior’ (ibid.: 11-12). Almost all of the puzzles he discusses hint to the decisiveness of political and social factors that underlie economic policies, their implementation and the results of liberal reforms. What amazes in the light of the nature of these questions is the almost universal neglect of political science approaches and theoretical concepts by the vast majority of economists, even though it is true that a number of books and papers have been co-edited or co-authored by economists and political scientists (most prominently: Richards & Waterbury 1996).

It is suggested here that, due to the genuinely political nature of (economic) policy formulation, to the essentially socio-political nature of policy outputs (creation of ‘winners’ and ‘losers’, both socially and politically), political science and political sociology concepts do in fact deserve consideration; is is these disciplines that are based on the analysis of exactly such phenomena, and which therefore, should be able to provide answers where economics ends with open questions and fails to deliver satisfying explanations. Thus, an economist’s conclusion that ‘we need to understand better why broadly similar policies [that is: economic recipes; O.S.] can produce quite different outcomes in different societies’ [and, one should add: polities; O.S.] (Rodrik 1996: 21) comes thus hardly as a surprise for the political scientist or the sociologist. Conventional economics has evolved along a dominating trend to overlook or dismiss as irrelevant extra-economic variables. Without taking these into account, however, the origins of economic policy reform, its divergent patterns of implementation, and its outcomes cannot be explained in any satisfying manner.

This, of course, is not to deny the merits of modern economic theory for the analysis of socio-economic processes: Nobody would seriously imagine today political science or political economy without the foundational assumptions that economic theory has provided, including, but not limited to, the generally accepted theories of rational choice, bounded rationality and the related idea of methodological individualism, game theory, growth theories, transaction costs and their influence on production and productivity, and many

others more. Thus, it should be stated clearly that my critique targets classical economic theory only insofar as it has, in deed, been demonstrated more than once that its core assumptions suffer from serious deficiencies or even faults that are in need of rectification. The main points where such ‘corrections’ are desirable and where classical theory’s flaws are to be overcome lie outside the field that economics usually covers. Economists that have become aware of these problems have usually not the background knowledge of what disciplines like political science or sociology have established. Therefore, their efforts to analyze social and political structures and processes are often bewildering, simplistic, implying not seldom assumptions, reflections and methods that are made up in an *ad-hoc* fashion that is neither sustainable methodologically nor consistent with the state of the art in the social sciences outside economics. The ‘corrections’ needed can be provided more effectively and founded on sounder methodological and conceptual bases by those disciplines that have developed theories, established concepts and elaborated methods, in short: that have specialized since many decades in the analysis of exactly the phenomena that make classical economic theory stumble.

Based on these reflections, there are a number of analytical approaches that will be integrated with the more general political-economy approach outlined above in order to reach an enhanced level of explanatory power and thus enable us to provide more convincing answers than economics alone could do.

### *Economic Sociology, Social Capital, and Networks*

It was sociologists who maintained they could provide a ‘bridge’ over the gap that economic theory leaves and which has been outlined above. Some of the approaches and concepts of sociological provenience which have been brought forth deserve mention in the context of the present study. These are mainly those formulated by sociologists such as Granovetter (1983; 1990) or Deutschmann (1988) who contend that they can ‘help’ economists in covering analytically the dimensions of social relations which, as has been stated above, impact on the meso-level of institutions and institutional performance, which, in its turn, is important for overall economic efficiency and performance. Economic sociology thus tries to ‘bridge the gap between economics and sociology’ (Powers 1996; for an overview see Smelser and Swedberg 1994).

*Economic Sociology* could be said to start with Mark Granovetter’s (1973) early article on how job seekers can succeed, and with his revision of that work a decade later (Granovetter 1983). Again, this is not a uniform concept but one that has been elaborated in various currents and with different analytical *foci*. Sociologists have undertaken remarkable efforts and gained considerable attention in their attempts to identify such problems and to search for solutions to the problem of how to integrate sociological knowledge with the



discipline of economics (see, i.a., Smelser 1976; Granovetter 1985; 1990; Granovetter and Swedberg 1990; Stinchcombe 1983; Deutschmann 1988; Swedberg 1990; Kalleberg 1995).

Among the most widely reflected of these approaches are today without doubt theories of ‘social capital’ – which at the same time have risen to the dubious heights of the currently most *fashionable* approaches. While many divergent approaches exist here, too, the basic idea of social capital ‘can be summed up in two words: relationships matter’ (Field 2003: 1). In this sense, the concept of social capital seems to match well with the approaches focussing on *wasta* and the neopatriarchal society that will be discussed below, at least at first sight. It even seems to bear the promise of being able to integrate such concepts into a larger analytical frame that is not *a priori* restricted to the analysis of the developing world. Social capital approaches are today associated mainly with three eminent names in social science research: Pierre Bourdieu (mainly 1980; 1991; 1992), James Coleman (mainly 1988-9; 1994), and Robert Putnam (cf. mainly 1993b; 1995; 2000).<sup>17</sup>

While Coleman and Bourdieu have in common that their interest in social capital originates from sociological research on the young generation (as is the case with Granovetter’s otherwise different interests), Putnam’s interest in social capital, as a political scientist, stems from a decidedly Tocquevillean point of departure. He asks about the guarantees of functioning democracies not in terms of institutional design or economic prerequisites, but like Tocqueville in his famous account of the American democracy (which he had visited twice in the 1830s and where he was fascinated by the multitude of voluntary social organizations) from the view of societal structures that constitute democratic polities from below (cf. Putnam 1993; 1995 and Tocqueville 1838-40). Putnam sees public civic life and voluntary social organization as one of the main pillars that contribute to ‘making democracy work.’ In his book with this title, he defines social capital as ‘features of social organization, such as trust, norms and networks, that can improve the efficiency of society by facilitating coordinated action’ (Putnam 1993: 169).

This is a very optimistic view, understandable from Putnam’s specific research interest in social capital as one of the pillars of democratic societies as a whole. This view is very much geared toward what social relations within networks and group membership mean for the polity. On the other hand, it totally neglects its possible impacts on economies and economic performance, which is the focal area in this study. As Coleman (1994: 302) notes, ‘a given form of social capital that is valuable in facilitating certain actions may be useless or even harmful for others.’ In contrast to the concepts of clientelism or neopatrimonialism (see below), the concept of social capital and network (often a bit euphemistically termed ‘network theory’ or even ‘theories’) in itself is open and does not carry within itself any inherent statements as regards economic outcomes; these approaches are, in this respect, less specific. Whether social networks are conducive to growth and development or constitute an

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<sup>17</sup> For a general overview of the various and divergent strings of social capital approaches, see the contributions to the volume edited by Baron, Field & Schuller (2000).

impediment to them largely depends on the nature of the networks and on the actions it facilitates. It is important, therefore, to be aware of the fact that ‘social relationships can sometimes serve to exclude and deny as well as include and enable’ (Field 2003: 3). For the region to be analyzed and the type of social relationships that dominates in the societies concerned, there is not the slightest shadow of a doubt that networks are most influential where they comprise elite members, where political and economic elites coalesce in order to determine both political and economic outcomes. Until today, there is only one volume that tries to use network theory as an analytical basis for economic processes, specifically in order to detect ‘networks of privilege’ in fiscal policies, in the Arab world (Heydemann 2004 [forthcoming]).

What seems problematic is that almost all of the contributions to that volume fall prey to exactly those pitfalls that the concept itself lends itself only too readily: A total neglect of the impact of networks on power constellations. In this sense, the book repeats weaknesses of specifically Coleman’s and Putnam’s considerations on networks and social capital who rather stressed the importance of horizontal relationships – whereas Arab societies have are, as will be shown below, primarily structured along strictly vertical lines of authority and patron-client relationships.

All of these sociological approaches (network theory, social capital approaches and economic sociology) deal with problems that are relevant for the present study. Often, they are related to those political scientists have analyzed with the concepts of patronage, clientelism or neopatrimonialism, that is: the issue and importance of informal connections and networks in social systems. However, differences become evident rather soon. With the exception maybe of some of Pierre Bourdieu’s writings, they also have a significant weakness in that they tend to overlook the dimension of power that comes along with social networks. Many of the proponents seem so fascinated with analyzing the presence of networks, of multiple roles individuals can take on in a given social context, of mapping varying and multiple group memberships, that they miss out on the genuinely political and power-related consequences of such patterns of social interaction and the implications different types and levels of ‘social capital’ brings with it.

In that sense, the sociological concepts discussed here strongly parallel economic approaches such as NIE or certain currents in NPE in that they often miss the decisive nature of power-constellations that are part and parcel of informal social relations, just as well as they exist in formal ones. Thus, they lack one of the most essential ingredients any social science concept has to capture in order to explain economic outcomes in development processes. Therefore, they have been briefly discussed here and their position in the context of concepts related to the topic under consideration here has been clarified, but they will not be an integral part of the integrated and interdisciplinary approach developed in the remainder of this chapter and the study as a whole.

## *The Rentier-State Approach*

With the sharp rise in world oil prices in 1973-74, the income accruing directly to Middle Eastern states had multiplied. It is important to note that this does not only hold true for the oil-rich monarchies of the Gulf peninsula, but also for those Arab states that have no or little mineral resources to export. They benefited from large amounts of mainly official transfers from the oil producers that came mostly in the form of unconditional budgetary support. Thus, a political-economic sub-system that has been termed 'political petrolism' (Korany 1986) evolved, linking all the Arab states in a region-wide circulation of oil-revenues. Secondly, international aid flows from the Soviet Union as well as from the western hemisphere have additionally increased the Arab states' reliance and, in fact, dependence on external capital inflows. Since they have similar political effects as have differential economic rents from the export of oil and gas, they can be seen as 'political rents' that also enhanced the allocative potential of the state and, therefore, added to political stability (Albrecht, Pawelka and Schlumberger 1998). As a consequence, the states became the largest and most powerful actors by far within domestic economies and, in fact, the 'major and ultimate employer' (Beblawi 1987: 55), irrespective of the political system (republican or monarchical) or ideological orientation ('socialist' or conservatively western-oriented) that the regimes under consideration here have pursued.<sup>18</sup>

Based on the observation of these phenomena, as well as on earlier economic research on the 'rent-seeking society' (see, for instance, Krueger 1974 or the volume edited by Buchanan, Tollison, and Tullock 1980), the concept of the 'rentier-state' was developed by Beblawi and Luciani (1987) and the contributors to their volume, and subsequently elaborated in important aspects by Pawelka and Schmid (see Pawelka and Schmid 1988 on crisis management in rentier states; Schmid 1991 on the historical development of the concept; Pawelka 1993 on the political economy and international relations of rentier states; Pawelka 1994 on the foreign policies of rentier states). It holds that the nature of the state and form of government is determined, *inter alia*, by the nature and sources of the state's revenues. The basic idea is that if a state earns its revenues externally rather than domestically (through taxation), then this has repercussions on patterns of legitimation,<sup>19</sup> as well as on the nature of the state and its domestic behavior.

A state that mainly depends on the extraction of resources from domestic society for its survival is, according to this concept, more prone to societal demands from that population than a state that mainly relies on external finance. In a reversal of the slogan that stems from

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<sup>18</sup> This point has convincingly been demonstrated in an empirical investigation by Bradley Glasser (1995). Likewise, Richards and Waterbury (1996: 173) find 'striking' the 'lack of variation in the degree and scope of state intervention across countries that otherwise greatly differ'.

<sup>19</sup> While legitimacy can roughly be circumscribed as popular support or the level of content that a state and its institutions enjoy among the populace, 'legitimation' designates the process and mechanisms of *creating* legitimacy.

the American War of Independence ‘no taxation without representation’, the oil-rich Arab countries of the Persian Gulf generate can be thought of as countries that follow a motto of ‘no representation without taxation’; by generating almost all of their revenues through the export of petroleum and natural gas (where the lion’s share of income can be identified as international rents due to the immense difference between low production costs and world market prices), the state becomes largely autonomous economically, but also politically, from domestic society.

While income from productive investment must be re-invested in the production circle, income stemming from international rents is at the disposal of the incumbent political elite and can be used for political purposes (regime maintenance, co-optation, and thus legitimation) rather than according to the logic of economic efficiency or productivity. It is the state itself (that is, the public budget) to which external capital accrues because the oil wells, as a rule, are government-owned. Thus, the occupancy of the state apparatus (at least initially) secures the economic survival of political elites. Political stability through acquiescent policies are therefore a question of survival for Arab rulers more than for political elites in other developing countries that depend less on external finance. In this sense, alimentionation of domestic societies became an exigency for political survival for rulers in the Arab world. On the other hand, the degree of autonomy from domestic society that such states enjoy is large compared to ‘extractive’ states: ‘Even limited revenue from abroad dramatically improves the state’s ability to buy legitimacy through allocation and increases regime stability’ (Luciani 1987: 76). As long as regimes were able to generate enough external resources, there was little threat to the legitimacy of authoritarian regimes. Hence, it is evident that such an income structure has important political corollaries: ‘Rentier states, because they do not have to rely on taxing citizens to gain revenues, have a tendency to be less democratic and accountable than governments that must engage fiscally with their populations’ (Shafik 1998b: 224).<sup>20</sup>

Rentierist policies with a strong priority on securing and controlling political power have been practiced by virtually all Arab states since the oil-price revolution of the early 1970s: First, comprehensive welfare systems, including free public health-care and educational systems, a broad range of subsidized consumer goods, and job-guarantees in ever-expanding public sectors had become typical of states that primarily or significantly lived on international rents. Second, many states built up enormous systems of repression by expanding the police, military and security services. Third, and maybe most importantly, the political logic of a domestic distribution of externally generated resources requires also a more targeted allocation of resources to social groups that are strategically important for regime maintenance. Among such groups were, for instance, the military, but also the heads of trade unions and institutions that organized the social strata on which the regimes relied as

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<sup>20</sup> For similar arguments on this point, see also Luciani (1987: 73-8), Ross (2000), and Waterbury (1997).

their social bases (farmers, public sector employees, etc.) in countries that had pursued collectivist ideologies of a nominally socialist type. On the other hand, a rather narrow stratum of politically connected private entrepreneurs was courted by the regimes of the more ‘conservative’, pro-Western Arab regimes (Saudi-Arabia and other countries of the Gulf peninsula; Jordan and Morocco).

Yet, such policies are costly, and the regimes are vulnerable to a reduction in the stream of external finance. This, however, is precisely what had happened in the Arab world since the second half of the 1980s: With structurally decreasing world prices for petroleum,<sup>21</sup> the oil-rich Arab countries have suffered huge losses of revenues. On a second level, this also concerned the oil-poor Arab countries: Their migrant workers who had found well-paid jobs in the Gulf were often forced to return from the high-wage oil-rich monarchies back to the oil-poor states with lower wage-levels, and the Gulf countries’ transfers towards the poorer Arab ‘sister countries’ (which had helped stabilize them politically) dropped dramatically. Most of the Arab countries, and especially the oil-poor states, slipped into foreign exchange crises that soon widened to become serious fiscal crises of the state. External commercial borrowing was often the only resort for the poorer Arab governments, but that involved the accumulation of an unsustainable external debt stock, pressure on local currencies, subsequently rising inflation, and a rapid depletion of foreign reserves. In short: as the regional system of petrolism had begun to erode by the late 1980s, so had the rentierist allocation policies in the oil-poor Arab countries. Previous mechanisms of legitimacy-creating rentierism could no longer be sustained. Many countries – even the oil-monarchies in the Gulf – had to follow paths of stern austerity for at least some years, while those countries with little or no oil and gas reserves saw themselves forced to embark on stabilization and structural adjustment programs in order to escape the threat of complete economic collapse.

However, this development entailed new political problems for the Arab countries: As the experience of many developing countries has shown, structural adjustment brings about adverse social effects – at least in the short run. Since political legitimacy throughout the past decades had been founded mainly on the state’s allocative power, the liberalization policies initiated since the late 1980s added to the Arab states’ crises of legitimacy. Bread riots, Islamist resurgence, and other protests were the visible symptoms of this in countries like Egypt, Algeria or Jordan. Not surprisingly, a significant number of case studies revealed these structural crises of legitimacy the Arab governments began to suffer from (see, among many others, Luciani 1994, who covers the entire region in his analysis).

In times of liberal economic policy reform, all countries have cut down the widespread and rather untargeted allocation of resources to their societies, and instead come to rely much more on the private sectors. Especially large firms have gained in strategic importance and are to be counted, apart from the military and secret services, among the main social

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<sup>21</sup> Since their peak in 1981, oil prices (in real terms) have never again reached the levels they had attained in the 1970s. The only exception to this is a short period at the beginning of the second Gulf War in early 1991.

pillars of all Arab regimes today, which involves significant changes to the overall socio-economic fabric of the countries under consideration.

In analyzing the political economy of the Arab world, the so-called rentier-state approach is now, after years of considerable skepticism from mainstream economists, generally accepted as a useful tool in explaining the nature of the state and state control over the economy in the Middle East – and beyond. Virtually all of the relatively few international economists who specialize in Middle Eastern affairs today recognize the importance of international rents as one of the most important structural factors that have shaped Arab economic and political life. A second such generally acknowledged factor is the specific type of political rule that prevails in the Arab world, and which is captured by the concept of neopatrimonialism.

### *Neopatrimonialism, Patronage and Clientelism*

It is textbook knowledge and hardly contested that Arab socio-political systems are characterized by strongly neopatrimonial forms of political rule, thus by asymmetric relations of superiority and subordination which are based on clientelist relations and personalist networks of patronage. While the term ‘patrimonialism’ dates back to Weber (1947), the concept of *neo*-patrimonialism has first been advanced by Eisenstadt (1973). With regard to the Middle East, it is common currency in analyses of politics also since the early 1970s (see Bill & Springborg 1990: Ch. 3; more elaborate: Pawelka 1985: 22-99).

While patrimonialism is seen by Weber as a type of political rule that originates from the authority of the head of a household in the classical economic sense, neopatrimonialism hints to modernized political structures and a re-formation of traditional patrimonial rule. As an approach, neopatrimonialism was advanced in the early 1970s as a reaction to the deterministic assumptions of modernization theory that Third World developing nations who had just obtained sovereignty and escaped imperialism were seen in an interim stage on their way to the modern nation state as they existed in the Western world (cf. Eisenstadt 1973: 10). Empirical observations showed amazing parallels between modernized Third world regimes that had installed many of the outward institutions of Western societies (such as parliaments, bureaucracies, etc.), and traditional patrimonial rule as described by Weber (1947). This means that decision-making mechanisms remained, as a rule, ‘unofficial’ or rather: informal, even though many of the formal features of modern nation states had been adopted. A façade of formal institutions had been installed, but came to fulfil functions fundamentally different from those they fulfilled in Western settings from where they originated. This ‘export’ of institutions can be regarded as a long-term corollary of imperialism which strongly influenced decades of political development in Third World countries.

Key features of neopatrimonialism are that political rule is almost unrestricted by law because it is, in essence, *informal exercise of power* in a *personalized* system in which the

ruler entertains close informal networks with various ‘circles’ of elite members (the top-, or: core-elites within the military and security establishment, the business community, the bureaucracy, etc.) who are personally loyal to the *ruler* who acts *as a referee between competing elite interests* and balances them. Intra-elite competition is functional since it prevents any single elite segment from becoming a possible alternative power-base that could threaten the rule of the regime leader(s). Relations between the ruler and the elite are strictly *hierarchical*, i.e., they represent relations of *loyalty, dependence, and power*. The core and intermediate elites themselves, however, build up their own networks of loyal clients, and, in this sense, work to extend the system of informal, hierarchical relations into the wider society. Neopatrimonialism is invariably built on (equally informal) *patron-client relations* that shape social relations not only at the helm of the state, but *exist throughout society at large* and shape the social fabric.

Typically, the neopatrimonial system has a single person with almost unrestricted authoritative powers (often a figure to whom Weber would ascribe ‘charismatic’ leadership) as a ruler at the top of the polity. Below, political society can be imagined in concentric circles of clients who are related to their respective patrons in varying degrees of loyalties (see Pawelka 1985: 22-29). In that sense, it seems logical that patterns of political patronage and clientelism (on the concepts see Gellner & Waterbury 1977; Gellner 1977 and 1987; Günes-Ayata 1994; Eisenstadt & Roninger 1984; Roninger 1994; Lemarchand 1981; Weingrod 1977) have often been used not only in their own right to describe a certain type of social fabric, but also as a complement to explain neopatrimonial political rule.

Third, existing social relations between ruler and ruled are, on all levels, highly personalistic. ‘[...] the power structure remains personalistic and clientelistic. In such circumstances, authority is often ascribed to individuals rather than to institutions’ (Dorraj 1995: 121).<sup>22</sup> Thus, the position an individual occupies in the neopatrimonial polity may often not be recognized from looking at the *formal* post he or she occupies in the political system. Rather, it is the strength or weakness of *personal ties* to the ruler that determine the actual influence on decision-making any individual can enjoy. The analytical problem that goes along with that is that it is much more difficult to assess how and in what respects individuals are related (often privately, e.g. through inter-marriage in the larger family, or through business ventures with relatives of each other) to the leading figures of a neopatrimonial regime than in conventional elite studies that proceed along strictly positional approaches only and do not take into account this informal level. As a result, categories that are essential in any political analysis of Western societies (such as nation, state, class and the like) are far less helpful in turning our view towards neopatrimonially organized systems of political rule (cf. Albrecht 2002a: 23). In order to grasp the essence of this type of polities, another characteristic (apart from the pervasiveness of patron-client relationships) may help: The

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<sup>22</sup> Note the different usage and notion of the term ‘institution’ in political science when compared to NIE!

patrimonial state, as a rule, displays strongly paternalistic traits. Clients will, in the long run, not be acquiesced if they get nothing in return for the loyalty to their patrons. Therefore, it is not only repression, but also an elaborated system of legitimacy mechanisms that makes patrimonial systems survive. The allocation of favors, material benefits and chances compensates effectively for lacking formal participatory chances in political decision-making.<sup>23</sup> Charles Tripp (1995: 23) is therefore right in his finding of a legitimacy system of ‘protection and provision’, even though it was probably Pawelka (1985: 25) who formulated this feature most pointedly a decade earlier: ‘The patrimonial state is elitist, but soft.’

Linking the concept of neopatrimonialism to the above discussed idea of the rentier state is not difficult: It is obvious that the political-economy concept of the rentier state can well explain the material foundations of neopatrimonial political rule as a distinct form of non-democracies: ‘The patrimonial non-national state is [...] best adapted to being an allocation state, because its origin naturally restricts the number of people who have a say’ (Luciani 1987: 75). In this sense, it is precisely the rent-influenced nature of state revenues which provides patrimonial leaders and, in a sort of trickling-down effect, the respective patrons on lower levels, with the material resources necessary to build up and maintain circles of loyal clients.

A last word is due to those who reject the *concept* of neopatrimonialism because they think it was culturalist and that therefore, patronage, clientelism and patrimonialism were essentially culturalist concepts with little explanatory value that risk becoming some sort of a residual category for whatever cannot be explained by ‘regular’ concepts, i.e. concepts that have been used to explain socio-political constellations and systems of rule in Western societies.<sup>24</sup> First: there is something *to* this argument, since it is based on the assumption that analytical concepts should indeed be universal - or else they are none. However, it is grossly misleading to assume that some notion of ‘Arab mind’ (al-Jabiri) or other culturalist ideas figured the assumptions inherent to the concept of neopatrimonialism. Empirically, this reproach is easy to discard: Throughout sub-Saharan Africa, patrimonial systems have been found (cf., for instance, Bratton & Vandewalle 1997), and likewise, Southeast Asian polities (for example the Philippines under Marcos) have been convincingly analyzed with the help of that concept. Political rule in large parts of Central Asia, too, could be explained with this concept (Turkmenistan, Kyrgyzstan, Azerbaijan, and maybe Kazakhstan), and even today’s Russia has been ascribed certain characteristics of patrimonial rule ever since Boris Yeltsin succeeded Mikhail Gorbachev, and even more so under the currently re-authoritarianizing

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<sup>23</sup> There are, no doubt, important informal channels of participation, most notably on the local socio-political level. See Diane Singerman (1995) for a fascinating case-study on such informal ‘avenues of participation’ (thus the title of her book).

<sup>24</sup> I insert this passage because, when discussing the early versions of the argument of this study with colleagues, mainly from the US, this was among the most serious criticisms that were brought forth against the approach presented here. While I consider it perfectly normal that, given the large number of concepts referred to in this



presidency of Vladimir Putin (cf., e.g., Jensen 2001; 1997). There is thus no doubt that the concept has proven explanatory power far beyond the Arab world. The problem is a methodological one: If a certain type of polity is not met in all regions, that does not mean that the concept itself is deficient or inapplicable. Rather, it is a perfectly normal thing to have classes and categories, and see where they exist and where not. Assuming the concept of neopatrimonialism to be culturalist or a residual category just because patrimonial rule is hardly found in *Western* societies would be the same as dismissing ‘democracy’ as an analytical concept on grounds that it cannot be found in a certain region or with the argument that it dominates nowhere else than in the Western hemisphere. With this analogy, the methodological weakness of that argument should be evident. There should therefore be no need for discussing it any further.

### *Neopatriarchy, ‘Wasta’, and Corruption*

Georgetown Sociologist Hisham Sharabi (1988), in his ‘theory of distorted change in Arab society’, describes what he calls the ‘neopatriarchal society’. He focuses less on the system of political rule but embeds the phenomenon of political neopatrimonialism into a wider context of social relations that prevail on all levels of *society*, and of which neopatrimonial political rule is but one symptom.

For Sharabi, the dominance of neopatrimonial political rule can be traced back to prevailing structures on the micro-level, within the family, which is no less compatible to how Weber views the origins of neopatriarchal rule than what Eisenstadt, Pawelka and others write on neopatrimonial politics: Stating that ‘its [patriarchal rule’s; O.S.] seeds lie in the authority of the head of the household within the domestic community’, Weber (1947: 681) is clearly at the heart of Sharabi’s ideas. In fact, for Weber, patrimonialism is ‘a special case of patriarchal rule’ (ibid.: 683). It is clear, therefore, that the sociological concept of neopatriarchy and the political science approach of neopatrimonialism are not only of common intellectual origin, but are compatible with on another on an analytical level. While the latter focuses on the political sphere proper and on the system of the exercise of power and rule, the other emphasizes prevailing social relations within society at large, from the micro- to the macro-level of analysis.

In such a neopatriarchal society, how do humans act and interact? The mechanism that primarily regulates intra-societal allocation of resources is circumscribed with the rather vague Arab term of ‘wasta’ (literally: ‘intercession’ or ‘intermediation’) that describes personalist and informal networks that are based on friendship, kin, or on patron-client relations. They are thus personal relationships for the purpose of – in the long run – mutual benefit and aim at an enhancement of the individual situation of the one seeking for *wasta*. In

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chapter, not every reader may like all concepts equally well, the critics of patrimonialism turned out to be the fiercest ones. They therefore deserve a short reply.

contrast to the original meaning of ‘rent-seeking’, however, the search for ‘wasta’ does not necessarily or primarily refer to the search for material gains, but also refers to immaterial issues and benefits such as, for instance, an enhancement of social status, the search for scholarships, licenses, a parliamentary seat, or other advantages and privileges that might enhance the well-being or social status of a person looking for wasta. This aspect constitutes an at least equally important part of relations based on ‘wasta’. The individual who is in a position to extend favors (both material and immaterial) will do so towards his kin, his friends, and business partners. The reason for doing so is, simply put, the expectation of iterated game situations with changed positions – that is: expecting that the favor advanced to the other party will one day yield payoffs in a situation when the one who first extended *wasta* to somebody is in need of ‘getting something done’ himself, so that in the long run, the relationship is expected to be mutually beneficial (see, i.a., Cunningham and Sarayrah 1993: ch. 1). Thus, the prevalence of *wasta* in societal relations is compatible with rational behavior and can be described as ‘the lubricant of the patronage system’ (Sharabi 1988: 45), the mechanism that makes patronage work. In the economic arena, this includes, again just taken as some examples, firms that aim at securing the power they possess due to a dominant position they occupy within a given market by political means, the *de facto* closure of markets for the entry of new competitors, the granting of import licenses and other permits, the speeding up of bureaucratic procedures, and so forth.

Such structures of ‘personal relationship-networks’, as Czichowski (1988: 566) notes with regard to the whole Middle Eastern region, ‘dominate all countries under consideration here’, continuing that ‘it is important to hint to the fact that the allocation of resources through “wasta” is a basic principle of society’ (ibid.: 567). Similarly, Cunningham and Sarayrah (1994: 36) point out that ‘wasta is the societal norm’ – and by no means an exception, as some would have it. Since it is personal loyalties on which these social norms are built, the dominant role of patronage and the inherent use of *wasta* networks are most obvious for the Western observer in the context of governmental authorities, in the selection of persons for influential posts, and in the public economic sector. Yet, neopatriarchal relations, the use of *wasta* and the prevalence of patronage are dominant within society at large; therefore, its economic consequences can hardly be restricted to public sectors that are often seen as inefficient and endemically corrupt. If socially dominant, we should be able to trace the influence of personalist networks and the excessive use of *wasta* in the private sector, too. And indeed, even here, where Weberian spirits and Schumpeterian entrepreneurs should be found with the greatest likelihood, personalist and informal relations clearly dominate and often take priority over categories such as competence and productivity.

While Westerners often expect officials to display some sort of loyalty towards office, ideology, or constitution, that is: towards some abstract value, this mostly does not grasp the realities of social life in the Arab world. Such an assumption neglects the fact that social norms and personal affiliation in Arab society do not work in the same way they do in liberal

democracies of the Western style. As a result, the search for individual advantages or for the benefit of one's family or one's clientele – something that is usually regarded as self-understood and perfectly normal – is often labeled 'corruption' by Western authors writing on the subject. This terminology is questionable for several reasons: First, it does not capture Middle Eastern realities since it is inherently based on the systems of the industrialized countries of the West and try, on that basis, to assess, to measure and, most problematically, to judge patterns of behavior that deviate from those common in Western societies as they would be judged in a Western context. There is thus a strong normative bias.

Second, there is also a more important and more categorical difference. Rent-seeking, *wasta*, and corruption describe patterns of social behavior that are not the same, even though literature often uses them synonymously because their *results* are similar in some ways: The most important trait the three have in common is that all of them describe behavior that raises transaction-costs and, thus, produces socially sub-optimal outcomes in that they all create overall welfare losses. Moreover, they all constitute collective action problems (cf. Olson 1965; for details on the argument with respect to the Middle East: Schlumberger 2000b), which can easily be illustrated: Imagine one person intervening on behalf of a cousin for, say, an import license. Fine, it will be granted, and the overall societal damage done will not be great. However, if everybody intervenes on behalf of everybody's cousins, licenses can not be granted to everybody. The bribe that has to be paid, and/or the amount of time and energy to be invested in having the closer personal relationship to the official in charge, will rise with the number of participants in the informal system. Also, for the state to re-gain control of corruption, the problem of formal rule enforcement increases with the number of corrupt individuals since every individual, knowing that corruption, rent-seeking or the *wasta* phenomenon is pervasive, will reckon on not having to bear the costs (i.e. not being legally sued for adhering to informal rather than to formal rules). As an economic result, overall welfare is greatly reduced. Transaction costs will have risen, as will enforcement costs for the state, and overall welfare is reduced while paradoxically, every individual will have the feeling of being better off *with* the use of *wasta* because he or she has an ability to become active in pursuing their own private ends through searching for *wasta*. As a result on the macro-societal level, followers of the informal rules will have begun to set the norm up to a point where it has become a social norm in itself to deviate from formal rules. This is actually the case today in most of the Arab region – not to mention large other parts of the developing world.

However, as alluded to above, the phenomena of 'rent-seeking', 'wasta' and 'corruption' also differ in important respects: Acting corruptly in a Western context means to *deviate* from a given norm. This norm is so strong that norm violation, if known, is considered a crime that will be punished by the judiciary. Corruption is thus a term of Western origin with a strongly negative connotation that depicts criminal behavior. Quite the opposite is the case with *wasta*: It is a term of Arab origin that does not denote behavior

against, but *according* to a social norm. Therefore, while economic results of both corruption and excessive intercessory *wasta* are comparable in that they have welfare-minimizing effects, the normative values that are an integral part of the understanding of both terms come close to being opposites. He who rejects the use of *wasta* for achieving his or his family members' goals in Arab societies will be socially isolated and come under the greatest pressure from his kin (cf. the examples given in Cunningham & Sarayrah 1993: Part II). Note that this is not only a terminological question, but a question of content associated with the terms we use!

As concerns corruption and its consequences for development, there is a relatively large body of (mainly economic) literature on the issue (instead of many titles, see e.g. the review on recent literature by Hopkin 2002), most of which is concerned with the question of how corruption impacts on development or not.<sup>25</sup> However, much of this is written by academics of Western origin (Klitgaard 1998; Mauro 1995; Mbaku 1998; Shleifer & Vishny 1993; Thornburgh 2003) who often also work in development practice or as consultants, but who mostly miss or neglect the difference in the social meaning between corruption or rent-seeking (also a term of Western origin) on the one hand and the fundamentally different connotation *wasta* and other indigenous terms carry with them in the respective non-Western contexts on the other. To be sure and to repeat that again: I do not speak here with any sort of culturalist voice. The existence of *wasta* is a phenomenon that is by no means restricted to an Arab socio-economic environment. Whether called '*blat*' in Russian or '*utang na loob*' in Filipino, such informal systems of 'getting things done' as well as a specific language for them exist in many regions and are by no means a predisposition of any one ethnic group, geographical region or cultural sphere (I shall get back to this point in Part [III] below).

There are important differences between the sociological and political science approaches presented and discussed above as concerns the level of analysis they capture, refer to and operate on: The modern forms of 'neopatrimonialism'-approaches as discussed in the previous section above are distinct from the sociological concepts presented here insofar as they explicitly aim at explaining power relations and, in fact, are models for explaining a certain type of political *rule*. Secondly, the rentier state approach is able to explain the political economy underlying neopatrimonialism and its material bases, while neopatriarchy explores into the social underpinnings of neopatrimonial political rule. The latter is based on behavioral assumptions derived from development psychology, namely the works of Jean Piaget (cf. Sharabi's references [1988: 43-45]). Nevertheless, Sharabi aims at explaining the social structures that prevail on a *macro*-societal level. By contrast, most economic and public-choice efforts to conceptualize corruption deal with the phenomenon in the context of institutions, that is: on a *meso*-level between the society at large and the individual, while they try to capture the behavioral foundations of corruption by following the economic idea of

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<sup>25</sup> A remarkable exception that distinguishes between corruption in the developing world and in industrialized countries, and which deals with the issue in an analytical way is the vast study edited by Williams (2000).

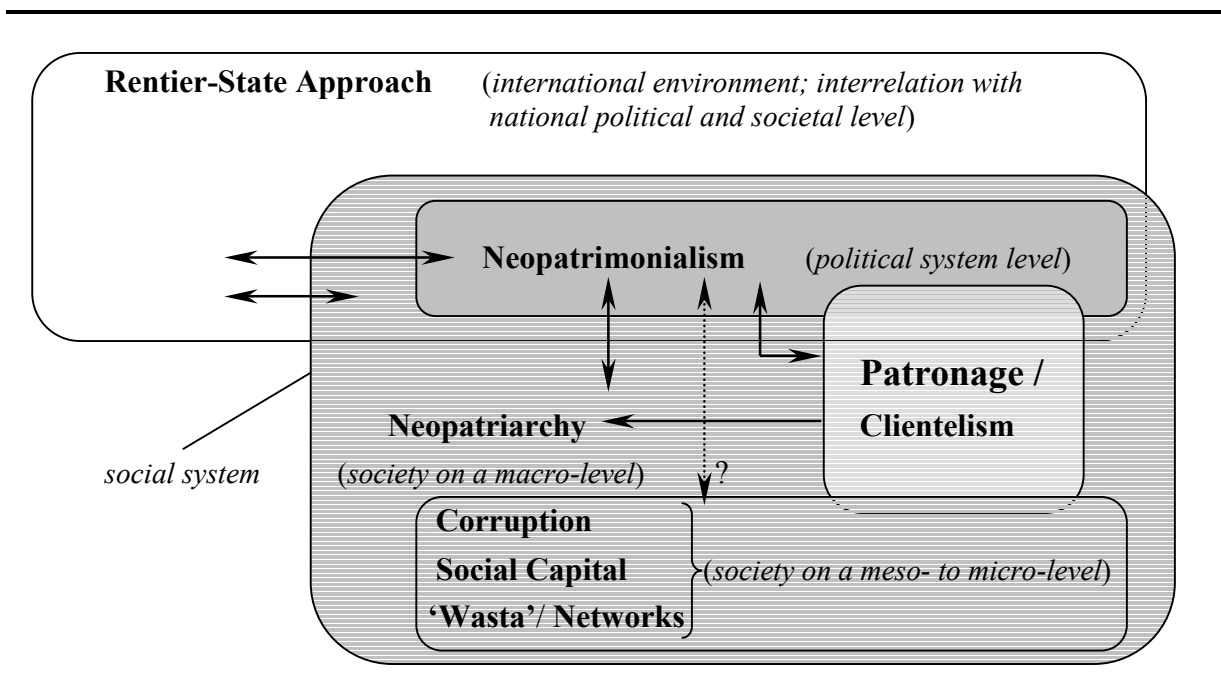
‘methodological individualism’, that is: micro-economic rationality on the individual level according to rational choice models. Finally, the very few writings that aim at conceptualizing the phenomenon of ‘wasta’ situate the phenomenon on exactly that same level.

Thus, in terms of analytical *levels*, neopatriarchy is the most encompassing concept (the above mentioned conceptual flaws notwithstanding), whereas neopatrimonialism explicitly restricts itself to the political-system level, and conceptualizations regarding corruption and *wasta* as well as informal networks are located on a meso- to micro-level of analysis. With regard to the description and analysis of the underlying social relations, a comparison between currently fashionable approaches of social capital and economic sociology on the one hand and the older concepts of political patronage and clientelism on the other have a clear winner in the latter: These concepts point directly to the heart of the matter in that they emphasize the role of vertical hierarchies and power which social capital approaches for the most part neglect or loose out of sight.

Figure (2.1) below tries to ease the understanding of the previous paragraph by showing exactly which concept (printed in bold) applies to which analytical level (printed in lower case italics), and how the phenomena explained by them possibly impact on one another in the sense of reinforcement, though not necessarily causally (the arrows in the figure). Not for comprehensiveness, but in order to demonstrate the compatibility of political economy’s rentier-state approach with other political science and sociological concepts discussed here, the rentier-state approach (RSA) is included in this figure.

*Figure 2.1:*

CONCEPTS ADVANCED BY POLITICAL SCIENCE AND SOCIOLOGY



To be sure: most of the key words mentioned in the figure are not terms, but analytical concepts in themselves. They represent social science approaches toward the analysis of what is deemed essential independent variables for *economic* analyses by NIE and are therefore highly relevant to the analysis of economic performance and prospects for development. As a matter of fact, neopatrimonial socio-political systems, extremely personalized patterns of political rule, and socially dominant patronage networks as well as the search for *wasta* dominate the entire Arab world's socio-political systems without exception (on *wasta*, see also Cunningham and Sarayrah 1994; Kilani and Sakijha 2000 and 2002). Political decision-making, elite formation and recruitment mechanisms (cf. Perthes 2004), law endorsement and enforcement, and even agreements of a contractual nature between non-state actors are often done in an informal fashion. These issues belong to the most fundamental structures that shape social, political, and, not least: economic life throughout the Arab world.

### *Political Systems, Regime Research, and the Analysis of Economic Orders*

Finally, and on the most abstract level, the root concept of comparative politics, namely the idea and logic of political systems or 'polities' must necessarily be included into this chapter on concepts because the book is about economic orders. This inevitably involves questions of classes, types and subtypes. There is, however, comparatively little literature on economic systems apart from the popular dichotomous imagery of capitalism versus socialism, and apart from what we have come to call 'free' market economies versus those we call 'centrally planned' ones. The idea here is that a look at comparative politics and, more specifically, at research on political regimes may not only enable us to assess the current state of classificatory questions on political systems, but also to draw an analogy to the situation of research on *economic* systems, their characteristics and definitional elements. The discipline of economics provides no convincing answers when it comes to the question of the transformation from one economic order to another. It is here where political science has gathered considerable expertise in the dynamics of systems transformation, the systemic change from one system to one different in kind, not only in degree. It is suggested therefore that the knowledge political science research has acquired under the conceptual umbrella of research on political regimes and 'transitology' could be made useful, in an effort of transfer, to other than political systems, namely to the evolution of economic orders and their change, too.

As noted above, it is a 'political analysis of markets' (White 1993) that seems necessary. The way such an approach looks, of course, depends to a large degree on what we understand by 'political' or 'polities'. I use here the standard definition provided by David Easton and made popular by Gabriel Almond and others that can be found in every comparative politics textbook since the 1960s: Politics, Easton says, comprises anything that includes or relates to the 'authoritative allocation of values' (Easton 1965: 50). This includes

more narrow definitions of politics as the ‘art and science of government’ in the face of ‘an enormous volume of demands made upon it’ (Schattschneider 1942), but at the same time realizes that government is not the only institution where the ‘struggle for power’ (Morgenthau’s definition [1948] 1954) is exercised among groups and between opposing interests. What is common to all definitions of politics that are accepted by a significant number of political scientists today is that they all involve – at least implicitly – the struggle for and the exercise of power, very much in a Weberian tradition (cf. his famous [1988 [1919]: 505ff.] ‘Politik als Beruf’). But what, then, is ‘power’? While there is a tremendous amount of literature on that question, the traditional definition given by Weber has proven long-lived and still is among the best because of its operationalizability. Power, for him, is ‘every chance to impose ones own will in a social relation, even against resistance, no matter where this chance results from’ (Weber 1947: 28).

While the notion of political systems itself is not contested in comparative political analysis, it is the question of types or classes of polities which has become a matter of heated debates, especially over the past few years. Back in the 1960s, established categories of political systems were democracies on the one hand and, the experience of Nazism being still close historically, totalitarian regimes on the other. It was in this situation that Juan Linz, in what later became the maybe lengthiest lexicon article ever written, invented the famous concept of ‘authoritarianism’ (Linz 1964) as a category somewhere in between both. Analyzing Spain under General Franco, he found that this polity obviously was not a democracy, but could neither be grasped with the by then established concepts of totalitarianism (cf. Friedrich & Brzezinski (1968) as the most important [short] conceptualization of totalitarianism). Thus, he felt, a category in between both was needed. And although Linz’s definition of what today is a firmly established class (authoritarian regimes) is for the most part a definition *ex negativo* towards both democracies and totalitarian regimes, it still stands uncontested for lack of better alternatives forty years later.

In this situation, research about systemic changes began to set in, most notably with two directions. The first, inspired by classical modernization theory, focussed on structural factors that were seen as determining the type of political order (the classical examples are Lipset 1959 and Parsons 1964). Later on, in the 1980s, a second and competing string of literature emerged that addressed what was perceived as a deficiency in the earlier works: A school focussing rather on agency, on political actors and their strategic interests and choices (cf. mainly Przeworski 1986; 1991; O’Donnell & Schmitter 1986). Soon, it became clear that only a synthesis of both could be expected to bring about satisfying results since both structure and agency included important explanatory variables for outcomes on the polity level (cf., e.g., Merkel 1994).

But even though it began promising, this current of research on systemic political transitions (which then has come to be referred to as ‘transitology’) remained unsatisfying because it almost exclusively concentrated on transitions to democracy and in large parts

neglected the possibility of transitions in the opposite direction (one notable exception is by Linz & Stepan 1978). While, after the collapse of the Soviet Union and after almost all the Latin American continent had democratized collectively, Fukuyama's (1992) idea of an end of history (final victory of democracy and capitalism worldwide) gained much attention and seemed indeed plausible. But time told that not everything that had been taken for democracies or for processes of democratization resulted in fact in systems that would be called democracy according to the established and classical concepts for that type of political regime (foremost: Dahl 1971: ch. 1; analogous: Diamond, Linz & Lipset 1988: xvi). Thus, since most scholars shied away from giving up the notion of democratization, a whole range of adjectives such as 'semi-', 'illiberal', 'defective', 'delegative', 'façade' or even 'authoritarian' was put in front of the noun democracy in order to classify the polities that emerged after processes of systemic transition, but did not meet the criteria of liberal democracies as known from the Western hemisphere (cf. Collier & Levitsky 1997 for the theoretical argument in favor of such terminological innovations).

However, this led to blurred lines between democratic regimes and non-democratic regimes: The adjective attributes that were inserted made it no longer necessary that a system termed 'democracy' had to display all the features and characteristics that hitherto were required in order to speak of that type of polity. Some scholars became critical about these all too obvious methodological deficiencies, all the more so since they had been criticized rather explicitly by Giovanni Sartori (1991: 248ff.), one of the most eminent scholars not only in democratic theory (1962), but also a concerns methodological soundness of the discipline. 'Misclassification' and 'degreeism' were his main counter-arguments against 'democracies with adjectives' (Sartori 1991). Scholars began to ask whether 'authoritarian democracies' should not better be labeled as authoritarian systems, or what actually the arguments were to speak of 'illiberal democracies' rather than of 'liberal authoritarianisms' (cf. Maćków 2000). Recently, research followed these propositions in a new wave of 'adjectivism' and adopted a range of adjectives to attribute to authoritarian regimes instead of democracies. 'Competitive', 'electoral' or 'liberal' have gained some attention.

What has all this to do with the subject of this study? The point here is a methodological one: The whole debate within transitology clearly shows that we have to have clear-cut, universally applicable categories in order to be able to distinguish 'apples' from 'pears'. This is a necessary step in the course of any analysis that works on an economic systems level. Recently, an academic debate has set in about 'varieties of capitalism' (cf., e.g., the large volume edited by Hall & Soskice 2001). The problem is, however, that this debate on varieties of capitalism only covers liberal Western market economies and is entirely restricted to OECD countries. Therefore, an analysis that sets out to grasp systemic differences between a certain category of developing economies on the one hand and competition-based market economies as seen in Europe, Japan or North America can hardly benefit from that debate because on a global scale, it covers an extremely narrow range of



‘varieties’ that all are liberal and competition-based market economies and which differ mainly with respect to their relative level of direct state intervention in the economy and the level of social security the state provides to its citizens. While these are important topics, the literature does not constitute any foundation to build on when asking about developing economies, and even less so when inquiring into processes of systemic economic change. Since I know of no satisfying work to build on, this is done for possible economic orders or systems in chapter three below – in an admittedly very preliminary effort and merely for the purpose of being able to push the analysis further. The reader will notice how essential such distinctions and classifications are in Part (III) when it comes to determining specific traits and inherent developmental potentials of classes presented in the next chapter. But let me summarize this chapter before turning to the question of economic orders in greater detail in the following Chapter (3).

### Method and Scope: Three Types of Questions

Many efforts have been made to carve out the most relevant questions to be answered regarding the subject matter of structural economic reforms, their mode of implementation, and their results. Of course, this is the most basic requisite for determining a research agenda in order to analyze economic change and its consequences in numerous respects. Since this is a rather general and methodological task, and since, secondly, I know of no such methodological effort in the context of Arab economic reform, it might be useful to consider one example of a simple, but nevertheless successful effort to establish such helping guidelines for research that was presented in a Latin American context by John Williamson (1990). In his introductory chapter on ‘Latin American Adjustment’, he asks the authors of the following country studies to adhere to three basic questions (ibid.: 19): ‘Is the [Washington; O.S.] consensus shared in Latin America? – Have the recommended policies been implemented in Latin America? – What results have been achieved where the recommended policies have been implemented?’

While this author shares Williamson’s own view that this approach is not all-comprehensive, there is no denying the fact that it seems plausible to take these guiding questions as a basis in analyzing the implementation and results of adjustment policies in any given geographical context. What becomes evident here is that the questions proposed cover quite diverging research interests: The first one asks very obviously about the perception of what Williamson calls the ‘Washington Consensus’ in the area where structural adjustment is implemented, thereby acknowledging at least implicitly the relevance of cultural, or rather: *socio-political* factors for the implementation of externally designed economic policies. The second question certainly inquires into economic policy implementation and, as such, genuinely falls into *political economy*, whereas the last one is *purely economic* in that it asks

about economic outcomes. While these three rough guidelines proposed by Williamson surely are relevant in assessing the process and success of economic adjustment, it is easy to make up other, additional questions that might be just as relevant; a fourth one, for instance, would be the one asking for an explanation of outcomes: ‘Why have results been the ones they are?’.

The problem here is obvious: what is understood by ‘relevant’ depends to a large extent on the professional background of the one who inquires. To illustrate this, let us for a moment imagine three persons: first, a political scientist, second, an economist (and suppose both are academics), and third, a development practitioner. Regarding the subject of economic policy reform in the Arab world, each member of our fictitious trio would be interested in largely different aspects of the subject and, thus, ask different types of questions on the subject.

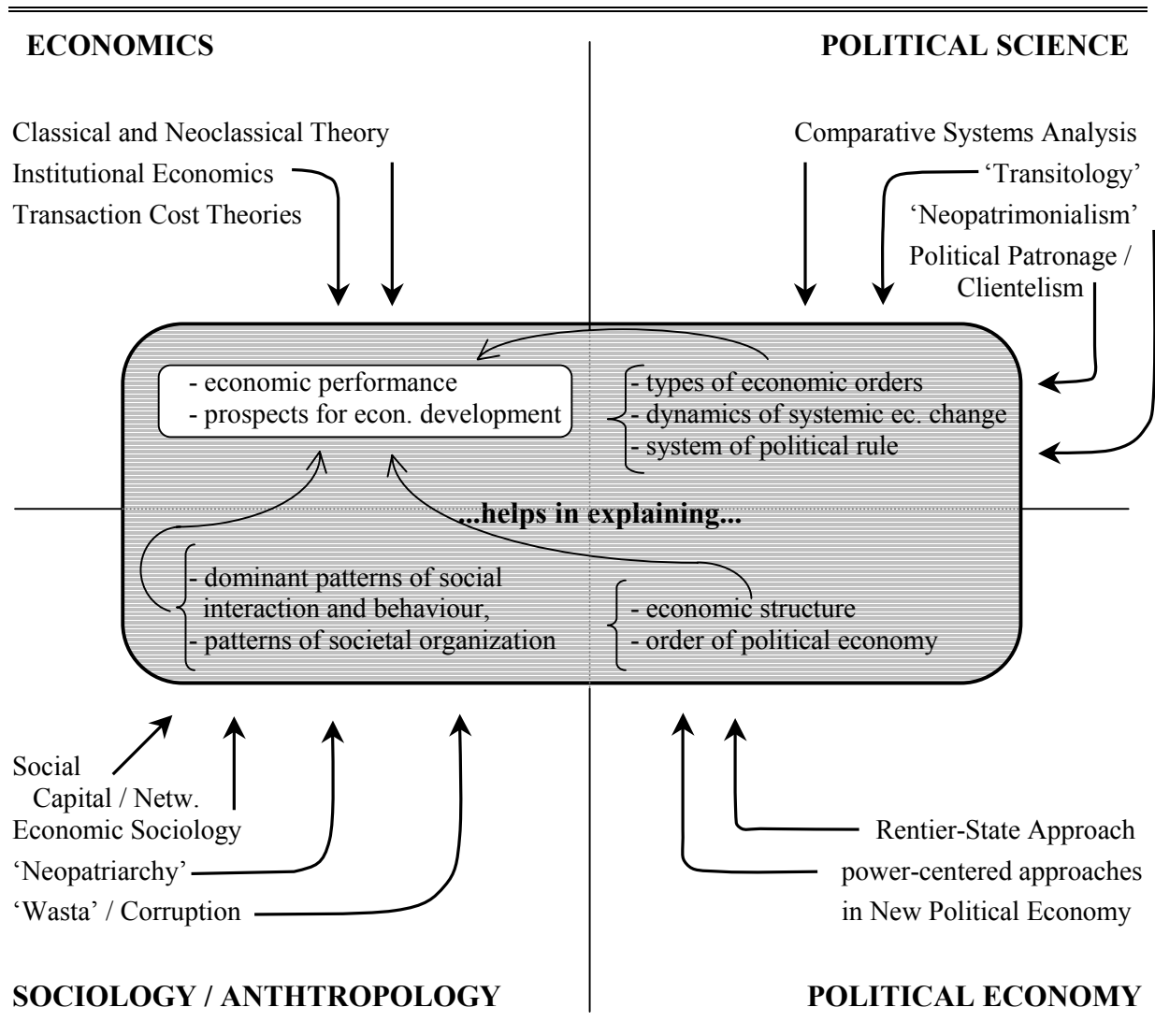
The economist’s main focus would almost inevitably be *economic performance*: ‘How does the economy concerned work, and how well does it perform?’; ‘How does economic performance change as a result of structural reform?’; ‘Is economic performance enhanced by economic policy change?’ and: ‘If so: to what extent – and if not: why?’. By contrast, the staff of donor organizations will want to know what results the projects and policies trigger they designed, agreed upon with governments in the region, and which they help to implement: Do they conform to the ones intended at the outset, and if not: why?; also, given the non-democratic nature of all Arab regimes, one might expect the practitioner to ask: ‘Can the “authoritarian advantage” of Arab regimes be used for enhancing developmental prospects?’. The political scientist, finally, would probably have largely indifferent feelings towards these types of questions. Rather, one can expect him to take on a different viewpoint and be interested in the *exercise of political power*, and to what extent the ways and means of doing so is influenced by structural economic change. His primary interest is thus likely to lie in the *nature of the political system* or polity, and in the degree to which this is affected by changes to the economic order: Since structural economic reform poses a latent threat to the prevailing autocratic rule of Arab leaders, he might ask: ‘Are the political regimes flexible enough to adapt economically to an altered international environment that promotes liberalism while at the same time maintaining the foundations of non-democratic political rule?’ and, subsequently: ‘If so, how (i.e. by what mechanisms and political strategies) do they manage to bridge this seemingly irreconcilable dilemma?’. Each of these divergent questions will be raised in Parts (II) and (III) of the study.

*Prima facie*, these are fundamentally different research interests and, in fact, entirely different *types* of questions. This is so because the subject of this study touches on various disciplines and therefore, has a rather wide scope, as has been mentioned in the introduction. And while it is usually almost considered a natural law that economic policies are best analyzed by economists, it should be clear by now that economic policies are considered here an issue area of *politics*, as one among others like foreign policies, environmental policies, and the like. As such, the know-how acquired in political science over the past decades cannot

be neglected when analyzing economic policies. Also, as figure (2.2) below demonstrates, there are social and socio-political factors that decisively impact not only on economic policy formulation, but even on economic performance and development. Therefore, a number of concepts, derived from all four disciplines mentioned here, have been identified as helpful in explaining the reasons for, mode of implementation of, and outcomes of economic policy change that have occurred in the Arab world since the late 1980s. Figure (2.2) now visualizes both their interconnectedness and the inter-disciplinarity of the approach established here and pursued in the course of the book. The findings so far have been achieved by building on quite diverse analytical concepts that originate from at least four different academic disciplines. In order to be 'readable' for representatives from all the disciplines concerned, I have tried to visit – at least in brief - each of the four corners of figure (2.2), i.e. representatives of each of the relevant disciplines at a point that is familiar to them.

Figure 2.2:

## AN INTERDISCIPLINARY APPROACH FOR THE ANALYSIS OF ECONOMIC POLICY REFORM IN THE ARAB WORLD



At this stage, a judgement whether there is method in my madness – or vice versa – must be left to the reader. In any case, some explanatory remarks on the figure seem helpful: Beginning from the outer corners of the figure, analytical approaches or theories that originate from four different (sub-)disciplines (political science, economics, sociology, and political economy) are depicted here as potentially helpful in explaining the various aspects of economic policy reform that have been discussed above.<sup>26</sup> The arrows that lead from the approaches and theories listed inwards toward the gray box relate them to social, political or

<sup>26</sup> Of course, many of them are related to or based on even more basic psychological and biological theories and assumptions about human behavior in general, but for the purpose of clarity, these are omitted in the figure.

economic phenomena which they are expected to explain or, put less ambitiously: in whose explanation they have been used.

Inside the gray box (to which the arrows from the outside point) mentions the various aspects and implications related to economic policy reform to which answers and explanations are sought for. Their importance is either self-evident (as in the case of economic performance, prospects for development) or is evident from what has been outlined earlier in this chapter (impact of political and social factors on the two aforementioned factors). These various aspects and phenomena inside the gray box, I contend, can be analyzed and explained by the concepts outside the gray box which have been advanced by the four different disciplines that mark the cornerstones of the figure (printed here in bold capitals).

On a third level, the inter-relatedness of the various factors listed inside the gray box is hinted to through three exemplary arrows. The important point here is that economic performance and prospects for development (inside the smaller white box) remain, in any case and for any question, always the *dependent* variables and thus at the far end of any causal chain that might exist. Hence, while they represent maybe the most pressing questions that answers are searched for, they can – at best – be partially explained by economic theory while they depend to a larger extent on other independent variables that reside outside the field of economics proper and which can *not* be explained by economic theory (The other phenomena mentioned in the gray box).

Accordingly, any approach that is based on one of the four disciplines alone (that mark the corners of figure [2.2]) is unlikely to provide comprehensive answers to the problems that have been outlined in the introduction, as well as to the different types of questions that our three imaginary inquirers would pose. The integrated approach outlined and proposed here, I maintain, adequately reflects the nature of the subject under examination which itself is a cross-disciplinary one and lies on the edge of various social science disciplines. By using this explicitly interdisciplinary framework that tries to knit together some hitherto rather unconnected threads of economic and political as well as sociological theory, I claim to be able to provide each of the imaginary inquirers with significant answers to the questions of his or her specific interest – without recourse to any variant of rather fishy ‘concepts’ of ‘Arab culture’ or some sort of ‘*homo arabicus*’ which exists but in the minds of some Westerners who have failed to de-colonize themselves from culturalist ideas.

In sum, the approach proposed here for the analysis of economic change in the Arab world can thus be identified as an NIE-based, power-oriented New-Political-Economy approach that is complemented by insights from political science and sociology. Bearing these theoretical reflections in mind, the task will now be to cast an eye on the processes of economic development under conditions of structural economic reform in the Arab world since, roughly speaking, the late 1980s / early 1990s.

## Conclusion: Some Hypotheses

Assuming that the approach pursued here has at least some explanatory power, a number of hypotheses to work with in the analysis of economic policy reform in the Arab world can be advanced. They constitute expectations concerning the empirical chapters that follow in part (II) below. In this sense, they serve as a ‘reality check’ to the applicability of the analytical concepts as presented and knit together here. By thus proceeding, falsification becomes possible; furthermore, the following hypotheses are aimed at facilitating the reading and understanding of part (III) below where I pass on to the implications part (II) has on both the conceptual level of analysis as well as on practical policy-making.

According to the interdisciplinary and integrated approach presented here, the following tentative points<sup>27</sup> should be expected:

- (1) Considering the fact that, as I have outlined above, the Arab world’s economies remain subordinated to politics, we should expect the *structure of Arab economic orders to be qualitatively different from the Western-style market economies*. We find there ‘very political economies’, as is the title of a recent study by Brynen (2000) on Palestine. The reason is that incumbent regimes aim at controlling the entire social system, including the economy, in order to minimize any potential threat to regime survival. Therefore, any economic or developmental interest can at best have second priority – after regime maintenance. Economic outcomes are therefore, as a rule, much less determined by market forces (and much more so by political considerations of the ruling elites) than are outcomes of transactions in market economies.
- (2) As a consequence of the first point mentioned here, we should expect *long-term developmental prospects of Arab economies to be sub-optimal*. If the market mechanism leads, in general and with some exceptions, to the most efficient allocative solutions and thus creates the greatest social welfare when compared to other mechanisms of resource allocation and exchange, then it seems logical that every step leading further away from market solutions will produce socially less optimal results. Now, while a number of Arab countries are quite well off and some even are among the most developed nations (such as the United Arab Emirates, for instance, which figure among the top ten or twenty of the worldwide in some of the variables measured by the United Nations’ Human Development Indexes [HDI] and rankings), there are others which are rather poor. Regardless of the oil wealth of some and the lack of such resources in other countries, the fact to be expected is that all of them could perform better than they actually do as a consequence of the assumed frequency of transactions that are of a non-market nature.

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<sup>27</sup> This list is not intended to be complete, but rather to serve as a guideline, enabling the reader to follow the core argument of the book through the following chapters.

- (3) Economic policy reform in the Arab world was initiated only after external pressures had become unsustainable (due to the accumulation of large amounts of external commercial debt throughout the 1980s). Because of the primacy of the political goal of power maintenance that applies to regimes of neopatrimonial polities, the *political will to implement structural economic changes* should be *limited*. The reason is simple: The comprehensive control that patrimonial rentier systems exert over their domestic economies (and, via this track, over domestic society) comes under serious pressure when liberal reforms are introduced. Not only is the explicit goal to reduce the state's direct economic activities (also as an employer, which in turn has important consequences for political legitimacy), but the deregulation of existing legal and institutional framework leads to fewer possibilities of indirect control over both the economic process and its private actors.
- (4) Since economic reform can thus be seen as forced upon the Arab governments through external necessities, *the degree to which they did embark on policy reform is a function of the relative amount of resources available to the regimes in combination with the level of external economic imbalances* that had accumulated through much of the 1980s (cf. also Beck & Schlumberger 1999).
- (5) Another result of the political primacy of regime maintenance over economic development follows: *Economic policy change can be expected to be conducted in a piecemeal approach, or, more precisely: in a selective and controlled fashion*. Even after a process of structural economic change, the respective regimes must seek to remain in control of the national economy and the economic process in order to maintain political rule stable and not to risk the emergence of serious political competition to the incumbent regimes as a sequel of the dynamics of reform (as had happened in other parts of the developing world). *The process of economic liberalization and reform is thus subject to the political priorities (regime maintenance) of the neopatrimonial leadership*, or, as classical systems theory would put it: Within the entire social system, the economic (sub-) system is subordinated to the imperatives of the political system.<sup>28</sup>
- (6) Structural economic change inevitably creates social winners and losers, and inevitably brings about changes in the constellation of elites. The late Nazih Ayubi (1992: 45) realized this point relatively early: 'policies of economic adjustment [...] by necessity carry with them important social outcomes and therefore require significant shifts in political coalitions'. This is important in our context since it first alludes to changes to the previous constellation of key stake-holders, and since it secondly impacts on prevailing

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<sup>28</sup> Of course, this point sounds quite similar to what Talcott Parsons (1964) had assumed concerning the prospects for the socialist countries whose downfall he had predicted already then, based on classical systems theory arguments. While the parallel in the argument is obvious, there are also important differences. One point is that I wish to leave open – at least at this point – the 'survival question' of socio-economic systems that Parsons emphasized. That question will be discussed on a different background in Chapter (13).

structures of political legitimacy. In past times of import substitution and state-led growth ideologies, the emerging working classes and wage- and salary-dependent middle strata of society were the main beneficiaries of statist policies. Unions and syndicates became influential in the single-party regimes that followed collectivist ideologies. By contrast, under conditions of the new orthodoxy, these are precisely the social groups that are bound to turn into social losers when labor markets become more flexible, subsidies are cut, real incomes stagnate or fall, and employment opportunities in the public sector become ever more scarce. Even though this might imply significant losses of popularity and legitimacy for the regimes, the dictates of liberal reform as implemented along the lines of the Washington Consensus hardly leave any space to avoid this consequence which necessarily constitutes a dilemma for political elites. *It can therefore be expected that (a) the regimes suffer from losses of legitimacy in the period of structural adjustment (which, in turn, impacts on the political feasibility of any continuation of liberal policies), or (b) – if avoiding (a) is preferred to cooperation with the international institutions – that the Washington Consensus will be implemented partially at best.* This point seems especially relevant in a politically neopatrimonial and economically rentierist environment as it dominates the Arab world since here, the state has a strong tradition of being perceived by the populace as a distributor of employment, income, and chances for upward social mobility. In fact, the welfare systems that had been established in the Arab countries (especially in the Gulf region) were so all-encompassing that they were not even paralleled by the former socialist countries of the Warsaw Pact.

- (7) As a consequence of hypothesis four, and assuming rational behavior on the part of the incumbent regimes, public sector reform along the lines of allocative efficiency seems thus the aspect of economic reform that bears the greatest threat of political instability. Therefore, *we should expect reforms in monetary policies, foreign trade, and the like, to be implemented more smoothly and swiftly when compared to the more directly politically sensitive issues of privatization and public sector reform.*<sup>29</sup> It is in the public sector where officials have been able to knit their clientelist networks more closely and reliably in the past than in the private sector. Therefore, any serious attempt at public sector reform will meet with considerable and, most probably, a higher degree of resistance ‘from within’ the ruling elites than monetary and macro-economic reforms.
- (8) However, the argument concerning privatization on the one hand and public sector reform on the other should be differentiated: After statist policies had led to near-bankruptcy, the states’ resources had been depleted, and the states’ enterprises had no chance of achieving economic survival, it was necessarily the private sector that was courted in order to increase its share in national products. New private business elites emerged and seized

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<sup>29</sup> A similar argument was made by Waterbury (1992) who had termed the question of public sector reform the ‘heart of the matter’ as regards liberal reforms.



new business opportunities, often in fields hitherto monopolized by the state. In the context of a thus increased role for private entrepreneurs, there are obviously also *incentives for rational governments to sell state assets to private sector clients*. Thus, while public sector reform might alleviate budgetary imbalances in the medium and long term, it is more risky politically than other reform measures. *In the perception of neopatrimonial governments, the short-term political costs of public sector reforms that involve large lay-offs tend to outweigh the prospective economic benefits*. By contrast, *privatization is, obviously, equally restricting the regimes' leeway for the creation of political legitimacy, but it can be seen as a welcome opportunity to bind private sector actors as loyal allies* when exactly this is needed. This is an important – maybe the most important – of the hypotheses since it links the implementation of economic policy reform to the constellation of economic and political elites. We should assume the private sector business elites to be either successfully co-opted by the political leadership and top elites, or else to emerge as a potential threat to the regimes since private sector elites, by definition, are strengthened through liberal economic reform.

- (9) My last point refers to the economic systems level: Institutional economics assumes – and political science and sociology confirm – that formal rules (laws, regulations, contracts, etc.) can be changed easier and quicker than can informal patterns of behavior which are often passed on in an intergenerational manner.<sup>30</sup> When structural economic policy reform is pursued in neopatrimonial or neopatriarchal socio-political systems, we should not expect that the outcome be a Western-style, competition-based market economy. Rather, *we would expect hybrid economic systems to emerge that combine some of the features of Western market economies that have been created through a change in formal rules, while the post-reform economies would still be shaped to some extent by informal patterns of behavior that originate in the pre-reform period*.
- (10) Unless these informal patterns of behavior that run counter to the logic of the market mechanism are changed, *the newly emerging economic systems in the Middle East should be expected to follow a checkered path of development and prospects for a developmental take-off to be dim*. This becomes understandable when we look back at the first and second hypotheses above: The reasons for market failures are of a socio-political nature that is embedded in the specific socio-political system of neopatrimonial political rule and the pervasive presence of patronage at all levels of society. Economic transition notwithstanding, these characteristics will remain in place even in a changed economic setting since changed *formal* rules do not automatically lead to changed informal norms and patterns of behavior which, in their turn, make sustainable development unlikely.

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<sup>30</sup> See, for instance, North (1997; 1990b: 87), as well as, from the political science viewpoint, Schlumberger (2000b)

The reader may bear in mind these ten points through the empirical part of the book. I shall get back to them in Chapter (10) below. However, as my eighth hypothesis implies, the question of economic orders shall play a crucial role in the rest of this study (see Chapter [11] for details). Therefore, it is unavoidable to share with the reader some thoughts on the question of existing economic systems and their systemic attributes.

## Chapter 3

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### Economic Systems: Capitalism, Market Economy, and other Terms of Uncertain Meaning

The purpose of this study is to suggest a model to explain why economic reform in the Arab world has failed to achieve the results expected by those who designed the reform schemes. As such, I propose not a grand theory, but a model of limited geographical (parts of the Third World) and explanatory (economic, not political or social change and transition) reach and applicability. However, it will be impossible to understand the argument of the book if the historical and international context is unclear, if the factors into which the problem of economic reform in the Arab world is embedded are not taken into account. Hence, it seems unavoidable to sketch out these wider contexts in order to present the suggested model, and in order to benefit from the empirical parts of the book that provide some indicative evidence to support the model. When looking at economic reform or, rather, transition, the most basic question that has to be answered before any empirical investigation can be started is: What are the points of departure?

Unfortunately, little systematic has been written in terms of categories or types of economic systems. While Gardner (1998) distinguishes economic orders, in his textbook on *Comparative Economic Systems*, according to various ‘modes of classification’<sup>31</sup>, conventional economics has, to a large part, distinguished economic orders along the lines of private or public ownership as the sole criterion: ‘Capitalism’ or ‘market economies’, mostly used interchangeably, have been opposed to centrally planned systems of the communist type. In between the ‘free market economy’ and the socialist model, the label of ‘social market economies’ has been applied to systems like Germany’s post-world war II economy, economies that explicitly called for some extent of state intervention in order to overcome market imperfections while leaving the general principles of capitalism uncontested.<sup>32</sup>

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<sup>31</sup> According to the criteria of ownership, coordination, incentives and objectives. See Gardner (1998: 5-15).

<sup>32</sup> One of the few examples for a methodologically sound effort of distinguishing types of economic systems is by Harvard economist János Kornai (2000). Yet, while he does invest an effort in outlining the ‘basic system-specific attributes’ of economic systems, he remains restricted in his analysis to ‘capitalism’ on the one hand and ‘socialism’ on the other, thus sticking to the same old and well-known conventional vision of the world as consisting of two camps or types of economies only (capitalism vs. socialism), - a vision that corresponds just all too closely to the long-overcome picture of two existing types of political orders only (democracy vs. dictatorship). This is the reason why he encounters difficulties already in the characterization of economies like Austria (large state-owned sector), France or Sweden (both with a tradition of relatively strong bureaucratic interference) (Kornai 2000: 30). My suspicion is that, had he chosen to take a view to some of the world’s developing economies and economies in transition, he might have encountered yet greater deficiencies in

It must be noted that, far from any further differentiation of the tri-partite typology mentioned here, most economists still view the world as divisible into *two* types of economic systems only: Capitalist and socialist (or communist, respectively). Even a most casual glance on today's world is sufficient to realize that numerous economies exist that neither fulfill the requirements to be called 'capitalist' economies nor can be, in any sensible way, characterized as 'socialist' ones. Still, it is common especially among economists to cling to this dichotomous view of the world which is extremely resistant to criticism. It has been shown in the previous chapter that there is a strikingly strong parallel between this view of economic systems and the long-held view among political scientists that political systems could be either 'democratic' or 'totalitarian'. Yet, in political science, this had changed in the mid-1960s through a seminal essay by Juan Linz (1964) who, looking at Franco's Spain, realized that Spain in these days differed from the definitions of 'totalitarianism' significantly enough to not fall under that category of polities at all – while at the same time there was no doubt that Franco's regime came in no way close to what could be termed a democracy either. Thus, the only possible conclusion for Linz was: There is 'something' in between democratic and totalitarian regimes that requires political science to establish a new analytical category in order to better grasp the developments that had occurred in the real world. Consequently, he elaborated this idea extensively and developed it into a viable (and still accepted) definition (Linz 1975), calling his new analytical category 'authoritarian regimes'<sup>33</sup>. 'Authoritarianism' today is so well-known a term and so generally accepted that it even entered colloquial language after originally having been a purely academic term.

Like totalitarian polities, socialist economies have today become virtually extinguished, and even the tripartite typology of economic orders presented above is clearly deficient in that it fails to reflect the numerous variations that emerged in the evolution of capitalist systems. This has become more than obvious not only, but especially after the end of the bi-polar post-World War II international order and the spread of capitalism to the East, to Russia, the Newly Independent Countries (NICs) of the Baltic, the Caucasus and Central

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maintaining this simplistic dichotomy of economic systems. Therefore, while his methodological soundness stands out, the dichotomy he maintains does not reflect the width of real developments in economic orders or systemic economic change.

<sup>33</sup> This, of course, is not where political science stands today, but reflects developments within the discipline that occurred some thirty years ago. It is not surprising, but all the more a pity that most economists, not being familiar with the works of comparative politics, often continue to write about politics and political regimes in terms of 'democracy' versus 'dictatorship' as if the past fifty years of political research had never happened. On top of that, the latter term has never been defined in any academically sustainable manner, and has thus been avoided by most political scientists in their strife for terminological clarity. I would therefore like to suggest that, with regard to the analysis of economic policies (which are, as has been outlined above, determined to a large extent by political factors), both economists and political scientists should pay more attention than they did until now not to re-introduce ambivalent and ill-defined analytical categories by their failure to take into account language usage of the neighboring disciplines. This would inevitably lead to misunderstandings and misinterpretations of events. While it is easy to advocate 'interdisciplinarity' rhetorically, it necessarily requires at least some minimum knowledge of language, usage, definitions and terminology of *both* disciplines. In the above discussion of the problems of institutional economics, the importance of this point and the severe consequences of ignoring it have already become clear.

Asia. Earlier yet, Latin American economies, beginning with Chile after the 1973 coup, have begun to follow the liberal capitalist model after the collapse of CEPAL's earlier development strategies. And during the 1960s, at least some of the economies in the Far East (Taiwan, South Korea, Singapore, Hong Kong - Indonesia, Malaysia and Thailand followed suite during the 1970s) had already begun to establish export-oriented strategies that resembled, but at the same time differed in important aspects, from Western free market economies like the ones found in Great Britain or the USA.

It was very recently only that a lively debate on the 'varieties of capitalism' has been initiated within the discipline of political economy (see Hall & Soskice 2001). However, this debate usually inquires into very few of the world's capitalist systems only, namely the ones of the Western industrialized nations: Comparisons between the US-American, the Swedish, the British, the French and the German economies, sometimes including Japan, have become fashionable, and there is a great merit in this approach of comparing most-similar cases. However, capitalist economies have also evolved throughout most of the developing world – and go almost always unnoticed and unexamined in this debate. There is thus a need to distinguish between different (sub-)types of capitalism that are alike in their key principles. Their classification as *capitalist* economies is justified, but they also differ in other important aspects.

On the other end of the scale, very few economies of the 'socialist' type remain on the globe; Cuba and North Korea are among them. Other economies have been transformed into either capitalist orders of the Western type (in Hungary, the Czech Republic, Poland, etc.) or have emerged as capitalist, yet profoundly different from the Western economies (the former Soviet republics of the Caspian region, or some of the Southeast Asian economies, for example).

Finally, with regard to the Middle East, since the early 1970s there has been a proliferation of economies that resemble the capitalist ones as well as the socialist ones in some respects, but which are ultimately characterized by traits that neither of them knows. These are the so-called rentier economies. Before beginning an empirical analysis of the MENA region, the key elements of the economic systems of capitalism, market orders, socialist-style central planning, and of rentierism have to be outlined and clarified.

## Capitalism

Since 'Capitalism' is one of the two key words of the title of this study, it is necessary to create a minimum of common ground in order to avoid misunderstandings and misinterpretations of what is understood here by this term. The need for such a step might – in itself – serve as a proof for the fact that capitalism today has so many faces and includes so

many different economic orders that, without initial clarification, the term would remain far too obscure to be used for analysis.

Strangely enough, not even Adam Smith ([1776] 1838), godfather of liberal economic theory, provides us with any definition of capitalism. True, what he describes would today certainly be labeled a market economy, but he does so without ever defining the terms ‘capitalism’ or ‘market economy’. He does, however, write on what he calls the ‘third order, that of those who live by profit’, meaning the capitalists. And it is in this context that he provides at least an idea of the *aim* of capitalism: ‘[...] profit is the end proposed by all those plans and projects. But the rate of profit does not, like rent and wages, rise with the prosperity’ (ibid: 116).<sup>34</sup> From this point of departure, Smith elaborates his argument that the individual pursuit of wealth necessarily results in the benefit of all (ibid: 199).

‘Every individual who employs his capital in the support of domestic industry, necessarily endeavours so to direct that industry, that its produce may be of the greatest possible value [...]. But the annual revenue of every society is always precisely equal to the exchangeable value of the whole annual produce of its industry, or rather is precisely the same thing with that interchangeable value. As every individual, therefore, endeavours as much as he can both to employ his capital in the support of domestic industry, and so to direct that industry that its produce may be of the greatest value, every individual necessarily labours to render the annual revenue of society as great as he can [...]; and by directing that industry in such a manner that its produce may be of the greatest value, he intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention’.

This is about as concrete as Smith gets in roughly outlining the concept of his liberal economy. While the assumptions he presents have not all proven to hold true under all circumstances (it took roughly one and a half centuries until John Nash could show their limits), Smith provides here a short description of some of the basic features that today’s definition of capitalism would have to include.

Others after him, like Max Weber (1905) or Werner Sombart (1902) hold that the decisive element of capitalism was the capitalist spirit or ‘*Geist*’ that governs the search for profits. Joseph Schumpeter ([1911] 1934: 110-39) elaborated on that idea with his concept of the capitalist entrepreneur who constantly disrupts the equilibrium of the system by his innovations and thus brings a continuous impetus for change – not as an individual, but as a ‘type’. Ever since Weber, scholars have engaged in heated debates whether such a spirit existed and, if so, where it may come from. Apart from this analytical difficulty, a further question would be how to operationalize such a spirit; in any case, definitions of capitalism based on ‘spirit’ simply do not seem to be very *practicable* in empirical investigations and are therefore dismissed.

Marx, by contrast, saw the essential new element of modern capitalism in the commodification of labor: The owner of capital now employed the individual who offered his

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<sup>34</sup> Interestingly, there is a hint to the theorem of diminishing returns roughly half a century before Marx, but this is not what I am interested in for the moment. Rather, the search here is for a definition of capitalism.

labor power on a market that determined the value of that labor. Both entered into contracts and exchanged labor for wages – in Marxist terms: the exploitation of labor, since wages necessarily had to be lower than the surplus produced by it; otherwise, profits would not be realized by the employer. Even though Marx was probably wrong in overstating the role of labor in the creation of surplus (he largely neglected the influence of technological progress, for instance), political economists since have increasingly agreed that this is one of the most fundamental changes in economic history, and thus the wage-labor relation is also included in Eric Schulz's (1999: 67–9) recent definition given in the *Encyclopedia of Political Economy* edited by Philipp O'Hara. He tells us that capitalism

‘designates a market system in which there are two main conditions: The first condition is that the vast majority of the physical means of production are privately owned; the legal rights to their use, profit and disposal are in the hands of private individuals or corporations. The second condition is that production is done by wage labour, whereby workers can contract with employers to allow the latter discretion and command over their labor for a mutually agreed period of each day, in return for a regularly paid wage, until either party declines to continue the contract.’

Yet, one further point may be helpful in distinguishing capitalism from other types of economic orders and therefore deserves mention: Immanuel Wallerstein (1983: 14), surely no advocate of *laissez-faire* capitalism, implicitly takes up Smith's assumptions about the *point final* of capitalism in his definition when he notes that the term ‘came to be used in a very special way. It came to be used with the objective or intent of self-expansion. In this system, past accumulations were “capital” only to the extent they were used to accumulate more of the same. [...] Whenever, over time, it was the accumulation of capital that regularly took priority over alternative objectives, we are justified in saying that we are observing a capitalist system in operation’.

In this sense, Vladimir Lenin (1916) was convinced that the self-expansionist trend noted by Wallerstein would necessarily come to an end, simply because of the geographical limitations of the world: Once the industrial states had colonized the last bit of the globe, this expansionist trend could no longer be sustained, he thought. This is why he saw ‘imperialism as the highest stage of capitalism’. What he had not foreseen was the fact that technological progress could, at least for some time, offset the law of diminishing returns and that therefore, capitalism was not at its end when it had conquered the Third World. Later on, Francis Fukuyama (1992) had proclaimed that, with the collapse of the Leninist Soviet alternative, ‘the end of history’ had come, but he was just as short-sighted as Lenin in this respect. What is important here is the self-expansionist tendency of capitalism, resulting from the overall priority of amassing ever more capital that regularly takes priority over other possible aims or ways of using resources. It can be used analytically to identify capitalist systems and to separate them from other economies. It is therefore an important element of what makes capitalism.

To put it more simply: Any term ending with ‘-ism’ describes the strife for what proceeds the ‘-ism’: in this case capital. Capitalism can thus be defined most simply and ‘un-academically’ as an economic order that is specific in that, over time and in comparison with other possible goals, the top priority for those individuals or groups operating in it is the pursuit of private capital accumulation; this may be the single most important constituent element of that system. Added must be the notion that capitalism exists only insofar as other individuals enter the market for labor, offer and sell their individual labor force for wages in a system in which private ownership of the means of production clearly dominates. Whether the individual laborers own the instruments of their work or not seems irrelevant as long as we do not want to know at what point in history capitalism began to exist (see the discussion in Dobb 1963: Ch. 1). It is clear from such a definition that the range of different economic systems that can be termed capitalist is wide, and that therefore possible varieties of capitalism are numerous. If private ownership, wage labor and future accumulation of capital as the dominating goal are the three conditions for an economic system to belong to the category of capitalism(s), it is quite amazing that the currently fashionable debate on ‘varieties of capitalism’ has started so late.

### ‘Market Economies’ or ‘Competition Economies’ as a Subtype of Capitalism

One thing has to be stated at the very beginning of this paragraph: Markets are, of course, imperfect wherever they exist (and they exist in each and every type of economic order). This is nothing new, and in this respect, the term ‘market economy’ refers to an *ideal* type that might not even exist in reality. However, *all* types of economies that can be established by analytical exercise (and, for that matter, all analytical categories as such) are ideal types that will most probably have no single one hundred percent equivalent in the real world. Yet, typologies are sensible in that they make it easier for humans to assess, structure and differentiate between different real types.

Market economies vary between the largely ‘free’ or *laissez-faire* type as in the United States, and ones that have traditionally been characterized by more state-set regulation of economic processes for social purposes without questioning the fundamental principle of free market forces; the German or ‘Rhine’-model of a ‘social market economy’ as imagined by then minister of economy Ludwig Erhard is usually referred to when speaking about this category, but Nordic examples such as Finland or Sweden might prove longer-lived. In between, there is a ‘wide range of variation between market economies’ (White 1993: 4). However, some analytical rigor must necessarily be maintained in order to define the market order. David Beetham’s (1997: 79) definition of market economies is elegant because it is short: ‘an economy based upon the free exchange of commodities under conditions of competition, together with the minimum necessary institutional framework to make exchange



possible over time – a predictable system of law guaranteeing property rights and the security of contract’. This deserves some explanation since it combines three elements that are part of most definitions of market economies.

In all concepts of market economies, emphasis is laid on the freedom enjoyed by buyers and sellers alike. And, as Milton Friedman (1960: 2) points out, ‘our mind tells us, and history confirms, that the great threat to freedom is the concentration of power’. In any given economy, the greatest thinkable concentration of power are monopolies where one agent only – sometimes the state, sometimes a private agent – remains in the market-place to determine supply and prices.

This is why *competition* has been stressed as a necessary component of a market economy, from Adam Smith ([1776] 1838: 311), who states that ‘Every man [...] is left perfectly free to [...] bring both his industry and his capital into competition with those of any other man’, to Friedman (op.cit., throughout) who, not accidentally, speaks of ‘*competitive capitalism*’. To confirm with another -by now classical- author: ‘Liberty in market systems exists only if everyone is able to escape coercion at the hand of any one buyer or seller by turning to another’, as Charles Lindblom explains in his seminal *Politics and Markets* (1977: 49). This connection ‘makes liberty dependent on competition’ (ibid.).

While competition can thus be considered a first necessary condition for an economy in order to define it as a market economy, there is a second important point in Beetham’s definition of market economies quoted above, namely a ‘predictable system of law’. Obviously, the implication here is not merely a *predictable* system, but one in which agents can rely on what is today commonly called the ‘rule of law’ or the *Rechtsstaat* (law[-abiding] state): a legal environment in which laws are applied equitably and that guarantees property rights and contract security. Why should the rule of law be so essential as a defining element for market economies? Let me begin the answer to this question with one of the most persistent implicit assumptions, or rather, myths in conventional economics: that the ‘free’ market was a neutral sphere where demand and supply, and thus prices, only matter. This may, of course, be assumed theoretically, but often leads analysts to forget that markets, just like any other field of human interaction, are shaped by the actors operating in them, the resources they possess, and the latter’s relative distribution among the former. A typical (erroneous) view resulting from neglecting this context is to suggest:

‘the “political market” is cruder and harder to study than the market system. Market transactions can be measured and analyzed in the common unit of money ... Political action involves the exercise authority, power and influence’ (Self 1993: 3-4)

What is omitted here is that economic action, too, may involve the exercise of authority, power and influence. Markets are no neutral or a-political realm, but ‘embody political processes of conflict and co-operation and political relations of dominance and subordination’ (White 1997: 5). If, assuming all legal regulations are absent, the ‘invisible hand’ was to reign

solely, it would invariably be the hand of the most powerful economic agent, whose main concern – assuming he is a utility maximizer – would be the exclusion of as many competitors as possible in order to maximize his marginal revenues. Thus, unchecked powers in a market will inevitably tend to rule out competition. For ‘competitive capitalism’ or, in other words, a ‘market economy’ to emerge and survive, a possibly impartial and institutionalized check is needed. Thus, the equitable application of laws is the second necessary (though not in itself sufficient) condition in order to speak of an economic system as a market economy.

Furthermore, the rule of law and competition are intimately related, with the former being the single most important guarantor for the latter in any given system. While liberty, as Lindblom put it, depends on competition, competition, in turn, depends on the rule of law.

It is at least these two characteristics of market economies that go well beyond the above definition of ‘capitalism’: In market economies, competition is guaranteed by competition policies, including effectively enforced anti-trust legislation. Second, the fulfillment of this function requires legal security or a ‘state of law’. Thus, guaranteed possibilities of *competition* and the state-enforced *rule of law* are what make market economies a very distinct type of capitalism.

No one has expressed this more pointedly than Walter Eucken (1990: Ch. 16), founding father of the so-called *Freiburg School* and the most eminent designer of Germany’s post-War economy, who chose to term this specific type of economic system not ‘market order’, but ‘competition order’ (*Wettbewerbsordnung*), thereby stressing the paramount importance of competition for the very existence of this (sub-)type of economy. Under no circumstances can competition be compromised or ruled out by those social forces that possess the power and resources to eliminate the market mechanism, at great social costs and to their individual benefit. For Eucken, the ‘basic principle’ (*Grundprinzip*) of his ‘competition order’ was a functioning price mechanism, which, of course, cannot exist without competition. ‘The establishment of a functioning price system of full competition’ should, Eucken contends, be ‘made the essential criterion of every economic policy measure. This is the legal economic-constitutional basic principle.’ (Eucken 1990: 254)

From this basic condition, he then develops seven further definitory characteristics (plus the necessity of their *simultaneous* presence as number eight), or rather: ‘constituting principles’ (Ch. 16) of this type of economic system<sup>35</sup> which must be given in order to speak of an economy as of a market economy or ‘competition order’, and it is no wonder that all of

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<sup>35</sup> These include, apart from the ‘basic principle’, (2) a primacy of exchange rate policies, (3) open markets, (4) private property as a necessary (though not sufficient!) condition for a competition-based market economy, (5) the liberty to conclude contracts, (6) liability, and (7) continuity in economic policies. Additionally, he requires (8) that these must all necessarily be present *simultaneously*, as an eighth condition. These ‘constituting principles’ may form a market economy, but will not suffice to keep it alive and working. Therefore, he adds the ‘regulating’ principles of a competition order (as complementing the more essential ‘constituting’ ones) (cf. Eucken 1990: ch. 17). The regulating principles are for the most part features and strategies on how to design the economic order. (the forms of anti-cartel laws and monopoly-supervision, the ways of organizing the national account, and income policies).

the essential criteria he mentions as elements of a definition of what he calls the competition order hover around that one issue of competition. Confirming Friedman (historically rather: vice versa!) as that famous Chicago economist has been quoted above, Eucken points out that ‘The more power individuals possess, the greater the danger that a conflict between individual interests and the common interest [*Gesamtinteresse*] arises’ (ibid.: 359). Competition is thus at the basis of market economies, of greater importance than any other single characteristic of this system. In turn, competition cannot be effectively guaranteed and maintained without the rule of law.<sup>36</sup> Enforcement possibilities are a necessary condition for any functioning economic system, and without the latter, contract security, private property, and a range of other integral features of market economies would no longer be guaranteed. Therefore, *the rule of law and competition must be analyzed as two constitutive elements of market economies that mutually depend on one another.*

Even Milton Friedman, highly ideologized and probably the most radical of the ultra-conservative “Chicago boys”, calls for ‘competitive capitalism’ (Friedman [1962] 1982: 13). He does not demand competition explicitly; rather, it seems as if the existence of competition in a given market for him is somehow *a priori* existent in the market place. While it is not contested here that markets may allocate resources efficiently, the basic problem is that market imperfections and failures occur wherever there are markets. The perfect market exists in theory only, and not in reality. Hence, there is a need to counter market imperfections and provide for alternative regulations when markets would fail to perform their functions. Unfortunately, Friedman did not pay much attention to the exigencies of the market mechanism to be and remain in place; he overlooked that reality differs from ideology. For competition to take hold or survive in any market, rules have to be established and enforced *authoritatively*<sup>37</sup> and independently of economic agents in order to avoid the emergence of concentration, monopolies, and a breakdown of the market. This can only be achieved by the one institution that has a legitimate claim to authoritative decision-making and the possibilities of sanctioning non-compliant behavior, which – in our times – still is the state. The rule of law and competition thus both require a state that is independent enough from business to design adequate competition policies *and* that is strong enough to enforce them by keeping markets open for the entry of new competitors against the interests of monopolists or oligopolists, and by being able to legally sanction non-compliant behavior.

The definition is essential for the purpose of this study: a synonymous usage of ‘capitalism’ and ‘market economy’ would blur the lines between any sort or variety of a capitalist mode of production and the more narrowly defined limits of a market economy. While market economies are a sub-type of capitalism, every capitalist system is not

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<sup>36</sup> It is interesting to note here that views of several economic theory currents, from neoclassical theory to ‘ordoliberalism’ to NIE all concur in that point!

<sup>37</sup> Remember Easton’s definition of the political as the authoritative allocation of values.

automatically a market economy. When Jeffrey Sachs writes, in his 'brief history of global capitalism' (1999: 98), that 'by the 1990s, then, almost the entire world had adopted the fundamental elements of a market economy', he is right partially at best, but at the same time fundamentally mistaken: While, admittedly, almost the entire world had adopted the key elements of capitalism, the fundamental elements of a market economy are more, or rather: others and much more far-reaching ones than those he sees as elements of a market economy. In fact, what he lists ('private ownership at the core of the economy, a currency convertible for international trade', or 'shared standards for commercial transactions') are not primarily elements of a market economy, but of capitalism in a much broader sense. While Sachs certainly is one of the most eminent contemporary economists, he nevertheless joins the long row of victims of terminological ambiguity and of a lack of clear definitions. Unfortunately, this seems symptomatic for economists involved in practical policy making in the last quarter of the twentieth century.

### Centrally Planned or Controlled Economies

Centrally planned or controlled economies are usually understood as those of the Soviet type. While the evolution of the typical socialist and / or communist political economy was debated early and their existence in reality has lasted, in different forms, for almost a century, most of the writings since Marx (and even he himself to a good deal) have elaborated a critique of capitalism (or, in Marx's case: of 'political economy' in the sense understood in his days) more than a precise outline of the alternative<sup>38</sup>. Also, numerous intra-socialist debates have hardly helped to come to a commonly acknowledged definition of what a socialist economy actually is. There is, to mention but one point of the discussion, no space to engage into the details of this debate between state socialism and worker-control socialism (see, for instance, Sirianni 1982, Nove & Nuti 1972, or Bottomore 1990; Wolff 1999 gives a short overview). What is important here is the contemporary general meaning of the term.

As Breitenbach, Burden and Coates (1990: 13) write, 'socialism in its Eastern European sense has come to be understood as a society whose economy is centrally planned, whose major industrial plant and equipment is state-owned, and where state power is monopolized by a single party'. While this is certainly not a satisfactory definition for all purposes, it can be regarded as sufficient for the purpose of this study. When speaking of centrally planned economies, we usually think of the former Soviet Union and its socialist satellites such as Romania, Bulgaria, the former German Democratic Republic, or Yugoslavia, plus some third world economies in which Soviet ideas and/or politics had gained influence, such as Cuba or North Korea. The prime feature here is that state ownership of the

means of production is dominant, and in this respect, the socialist economies were in deed an opposite to capitalism. Scientific planning was conducted inside large bureaucracies with the aim of maximizing social well-being and employment. In this sense – even though in practice things have looked differently, the overarching goal was meant to be social justice rather than individual capital accumulation – a clear difference in comparison to capitalism as defined above. Because of this, the entire economic process had to be placed under political control – a fact that Talcott Parsons (1964) had criticized as inhibiting ‘functional differentiation’ which, in turn, he saw as an underlying principle of all ‘evolutionary universals of society’, and on the basis of which he had predicted the eventual collapse of the Soviet Union as early as the 1960s.

Yet, ultimate political control over the economy has not only been exerted by the Soviet Union and its clients, but also by totalitarian regimes: During Hitler’s rule in Germany, since 1936 at the latest, economic planning had been placed in the hands of government officials even on the firm level, as the history of *Volkswagen* demonstrates. Other examples are fascist Japan or Italy under Mussolini. None of these had followed the communist path and ideology; however, their respective economic orders have in common with the Soviet economies that the regime in place was far more involved in genuinely economic processes than in capitalist systems where the variations reached from social capitalism to *laissez-faire* economies, but which were all determined by the decisions and strategies of private individuals who were qualitatively freer to determine the fate of their own businesses than were entrepreneurs in totalitarian regimes. Therefore, economic orders that are characterized primarily by public ownership and/or by political regimes’ control over the economies are different in kind from capitalist economies as defined above, even though some authors used the attribute of ‘state monopolistic capitalism’ to designate socialist economies. This label is inadequate since centrally planned or controlled economies differ not only in the structure of ownership of the means of production, but also in the very idea of how economic well-being could be achieved, and, as a consequence, in the ultimate goals pursued by the most powerful economic agents. In fact, it is a systemic attribute of centrally-planned economic systems that there is an ‘ideological monopoly’ (Kornai 2000: 31).

With the demise of totalitarianism after World War II and later the collapse of the Soviet Union, the type of centrally planned economies hardly exists any more in reality. The interest scholars take in it today is mainly historical, and it may be of some interest for this study insofar as some of the Arab regimes to be discussed as case studies below claimed to pursue ‘socialist’ economic policies. But this, too, was at some long-past point in their history. Centrally-planned or –controlled systems in the economic sphere seem to have suffered roughly the same fate as have totalitarian dictatorships which exist no longer in

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<sup>38</sup> A notable exception is by Kornai (1992) where he tries to carve out the systemic characteristics of the socialist model. See esp. his chapter 15.

today's world (North Korea aside, Cuba is debatable). Is, then, all economic activity capitalist activity? Maybe much of it, I would say, but certainly not all.

### Rentierism or: the Rentier Economy

'Rent is, in every case, a surplus over and above profits' (McCullough 1838: 475; 'Note VII'). This early definition of rent is elegant because it is short and very general, even though it fails to include some important aspects of rent. What is called 'rent-seeking' in modern societies (cf. Krueger 1974) is thus the search for gains above the level of profits. What is more, rents can originate from a dominant market position (monopoly or cartel), but also from a social position that provides access to non-market material benefits – a fact that has been observed as early as the fourteenth century by Ibn Khaldun ([1342] 1987). Industrial or commercial activity is therefore not necessarily a pre-condition for the acquisition of rents. In a modern sense of the term, acquiring rents is thus (a) not an economic activity in the strict sense, and (b) not restricted to a Bourgeois class or to entrepreneurial groups. Marx had focussed on rents that are acquired by landowners, but they can also be realized by bureaucrats, teachers, lawyers, physicians, etc.

Some of the world's economies have been described as 'rentier economies'. The application of the term rent to a type of economic order implies that such economies are essentially characterized by the fact that situations in which rent occurs are predominant economically and, consequently, that rent-seeking is a socially dominant phenomenon. However, if rent-seeking is an individually rational behavior, this pre-supposes the existence of large amounts of rent within such an economy. With land reforms, anti-trust legislations and other measures that minimize the existence of rents in a given economy in place around most of the globe, the most important category of rent that occurs today is international rent.

International rent occurs only when prices on the world market are significantly higher than the total production costs of a commodity, and this is mainly and firstly the case with strategic goods that the world economy depends upon and which cannot be easily replaced by alternative products. While international rent might exist in the case of Argentinean beef or Uzbek cotton, the most important such product by far is petroleum. It is thus not surprising that the concept of 'rentier economies' or the 'rentier state' has been proposed by authors who studied regions in which petroleum dominates national economies, which is the case mainly in the Arab Gulf monarchies, and to a lesser extent in other Arab countries, in some of the former Soviet republics (e.g., Azerbaijan), and in some Latin American (Venezuela, Mexico), African (Nigeria) and East Asian (Malaysia) countries. Twentieth century history has witnessed the evolution of entire national economies that mainly live on the acquisition of international rents.

While Mahdavi (1970) was the first to analyze a country (Iran) as a ‘rentier state’, the elaboration of the rentier-state approach as an analytical tool was by Beblawi and Luciani (1987). Both (Beblawi 1987: 51; Luciani 1987: 68f.) stress the importance of the external origin of financial resources that accrue to the state. Through such capital inflows, Luciani maintains, the state can become what he terms an ‘allocation state’ (as opposed to ‘production states’) that distributes resources of external origin domestically rather than taxing its population. Thereby, the state becomes largely independent of domestic society since there is a lesser or no need to extract resources from its citizens by taxing them; this, in turn, has political consequences. As Luciani (*ibid.*: 65) writes:

‘One is tempted to believe that differences in state income per subject (i.e. *per capita*) reflect differences in *per capita* GDP, on the basis of the assumption that the ability of individual states to appropriate a certain share of GDP is a constant in the short term. Yet this is certainly not the case for the oil-producing countries, where the causal chain is inverted and state income determines GDP rather than the other way round. In these countries, differences in per capita GDP simply reflect the variable income opportunities and spending preferences of each state structure – indeed state income cannot in any meaningful sense be considered as being part of GDP until it is actually spent, and then only insofar as it is spent domestically.’

Hazem Beblawi even carries the approach one step further in his analysis of ‘the rentier state in the Arab world’ by focussing on the internal effects of external state revenues in terms of micro-economic rationality and political consequences. As a corollary of such an income structure of the state, he claims (*ibid.*: 52), the wage-labor relationship is largely offset:

‘[...] such an economy creates a specific mentality: a *rentier mentality*. The basic assumption about the rentier mentality and that which distinguishes it from conventional economic behaviour is that it embodies a break in the work-reward causation. [...] For a rentier, reward becomes a windfall gain, an *isolated* fact, situational or accidental as against the conventional outlook where reward is integrated in a *process* as the end result of a long, systematic and organised production circuit. The contradiction between production and rentier ethics is, thus, glaring.’

Rent-seeking, in a rentier economic system, is thus rational. Unlike Beblawi’s perception, reward is not purely a ‘windfall gain’. It requires prior investment; not in the conventional economic sense, but rather in gaining access to the circuits where rent gains accrue. If rent occurs mainly and foremost within the state, as is the case in many Arab countries and as has been described in chapter two above, access to political decision-makers will trigger economic benefits. And as in any application of the economic principle (maximizing utility), competition takes place for the access to rent. In the Arab economies, therefore, ‘competition does take place, but rather in the diwans of public administration for the establishment of personalistic ties to patrimonial decision-makers, much more so than in the marketplace’ (Schlumberger 2000: 121). The dichotomy between ‘the public’ and ‘the private’ which is so popular in conventional economics also does not hold: ‘The primary problem is not public versus private, the problem is excessive intercessory *wasta*’ (Cunningham & Sarayrah 1993: 179).

It is hardly contested today that these realities and phenomena are adequately grasped by the concept of the rentier state as far as the Arab oil-exporting states in the Gulf are concerned (Saudi-Arabia, Kuwait, Qatar, the United Arab Emirates, to a lesser extent Oman and Bahrain). However, if one accepts the basic idea that external capital inflows accruing to the state have an impact on the state's as well as on citizens' behavior and economic rationalities, it cannot be denied that other external sources of income may have similar effects as have oil export revenues. Most important were military and political aid from the superpowers to the Third World during the Cold War era: Politically motivated, both the USA and the Soviet Union had transferred large amounts of financial resources to Third World countries in search of stable and loyal allies on various parts of the globe. This was even more so in strategically important geographical regions – most of all the Arab World: Due to the region's wealth of natural resources that were needed in the industrialized 'First' and 'Second' world, 'the whole Arab area – oil rich as well as oil poor – has assumed strategic value in the world chessboard' (Beblawi 1987: 59). The Arab world as a whole, therefore, enjoyed the influx of large amounts of such political transfers that, because of their similar effects, can be termed 'political rents'.

Additionally, intra-Arab capital flows, mostly in the form of unconditional budgetary support, from the oil rich to the oil poor countries had multiplied after the 'oil price revolution' of 1973/-74, and had become a substantial source of external, rent-like income for the oil poor countries. The reasons for this are obvious: In their dependence on a stable regional environment for the production and export of oil, the oil rentiers tried to stabilize those Arab states with radical social forces in order 'to buy allegiance or rather avoid trouble' (ibid.: 60). In fact, since the early 1970s, an entire regional subsystem of 'petrolism' had thus developed, with oil poor countries as labor exporters and recipients of migrant workers' remittances, and with the oil rich states as labor importers and aid donors (cf. Korany 1986).

Third, some of the oil poor countries enjoy considerable external revenues from their strategically important location within the region. Syria, for instance, received substantial royalties as a transit country for oil that was pumped from Iraq (before the second Gulf War and the Iraqi invasion of Kuwait) through the country and then shipped abroad from the ports of Baniyas, Tartous and Lattakia, all on the Mediterranean Sea. Another example is the Suez Canal in Egypt, together with the SUMED pipeline that replaces some of the traffic that formerly went through the canal since 1996: Both are among the most important foreign exchange earners for the Egyptian economy and clearly form one type of geographical or location rent.

There are thus at least three major sources of external finance even for the non-oil Arab economies that transformed them into what Beblawi calls 'rentier states of the second order' or 'semi-rentiers'. These differ structurally from the oil-producing countries in that the continuous flow of external resources depends not so much on commodity exports but rather



on political considerations of powers, both within and outside the Middle East. Nevertheless, this, too, has left traces in the dominant economic behavior of the societies concerned.

In both the ‘ideal type’ rentier economies and the ‘semi-rentier’ economies, the state is the principal recipient of external finance. While rentier economies might exist elsewhere, the Arab rentiers are specific in that most of the external income containing a significant rent component accrues directly to the state. This might be important not so much in a general discussion of economic orders, but it certainly is for a political economy of the Arab world: It means that the state can exist, expand and secure its own survival without having to tap the domestic economy. Even in the semi-rentier states, the state apparatus is way larger than it could possibly be when financed solely with the resources extracted from the domestic economy. The consequence is that, first, the state is the most powerful agent in the domestic economy and, over the past decades, has come to be seen as the ultimate employer and distributor of resources. Quite logically, the state has also become the most powerful economic agent in all Arab economies. Even in the economies of countries such as Jordan, where the regime has never succumbed to the challenge of collectivist ideologies and has traditionally been private-sector oriented, more than half of the labor force was employed by the state as late as the 1990s – a ratio that is roughly 250 per cent higher than, for instance, in socialist China in the 1980s.<sup>39</sup>

After some initial protest and doubts against the model of the rentier economy, mainly from orthodox economists, there is a wide consensus today that no other concept captures the main characteristics of the Arab economies – at least in their development from the early 1970s to the late 1980s – equally well. The question in the context of this chapter is therefore: Are rentier economies to be regarded as a subtype of capitalism, do they rather resemble the centrally planned systems with significant state control and ownership, or are they distinct from both and form a separate type of economic order altogether?

I propose here, *very preliminarily*, to take rentier economies as a separate type of economic order for two reasons: On the one hand, they share with socialist economies the trait that the resources they significantly depend upon for economic survival are often state-owned. Centrally-controlled or –planned economies are different, however, in that their regimes’ ultimate goals are social justice and full employment. It is difficult to see why: Most of the rentier and semi-rentier economies had in fact established large social welfare nets, including free education, health care, and often employment guarantees in ever expanding public sectors. However, these were not developmental priorities in their own right, but rather a means to secure political rule of the incumbent leaders. True, some of the political regimes in semi-rentier states may, in fact, have started their social transformations with an explicitly developmental project: The land reforms and nationalizations undertaken by ‘new middle

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<sup>39</sup> Ca. 18 % in China (cf. Sachs 1999; on Jordan: Glasser 1995). On the expanding bureaucracies in Arab states see Ayubi (1990).

classes' (cf. Halpern 1962 for the concept) in countries such as Iraq, Syria, Algeria, Tunisia or Egypt throughout the 1950s and 1960s did aim at a more equitable distribution of wealth and ownership, but they came mainly as a nationalist, not a socialist reaction to the absentee landlord system on which the colonial powers had built their rule in the Middle East. While some figureheads of, e.g., *Ba'thism* like Michel Aflaq and Salah ad-Din al-Bitar fashioned decidedly socialist viewpoints they had learnt during their studies in France in the 1940s, such intellectuals had soon become marginalized after the coups and revolutions of the military during the 1950s and 1960s (cf. Seale 1965). By the 1970s, none of them had survived in any position of political influence, and the incumbent military elites had firmly established authoritarian systems of rule that, on paper, favored peasants and workers, while in reality they pampered new capitalists that depended in their economic success on the regimes' benevolence and protection. The oil wealth, either directly through export earnings acquired by the regimes or indirectly through international transfers, greatly helped rulers such as Hafiz al-Asad of Syria, Anwar as-Sadat in Egypt or Mu'ammarr al-Qadhafi in Tripoli to enshrine their claim to power in a thoroughly transformed political order of personalized neo-patrimonial systems in which Marxist ideology played an ever decreasing role. Thus, the 'socialist Arab republics' might in fact never really have been such, and if they once were, they had lost their initial ideological foundations long before, by the late 1980s, economic reform in the Middle East set in. None of the Arab regimes has ever adhered to any ideology as strictly and continuously as have the countries of the former Soviet bloc. This has made them much more flexible to respond to changes in the international environment or to economic changes on the international and regional level, and probably is one main reason why they could survive in times when the centrally planned or controlled economies collapsed.

But rentier economies are also distinct from capitalist ones: First, rentier economies are distinct from capitalist systems in that they promote a fundamentally different if not contrary micro-economic rationality. The genuinely capitalist wage-labor relation is broken up and thus the strife for investment in order to realize profits is not a dominant determinant of economic behavior, an observation which probably nobody expressed clearer than Beblawi (1987: 50): 'The distinguishing feature of the rentier thus resides in the lack or absence of a productive outlook in his behavior [...]. Dynamic, innovative, risk-bearing, Schumpeter's entrepreneur is the antithesis of the rentier'. Second, *states* are dominant in the resources they control, are the largest employers and are the most powerful economic agents – all features that are, obviously, incompatible with the definition of capitalism given in the discussion of that order in the section above. Third, the ultimate goal of states that can be traced over time is not the accumulation of ever more capital through productive investment, but the maintenance of political power. Historically, this has, of course, involved seizing opportunities for self-enrichment and, later on, triggered a wave of private entrepreneurial activities by political elites. Despite this, however, the ultimate aim was to continue the

exercise of authoritarian political power, not capitalist economic power. Therefore, rentier economies are here conceived of as a distinct type of economic order that neither fulfills the necessary criteria to be termed capitalist, nor can reasonably be called socialist (an option that was, at best, present for some semi-rentier economies during a past phase of their history only).

This brief review of existing economic orders results in figure (3.1) which may help in clarifying the fundamental premises on which the argument of the book is based.

*Figure (3.1):*

TYPES OF ECONOMIC ORDERS

Types	Subtypes
<b>Capitalist Economies</b>	<ul style="list-style-type: none"> <li>• <u>Market economies</u> (incl. varieties on the scale between free and social market economies; most obvious examples are the OECD member states).</li> <li>• Other possible varieties of capitalism that have yet to be identified and defined, in all world regions</li> </ul>
<b>Centrally Planned Economies</b>	<ul style="list-style-type: none"> <li>• Varieties of the <u>socialist</u> model of centrally planned, “state monopolistic” economies (ex- Soviet Union and her client states, Cuba, North Korea, ...).</li> <li>• Economic models pursued by <u>totalitarian</u> / <u>fascist</u> regimes in the first half of the 20<sup>th</sup> century (Germany, 1936-45; Italy under Mussolini; Japan)</li> </ul>
<b>Rentier Economies</b>	<ul style="list-style-type: none"> <li>• Rentier economies (monarchies of the Arab Gulf region, Iraq, Iran, Libya...)</li> <li>• Semi-rentier economies (most of the Arab non-oil economies, Nigeria, some Latin American countries like Mexico, Venezuela...)</li> </ul>
<b>Traditional Subsistence Economies</b>	<ul style="list-style-type: none"> <li>• Tribally organized economies with no or negligible outside commercial exchange relations (hinterland of Gulf sheikhdoms before the oil era; central Africa, Pacific, etc. before colonialism)</li> </ul>

One historical type of economic order that has not yet been discussed here are traditional, often tribally organized economies of subsistence; however, today’s world has so thoroughly been transformed by capitalist structures, imperialism and globalization that such an economy – at least on a national scale – can not reasonably be said to exist in the twenty-first century. Even in large parts of the ‘periphery,’ where access to the sea had enabled tribal societies to establish trade relations with distanced countries and societies, this type of economy was transformed centuries ago. In areas such as the Gulf peninsula, it was the tribes that lived as Bedouins in the desert who lived in this sort of economic system, while the urban centres on

or close to the coastline (such as Aden, Mecca, al-Mokha or Musqat) had built up early form of wide-spread trade long before falling prey to the insatiable appetite of Western imperialist powers.

A first observation shows: not only have subsistence economies become obsolete by the twenty-first century; equally outdated is the model of centrally planned economic systems. China has begun to implement capitalist reforms in 1976, North Korea is today opening up towards their Southern neighbors, and in Cuba, the times of tourist-attracting thriving black markets will most likely become history within the next few years when president Fidel Castro, long in frail health, follows Mao Tse Tung (died in 1974) and the country will most likely start a profound economic transition.

As previous economic orders vanish from the landscape and enter the history books, the disciplines of economics and political economy should engage in new categorizations that are more adequate to reflect the state of the real world than the somewhat naïve picture of one world, one capitalism. For the moment, however, developments of the late twentieth and early twenty-first centuries seem to mark the triumph of capitalism world-wide, whatever its forms may take – were it not for the MENA region and its rentier economies.

As has been outlined above and as figure (3.1) shows, market economies are one specific type of capitalist economies. The market system is determined by characteristics that in part apply to all variations of capitalist economies, but over and above this, they display specific traits that make the market order unique. There are, in essence, two most fundamental characteristics specific to market economies that distinguish this system from any other (sub-)type of economic order. First, they are determined by guaranteed and institutionalized competition. Second, the market order is based on the rule of law and can exist only under this condition. It may sound somewhat trivial to insist on these two features as something distinct to market economies, and, in fact, most of today's economists do not even see any necessity to mention that point; rather, it seems as if this goes as self-understood. One might also argue that *any* sort of capitalism as imagined in modern political economy and not only the market order, is 'naturally' determined by competition. The answer is a clear 'no'. As I will explain in the chapters below, this distinction between the market order and other forms of capitalism is maybe the single most important point for understanding much of the Third World's economic development, and certainly so as far as the Arab region is concerned.

Part (II) now examines empirically the course of economic reform in four Arab countries. These cases serve to find – or at least approach – answers to the reasons why structural economic reform has been implemented in the Arab world in the first place (which is not obvious, given the reluctance of the respective regimes when it comes to structural changes), how and in what ways Washington's policy prescriptions have been implemented or not, what the outcomes of reform have been to date and, finally, why they do not correspond to the expectations of the international financial institutions and developmental agencies.

## Part II

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# The Political Logic of Economic Reform in the Arab World: Empirical Illustrations

## Chapter 4

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### Selecting Cases, the Time Frame, and Issue Areas

#### Empirical Observations: Illustrative Evidence, not Proofs

Constructing methods and models is like designing a chair: The result can either be beautiful artwork, but totally uncomfortable to sit on, or the chair might be ugly to the point that we would not want to have it in our home, but extremely comfortable to sit on; it might, of course, also be both well-designed and functional. In *academia*, it is only empirical findings that will ultimately prove whether a neat model is of any use in that it furthers our understanding of the subject concerned, or not. However, it has been said in the introduction and it must be stressed again that *proving* is beyond the possibilities of this study, and this is so for two main reasons: First, the countries to look at should ideally cover all Arab economies, and, again ideally, probably more than a dozen of economies outside the Middle Eastern region in order to accumulate enough hard evidence to support the model suggested and outlined in Part (III). This is obviously beyond what can be done here. It is already well beyond the possibilities of a single book to cover all relevant countries of one region.

Second, it lies within the nature of the subject under examination (rules, legislation, but also informal social relationships that are in part legal, in other instances semi-legal or even illegal) that it is extremely difficult to provide evidence for such topics on several countries, unless there is a considerable staff of researchers from among which each can find support in the socio-political setting he or she knows best. By contrast, it is evidently beyond the capabilities of a single person to provide hard evidence for this topic on more than one country. The fact that interviewees are unlikely to tell much about their business practices, about the unwritten rules that govern bureaucratic interference in the economy, and the like, unless they consider their counterpart a friend, makes it difficult to find even anecdotal evidence (let alone hard proofs) for the landscape that emerges behind the façade of formal laws and rules. While it is not impossible to penetrate networks of patrons and clients and realize who exactly entertains which deals with whom else, this is a question of how deep the researcher is ready to plunge into muddy waters. Therefore, often secondary evidence will be used (which only indirectly hints to underlying socio-political structures) in order to demonstrate the prevalence of informal rules that can, by definition, not be cited.

The purpose of this empirical part is an illustrative one, as the title suggests, and nothing more. What *can* be shown, however, is that empirical results and findings not only do not contradict the analytical concept introduced here, but can be analyzed with less contradictions and a lesser number of ‘anomalies’ than would occur in any conventional analysis with other analytical ‘background slides’ that have been suggested, and most of all: better than with the neoliberal recipes which, while increasingly criticized, have not faced any conceptual competition by similarly coherent and encompassing analytical approaches until the time of writing.

The aim here is rather to present *some* empirical support (though certainly not a hard test) for the model of patrimonial capitalism that is suggested in Part (III) below in order to reach a better analytical understanding of economic reform processes and, more importantly yet, their outcomes and results, in the Arab world. In the following chapters, this is all that can reasonably be done on the way to demonstrate that the ‘chair’ I call patrimonial capitalism is not only nice to look at (the reader will decide on the (im-)plausibility of the model), but that it also holds the weight of the one who sits on it. Aside from the limited support that the empirical illustrations given here can provide, it must be left for future research to investigate into the limits and flaws of the model carved out here. An adequate frame might be the work of some research group with more funds, to generate more detailed case studies for more cases than can be dealt with here.

For all that, it should be said straightaway that the goal of the following chapters is not provide the country specialist with new insights on his or her geographical area of specialization. The time-frame of this analysis is in fact such that those who seek topical and new insights into specific countries might not find it very useful for their ends. There are other reasons for choosing the time-frame precisely the way it is chosen here (roughly 1990-2000).

First, the word of the so-called ‘Washington consensus’ emerged roughly in the mid-to late 1980s, and was implemented in the Arab world – at least on paper – exactly according to the recipe described by John Williamson (1990). At the same time, the economic crisis that almost all Arab countries slipped in was at its heights in the late 1980s to early 1990s, and it was at that stage that economic policy reform started to be implemented all over the Middle East. The 1990s thus became the decade of liberal economic reform in the Arab Middle East, just like the 1980s had been the decade of liberal reforms for many Latin American countries. On the other hand, at the end of the decade, politicians both in the Western world and in the Middle East had accumulated experience enough with the neoliberal recipes that criticism against the Washington consensus had been voiced louder and louder. Also, economic success – apart from short-term macro-economic stabilization – had been rather mixed, at best. It had become clear, therefore, that somehow the results of reform had not matched expectations. For Arab governments, this was reason enough to question the sense of further reforms that tended, for various reasons (most of all harsh and increasing social imbalances that threatened to delegitimize the regimes in power), to undermine political stability. Some countries, such as Egypt (in 1998), stopped their close cooperation with the international monetary fund and

let their countries slip out of official IMF-programs. Others maintained their relations with the World Bank and the IMF as they had been before, but criticism of the lack of tangible success came increasingly from within these institutions themselves. By the time of writing, it had been clear that new programs and policies would have to be developed and designed. Therefore, the end of the decade and early years of the new century also marked the end of the neoliberal paradigm. It is now the time to take stock of what results structural adjustment policies have achieved, and what not, and what that implies for future development prospects for the Middle Eastern countries. This is why the decade of the 1990s is the only reasonable time-window to examine. While here and there a tentative view to the present or into the future will be cast, the time span from 1990 to 2000 (roughly, exact years vary from one country to the next) is at the heart of the examination of the reform process in the following chapters.

But at this stage, the first question is: What case(s) should be chosen for collecting empirical evidence? This Part (II) sets out to examine whether the concept of patrimonial capitalism is applicable not only to a certain single country, but has applicability throughout the region. Only a comparative approach is adequate to underpin such claims. In recent years, it has become fashionable in comparative politics, comparative political economy, and development studies to engage in (usually four-case) paired (usually cross-regional) comparisons, that is: take four cases, two belonging to one world-region each, and show how two cases from different regions display similar outcomes.<sup>1</sup> While comparisons between Latin America and Southeast Asian or Eastern European countries have been *en vogue* for quite a while, it is with David Waldner's widely acclaimed 1999 *State-Building and Late Development* that this type of comparison has begun to become fashionable with respect to Middle Eastern cases. A second important and well-designed example is Jason Brownlee's "Double Edged Institutions" (2003) on what he and others before him call 'electoral authoritarianism'. While these efforts clearly are among the very best ones undertaken so far, they also demonstrate the various dangers inherent in such broad-band case selection: Either the desire to find cross-regional commonalties is so dominant that the justification for single cases *within* one region gets lost (Waldner 1999 is the example here),<sup>2</sup> or the temptation to establish two cross-regional 'tracks' (similar outcomes in two cases located in different

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<sup>1</sup> See also the theoretical underpinnings to such designs given by Sidney Tarrow (1999). Obviously, such a design is compellingly parsimonious; moreover, it demonstrates the importance of universally testable variables rather than region-specific factors such as culture, religion, or ethnicity which often lead to non-falsifiable culturalist 'explanations'.

<sup>2</sup> Waldner (1999) examines Turkey, Syria, Taiwan and Korea: While all cases constitute examples for his argument, Waldner remains silent on the question why we should look at those specific ones (and not others). Would a different case selection affect his argument? Was case selection based on personal tastes or analytical reasons? Why Syria – and not, for instance, Egypt; why Taiwan and not the Philippines, why Turkey and not Iran? Unfortunately, Waldner's book invites criticism as to the arbitrariness of cases chosen – or, worse even, to a 'cooking the book' kind of criticism, that is: to have chosen those cases that fit the model best while others which might have disproved it might have been avoided. Also, Eva Bellin's (2002) cases seem not well-justified – if one can speak of cases here at all, since she rather seems to have worked on Tunisia and then inserted some of what she read on other countries in order to evoke the impression of a comparative approach.



regions) becomes so strong that one ends up lumping apples and pears together, i.e. declaring different outcomes as same or similar ones which, in fact, are not (as does Brownlee 2003).<sup>3</sup> Such mistakes in the design seriously undermine the credibility of the studies as such, however plausible the results may sound, because the way in which results were obtained, the method by which cases were grouped and examined, is flawed. It is better then (because methodologically sounder) to limit a study to a well-justified two-case intra-regional comparison, as does, for instance, David Kang (2002a) in his book on development and corruption in Korea and the Philippines.

In order to avoid the various traps of paired cross-regional investigations, the design presented here is ‘double-paired’ (along two criteria rather than one, which, of course, makes things a bit more complicated, but also renders the claims stronger than in Waldner’s and Brownlee’s works; see figure 4.1) and has four cases (like theirs), but remains intra-regional (as does Kang’s study). One major disadvantage of thus proceeding is that applicability of the findings outside the one region the cases are taken from cannot be proven within such a design. This is especially problematic for Middle Eastern cases since a good deal of the literature still seeks to explain development or the lack thereof (just as the absence of democracy) through some sort of ‘Middle Eastern exceptionalism’. In order to confront this danger and counter criticism about possible geographical restrictions of the model presented in Chapter (11) below, I shall argue, in Chapter (12), that cases outside the MENA region, too, can be classified and explained along the lines and with the concept of patrimonial capitalism.

On the other hand, the intra-regional selection of four cases renders the present study representative for the entire region, and it does so in more than one respect. This, in turn, is an asset which none of the above quoted authors can credibly claim. Also, when asking for dependent variables that we know result from a larger mix of independent variables, it is obviously preferable not to limit the examination to two ‘sets’ of cases, that is: To be open for more than one explanatory variable and to design the research not only in a binary way (‘0’ or ‘1’) along that single factor – as do all of the above mentioned authors.

The Arab countries and their economies differ enormously in size, sectoral structure, their political structure and policies, with respect to the degree of natural resources they are endowed with, and in their wealth. What cases, then, should be looked at in order to achieve some initial results in examining the validity of ‘patrimonial capitalism’? A ‘most-different’ selection method seems the adequate way of determining cases in order to cover the broadest possible range of countries, and to eliminate or at least decrease the problem of possible

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<sup>3</sup> Iran and the Philippines on the one hand, Egypt and Malaysia on the other are Brownlee’s (2003) cases. When examining ‘electoral authoritarianism’, he finds that authoritarian regimes faced electoral losses involving significant ‘regime change’ in Iran and the Philippines while regimes managed to avoid this in Egypt and Malaysia. This denies the fact that the Philippines have witnessed a political transition (i.e. the change from one *type* of political regime to another) while Iran has not. Lumping them together thus represents the (rather common) methodological error of confusing changes in kind with changes in degree. See Giovanni Sartori (1991) for more on this methodological point.

‘competing explanations’.<sup>4</sup> Moreover, it necessarily has to be applied when the theoretical claim is that the concept be of explanatory value for the entire population ( $n$ ) (here: the Arab world) of a given universe, and not only for a certain (sub-)class of cases of that universe which share distinct properties ( $p_1, p_2, \dots, p_n$  - e.g.: ‘liberal Arab monarchies’, ‘oil-rich economies’, ‘revolutionary-progressive states’, etc.) that others of the same universe do not. Only by selecting most different cases can the entire population be covered, through exemplary evidence from each of  $n_1, n_2, \dots, n_n$ , and this in a way that leaves room enough for counter-evidence to manifest itself. By choosing representative cases, this design works even if not every single case is examined.<sup>5</sup> But what, then, *are* representative cases?

### Selecting Cases: Two Criteria

In what way should the cases be selected to be most different, and to be, in their entirety, most dissimilar?<sup>6</sup> The general methodological demand is utmost simplicity in order to be challenged more easily. Therefore I limit the number of variables to two only. Number one is an economic one, namely the *relative amount of natural resources at the disposal of the respective governments*: Hardly anyone will debate the fact that Arab economies are more different from one another than probably in any other field as regards their oil-wealth or, vice versa, their lack of natural oil or gas. Most of the Arab countries bordering the Mediterranean are relatively resource-poor, compared to their sister-countries on the Gulf-peninsular, where the ideal-type ‘petro-states’ with abundant mineral resources (oil and/or natural gas) are located. Recent literature additionally justifies this choice of distinction as it has shown that, as a rule, the resource-rich Arab regimes are significantly less prone to economic liberalization than the resource-poor ones (Beck and Schlumberger 1999). Thus, this variable has already been identified as having a major impact on the trajectory of economic reform.

Since this study follows a *political-economy* approach (i.e. economic processes seen as made and entertained by man and man-made institutions, policies, the relative distribution of power among agents, etc.), the second criterion is a genuinely political one: I adopt here the traditional *distinction between Arab republics and Arab monarchies* as a second variable for the classification of cases. The reason for doing so is not that the distinction is classical and

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<sup>4</sup> ‘Competing explanations’ are an epistemological problem: If, in any given case, one explanation is used to analyse and explain a certain situation or process, somebody might come up with a different explanation. Even if that second explanation is also plausible, it will most probably not be adopted since the first one still holds and is better received, while both approaches now are problematic since they constitute competing explanations. One way of verifying which one of them seems more likely or adequate to account for the addressed situation or process (*explanandum*) is to cross-check or test the offered explanation in a different setting. If then one of the two fails to explain similar outcomes, the other explanation obviously is more likely to account for the initial *explanandum* as well and thus preferable to the first one.

<sup>5</sup> Given the fact that the number of cases in the Arab world is high ( $n > 20$ ), there is obviously no way to follow the positivist approach of examining all existing cases.

<sup>6</sup> Note that this question is synonymous with searching for possible independent variables for explaining the emergence of patrimonial capitalism.

well-established, but because an argument has been brought forth explicitly by some scholars and implicitly by others that seems convincing:

The Arab republics, at least at some point during their history, have experienced social ruptures that have led to ‘revolutions from above’ (Trimberger 1978), coups d’état, or other forms of abrupt and systemic social and political change: Consider the revolution of Nasser’s Free Officers in Egypt, the Ba’thist ‘March Revolution’ (*thawrat adhar*) of 1963 in Damascus, Qaddafi’s accession to power in Libya, the early Bourguiba years in Tunisia, the development of the People’s Republic of Yemen, or the Iraqi path since 1958. In these years, the economic structure of the Arab republics had been greatly transformed through land reforms, expropriations and a re-distribution of land to small and medium farmers in order to break the power of large absentee landlords, the nationalization of virtually all large industrial establishments and of the national financial sectors as part of import-substitutionalizing strategies and ideals of state-led growth. It was only in the late 1980s that this economic strategy had ultimately failed. In the context of structural economic reform, it was argued, these countries have a more difficult legacy and heavier burdens to overcome than the conservative Arab countries (mostly monarchies), where private sectors had remained largely intact over the decades since the countries’ independence. Significant differences should therefore be expected regarding the outcomes of economic adjustment, depending on the type of political system that implements reform. In brief, this political criterion can be sketched out and operationalized as follows:

*Traditional authoritarianism*<sup>7</sup> in the Arab world defines a polity in which

- decision-making is primarily determined by primordial patterns of influence (tribe, clan),
- which either lacks modern bureaucratic institutions or has undergone an only incomplete bureaucratization (e.g., formal institutions and procedures, political parties, systems of political participation or representation, organized interest groups for different societal segments, a formal and secular judiciary providing formal mechanisms for dispute resolution; electoral systems, etc.), and in which
- society is organized neither along a system of individual interests forming voluntary groups and thus building pressure groups for collective action, nor based upon class relations, but where personal interests are determined by one’s birth into a certain social segment or group of common regional, religious or ethnic origin.
- These polities are monarchies (or sultanates, emirates, sheikhdoms), which obviously implies a dynastic system of succession to power, and they
- have traditionally been oriented towards the Western hemisphere in their international relations.

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<sup>7</sup> This term emerged in the academic literature more than thirty years ago; see Khaddouri (1970: 39 ff.). He opposes it to ‘Arab Socialism’ (1970: Ch.7).

- Legitimacy of the regimes / of the rulers is mostly and ultimately based on historical-traditional and/or religious arguments rather than on any form of secular political ideology.

*Bureaucratic authoritarian polities*<sup>8</sup>, by contrast,

- have experienced major social ruptures, including revolutions; they
- have thus gone through political transitions during the 1950s or 1960s, resulting in
- a traditionally strong role of the military that almost always is a crucial factor in the resulting
- presidential republics with ‘state classes’, or, as they have also been termed, ‘state bourgeoisies’ as incumbent elites,<sup>9</sup> (and characterized by multitudes of layers of institutions with often overlapping responsibilities and unclear competences, although this may, in part, also apply to traditional authoritarian polities).
- These polities were based on legitimacy provided by an explicit political, often collectivist ideology (some variation of ‘Arab socialism’), and, hence, in their external relations they were
- often characterized by alliances with the Soviet Union in times of a bi-polar world order.

Obviously, not all Arab polities can easily be subsumed under these two types of authoritarian regimes; as always, the problem with a dichotomy based on more than one factor is that it is hardly all-inclusive or all-exclusive: countries like Morocco or Jordan, for instance, are characterized by essentially traditional societies and a likewise traditional and dynastic pattern of political rule, while at the same time they possess large bureaucracies,

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<sup>8</sup> Both ‘traditional’ and ‘bureaucratic authoritarianism’ have first been used as types of non-democratic regimes by Guillermo O’Donnell (1979); however, the way they are used here is different from the definition O’Donnell derived from (mainly) the Argentinean and Brazilian cases during the 1960s; my usage of the terms might therefore seem slightly idiosyncratic. While O’Donnell explicitly excludes traditional monarchies from his category of ‘traditional authoritarianism’, these are at the heart of the class as I adopt it for the Arab world. Even though it is not synonymous, ‘bureaucratic authoritarianism’ as used by O’Donnell has strong parallels to what is understood by the term here. Most importantly, I choose to use the term because for O’Donnell, the presence or absence of military government is typologically irrelevant; rather, it is the existence of a ‘coup coalition’ that matters (O’Donnell 1979: 108). This is the crucial point since it hints to one of my most important definitional elements of bureaucratic authoritarianism, namely the existence of social ruptures (coups, revolutions, etc.) that lead to political transitions during the 1950s and 1960s in the Arab bureaucratic authoritarian regimes. I am certainly guilty of idiosyncrasy insofar as my main focus is not the link between regimes and modernization in a broad sense. Yet, the advantage of using the term is that it stresses the existence of the said social ruptures as a feature that distinguishes the Arab republics from the monarchies.

<sup>9</sup> By occupying the positions of political decision-making, state classes, even though they mostly had middle class backgrounds, were able to benefit from public resources and, later, enriched themselves to considerable *grandesse*, often exceeding the one found in traditional-authoritarian (or: ‘conservative’, as they have also been labeled) states. Elsenhans (1996) develops his concept of the ‘state class’ as an incumbent elite which does not possess resources itself (unlike a Schumpeterian Bourgeoisie), but survives by monopolizing the state apparatus. His definition is largely congruent with the better known term of ‘state bourgeoisie’. For this latter term, see, i.a., Waterbury (1991).

political parties, active trade unions and other interest groups – all signs of a modern political system. They are thus somewhere ‘in between’ on the continuum between the ideal-types of bureaucratic and traditional authoritarianism even though they have more in common with the traditional systems than with the bureaucratic authoritarian regime type. Most notably, they share with the ‘traditional’ group of cases the characteristic that no systemic political transition (triggered by social ruptures and leading to ideologically legitimized political rule) has occurred prior to the current period of economic and political change. Also, all political systems on earth have, over time, become more and more ‘modern’ in the sense that institutionalization has become stronger over the decades, which makes this a criterion of lesser importance.<sup>10</sup>

However, real life is more complex than this, forcing us to distinguish on at least one additional level: Most of the Arab countries bordering the Mediterranean are relatively resource-poor, compared with their sister-countries on the gulf peninsula where the ideal ‘petro-states’ with abundant mineral resources are found. Thus, an essentially economic criterion for intra-regional distinction is introduced here. Apparently, the question whether a country was endowed with significant oil- or gas reserves had no decisive influence on its pattern of state formation during the 1950s to 1970s: As figure (4.1) below shows, there are resource-rich ‘bureaucratic authoritarianisms’ as well as resource-poor ones, and although the majority of ‘traditional authoritarianisms’ are resource-rich, there are also cases of traditional authoritarian polities which do not fit easily into the pure ‘rentier-state’ model.

Political and economic liberalization all over the region coincided during the past decade. This simultaneity, main-stream wisdom had it, certainly indicates a correlation, but maybe even a causation, between economic and political developments. The degree to which a country was endowed with natural resources as foreign exchange earners for the rulers and their clientele *did* influence the course of political change during the 1990s (see Schlumberger 2002c), even though democratic transitions were out of discussion in all Arab countries. In the literature on Middle Eastern economic reform and development, on the other hand, it has been hypothesized that the bureaucratic authoritarian regimes face more and deeper difficulties on their way of becoming open-market systems than their monarchical, traditionally conservative and pro-Western counterparts, because the ‘socialist’ states had once nationalized their financial systems, implemented land reforms to the detriment of large capitalist absentee-landlords, and nationalized a good deal or even all of their national industrial base. Along this or similar arguments, it was claimed that countries like Egypt, Algeria or Syria will encounter much greater difficulties in their transition towards market economies than the Arab

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<sup>10</sup> Examples within the region under examination include Saudi-Arabia as a case where probably everybody would agree that it is to be categorized as a traditional system. The differences between polities such as Jordan or Morocco on the one hand, and Oman or Kuwait on the other, are diminishing over time. What remains common and unaltered in both kinds of systems is that they are ruled by a monarch, and the fact that, in their periods of state formation, they have not experienced the kind of revolutions or social ruptures the republics have witnessed.

monarchies like Jordan, Kuwait, or others (Henry & Springborg 2001 provide a prominent example).

Obviously, problems of categorization occur when classifying countries as ‘resource-poor’ or ‘resource-rich’ just as they have occurred above when subsuming them under the types of bureaucratic or traditional authoritarian polities, since ideal types hardly exist. However, the purpose here is to provide a rough scheme in order to assess those intra-regional differences that are likely to be most important for the examination of processes of structural change.<sup>11</sup> Proceeding that way, we arrive at four sub-types of Arab states and economies:

Figure (4.1): TYPOLOGY OF ARAB STATES, CA. 1970 – 1990

<i>Regime type</i> →	Traditional-Authoritarian	Bureaucratic-Authoritarian
<i>Economic position</i> ↓		
<b>RESOURCE-RICH</b>	(A) Saudi-Arabia; Bahrain; Oman; Qatar; U. A. Emirates	(B) Iraq until 2003; Libya; Algeria
<b>RESOURCE-POOR</b>	(C) Jordan; Morocco (Lebanon)	(D) Egypt; Syria Tunisia; Yemen; Palestinian Entity

Case selection is based on this figure. Within the four boxes, Egypt has been chosen to represent subset (D) for it is by far the politically and economically most important and largest country in that group. For box (B), Iraq poses problems since it has been subject for the entire period of observation to massive external distortions (Second Gulf war, UN sanctions, and finally the 2003 war by the US that overthrew the Iraqi regime), while Libya is an extreme case for it has been, again for almost the entire period of observation, closed off the rest of the world and the world economy, equally subject to international sanctions (cf. Niblock 2001). Therefore, Algeria remains the only possible case to represent subset (B) in this study. As for the traditional resource-rich countries, the United Arab Emirates (UAE) provide the case that comes closest to the ideal-type because resources, in relation to the size of the population, are most abundant here, and this is why they have been chosen. Also, the great internal variance of the level to which the seven Emirates are endowed with natural exportable resources provides a rich testing ground for the impact of the ‘oil-factor’ (cf. Chapter [9] for details). Lebanon, as has been said, is clearly a border case in group (C). One could just as well say that Lebanon, being politically and, at least to a large extent, controlled by Syria, should really belong into group (D), so that the choice is only between Jordan and

<sup>11</sup> Given the fact that the number of cases is large, the matrix suggested in figure (4.1) is certainly problematic for some countries more than for others, and some might be difficult to include at all (consider, e.g., Lebanon or Yemen); however, the figure *does* provide an analytical tool for examination for *most* of the cases to be considered here by grouping them into the four subsets of cases

Morocco. Both constitute equally suitable cases, are clearly dynastic as concerns their system of rule, and are both resource-poor by any standards. Jordan has here been chosen for practical reasons.<sup>12</sup> The cases that are dealt with in the following chapters are thus: the ‘Democratic and Popular Republic of Algeria’, the ‘Arab Republic of Egypt’, the ‘Hashemite Kingdom of Jordan’, and the ‘State of the United Arab Emirates’, roughly following a most-dissimilar case design for the inquiry.

## Selecting Issue Areas

Generally speaking, ‘structural adjustment’ aims at (re-)activating the market forces in order to bring about functioning market economies. This is so since – according to economic theory – market systems are universally regarded as the type of economy that optimizes social welfare by achieving optimal allocative efficiency. In this vision, the free interplay of supply and demand creates a reliable price mechanism that, in turn, accounts for allocative efficiency.

The main institutions that have, since the 1970s, designed and assisted in the implementation of liberal economic reform in developing countries being located in Washington (mainly the International Monetary Fund [IMF] and the World Bank Group), John Williamson (1990) has given an outline of ‘what Washington means by policy reform’. The ten ‘commandments’ that, as he claims, have provided the basis of what he calls the ‘Washington Consensus’ are comprehensive, inter-linked, and, assuming their full implementation, would almost inevitably seem to lead to the establishment of open market economies as understood by neoclassical economists, regardless of place and time. The Washington Consensus as formulated by Williamson in 1990 reflects, at the same time, the concept that underlies economic stabilization and structural adjustment programmes as they have been initiated in the Arab world. It is based on a strictly neoliberal theoretical approach to economic policy reform.<sup>13</sup> Because of their importance and in order to recall them to the reader, the ten commandments of the Consensus may briefly be recalled to the reader’s mind here:<sup>14</sup>

- fiscal discipline

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<sup>12</sup> Unlike Jordan, in Morocco the case is somewhat complicated by the fact that recently, oil and gas reserves have been discovered. While their commercial value was not yet known at the time of writing, it was safer to opt for Jordan than to risk the case shifting from one group to the next in the course of writing. The fact that this author had conducted prior work on Jordan, and the less complicated travel arrangements eased the decision.

<sup>13</sup> Tahir (1997) provides an example of just how exclusively structural adjustment as implemented in the Arab world is based on neoliberal ideas.

<sup>14</sup> The list given here is based on Williamson’s own later summary (2000) and discussion of the ‘Washington Consensus’. A good non-technical explanation of the elements associated with structural adjustment is by Glover (1991).

- redirection of public expenditure priorities toward fields that offer high rates of return and an improvement of income distribution
- lowered marginal tax rates and a broadened tax base
- interest rate liberalization
- competitive exchange rates
- trade liberalization
- liberalization of inflows of foreign direct investment (FDI)
- privatization
- deregulation (to abolish barriers to market entry and exit)
- secure property rights

What are, now, the issue areas of reform that should be selected in order to examine the plausibility of the hypotheses advanced in Chapter (II) above? Analytically, we can distinguish between points that fall within the scope of structural adjustment as a medium-term strategy for the re-organization of an economic system with the goal of generating greater liberty for the interplay of market forces to take hold and enhance the prospects for economic development in the long run on the one hand, as opposed to those that are more directly aimed at alleviating an acute situation of crisis (what is referred to as macro-economic stabilization). This latter process has, by and large, been successful in most countries world-wide, and in this regard, the Arab economies are no exception (see the overview in the following Chapter [5]).

For the purposes of this study, however, those issues that bear on the longer-term restructuring of economies are much more relevant: Those are the points that impact on the systemic attributes of the economic system as such. Doubtlessly, these are commandments five to ten in the above list. The problem is that the commandments as formulated in the Washington Consensus do not – at first glance – match too neatly with the distinction made here between politically sensitive and (relatively) insensitive measures, a distinction that is needed to examine the hypotheses advanced in Chapter (2) above.<sup>15</sup> According to these, the most important issues to examine in order to assess to what extent economic reform in fact promotes the establishment of market economies as defined above, and, secondly, to what extent reform policies *de facto* deviate from the neoliberal logic of the Washington Consensus and, instead, rather follow a political logic of regime maintenance, are those areas that are politically sensitive for incumbent political elites. Such areas are those where full implementation of the Consensus threatens to undermine the authoritarian political power of the regimes directly or indirectly through a possible reduction in allocative capacities of the state, through loss of control over social actors, and through a possible loss of control over economic decision-making and the economic process as a whole. Obviously, if fully implemented, all of the non-stabilization items of the Washington Consensus fall under this category, since their *explicit aim* is precisely to reduce state interference in the economy.

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<sup>15</sup> ‘Politically sensitive’ is used here in the sense of crucial to power maintenance of top political decision-makers.



Here, three issue areas have been selected for further examination in each of the cases to be looked at:

- 1) *banking and the financial system*
- 2) *public sector reform and the privatization of state-owned enterprises (SOEs)*
- 3) *the investment climate, investment legislation, and actual foreign investment*

The *financial sector* is key for the exercise of economic power for various reasons: First, the availability and the allocation or non-allocation of credit essentially determines business opportunities for the private sector. This obviously requires a look at the structure, development and performance of the banking sector, the interest rate regime, as well as the performance of credits. Secondly, however, the financial sector has in some Arab countries also worked as a means of generating ‘artificial’ revenues, to diminish the state budget via deliberate exchange rate (mis-)calculations and thereby increase the allocative leeway of the regimes under the increasingly difficult conditions of liberal economic reform. National budgets and fiscal policies are third interesting area which makes sense looking at, but the problem here is that budgets in the Arab world, as a rule, are opaque, late, and mostly incomplete with respect to both the revenue and the spending sides. They are therefore commented only when they really tell us something interesting about state practices of ‘political’ economics. On the other hand, it might be worth considering that the fact of opaque fiscal practices in itself is hardly an accident or caused merely by a lack of well-skilled human resources. Rather, the general rule is: the more intransparent a budget, the more important and sensitive are a government’s reasons for doing so.<sup>16</sup>

As for *privatization and public sector reform*, this seems in deed, as Waterbury (1992) has put it, at least one of the ‘heart[s] of the matter’ of structural adjustment because it most directly impacts on a regime’s legitimacy: The rationalization and privatization of poorly performing and overstaffed public enterprises by definition involves large-scale layoffs of workers. Considering that the public and state sectors have functioned as an indirect means of legitimacy-creating job-guarantors, the likelihood of political unrest and direct threats to regime survival are imminent when public sectors are downsized and the large state-owned enterprise sectors are privatized. Therefore, the question of how to handle the re-structuring and downsizing of the public sectors and the privatization process in a way as demanded by the external institutions and at the same time not risking violent uprisings is a major challenge for the regimes in place and must be examined. Perhaps nowhere is political power as directly at stake as in this field of structural reform.

Finally, in times where public sectors have for years produced under capacity, had incurred losses and thus constituted a huge and unsustainable fiscal burden for the regimes, the importance of private sector contribution to the GDP rises structurally. However, even the

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<sup>16</sup> The academic community is therefore eagerly waiting for the forthcoming volume ed. by Heydemann (2004).

Arab states cannot force private investments to be made. Therefore, the investment climate becomes a third key factor for the future performance of the reforming economies – all the more so since official capital transfers have sharply decreased in importance over the past two decades when compared to private capital flows.<sup>17</sup> Of course, this is an area where measurements are difficult; for instance, there is no commonly acknowledged method of calculating *foreign direct investments* (FDI). However, one issue that definitely matters more than others in this context is the *investment legislation* and its mode of application to local and foreign businesses. With FDI today being one of the most important factors for the performance and developmental prospects of any economy, a look at the levels of FDI in the region as a whole and, more specifically, at the levels that the four countries under consideration are able to attract can therefore serve as a means to check in how far the countries have managed to present themselves to the outside world and to local business as having achieved a reliable and conducive *business climate*.

The three issue areas that are chosen here for further examination will, taken together, make it possible to generate an overall picture of the reform process. Of course, not each of them can be assessed as much in such great depth as would be possible in a study on, say, privatization alone. Yet, it is important for the argument of this book to present a possibly broad overview since a single issue area does not allow for similarly broad conclusions as a more general overview; also, checking whether the advanced hypotheses are viable or not cannot be done by singling out one aspect only. If we were to examine only one issue area, we would not be able to see whether or not the reform process as a whole is subordinated to a political logic or not, or whether other variables might account for the results observed. To exclude as many competing explanations as possible, the three issue areas selected here can be taken as a necessary minimum in order to be able to support or discard the hypotheses of Chapter (2).<sup>18</sup>

However, it must be noted that not all three issue areas assume equal weight in all cases and are covered in equal detail. They serve as a rough guideline for the analysis, but are

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<sup>17</sup> Net private flows to developing countries (debt and equity) were roughly three times higher than official flows (aid and debt) during the late 1990s and early 2000s. In the MENA region, figures vary more strongly from year to year, but the trend is the same, even though workers' remittances outpace both. It should also be borne in mind that MENA comprises Israel and Turkey, two countries that attract more private investments than any single Arab country. Still, the MENA region ranks last among all world regions in the attraction of net FDI. For details see World Bank (2003: 201–8). See also the *The Economist* 2003: "Survey of Global Capital", 3 May 2003, 3–26.

<sup>18</sup> However, this is not to say that this Part (II) could serve the purpose of verifying or falsifying hypotheses in a sense of 'testing'. Such an endeavor would require more extensive field research in each of the Arab countries that would have to result in detailed case studies, as a row of Ph.D. theses, for example, and such studies would then have to be available on each of the countries. Only then could they be compared and general conclusions be drawn to strictly verify or falsify hypotheses that, taken together, result in a *verification* of any model akin to the one outlined in Part (III) below. However, such detailed micro-level studies exist only on a few sectors in a few countries only. There is no means of gathering evidence enough to have hard proofs for the correctness of the model presented here. Therefore, the following chapters should be regarded as a way of presenting first tentative and indicative evidence only, and to demonstrate that the implementation of economic reform as pursued in the Arab world is not 'erratic' or 'arbitrary', as often heard, but, on the

not handled mechanically. Rather, depending on the relative importance for each country, some areas may be more important to look at in one case, others in a second or third one. Thus, the structure of the following chapters in itself reflects the relative weight of individual aspects of the overall economic reform process, and not each issue area chosen here is discussed in an equally detailed manner for every case selected. Thus, divergence from the structure given by the issue areas selected here reflects differences between individual cases and serves to highlight each country's specificity in comparison to others. But first, a number of similarities must be stated (in Chapter [5]) which are not directly related to *structural* reform, but rather to macro-economic stabilization which did not differ much from one case to the next between those countries that *had* to undergo stabilization.

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contrary, should be regarded as highly coherent if looked upon from a different angle than the neoliberal economic one.

## Chapter 5

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### Some General Features of Economic Crisis and Reform in the Arab World

Considering the problematique of economic reform and structural adjustment in the Arab world, there are a number of commonalities that hold true for almost all states across the region. It makes sense, therefore, to highlight these regional features briefly before dwelling on single cases. In the chapters that follow, I shall focus not on the emergence of economic crisis and stabilization, but on the subsequent structural reforms that have wider impacts on the economic orders than macroeconomic stabilization.

There are five points that can be said to pertain to the Arab world's experience with economic crisis and reform in general:

- 1) Before the era of economic reform, all countries examined here had types of rentierist economic orders; this implies a number of characteristics that are outlined below.
- 2) All Arab countries slipped into fiscal crises of the state that soon widened – albeit to varying degrees – into profound economic crises.
- 3) While the ‘pure’ rentier states, the oil-rich Gulf monarchies, were able to manage and overcome this crisis by policies of austerity for a number of years, all non-oil Arab states (semi-rentier economies) had to resort to IMF-designed programs of macroeconomic stabilization and structural adjustment, involving massive external borrowing and debt-rescheduling. From that point on, the non-oil countries had to cope with a significant level of interference by external actors into their domestic economic affairs because as a way of last resort, they succumbed to externally established and controlled conditionalities.
- 4) Typically, these externally induced policies can – at least analytically – be separated into two phases, with the first aiming at macroeconomic stabilization, the second consisting of a further-reaching structural adjustment process that was geared at reshaping the entire structures of the semi-rentier economies.<sup>19</sup> As is shown below, macroeconomic stabilization was, by and large, a successful undertaking in the Arab world, much as it had been in Eastern European countries and other regions, too: Within a few years only, the

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<sup>19</sup> This is not to say that both cannot or did not overlap in practice, depending on the timing and sequencing of reform measures. The Egyptian experience (discussed in the next chapter), for instance, is a clear case of such an overlap. However, their respective elements can relatively easily be distinguished according to their impact on economic structures, decisions, legal and regulatory framework and (formal) institutions.

most important macroeconomic indicators could be brought back on track and under control in all Arab countries (see table [5.1] below).<sup>20</sup>

- 5) By contrast, and that is one of the main points to be demonstrated in this part of the book, the further-reaching efforts at structural economic change and improved long-term prospects for economic performance did not yield similarly encouraging results; in the following chapters on individual cases, this will be demonstrated in greater detail.

The entire Arab state system, from the early 1970s up to the late 1980s, was characterized by a high degree of dependency on external capital inflows that made up a significant portion of the central governments' revenues.<sup>21</sup> These inflows largely consisted of international economic (differential) and international political rents,<sup>22</sup> enabling the state to act as the most powerful economic agent and the largest employer, controlling resources and production processes, irrespective of the political orientation of the regimes (nominally socialist or conservative pro-Western).<sup>23</sup> Even in a 'resource-poor' country such as Jordan, external government revenues accounted to over 31 percent of total public revenues by 1989 (HKJ/Ministry of Planning 1993).

Thus, the composition of budgets in all four countries was highly dependent on the continuous influx of external capital. Of course, this holds true even more for the Emirates' oil economy than for the semi-rentiers of Egypt and Jordan, but even these latter ones could not have maintained their economic systems without the 'rent factor', given a generally narrow domestic tax base. Second, the states' role as an 'major and ultimate employer' (Beblawi 1987: 55) came pretty close to socialist countries and even outpaced some of these.<sup>24</sup> However, public sector share of GDP in the Arab semi-rentier economies did not conform to employment structures: While the state still acted as a major employer, the public sector's share in GDP generation had dropped significantly in all semi-rentier economies by

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<sup>20</sup> The obvious exception is Iraq, but here the reasons are clearly the externally imposed sanctions which paralyzed the official economy to an extent that no stabilization could possibly occur. On the UN-sanctions imposed on Iraq, Libya, and Sudan, and their socio-economic consequences, see Niblock (2001).

<sup>21</sup> Bahgat Korany (1986) tellingly calls this regional sub-system 'petrolism' in order to describe the regional circulation of international capital that originally entered the economies as differential rents for the large oil exporters, but parts of which then circulated on as political transfers to non-oil countries. Even these semi-rentier states or rentier states of second order managed to link themselves to the streams of oil money effectively enough to afford large systems of subsidized goods, free health and educational systems, and resources that could be spent for the political co-optation of potential rivals and to reward a loyal clientele.

<sup>22</sup> At times, authors refer to migrant workers' remittances as a form political rents (e.g. Beck 1996: 115). Yet, from a political economy perspective, this is wrong since the lion's share of such private remittances accrues not to the state, but to the families of the workers. While that phenomenon helps in maintaining artificially elevated consumption levels on the recipients' side, it runs directly counter to central claims of the rentier state approach in that it does not enhance state's allocative capabilities (except maybe for a small portion of the remittances the state might be able to tax) and therefore makes the state not more, but less autonomous from domestic society. Note that it is misleading to subsume them under the state's rent income.

<sup>23</sup> This point is convincingly elaborated and supported with figures in Glasser (1995).

<sup>24</sup> In communist China, for instance, state-enterprise employment in the late 1970s was only around 18 per cent of the work force (see Sachs 1999: 98).

the late 1980s and state-owned enterprises were often running well below production capacities.<sup>25</sup>

The political-economic strategies of this allocative model that is so typical for rentier economies began to erode when, in the early 1980s, world oil prices structurally decreased and did not recover until the end of the 1990s except during a short period during the second Gulf war. In order to maintain their allocative policies, the governments resorted to large-scale domestic and, more importantly, external borrowing. External debt in all countries greatly increased in the course of the 1980s. While this was not a problem for the oil-rich countries such as the Emirates who still maintained international credibility because of their ability to generate sufficient foreign exchange receipts through oil exports, it became a most serious problem indeed for the less resource-rich regimes of Jordan and Egypt. Inflation rates increased to more than 20 percent annually in Algeria, Jordan and Egypt (only the UAE could maintain inflation under control with some 3 percent in 1991; cf. Sadik 2001: 226). Debt service obligations swallowed more than 30 percent of Egypt's and Jordan's GDP.

Algeria stood somewhere in between the extremely resource-rich cases such as the UAE on the one hand and extremely resource-poor countries such as Jordan. The peoples' republic could, with the help of the receipts of mineral resources exports, drag on the initiation of structural economic reform longer than could Jordan and Egypt, but unlike the Emirates, it could not avoid them altogether. Consequently, the Algerian program of macroeconomic stabilization and structural adjustment began with a time-gap of four to six years delay compared to Egypt and Jordan, but in 1994, a deal had to be struck with the IMF and the country has, ever since, been subject to similar conditionalities as were the resource-poor countries.

In Egypt and Jordan, the two relatively resource-poor cases examined here, external debt amounted to up to over twice the size of GDP, and the threat of state bankruptcy was imminent soon. Access to international capital markets became difficult if not impossible, and in consequence, inflation rates skyrocketed due to excessive domestic borrowing from the central banks. At the same time, foreign exchange reserves held by the central banks dwindled. Not surprisingly, these developments often translated into negative real GDP growth rates. It becomes clear here that the UAE are an exception to the developments described here insofar as their revenues were high enough not to let it slip into the same type of deep fiscal crises that the other three countries under consideration here experienced. 'Despite the oil price crash, the UAE was still in a strong financial position. The current account was roughly in balance in 1986, but has since moved back strongly into surplus' (Rizvi 1993: 673).<sup>26</sup>

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<sup>25</sup> Of course, this assessment is misleading to a certain degree in that it does not take into account hidden subsidies for *private* enterprises – this is relevant especially where the state's *direct* financial aid to private entrepreneurs becomes significant, as in the United Arab Emirates.

<sup>26</sup> It is notable here that 1986 signifies the year when the oil sector's share in GDP creation in the Emirates experienced an all-time low due to low world market prices. Consequently, the UAE's GDP fell by over 20 percent from 1985 to 1986 (cf. Rizvi 1993: 675ff.). The fact that despite slump, no economic breakdown

In short, the governments had turned a blind eye toward the fact that their distributive policies were not sustainable in the long run; instead, they pursued them as long as possible. This becomes understandable only when we take into account the fact that governments in the Arab world are not the impartial and benevolent steering agency that conservative economists tend to see in ‘the state’, but that the stability of political rule essentially depended on the resources the state could use for the co-optation of potential rivals for power, to build up extensive networks of patronage, and to preempt the emergence of autonomous centers of power outside its control. Therefore, the rentierist model is not only an economic one, but also has strong political corollaries that stabilize non-democratic rule. As a general trend, it is therefore correct to state that ‘oil hinders democracy.’<sup>27</sup>

Empirically, too, it can be demonstrated that economic reform was not on the minds of Arab policy makers until they were forced by external actors to consider that possibility as the only way out of the crisis (see, i.a., Beck and Schlumberger 1999). Rather, it is important to note that they clung to the distributive model of buying support as long as possible and were willing to initiate reforms only after their economies had collapsed. Egypt is a case in point: Its first agreement with the IMF that resulted in a stand-by credit came as early as 1987, but the IMF refused any further loans after Egypt had refused to implement reforms as demanded by the Fund. Nevertheless, both Jordan and Egypt could not avoid succumbing to the Fund’s prescriptions and entered into renewed relations in 1989 and 1991 respectively (see, i.a., Niblock 1993: 58–68; Albrecht, Pawelka and Schlumberger 1998). While structural reforms including privatization had been a subject of debate among decision-making elites for more than a decade, the stabilization and adjustment program did not take off before 1991. The same goes for Jordan, although here, the impact of the war in Kuwait set the initial program off track and necessitated renewed agreements with the Fund and the World Bank in 1991. Algeria was a somewhat belated candidate in that the start of a comprehensive reform package took place only in 1994, even though here, too, earlier agreements with the IMF had existed. But both the civil war and a reluctance on behalf of the administration to initiate deep-going reforms because of socio-political concerns delayed their implementation. The Emirates, finally, did pursue economic reform, but in a fundamentally different mode from the other three countries. No external conditionalities were imposed, and the external debt, though significant, was internationally viewed as still manageable.

The reason for the reluctance to implement liberal reforms is that economic conditionalities and the liberalization as suggested by international financial organizations posed a direct threat to the political rule of Arab authoritarian leaders in the ‘less-than-pure rentier’ countries: Reducing the state, as the Washington Consensus prescribed it, would by definition translate into the emergence of alternative and potentially powerful economic actors. Once the state could no longer control these, it had to fear that at some point they

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occurred demonstrates the richness of the Emirates’ economy and the abundance of oil revenues that accounted for the –relatively- little effect that the crisis had on the Emirates’ national economy.

<sup>27</sup> For detailed and quantitative support of this argument, see Ross (2000).

would claim not only economic freedom, but also influence over policies that ultimately determined their economic success or failure. This could hardly be tolerated by incumbent regimes who had, for the previous decade or more, lived precisely on their positions within a state apparatus that gave them command over public resources – not only, but also for self-enrichment. We should therefore not be surprised that elite support for liberal economic reform in the Arab world was virtually non-existent at the outset of the liberalization process in the late 1980s to early 1990s. Contrary to the proclaimed fears of large-scale unemployment and economic collapse in the face of increased competition, the initial intention and incentive for incumbent regimes to change attitudes when faced with that threat were less public welfare considerations, and rather their own political survival. This situation caused vehement resistance from ‘within’: a clear case of ‘frogs being told to dry up the swamp.’

Quite naturally, the large-scale adverse social effects of liberal reform were also feared; they threatened to further delegitimize the regimes in power and would possibly lead to social unrest and political instability – a fear that was well-grounded, as became evident in virulent social uprisings and bread riots later in the 1990s.

Thus, in the early 1990s, three out of the four cases to be discussed here were ripe for IMF-brokered macroeconomic stabilization programs. Only the well-endowed oil monarchies of the Persian Gulf could escape direct external involvement into their domestic economic affairs. Despite variations from one country to the next in timing, sequencing and concrete policy priorities, all three managed to bring their most important macroeconomic indicators back on track within a relatively short span of time. Table (5.1) demonstrates the success of macroeconomic stabilization in these cases. With the help of debt forgiveness and rescheduling, stabilization turned out to be a feasible task, and it was so in a span of time which was shorter than many had expected beforehand. It was necessary in order to avoid state bankruptcy, and it faced relatively little and manageable resistance from the Arab regimes themselves and from their bureaucracies who realized that successful stabilization was a *conditio sine qua non* for their staying in power. This represents a marked difference when compared with structural adjustment programs which are discussed in Chapters (6) to (9) below.



Table (5.1):

SUCCESSFUL MACROECONOMIC STABILIZATION<sup>28</sup>

Indicator	Years (dependent on country – see left column)				
<b>Real GDP</b> (% change to previous year)					
Algeria (1994 – 98)	- 0.9	3.9	3.8	1.1	5.1
Egypt (1991/-2 – 95/-6)	1.9	2.9	3.9	4.7	5.0
Jordan (1990 – 94)	- 0.7	2.6	12.1	5.3	5.7
UAE (1991 – 95)	- 2.4	- 0.9	- 0.6	- 2.4	- 0.8
<b>Debt-Service Ratio</b> (debt as % of exports)					
Algeria (1993 – 97)	92.3	48.7	42.5	29.2	29.8
Egypt (1990 – 96)	22.5	15.9	14.9	13.4	12.7
Jordan (1989 – 93)	24.9	23.2	38.7	22.4	19.9
UAE (1991 – 95)	...	...	3.0 (1993)	4.9	3.6
<b>External Public Debt</b> (in % of GDP)					
Algeria (1994 – 98)	70.3	76.7	71.9	65.1	64.3
Egypt (1991/-2 – 95/-6)	89.5	69.2	58.0	55.7	49.2
Jordan <sup>a)</sup> (1989 – 93)	157.0	188.8	163.9	128.9	118.8
UA Emirates (1991 – 95)	...	...	27.7	33.3	23.7
<b>Current Account</b> (% of GDP; incl. transfers)					
Algeria (1993 – 97)	1.6	- 4.4	- 5.4	2.7	7.6
Egypt (1990/-1 – 1994/-5)	5.2	4.1	5.1	0.2	0.6
Jordan (1989 – 93)	- 2.5	- 19.1	- 17.0	-14.4	- 11.6
UAE (1991 – 95)**	...	...	3.4	0.9	1.4
<b>Overall Fiscal Balance</b> (% of GDP, excl. grants)					
Algeria (1993 – 97)	- 8.7	- 4.4	- 1.4	3.0	2.4
Egypt (1990/-1 – 1994/-5)	- 18.1	- 5.4	- 3.5	- 2.1	- 1.2
Jordan (1989 – 93)	- 20.6	- 18.3	- 12.9	- 3.4	- 5.6
UAE (1991 – 95)	...	...	...	- 12.3	- 12.5
<b>Inflation</b> (% change in CPI)					
Algeria (1994 – 98)	29.0	29.8	18.7	5.7	5.0
Egypt (1991/-2 – 1995/-6)	21.1	11.1	9.0	9.4	7.2
Jordan (1989 – 93)	25.7	16.2	8.2	4.0	3.3
UAE (1991 – 95)	3.6	5.5	3.2	5.0	5.5
<b>Official Reserves</b> (in US\$m)					
Algeria (1993 – 97)	1,500	2,640	2,110	4,230	8,040
Egypt (1990/-1 – 1994/-5)	6,100	10,600	14,900	17,000	17,900
Jordan (1989 – 93)	48	221	824.4	588.4	432.2*
UAE (1991 – 95)	5,370	5,710	6,100	6,888	7,701

\* Foreign exchange reserves at the central bank had decreased in 1993, but due to a revaluation of gold reserves, net assets still grew positively that year. // \*\* Balance of Payments for the UAE.

**Sources:** World Bank (1997b/1:4); Daves (1997: 12); Schlumberger (2002a); IMF (1995); EIU, *Country Profiles*, various years and countries on Jordan; IMF (1998a & 1998b); EIU (var. years) on Egypt; IMF (2000b) and Nashashibi et al. (1998) on Algeria.

<sup>28</sup> Depending on the sources one uses, there are, of course, slight variations in absolute figures. What is important here, however, is the development over time and the trends that can be discerned in these developments. And the trend that becomes evident from the development of the most important macroeconomic indicators is clear and unambiguous.

<sup>a)</sup> Figures given in the IMF staff report 1995; actual figures are higher since in most calculations, the IMF staff exclude non-disbursed loans.

In sum, table (5.1) demonstrates that all economies that have undergone stabilization processes or which, like the Emirates, at least implemented austerity policies for a limited span of time, have in fact managed to bring their economies back under control through tight fiscal and monetary policies, and with the help of external debt rescheduling and debt forgiveness where externally designed programs were initiated (Jordan, Egypt, Algeria). These developments in themselves, however, are but interim results and do not represent fundamental *structural* changes, neither to the economic orders nor to the underlying power relations that shape outcomes and *long-term* performance in the overall economic process.

The picture looks markedly different when we turn towards the results of the subsequent more far-reaching processes of structural adjustment. To outline this with the example of the three issue areas chosen above for closer inspection (financial system and banking, public sector reform and privatization, and private sector development and investment policies), and in the four countries selected here (Egypt, Algeria, Jordan, UA Emirates; see Chapter [4] above) is the task of the following chapters.

## Chapter 6

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### ‘Pure Patrimonialism’: Egypt

Apart from the selection criteria given above in chapter four, Egypt is among the most important countries in the MENA region for a number of different reasons: Its population of roughly seventy million inhabitants makes it an influential player in regional politics and the largest single Arab market. It has a rich cultural, religious, intellectual and ideological heritage, from Pharaonic times to the days of Gamal Abd an-Nasser and on to Mubarak. While the center of gravity within the region has certainly shifted towards the oil-rich Persian Gulf after 1973/-74, Egypt is both militarily and politically still influential enough not to dominate the regional sub-system, but to be seen by many as the most representative and relevant voice among the Arab countries.<sup>1</sup>

In the economic sphere that is of interest here, the country’s history is exceptional insofar as Egypt is the only Arab country that has autonomously undertaken relatively successful efforts at early industrialization during the first half of the twentieth century (see, i.a., Vitalis 1995; Pawelka 1985 and 1993; Owen 2000). Along with that, new social forces such as an autochthonous bourgeoisie or large scale labor had emerged. However, Egypt’s economic history is not unilinear: The revolution of the ‘Free Officers’ under Gamal Abd an-Nasser that set an end to the monarchy in 1952 transformed the socioeconomic structures of the country through nationalization of industries and the financial system, through land reform, and many other measures (see Baker 1978; Waterbury 1983). It was only after Sadat had taken over office that, starting from 1974, his *infitah* policies allowed for new private actors to appear on the economic scene, assume wealth and influence, and change the picture of Egypt’s socioeconomic profile (cf. Baker 1978: 143-51; Waterbury 1983: Part 2, esp. chs. 6-9; Henry 1996: 65-69). As concerns the period examined here, however, Egypt’s way into economic reform resembles that of many other Arab countries. A quick overview of economic developments since the late 1980s may serve to illustrate this.

After a decade of discussions within the decision-making elites and the typical profound fiscal crisis that entailed mounting external debts, the country was close to bankruptcy in the late 1980s. – Why? Sadat’s *infitah* policies of the 1970s had worked up until circa the mid-1980s and can be understood as a strategy to increase and consolidate external revenues to the state without weakening the allocative power of the regime (Pawelka 1993: 129ff.). The president’s

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<sup>1</sup> This is complemented in the religious realm by the Mosque and University of *Al-Azhar* whose guidance serve as a major reference for Sunni believers all over the world.

decision to conclude the Camp-David peace agreements with Israel in 1978 resulted in a structural change of Egypt's revenue structure: While the country had enjoyed large amounts of official transfers from the Arab Gulf as a 'front state' versus Israel, it now became the recipient of substantial Western military, economic, budgetary and technical aid mainly from the US ( for discussions see Bangura 1995; Handoussa 1990; Sullivan 1996) as well as from the EU in the frame of the third and fourth financial protocols.

The second pillar of Sadat's economic *infitah*, as has been described in detail elsewhere (see the citations above; also: Deeb 1976; Bianchi 1989; Hinnebusch 1985: ch. 9; Richards & Waterbury 1996), consisted in opening up the domestic space for private business, most notably in the contracting and import-export sphere, but also in banking, where foreign investment was – albeit with significant legal restrictions – accepted for the first time since Nasser had nationalized the sector, as well as in manufacturing, construction, and the tourism industry. These opening policies meant a gradual but nonetheless significant shift away from the state-led economy that had prevailed for almost twenty years.

However, it took another sixteen years and the threat of state collapse until what has come to be understood as stabilization and structural adjustment gained ground under the presidency of Hosni Mubarak due to massive external pressure. The core of the reform process, if such a core can be discerned,<sup>2</sup> was the introduction of the Public Enterprise Law (Law No. 203 / 1991) which reorganized the administration of the Egyptian state-owned enterprise sector with a clear view to privatization and/or liquidation of loss-making public enterprises that were seen as an unsustainable burden on the budget. Along with that, the external sector was to be gradually liberalized and the financial sector opened up for both foreign and domestic investment. The monetary and fiscal policies that were initiated under the stabilization program (more market-oriented interest rates, dollar-peg of the Egyptian pound, abolishment of restrictions on foreign exchange dealings and the revitalization of domestic capital markets) were a necessary precondition for the more far-reaching and ambitious projects discussed below.

A quick look at the economic structure of the country seems in order before embarking on the analysis of the three most important areas of reform: Private sector development and investment policies, the banking and financial sector, and the question of public sector reform.

An impression of the national economy can be gained through the repartition of individual sectors' share in GDP as table (6.0) below shows. Agriculture accounts for roughly 16-18 percent of GDP, but this under-represents the sector's importance in terms of employment: According to the 1996 population census, the sector accounted for over 30 percent of the country's total labor which represents the single most important employment creator, with more than twice the number of persons employed in comparison to

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<sup>2</sup> Between January 1996 and June 2000 alone, almost 200 laws, presidential and prime ministerial decrees have been issued only in the realm of economic affairs. This indicates the scope and comprehensiveness of Egypt's ambitious program – at least as concerns the formal changes to the legislative frame of the economy. The mentioned regulations are listed in ARE / MEFT (2000c: 126–38).

manufacturing, and more than thrice the levels of the entire trade sector (CAPMAS 2000: 26ff.). While there is some large scale agro-business (mainly by entrepreneurs who also pursue activities in other fields), most of the sector consists of subsistence-level farming and animal breeding. In fact, as Tim Mitchell recently forcefully demonstrated, structural adjustment has proven to be counter-productive in gearing the sector towards export-led growth. As he shows, state policies have induced a return to more subsistence farming rather than away from it (cf. Mitchell 2001; see esp. chs 8 and 9).

*Table (6.0):* EGYPT'S GDP BY SECTOR (AT CURRENT PRICES, IN MN LE.)

<b>Fiscal Year</b>	<b>1997/-8</b>	<b>1998/-9</b>	<b>1999/2000</b>	<b>2000/-1</b>
<b>Sector</b>				
<b>Agriculture</b>	45,182	48,935	52,845	56,861
<b>Industry &amp; Mining</b>	48,798	55,225	61,211	65,129
<b>Petroleum &amp; Products</b>	15,534	12,995	23,300	25,747
<b>Electricity</b>	4,264	4,586	4,936	5,300
<b>Construction</b>	13,730	14,555	15,140	15,760
<b>Transportation<sup>a</sup></b>	24,507	26,300	27,949	30,380
<b>Trade, Finance, Insur.</b>	58,079	65,876	70,624	73,373
<b>Hotels &amp; Restaurants</b>	3,332	3,682	4,925	5,357
<b>Housing &amp; Real Estate</b>	4,860	5,412	6,003	6,880
<b>Utilities</b>	1,038	1,179	1,305	1,444
<b>Social Insurance</b>	185	214	236	260
<b>Government Services</b>	20,662	22,481	24,190	26,779
<b>Social, Personal Services</b>	19,552	20,915	23,740	25,330
<b>Total GDP</b>	<b>259,723</b>	<b>282,355</b>	<b>316,404</b>	<b>338,600</b>

*Source:* EIU (2003: 66); a: includes revenue from Suez Canal

The economy as a whole is heavily service dominated, with the sector accounting for almost half of GDP (US Dept. of Commerce 2002a) which is unusual for a country in that stage of development. However, much of the service sector, like in agriculture where family members help the household survive, is informal. In fact, the importance of the informal sector rose significantly as the official labor market contracted in the course of structural adjustment, which creates, of course, serious problems of social security.<sup>3</sup> As of 2001, official figures put informal employment at around 10 million or 54 percent of the total labor force (18.617 million; around twenty by the time of writing), compared to five million civil servants and public sector employees (a high 27percent of the total), and only 3.5 million or 19 percent in the official private sector (cf. *ibid.*). This indicates that the state, after one and a half decades of structural adjustment, dominates the national economy and still accounts for more

<sup>3</sup> For excellent accounts on issues of social security and state policies in this area, cf. Loewe (2000).

than half of all jobs in the formal economy. Moreover, petroleum export revenues and transit fees from the Suez canal and the Suez-Mediterranean (SUMED, since 1996) Pipeline respectively are major foreign exchange resources which are also entirely in the government's hands. But of course, there *is* a private sector, too, and that was supposed to be activated in order to achieve an export-led growth economy.

## Private Sector Development and Investment Policies

### *Development of the Egyptian Private Sector under Structural Adjustment*

Contrary to what is often stated in policy reports by external agencies, Egypt did not have to transform from a 'socialist' economy to a market economy with the start of the current economic reform and structural adjustment program (ERSAP). With the first liberalization of the economy initiated by former president Anwar Sadat, the private sector had already been permitted to operate in a larger number of areas that had been monopolized by the state earlier. Thus, when liberal reforms started in the 1990s, Egypt already possessed a quite active private sector, as can easily be seen when looking at the public-private distribution of shares in GDP creation as table (6.1) shows:

*Table (6.1):*

PUBLIC AND PRIVATE SHARES IN EGYPT'S GDP CREATION, 1991 – 2002

<b>Contribution to GDP, in %</b>	<b>91/-92</b>	<b>95/-96</b>	<b>98/-99</b>	<b>99/-00</b>	<b>00/-01</b>	<b>01/-02</b>
<b>Private Sector</b>	61.2	63.3	72.5	73.1	76.0	76.3
<b>Public Sector</b>	38.8	36.7	27.5	26.9	24.0	23.7

*Source: Handy et al. (1998: 47) for first two columns; CBE (2002: 54 & 2000: 54) for rest.*

However, the state enterprises could no longer alone accommodate changed patterns of consumer demands. They suffered from large debt stocks accumulated over the ISI years, and their production had not been geared towards the exigencies of export-oriented growth which had now become official policy. Their overly bureaucratic structure was seen as inadequate for attaining the new goals set by the changed developmental paradigm of liberalism, and many cases, Egypt's public firms were even considered non-reformable. In conclusion, the rapid development of a stronger private sector, including the re-attraction of Egyptian capital held abroad, seemed inevitable if the state wanted to overcome the economic crisis of the 1980s. Active strategies of private sector development thus figured high among the government's priorities. Thus, table (6.1) demonstrates that Egypt did not have to start encouraging private economic activity from scratch (as Syria, for instance, had to at about the same time), but the task was nevertheless an enormous one. Numerous incentives,

liberalizations and eases were introduced to induce the spread and growth of private businesses.

In fact, an entire set of new legislation was enacted for that purpose. Investment Law No. (43) of 1974, progressive when it was enacted in comparison to the previous Nasserite era, still posed numerous restrictions and disincentives to private business when compared to global investment trends fifteen years later. It was superseded by Law No. (230) of 1989 which, in turn, was replaced again by Law No. (8) of 1997.<sup>4</sup> As in other areas of legislative reform, this represents the continuing process of a comprehensive overhaul of the regulation of economic activity in the country. In order to achieve this, a second focus of government policies were efforts to revive the local bourses in Cairo and Alexandria which had been dormant for decades, but were now seen as an essential element to boost private sector activity.

The restructuring and revitalization of Egyptian capital markets included not only a new Capital Markets Law (95/1992), but also the creation of a *Capital Markets Authority* (CMA) as a supervisory body to oversee the bourses as well as the abolishment of the capital gains tax (at 2 per cent up to then). These efforts were seen as a necessary pre-requisite for the privatization process in order to attract private capital into formerly state-owned enterprises (SOEs) which had been discussed for roughly a decade by then (see Albrecht et al. 1998), but not been implemented despite heavy pressure from international donors – most notably the Bretton Woods institutions (on privatization, see below). Also, the commercial banking system, already opened up to private participation during the first infitah (see Henry 1996: 66-70 on that point), was in urgent need of reform (see more on that below).

Thus, the primary goal of private sector development in Egypt was, in coherence with the ‘Washington Consensus’, to transform a formerly ISI-based, state-led economy into an economy based on a dynamic private sector that would turn into a corner-stone for sustainable and long-term export-led growth. While this sounds simple, the concrete policy measures in only those areas mounted to a complex and comprehensive web of new legislation and regulations.

Just like in agriculture, family-owned and –run small scale businesses remain the rule in other sectors, too. Even in manufacturing where large scale enterprises can be found, they exist alongside a vast majority of small workshops and artisan shops.

*The Social Fund for Development* (SFD), designed as a job creation machine, was expected to create, in its second phase and under the umbrella of its enterprise development program, 39,089 small enterprises with a total of 104,141 permanent jobs, i.e. enterprises with an average of 2.6 jobs per enterprise, the founder included. This leaves an average of 1.6 employees per unit (World Bank 1996b: Annex 5-2). Sure, this is a somewhat extreme example since the SFD was especially designed and mandated for SME encouragement. But a look at the wider structures of Egypt’s private sector does not yield a significantly different

impression: The vast majority of Egypt's private sector is comprised of small and micro-enterprises; only very few create a large number of employment opportunities, and are also able to contribute more significantly to the GDP. This is not surprising, given that estimates put the total number of persons employed informally at ten to eleven million or 54 percent of the total work force (US Dept. of Commerce 2002a: Chap. 2).

This general picture of the Egyptian private sector's structure is typical for the region and matches with observations made elsewhere (cf., e.g., OBG 1995b on Syria). Employment structures in the Arab world are based on family as the *nuclei* of business. Even most larger and largest private firms are essentially run as family enterprises: Bahgat, Ezz, Lakah, Osman, Sawiris, Seoudi, or Marai are among the tycoons whose names everybody in the streets of Cairo knows. Even the large private sector mainstays listed at the Cairo and Alexandria Stock Exchanges (CASE) are predominantly run as family businesses: 'A significant number of the companies listed on the exchange are family-owned or dominated conglomerates, and free trading of shares in many of these ventures [...] remains limited. Fewer than 10 percent of the companies listed on the exchange are actively traded' (US Commercial Service 2002: ID 110558). Or, as Naguib Sawiris, head of the giant *Orascom Telecom* as one of Egypt's largest private entrepreneurs puts it: 'We are a very united family' (EIU 2000e, 19 June 2000).

As the figures given in table (6.1) indicate, the private sector's share in GDP has risen, but its structure has not changed significantly. Wholesale and retail trade, small workshops and light industry such as food processing are the mainstays where private enterprise clearly dominates. The exception are of some newly created private monopolies or market-dominating positions in heavy industries and relatively new fields such as the IT branch and telecommunications. One example is the production of steel, dominated entirely by the *Ezz*' group of companies whose owner, Ahmad Ezz, the family head, also is a member of the Egyptian parliament.<sup>5</sup>

In the telecommunications and IT sector, another very large company that benefited directly from the liberalization of the market is *Orascom Telecom*, owned and headed by Naguib Sawiris.<sup>6</sup> Not only did the company increase the 40 percent stake it had in Egypt's

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<sup>4</sup> The full name is 'Investment Guarantees and Incentives Law'; the relevant executive directives are found in Prime Ministerial Decision (*qarrar*) No. 2108/1997.

<sup>5</sup> The *Ezz*-Group also enjoys dominating positions in other markets as it is, inter alia, the biggest producer of Televisions in the Middle East, and is active in areas as diverse as wholesale and retail marketing, hotels, internet services, and computer software. Moreover, Ahmad Ezz is on the board of numerous business associations and 'reputed to be a front-man for members of the presidential family, which may explain why the roads out to *Dreamland* [a huge internet-wired leisure facility outside Cairo built by Ezz] were built in such rapid time' (Mitchell 1999: 462).

<sup>6</sup> *Orascom Telecom*, which owns more assets and shares abroad than domestically, and has bought the GSM licenses for mobile phone services in large parts of Africa, is only one out of a group of *Orascom* industries owned by the Sawiris family, with a prominent other one in construction (*Orascom for Construction*). These latter are politically well-connected contractors and implementers of, inter alia, large-scale government projects in infrastructure. Among others, the Orascom group holds the exclusive local rights in Microsoft, McDonald's and other international brand names, apart from controlling the country's largest private construction, cement making, and natural gas supply firm, as well as Egypt's largest private tourism developments (partly funded by the World Bank), as well as an arms import establishment 'with offices close to the Pentagon outside Washington D.C.' (Mitchell 1999: 463).



largest internet service provider, *InTouch*, to 99 percent, but it also holds another majority stake in a second provider, *Link Egypt*. Apart from that, it established Egypt's first privatized public payphone system and provides very small aperture terminal services (VSAT). Its most far-reaching deal, however, was probably struck when *Orascom* acquired, together with *France Télécom* and *Motorola*, a GSM license for mobile telephone service operation from the state, creating *MobiNil*, one out of two mobile phone network providers to date in Egypt (the other one being *GSM Click* operated by *Misrphone* in a consortium with *Vodafone*). This step established, in 1998, a private duopoly in the lucrative mobile telecom market which was granted by the government a period of four years before any competitor was allowed to enter the market. In 2000, Ahmad Ezz announced that he was willing to buy and operate a third mobile net that had been planned to be offered by *Telecom Egypt*, the state's former monopolist.

*Telecom Egypt* had planned to invest in a third mobile phone network that was to start operation in early 2003. However, these plans did not materialize, and at the time of writing, the two local patrons of *MobiNil* and *Click GSM / Vodafone* still saw their duopoly in place – well over the duration provided for by the initial regulations in any case. Discussions about the introduction of a third licence continued, albeit without result. While rumor had it that *Siemens* was interested in operating such a line, Siemens' president of the Cairo office is sure: 'we don't want to enter into competition with the two other operators, Vodafone and Orange' (Svensson 2004). This development offers an interesting area for comparison with the telecommunications sector in Jordan, where parallel developments took place, and where a further study on the 'how' and 'who' would certainly be a topic for fruitful analysis - especially since *Orascom Telecom* owns a 65 percent majority share in *Fastlink*, one of the two Jordanian mobile service providers (cf. Chapter 7 below for details).

As for the regular phone-lines, *Telecom Egypt*'s monopoly was planned to end by 2006, but whether this will happen is not certain. Consequences would most likely be lower costs for long-distance and international calls, but further price increases in local calls, which might, in turn, impact negatively on the growing number of internet users in the country – a sector of the new IT branches on which Egypt wants to build and compete with Jordan and the Arab Emirates as a regional hub for the industry.

More remarkably yet: *Telecom Egypt* bought twenty-five per cent of the shares of the mobile company *Vodafone Egypt*. This is a step towards the return of the mobile-license to the Egyptian government, rather than a step towards increased competition. The situation on the market is thus such that the state first created a private duopoly, but then re-bought a quarter of the shares of one of them, thus almost equalizing the relative shares each of *Orascom* and *Misrphone* owned in their respective companies – creating a 'just' balance, in a very distorted sense. This reminds more strongly of the arbiter-function that is ascribed to neopatrimonial leadership than of any economically justifiable considerations.

Yet another case for the dominance of a small group of well-established liberalization winners is the segment of internet providers. Here, a relatively large number of private

providers were allowed to enter the market, while at the time of writing the carrier RITSEC was still in the hands of the government. Not only were *InTouch* and *LinkEgypt*, wholly and partially owned by Sawiris, an example for prominent names rushing into the new business opportunities. Other providers were Siemens in cooperation with the government (through *Giganet*), Ahmad Bahgat (through *Internet.Egypt*), the Muhammad Mahmoud group (*MM*, through *Egybell*) who had kept a relatively low profile, as well as Gamal Sadat, son of the former president (*Egypt.Online*) or Ashraf Marwan who is married to a daughter of former president Abd an-Nasser (through *MENA Net*). All of these experienced, large, influential and politically strong figures shared, under the control of the government, the politically sensible market for internet providers.<sup>7</sup>

These examples may illustrate that, during the years of structural adjustment in Egypt, there were many opportunities for high and extremely quick profits for some large businesspeople who were well enough connected politically and had timely access to relevant information about upcoming governmental policies. In that sense, a small number of entrepreneurs who had already operated successfully under the more closed previous conditions prior to the 1990s have benefited most from private sector development as part of the national and international efforts at neoliberal reform. While the appetite of these tycoons seems to be literally insatiable, the vast majority of smaller businesses have extreme difficulties in investing, simply because access to credit remains a major problem. In fact, it was cited in a representative business survey as the number one obstacle to investment by the respondent entrepreneurs. (ECES 2002b)

On the other hand, having access to large amounts of resources through the state-dominated financial system may turn out bad even for the large and well-connected figureheads of private business, precisely because they need not demonstrate their credibility for political reasons. The most spectacular case is a rather recent one that happened to Ismail Osman who was chairman of *Arab Contractors*, the country's largest single firm in construction and infrastructure, employing over 70,000 people. Established under Osman Ahmad Osman, the family was able to retain control over the enterprise even after its nationalization by Gamal Abd an-Nasser in 1961, which was, at the time, made possible through a special presidential decree, issued in conjunction with the company's mandate to undertake construction of the Asswan High Dam. In subsequent years, the firm also widened the Suez Canal, and 'built most of the nation's highways and bridges' (Al-Ahram Weekly, 13-19 Dec. 2001). Under the presidency of Sadat, Osman managed to retain his influence, not least through the fact that his son married Sadat's daughter, after himself had become minister of housing in 1973. The company then expanded into other areas such as banking, insurance, manufacturing, foodstuffs, industry, hotels, health care and engineering, not to mention its 38 construction subsidiaries in Europe, Africa, and Asia. Seventeen new companies had been established with *Arab Contractors'* participation, owning shares of between 40 and 100

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<sup>7</sup> Information stems from author's interviews with businesspeople involved in the sector, Cairo, December 2000.

percent. In 2001, however, the problem of 3.5 bn LE. of debts to local banks had become so serious a problem that settlement was urgently needed. Ismail Osman negotiated with the banks,<sup>8</sup> with the Minister of Finance, Medhat Hassanein, and the Minister of Housing, Ibrahim Suleiman (cf. *Middle East Times*, Egypt Business Brief No. 11-2002). When, in early 2001, the latter replaced many of the directors of the board, it was rumored that he was trying to curb Osman's influence and 'bring the company more directly under the ministry's control' (ibid.). If the story told by Osman is correct (that the government owed the company most of what the company in its turn owed domestic banks), that would – once more – prove that entrepreneurship, even if conducted under the auspices and with the agreement of the regime, remains risky insofar as too great an accumulation of influence and power becomes dangerous since the regime itself will not tolerate any alternative centers of arising aside from the presidential palace. The precarious situation of private enterprise places even the largest businesses under close scrutiny, making them dependent less on their economic performance than on their relations to the country's top decision-makers. In consequence, Ismail Osman was forced to resign from his CEO position at *Arab Contractors* in late 2001.<sup>9</sup>

Much has been said about the large private sector representatives in Egypt. Irrespective of the economic sector, private business is dependent on the state in Egypt. When foreign observers draw, in the light of economic liberalization, parallels to the European process of industrialization and try to detect a vibrant bourgeoisie that would act as an engine of development in Egypt, as, for instance, representatives of foreign chambers of commerce in Egypt love to do, this is based on a profoundly wrong understanding of the entire sphere of private sector activity in the country. The private sector as a whole is politically and economically dependent on the regime for survival and economic success.

This holds true even more for the small and medium sized enterprises and companies. For them, the multitude of quickly changing legislation which results from the adjustment process creates legal obscurity which is difficult to assess and overlook. Furthermore, overlapping responsibilities of various authorities lead to ambiguities considering competences, adding to all other existing difficulties of the business environment. As one study on private business in Egypt concludes,

'Having "your men" within the bureaucracy to maneuver through the red-tape and expedite the process is vital if the transaction costs are to be reduced to manageable levels. Most of the businessmen interviewed indicated that they have large public relations departments to handle matters involving the state's bureaucracy. Although they are irked by the costs entailed in terms of time and money, they admit that by virtue of their resources they eventually manage to overcome most impediments without excessive delays. Obviously, the situation is very different for small and even medium sized businesses, which with only limited resources and lacking *the connections and power of*

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<sup>8</sup> Arab Contractors had sought to get a low-interest loan from the state-owned National Investment Bank in order to be able to pay back its more than 3.5 m LE. debts to other local banks, while interests alone had already mounted to over 475 m LE. per year. Arab Contractors, however, blamed its debts as arising from government payment arrears for completed projects.

<sup>9</sup> In turn, and as a rather cynical move, he had been offered a post as an advisor to the minister of housing which he rejected.

large firms, can be virtually crippled by the excessive level of their transaction costs'.  
(Zaki 1999: 216; emphasis added).

Enforcement of legal claims is quick only if the political backing for an entrepreneur is beyond doubt. If not, property rights or infringements thereof will hardly be dealt with satisfactorily by the Egyptian judiciary. When, in 2002, an anti-trust law was debated (the law was then actually already in its eleventh draft, lingering on since the mid 1990s), fierce resistance was met with from 'the local business community', which means, of course, those who feared that the law would threaten monopolistic privileges. In short, the law is 'pliable to those with the right connections. With the use of either method – the right contact or a bribe – one can often get away with anything: from obtaining immediate approval of justifiable as well as dubious claims, to destruction of documents in the official files if these are unfavorable to the claimant' (Zaki 1999: 217). On the flip-side, it is detriment to one's economic success and potentially even dangerous for businessmen not to line with the top-level decision-makers. Bakry (1996: 76), for instance, reports that an interviewee of hers 'unconsciously opposed one senior government official in one of the meetings, a matter that put him for six months under complete sensitivity [sic.] and uneasiness with the government, which naturally affected his business negatively.'

Even if best intentions were supposed to guide the government in its process of reform, there is no shadow of a doubt that as a result, the rule of law in practice is absent. At the end of 1997, it was estimated, 3000 judges had to cope with a backlog of nine million cases to be reviewed – a sheer impossibility. No wonder, thus, that international organizations state: 'In any case, the judicial civil system needs to be reformed' (UNCTAD 1999: 33). Especially as concerns business arbitration, USAID's first subcontractor for monitoring the government's privatization project concludes, in its recommendations to the American agency: 'The inability to enforce contract law remains another problem restricting direct foreign investment. The passage of an arbitration law has not solved the problem and the court system is dysfunctional especially as that relates to business contracts and corporate governance problems' (IBTCI 1997a: 13).

Even if a ruling is made, 'enforceability of rulings is often virtually impossible' (Zaki 1999: 219). The third party to enforce judicial rulings is the executive, 'the state'. This state, however, can not be interested in enforcing judgments that would run against some of its prime representatives or against their immediate clients. To presuppose such good intentions on the government's side, therefore, is highly problematic. To assume that the government, or rather: the regime and its top leadership was willing to reform its legal and administrative system, including the judiciary, in a way that the rule of law could or would be readily enacted seems grossly naive because regime members, their families and clients and their client's clients directly benefit from the absence of the rule of law. If we assume economic and political actors to be economically and politically rational, depriving oneself of benefits one has the power to control is an absurd assumption.

In the light of this, it is not surprising that ‘access to powerful individuals has become the most potent means of resolving disputes in one’s favor. Through such connections, property rights may be protected, and encroachment on the property of others is also made possible’ (Zaki 1999: 218). This shows: One of the most essential prerequisites for speaking of market economies is structurally ruled out in the Egyptian experience over the entire period of the economic reform and structural adjustment program. Moreover, it has not even been addressed seriously by those who are in the position to establish conditionalities.

Yet, the assumption that the leaders’ intentions were the best, only ‘the system’, ‘the bureaucracy’ or ‘the state’, in any case some abstract and non-identifiable entity, was responsible for the described deficiencies is a phrase that can still be heard from local business people (most notably those who benefit from the absence of the rule of law and the present patron-client networks), and not rarely from representatives of Western donor organizations, including the Bretton Woods institutions, when talking *on* the record. As has been indicated here, however, such assumptions have not only no rational arguments to build on, but also contradict all indicative evidence. An example might help clarify the argument made here:

An Egyptian businessman, toward the end of the 1990s, wanted to start a private high-tech enterprise in the ecological tourism sector, but – as expected – encountered trouble in getting his paperwork done by the authorities. Within days, he received the telephone call of a close affiliate of one of the president’s sons, offering him to get his project going immediately – in exchange for a fifty-one percent share in it. Even though the entrepreneur had already invested an amount of financial resources that would be considered substantial by any criteria, he considered the ‘danger’ to be involved in such a project which would then no longer be under his own control too great to accept the proposed deal, and wrote off what he had already spent; in his own words, the problem was the lack of a political ‘sugardaddy’.<sup>10</sup>

Another case is by an importer who wanted to import medical equipment and computers for charitable purposes (i.e. free of charge) into Egypt, but was denied clearance of his goods at the customs. He was not able, finally, to get the stock into the country and was very frankly told by a customs officer that the only one allowed to import this type of material was the son of one of the main political decision-makers in the country.

It is not necessarily by accident that both examples given here involve not top political power-holders directly, but rather their sons who have ‘gone private’. A career in the military or the bureaucracy no longer promises influence and power. Where power is already firmly held within the family, the sons of key decision-makers rather tend to open up their own businesses or act as shareholders in others’ in order to increase their families’ wealth. This phenomenon of what is called ‘al-geel al-wasat’ (the generation in between) in Egypt is a phenomenon that has brought about important changes to the socio-political fabric of Egyptian elites and which is until now much understudied. But that is not the focus here. The important point is that, as long as this kind of business practices prevails in Egypt, it is against all odds to assume an impartial political regime that would do its best to enhance the business

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<sup>10</sup> Conversation with the said entrepreneur, Cairo, December 1998.

climate and actively work for a competitive and dynamic private sector. The impediments to private sector development are genuinely political and help to ensure the continued dominance of a narrow stratum of ruling elites which are composed of closely and increasingly entwined networks of private entrepreneurs with the 'right contacts' to government or public sector officials who find their connections to be of mutual benefit.

Combating such networks of governmental patrons and private clients would directly endanger the position of today's ruling elites in Egypt. It cannot be expected of any actor in politics nor of any of those who benefit directly from this type of economic system – including the large private sector representatives. While we have here one major reason for the seemingly 'arbitrary' exclusion of potential competitors from the market and the inclusion of others into it, the current practices of informal, not legal, political influence in economic affairs impacts negatively on the investment climate, because such discretionary power cannot be exerted when an economy is subject to the rule of law. This is especially dangerous for foreign investors who do not exactly know the political-economic landscape, and might quickly ensue disastrous results for a not-well-enough-connected foreign investor or for such who have chosen the wrong local allies.

One example is the case of *Sainsbury's* (the British chain of supermarkets) market entry – and subsequent exit – from Egyptian. In that case, an initial contract was made with *Edge*, a local food retailer in which local businessman Amr el-Nasharty had bought a 20 percent stake in the course of the government's privatization program. As Kalmbach (2003: 5)<sup>11</sup> writes, it appeared that *Sainsbury's* seems to have wrongly assumed el-Nasharty to own much more than the 93 grocery shops he actually did at the point when *Sainsbury* entered into a 150 m US-\$ agreement with him which established *Sainsbury-Egypt*. Increasing its shares in *Edge* to 80 percent, *Sainsbury* and Nasharty became the largest retail group in Egypt. The heritage of an agreement with the Ministry of Supply and Internal Trade to co-manage 51 cooperatives was another indicator that demonstrated their high ambitions. In January 2000, then, the first store was opened and quickly, one hundred others followed, employing 2,500 people. Plans to expand to a total of 250 shops, 16,000 employed and using Egypt as a hub for regional expansion (*Egypt Focus*, Dec. 2000), there seemed little domestic competition.

But a multi-million operating loss over the first six months proved to be a sobering experience. Blocked building permits, difficulties with licensing and delayed customs clearing of goods were but some of the difficulties encountered. While *Sainsbury's* claimed it was introducing competition to the market, local media began to report on foreigners monopolizing the market 'and thus force down prices and profit margins' (Al-Ahram Weekly, 11-17 Nov. 1999). Ultimately, in a clash between a local dairy producer and *Sainsbury's*, the *Federation of Egyptian Industries* (FEI) stepped in and tried to convince *Sainsbury's* not to sell milk below production costs. False allegations of a support by *Sainsbury's* of Jewish settlements finally resulted in the Federation of Egyptian Chambers of Commerce endorsing a

boycott of *Sainsbury's* which was then followed by Muslim clerics who forbade buying at their stores. In demonstrations which ensued, the windows of several of the stores were smashed with stones. In reaction, the chain ascertained its British ownership and posted Qur'an quotations on its walls, but the boycott continued. Consequently, *Sainsbury's* left the Egyptian market in spring 2001. Whatever the real reasons behind the failure to establish the chain in Egypt and, even more so, behind the withdrawal from a potentially promising market, it seems clear that not public protest alone made the foreign investor pull out. At least one report suggests that the losses incurred were not the only reason for the withdrawal, but that Sainsbury also saw itself without political backing in Egypt (Olivier 2001). As one staff member from the Cairo University says, 'the Egyptian economy is controlled and restricted by very elusive non-economic forces' (quoted in Kalmbach 2004: 10). Local partner el-Nasharty, on his part, turned out to be involved in a series of scandals concerning non-performing loans from state-owned Egyptian banks (see the section on banking below), to which he owed several hundred million LE. When he fled the country for fear of a 30-year prison term, he left behind not only 170 m LE. debts to government-owned National Bank of Egypt, but also another 370 m LE. to other banks.

This instance 'depicts how personal relationships and hefty bribes rather than adequate collateral or reliable feasibility studies play a large role in business dealings and political maneuverings' (Kalmbach 2004: 12). On the other hand, there is the majority of those private sector representatives who have not the resources to influence political decisions and who suffer from bureaucratic interference in their daily business. Since these segments also produce primarily for the domestic market, they are bound to be net losers from the ongoing process of selective liberalization and economic restructuring.

It is therefore not amazing that the distribution of wealth among the population in the years of structural adjustment in Egypt did not only remain stagnant, but that the winners were those lucky few who either originated from the 'right' families or else were connected and fared well under previous policies. In the arena of private sector promotion, the SAPs as prescribed by the Bretton Woods institutions therefore actively contributed to stabilizing authoritarian regime elites who rely in their power on the absence of the rule of law. For long-term development prospects, this mode of implementation of economic reform proves detrimental. Stabilizing a political regime that is not willing to cede control over the economic process contributes not only to rapidly rising inequalities that are created through the inequitable application of laws and rules, but also brings further damage to the investment climate which is key to international investors. Table (6.2) below demonstrates Egypt's FDI record. Considering the size of the Egyptian market and the willingness, in principle, of many investors to consider Egypt 'a place to go', this record is poor by all standards. The reasons for that should be clear by now. Imagine you were an investor and have all of the above in mind: Would you consider investing in a country where you have to have a very specific

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<sup>11</sup> Much of the details on this following example is taken from Kalmbach's (2004) detailed account on the

knowledge of the political-economic landscape which most international consultants can not come up with? Indirectly, the answer to these questions is provided in table (6.2):

*Table (6.2):* NET FDI INFLOWS TO EGYPT, 1990 – 2001

	1990	1992	1994	1996	1997	1998	1999	2000	2001
FDI inflows (in US\$ mill.)	734	459	1,256	637	888	1,077	1,500	1,184	498
FDI per capita (in US\$)	14	8	22	11	15	18	24	--	--
FDI in percent of GDP	1.7	1.1	2.4	0.9	1.2	1.3	1.6	--	--
FDI to developing countries (in US\$ bn.)	31.2	35.3	47.1	130.1	172.6	176.8	185.1	--	--
Egypt's share (in percent)	2.35	0.97	1.41	0.49	0.51	0.61	0.81	--	--

**Sources:** World Bank (2001b: 26); IMF: *International Financial Statistics*, World Bank: *Global Development Finance*, various issues; EIU (2003a: 72).

Large fluctuations are due to the nature of investments: most of FDI to Egypt are restricted to a very limited number of areas, such as the oil sector or tourism, and that one large investment directly impacts on the country's overall FDI inflows. What all of the above means for the investment climate is made clear in a 201 World Bank report: 'Egypt could pull in larger inflows provided the business environment is more hospitable' (World Bank 2001b: 25). In a 1998 survey among international investors on the main obstacles to investment in Egypt, the average indexed weight accorded to each of them varied between 2.13 and 14.80 (UNCTAD 1999: 106). The four that reached an average index above 12.0 were: Corruption (12.07), political instability (13.27), financial risk (13.87) and bureaucracy (14.80). All of them can be traced back to the political logic of control that governs the implementation of structural adjustment in the country.

'Corruption' refers to the informal practices by which loyalties are kept in place and networks between patrons and clients in state-business relations function. By 'political instability', obviously, is not meant to circumscribe an unstable regime, but rather the threat of militant opposition of the majority of the population that has incurred significant material losses in the course of liberal reform; this is the flip-side of fast, often semi-legal and informal gains that have been reaped by the small group of 'adjustment winners'. This kind of political instability is therefore less due to an unstable international environment than a home-made problem generated through the selective implementation of structural reform measures according to a political, not economic logic.

Third, it is all but understandable that investors complain about financial risks, given an unpredictable judicial system where cases are dragged on average for nine years. This point leads us back to the absence of firmly guaranteed property rights, where informal relations decide whether or not legal claims can be enforced or whether the investor falls prey to the conflicting interests of some politically better-connected competitor who impinges on

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events.



his property rights. The absence of guaranteed rights and, due to the weak judicial system, their 'erratic' enforcement makes any economic undertaking highly risky.

Last, the fact that bureaucracy is cited the heaviest obstacle should not come as a surprise: After all, the bureaucracy is the executing institution in charge of the practical implementation of politically motivated economic policies on a day-to-day basis. It has to guarantee that the interests of the leaders, their families and friends are not negatively affected by potential international or domestic competitors, be they foreign investors or international institutions involved in the reform process, or local businessmen.

The majority of the other remaining top 'obstacles', too, can be read as parts of the underlying logic of power maintenance pursued by the regime: the legal system, the tax regime, tariff barriers, business establishment procedures, access to land and others more are all possible instruments to prevent the emergence of unwelcome competitors to the economic power and dominant positions of the small stratum close to political power, and are often handled and used as such. Furthermore, if one wants to establish a business operation in a field where a high-ranking general or politician or a family member or a friend of such persons has a stake, the likelihood to encounter a 'lack of capable/trustworthy partner', another one of the most-cited obstacles to investment, is also high.

The fact that the state of emergency remains in place in Egypt ever since the assassination of former president Anwar al-Sadat back in 1981 certainly does not help to improve the investment climate either. It is simply not reasonable to assume that foreign business would tolerate emergency rule forever under the pretext of the need to fight Islamism, the 'war against terrorism' or whatever else might emerge in these kinds of arguments. For those more familiar with the regime's customs, emergency rule remains a clear sign for the regime's unwillingness of ceding power, including economic control. Legal and trusted arbitration mechanisms, forceful anti-trust legislation that does not protect monopolies but would abolish them, and further core elements that would have to be in place in a market economy are not in sight in Egypt in the early twenty-first century.

The political regime has a clear hierarchy of policy goals, and the overarching one of them that ranks above all others is political power maintenance. All other policy goals are secondary to this prime objective. Rather is economic stagnation or even recession tolerated than the priority of regime maintenance being given up. However, Western economists and policy advisors still refuse to take into account in their analyses this elementary fact. In more analytical terms, one cannot but agree with Charles Tripp: Rather than the pursuit of economic reform as a means to achieve economic ends, it is 'the state' which has top priority because it is through the state apparatus and the means for patronage this state provides that regime elites maintain their political *and* economic power: 'It is hard to argue that liberalization and privatization in the economic sphere are symptoms of the malaise or bankruptcy of the state. On the contrary, they could be said to testify to the resilience of the state as an organization maintaining a particular kind of hierarchy through the use of patronage and incorporation in various forms by ruling elites which see these measures as

helping to extend their own power' (Tripp 2001: 223; see also Ayubi 1995: 339–67). In the economist's terms: it is the predominance of informal patterns of behavior and interaction in the political sphere that determines outcomes of economic interactions. In the world of a political scientist, the above description is nothing else than a testimony for the presence of the classical type of neo-patrimonial political rule, and it is not by accident that it is Egypt which often serves as the example for demonstrating how neo-patrimonial types of authoritarian regimes work (Pawelka 1985: 22–99; cf. also Bill & Springborg 1994: Ch. 3).

## Banking and Finance

### *The Budget and Fiscal Practices*

The most basic element of a country's financial sector are public finances as planned in the central government's budget on the macro-level. However, this also is an area that is handled with great caution by non-democratic regimes since the publication of irregularities, misuses or theft would greatly de-legitimize the regime. Moneys that are budgeted and disbursed but somehow magically lost in public bodies such as banks, state-owned enterprises or the bureaucratic apparatus and administration would much more easily be traceable through an accurate and transparent budget. Thus, if Egyptian fiscal policies were sound, transparent and objectively controllable, this would run counter to the hypotheses advanced in chapter 2 above. A look at Egypt's budgetary practices strongly supports the hypothesis that political priorities necessitate or at least provide strong incentives for opaque budgeting practices. A recent World Bank report leaves no doubt:

'Budget transparency is limited in Egypt at all stages. Even upon approval of the budget by the People's Assembly, it is not made available to the general public. Within the public sector, sections of the document are only available on a "need-to-know" basis. During the implementation phase, basic financial statistics are not disclosed, making it difficult to assess whether expenditures are in accordance with the approved budget. Upon completion of the fiscal year, actual expenditure data are made available in a very aggregated form and with great delay. [...] since the budget does not convey information as to the objectives that are to be achieved, debate is restricted to how much is spent in broad public policy areas, absent considerations of efficiency and effectiveness. Finally, the CAO's audit reports are narrowly disseminated and do not seem to contain any consideration of effectiveness and efficiency of government expenditures' (World Bank 2001b: 46 and 48)

It is clear, then, that any efforts of thorough analysis of the Egyptian budget are not very promising – at least not at this stage of the reforms. Why, one might ask, has no one insisted on improving a factor that is as central to economic reform as budget transparency during over a decade of reforms and closely monitored conditionalities? Why have the international financial institutions not insisted on a restructuring and disaggregation of the budget? As the

above quoted report states, two major obstacles toward greater fiscal transparency are '(i) the level of budget aggregation, which makes it difficult to distinguish what uses the resources are being authorized for. [...] and (ii) the absence of monitorable objectives, which makes an appropriate expenditure tracking impossible' (ibid.: 50).

It is hardly imaginable that the recurrent visits of IMF staff teams and World Bank experts (the Bank even has a permanent resident representative!) should never have led any of these persons to reflect on the basic nature and necessities of budgetary planning and practices. The only conclusion that can be drawn from these findings is that either the Egyptian regime so strongly opposes budgetary transparency that not even the mighty Bretton Woods institutions had a chance of making their reform a condition for future lending, or that really a group of totally incompetent international 'experts' have been advising Egypt in the state's financial matters. As we all know, the latter version is not the case – which leaves only the first possibility with some plausibility. But if it was true that resistance to government expenditure is so fiercely resisted by the Egyptian regime, then there must be extremely strong reasons for that: Risking serious arguments with the most important donor nations and organizations for maintaining the status-quo of an issue or item that could be reformed at little cost and with limited effort must be essential for those who instruct Egyptian-side negotiators with the international financial institutions on external conditionalities.

The suggestion here is, obviously, that the intention behind the lasting budget intransparency despite reforms is to maintain areas of arbitrariness in financial matters that cannot be discerned by whoever wants to control state expenditures. Even the central auditors office's task is rendered a *farce* through current budgetary practices: 'The auditing system does not help in ascertaining whether the resources used have led to the desired results. Though the legislature has given the CAO the mandate to undertake performance audits, these are not performed on the budgetary account. ... Even if the CAO desired to carry out performance audits on government expenditures, the format of the budget and the subsequent reporting by line ministries would prevent any meaningful performance audit' – this is the wording not of any confidential paper, but of an official and publicly available World Bank document (ibid: 50). In the light of these findings, there seems hardly any necessity to take a closer look at annual budgets as published in the Official Gazette: The use of proceeding that way in this study is more than limited because even the most basic prerequisites for meaningful budget analysis are not given. However, Egypt stands not alone in terms of budgetary intransparency. Syria's budgets, for instance, are another case in point where excessive aggregation of single budget lines, the exclusion of relevant sources of revenues (oil, military aid, and others considered 'sensitive'), and a general sense of secretiveness make it extremely difficult to gain an accurate picture about both the government's revenues and its expenditures (see Schlumberger 1998: 15-22 & A.4-A.6).<sup>12</sup>

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<sup>12</sup> In fact, fiscal intransparency is so salient a feature of Arab economic governance that it formed the subject for an entire research team which, under the direction of Steven Heydemann, examined fiscal practices in Egypt, Lebanon, and other Arab countries for several years. The results are published in Heydemann (2004).

## *The Banking Sector*

Considering the findings of the above section, the question is: how do such intransparent practices on the fiscal macro-level translate on the meso- and micro-levels of banking? This question shall, at least in parts, be discussed here. After one and a half decades of comprehensive economic reform and structural adjustment programs, governmental players still dominate the scene in banking and finance. At the end of the fiscal year 2001, Egypt had sixty-two banks with a total of over two and a half thousand branches.<sup>13</sup> The lion's share in terms of power and capacity lies with commercial banks of which there were fourteen private institutes and public-private joint-ventures, plus four state-owned banks, with together almost 1300 branches. Figure (6.1) below gives an overview of the structure of the Egyptian banking system.

The structure of Egypt's banking system continues to be shaped by four major public sector commercial banks: *National Bank of Egypt* (NBE), *Banque Misr*, *Banque du Caire*, and *Bank of Alexandria*. At the end of 1999, they accounted for 85.6 percent of deposits and 84.4 percent of bank loans (EIU 2000d; US Dept. of Commerce 2002a). These figures were even higher when the *National Investment Bank* (NIB) was taken into account which held dozens of billions of the *National Authority for Social Insurance* and is responsible for their administration, management, and investment.<sup>14</sup>

Although the Egyptian government has plans to privatize, in the frame of the banking privatization program that was to complement the privatization program of public enterprises earmarked under the Public Enterprise Law (No. 203/1991; see next section for details on public sector reform and privatization), at least one of the 'Big Four', these plans had not materialized at the time of writing. The privatization of at least one of the four public sector commercial banks is a commitment of the Egyptian government dating back to its 1993 agreement with the IMF. In 1998, a new banking law (155/98) laid the legal basis for the envisaged privatization of at least one of the big public sector banks. Yet, in mid-2000, then Minister of the Economy and Foreign Trade Yousouf Boutros-Ghali had explained the postponement of such a sell-off by a 'lack of public support' (EIU 2000d; 16 May 2000). In fact, parts of the academic and semi-public debate made a strong case against selling off public banks 'established with the money of the people' as selling out socially owned resources – possibly even to foreigners (El-Naggar 1998; quotation from p. 18).<sup>15</sup> Apart from such semi-official versions of the story that strongly play on anti-Western sentiments, the

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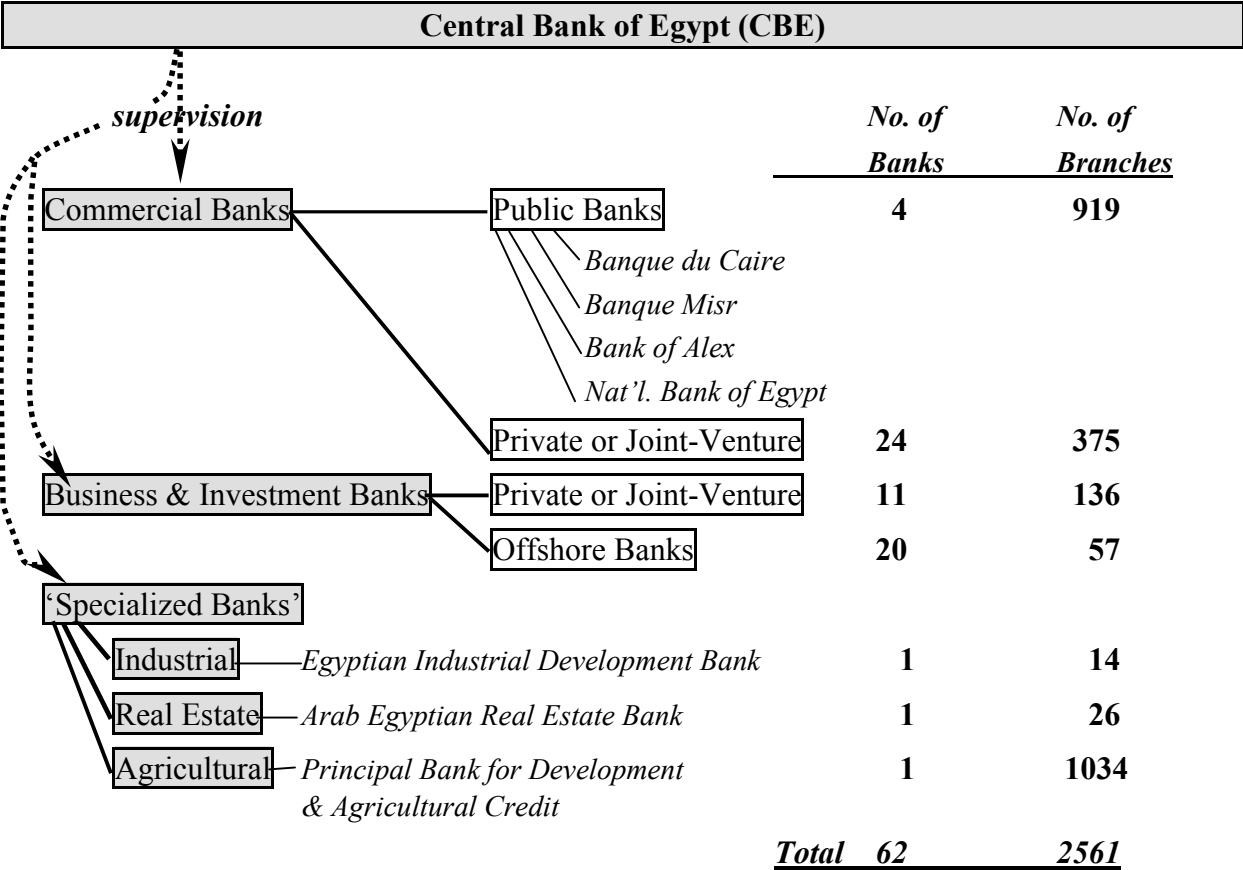
<sup>13</sup> The *Principal Bank for Development and Agricultural Credit* alone entertained 1031 branches, most of them small village banks to serve the local population in the countryside. However, the four state-owned commercial banks also had 921 branches.

<sup>14</sup> The deposits of the *National Authority for Social Insurance* with the NIB amounted to 119.9 bn LE (ca. 34.9 bn US\$) in 2000 (see CBE 2002a: 64).

<sup>15</sup> This, of course, is the statement of a publication stemming from the Al-Ahram Center which, while at times coming up with serious studies, nevertheless represents a (semi-)official institution strongly under the direct control of the regime itself.

truth is that the government of Egypt has succumbed to making the sale of at least of one of the ‘Big Four’ a mandatory issue in its discussions and agreements with the Fund in 1993. Therefore, it is at best uninformed, at worst some pro-government rhetoric that might be used to buy time for the regime against mounting pressure to implement sooner rather than later the policies and measures it had agreed upon with international donors.

Figure (6.1):  
STRUCTURE OF THE EGYPTIAN BANKING SYSTEM, (AS OF 30-6-2002)\*



Source: CBE (2003a: 105)

In addition to their dominating position in the market place, the ‘Big Four’ also hold significant shares in joint venture banks. Taken together, it has to be stated that the Egyptian state retains a close control over the entire financial system in the country. Table (6.3) gives an impression of state-owned and –controlled segments and shares – apart from the four large public sector banks themselves.

\* Excluded here are Egyptian banks outside the country as well as the *Nasser Social Bank* and the *Arab International Bank*, two banks established under private law and not registered with the CBE. The total number of banks is 81 and includes the two aforementioned plus 17 smaller banks for development and agricultural credit all over the country.

Table (6.3):

STATE OWNERSHIP IN EGYPTIAN JOINT VENTURE BANKS (SEPT. 2001)

Joint Venture Banks	NBE	Banque Misr	Banque du Caire	Bank of Alex.	Total State Bank Interest	Other State Interests	Total State Interest
Alex. Commercial & Maritime Bank	*	-	5.0	-	5.0	52.1	57.1
El Togarioun Bank	17.0	16.0	16.5	9.7	59.2	27.2	86.5
Export Development Bank	11.5	11.5	11.5	10.1	44.5	40.0	84.5
Housing and Development Bank	*	-	-	*	*	62.5	62.5
Islamic Bank f. Investm. & Developm.	20.0	20.0	20.0	20.0	80.0	-	-
Misr America International Bank	-	-	32.8	-	32.8	67.2	67.5
Misr Iran Development Bank	-	-	-	39.7	39.7	37.5	37.5
Banque du Caire et de Paris	-	-	22.0	-	22.0	-	22.0
Cairo Barclays International Bank	-	-	40.0	-	40.0	-	40.0
Cairo Far East Bank	-	-	19.2	-	19.2	20.0	39.2
Egyptian American Bank (EAB)	-	-	-	35.3	35.3	-	35.3
Egyptian Gulf Bank	-	-	-	-	-	24.4	24.4
Egyptian Saudi Finance Bank	7.7	-	8.5	7.4	23.6	12.7	36.3
MIBank (Misr International)	-	20.0	-	-	20.0	4.0	24.0
Misr Romanian Bank	-	33.0	-	-	33.0	-	33.0
Egyptian Commercial Bank (Alex Kuwait International Bank)	-	-	-	9.8	9.8	0.1	9.9
Commercial International Bank (CIB)	19.6	-	-	-	19.6	-	19.6
Credit Internationale d'Egypte	0	-	-	-	0	-	0
Egypt Arab African Bank (EAAB)	-	-	-	-	-	0.7	0.7
Misr Exterior Bank	-	20.0	-	-	20.0	-	20.0
National Bank for Development	-	-	-	*	-	11.9	11.9
National Société Générale Bank	19.3	-	-	-	19.3	-	19.3
Suez Canal Bank	4.3	*	0	*	4.3	11.8	16.1

\*Company sold to ACE and Commercial Int'l. Investment Company.

Source: PCSU / CARANA Corporation (April-June 2002: 30).

As these figures undeniably show, the numerous reiterations of the government's intention to privatize the banking system and make the financial sector more independent from direct regime control have not translated into action. It was only in 2002/-03 that rumors of a new impulse for possible partial withdrawals of the regime in some parts of the financial sector gained voice again. Whether this materializes remains to be seen in the future. However, the regime would deprive itself of one of the most effective instruments of regime maintenance and the control over domestic private business elites were it to really privatize the banking system and make it not subject to new arbitrary state regulations and control. Therefore, any scenario that sees a competitive, non-restricted and independent Egyptian banking system seems unlikely unless and until regime elites have found alternative ways of maintaining control over potential rivals for power and influence. As long as such alternative instruments of informal control are not in sight, banking liberalization and privatization in the financial sector will remain a wishful thought in the minds of Western advisors.

Yet, the state's involvement in banking is not unilaterally imposed. Several foreign banks find it extremely useful and even ask for the continuous engagement of state-owned banks in their capital as a means of securing smoothness of operation, or, in other words: as a

guarantee not for the operating success, but for the bank's political standing in the framework of an economy where institutional guarantees for economic undertakings are virtually non-existent. The connection between this state-private relationship on the bank-level and the fiscal situation on a macro-level is alluded to by Roe (1998: 24) who claims that 'there has to be a realistic assessment and management of the broad fiscal situation, including contingent government liabilities hidden for the moment in large unrevealed bad loans in some major banks.'

A second serious problem already hinted to in the above section on private sector development and which has plagued the financial system for years and, in fact, most of the time since liberal reforms have been initiated, is the question of non-performing loans (NPLs) that have been extended by the banks, but are not repaid. The IMF, in 1998, officially estimated such 'bad loans' at around 12 percent of all loans, but this does not match with the unofficial views held by local analysts. While no reliable data are available since banks do not disclose anything on non-performing loans at all, most local observers agree that the real magnitude of non-performing loans lies somewhere in the range of twenty to twenty-five percent (author's interviews with CBE officials, Commercial Banks' staff, and local economists; cf. also US Dept. of Commerce 2002: Ch. 2 [banking section] and Ch. 7 [section A.9]). By the time of writing, the CBE still did not require banks to list NPLs in their auditing reports; thus, Egyptian disclosure standards continue to lag behind even in regional comparison despite a spectacular clampdown on a number of bank leaders and businessmen whose beneficial alliances had become all too obvious. These levels are extremely high and pose a heavy problem for Egypt's economic performance as well as for the underpinnings of the overall reform program. What is at the heart of non-performing loans?

The conventional explanation brought forth by advocates of neoliberal reform is as follows: The huge and overstaffed state-owned enterprises are chronically loss-making, and what is more, they finance their losses through non-performing loans from the local banking system – preferably from public sector banks. This was a process which, in turn, was accepted by the government for social reasons (job security, fear of rising levels of unemployment and poverty in cases of large-scale layoffs of public-sector workers, etc.). Therefore, the proposed strategy by the advocates of this view is easier access to credit for 'the private sector', and possibly the liquidation, restructuring, or privatization of loss-making public entities.

However, empirical evidence suggests a decisively different story. Let us first take a look at who has access to what amounts of credit: Table (6.4) demonstrates that private sector borrowing from local banks has not only greatly increased in absolute terms, but also increasingly outpaced public sector borrowing in ever greater acceleration. In other words: The complaints about the non-availability of credit for private entrepreneurs discussed above in the section on private sector development and investment does obviously not hold true for *all* entrepreneurs. Some, it seems, do not face such difficulties in obtaining loans.

*Table (6.4):*

BANK LENDING AND DISCOUNT BALANCES TO PUBLIC & PRIVATE SECTORS

<i>(in LE bn)</i>	1995	1996	1997	1998	1999	2000	2001
<b>Commercial Banks</b>							
Public*	32.1	35.9	34.9	27.4	28.8	31.3	28.7
Private**	32.3	42.1	52.4	67.3	86.9	103.7	114.0
<b>Business &amp; Investment B's</b>							
Public*	2.5	2.7	2.9	3.2	3.4	3.2	3.1
Private**	5.4	6.8	7.9	10.0	14.6	18.1	20.9
<b>Specialized Banks</b>							
Public*	2.7	2.8	3.0	2.9	2.8	2.4	2.4
Private**	7.3	9.2	12.0	14.7	18.3	21.m	23.4
<b>Total</b>							
Public*	37.3	41.4	40.8	33.5	35.0	36.9	34.2
Private**	45.0	58.1	72.3	92.0	119.9	142.8	158.3

\* includes government sector and public enterprises, both subject and not to Law No. 203 / 1991.

\*\* includes private business sector and households.

Source: calculated and rounded from CBE (2001b: 86-98).

Secondly, as table (6.4) also demonstrates, public sector borrowing has remained roughly stable since the mid-1990s and even shows a slight decrease in absolute numbers. By contrast, loans advanced to the private sector have increased by more than 300 percent over the same period until 2001. The private sector's share in bank loans has thus dramatically increased since the mid-1990, up from around 55 percent in 1995, to ca. 73 percent in 1998, reaching 82 percent in 2001. In the same time, however, the problem of non-performing loans has not been ameliorated, but was significantly aggravated. Had it been primarily the public sector that accounts for financial non-performance as a bank debtor, its overall performance would have to have worsened to the extent that *all* public sector loans would have to be non-performing to make possible, mathematically at least, the persistently high level of bad loans. Even then, it seems, the estimates of the size of NPLs would have been higher than all loans to the public sector. This idea is obviously absurd, especially when one compares the overall performance of state-owned enterprises over these years which has improved and not deteriorated (see the next section for details, esp. table [6.5]!). The problems associated with non-performing loans can thus not primarily be associated with the public sector nor with the government. Rather, it is large private sector borrowers who gained access to credits they were not able to repay.

A recent report in *BusinessToday Egypt* (Oteify 2002) gives a quick overview of the numerous aspects of the problematique: 'Banks leaders were responsible for giving loans through personal contacts without referring to field investigations, in the absence of sufficient guarantees and in violation of banking regulations' – even though 'industry analysts had been quietly warning about corruption and the banks' penchant to for giving unsecured loans since the early 1980s. [...] And on those rare occasions when bad loan cases wound up before the courts, judges almost invariably cleared the heads of the banks'.



On the one hand, there are serious concerns about the problem itself: Reports of non-performance of loans to large private borrowers have increasingly haunted the Egyptian press since at least the early 1990s. *Capital Intelligence*, a Cyprus-based rating agency, has recently voiced concern about the fact that ‘transparency in the banking sector seems to have suffered a setback in recent years’ (quoted in Oteify 2002: 3).

On the other hand, local media increasingly focused on the problem since 2001. Is this a sign of an amelioration of the state’s performance? While bad loans remain a major sign of the general intransparency of the banking sector, there are also credible voices who estimate that the real level of the problems of bad loans is not as high as reported in the media. If this is true, what, then, is the reason for this ‘daily diet of tales of bad loans, systemic corruption and other misdeeds by fat-cat businessmen and their banker-buddies’ (Oteify 2002:1)? The sudden prominence with which the problem is publicly dealt with does not happen without the consent of the prime political decision-makers. Rather, it can be interpreted as a sign to those large-scale private borrowers that the regime might tolerate their informal business practices and allow them quick and illegal self-enrichment to the detriment of the public. But the regime is also capable to stop such practices at once if it deems opportune – or rather: if tacit support of this kind of the ‘privatization’ of public assets becomes inopportune because either the general public gets too enraged or the local business community becomes too bold and threatens to form autonomous power centers that search independence of the political regime.

The 2002 crackdown on private businesses as well as the replacement of high-profile bank leaders included as its victims personalities like Abdullah Tayel, chair of the economic committee in the Egyptian parliament, the *Maglis ash-Sha’b*, and ex-chairman of the *Misr Exterior Bank* (in which the state holds a 20 percent stake), or Hussam Abul Futuh on the businessmen’s side. Wagdi Rabat, who then replaced Tayel at *Misr Exterior*, is quoted pointedly and leaves no doubt: ‘You need two to tango. There *were* bankers who were involved with businessmen’ (quotation from Oteify 2002: 2). As part of the same move, the government has – at least partially – exchanged some of the senior staff of the public sector banks, including the establishment of Mahmoud Abdel Latif as the new president of the *Bank of Alexandria*, thereby demonstrating its activity in favor of sound and clean business practices. The unknown and rather outspoken language of the ‘new guard’ that today has replaced some of the older generation that had been involved in the tacit agreements with private entrepreneurs for years is functional for a government that portrays itself as pro-active in the strife for an up-to-date and transparent financial system. Also, the fact that this active stance of the regime came only after the Egyptian banking system had slipped into a veritable crisis in which serious questions about the general quality of the banks’ assets were raised by international observers (with the problem of NPLs at the basis of such painstaking questions) seems hardly an accident.

By contrast, the usage of anti-corruption campaigns is an integral element of this type of economic system through which the government gains legitimacy by periodical clampdowns on those ‘black sheep’ who are (a) not close enough to political power to be kept

from unpopular publicity and (b) through this, have become too exposed to public anger and can no longer be tolerated by a regime that once turned a blind eye toward their practices since this would delegitimize the political power holders themselves.

The government still effectively controls access to loans, and, in some cases, seems willing or at least prepared to tolerate non-performance. At the other end, access to loans can be restricted relatively easily for those without the right connections. Practice shows that ‘financing is generally limited to well-established companies and individuals’, as the EIU states bluntly (EUI 2001c: 36).

Given the dramatic increase in private sector loans, and adding the fact that most of the sector has hardly access to credit facilities, there can hardly be any conclusion other than that some ‘well-established’ persons or their companies prove to be not too credit-worthy in their business practices – a fact that apparently does not keep them from receiving further loans. The public, in such cases, has to compensate such losses through other means. Only occasionally does it happen that a borrower underestimates the regime’s capacity or willingness to turn a blind eye on such practices – in case, for instance, the borrower overestimates his well-connectedness to decision-making circles. In such instances, deals have been struck in the past to write off the debt incurred by a businessperson, for instance by declaring that moneys (here: several hundred million) had been invested for a purpose of ‘national interest’, as was the case with one MP and head of a private sector conglomerate in 2000. Another instance in which a long-standing tacit agreement between Egyptian banks (and, implicitly, the government) and one of the most prominent Egyptian private entrepreneurs suffered and where a clash over loans escalated is the case of *Arab Contractors* discussed above.

All of the above demonstrates that liberalization and structural reform in the financial sector has been implemented partially at best. Neither were, up to the time of writing, any significant measures taken to fulfil the promise of a privatization of the ‘big four’, nor were the currency-political problems solved. Neither had fiscal transparency been effectively enhanced, nor was the leeway for bureaucrats and political power-holders for discretionary decision-making eliminated or tangibly ameliorated. The continuing existence of pressure by the World Bank and the IMF in this area can plausibly be assumed to figure high among the reasons why the Egyptian government did not, in 1998, renew its programs with the Fund. At that point, the economy performed not well, but well enough in order not to make any immediate threats a likely development. At the same time, the obligations Egypt would have to enter into if a continuation of the program with the IMF were concluded seemed to bear an even greater, political threat: It was not clear whether or not Egypt would once more be able to avoid banking privatization and changes to its fiscal practices, as it had been able for the entire decade. Therefore, canceling cooperation with the IMF apparently seemed the politically more secure option in 1998.

In conclusion, the Egyptian financial sector has remained one of the most powerful instruments for the regime to exercise control over private economic agents in times of liberal reform. The problem of informal networks of ‘cronies’ has neither been eliminated nor ameliorated through the increased role of the private sector in the economy nor through the periodic crackdowns on a number of overexposed representatives of the business community. The success or failure of private business crucially depends on access to credit. It is this access that is controlled by the regime. Rather than ‘lack of public support’ for the privatization of public banks, it seems that vested interests resist such an idea. Privatization of the large state-owned banks would threaten to destroy existent networks between individual private entrepreneurs and bank managers. Considering further that, at the end of 1999, 84.4 percent of all loans were extended through the channels of the ‘Big Four’ (EIU 2000d), it can reasonably be assumed that it is mainly through public banks where credit is allotted to entrepreneurs which might not perform. Despite repeated advice from IMF staff to disseminate data on non-performing loans, the Egyptian authorities resist any sort of publication on them and prefer to maintain complete intransparency in this area.

Non-performing loans are – of course – a problem economically. Simultaneously, however, they are also a political asset to keep a dependent private sector under control: their persistence is an asset in the hands of the regime in case an entrepreneur does not adhere to what is expected of him in terms of loyalty towards the regime. Given the lack of transparency in legal and judicial practices, ultimate power to decide whether to tolerate or punish private entrepreneurs rests within the hands of the top regime leadership and is not open to contestation. The regime leadership and their inner circle allies in the core elite remain in the position of referees who decide whether foul play by banks and business is sanctioned – or not. This is a question decided on the basis of political considerations much more than according to criteria of economic performance. What is more: While high-ranking political decision-makers do enjoy some leeway for autonomous action, they, too, have to adhere to the unwritten rules and red-lines that are not to be transgressed.

The minister of foreign trade and former minister of the economy, Youssuf Boutros-Ghali, is a case in point: His candidacy in the 2000 general elections was a clear sign for caution. His seat being seriously contested by an opposition candidate by the fact that he had to run in an electoral district other than his home district, he succeeded only in the second round of the elections in assuring his parliamentary seat. Furthermore, he was deprived of parts of his portfolio in the cabinet reshuffle that went along with a restructuring of the ministries’ competencies. In the words of one advisor close to the president: ‘His plans for reform come years too early for Egypt. So we had to show him: “We can kill you like we made you”’.<sup>16</sup>

Thus, while the first section has shown that the lion’s share of what is called ‘the private sector’ consists of small and micro enterprises that suffer from heavy-handed

bureaucracy and excessive regulatory interference that keeps the state in absolute control of the overall economic process, the relatively small stratum of the rich and super-rich are beneficiaries of the reform process through their informal relations to the centers of political decision-making that make them quasi-immune to formal rules and regulations – as long as they do not openly contest for decision-making power. Competition as the single most important trait of market economies (see chapter three above) is systematically ruled out due to the systemic attributes that characterize the thus modernized economic order in Egypt after well over a decade of economic reform.

## Public Sector Reform and Privatization

Reforms in the banking and wider financial sector overlap with public sector reform since, as is explained in the section on banking and financial affairs, the Egyptian regime has resisted all arguments in favor of privatizing one of the four big public banks.<sup>17</sup> After well more than a decade of reforms, the financial sectors share in GDP generation is still dominated to over two thirds by the public sector; more importantly, the regime effectively controls private interests not only through entirely state-owned banks, but also by means of its wide-spread holdings in dominantly or partially private banks. If structural economic reform is to increase efficiency and performance of the overall economy, competition would necessarily have to be increased in an area as vital as finance since it determines directly the success or failure of economic ventures. Since this has not happened in banking and finance, let us examine other areas where reform had been recommended.

The ‘heart of the matter’ in structural adjustment, as John Waterbury put it about a decade ago (Waterbury 1992), is public sector reform as a testing case for the willingness and ability of a country to effectively transform the underlying structures of a poorly performing economy. Public sector reform, conceivably, is meant to end state monopolies on the production of goods and services, to remove financial burdens from the state budget, and to create an environment of competition that would, in the long run, lead to a viable private sector able to contribute to enhanced performance and the sustained growth sought for in order to absorb the 500,000 to 700,000 persons who enter the Egyptian labor market every year.

Public sector reform conceivably has two components: First, a re-(e)valuation and restructuring of public enterprises, including the liquidation of such enterprises when necessary or, if possible, their sale to private investors. Privatization has been a top priority in

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<sup>16</sup> Author’s interview, Cairo, December 2000. Interestingly, the interviewee told this author off the record almost one year before the actual events that Boutros-Ghali would not remain minister of the economy for much longer.

<sup>17</sup> The insurance system, too, is state dominated with four major public companies in the field who control a market share of more than 75 percent. While *Misr*, *Ash-Sharq* and *Ahliyya* are insurance companies, *Egyptian Reinsurance*, as its name says, is the fourth among the large state-owned companies which serves as the only re-insurer.

Egypt ever since the reforms started in 1991 since it was a conditionality imposed upon the regime by international donors. However, privatization had already been an issue of heated debates in policy-making circles since at least a decade earlier (cf. Albrecht/Pawelka/Schlumberger 1997). Second, public sector reform may include the overhaul of public administration in order to achieve efficiency, rid the bureaucracy of overlapping responsibilities and competencies, streamline everything from the issuance of licenses and permits to the gathering and publication of statistics. This, too, would necessarily involve the large-scale lay-off of employees of a governmental bureaucracy that can be considered nothing else but massively overstaffed – if and when judged by criteria of economic efficiency. Both aspects represented a formidable task because the public sector had dominated the entire economy for decades in almost every field.

The legal cornerstone of privatization and, indeed, of the whole structural adjustment process, was laid in 1991 with the Public Enterprise Law (No. 203 / 1991) that reorganizes the SOEs under the umbrella of ten (initially 16) holding companies according to economic sectors. The latter are responsible for the preparation of companies for sale. After several years of debate about overvalued prices, it was amended in 1998 in order to allow the general assemblies of the holding companies to accept bids below the initial reserve price (US Commercial Service 2002, ID 110562). With this framework, it was thought, the drain SOEs and the salaries and wages of their numerous employees placed on the state's budget could be reduced and resources be set free to be used for alternative developmental purposes. And in fact, although the privatization program took a number of years to gain pace and get going (cf. Albrecht et al 1998 for details on the process), almost half of the enterprises that were earmarked for privatization have either been liquidated or else been sold off wholly or partially to private investors. Tables (6.5) below gives an overview of the remaining companies under the supervision of the respective holdings and their performance.

While a minority of sectors (trade, engineering and textiles) continue to incur significant losses, the overall balance of the remaining SOEs that are managed within the framework provided by Law 203 is clearly positive. In other words: These SOEs, under the umbrella of the remaining ten holding companies, are successful in absolute terms – a fact that contradicts the neoliberal imagination of the notorious inefficiency of anything run by 'the state'. Moreover, the companies still under the control of the holding companies are not those that were the top-performers at the outset of the reform process, but rather those that were initially difficult to sell or that needed much time to restructure. Also, the gains are not primarily resulting from monopolistic conditions in the market: Those areas where the state still maintains strategic monopolies are few and restricted to areas considered of strategic importance such as local oil production. However, companies from these areas never figured in the Law 203 portfolio. This is a strange finding in the light of the very bad performance record that was always attributed to SOE-performance by advocates of neoliberal reform. While performance was certainly not bright, this finding might in large parts be due to the employment patterns as outlined above. If overall performance of these SOEs is not as

negative as it is often said to be by staunch advocates of neoliberalism, then what about the problem of overstaffing and redundant workers in public enterprises?

*Table (6.5):* REMAINING LAW 203 PORTFOLIO (AS OF END 2000)

SECTOR	No. of Companies	Net Income 2000 (LE m)	No. of Workers	
			2000	1999
Chemical	18	78.4	41,392 <sup>d)</sup>	40,400
Construction	20	304.7	n/a	46,724
Trade	14	- 143.4	8,860 <sup>e)</sup>	34,987 <sup>f)</sup>
Engineering	16	- 317.0	25,172	n/a
Food Industries	23	247.3 <sup>a)</sup>	58,346 <sup>e)</sup>	65,823 <sup>e)</sup>
Housing, Tourism, Cinema	9	156.3 <sup>b)</sup>	6,421 <sup>f)</sup>	6,339
Maritime and Inland Transport	13	210.7	6,545 <sup>e)</sup>	9,313 <sup>e)</sup>
Metallurgical	19	106.7 <sup>c)</sup>	57,781 <sup>f)</sup>	59,869 <sup>f)</sup>
Pharmaceuticals	11	318.6	22,147	24,911
Spinning & Weaving (Textiles)	43	- 692.3 <sup>c)</sup>	106,017 <sup>e)</sup>	96,019 <sup>g)</sup>
<b>Total</b>	<b>186</b>	<b>+ 270.1</b>	<b>323,821*</b>	<b>384,385*</b>

a) No figures were available for *Egypt Meat, Poultry & Supplies*. // b) No figures were available for *EGOTH*. // c) No data were available for three out of all the sector's companies. // d) 2000 figures are higher because one company's figures were not included in the 1999 data. // e) employment figures for 7 – 10 companies are missing in the data set // f) employment figures for 1 - 4 companies are missing in the data set // g) employment figures are missing for 14 companies out of the 43 in that sector // \* the 2000 figure does not include employment in construction; the 1999 figure lacks employment in the engineering sector.

Source: PEO; author's calculations from PCSU / CARANA (2002a [Oct.-Dec 2001]: 95–99).

Available data show that the number of employees in SOEs has decreased in total, but there is a clear tendency that overall government employment has not (see table [6.6] below). How come? Between 1990 and 1995, official figures show a 64,000 decrease in public enterprise employment – but this is offset more than ten times by a 863,000 increase in employment in 'government agencies', thus creating an additional burden for the public payroll (ARE/CAPMAS 1996: 311). No wonder, thus, that the central government's expenditures for salaries and wages in the public sector are the single most important drain on the budget and, remaining at around one quarter of GDP, even surmount total tax income. The government, during the 2000/-1 fiscal year, still spent around 25.84 bn LE on wages and salaries, a figure that represents some 27.1 percent of total budgetary expenditures (MEED 12 April 2002: 28).

While table (6.5) above demonstrates the downward trend in employment in SOEs and, at the same time, their overall positive performance record, this trend and is in line with other, independent assessments: For instance, it concurs with the findings of an IMF-edited paper by Handy et al. which demonstrate (1998: 50; table 21) that there was not a single year since the reform process started in the fiscal year 1990/1991 where the overall balance of Egyptian public enterprises was negative. One must add, of course, that great exchange earners such as the petro-industry distort the picture of a sector which performs a lot worse in

other areas (such as engineering). Nevertheless, the general picture that appears hints to a certain likelihood that it is not primarily the public enterprise sector, but rather public administration as well as the state-dominated financial and insurance system where large amounts of resources are drowned in muddy waters which then poses problems to the national economy.

Where these resources – at least in part – go becomes clear through a glance at employment strategies, even at the end of the 1990s, as has been hinted to above: ‘a major component of the government’s employment drive at present is to recruit 170,000 into civil service, thus maintaining the state’s role as a major employer. [...] In 1998, some 52 percent of males and 63 percent of females with secondary education and above were employed in the public sector’ (Labib 2002: 7). This concurs with the overall picture in the *private* sector where, ever since early 2000, private businesses’ plans are continuously built on dismissing employees rather than increasing employment prospects (ECES 2000; ECES 2000b and 2001b). In fact, roughly 85 to 95 percent of business in all sectors report stagnant or lower employment since 2000 (US Commercial Service 2002: ID 109293; ECES 2002b).

*Table (6.6):* EMPLOYMENT IN EGYPT’S PUBLIC SECTOR, (1993 – 1998)  
(in 1,000s)

	1993	1994	1995	1996	1997	1998
<b>Public Sector and SOEs</b>	1340	1317	1281	1249	1201	1106
<b>Government</b>	<b>3724</b>	<b>3899</b>	<b>4105</b>	<b>4292</b>	<b>4601</b>	<b>4617</b>
<b>TOTAL</b>	<b>5064</b>	<b>5216</b>	<b>5386</b>	<b>5541</b>	<b>5802</b>	<b>5723</b>

Source: ARE / CAPMAS (2000: 289).

If, despite officially proclaimed policy strategies that openly contradict such practices of an ever expanding bureaucracy, the regime keeps clinging to the state as an ultimate employer and thereby tries to preserve the legitimacy effects that creates, this can hardly be interpreted as anything else but a clear indicator for the fact that political priorities rule out economic performance criteria in the regime’s hierarchy of policy goals. After more than a decade of ‘structural reform’, the declared aim of downsizing the public sector – and here most of all the administrative state sector – has not been reached in Egypt to any extent that could be said to come close to what Western observers and policy advisors had hoped for. Quite the contrary: Public sector employment in enterprises has gone down, but increased massively in the bureaucracy. What has to be remembered in this context is that the enterprises gathered under the frame of Law 203 represent less than 15 percent of the entire public sector which has an estimated value of over 600 bn LE! (Weiss & Wurzel 1998: 131).

Asking for the underlying reasons for such trends, it seems obvious that the government has not accidentally forgotten to reform the public administrative sector. Rather, as has been so aptly formulated by Waterbury, it is precisely the fact that we are here entering

the ‘heart of the matter’ of the overall process of economic reform where reform efforts would become directly political in that they would pose a double threat to the political survival of the Mubarak regime if reforms were carried out and implemented rigidly along the lines suggested by the international agencies and institutions: First, of course, political delegitimation would most probably follow the large-scale layoffs that by necessity were a component of any effective reform of the public administrative sector and the bureaucracy. But this is only half the story: The regime is safe enough and possesses credible instruments of repression and coercion that public opinion is not a real threat for the authoritarian regime in the short run. The second threat is that the state would, by effectively reducing the state bureaucracy, deprive itself of the staff needed to exert control over the overall economic process, including private sector businesses and their activities.

This demonstrates that, despite more than a decade of liberal reforms and deregulation, the state still remains *the* core player in the economy. In 1998, the year when Egypt did not renew its program with the IMF, local IBTCI business consultants estimated that the state still directly *owned* more than half of the economy, which leaves no doubt about the extent of not ownership but state *control* of the economic process (IBTCI 1997a: 12). Also, while, as has been shown above, there is no denying the fact that Egypt’s privatization program means nothing less than a thorough restructuring of the national economy, when looking at employment in the administration, the picture somewhat changes: While, due to the privatization process, employees had to be dismissed, the administration and bureaucracy, in turn, grew stronger, which led to an overall increase of employment. While wages were decreasing over the period of structural adjustment, the Mubarak regime nevertheless further loaded its already overstuffed bureaucratic apparatus. Thereby, the total number of persons employed steadily rose throughout half of the observed time-span.<sup>18</sup> It was only in 1998 when the upward trend was finally broken through at least in total public employment (not so in government agencies though, where figures continued to increase!), and that was, as has been noted, when Egypt boldly declined to renew its program with the IMF in order to remain in control of the reform process and not succumb to what would have been considered unacceptable conditions.

Given the above described public employment trends in the frame of the privatization program, the Egyptian government could certainly gain some credit if it pursued its privatization program with more vigor and achieved a quick finalization of the Law 203 portfolio. But this will not necessarily result in a greatly changing performance of the overall economy. While the privatization process has a great impact on the economic *order*, it does not necessarily have that on economic *performance*. This might be one rather amazing and disturbing finding of the present section. For the Egyptian case, then, it would seem as if at least privatization is not the heart of the matter, as Waterbury had assumed. He might still be right, however, with the issue of public sector reform. In fact, there is good reason to suspect



that he is very right indeed: Nothing (except for welcome invitations to training courses abroad in foreign donors' institutions) has touched, in fifteen years of reform roughly, on the still expanding internal organization and staffing of the public administrative sector which is maybe the most important guarantor today for the survival of patronage networks that take their roots in the administration and are then finely woven to include the more privileged private clienteles as well. In that sense, one could still agree with what Clement Henry (1996: 69) wrote almost a decade ago about Sadat's Infitah-policies of the 1970s: 'If Sadat's infitah made little sense economically, its political logic was compelling.'

This political logic is even more evident when looking at the revenue side of privatization. Selling off SOEs presumably could not only alleviate the government from fiscal burdens, but also create some room for maneuver in that the proceeds of privatization can be used for long-term developmental purposes. The significant funds the government has received from the proceeds of the privatization process are listed in table (6.7) below. However, transparency as to its uses is, to say the least, sub-optimal. While, until the end of 2000, a total of 13,100 m LE. had been collected in sales proceeds, ca. 4,200 m LE. of these were used to settle bank debts, according to figures from the Public Enterprise Office. Another close to 6 bn LE. had been transferred to the Ministry of Finance, whereas 2,440 m had been used to finance early retirement schemes, pensions, and salaries. Finally, more than 1,200 m figure under the title 'restructuring' and 'other', which leaves almost 300 m LE. unutilized (PCUS / Carana Corp. 2002: 34).

*Table (6.7):* PRIVATIZATION RECEIPTS IN EGYPT AS OF DEC. 2001 (IN M. LE.)

<b>Method Year</b>	<b>Anchor Investor</b>	<b>Employee Sharehold. Assoc.</b>	<b>Minority Initial Publ. Offerings</b>	<b>Majority Initial Publ. Offerings</b>	<b>Sale of Production Assets</b>	<b>Total per Year*</b>
<b>1994</b>	443	433	64	0	M	<b>733</b>
<b>1995</b>	None	139	926	85	M	<b>2141</b>
<b>1996</b>	453	M	338	1650	350	<b>3479</b>
<b>1997</b>	447	79	346	2519	6	<b>3748</b>
<b>1998</b>	276	351	76	1342	316	<b>2753</b>
<b>1999</b>	2665	M	0	0	45	<b>2829</b>
<b>2000</b>	2435	75	0	47	84	<b>2650</b>
<b>2001</b>	349	69	0	670	39	<b>1127</b>
<b>Total by Method*</b>	<b>6978</b>	<b>950</b>	<b>1755</b>	<b>6315</b>	<b>862</b>	<b>16,860</b>

*Source:* PSCU / Carana Corp. (2002: 35–6).

\* Individual figures by method (vertical columns) do not sum up since totals also include receipts for 1<sup>st</sup> quarter 2002. Figures for annual totals (rows) diverge because of inconsistencies in the source. Also, they do not sum up to grand total, which would be 19,460 LE. In the addition of annual values. Also, no values at all are available for liquidations. In addition to that, some public sector companies were leased on a multi-year basis (ranging from 5 to 20 years) to private companies. It is not clear whether authorities introduced lease gains into receipts in one or more instances.

<sup>18</sup> Unfortunately, more up-to-date data on public employment was not available at the time of writing.

While this may cast some doubt on financial intransparency in the process of privatizing the Law 203 portfolio, there is a range of other aspects that implies serious deficiencies in the process as a whole (for an excellent critical account of the privatization see Wurzel 1998). It seems amazing, for instance, that apparently none of the international donors managed to break through the opaqueness of policies and procedures that allowed profit-making public companies to be run down while their sale was delayed: 'There are many instances where privatization decisions have been deferred, the delay being used to enrich insiders by a wide range of illegal practices' (Weiss & Wurzel 1998: 179). Also, there is a number of evident management problems. For example, the privatization guidelines issued by the PEO in 1993 do not measure the holding companies' performance according to the number of privatized companies. Therefore, there is little incentive for the chairpersons of the ten holding companies to actually prepare the companies in their portfolio for privatization. Rather, the opposite is true: 'Their fees are directly related to the number of affiliated companies under the holding company. In other words, managers of holding companies are more interested in portfolio management than in privatization, since the latter would reduce their status and would make their positions redundant' (ibid.: 176). All of this signals the existence of an underlying logic of reform that has little to do with efforts of increasing productivity, efficiency, or development prospects, and much more with a regime that has a certain loyal clientele to whose aspirations it must live up in order to maintain the political fabric intact.

On the whole, therefore, it must be stated that structural adjustment as implemented by the Egyptian government during the 1990s did change the legal and regulatory framework of the country's economy, and it did so most visibly in the area of public sector reform and privatization. On the other hand, however, the entire process of re-organizing the public sector remained laden with what economists usually perceive as 'deficiencies' in both technical-managerial and procedural aspects. Yet, 'deficient' refers to something that has not resulted in an intended outcome. Whether this is so in the Egyptian case is strongly doubted here: The intended outcome for the Egyptian regime was to retain politically motivated control over the economy, and that has certainly been achieved. Therefore, to speak of 'deficiencies' is to look at the issue of economic reform from the wrong side. The massive amount of evidence from individual instances miraculously adds up to a very coherent picture when assuming that there is a logic of political control behind the policies. It would be against all evidence to assume that Egyptian top managers and top bureaucrats were somehow all backward, stupid, uneducated, and simply unfamiliar with modernity or techniques necessary to conduct a coherent process of reform. While errors occur everywhere in policy-making, the level of 'errors' that has occurred in Egypt and other dictatorial countries where regimes try to make the best of externally induced economic reforms that could no longer be avoided forbids such naive assumptions. On the contrary, they are much more experienced than their Western

counterparts (who come to train them) in the logic of ensuring private interests and socializing losses according to the neopatrimonial rules of a primarily political, not economic game.

### Additional Illustrations from the External Sector

If further evidence were needed to illustrate the selective implementation of liberal reforms in Egypt, the external sector would be a telling example: While the declared aim of structural adjustment is deepened integration into world markets in order to promote export-led growth, this has clearly not been achieved over the course of the 1990s. As a World Bank report states: ‘Various measures of trade integration lead to the same conclusion: Egypt has lagged behind many developing countries’. The same report also notes that ‘exports were not a force behind its growth performance in the past decade’ (World Bank 2001b [Eg.: Social and Structural Review 22397-EGT]: 21). This concurs with what Mitchell (1999: 457) had found in an article two years earlier who found that neoliberal reforms in Egypt in fact worked towards ‘insulating the country further against the global market.’

*Table (6.8):* TRADE PERFORMANCE AND OPENNESS IN EGYPT, 1990 - 2000

		1990	1994	1997	2000
<b>Exports</b> of goods and services	in % of GDP	30.9	27.9	22.0	18.6
<b>Imports</b> of goods and services	in % of GDP	40.6	36.4	27.4	24.8
<b>Ratio</b> of exports to imports	in %	28.1	36.7	29.7	34.4
<b>Openness*</b>	in %	13.7	12.6	11.3	9.6
<b>Average tariff</b> (unweighted)	in %				28 (1999)

\* Openness is defined as the percent of trade turnover divided by two of the GDP.

Source: World Bank (2001b: 21)

Although the period examined overlaps only partially with the long-term study by *Morley and Perdikis*, whose results confirm the trend evident here: Export-led growth has not succeeded in Egypt. ‘The switch in Egypt’s development strategy from one based on public sector growth to one based on economic reform and export led growth has not yet affected the growth rate positively’; therefore, the authors conclusion is leaves no doubt: ‘the export-led growth hypothesis is rejected for Egypt’ (Morley and Perdikis 2000: 51, 50).

From a conventional economics viewpoint, it can relatively easily be demonstrated that in the Egyptian case, monetary orthodoxy sacrificed growth – one of the major points of critique of those who oppose IMF-designed stabilization policies on *economic* grounds. But while this criticism is clearly justified for Egypt during 1998 to 2002, it misses the most important aspect: Through its focus on fiscal discipline and containing inflation, the Egyptian regime effectively distracted donors’ attention from those areas where structural reform would

have been imperative but has not been implemented for purely political reasons of regime maintenance.

## Conclusion

Egypt is a clear case where the exigencies of neopatrimonial political rule have ruled out the establishment of a competition-based market economy in the sense defined in chapter three above. Instead, an economic order has emerged that, on the one hand, presents itself thoroughly transformed when compared to the pre-adjustment situation. The privatization process, dozens of new laws in key economic areas, the revitalization of the capital markets in Cairo and Alexandria, and also the significant changes in the relevance of private sector investment in comparison to the state's economic activity leave no doubt that the Egyptian economy can no longer be considered the same as it was in the 1980s. There is no doubt that Egypt has embarked on a decisively capitalist course of development. The opening up of formerly restricted areas for private investment was complemented through private enterprises taking the lead in new industries such as the IT sector.

On the other hand, however, it has been shown in this chapter that despite a greatly changed institutional and legal *façade*, the underlying mechanisms for economic decision making and for determining the 'who gets what' have not changed: After one and a half decades of reform, decisions are predominantly made informally and the regime has effectively avoided having to rely on the uncertain outcomes of formal institutions and decision-making bodies that would act according to the rule of law. Eberhard Kienle was certainly right to call for closer observation of 'the tension between informal logics and loyalties on the one hand and the weight of institutions [in a narrow, i.e. formal sense; O.S.] and bureaucratic procedures on the other' (Kienle 2001: 173). However, as this chapter attempted to clarify, the logic between formality and informality is not likely to change significantly as long as president Mubarak's authoritarian regime remains in power. This applies not only to the political process of electoral practices, political parties, and the like, but just as well to the development of the national economy.

While formerly reputed as a figure with various private business interests, signals increase in the early twenty-first century that Hosni Mubarak's son Gamal, maybe *the* outstanding representative of the above mentioned 'generation in between', also becomes the political mastermind of the economic reform process since he 'spearheaded reform of the sclerotic ruling party' (EIU 2003b: 13), was appointed head of the party's 'policy secretariat' (in 2002), in addition to his post as a member of the party's steering committee. Within the party, he is now the dominant figure, behind his father. 'In the past year government policy decisions, particularly in the economic sphere, have increasingly been attributed to the NDP' (ibid.). Gamal Mubarak personifies Egypt's post-structural adjustment economic order in his

decisive political position, combined with simultaneous control over his own and other economic businesses. Whether he will really succeed his father on the ‘throne’ of the republic is hardly interesting for the argument presented here. The important fact is his being a symbol for the strong link between political and economic elites that characterizes post-adjustment Egypt and that is predominantly intransparent, informal and promotes genuinely non-market economic modes of decision-making which lead to equally non-market outcomes. As Weiss and Wurzel (1998: 194) write in their outstanding OECD-study: ‘The ruling establishment is identified with extensive corruption. A son of a leading politician is eager to share in any larger successful private business. The new business community is one of the regime’s main constituencies and therefore shares the flows of rent income.’

In spite of the close eye international donors have continued to cast on the Egyptian reform process, they were not able (or willing) to trace and recognize the genuinely political nature of the reform process from a successful stabilization coherent with international expectations with no big political risks for the politico-economic elites involved, to a ‘failed’ structural adjustment. ‘Failed’, of course, is a wrong expression since the entire structural adjustment was a highly successful *political* adaptation to internal and international economic developments; and it was, most of all, the changed international economic setting increasingly exerted pressure on the Egyptian state to adapt. In this sense, Egypt was extremely *successful* in adapting. What is even more: the regime managed to acquire billions of aid for engaging into this adaptation that can on large parts be seen as politically stabilizing rent-equivalents, and the regime was, finally, successful in adapting in that it managed to change the face of the domestic economy in a way external donors wanted to see it, while skillfully maintaining the regime and dominant power constellations intact, even though this involved the crafting of new social alliances and ousting of parts of the older and statist elites from the inner circles of decision-making.

While, generally speaking, there is no doubt that economic reform curtailed the social position and rights of those who lost economically through liberalization and extended those of the ‘winners’ (most likely to be found in parts of the private sector and within the ranks of family members of the regime itself), the regime’s clientele of winners ‘could be subject to restrictions once their gains served them as a basis for claims the regime did not want to fulfil’ (Kienle 2001: 145), as the case of Ismail Osman might indicate. This underpins the continued and comprehensive dependency of those who constitute ‘the private sector’ on the political decision-makers. In a *purely patrimonial polity* such as Egypt under Hosni Mubarak, there is but one ultimate decision-maker, and for reasons of regime maintenance and stability, no other power centers can possibly be tolerated by that one ruler. While the means used to exercise power may become more subtle as external influences rise and demand adjustments to the structure of the economy, the fact that the logic of political power determines economic decision-making remains valid over the entire period of reform until this day – and for the foreseeable future.

## Chapter 7

\* \* \*

### ‘Benevolent Autocrats’: Economic Reform under Two Kings in Jordan<sup>1</sup>

Economically, Jordan is certainly not Somalia, but after over a decade of structural economic reform, neither has the country’s economic restructuring process come to an end, nor come performance, since the second half of the 1990s, close to the hopes and expectations of external and local policy-makers and reformers. While a number of achievements were indeed made and Jordan ranks among the ‘best’ Arab countries as concerns economic liberty (cf. IAIG 2002: 83; for historical comparison cf. IAIG 1999)<sup>2</sup>, performance after one and a half decades of structural adjustment policies is today a mixed success at best that does not meet the criteria established by those who advocated reform in Washington and, later on, in Amman. Several of the declared goals economic adjustment had aimed at have not been reached until now. Many observers have set their hopes for better economic performance in the new and young King Abdullah II, son of the late King Hussein who was known to be not too pre-occupied with economic development, but rather ‘left the economy to Prince Hassan’, his younger brother.<sup>3</sup>

#### Modest Long-Term Development Prospects, and Possible Explanations

After the economy was set on track again through stabilization in the early 1990s and the acute danger of an economic collapse of the country had been averted, more far-reaching reforms were implemented. Exports were envisaged by both the international financial institutions and the government to become the cornerstone of sustainable growth on which the economy should in the future rely. For this purpose, it seemed clear that state influence on the economy proper had to be reduced since many of the public sector entities worked

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<sup>1</sup> While the text and composition of this chapter is new, parts of the results of two earlier publications this chapter draws on have found their way into the present chapter. These are: ‘Jordan’s Economy in the 1990s: Transition to Development?’, which appeared in Joffé, George (ed.) 2002: *Jordan in Transition, 1990-2000* (London: Hurst), 227-53, as well as the 2002 ‘Succession, Legitimacy, and Regime Stability in Jordan’, an article authored together with André Bank and which came forth in *Arab Studies Journal*, 10 (1), spring, 50-72.

<sup>2</sup> This comprehensive report on the investment climate takes its data on economic freedom from the index established by the conservative Heritage Foundation ([www.heritage.org](http://www.heritage.org)) where a strong political bias cannot be ruled out. A comparison between country data from the region makes that more than obvious. However, like in the political realm with ‘Freedomhouse’ ([www.freedomhouse.org](http://www.freedomhouse.org)), there is hardly any alternative to these data sets.

inefficiently and produced losses the budget could no longer sustain. Cutting down the state was to be achieved mainly by privatization and expenditure restraints, which would at the same time generate resources to be employed otherwise.<sup>4</sup> Deregulation and the liberalization of the trade regime were a second pillar which was hoped to create a surge in private investment and exports, to be complemented by a comprehensive legislative overhaul in the areas of investment, finance (including, i.a., tax, banking, and debt management), and commercial and industrial companies laws. Indeed, the structural reforms Jordan has been undergoing until 2000 were of such comprehensive nature that hardly any sector of the economy was left out.

Accordingly, the government and international financial institutions agree that Jordan's implementation of the *structural adjustment program* (SAP) is a success story: In a 1996 statement on Jordan, an IMF representative spoke about the 'impressive progress' Jordan had made, reflecting the 'appropriate macroeconomic and structural reform policies', while the economy was 'well poised to continue on the path of high growth, increased employment opportunities, and improved living standards' (IMF 1996a). In retrospect, the words quoted here sound almost cynical:

High growth was not experienced since the inflow of capital brought in by returnees from the Gulf countries in 1991, and came close to zero (or maybe even below; see table 2 below) in 1998; real per capita GDP has remained negative from 1996 through the end of the decade. Unemployment, too, remained essentially unaltered at high rates of an estimated percentage somewhere between 20 and 30 points.<sup>5</sup> For most of the decade, real wages continued to fall, and a 1999 study by the World Bank (1999c) shows that poverty was alleviated only marginally; the absolute number of poor people had remained constant in comparison to 1992.<sup>6</sup> The 1996 riots in Kerak - a result of the government cutting down bread subsidies - were a clear signal of the precarious standard of living of large parts of the population (cf. Dougherty [1996: 95 – 99]; see also Ryan [1998]).

A high number of poor and the deterioration of living standards for the middle classes are often dismissed as 'temporary adverse social effects' of structural adjustment. However, as the Latin American experience shows, where Gini-indices are today among the highest in the world, such effects may well perpetuate. These findings do not sound all too promising.

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<sup>3</sup> Author's

<sup>4</sup> Although the Jordanian economy is traditionally private sector-oriented, the public sector's impact on the economy is larger than its GDP shares suggest. For details on this point, cf. Kanaan (1999).

<sup>5</sup> Considering the growth rates during the 1990s, and knowing that an average annual rate of ca. 6 % would be needed only to absorb the annual new entrants to the job market, an unemployment survey conducted in 1999 by the Department of Statistics which places the total unemployment rate at only 10.2 % can hardly reflect real circumstances. Results of the survey are published on the Department's internet homepage: [www.dos.gov.jo/dos\\_home/press\\_130799.htm](http://www.dos.gov.jo/dos_home/press_130799.htm). By contrast, the Ministry of Planning gave unemployment rates, in its 1993-1997 Development Plan, of around 17-18 % in the same period. Cf. Ministry of Planning (1993d: 39). The 1998 figures of 13.4 % given by the ministry (1999c: 215ff.) in its subsequent plan for economic and social development are generally regarded as fictitious.

<sup>6</sup> For a fuller assessment of the development of living conditions, see the Norwegian study by Hanssen-Bauer, J., Pederson, J. and Tiltnes, Å. (1998)(eds), *Jordanian Society: Living Conditions in the Hashemite Kingdom of Jordan*; (Oslo: FAFO Institute for Applied Sciences).

Table (7.3) shows the development of some selected indicators to approach the question in how far the objectives of the reform were achieved. The data presented here do, in fact, not give too much reason for enthusiasm.

*Table (7.1):* STRUCTURAL ADJUSTMENT IN JORDAN: MIXED RESULTS

Year	1995	1997	1999	2000	2001
<b>Indicator</b>					
Real GDP (% change)	3.9	1.3	3.1 <sup>c</sup> / 1.3 <sup>b</sup>	4.1 <sup>a</sup>	4.2 <sup>a</sup>
Gov't. Expenditure (% of GDP)	37.3	35.9	31.5 <sup>a</sup> /35.6	33.5	33.2
Exports (in % of GDP)	22.0	21.6	25.7	25.4	21.6
Imports (in % of GDP)	56.7	58.8	64.5	76.7	55.2
Net FDI (in m US-\$)	16	361	156	300	100

**Source:** Schlumberger (2002b: 234), EIU (2002b: 45ff.); HKJ, CBJ (2003a); HKJ, MoF (2004a); *Arab Bank Review* 3 (2): (2001: 18).

First, curbing down the state has not taken place to the desired extent. Government expenditure as a share of GDP has remained continuously at similar levels, and was budgeted for 2000 at the same percentage as in 1995. Government services, too, remained high, continuing to represent one of the largest single contributors to GDP, with 21.6 per-cent, only exceeded by financing, business, and real estate services (22.1 per-cent; cf. CBJ [1999: 21]). It is quite obvious that the state has not been sized down to the expected extent in the course of transition.<sup>7</sup>

Second, the volume of foreign trade has not increased when seen in relation to GDP, which is a sign that the economy has not – or not yet – become as liberalized and outward-oriented as was hoped by the advocates of the reform process. Third, and related: What had – temporarily – increased were imports, but without export following suite, thus indicating a development which even widened the country's chronic trade deficit. Reform policies have not brought about any substantial change in Jordan's chronic trade deficit: While the trade deficit recently narrowed by five percent from 2000 to 2001 (Jordan Focus, 15 Feb 2002), Jordan's heavy structural dependence on imports for industrial inputs and energy cannot be overcome in the foreseeable future. Thus, in order to make export-oriented policies a successful development strategy, Jordan must necessarily find alternative export sectors in which its products have significant comparative advantages in order to reduce its trade deficit structurally. Given the current economic structure of the country, their identification will be difficult. From the evolution of the composition of exports, it is obvious that until now, such niches have not been found, let alone been exploited. Export earnings continue to depend on

<sup>7</sup> This, of course, is also one of the most difficult tasks in the economic transition of an economy where vested interests have been firmly entrenched to serve the personal interest of incumbents and their families rather than



the mineral resources sector (mainly phosphates and potash) and a few related downstream products of the chemical industry such as fertilizers or detergents.<sup>8</sup> Although the continuous rise of imports was stopped in 1997 and in subsequent years the trade deficit narrowed, recent developments indicate a further increase by over 30 % during the first four months of 2000, compared to the corresponding time span in 1999 (Jordan Times, 8. 6. 2000). The underlying problem is that only few industries are competitive enough to become viable export earners, and that most of the economy consists of family-run small and medium scale enterprises without any substantial potential for export (for details see Piro, T. [1998: 38 ff.]). The potential to increase revenues generated by tourism and the bright prospects of information technology notwithstanding, the King's 'great hopes for the future' and expectation 'that we are bound to reap the fruits of our efforts in the coming year [2001; O.S.]' neglect these structural obstacles to development. The 'real leap in social and economic conditions' he speaks of<sup>9</sup> has neither taken place during the 1990s nor is it likely to do so in the early years of the new decade.

It was only towards the end of the decade that voices were raised suggesting that Jordan could and should promote the IT (information technology) sector because of its huge potential for growth.<sup>10</sup> King Abdullah's personal interest in promoting the industry became apparent when he managed to bring leading international IT companies to a conference at the Dead Sea. Given the size of the Arab market and the skilled labour force Jordan possesses, this could in fact become a future focus and should be promoted by the government. However, Jordan is not the first country to discover the possibility; Egypt is one neighbour which has already had some success with focussing on the computer industry, and some of the Gulf countries, too, are in the business<sup>11</sup>. Jordan will surely secure its share in the regional market. But for the period observed here, one must note that new and competitive sectors for increasing exports have not been found or sufficiently expanded, and it seems doubtful whether Jordan can compete successfully with other regional competitors for becoming the Middle Eastern hub for the IT industry, given the fact that some of these have established world class infrastructures through politically backed projects the costs of which range in spheres the Jordanian state can not afford to invest (especially Dubai is one serious competitor. For more on media and IT there, see Chapter [9] below).

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the public, and where, secondly, public sectors widely functioned as 'employers of last resort'. For an analysis of this aspect, see the contribution to the debate by Waterbury (1992: 182 – 220).

<sup>8</sup> In fact, production of these commodities has increased more than other manufactured products during the second half of the 1990s. But in themselves, they are no sufficient means to reduce the trade deficit, let alone a pillar on which to build development.

<sup>9</sup> In a speech on Jordanian Television on the occasion of the 'Army Day', as quoted by the London-based Jordan Focus (ed.)(2000), *Jordan Focus*, (online newsletter), issue 075, (15. 06. 2000).

<sup>10</sup> A 1999 USAID-financed study estimated that the sector could generate up to 30,000 new Jobs and earn as much as 550 m US-\$ annually in exports by 2004 (MEED 9 June 2000: 12). Cf. also REACH Initiative (2000).

<sup>11</sup> For a review of the Jordanian IT sector, cf. *ibid.* (REACH-Initiative). Interview with Karim Kwar, president of the *Ideal* Group of Companies, chairman of the Information Technology Association of Jordan, *Int@j*, and lead figurehead among the participants of the REACH Initiative. (The interviewee today is Jordan's ambassador to the United States).

Although investment incentives in Jordan did improve and FDI increased in absolute terms, Jordan could not manage to catch up with other MENA countries, let alone with other developing regions, when looking at FDI in relation to GDP. While there is an increase in absolute FDI over the years, this figure had almost halved within a single year, down from 100 m US\$ (2001) to 56 m US\$ (2002) (Jordan Times 23 Nov 2003). Portfolio investments, too, have not yet become an attractive alternative for investors: Total trading volume at the AFM in 1998 (413.6 m JD) was below 1994 levels (430.3 m JD). More recently, the AFM saw a decline in non-Jordanian net investments during the first five months of 2000, down to 5.3 m JD from 12.4 m JD during the same time span in 1999 (Jordan Times, 12 June 2000).<sup>12</sup> which is no great sign of international investors' confidence in the shares traded. Activity at the AFM remained limited well into 2000, when 165 shares were listed, but where a few large institutional (and sometimes even state-owned) share-holders such as the *Social Security Corporation* or the *Jordan Islamic Bank* dominate the market and, therefore, no great fluctuations occurred.

At the same time, however, Jordan's reforms indeed deserve to be labeled 'structural' since virtually all aspects or rather: sectors of the national economy have been targeted and fundamentally reshaped, especially during the second half of the decade in the context of accelerated privatization, as will be shown below.

However, it is also clear that the Kingdom faces enormous developmental challenges. Most of the goals of economic reform in Jordan have only partially been achieved. Many hopes have not materialized, although, especially since 1999, Jordan has been more determined in achieving a transition from the rentier economy than maybe any other Arab state. But however far-reaching Jordan's attempts at reform were, performance clearly falls short of what would be expected as the results of such enduring efforts at liberalization; even though GDP growth in 2001 and 2002 was higher than in 1999 and 2000, today nothing indicates a developmental take-off.

When looking at the country's profile and specific situation, it is not difficult to find plausible possible explanations for the less than optimal economic performance and the less than bright development prospects. Two explanations in are particularly popular and often invoked as accounting for Jordan's continuously wobbling economic performance.

The first one runs as follows: Jordan obviously is a small country that is very resource poor in regional comparison. It also has a relatively small population and therefore limited markets. Moreover, at the time of writing, the Jordanian economy still had to cope with a significant number of Palestinian and Iraqi refugees living in camps and an estimated one million Iraqis who had fled the Saddam regime during its war against the coalition in 1991, or who had subsequently left the country when it was under UN sanctions and life was dire, or who, later yet, poured over the border in the context of the looming US invasion of Iraq and

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<sup>12</sup> Rather, it seems as if the foreign investors' interest in Jordanian stock markets decreased to 1996 levels, when

the war that followed in 2002 and 2003. All of these groups are, needless to say, difficult consumers and certainly not those with the largest purchasing power. On top of all that, Jordan is landlocked except for the relatively small port of Aqaba in the south. Given all these traits and structural and contextual obstacles to development, it is not difficult to predict that achieving long-term sustainable growth is a formidable task in such an economy.

A second explanation that is often invoked in order to make sense of the lack of success of economic reform programs pursued by numerous governments since 1989 or 1991 respectively is the Arab-Israeli conflict (see, for instance, Andoni 2000). This includes Jordan's precarious geographical position, bordering both conflicting parties. In addition to that, the conflict impacts directly on Jordan's internal affairs through the country's specific demography with a Palestinian majority ruled over by Hashemite kings and with Trans-Jordanian tribal leaders affiliated to the regime and sometimes, at least in the eyes of Jordanians of Palestinian origin, privileged by that regime.<sup>13</sup> That this is not the place any foreign investor would fancy first seems obvious, too – even though this certainly is the weaker of the two explanations; other war-torn nations, too, have attracted significant investment and the rule is that business does not shy away from politically difficult situations as long as profit-margins are attractive. Moreover, Jordan has experienced a measure of political stability that is exceptional even within the region during the reign of the late King Hussein bin Talal (1954-1999).

However, there also is a third possibility to explain the 'mixed bag' results of structural adjustment in the country, and that is the argument of this book. In brief: Personalistic and informal networks (that work according to the social norm of *wasta* which has enabling consequences for clientelist structures) penetrate formal institutions and overlap with them, thereby creating a negative impact on economic performance in all issue areas. This is all the more relevant for development prospects and performance since, when prevalent in society as a whole, since it occurs most evidently within the interactions between political and economic elites who are in control over the largest public and private enterprises that are most relevant to overall performance. At the same time, these elite networks are dominated and controlled by the political rulers according to their political priorities of power maintenance in a way that competition in the marketplace is regularly ruled out, law enforcement depends on the socio-political position, and therefore, the legislative system is instrumentalized, too, and serves the interests of dominating elites, whereby the price mechanism that determines performance in market economies becomes ineffective. So much in short as to the third possible explanation.

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net foreign investment stood at JD 4.8 m only.

<sup>13</sup> This demographic specificity of Jordan is among the most politically sensitive issues in Jordan, and at the same time among the most debated ones domestically. For examples see, e.g., Hamarneh, Hollis & Shikaki (1997) or Center for Strategic Studies (1996).

At this point, the present chapter arrives at a methodologically serious problem because we are now faced with competing explanations which could each cause the symptom observed. This is an especially tricky thing to happen, but do not worry, there is a way out. While one could not judge which one(s) of the explanations given above really hold(s) true by looking at Jordan alone, the comparative approach pursued here makes possible a number of statements.

If the lack of economic success was due to the Jordan's small size and markets, or the fact that it is resource poor, then one would suspect Egypt to be a top performer: It has, with 70 million, clearly the largest market of consumers in the entire Arab world. Also, it earns significant revenues from the export of oil as well as transit fees from ships passing through the Suez Canal, plus transit royalties from oil that is pumped through the SUMED pipeline. Moreover, it boasts some of the world's most spectacular tourist attractions, has the fertile Nile valley with water enough to plan for large new irrigated living areas and – last but not least and, in fact, very importantly: It is among the countries with the highest aid-reception levels in the world, grace to the Camp David Accords in 1978/79 when levels of American aid to Egypt were inscribed in the countries' cooperation agreements (cf. Quandt 1986 on Camp David). Finally, Egypt has made peace with Israel and thus ended bilateral conflict with the Jewish state as the first Arab state. Therefore, even the second explanation that has been described for Jordan does not hold for Egypt. However, the results in Egypt, as demonstrated in the above chapter 6, are, in terms of overall macro-economic performance, quite comparable in Egypt and Jordan. Both have experienced a longer period of structural liberal changes to their economies. And both still have not been able to enhance the long-term prospects of their national economies.

Looking north, Syria is another neighbor which, like Jordan, remains involved in the Arab-Israeli conflict, but even though Syria has not made peace with Israel, tensions on both sides were low for the past decades (excluding Syrian-controlled Lebanon), and the truce in place since 1973 and enforced through the UNDOF troops (United Nations Disengagement Observation Force) has been robust ever since its establishment. Syria is far more fertile than Jordan, has a lengthy green coastline at the Mediterranean and an arable *hinterland*, in addition to the rivers Euphrates and Tigris which run through its territory. Syria also possesses a significant oil export sector (the IMF estimated that in the 1990s, half of the country's budget in real terms stemmed from oil export receipts; cf. IMF [1996b: 12]), and it has Palmyra and the crusaders' castles just as Jordan has Petra and the Dead Sea. Moreover, Syria has an economically important additional asset in that it can, through its political control over the country, export labor to Lebanon (roughly one million Syrians find work in the Lebanese economy). Yet, after a short interim in 1995 and 1996, Syria, too, fell into recession and nothing indicates that any of the long-term scenarios for Syria look particularly encouraging (cf. Henry & Springborg 2001; Schlumberger 1998; Perthes 1995), or more encouraging than do Jordan's.

Hence, were explanations one or two correct, the comparison with neighbors in the region such as Egypt or Syria would have to look quite differently from what it does. This suggests that, while the factors given in the first and second explanation for Jordan's ambiguous economic performance are there and certainly do play a certain role, they can not be made responsible as causes for the symptom of lacking developmental prospects.

A closer look shall now be taken at the Jordanian version the overall economic reform process, which will, as in the previous chapter, again be focussed on the three issue areas of private sector development and the investment climate, the sensitive question of public sector reform and privatization, and banking and finance. In addition to that, Jordan features a very special case of political institution-building within the process of structural adjustment, namely the creation of the *Economic Consultative Council* (ECC) established in 1999 under the reign of then newly instated King Abdullah bin Hussain (see below).

### Private Sector Development and the Investment Climate

Jordan, like almost all countries in the region, realized that investment legislation needed to be fundamentally reformed were the country to compete successfully with its neighbors. With a private sector that, at the time of writing, accounted for roughly 80 percent of the total value added, relying on a non-performing public sector is no alternative to keep an economy afloat. While Syria in the north had already introduced a new investment law (No. 10) in 1991, Jordan did so four years later (the 'Investment Promotion Law' No. [16] of 1995, which was amended five years later in 2000), followed by the introduction of a law on investment areas and sectors (Law No. [2] of 1996, amended in 1997).

A new institution, the '*Higher Council for Investment Promotion*' was formed under the chairmanship of the prime minister, including the minister of industry and trade as vice-chairman, as well as the ministers of tourism, transport, and planning, in addition to the Central Bank governor, the chairmen of the Union of Jordanian Chambers of Commerce and Industry and of the Amman Chamber of Industry. A director general acts as rapporteur. In accordance to the new governmental strategy of incorporating private sector representatives into economic policy decision-making, three 'competent and experienced persons from the private sector appointed by the chairman upon a recommendation from the minister [of industry and trade; OS] for two renewable years' are also included on the board of the council (cf. Law [16], Art. [11]). Also, the law called for a new 'Investment Promotion Corporation' to be set up, headed by a director-general to be appointed by the minister of industry and trade and by royal decree. Again, not surprisingly, it is a well known name that appears towards the late 1990s at the head of this organization – in the meantime renamed '*Jordan Investment Board*' (JIB): Reem Badran, daughter of former prime minister Mudar Badran, and married to

*Economic Consultative Council (ECC)* member Salah al-Bashir; the latter was Minister of Industry and Trade at the time of writing - ....and also chairman of the JIB.

Apart from the new Investment Law and the introduction of a General Sales Tax which became a fully fledged VAT, the Companies Law (22) of 1997 was another step of importance for the private sector. However, yet another revision, or rather: a new one to replace the only five year old law was already being drafted at the ministry of industry and trade in fall 2001. Among the main goals was to allow private shareholding companies to be listed at the Amman Financial Market.

While it is not possible to give a comprehensive overview of the private sector's development over the entire decade under consideration and of the innumerable legislative changes that have been introduced over the same period,<sup>14</sup> a look at the development of private sector investment in the years after the introduction of the new legislation demonstrates that, indeed, at least pledges and the capital earmarked for private investment has risen by more than 100 percent between 1996 and 2000 only, as table (7.2) below shows.

*Table (7.2):* APPROVED INVESTMENT PROJECTS, 1996 –2000, (IN 1,000 JDs)  
as registered with the Jordan Investment Board

	1996	1997	1998	1999	2000*
<b>Industry</b>	225,146.4	222,097.9	184,308.9	369,363.6	169,800.9
<b>Hotels</b>	84,609.0	118,606.0	208,117.5	99,156.6	497,030.m
<b>Agriculture</b>	17,815.0	17,060.0	25,567.3	27,930.m	2,105.m
<b>Hospitals</b>	20,090.0	5,500.m	46,170.0	31,580.9	32,191.m
<b>Maritime Transport and Railways</b>	---	4,200.m	14,510.0	50.0	---
<b>Conventions and Exhibition Centers</b>	---	---	---	50.0	---
<b>Leisure &amp; Recreat. Compounds</b>	---	11,780.0	3,000.0	20,750.0	1,750.m
<b>Foreign Share in Investments (%)</b>	21.80	32.61	32.15	33.56	53.77
<b>Number of Projects</b>	251	184	199	312	221
<b>Grand Total</b> (in 1,000 JD)	347,660.4	379,243.9	481,673.7	548,881.2	702,876.9

*Source:* computed from data from HKJ, JIB (2000). \* data for 2000 is up to 10/10/2000 only.

Note that project approval is not equal to project implementation!

At first sight, these figures demonstrate an impressive upswing in investment since the mid-1990s. However, some considerations must be borne in mind in order to gain a realistic picture of private sector investments under the new law.

<sup>14</sup> For a more detailed overview of events and legislation, also as concerns the early period of the adjustment policies implemented in Jordan, see Schlumberger (2002a); Zu'bi & Zu'bi (1995), Worldbank (1999c), as well as the regular newsletters *Jordan Focus* and *J-Biz*, also edited by Jordan Focus.

First, the number of projects approved to not necessarily relate to the number of projects established. In Jordan as in other countries too, this is a sensitive issue. In Syria, for instance, the actual implementation rate of projects approved under the new investment law no. (10/1991) had only reached ten to 12 percent by 1997, which casts a different light on the success of changing the investment climate. Actual figures on implementation were not publicly available for the Jordanian case, despite the fact that the following up of investment projects figures among the JIB’s explicit tasks according to the law. According to JIB vice-director general, the problem was that the JIB has data only on those projects which it licensed itself, whereas other projects that were deemed of national interest were taken from the JIB’s responsibility and transferred to be dealt with directly at the prime ministry or at the ministry of industry and trade.<sup>15</sup>

In addition to reforms in legislation and institution-building, in early 2001, the Jordanian government launched a major new project: the *Aqaba Special Economic Zone* (ASEZ). The specialty of ASEZ is that it is a free zone not built on brown ground, but which encompasses an entire grown city, including its inhabitants. In that, it is unique in the Middle Eastern region. Apart from that, it also offers duty and quota free access to US markets for qualifying enterprises, as well as other tax holidays and exemption. Land can either be bought or leased, and foreign ownership of companies is unrestricted, with permits and visa procedures facilitated for investors and the labor staff they import. ASEZ was Jordan’s fourth public free zone.<sup>16</sup>

The ASEZ is supervised by the ASEZA (-Authority)<sup>17</sup> which has its own budget (independent of the government’s), and counts six ministerial-level commissioners. First chairman of the ASEZA was, as became know in fall 2000, former minister Kalaldeh, but the

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<sup>15</sup> Author’s interview with Reem Badran, director-general, Amman, October 2000, and Hussein Dabbas, vice director-general of the JIB, November 2000. How many projects actually experienced such a transfer to the prime ministry or to the ministry of industry, as well as their respective financial volume, however, were also not officially known. Whether this hints to a question-mark concerning the communication between the prime ministry and the JIB’s directors, or whether the issue is too sensitive to be talked about to researchers remains unclear. It would certainly benefit the credibility of the overall investment climate if such information were readily and publicly available. According to the Investment Promotion Law, there is nothing that would justify any such procedures as taking individual projects away from JIB’s responsibility and re-locate them directly at the prime ministry. The only data available at the time of writing were from a restricted USAID-conducted study dating back to 1998 (“Investment Realization Analysis for the Jordan Investment Board – Draft Report April 2000” / USAID Jordan Project No. 278-C-00-98-00029-00). This study suggests that the overall ratio of realization / approval was 39.3 % during year one after approval, and above 50 % in year two. The following actual realization figures were given in the report and by JIB vice director general:

	year 1	year 2	year 3	year 4
1996	ca. 35 %	ca. 55 %	ca. 78 %	ca. 90 %
1997	< 40 %	ca. 70 %	> 100 %	...
1998	ca. 25 %	ca. 50 %	...	
1999	> 60 %	...		

<sup>16</sup> After the ‘Queen Alia’ zone at the International Airport, as well as the Sahab and the Zarqa free zones. In addition, there are privately run free zones in the country such as in Quwaira, Aqaba, Qaa’ Khana and Shidiyah. These are often smaller and restricted to certain economic sectors or the production of specific goods (such as, for instance, fertilizers, phosphoric acid, or other chemicals, as well as for the import and slaughtering of sheep. Other requests to set up private free zones were under consideration by the time of writing. (cf. Free Zones Corporation [FZC] 2000, accessible at [www.free-zones.gov.jo/guide.htm](http://www.free-zones.gov.jo/guide.htm)).

<sup>17</sup> This is a play of words with the female Arabic term ‘*aziza*’, which translated means ‘dear’.

upcoming new 'generation Abdullah' of dynamic young leaders also was on board, in this case, i.a., through Imad Fakhoury who took the investment and economic development portfolio within the commission. On the other hand, familiar family names appear, of course, in such a prominent new institution. The portfolio for customs and revenues, for instance, was headed by a member of the Rifa'i family, whereas the first confirmed investor in the SEZ, on 1 January 2001, i.e. the opening date, was the *Jordan Industrial Estates Corporation* (JIEC), chaired by 'Amer al-Majali (cf. also *J-Biz*, 20 June 2001). Kalaldeh, in turn, represents the outgoing older generation of politicians which had yielded influence under the late King Hussein, but who were successively driven out of real decision-making positions as the new king sought to posture the economy and those running it with new faces that would bring international credibility. It is not surprising, therefore, that Kalaldeh resigned from the post only half a year after he was appointed chairman of the board of the ASEZA, even though official reasons may sound differently. However, the possibility of the new institution supervising newly created channels of non-market gains cannot be entirely dismissed considering the family names of some of the representatives and considering the relatively large sums of money involved (for a critical account of the ASEZ, see Kanaan 2000).

The ASEZ comes in the context of the earlier qualifying industrial zones (QIZ), an idea originally promoted by former US president Bill Clinton, which allow goods exported from Jordan duty- and quota-free access to the US as long as the product's value added is combined of an Israeli and a Jordanian share. Despite the recent free trade agreement, which Jordan reached with the US in late 2000 and which entered into force in December 2001, exports from the QIZ continue to account for a good deal of Jordan's growth in manufacturing output. At the time of writing, there were six QIZ-zones and one sub-zone in operation, with an additional four in the pipeline. Recently, however, the QIZ have come under pressure because the US government agreed with Turkey to establish similar zones there (cf. *J-Biz*, 11 March 2002). However, Jordan remains the fourth country in the world only to have reached an FTA with the US.

One core question is: Who benefits from these new policies? One senior Jordanian personality who was, over the years, an advisor to both King Hussein and King Abdallah, as well as entrusted with several successive senior government and royal court positions, maintains from his insights 'that those entrusted with reform are themselves corrupted', adding that 'the young elite who is sprouting from the old bureaucracy are in the business', creating a new 'wedding between wealth and power'<sup>18</sup> This former member of the core elite sees economic liberalization and transition as a catalyst for a new merger between political power and economic wealth in the hands of some lucky few who are *de facto* monopolizing business opportunities grace to the fact that their families are well-established, while the large majority of the population is 'denied their chances'.

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<sup>18</sup> Author's interview with the person. Amman, October 2000.



While this sounds abstract, a small example might help clarify the point: Recently, the Jordanian government has announced ambitious plans to staff even classrooms of elementary school with personal computers in order to prepare kids for the knowledge based economy, modernize education, and combat illiteracy. – All goals in line with the human development report, one might think, and a clever idea to make elementary school-kids familiar with the modern IT techniques early on. However, assuming that Karim Kawar, who owns and presides over the *IDEAL* group of companies, introduced this idea into discussions on the royally appointed *Economic Consultative Council* just for the sake of improving Jordan's human development record, seems, in the light of his business interests, a rather bizarre idea. After all, the *IDEAL* group includes companies that are Jordan's exclusive dealer for *Apple* Computers, as well as Jordan's exclusive dealer for *Compaq*, plus another firm for software development. And it is also not really surprising that Kawar also figured as the main engine of the 'REACH'-initiative with the motto 'launching Jordan's IT sector'. Third, it may also not be accidental that the ECC, in 2000, recommended that the Jordanian government announces plans to proceed quicker with e-government services, including government-to-government services, but also government-to-citizens services. When criticism was voiced that not so many citizens were actually able to use these services because not everybody has his or her high-end notebook at home in a developing country where a significant part of the population is still illiterate, the suggestion was that offices could be created where people would then have free computer and internet access (*J-Biz*, 27 Sept 2000). Answering the question of who benefits usually also answers the question of who does not, and all economic outlooks do not suggest, at least until now, that the majority of the population would stand great chances for doing so.

To be sure: New times have begun for Jordan, and the picture of the country is changing rapidly through the initiative described above and other similar projects, plans, and actions. However, there is a danger that this also leads to a further estrangement of the population from those who rule over it as well as from those who are in close personal contact with these rulers in order to maintain and expand material privileges that have nothing to do with the capacity and ability to survive in a competitive market environment. While this is not to say that these entrepreneurs do not have the skills to survive in such an environment (many of them sure do), it is the actual practice that matters for the actual performance of the economy on a macro-level.

At the beginning of King Abdullah's reign, there were still government members (and most of all then prime minister Abd ar-Ra'uf Rawabdeh) who would oppose strategies of quick change or privatization. The *Aqaba special economic zone* for instance, was fiercely opposed by Rawabdeh. But it was made clear to the government that the Economic Consultative Council had, in fact, the mandate from King Abdullah to accelerate economic development plans for further free zones, including Aqaba.<sup>19</sup> As a consequence, as the same

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<sup>19</sup> Author's interviews with ECC members. Amman, November 2000.

Karim Kawar (also a member of the Economic Consultative Council) some of whose activities have just been listed, describes the eventual dismissal of the former prime minister swiftly: ‘You have to change people’s mindset. And if that doesn’t work, you have to change the people. – You know, the king had kept Rawabdeh as long as possible.’

While most would expect rent-seeking and *wasta* to dominate poorly performing public sectors, and while certainly there is no alternative to economic reform, it is precisely in the inter-linkages between government and the flourishing parts of the private sector that patronage dominates to at least a similar extent, but where consequences for the overall economy are potentially greater yet.

True, the national economy experienced a slight recovery in 2001 for the first time in five years, which, of course, is mainly due to private sector contributions. This picture is confirmed by a view from the international side when Ihsan Mansour, senior IMF representative, hailed Jordan’s efforts under the new king, announcing his intentions, in early 2002, to help the country in arranging a rescheduling of its debts with the Paris club and ‘convey a very good image of Jordan’s economy in a report to the IMF governors’ (*J-Biz*, 22 Mar 2002: 2). But it is important careful not to confuse this with a long-term developmental take-off! A year earlier yet, the growing differences in the positions of the IMF and the World Bank became manifest when Ander Sud, a senior Bank representative, also reporting on Jordan, noted that ‘the Kingdom has not done anything to counter the potential social consequences’ (*J-Biz*, 24 Sept. 2000) of its privatization scheme (for details on the latter see the next section).

A critical point for assessing the economic order that emerges from structural adjustment is the fact that a small stratum of private entrepreneurs benefits from its political connections. The known practice of circumventing or instrumentalizing laws for individual purposes continues and impacts negatively on Jordan’s investment climate, as clearly can be seen from the lack of FDI and foreign portfolio equity. And this absence of the rule of law as a guaranteed security for foreign investors is one of the single most important obstacles to long-term development in the country, as is the lack of competition under market conditions in many instances of the larger private sector businesses.

## Public Sector Reform and Privatization

The above described developments in the private sector happen at a time when there still is a vast bureaucracy that consists of mainly statist former elites. Here, rent-seeking and *wasta*-networks are also at work, representing a continuous drain on the state’s finances. Many of the public sector staff are not adequately educated (because in many instances they did not accede to their posts for reasons of competence in the first place) in order to fulfill the tasks required from a modern state (think of the above mentioned e-government plans, for

instance). What is maybe more serious a problem: old attitudes towards the state as the provider of income, jobs and opportunities have not changed much, or, in the World Bank's terms: 'nepotism and "wasta" is problematic' (World Bank 1999c: 7).

Since the late eighties already, a debate has existed in Jordan about the possible necessity of selling off loss making parts of state-owned enterprises. After 1991, the numerous successive governments that were responsible ever after the Taher al-Masri administration signed the first stabilization agreement with the IMF,<sup>20</sup> had to embark more seriously on a course and earmark concrete companies and entities. As in Egypt, however, privatization is most politically sensitive not only because the regime cedes, by privatizing, its direct control over parts of the economy, but also because of the social problems related to privatization and the lay off of workers that usually encompasses. To turn a public enterprise into a well-performing private company more often than not requires the investor to rationalize labor, which means to fire employees who owed their positions to governmental socio-political considerations rather than to any economic sense.

Therefore, one might expect that such a regime does anything it can in order to avoid privatization. Among the steps to do so, one could argue, was the reform of loss-making public entities, including not only firms, but also parts of the overstuffed and inefficient bureaucracy (on bureaucratic reform in Jordan, see Kassay 1998). Administrative reform is also an important issue for reasons of political legitimacy. Corruption is known to be rampant in government administration, and employment is largely based on tribal structures and the *wasta*-mechanism (cf. Sakijha & Kilani 2000).<sup>21</sup> True, an anti-corruption unit was established in 1996 – but strikingly: organized as a department of the *Central Intelligence (al-Amn al-'Amm)*, and headed by *mukhabarat*-officer Muhammad al-'Ada'ileh! With the accession of King Abdullah, the department has been transferred to the ministry of justice, but with 'Ada'ileh remaining on its board. While the image was thus corrected, political legitimacy clearly ranges second when it comes to protecting well-established interests. Public opinion in Jordan is convinced that the creation of the department only served to protect the 'big fish', and that the unit has not, until now, challenged 'real' corruption. After more than four years of Abdullah's reign, nothing has changed the 'general sense among the Jordanian public that financial and administrative corruption is prevalent in the civil service at the highest and lowest levels' (Henderson and Pasch 2001: 14).

While a far-reaching reform of the bureaucracy would thus be desirable and is likely to have a real impact on economic performance in all areas of the economy, this seems unlikely

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<sup>20</sup> Jordan's programs with the IMF continue until today and were last renewed for another three-year period in April 2002. However, one of the main reasons for the Jordanian government of doing so is that only the reviews and evaluations of Jordan's economic performance and policy reform undertaken by the IMF help the country in rearranging and rescheduling its debts (which have risen again over the ceiling of 7 bn US-\$) with the Paris club members.

<sup>21</sup> This study by Sakijha & Kilani gives details from the first quantitative study on *wasta* in the Arab world, which deserves mention here.

thing to happen in the near future because the issue is laden with several dilemmas which make reform often not feasible.

First, the Jordanian bureaucratic apparatus itself is a major instrument of the clientelist system where patronage networks continue to maintain the neopatrimonial political regime, even after the structural reforms are in their second decade. Patronage networks work untouched by any changed international circumstances or because of domestic changes brought about through economic reform. In fact, many of today's top bureaucrats, and even a number of those of the most prominent ones brought into their current leading positions by the new king who himself paints an image of himself as the great innovator of the Jordanian economy, are using these networks precisely in the way their fathers' generation had done under the late King Hussein. No competent party, neither national nor international, has insisted on comprehensive administrative or public sector reform until today - fifteen years after the first Jordanian politician put his signature under an agreement with the IMF.

The second point comes as a logical consequence of the first: administrative reform, if tackled seriously, would undermine the very pillar on which political rule and regime maintenance in the country rests, and would do no less than endanger the continuation of the previous half century of Hashemite rule in the country. The bureaucracy and the administrative sector can be identified as *the* key pillar on which the Jordanian system of non-democratic and neopatrimonial political rule is built on, and where politically motivated patronage continues to be the recipe of the day, structural economic adjustment notwithstanding. However well-intended King Abdullah's initiatives to prop up the economy and to present Jordan as a top economic performer within the region may be, tackling the reform of public administration, introducing merit-based recruitment and payments, neglecting tribal and family affiliations or denying long-established privileges to those who have come to depend on them for the survival and well-being of their families over more than a generation would most likely be synonymous to political suicide of the Royal Court.

Interestingly enough, in mid-2000, the *Economic Consultative Council* (ECC) drafted, upon the urging of His Majesty himself, a document envisaging administrative reform in Jordan's large public sector. However, the document endorsed by the council remains vague in its recommendations, sticks to common places (such as enhancing efficiency, etc.), and does not shed any new light on the issue. The file remains remarkably silent about how such broad goals could be achieved in practice. Again, the reasons for such vagueness are very likely to be found in the delicateness of the sociopolitical equilibrium between the different ethnic and social groups who benefit from the existing system on which the king's system of political power still rests, even after succession.

Far from needing more external and donor-financed 'training' in 'new managerial techniques' at European five-star venues or 'capacity-building' at fancy premises, top and medium-level Jordanian officials are very well aware of these political dilemmas that are inherent in the highly sensible issue of administrative reform. The issue is so delicate that the Jordanian government even refused, in 1997, a World Bank offer of a scheme to assist the

regime in reforming its civil service according to internationally accepted criteria of governance and transparency. It is with the realization of these dilemmas in mind only that the words of one director general of one of the largest public sector corporations interviewed can fully be understood. The interviewee, himself personally close to King Abdullah and his family, answered, when asked about his views on public sector- and administrative reform: ‘Public sector reform? You cannot reform our public sector. You’d need a public sector *revolution*.’<sup>22</sup>

In the light of the preceding paragraphs, it is not surprising that privatization, though also a risky undertaking, was to be preferred over any meaningful efforts at reforming the bureaucracy and public administration. After years of discussions and hesitations, the privatization program finally gained momentum towards the end of the 1990s with the (partial) sale of formerly state-owned companies or their restructuring for privatization in the sectors of telecommunications, transport and energy, as well as in the cement industry and in water management; preparations for privatizing the postal service were under way in 2000. The *Jordan Investment Corporation* (JIC), too, began to sell some of the shares it held in dozens of industrial ventures, banks, and service companies, and yet another new law with a view to providing a framework for the treatment of privatization proceeds (against unsustainable increases in government expenditure) was in the pipeline at the time of writing.

While the pace of reforms had noticeably slowed down in 1998 compared to the previous year, the young King Abdullah II quickly gave new life to the reform process after his succession to the throne. His determination to accelerate Jordan’s economic transition became apparent in 1999 and 2000, when a series of difficult tasks were tackled. Although privatization is an issue with even heavier weight for the yet more state-dominated Arab republics which had, in earlier decades, nationalized their economies, it still remains a politically difficult undertaking for the conservative monarchies, too.

Even after a decade of reform, when the 1990s had given way to the new millennium and even after the advent to power of the new King Abdullah II and his ‘economicization’ of the political elite through the creation of new institutions, and even after he had installed a new government, views on privatization held by top politicians were ambiguous. Let’s hope the IMF’s staff did not listen too closely when the newly appointed prime minister Ali Abu Ragheb pronounced, in 2000, that ‘when it comes to dismissing employees [from the *Jordan Phosphate Mines Company JPMC*, among the largest Jordanian SOEs; O.S.], we have to make sure to rehabilitate and absorb them in other public institutions’ (quoted in Schlumberger & Bank 2002: 60). The still ambiguous position of government members on the consequences of privatization is understandable considering the immense benefits that are at stake for cabinet members who turn a blind eye toward corrupt practices of public sector

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<sup>22</sup> Author’s interview with the said official. Obviously, these are off-the-record discussions that can only take place when the interviewee can be confident that his or her identity will not be disclosed. In this case, the conversation was held at the said director general’s office at the Corporation in central Amman, November 2000.

entities' directors and managers, for the latter themselves, as well as for their counterparts in the private sector. But it certainly also is detriment to the overall performance of the national economy. Likewise, the regime's remarkable economic activism is amazing, but the pattern of creating ever new institutions and restructuring old ones also makes observers suspect that such new institutions might also create new opportunities for the upper echelons of 'the rent-seeking society' (Krueger 1974). Secondly, there is the unresolved social issue of lay-offs of publicly employed workforce. However, privatization being preferred over administrative reform and the structural budget deficit widening again during the second half of the 1990s, the government did move ahead with selling public assets since 1996, and the pace picked up again, after an interim slow-down in the last two years of King Hussein's reign, when the latter's son came to power.

Many of the SOEs were long debt-ridden and performed badly, such as the national airline Royal Jordanian, which was restructured While the government was moving ahead with the privatization of a 49 percent stake in *Royal Jordanian*, the national airline.<sup>23</sup> In addition to that, the governmental *Civil Aviation Authority* (CAA) was also subject of discussions of privatization in late 2000, after the telecom sector, the postal services, the cement industry and the national railway system had paved the way for further industries to be included into the process.

But by 2001, even the very large and strategic industries from the mineral resources sector, such as the *Jordan Phosphate Mines Company* (JPMC), were in discussion for at least partial privatization. The *JMPC* owed, in early 2002, roughly 22 m JD to the government. It sold 35 m JD in bonds which were guaranteed by *HSBC* and *Arab Bank*, and which were to be listed at the bourse of Luxembourg. It is world's third largest phosphates exporter behind Russia and Morocco. Another such large candidate of the same sector was *APC*, the *Arab Potash Company*. Plans to privatize these giants were first announced in fall 2001 (*J-Biz*, 25 Sept 2001), when the *Arab Bank* embarked on a first study how best to proceed, while *Rothschild & Sons* placed a successful bid to prepare a study for the electricity sector. Here, there are three firms in particular that were earmarked for privatization: The *Central Electric Generating Company* (CEGC, wholly state owned, but in which the government wanted to retain 40 percent of the shares), the *Central Electric Distribution Company* (CEDC) (also wholly state-owned, but set to be sold completely), and the *Irbid District Electricity Company* (in which the government was bound to sell all of the 55 percent it held).

While no definite decisions had been taken on all of these issues, it is clear that the privatization process has gained significantly in speed since the advent to power of the new king. However, given the current socio-political structure that impacts strongly on the implementation of the reform process as well as on economic performance, it remains to be

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<sup>23</sup> Recently, *Royal Jordanian* has been facing competition from the first local private carrier (*Jordan Aviation*) which offers low-cost intra-regional flights and whose general manager Mohammad Khashman, in his turn, had announced ambitious plans to add one Boeing 737 aircraft to its fleet every six months. (*J-Biz*, 31 January 2002)

seen whether the privatization procedures become more transparent than in the past and will open markets rather than just substitute former public monopolies by new private ones. Doubts are in order when one looks at the prevailing patterns of interaction among the closely connected bureaucratic and business elites in the country, and their respective formation around the inner circle of the royal court. It continues to be the general acceptance of the employment of *wasta* to further one's ends, a feature that enables patronage-based networks to persist during otherwise difficult times of reform. Even more so, it could be argued that it is precisely because of the emergence of new material uncertainties that people come to rely on personal ties maybe even more than in the past.

The problem is that *wasta*, if predominant, creates significant overall losses in any given society. Such remarks are frequently dismissed on grounds of their presumed insignificance to economic performance. Those few studies which have tried to address the issue in a scientific way usually try to give anecdotal evidence from a possibly wide variety of areas to underpin how widespread the phenomenon is. Yet, this was not enough to convince many of the need for further inquiry.

In Jordan, however, the first quantitative survey on *wasta* ever was carried out, and despite debatable methodological shortcomings, it does provide quantitative results: Of all respondents, over 65 percent said that they would look for *wasta* when they 'need to get something done at a government office, a company or organization.' Even more startling, 90 percent responded that, with reference to their past experience, they would now be ready to use *wasta* for either some or even all of their dealings. Strikingly, after twelve years of policy reform, when asked whether the need for *wasta* as a general tendency would decrease, remain as it is, or increase in the future, 39 percent thought it would remain as it is, and more than half of the sample assumed it would even increase, while less than seven per-cent thought the need for *wasta* was bound to decrease (Arab Archives Institute 2000). This clearly indicates that structural economic reforms in Jordan have not sufficiently – if at all – addressed the socio-political environment which strongly influences economic performance.

Respondents were chosen from both public and private sectors, from all age groups, various educational standards and job positions. Hence, the pervasiveness of the phenomenon can not be attributed to limited social segments. In the context of economic transition geared towards private-sector development, it has to be pointed out clearly that the socio-political phenomena discussed here are not the problem of some unwilling and inefficient bureaucrats only, as is often assumed.

Even privatization, which has long been approached very reluctantly because of its immense political importance and the interests at stake, cannot be thought of as alleviating the developmental problems associated with the prevalence of *wasta* and rent-seeking. With the example of the telecommunications sector and the *Export and Finance Bank* given above in mind, it is convincing when Cunningham and Sarayrah (1993: 179) hint to the fact that 'privatization neither eliminates *wasta* nor, in the absence of other factors, leads to development'. The distribution of resources and power to influence the market is often

handled just as discretionary in the private sector as it is in the public sector. Liberal economic policies open the door to public-private partnerships, true, but this also opens the door for new (quasi-) monopolies and oligopolies to emerge, so that market distortions may continue despite a transfer of ownership.

Several steps have been taken during the reform process which seem to point in the opposite direction. Examples are the establishment of the Anti-Corruption Directorate, or the anti-trust legislation passed in 1999 in order to be accepted as a WTO member. At the inauguration of the new Abul-Ragheb government in June 2000, King Abdullah is quoted to have told the new prime minister 'to introduce meritocracy as the guiding principle of public services', and that the government should 'establish a code of honor to put an end to waste, favoritism and cliques'. He demanded that 'we should put an end to monopoly and re-examine the system of choosing government representatives in the companies' boards of directors' (*Jordan Focus* no. 77; 20. 06. 2000). Yet, powerful interests are at stake which may well involve more of Jordan's political and economic elites than is commonly thought. Secondly, a social norm cannot be wiped out as if it was a stain on the carpet: 'No amount of external criticism can change the inner structure of patronage system, for wherever patriarchal relations exist [...], patronage *dominates*' (Sharabi 1988: 47; emphasis in the original).

It is evident that the currently prevailing patterns of social interaction are an important impediment to development in Jordan. The optimistic scenario King Abdullah and others, including international organizations, hope for, is not realistic because it fails to take into account this socio-political context. Minor ups and downs in GDP growth notwithstanding, as long as *wasta* is adequately described as the 'societal rule' (Cunningham & Sarayrah 1993: 36), the relation of productivity and profit will continue to be undermined from within. New institutions can be established, but they will come like a new slide on top of one already projected: The second one appears, but the contours of the first will not vanish.

## Banking and Finance

The financial sector, which has been identified as a major instrument in the hands of the regime for the maintenance of political power and control over the economic process in the above chapter on Egypt (cf. Chapter [6]), is not as strategically important a field for the Jordanian regime to remain in control over private actors in the course of economic reform. As the Economist Intelligence Unit states, Jordan has a 'moderately well-developed financial services sector' (EIU 1999a: 12).

Among the most important developments during the 1990s was the passing, in 1997, of a securities law which established the five member *Jordan Securities Commission* (JSC), chaired at the time of writing by Bassam Saket. It is responsible for monitoring and supervising the *Amman Financial Market* (AFM), the *Securities Depository*, and all financial



market-related companies. Since its establishment, it has issued a whole series of regulations that are aimed at tightening the supervision of public companies, improving their transparency, and at ameliorating both management and reporting practices. However, while important reforms were initiated over the 1990s, these measures could not cut through the densely knit informal networks of special privileges of some lucky few. Just like in other sectors of the economy, reform have not significantly touched on vested interests.

After 1994, for instance, the *AFM* had a relatively good year in 2001 with total trading volume rising by 100 percent to reach almost 670 m JD, and up again in 2002 to over 900 m JD. However, these figures have to be seen against the backdrop of its less than modest performance over the preceding half decade, when it was especially foreign investment which had decreased clearly below pre-restructuring levels. In order to measure the international acceptance of the Jordanian financial market, it is the net investment of non-Arab foreigners in particular which is of interest, and here, developments speak a decisively different language than the general increase in transactions: In 2001, net foreign portfolio investment at the *AFM* was negative, with – 7.4 m JD, and in 2002 it rose again to 16.5 m JD, which was still less than half the average of the period 1998-2000 (CBJ 2003a: 38).

Even after the re-organization of the *AFM* in 1997, this latter continued to be dominated by some few very large institutional players such as the state-owned *Social Security Corporation* (SSC) which holds shares in numerous public and joint stock companies, many of them of strategic relevance for the country's economy. It also is a major player in the state-owned media industry, most importantly the Jordan Press Foundation (which, i.a., publishes the main English language daily, the *Jordan Times*) which was rumored of undergoing preparations for 'privatization' in late 2000. 'Privatization' in this specific context was supposed to mean a partial sell-off of shares to the *SSC* which would then have figured as a majority shareholder – a somewhat off-beam understanding of 'privatization', some might argue. The example also shows how the different issue areas that are separated here for analytical reasons are interwoven in reality.

A similar picture can be gained by looking at the banking sector proper: At the time of writing there were 21 banks with over 400 branches serving the local market, certainly enough for a country of the size of Jordan, or even more than enough, if one agrees with local economists, analysts and central bank officials.<sup>24</sup> In fact, Jordan has seen discussions for almost fifteen years now which hover around the question whether the country was, in fact, 'over-banked' (cf. Akel 2000: 53ff.). Therefore, the Central Bank of Jordan has repeatedly urged smaller banks to merge - without much success, as of yet. This is due to the 'strong tradition of family ownership, and owners are generally reluctant to cede control to larger institutions' (EIU 2000a: 13). The banking system is therefore clearly dominated by the *Arab Bank* which was formerly known by its popular name as the 'PLO (Palestine Liberation

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<sup>24</sup> Author's interview with Taher Kanaan, former Minister of Planning and current director of the Research & Studies Department at the *Arab Bank*, the countries largest by far and one of the largest in the entire Arab world, Amman, November 2001.

Organization) – Bank’. This is one of the largest Arab financial institutes, holding around sixty percent of all assets in Jordan, and also dominating the *AFM* in accounting for almost 40 percent of the bourse’s total capitalization. Yet, as noted above, there are numerous other local and foreign banks to serve the market, and, unlike in Egypt, credit availability is not primarily controlled and instrumentalized by the state to the extent it is in Egypt.

Another difference with regard to Egypt is the issue of non-performing loans: As discussed above, such ‘bad loans’ have led to a loss of confidence in the entire Egyptian financial sector during the late 1990s and early 2000s, including in the central bank. By contrast, Jordan has had that experience much earlier, namely in the mid- to late 1980s.<sup>25</sup> Over the time of its economic adjustment programs since 1991, however, bad loans have not been a major problem in Jordan because its central bank, especially under Ziyad Faris as its governor, has taken a strict stance toward performance. To be sure, malpractice has existed in some instances.<sup>26</sup> But that has not been an outstanding or regular feature of the segment over the past decade.

However, this does not mean that the financial sector was not deeply penetrated by informal networks of both businessmen and bureaucrats, and often in cooperation with one another. The *Export and Finance Bank*, for instance, founded in 1995, immediately became *Merril Lynch*’s Partner in a bid for shares of the *Jordan Telecommunications Company* (*JTC*), and may serve as one example of this phenomenon. A look at the board members and main shareholders demonstrates why the international partner chose this particular bank: Founding members of the bank include Shaker bin Zayd, son of then acting prime minister and cousin of the king, Sharif Zayd bin Shaker, as well as Ali al-Husri (the bank’s CEO), grandson of Arab nationalist Sati’ al-Husri and son-in-law of Zayd bin Shaker. Moreover, a number of then acting ministers, as well as the acting plus some former governors of the Central Bank of Jordan were ‘on board.’ As Wils puts the story somewhat pointedly, it seemed ‘as if the bank had been founded upon a decision by the cabinet’ (Wils 2003: 196). While the composition of the board is politically relevant, the lion’s share of the initial capital was brought in by coopted private entrepreneurs whose names will sound most familiar to those who know the Jordanian scenery, namely businessmen from the Nuqul, Darwazah, Abu Jaber, and the Qa’war families. This bank was now supposed to evaluate the *JTC* and supervise the sale of 40 percent of its shares. Also on the board of the bank, not to be forgotten, sat then acting minister of post and telecommunications, Jamal Sarayrah, who worked, simultaneously and in addition to the presumably already existing conflict of interests, as a consultant for

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<sup>25</sup> The most spectacular case was the collapse, in 1988, of *Petra Bank*, then the second largest commercial bank in Jordan, due to a large non-performing loans affair. Although another bankruptcy occurred in 1997 with the much smaller *Amman Bank for Investments*, the Central Bank has generally maintained a comparatively rigorous supervision, ‘with particular attention focused on lending policies and provisioning’ (EIU 1999a: 13).

<sup>26</sup> Recently, for instance, the central bank urged three local banks to step up their capital and comply with central bank regulations because they had been involved in a bad-loans affair which could have endangered their existence. The affected banks include the *Jordan Gulf Bank*, the *Jordan National Bank PLC*, and the *Jordan Investment and Finance Bank* (for details, cf. *J-Biz*, 5 April 2002).

international telecommunications companies with interest in the Middle Eastern and Jordanian market, such as for FLAG (*Fibreoptic Link Around the Globe*); (cf. *ibid*: 197).

This is only one out of the many instances where private business interests coincide and enter into alliances with top bureaucrats' and politicians' interests for the mutual benefit of both sides. It is noteworthy that this is not an exception. Bearing in mind procedures such as the one quoted above, concepts like 'private sector development' or 'private sector encouragement' are still of Western origin, but certainly take on a totally different meaning when transformed into a local context in which they serve to gain non-market privileges as a result of information monopolies and semi-legal accords that rule out competition systematically. In this instance, the banking system proved functional for the conduct of such a non-market procedure, even though this particular plan did not work out as smoothly as those who planned it might have envisaged. However, it is not so much the Jordanian banking system *per se* which is the cornerstone of these alliances between private business and the top-level bureaucracy and political decision-makers. Rather, it is their informal ties that have existed between the larger family clans long before the current period of economic reform. While at times, new elite members such as Bassem Awadallah, (who, under King Abdallah, first became chief of the economic section at the royal court and was then promoted to the office of the minister of planning) are included into the inner circles of such networks, the Jordanian social fabric, very much based on tribal and familial affiliation and loyalty, proves to be a handy setting for this kind of economic strategies that transform the country's former rentier economy along the lines of what is suggested by funding international financial institutions. But at the same time, the incumbent elites know precisely how to avoid the emergence of a competitive market situation where old privileges would seriously be endangered.

Yet, the relevance for political control over the economic process and for the process of a transition from a rentier economy to some other type of non-market economy, the banking and financial system do not play the outstanding role for regime maintenance through the privileging of a loyal clientele via non-performing loans they do in Egypt. More importantly for Jordan is a rather recent phenomenon that appeared after the new King Abdullah II had assumed power, namely the creation of the *Economic Consultative Council* which will be discussed below.

### Formalizing Informality: The Economic Consultative Council (ECC)

During the first year of his reign, Abdullah invited over 150 leading representatives of the private and public sectors to a two-day seminar called the Dead Sea Forum. More importantly, he set up the *Economic Consultative Council* (ECC), a royally appointed body with twenty members presided over by the king himself. This new institution was established in December 1999 as an advisory body on economic policy and strategy formulation.

Remarkably for an economy in which the state for decades was the largest employer and most powerful economic agent, the ECC is dominated by fourteen leaders from the private sector. King Abdullah realized that Jordan, as a country facing serious economic problems without being endowed with significant natural resources, had to tackle the issue of economic reform seriously. Unlike his father, he seems personally preoccupied with the subject. However, then-Prime Minister ‘Abd al-Ra’uf Rawabdeh was known as a conservative figure who was not keen on changing the old system of rent allocation and state control over the economy. A government led by Rawabdeh was thus inherently opposed to the king’s strategies for development. Therefore, it is hardly surprising that the ECC soon gained the reputation of a parallel government, even though Rawabdeh was a member of the Council in his capacity as head of the government. In ECC discussions, Rawabdeh often firmly opposed proposals that the majority of the council—and the king himself—had endorsed.<sup>27</sup> In the course of 2000, the differences between the ECC and the government grew until Rawabdeh was finally dismissed in June and the government greatly reshuffled. As one ECC member said, ‘the king had kept Rawabdeh as long as possible, but in the end, there was no choice but to fire him.’ The ECC, formed by the ruler and staffed with personnel of his choosing, was obviously more powerful than the Jordanian government.<sup>28</sup>

Who are the members of this powerful body? As mentioned above, the majority are entrepreneurs. Fadi Ghandour, for instance, is the founder of *Aramex*, an international shipping company with more than 100 offices and almost 2,000 employees worldwide which is noted at the American NASDAQ. Ghassan Nuqul heads the *Nuqul Group*, a family enterprise that also operates internationally and employs several thousand people. Other initial representatives of this business group within the ECC are Damascus-born Suhayr al-Ali Dabbas, general manager of *Citibank Jordan*, Karim Ka‘war, president of the *Ideal* group of companies and of the Jordanian information technology association *Int@j*, Fawwaz Zu‘bi, who owns the *Adritec Group* (irrigation equipment), and Nasir al-‘Ammad, aged 42 at the time of writing, who heads the stock brokerage *United Financial Investments*.

While the six public sector representatives in the ECC ensure a balanced composition of the body, it is nevertheless striking that all members mentioned here are in their mid-thirties or early forties—from the same generation as King Abdullah II. Another private sector member of the ECC, lawyer Salah al-Din al-Bashir, 36, is among the youngsters. He is married to Reem Badran, head of the *Jordan Investment Board* and daughter of former Prime Minister Mudar Badran, who herself is another example of the young generation entering politics. But the most powerful person in Jordan’s young economic guard is probably Basim ‘Awadallah, who not only sits on the ECC but was also head of the economic unit at the

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<sup>27</sup> Authors’ interviews with ECC members, Amman, November 2000.

<sup>28</sup> Local media, for instance, reported that “the government received deadlines ranging from one to three months” from the ECC for presenting reform strategies. *Jordan Times*, 22 December 1999.

Royal Court. Named rapporteur of the ECC, he personalized the strong link between the ECC and the Royal Court.<sup>29</sup>

At first glance, it does not seem surprising that an institution with an explicitly economic task is dominated by persons with backgrounds in economics and business. On the one hand, this certainly reflects King Abdullah's 'prioritization of the economy' (Milton-Edwards & Hinchcliffe 1999: 30) Yet, the ECC's mandate is not restricted to purely economic affairs. It extends into areas such as education, water, administrative and institutional reforms, legislation, and planning. In other words, what has begun in Jordan is a vast project of transformation for development, with the majority of the most influential economic decision-making body having newly acceded to positions of direct political influence. This marks a significant 'economization' of the political elite. At the same time, the formation of the ECC might be interpreted as a mechanism to overcome resistance to reform from within the central administration.

In the meantime, a number of ECC members have become senior ministers in the government of Ali Abu Ragheb (who was, himself, already a member of the council before he acceded to the post of Prime Minister). A case in point is Muhammad Halayqa, who joined the Council as undersecretary of the Ministry of Industry and Trade. He headed Jordan's delegation during the negotiation of a free trade agreement with the United States when he was just thirty years of age, and today holds the economic portfolio himself. Minister of Education Khalid Tawqan, who was appointed to the ECC as president of Balqa University, lawyer Salah al-Bashir who had, at the time of writing been promoted Minister of Industry and Trade, Bassem 'Awadallah who became Minister of Planning in late 2001, or Fawwaz Zu'bi, who has taken over the Ministry of Post and Telecommunications, are other examples.<sup>30</sup> These developments lead to speculation about the necessity of the Council. As the *Jordan Times* noted, critics argue that the advent of the new government in 2000 'has made the Council 'redundant'(Jordan Times, 27 Dec. 2000). However, at the time of writing, there were no indications that an end to the ECC might be in sight.

Through the creation of the Council as a 'superbody,' Abdullah II has managed to bring into the political elite a hand-picked group of young entrepreneurs. Long-serving members of Hussein's system of rule silently lost much of their ability to influence actual policies. Adnan Abu Oudeh is a case in point. He still is a member of the upper house of Parliament, and for a long time was one of the key decision-makers in the country. Yet today he is not entrusted with any real power as a politician and is instead acquiring a reputation as an academic. The Senate itself is an institution that today seems composed of a mixture of retired, or as one interviewee expressed it, 'fired dignitaries of past times plus some tribal

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<sup>29</sup> By late 2001, 'Awadallah had become Minister of Planning. However, all positions referred to here are but snapshots at a certain point in time and are almost certain to undergo more short- and medium-term changes. They are subject to frequent and almost regular political interference for reasons of power maintenance of the top leaders, i.e. the king and the royal family. See the concluding section below for details.

<sup>30</sup> Karim Qa'war, in the meantime, became Jordanian ambassador to the US, while Rim Khalaf left the country for a senior UN post in Vienna.

rent-seekers,' who were included in politics by the late King Hussein in order to maintain social stability.<sup>31</sup> As one senator and former prime minister, referring to this old guard, put it: 'We're out. Our experience is not wanted any longer. In the Senate, we might be allowed to discuss and decide whether the brightness of light bulbs in public sector offices is sufficient, but when it comes to political matters, we have nothing to say.'<sup>32</sup>

In sum, what has happened in Jordan with the accession of King Abdullah is the advent of a new generation in power. The king, in choosing his allies from a number of well-established families, displayed a strong economic bias that reflects his new perception of the country's problems and reset policy priorities. At the same time, many, if not most, of those upon whom King Hussein had built his rule have been relegated to the back yards of politics.<sup>33</sup> While Hussein had relied on the Senate as a consultative body whose members' loyalty was guaranteed because they are appointed, it seems to have lost at least some of its former influence under King Abdullah. Instead, the ECC (and, of course, the new government under Abu Raghieb which significantly overlaps with the Council) is the institution upon which the king relies in questions of strategy formulation and actual political decision-making.

Obviously, the new king made his choices according to criteria of age and social background. It is striking that many of the members of the new generation come from families that were well-known in Jordan even a generation earlier. The fathers or grandfathers of the new guard established themselves and their families as leading figures in Jordan, either economically or politically. Sabih al-Masri, a relative of former Prime Minister Tahir al-Masri, is one of the few representatives of this older generation to remain on the board of the ECC. He is one of the richest and most influential Jordanian businessmen, with diverse business interests in Jordan and abroad.

However, there is one important factor in the Jordanian political process that remains constant. Nobody except the king had any say in the composition of the ECC, and many of the members even expressed surprise themselves when they heard they were nominated.<sup>34</sup> While Abdullah II created a new formal institution, his methods of staffing it are typical of neopatrimonial systems. The leader alone chooses to whom to grant influence and from whom to withhold it, in a process characterized by informality. Needless to say, a body like the ECC lacks any democratic legitimacy. In this sense, the Jordanian process of elite change can be characterized as formalized informality.

Recruitment of senior decision-makers, however, has not become more transparent or legitimate. Also, the king has continued the processes of elite reshuffling typical of

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<sup>31</sup> Author's interview with a senior figure of Jordanian public life, recently appointed member of one of the committees planning and supervising the privatization of the Jordanian media.

<sup>32</sup> Authors' interview, Amman, November 2000.

<sup>33</sup> This does not mean that none of the older generation have remained in key positions. Senator and ECC member Kamal al-Sha'ir is a prominent example of the older members of the core elite who have been integrated in newly built institutions.

<sup>34</sup> See the series of portraits of ECC members, including interviews with them, in the *Jordan Times* from late 1999 to early 2000.

neopatrimonial systems. This has happened mostly in sectors directly related to the security of the leader himself—the army, the police force, and the intelligence services. All this indicates that authoritarian rule is not at risk, but remains a political constant passed on from father to son.

The ECC is maybe the most remarkable feature of Jordan's economic reform process to date because it represents the formalization and official institutionalization of (parts of) hitherto informal linkages between both private businessmen and public officials and key political decision-makers. This to happen at a level as high as in Jordan is new with respect to the Arab world and enables us better to discern the non-market personal and otherwise exclusively informal inter-linkages between the protected winners of structural adjustment as implemented in the Arab world over the past one and a half decades. Therefore, Jordan is a place to observe more closely in future studies on economic transition.

## Conclusion

Oliver Wils (2003: 217), in one of the best case-studies on economic reform in the Arab world to date, asserts that

[...] in Jordan, an entrepreneurial oligarchy has been established. A deep economic reform in Jordan would therefore also have to take into account explicitly – apart from businessmen-bureaucrat-networks – the problems related to this oligarchy, since the entrepreneurial elites will try to prevent the introduction of an open economic system based on competition'.

This neatly captures the key point to be made with regard to the country's experience in structural adjustment policies. While the international financial institutions, as quoted in the initial section of this chapter above, repeatedly hailed the government as producing one of the most outstanding economic success stories in the Arab world, Wils has demonstrated with admittedly partial, but hardly contestable and meticulously researched insights on the micro-level that while the economy was transformed structurally, the outcome could not be farther away from what has been defined as a market economy above in chapter three.

The reform process has led to the establishment of a number of social winners who are closely affiliated to both the royal court and the key political decision-making centers. As elsewhere, these winners most often stem from well-known families which have already in past decades made clear their loyalty and benefited during the course of reforms from the fact that their loyalty was assured for the leaders at the outset of the transition process so that relying on them for their share of a contribution to the necessary if unloved reform process proved a vital means of power maintenance for the ruling elites while not ceding power to other and possibly contending segments of the population.

The Jordanian rulers' strategy – and in this respect Abdullah II does not differ in any respect from the strategy his father Hussein bin Talal had pursued – of a continuous rotation

and reshuffling of incumbent elites can be seen in this light: As illustrated with the example of the *Export and Finance Bank* in relation to the privatization of the telecommunications sector, top political positions bring about a vast degree of power to influence decisions of great economic importance. The fear of competing elite segments arising who could, over time, turn into real competitors for political power makes it necessary that no single individual occupy such a position for too long a span in time. While foreign consultants and analysts alike are still puzzled about the quick shifts of persons in their posts who have, as a consequence, often not enough time to get familiar with the tasks required from them on a specific decision-making position, let alone to design long-term strategies, this elite rotation is vital for regime survival in that it breaks off any political challenge well before it could become strong enough to turn into an actual threat. Among the many political aspects of economic reform, this is yet another one which demonstrates that the economic outcomes of structural adjustment policies are often determined by the purely political logic of power maintenance that underlies economic policies and their reform in the Arab world, as the title of this Part (II) of the present study suggests.



## Chapter 8

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### A Case for Kafka: ‘*Le Pouvoir*’ in Algeria

Algeria, like Egypt, had a nominally socialist historical phase from its relatively late independence in 1962 up to the late 1980s when the ruling party, the *Front de Liberation National* (FLN), allowed other parties, competitive elections were planned, and – at least on the communal level – even held (for the political history of these years [from the October Protests in 1988 to the Civil War in the 1990s], see, i.a., Ruf 1997; Quandt 1998; Zahraoui 2000; Boukhobza 1991). While Jordan and Egypt differ from one another in their forms of political organization (cf. Chap. [4] above), they are similar in that they can be considered relatively resource-poor and as having departed from a semi-rentier type of economy when they initiated their programs of structural adjustment.

Algeria, by contrast, shares with Egypt the presidential type of authoritarian republic that has also been labeled as ‘presidential monarchy’ (Hinnebusch 1990; Egypt and Algeria thus figure in one category with Syria where the presidency, in the meantime, has become hereditary and ‘dynastized’), but can afford to rely much stronger on external capital inflows resulting from the export of oil and gas for national economic survival than can Egypt.

Algeria, too, tried to escape harsh IMF conditionalities as long as possible, and just like Egypt’s 1987 program with the Fund, Algeria’s 1991 program, too, was canceled because of non-compliance of the recipient government with the conditionalities tied to the loans received. In line with the earlier argument put forth by Beck and Schlumberger (1999), it is not surprising that among those countries which have undergone structural adjustment and are studied here, the most resource rich, i.e. Algeria, began to implement liberal economic reform as the latest among these three, and continues to present an overall picture of the least liberalized and least structurally changed economy when compared to Egypt and Jordan.<sup>1</sup> In fact, while Egypt even chose not to conclude a new program with the IMF in 1998, the process of structural adjustment is still ongoing in Algeria. A World Bank designed ‘country assistance strategy’ had been planned until 2006, and while the stand-by agreements and extended fund facilities (EFF) with the IMF came to a close in 1998, another ‘contingency and compensatory fund facility (CCFF) was approved in 1999 (IMF 200a:40). Most areas remain subject to further reform, if the regime’s proclaimed intentions are to be believed in, and if the country is to reach a depth of reform similar to the one experienced by Egypt up to

the end of the 1990s. Thus, while the country was, with the help of oil and gas export receipts, able to ‘postpone’ structural adjustment for some time in comparison to both Egypt and Jordan, mal-performance continued until the debt burden, in line with the pattern that was so typical for the entire region, mounted beyond what the national economy could manage without external help. Algeria ultimately fell prey to the same internationally imposed conditionalities as Egypt and Jordan before, which eventually lead the country, in 1994, on the road to structural adjustment. However, it differs structurally from these latter ones in that the role of its hydrocarbons sector is overwhelming.

*The Hydrocarbons Sector and its Importance for the Algerian Economy*

A quick look at the following table (8.1) demonstrates this fact. Apart from crude oil, sources of revenue in this the sector are: (1) refined petroleum products, (2) natural gas, which can be transported in pipelines or be transformed into liquefied natural gas (LNG), (3) condensate, which is a by-product of natural gas production, and (4) liquefied petroleum gas, which must be separated into butane and propane. About 80 percent of the country’s total hydrocarbons production is exported while the remaining share is consumed on the domestic market (IMF 2000b: 12).

*Table (8.1):* ALGERIA’S HYDROCARBONS REVENUES (BY SORT, 2000)

Sort	Share (% of Revenues)	Revenues (m US-\$)
<b>Crude Oil</b>	22.87	4,815.1
<b>Refined Petroleum Products</b>	15.59	3,284.4
<b>Natural Gas</b> (gas + liquefied natural gas [LNG])	32.50	6,845.6
<b>Condensate<sup>a)</sup></b>	18.99	3,999.6
<b>Liquefied Petroleum Gas</b> (LPG)	10.06	2,118.6
<b>Total</b>	<b>100.0</b>	<b>21,061.3</b>
<b>Hydrocarbons in the National Economy</b>		
<b>Hydrocarbons / Total Gov’t. Revenues</b>	76.87	--
<b>Hydrocarbons / GDP</b>	40.75	--
<b>Hydrocarbons Exports / Total Exports</b>	97.13	21,061

Source: EIU (2002: 59, 60, 63-5); IMF (2001a) a) Condensate is a by-product of gas production.

While, admittedly, 2000 as a reference year might not be entirely representative because of a relatively high world oil price that year, it nevertheless reflects the dominance of hydrocarbons in the Algerian economy. Also, it demonstrates that it is not oil alone which generates foreign exchange inflows. In fact, crude oil exports make up for less than a quarter

<sup>1</sup> The UAE have not undergone structural adjustment but have implemented, instead, more moderate economic reforms at their own pace without external conditionalities being imposed upon the government by the

only of all hydrocarbons revenues of the state. This is in part due to Algeria's OPEC-quota which set rather narrow limits of 788,000 b/d (in March 2000, up by 100,000 b/d from the previous years). While Algeria had consistently exceeded its quota, the now allowed ca. 800,000 are still far below the country's actual production capacity of more than 1.3 m b/d. The ca. 9 billion barrels in oil reserves will last for another 35 years, assuming current production levels, but further discoveries are still being made, given the fact that upstream activities had suffered during the 1990s from the civil war. More important in terms of revenues, however, are receipts from gas (plus condensate) exports, especially as sold to Europe via pipelines to Italy and Spain, Algeria's close neighbors.

The two main players in the field are *Sonatrach*, the state-owned Algerian oil company, and *Sonelgaz*, its counterpart in the gas sector. Recently, fierce debates within the Algerian political elites and, later on, among the public and particularly in the unions were held about a possible partial opening of some 20 percent of *Sonatrach* to foreign investors. This was seen as a means of realizing the necessary upgrade of the company, but worries about selling Algeria's national assets to foreigners, mainly voiced by the relatively influential umbrella organization of the trade unions, the UGTA (*Union générale des travailleurs algériens*) and from employees in the sector, were instrumental in dragging the approval of a new hydrocarbons law drafted by Minister of Energy Chakib Khelil, a former World Bank official, for more than a year (cf., e.g., *La Tribune*, 7 April 2001: 11-14).<sup>2</sup>

#### *A Political Peculiarity: 'Le Pouvoir'*

An even more striking specificity of the country than its dependency on hydrocarbons is political in nature: In stark contrast to all other Arab countries, the hierarchy (and even the identity) of power-holders is not always clear in Algeria and dealt with in an extremely secretive manner. As Herzog (1995: 115f.) writes:

'If one asks Algerians to name their top politicians, most refer to the president and the head of government. Yet, they don't ascribe any power to the prime minister. It is the men "behind" who really reign. Their names are hardly known, since these people never appear on TV, don't give interviews and work anonymously. Also, it is not known where the most important decision-makers meet. Algeria is governed as if the country was still at war and the most important personalities had to hide. Their biographies are, in part, faked or even unknown. Some powerful people have never given up their pseudonyms from the war of independence.' (quotation from Ludwig 1998: 89f.)

While this was written almost a decade ago, the secretive way in which the top decision-makers behave remains much the same. Algerians and local media simply refer to this group of persons as *le pouvoir* ('the power'), somewhat reminiscent of the role some unknown, opaque and unpredictable power plays in the novels and stories of Czech author Franz Kafka. For the most part, this group consists of generals and high officers of the Algerian army and

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Bretton Woods institutions and international creditors. See the next chapter for details.

<sup>2</sup> At the time of writing, the law which had undergone more than a dozen revisions in the meantime had not yet been passed.

intelligence services (some of the most influential ones are officially retired), plus, since 1999, the current president Abdelaziz Bouteflika. While decisions of strategic importance during most of the 1990s seem to have been taken by consensus, there are also significant intra-elite struggles that impact, *inter alia*, on the course of economic policy reform as will be clear in the analysis below.<sup>3</sup> One consequence of this structure is that outside Algeria, is even less known how exactly existing socio-political power relations influence economic outcomes than in other Arab countries where it is obvious that affairs are directed or at the very least controlled from the centers of a single royal court or presidency.<sup>4</sup>

### *Economic Structure*

It may be helpful at this stage to gain an impression of the overall structure of the Algerian economy before plunging into an analysis of the reform process, which will then be done, as in the previous chapters, along the three issue areas determined in chapter four above. Table (8.2) gives an overview of economic sectors and their relative importance.

*Table (8.2):* ALGERIA'S GDP BY SECTOR, 1995 – 2000 (BN AD AT CURRENT PRICES)

	1995	1996	1997	1998	1999	2000	% Share*
<b>Agriculture</b>	190	278	261	309	336	324	8.1
<b>Hydrocarbons</b>	503	733	819	640	882	1,635	40.8
<b>Manufacturing</b>	208	222	236	270	283	292	7.3
<b>Construction &amp; Public Works</b>	201	246	275	299	316	347	8.6
<b>Administration</b>	230	313	344	374	403	424	10.6
<b>Other Services</b>	453	560	607	662	718	752	18.7
<b>Customs Duties, VAT</b>	181	212	221	226	230	237	5.9
<b>TOTAL</b>	<b>1,967</b>	<b>2,565</b>	<b>2,762</b>	<b>2,782</b>	<b>3,168</b>	<b>4,012</b>	<b>100.0</b>

*Source:* EIU (2002: 60); RADP/BA (2000: 19). \*) 2000 has been taken as a reference for this column.

The first point that catches one's eye as one looks at the composition of the Algerian GDP is, of course, the overwhelming dominance of the hydrocarbons sector as has been described

<sup>3</sup> The best recent study on Algerian elites is by Werenfels (2004), who most likely is the best Western academic *connaissanceur* of current Algerian political and economic elites.

<sup>4</sup> Another problem that makes statements on Algeria difficult is that currently, literature is just now beginning to be based on field research again, with Western scholars having virtually disappeared from the country during the 1990s. Secondly, most of the literature over the past decade was preoccupied with the political developments concerning government-Islamists relations and the civil war. Economic performance and development studies were hardly written. As a consequence, there is no significant recent body of academic literature on the subject. Therefore, other sources of information such as the well-informed and independent web-site of 'Algeria-Interface', apart from own interviews held during a field-research trip, gain greater importance for an analysis of the country than for other countries studies here. Algeria-Interface is a website run by Algerian and European journalists which critically informs about topical events in the country and which even the EIU regards as a 'valuable source of independent political, economic and financial news' (EIU 2002a: 58).

above. Again, taking 2000 as a reference year for the individual sectors' shares in GDP is not representative (even though world oil prices remained through 2001 as well), but it also shows how dependent Algeria's total GDP is of that sector. In 1998 for instance, when oil prices collapsed, GDP stagnated even when measured at current prices, signifying a clear real contraction. On the other hand, nominal growth increased by an impressive 27 percent in 2000 – which is, of course, primarily a result of rising prices on world energy markets, making the hydrocarbons sector almost double (plus 85 percent) its performance (though not its share) compared to the previous year.

Next in importance comes the services sector, where a significant part of activity has become informal over the 1990s as the economy has been liberalized, SOEs have been liquidated and labor has been set free. Representatives of the national statistical office estimate the informal sector to account for ca. 15 percent of all economic activity<sup>5</sup> – a figure that seems still relatively low compared to other developing nations such as Egypt or Latin American countries where the informal sector has overtaken the formal one, but even this relatively low figure means a significant increase for Algeria where work, up to the 1990s, was provided almost exclusively through the state (with the exception of small-scale agricultural cooperatives).

In terms of employment, agriculture is, like in other countries of the Middle East and North Africa, much more important than its modest GDP share suggests: Of a total labor force of ca. 8.5 million (in 1999), almost 1.2 worked in the sector. This figure becomes even higher when considering the fact that unemployment rates are very high at around 30 percent of the labor force (RADP/BA 2000: 20), and higher yet among the young generation. The central bank estimates that growth rates of 6-7 percent would be needed (a lot more than the recent 2.5 – 4 percent) in order to absorb ca. 250,000 annual newcomers to the labor market and for unemployment to begin being reduced (ibid.).

A third point that makes Algeria special in comparison to the other three countries observed in this part of the study is the still very strong dominance of the public sector. Most obviously, this is the case in the financial sector, which constitutes a strong parallel to the Egyptian case, but in contrast to Egypt, the Algerian public sector is also still involved as *the* major producer in most other sectors of the national economy (apart from agriculture), i.e. in other than financial services as well as in manufacturing, and, of course, in the mining and extractive industries, through which the public sector (economic and administration) is the single most important contributor to GDP by far. Thus, Algeria, in contrast to Jordan and Egypt, and like the UAE, must be considered, at the outset of structural economic reform, a typical rentier economy. However, while the UAE pursue the allocative policies typical of rentier economies in that the state-owned oil and gas sectors generate the revenues that are then distributed to a dependent private sector and its 'bourgeoisie', the 'democratic and

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<sup>5</sup> Author's interview with Hamid Zidouni, director of national accounts, ONS, Algiers, April 2001. See also Algeria Interface, 21 April 2003 ('Hamid Zidoumi [sic!]: "Le secteur informel représente 15 % de la production algérienne").

popular republic' of Algeria differs from that pattern insofar as the regime still rather controls the economy by *owning* it instead of having private 'entrepreneurs' spend the state's income as is the case in the UAE (cf. chapter 9 below for details). The latter, of course, have a significant advantage of creating an image of liberalism and openness, even though the economy is less able to survive without oil receipts than is the Algerian. By contrast, in the age of globalization and of the world-wide 'victory' of liberal capitalism, Algeria seems to have lagged behind in its efforts at structural adjustment, and is now eagerly trying to reverse that image through a possibly speedy and ambitious program of reform which is, on the other hand, hampered by numerous factors the majority of which is not economic, but political in nature, as will be explained in the remainder of this chapter.

### Public Sector Reform and Privatization

It is obvious, in the light of the economic structure as sketched out above, that a thorough reform of the Algerian public sector is unavoidable if the economy should survive; and in fact, this is what Algeria has done. The regime's privatization scheme is extremely ambitious, even in comparison to such major schemes as the Egyptian one, and part of the reason for that is that the task, too, is a tremendous one, given the fact that (a) the public sector still performs extremely poor and (b) the regime has to demonstrate its willingness to act in at least one major area that is considered crucial by international donor institutions to the success of liberal reform. The only two issue areas where the regime has the choice to demonstrate such willingness – or not – are (a) the privatization of public enterprises and (b) a genuine reform of the financial system. However, while there are staunch advocates within the government in favor of privatization, there are also influential forces who do not seem in favor of a large-scale sell-off of the country's public industries and services companies. Decision-making in the process of restructuring of the public sector has, for the most part, been split between various competing authorities, and results have been ambiguous up to the time of writing.

Before starting to analyze the outcome of the restructuring process, however, it is worth taking a look at the size and scope of the Algerian public sector. Unlike in Jordan, where the economic enterprise segment of the public sector is marginal compared to the bureaucracy, and much like Egypt, Algeria's entrepreneurially active public establishments are tremendous in scope, ranging from cattle raising to oil refineries. Not amazingly, the sector has suffered, over the years, from falling real wages for those employed, unmotivated and overstaffed enterprises, a lack of inputs, and political and administrative interference into economic decision-making. Output outside the hydrocarbons sector has dropped in most years in the examined time frame since the early 1990s (although not always), and it continued to do so in the early 2000s. Most of the enterprises run well below capacity which ranged, in 1999, between 15 percent (leather and shoes), to roughly 30 percent (e.g. metal, mechanical and

electrical industry [31.5 %], or wood and paper [30.1 %]) to 'medium performers' such as chemicals and plastics (running 46.6 percent of capacities) to the top performers such as food processing with 74.3 percent (RADP / ONS 2000: 8-15). On the whole however, the Algerian public industry ran at less than half of capacities (43.6 %) at the end of the decade, which makes clear that restructuring and, most likely, liquidations and privatizations were economically necessary (ibid: 8; cf. also: CNES 1995).

The following tables (8.3) and (8.4) on the next two pages allow for a view on the development of the relationship of public and private sectors in the economy over the decade of the 1990s. The picture that emerges suggests that while some trends towards a greater role for private economic activity are apparent, the expected large increase of its role has not yet taken place and therefore, the impact of economic reform remains limited as concerns the overall structure of the national economy . The public sector, not least through its large hydrocarbons sector described above, still prevails. Areas where the private sector has increased its share are mostly transport, communications, household services and some light industries. Also, the already existing private sector dominance in agriculture continued.

These figures clearly show how embryonic the Algerian private sector has still been in many respects even after the 1990s came to a close and after several years of structural reform. Public sector dominance continues unabatedly in almost all areas and respects. In terms of fixed consumption (investment, the CFF column), for instance, the private sector accounts for less than a third of the total figure, and the same holds true for the production-related tax. But while the public sector prevails in almost all areas, the exceptions are trade, transport and communications, plus the household services. In industry as a whole, the public sector still accounted for roughly three quarters of total output and production in 2000. However, while the private sector is weak, tables (8.3) and (8.4) enable us to conduct a cross-time comparison which demonstrates that certain shifts are non-deniable. The comparison over the decade of the 1990s shows a relative increase in the shares of both private sector activity and output . In terms of value added, for instance, the 1990s brought a structural shift in favor of private enterprise which overtook the public sector ( an up from 45.8 percent of the total in 1989 to 51.8 percent in 1999). Given the relatively small amount of assets the private sector has, this seems to imply a higher overall efficiency. In terms of revenues, however, an earlier relatively large private sector advantage in net gains has shrank over the decade of reforms, down to 61.9 percent of the total, compared to 69.6 back in 1989. Profits for private enterprises, while displaying a strong rise in absolute terms, have thus not been on an upward curve when compared to the public sector. This seems odd because one might think that changes to the business climate should have been conducive to the private rather than for the public sector to increase its share in overall revenues. But that has obviously not been the case. The reasons are hard to explain because there are more than one, and they interrelate.

Table (8.3):  
(1989)

PRODUCTION AND CONSUMPTION, PUBLIC AND PRIVATE

in m DA, current prices		PB	CI	VA	CFF	RI	ILP	RS	ENE
<b>Agriculture</b>	Public	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0
	Privé	61709,2	10076,0	51633,2	1690,3	49942,9	225,9	5522,3	44194,7
	Total	61709,2	10076,0	51633,2	1690,3	49942,9	225,9	5522,3	44194,7
<b>Water &amp; Energy</b>	Public	5291,6	1405,8	3885,8	1426,4	2459,4	203,0	1737,8	518,6
	Privé	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0
	Total	5291,6	1405,8	3885,8	1426,4	2459,4	203,0	1737,8	518,6
<b>Hydrocarbons</b>	Public	112648,6	38360,2	74288,4	7209,2	67079,2	23620,7	3143,6	40314,9
	Privé	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0
	Total	112648,6	38360,2	74288,4	7209,2	67079,2	23620,7	3143,6	40314,9
<b>Oil-Related Works and Services</b>	Public	6802,7	2184,2	4618,5	1507,9	3110,6	187,3	1790,2	1133,1
	Privé	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0
	Total	6802,7	2184,2	4618,5	1507,9	3110,6	187,3	1790,2	1133,1
<b>Mines and Carriers</b>	Public	1465,9	466,6	999,3	256,0	743,3	101,1	700,6	-58,4
	Privé	289,1	129,4	159,7	2,8	156,9	31,6	38,9	86,4
	Total	1755,0	596,0	1159,0	258,8	900,2	132,7	739,5	28,0
<b>I.S.M.M.E</b>	Public	24124,8	12814,9	11309,9	2776,7	8533,2	918,0	8564,2	-949,0
	Privé	2102,9	961,8	1141,1	48,4	1092,7	211,7	419,5	461,5
	Total	26227,7	13776,7	12451,0	2825,1	9625,9	1129,7	8983,7	-487,5
<b>Building Materials</b>	Public	5639,3	1994,9	3644,4	1105,3	2539,1	286,6	2315,9	-63,4
	Privé	925,7	402,1	523,6	31,8	491,8	78,2	234,1	179,5
	Total	6565,0	2397,0	4168,0	1137,1	3030,9	364,8	2550,0	116,1
<b>Construction</b>	Public	46560,1	14418,2	32141,9	3151,1	28990,8	3623,8	20312,3	5054,7
	Privé	32469,7	14458,5	18011,2	759,8	17251,4	988,4	10256,0	6007,0
	Total	79029,8	28876,7	50153,1	3910,9	46242,2	4612,2	30568,3	11061,7
<b>Chemicals, Plastics</b>	Public	6983,0	4722,9	2260,1	547,2	1712,9	294,0	1894,0	-475,1
	Privé	1883,3	1159,5	723,8	37,7	686,1	161,4	245,6	279,1
	Total	8866,3	5882,4	2983,9	584,9	2399,0	455,4	2139,6	-196,0
<b>Food Industries</b>	Public	28173,5	21427,9	6745,6	1482,2	5263,4	617,9	4206,7	438,8
	Privé	18514,0	13673,0	4841,0	50,5	4790,5	506,8	694,4	3589,3
	Total	46687,5	35100,9	11586,6	1532,7	10053,9	1124,7	4901,1	4028,1
<b>Textiles, Garments</b>	Public	5857,2	2803,9	3053,3	853,8	2199,5	216,2	2252,1	-268,8
	Privé	6800,3	3431,6	3368,7	42,0	3326,7	1181,8	1167,3	977,6
	Total	12657,5	6235,5	6422,0	895,8	5526,2	1398,0	3419,4	708,8
<b>Leather &amp; Shoes</b>	Public	2072,6	1171,0	901,6	81,5	820,1	59,9	604,0	156,2
	Privé	956,5	544,2	412,3	24,8	387,5	71,7	177,3	138,5
	Total	3029,1	1715,2	1313,9	106,3	1207,6	131,6	781,3	294,7
<b>Wood, Paper, Cardb.</b>	Public	5219,2	2824,2	2395,0	599,3	1795,7	324,2	1836,6	-365,1
	Privé	1665,5	862,9	802,6	22,9	779,7	195,7	310,4	273,6
	Total	6884,7	3687,1	3197,6	622,2	2575,4	519,9	2147,0	-91,5
<b>Various Industries</b>	Public	1481,5	749,8	731,7	78,5	653,2	87,4	531,3	34,5
	Privé	1416,5	807,3	609,2	66,4	542,8	125,4	155,3	262,1
	Total	2898,0	1557,1	1340,9	144,9	1196,0	212,8	686,6	296,6
<b>Transport &amp; Communications</b>	Public	18687,5	6837,7	11849,8	1989,0	9860,8	1303,4	8890,7	-333,3
	Privé	13129,3	3677,8	9451,5	1017,3	8434,2	446,0	166,2	7822,0
	Total	31816,8	10515,5	21301,3	3006,3	18295,0	1749,4	9056,9	7488,7
<b>Commerce</b>	Public	18934,0	6159,8	12774,2	1307,9	11466,3	918,9	7653,1	2894,3
	Privé	50470,5	7437,4	43033,1	1309,5	41723,6	2717,4	1791,4	37214,8
	Total	69404,5	13597,2	55807,3	2617,4	53189,9	3636,3	9444,5	40109,1
<b>Hotels, Cafés, Rest.</b>	Public	1016,9	176,2	840,7	152,0	688,7	164,2	443,4	81,1
	Privé	6636,5	1851,8	4784,7	114,7	4670,0	642,7	1196,0	2831,3
	Total	7653,4	2028,0	5625,4	266,7	5358,7	806,9	1639,4	2912,4
<b>Services to Entreprises</b>	Public	3501,9	655,8	2846,1	220,7	2625,4	421,6	1822,3	381,5
	Privé	1870,5	420,8	1449,7	162,2	1287,5	221,2	606,3	460,0
	Total	5372,4	1076,6	4295,8	382,9	3912,9	642,8	2428,6	841,5
<b>Services to Households</b>	Public	329,5	107,9	221,6	54,1	167,5	47,3	194,9	-74,7
	Privé	8638,4	1046,7	7591,7	16,5	7575,2	491,2	1721,2	5362,8
	Total	8967,9	1154,6	7813,3	70,6	7742,7	538,5	1916,1	5288,1
<b>TOTAL</b>	Public	294789,8	119281,9	175507,9	24798,8	150709,1	33395,5	68893,7	48419,9
	Privé	209477,9	60940,8	148537,1	5397,6	143139,5	8297,1	24702,2	110140,2
	Total	504267,7	180222,7	324045,0	30196,4	293848,6	41692,6	93595,9	158560,1

Source: ONS (2001; internal database) *Abbreviations:* PB: gross production; CI: intermediate consumption; VA: value added; CFF: fixed consumption; RI: internal revenues; ILP: production related tax; RS: wages and salaries; ENE: net revenue.



Table (8.4):  
(1999)

PRODUCTION AND CONSUMPTION, PUBLIC AND PRIVATE

provisional, in m DA current prices		PB	CI	VA	CFF	RI	ILP	RS	ENE
<b>Agriculture</b>	Public	4523,4	3084,9	1438,5	1248,8	189,7	100,4	571,0	-481,7
	Privé	411730,1	74934,9	336795,3	117,1	336678,2	296,6	47047,9	289333,7
	<b>Total</b>	416253,6	78019,8	338233,8	1365,9	336867,9	397,0	47618,9	288852,0
<b>Water &amp; Energy</b>	Public	64212,0	24174,8	40037,2	7568,6	32468,7	1780,4	11952,0	18736,3
	Privé	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0
	<b>Total</b>	64212,0	24174,8	40037,2	7568,6	32468,7	1780,4	11952,0	18736,3
<b>Hydrocarbons</b>	Public	1304939,3	458849,3	846090,0	93107,2	752982,8	203024,7	27264,3	522693,7
	Privé	58875,5	14022,1	44853,3	18599,9	26253,4	8966,0	133,9	17153,5
	<b>Total</b>	1363814,8	472871,5	890943,3	111707,1	779236,2	211990,7	27398,2	539847,3
<b>Oil-Related Services and Works</b>	Public	67222,8	30804,9	36417,9	12467,2	23950,6	2191,1	16496,8	5262,7
	Privé	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0
	<b>Total</b>	67222,8	30804,9	36417,9	12467,2	23950,6	2191,1	16496,8	5262,7
<b>Mines &amp; Carriers</b>	Public	7595,6	3112,4	4483,2	808,0	3675,2	273,0	2755,3	646,8
	Privé	522,0	294,5	227,4	39,4	188,0	8,6	74,9	104,5
	<b>Total</b>	8117,6	3406,9	4710,7	847,5	3863,2	281,6	2830,2	751,3
<b>I.S.M.M.E</b>	Public	81735,5	51724,7	30010,8	20933,0	9077,8	2639,1	23734,8	-17296,1
	Privé	4990,0	2405,6	2584,4	135,2	2449,2	224,8	1308,5	915,9
	<b>Total</b>	86725,5	54130,3	32595,2	21068,3	11527,0	2863,9	25043,3	-16380,2
<b>Construction Materials</b>	Public	29983,6	11550,1	18433,5	5103,3	13330,3	999,5	8395,8	3935,0
	Privé	11818,1	4986,2	6831,9	642,1	6189,8	691,3	3273,9	2224,7
	<b>Total</b>	41801,7	16536,3	25265,5	5745,4	19520,1	1690,8	11669,7	6159,6
<b>Construction</b>	Public	132133,7	45407,7	86726,0	12329,5	74396,4	6571,4	71788,7	-3963,6
	Privé	373087,1	188555,4	184531,7	6238,3	178293,4	12218,2	72117,6	93957,6
	<b>Total</b>	505220,8	233963,1	271257,7	18567,9	252689,8	18789,6	143906,3	89993,9
<b>Chemical, Plastics</b>	Public	33295,3	17297,4	15997,8	4433,7	11564,2	669,5	6195,3	4699,4
	Privé	9468,9	5723,6	3745,3	512,9	3232,5	339,8	1783,8	1108,9
	<b>Total</b>	42764,2	23021,0	19743,2	4946,5	14796,7	1009,3	7979,1	5808,2
<b>Food Industries</b>	Public	162387,8	130039,0	32348,9	6641,6	25707,2	4514,3	14947,1	6245,8
	Privé	273376,2	209639,4	63736,8	862,9	62873,9	1438,8	14630,5	46804,6
	<b>Total</b>	435764,0	339678,4	96085,7	7504,5	88581,1	5953,1	29577,6	53050,4
<b>Textiles, Garments</b>	Public	9198,6	6509,5	2689,1	2068,9	620,2	350,5	4253,0	-3983,3
	Privé	29475,0	22173,9	7301,2	201,3	7099,8	822,1	2315,8	3962,0
	<b>Total</b>	38673,6	28683,3	9990,3	2270,2	7720,1	1172,6	6568,8	-21,3
<b>Leather &amp; Shoes</b>	Public	2681,7	1755,3	926,4	291,8	634,6	75,7	936,1	-377,2
	Privé	2932,2	1676,7	1255,5	41,9	1213,6	71,6	340,7	801,3
	<b>Total</b>	5613,9	3432,0	2181,9	333,7	1848,3	147,3	1276,9	424,1
<b>Wood, Paper, Cardb.</b>	Public	14979,0	8736,3	6242,6	1271,2	4971,4	341,8	3264,4	1365,1
	Privé	8678,5	4798,0	3880,5	79,4	3801,1	582,8	1949,9	1268,4
	<b>Total</b>	23657,5	13534,3	10123,2	1350,7	8772,5	924,6	5214,3	2633,6
<b>Various Industries</b>	Public	33981,3	5526,0	28455,3	187,3	28268,0	458,2	2043,9	25765,9
	Privé	2278,7	1094,4	1184,3	151,4	1032,9	127,5	500,6	404,7
	<b>Total</b>	36260,0	6620,4	29639,6	338,7	29300,9	585,7	2544,5	26170,7
<b>Transport &amp; Communications</b>	Public	104575,4	39716,4	64859,0	6394,6	58464,3	2238,8	25785,9	30439,6
	Privé	269055,0	95058,0	173997,0	24772,0	149225,0	8249,0	25058,0	115918,0
	<b>Total</b>	373630,4	134774,4	238856,0	31166,6	207689,3	10487,8	50843,9	146357,6
<b>Commerce</b>	Public	15217,0	3173,9	12043,1	2463,7	9579,4	1818,6	9013,6	-1252,8
	Privé	476978,3	82714,2	394264,1	19012,0	375252,1	44157,6	22926,5	308168,0
	<b>Total</b>	492195,3	85888,1	406307,2	21475,7	384831,5	45976,2	31940,1	306915,2
<b>Hotels, Cafés, Restau.</b>	Public	7097,3	2894,3	4203,0	2126,2	2076,8	321,4	2417,5	-662,1
	Privé	53355,7	11174,1	42181,6	1282,2	40899,4	4157,7	7204,6	29537,1
	<b>Total</b>	60453,0	14068,4	46384,6	3408,4	42976,2	4479,1	9622,1	28875,0
<b>Services to Entreprises</b>	Public	12678,4	3929,5	8748,9	1575,8	7173,1	620,7	6063,2	489,2
	Privé	20514,0	3883,6	16630,4	1335,7	15294,7	820,7	5042,6	9431,4
	<b>Total</b>	33192,4	7813,1	25379,3	2911,5	22467,8	1441,4	11105,8	9920,6
<b>Services to Households</b>	Public	1473,8	912,1	561,7	200,0	361,7	61,5	784,8	-484,5
	Privé	590605,8	7896,3	51169,5	407,7	50761,8	1843,7	10916,5	38001,5
	<b>Total</b>	60539,6	8808,4	51731,2	607,7	51123,5	1905,2	11701,3	37517,0
<b>TOTAL</b>	Public	2089911,5	849198,5	1240713,0	181220,5	1059492,5	229050,4	238663,8	591778,3
	Privé	2066201,3	731030,8	1335170,4	74431,6	1260738,8	85016,8	216626,2	959095,8
	<b>Total</b>	4156112,7	1580229,4	2575883,4	255652,1	2320231,3	314067,2	455290,0	1550874,1

First, one factor affecting the relatively better performance of the public sector in 1999 is the government-initiated process of restructuring of public enterprises and the *maxime* to operate on a commercial basis. The fact that credit ceilings for loans were imposed on the commercial banks for loans to public sector enterprises plays a certain role in this respect. Second, the said process of restructuring with the aim at ultimately either privatizing or liquidating SOEs has already triggered some results by the end of the decade so that performance compared to before must have ameliorated at least to some degree. And third, up to 2000, roughly 450,000 workers from the public sector had lost their jobs because of the liquidation of SOEs, which of course signifies an advantage for the performance in terms of less costs for wages and salaries. This is, in fact, one of the items where the cross-time comparison between the above two tables (8.3) and (8.4) demonstrates the structural shifts between public and private enterprise most tellingly: While in 1989, the state paid 73.6 percent of all wages, this share decreased to roughly half of the entire amount ten years later. While that is still much in absolute terms and in comparison with other developing nations, it nevertheless represents a clear downward development of more than 20 percent in relative terms and in comparison with private salaries. Of course, it should be noted that laid off workers are not the only reason for this trend, since private sector wages have, over the decade, been galloping away from those paid in the public sector, but nevertheless, the trend is there.

The question is: How does this large public sector look like, and how is reform – if at all – feasible? The Algerian public enterprise sector, before the current era of reform, was characterized by a dual organizational structure that distinguished smaller public enterprises on a local level (*entreprises publiques locales* or EPL) from larger public sector enterprises (*entreprises publiques économiques* or EPE) (see figure [8.1] below). These were administratively supervised by the so-called *fonds de participations* which were, in their turn, subordinated to a National Council of State Participation (*conseil national des participations d'état*, CNPE) under the umbrella of the Ministry of Industrial Restructuring and Participation (renamed in 1999 to read: Ministry of Participation and Coordination of Reforms), the Ministry of Industry and other ministries concerned (Belhimer 1998: 245-73; here: 257).

When public sector reform started in 1994, the Algerian government followed a similar strategy as did the Egypt in first of all granting – at least *de jure* – autonomy to the enterprises and subsuming them under initially eleven newly created holding companies which replaced the *fonds de participations*. These holdings were, like in Egypt, formed according to the respective sectors of the economic activity of the SOEs.<sup>6</sup> Later on, the number of holdings was reduced, to five and finally, in late 2001, they were ultimately abolished.<sup>7</sup> Various suggestions were made to reform the sector and enhance performance,

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<sup>6</sup> The number of these holdings was later reduced. At the time of writing there were only five holdings left.

<sup>7</sup> According to a plan initially elaborated by Hamid Temmar, who had already left his post as minister in charge of privatization when his plan was executed under the new incumbent, Nouredin Boukrouh. Temmar's

ranging from an opening of the capital of the holding companies to large-scale full privatization (cf. CNES 1995). It was in June 1996 that the first list of enterprises that could be privatized appeared, set up by the investment agency APSI, and including 141 units in five sectors, with the majority of 59 being industrial companies, followed by some 40 commercial enterprises. However, this list was not to remain topical for long. While no exact figures and overall results are available due to the utterly intransparent process of documentation, the following figure (8.1) tries to give a rough overview of the results of Algeria’s privatization process to date. Figures in brackets show the number of establishments and their fate.

*Figure (8.1): PUBLIC SECTOR STRUCTURE AND PRIVATIZATION RESULTS, 2001/-02*

<b>Ministry of Participation and Coordination of the Reforms</b>				
	<u>Results of the Reform Process</u>			
<u>Organizations</u>	1996	2000/-01	2002	
<b>Holding Companies</b>	[11] =>	[5] =>	0	
<b>Entreprises Publiques Economiques (EPE)</b> stakes	[411]	[???] sales of [76] liquidated		
<b>Entreprises Publiques Locales (EPL)</b>	[1,324]	[935] liquidated [61] EBOs		

*Source:* Werenfels (2002: 8ff.); Algeria-Interface; CNES (1995: 7); *Le Quotidien d’Oran* (29.05.2001)

The process of the Algerian regime’s efforts at privatization is hard to assess accurately. Regarding the smaller EPLs, as Dillman (2000b: 83) and Werenfels (2002: 9) agree, there is confusion over how many of these have actually been sold – and who the respective buyers were. According to information from the Ministry of Industry and Werenfels(2002), 935 of the EPLs seem to have been liquidated officially. This number includes both industrial and non-industrial enterprises. If that figure was correct, a total of more than 70 percent of the smaller SOEs no longer exist. Of the remaining 123 industrial enterprises, 61 have been sold to the companies’ employees through employee buy-outs (EBOs). However, there was evidence in the local media that at least the assets of a portion of those EPLs that were officially liquidated had later been sold or just been transferred to private beneficiaries (Werenfels 2002: 9), but it is impossible to estimate the magnitude of such procedures. Whether illegal or not, the tendency that public monopolies were substituted for by private

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leave, however, proved to have been only a temporary one: In 2001, he left to become minister of commerce, but after some months only, he was back at the head of ‘his’ office.

ones was obvious in areas such as land transport. In essence, it can be assumed that the *official* number of liquidated EPLs is higher than the actual number which effectively stopped all operations. At any rate, more than three quarters of the formerly huge network of smaller local public enterprises is either liquidated or no longer under the control of the state, which certainly does signify a change in the *structure* of the national economy. However, their impact on economic *performance* on a national level was not huge: Their total debt stock had amounted to 34 bn DA in 1998 (ca. 525 m US-\$ at the time; Tlemçani 1999: 101), and their privatization ‘did not represent a great financial stake’ for the government since they seemed to be bound for a ‘natural death’ anyway (ibid; 102).

A much more controversial issue was the privatization of the larger *entreprises nationales économiques* which often were giant dinosaurs that controlled numerous subsidiaries. Privatization plans had several times been announced – and also been revoked or not been executed. Up to the time of writing, not a single majority sale of any of the EPEs had taken place, despite the fact that both the World Bank and the IMF repeatedly urged the government that this would confer a huge amount of credibility to the entire reform process. There are several alternative, in part competing, explanations for this.

The first explanation concerns organizational structures: As Werenfels (2002: 8) noted, ‘decision-making structures have remained opaque and arbitrary to date. It is, for instance, not clear which of the [...] agencies is entitled to officiate the transfer of a property to private interests. Moreover, administrative procedures, such as the evaluation of an enterprise are lengthy, complicated and inefficient.’ (cf. also Tlemçani 1999: 99). In fact, apart from the ministry of participation (de facto the ‘privatization ministry’) headed, at the time of writing, by Hamid Temmar, there is also the Investment Authority (*APSI*, renamed *ANDI* in late 2001; see the next section for details) which is supervised directly by the Prime Minister. Apart from those, the conseil national des participations, the holdings as well as the frequent changes introduced into the administrative framework operating toward privatization made a transparent process virtually impossible. Second, resistance to privatization from societal forces has, as is common, invoked as a factor delaying the process. However, even the Algerian UGTA, the most important syndicate, has not kept the regime from liquidating, within an extremely short span of time, roughly 1,000 enterprises, so that a large question mark must be made behind such efforts at explaining delays and the lack of even a single majority sale of an EPE. It seems implausible that while the unions could not obstruct the sale or liquidation of the smaller EPL units they would be capable of stopping the regime from privatizing the larger enterprises, especially in the light of the UGTA’s impact on economic policy making having greatly decreased in general over the decade. Also, remnants of socialist ideology being so widespread among the population that the regime would not dare selling the ‘peoples’ property’ can hardly be said to account for the slow privatization process. While such attitudes may exist in some parts of the population, these are certainly not the attitudes of those who rule the country.

An alternative, very plausible explanation that is at the same time a very specific Algerian one is put forth by Werenfels and links two of her findings: first, the fact that (a) ‘Overall it can be said that the Algerian bourgeoisie [...] is not interested in buying enterprises at market prices’ (2002: 16). Second, while during the nominally socialist period SOEs had a monopoly on imports of the goods in their respective sectors, this situation changed with trade liberalization that occurred simultaneously with the civil war. In that context, several private individuals and ‘*emirs*’ of (Islamist) armed groups had managed to create similar monopolies in certain niches, thereby creating parallel structures and private import monopolies. As Werenfels (2002: 13) writes, ‘trade liberalization simply moved import monopolies from industrial SOEs to oligopolies of private importers close to the army or, in some cases, belonging to the armed groups’. In that case, if there is no interest to buy factories at market value, and if privatization might enhance management, productivity and output and thereby seriously threaten existing import monopolies secured by either armed social groups or army officers or their clients, what comes next? Violence, suggests Werenfels: According to her reading of Algerian politics, high army representatives might have coalesced with armed social groups who carried out attacks on public enterprises (which were then ascribed to militant Islamist groups), with the result that such firms no longer posed a threat to the import monopolies / oligopolies from which a very particular group of entrepreneurs and their patrons benefited enormously. She has ‘little doubt that under the current circumstances import monopolies/oligopolies are a better source of rents for state elites than manufacturing, and that those profiting from such rents have no interest in enterprises being efficient and endangering the import sector – a sector which has been growing rapidly’ (ibid.).<sup>8</sup>

Into the political arena, such constellations translate into contradictory policies, rapidly changing legislation and personnel and insecure political outcomes. Hamid Temmar, for instance, is officially in charge and is clearly an appointee of president Bouteflika. However, ‘the sensitive issue of exactly what his department’s mandate is supposed to be has led to some hard talking’ (*Algeria-Interface*, 08.02.2000). Both Temmar and Bouteflika sought for the tasks associated with the privatization process to be united within one institution only, but ‘the army ... takes a dim view on Bouteflika’s advocacy of a single decision-making body, suspecting him of using it to serve his own ends through his close ties with Hamid Temmar and Finance Minister Abdellatif Benhachenhou’ (ibid.).

Things might even have aggravated in 2002 and 2003 which brought back to the Prime Ministry Ahmed Ouyahia who had already occupied that post in the mid- to late 1990s, and who is known to be favored by several influential representatives of the military. Another figure of this faction, Ahmed Tibaoui, was head of the CNEP (the national body which formerly was in charge of the holding companies) even beyond the end of the 1990s and into the new millenium. During the late 1990s, for instance, this latter had monopolized all

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<sup>8</sup> This author’s own conversations with entrepreneurs, with former officials of the customs, and with a former

negotiations with the directors of major foreign businesses who were interested in investing in public sector enterprises, until Temmar, now in the privatization ministry, seized his opportunity and met with a 90 member delegation of the French employers association in spring 2000, demonstrating thereby that he was the official contact for major foreign companies' directors (ibid.).

In the legislative sphere, the introduction of new laws or the amendment of old ones had been stalled over the late 1990s in the privatization sphere as well as in the banking sector, where even the IMF had urged the regime to act; needless to say: 'concrete measures against corruption have been ruled out' as well (*Algeria-Interface*, 17.01.2000).

While many political and power-related fights continued when this was written, the economic fight one for more productive investments seems to have been forgotten over those which are obviously considered of more vital interest to many of those who determine political and economic outcomes.

In sum, therefore, the privatization process 'à l'algérienne' is a highly opaque matter, and it is not sure whether inquiring too deeply into that process might not be too dangerous to risk, given the fact that even academic researchers already suffer from the consequences of having done just that.<sup>9</sup> What is beyond doubt: The interests that are at stake are extremely powerful, and they are represented neither by the prime ministry, nor by the investment body or the privatization ministry. All of these formal institutions that are officially in charge of the privatization process can reasonably be assumed to be involved in intra-elite in-fights and be in line with the EU, the World Bank, the IMF and other donor institutions. However, even with those allies, the problem that the government's authority to formulate and implement policies seems severely restricted by particularistic interests becomes maybe clearer than elsewhere precisely in the privatization process.

## Private Sector Development and the Investment Climate

One might doubt, with some reason, whether it makes sense at all to inquire into the area of private sector development, given the picture painted of the national economy so far which clearly demonstrates that the Algerian economy is still much more thoroughly controlled by the state than in Jordan, and even more than in Egypt. The answer is yes, because it is here that developments can be observed which take off from a very low level of activity, if not zero, and where thus the impact of structural changes might be felt most – both as regards the performance of the economy and as regards the beginning of the formation of new social alliances and coalitions.

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*chef du cabinet* of the Prime Ministry suggest nothing that would contradict this argument.

<sup>9</sup> Werenfels, for instance, was denied a visa to Algeria, and this despite the fact that she had been travelling the country for weeks accompanying the Prime Minister, and was personally acquainted to some of the important generals of the Algerian army.

The problem with regard to an analysis of the private sector in Algeria is that local authorities hardly compile regular data on the sector. Available data rarely allows for historical comparison of its evolution, and were it not for the internal material of some authorities that could be obtained during field research, there would not be much to analyze. Recently, even Algeria's new minister of industry complained:

'We have the greatest problems in the world of gathering statistics from private entrepreneurs. Those rare statistics we do have are from the ANDI [the Investment Authority; O.S.]. But they only provide us with figures on *declared* investments. And there is often a rift between what has been declared and what has been implemented. I must say that the private sector has not yet attained a level of transparency that would allow it to enter into an open dialogue with the ministries' (Interview with El Hachemi Djaaboub, *Algeria-Interface*, 21.02.2003).

While the private sector was legally no longer discriminated against in financial matters since the introduction of the 1990 Law on Money and Credit (see below for details), it had to wait until October 1993 before Legislative Decree No. (93-12) on the encouragement of investments prepared the legal ground for what was aimed at enhancing the investment environment and making it more private-sector friendly. Two years later, in 1995, *APSI*, the 'Agency for the Promotion, Support, and Follow-Up of Investments' or *Agence pour la Promotion, le Soutien et le Suivi des Investissements* was created which was, from then on, responsible for the services provided to private investors. The regime realized that it had to present a 'one-stop-shop' to the investors in order to facilitate their task of getting the necessary paperwork done in order to invest. These developments coincide with a new EFF agreement with the IMF that entered into force in 1994 (for details on the historical context of that program, cf. Benbitour 1998: 81-104).

As in other countries which decided upon an overhaul of investment legislation, the Algerian law, too, offers a range of benefits such as corporate tax exemption, other tax holidays, low import tariffs of three percent only for inputs to the investment scheme, and others to the investor. These vary according to the region of the establishment, with the government giving additional incentives such as covering half (or, in some cases even all) of the infrastructural works needed for projects to be established in the South of the country.

Given the extremely precarious situation in the context of the Algerian civil war, it is not surprising that *APSI* registered a relatively limited number of private investment projects in the years when violence was at its heights between 1993 and 1996. However, the number of projects applied for has steadily risen up to the end of the decade, without any interruption in the trend (the growth rate, however, has decreased significantly in 2000). In 1999, when the '*Concorde Civile*' brokered by then new president Abdelaziz Bouteflika with the Islamists was reached which signaled an end not of the violence altogether, but a marked return to everyday life at least in the major cities, the total number of registered projects mounted to well over 12,000, rising then only slightly to over 13,000 in 2000, as table (8.5) shows.

As always, these figures mean little unless compared to actual implementation rates. Out of the 43,213 projects registered, the Investment Agency undertook a follow-up study of

ca. 22 percent of the projects (9,468 surveyed projects), which therefore can serve as a representative source for how well private projects fare once they are approved. The results of this survey indicate that less than half of those projects that had been registered were either fully or partially implemented (48 percent), while eleven percent had been officially canceled. Of the total capital outlays envisaged, only 30 percent had actually been spent, while an amazing 62 percent of projected jobs had – according to APSI - actually been created, with an average of 34 salaried persons per project and average project costs of roughly 80 m DA (ca. one m US-\$ at the time).<sup>10</sup> Calculating all figures together, the overall average implementation rate among the projects surveyed was 44 percent.<sup>11</sup>

*Table (8.5): PRIVATE INVESTMENT PROJECTS REGISTERED WITH APSI (1993-2000)*

<b>Year</b>	<b>No. of Projects</b>	<b>%</b>	<b>No. of Jobs</b>	<b>%</b>	<b>Capital (in bn AD)</b>	<b>%</b>
<b>1993/1994</b>	694	02	59,606	04	114	03
<b>1995</b>	834	02	73,818	05	219	07
<b>1996</b>	2075	05	127,849	08	178	05
<b>1997</b>	4989	12	266,761	17	438	13
<b>1998</b>	9144	21	388,702	24	912	27
<b>1999</b>	12,372	29	351,986	22	685	20
<b>2000</b>	13,105	30	336,169	21	798	24
<b>Total</b>	<b>43,213</b>	<b>100</b>	<b>1,604,891</b>	<b>100</b>	<b>3344</b>	<b>100</b>

*Source:* unpublished APSI material (2001: 3).

Project implementation rates in Algeria are certainly not breathtakingly high, but they sound fairly reasonable, given the fact that the survey was conducted in January 2001 and included projects registered up to 31 December 2000, implementation of which could not possibly have begun. In fact, looking at implementation rates, and adding to that the difficult situation during the years when the civil war had been raging and project implementation was hampered by the precarious security situation, implementation rates could even be assumed to compare favorably with those of Jordan - given the fact that the follow-up process in Jordan is highly intransparent and there seems to be no accurate account of real figures. Moreover, the follow-up process in the Kingdom obviously suffers from a problem of overlapping responsibilities within the registration process itself between the Investment Board, the Ministry of Industry, and the Prime Ministry in the Kingdom. But there are also a number of explanatory factors behind that comparison which flatters the Algerian private sector's

<sup>10</sup> The question remains, though, whether the employment created during the establishment of a project turns into permanent jobs or not. Figures from other countries indicate that not all of the declared employment opportunities actually persist over time (Schlumberger 1998: 48-63).

<sup>11</sup> Data are taken from unpublished material of the internal ASPI database (print-out); author's interview with APSI's director general, Algiers, April 2001.



performance and that of government policies at encouraging private investments more than reality does, and which explain the relative ‘success.’

For instance, the average size of project leaves no doubt that larger ones are the exception. It must be noted that less than ten percent of the projects have a portfolio of over 150 m DA; more than 80 percent have envisaged investment costs of less than 50 m DA (or ca. 625,000 US-\$), with 60 percent remaining at total investment costs of below 20 m DA (or ca. 250,000 US-\$) per project. That indicates clearly that small- and micro-scale projects dominate, which seems squarely at odds with APSI’s statement that ca. 60 percent of the total number of projects (with also 60 percent of the employment to be created and more than half of total costs) are in industry which is the most labor intensive sector. Therefore, the APSI figures must be regarded with some doubt. Ahmed Benbitour, for instance, prime minister in the late 1990s and therefore a person who should be well informed about what was going on in these years, notes in 1998 that ‘industrial restructuring is not realized; the industrial sector continues to register low production. The medium and small enterprise sector in construction, in agriculture, which was supposed to re-launch growth, job creation and solve the housing problem, has not come to the ‘*rendez vous*’ (Benbitour 1998: 103).

While this obvious contradiction is insolvable, the relatively small number of employees per project confirms the continuing pattern of Arab private sector businesses being bent towards micro, small, and medium sized entrepreneurial activities, small workshops, light industries, as well as transport and trade. As has been noted with regard to Egypt and Jordan in the previous chapters, the structure of private business is such that family-owned and run companies dominate the scene. And as must be repeated, this is a general feature of economic structures in the Arab world that can be traced back to prevalent social structures. In Morocco, for instance, more than 95 percent of all businesses are SMEs (*L’Economiste d’Algérie*, 8-14 April 2001), and the Algerian share of small enterprises with less than ten employees is not significantly lower with 93.24 % at the beginning of 2000, according to the *Caisse nationale des assurances sociales (Algeria-Interface, 2.11.2001)*, whereas the contribution of SMEs to the overall value added in the Algerian economy reached some 70 percent in 2001, compared to only 40 percent a decade earlier (*ibid.*, 14.6.2002).

Second, with regard to the macroeconomic situation and the overall performance of the economy, the relatively high number of jobs that are to be created through such private investment schemes must be seen and calculated against a background of almost half a million jobs that had been lost over the decade as a consequence of the structural adjustment program (cf. EIU 2002: 34). This obviously lessens the positive overall impact of the APSI-registered projects in terms of an alleviation of unemployment rates.

Third, no figures are available as regards real implementation rates according to economic sectors. Given other MENA countries’ experience, this is crucial because implementation rates tend to be significantly lower in manufacturing; here, long-term investment is needed, and given the poor development of the banking sector in countries like Egypt, Syria or Algeria, industrial projects are more often canceled for a lack of finance than

in the less capital intensive areas such as transport or services (cf. Schlumberger 1998: 50ff.). In effect, this means that overall implementation rates cannot just be taken as the addition of all implemented schemes, but has to be split up according to sectors of activity and calculate their impact on employment. In this light, the official figure of 62 percent of actually implemented jobs (in relation to those planned) appears rather unlikely.

Fourth, and maybe most strikingly: The legislation regarding investment in Algeria, at least up to the time of writing and in the period examined here, was open to investment from both private and public sectors. And while the *number* of public projects registered [123] was marginal in 2000 (there is no public/private breakdown for other years), their size in terms of capital to be invested was not: The 123 registered projects for 2000 represented only one percent of the number of projects, but 19 percent of the capital to be invested [148,811 m DA] (APSI 2001: 13). To this, one must add the six mixed projects, that is: joint public-private partnerships. These projects account for another percent of total investment. In short, that means that in effect, more than every fifth Dinar invested in the frame of a legislation established for attracting private capital to be invested into the fledgling economy comes, in fact, again from public coffers.<sup>12</sup>

As concerns the picture portrayed towards the external business world, APSI's strategies seem to bear limited success, too: Less than one percent of all projects involved a foreign partner (397 projects). Apparently, investment in Algeria, at least outside the hydrocarbons sector, is still perceived as an adventure not too many are ready to embark on – unless they are safe and secure through possibly high-profile political backing by key figures from the regime, including the military (see the section below on banking for examples).

This fact matches with the general picture of the Algerian economy painted so far, where the state still holds the majority of assets and retains control over the economic process as a whole much more tightly than even in Egypt. As a local bi-weekly paper asks in this context:

‘At a moment in time when our ministers in charge of the national economy repeat it time and again that we are heading towards a liberal, open economy of competition, the *Services du Chef du Gouvernement* announce an economic conference to be held that unites public and private enterprises with the aim of “seeing what they can do together in order to lead the economy out of the crisis.” Is this the contestation, competition and economic emulation so vital for a liberal economy?’ (*L'Economiste d'Algérie*, 8-14 April 2001: 21).

One aspect in the government's decision, in August 2001, certainly was to change that image of a camouflage authority for the continuation of public subsidies, and the entire investment promotion legislation was again revised. In that context, APSI was renamed ANDI (*Agence nationale de développement des investissements*), providing aid to projects that are still in a planning phase in order to ensure higher rates of viable projects. Looking at the legislative

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<sup>12</sup> I said here that more than 20 % of capital invested are public moneys because one would, to the 20 % actively invested, have to add those resources the state provides in granting tax holidays and other incentives which is non-negligible, even though it also is not numerically measurable. Overall, one could therefore reckon with a 25 % share of the state in the project costs registered with the Algerian Investment Authority APSI.

changes, it can safely be assumed that real implementation rates did not figure as high as proclaimed by APSI at the time.

However, when looking at Algeria's private sector, there *are* figures that catch observers' attention and who very obviously operate highly successfully in this tricky market. One of these large private tycoons who managed to create huge private business empires within some very few years only is Rafiq Abdelmoumin Khalifa. He was so successful that the Algerian public joked they had only overcome the Caliphate (in Arabic: *khalifa*) to fall prey to another 'Khalifa.' In 1998, he created his own bank (*Khalifa Bank*), but he also ran his own airline (*Khalifa Airways*), and bought and operated TV stations (*ANN, K-TV*).<sup>13</sup> But this 'golden boy', as local media called him, was also active in car rentals (*Khalifa Rent*), in Pharmaceuticals (*Khalifa Pharma*), as well as in construction, a sector in which he had envisaged to build the never realized 'ville nouvelle' (New City) on the doors of Algiers.<sup>14</sup> While nobody knew precisely where the fortune came from that enabled Khalifa, apart from the activities listed here, to also buy shares in several other ventures, such as a 28 percent stake in the *Société Générale d'Algérie* bank (see below). Of course, such quick careers give rise to speculations. In Algeria, some suspected that he might have had access to part of the FLN's 'trésor de guerre', especially since his father Laroussi was in charge of the Algerian secret services. Others mention rich friends from Gulf countries, whereas yet others call his empire 'the greatest machine for laundering the generals' dirty money'.<sup>15</sup> This third explanation seems to come close to what reality might look like since it is most compatible with events as they unfolded most spectacularly between 2001 and spring 2003, resulting in the collapse of the entire *Khalifa Group* (see the next section for details).

However, Khalifa is not the only private sector representative in Algeria to tell a success story (although certainly the only one to have experienced success and failure of that magnitude in less than a decade). It is estimated that large private fortunes are amassed essentially by some fifteen to twenty entrepreneurs. Prominently among these figure, for instance, Issad Rebrab (with an estimated wealth of some 400 million Euros), who, among many other activities such as concessions in cars, the media, and metal industries, is the head of the *Cévitel Group* of companies which produces, i.a., vegetable oil and was the first private competitor to the public sector in this domain after the former state monopolist ENCG (*Entreprise nationale des corps gras*) had refused his offer of a joint venture.<sup>16</sup> Others include

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<sup>13</sup> Interestingly, *ANN* was bought by Khalifa from Rif'at al-Asad, younger brother of the late Syrian President Hafez al-Asad. It might be by accident that Algerian President Bouteflika entertained, for years, close friendly relations with Rif'at who is today based in London after his vain effort to overthrow his brother at the Syrian presidency in the early 1990s.

<sup>14</sup> Khalifa also bought the bankrupt German *Philipp Holzmann AG* after the German chancellor had personally intervened in order to save the jobs at *Holzmann* which were in danger because of the German patrons bankruptcy.

<sup>15</sup> Author's interviews, various correspondents, Algiers, March and April 2001.

<sup>16</sup> If allegations of the local daily *El-Khabar* in spring 2003 were correct, stating that Rebrab could evade due taxation in the range of two billion DA grace to the help of a military aide [quoted by *Algeria-Interface*, 08.05.2003], then the Rebrab fortune might actually be worth more than the estimations given above. It is

businessmen like Mustapha Aït Adjedou (mainly pharmaceutical labs), Hadjas Brahim of the *Union Bank*, real estate broker Mohammad Sahraoui, Mahfoud Belhadj in the transport sector, Mohammed Bouteldja (automobiles), Abdelkader Habchi (diamonds), or Bouteflika's *chef du protocole* Rachid Maarif.

Interestingly, Issad Rebrab too, started as an accountant and today overlooks what might be Algeria's biggest (official) private business interests, after Khalifa has been sized down and left the country. But what is more interesting, Rebrab also was the president of the FCE, the *Forum des Chefs d'Entrprises*, a new business association founded in 2000 only. Remarkable is that, in parallel to developments in Jordan, the private economic 'winners' of economic liberalization become more assertive in economic policies and demand being given a voice in the formulation and design of future strategies. While in Jordan, it is sectoral ([Int@j](#)) or age-specific groups (the *Young Entrepreneurs Association*) which bypass the old and established business associations like chambers of commerce and industry and which are known to be in line with the King's ambitions to provide a smart and modern picture of the country in the international arena, in Algeria it is size and public standing that decides over membership.

By early 2002, the FCE counted some 80 members only, with access being handled informally and quite strictly. The Forum was, according to its leaders, implicitly restricted to 'prominent members of the private sector' who were active in manufacturing or services rather than trade (cf. Boulhares 2003: 16). Apparently, the aim was to remain small in numbers in order to reduce the risk of becoming fragmented or subject to state patronage. – This seems, in itself, a rather bizarre stance, given the fact that most of Algeria's private entrepreneurs, irrespective of their size, are dependent on the continued benevolence of the *décideurs*, that is: of those with the ultimate say and control over who is granted chances of economic success. Nevertheless, this pattern of new private business actors forming parallel structures to the ones established decades ago and deeply penetrated by the regime, is a remarkable outcome of structural adjustment. Such associations usually combine only those entrepreneurs who have directly benefited from liberalization policies and wish to distance themselves from those entrepreneurs who are known and infamous within the population for their inward-looking policies and their being associated with domestic rent-seeking activities and corruption in statist economies.

This, in turn, makes them an attractive 'partner' for co-optation to liberalizing regimes who depend, in their appearance on the international scene, on private business representatives who know the language of the free market, productivity and competition – even if domestic business practices for the most part do only exceptionally have anything in common with this type of economic order. Clear candidates for gaining privileges from the regime, to the detriment of other, longer established business associations, the FCE's strategy in Algeria seems to work quite well, as can be seen from the statement's of officials who have

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currently being further expanded not only by Issaad, but also by his son Yacine who at the time of writing

come to consult the FCE and its leadership on a more and more regular basis.<sup>17</sup> Yet, however fancy and glamorous this new private sector may present itself, the policy-views they present could well date from an earlier epoch. Even the modern FCE has repeatedly called on the government not to liberalize the economy, but to raise tariff rates in order to protect them from international competition. It is not clear how these entrepreneurs manage to bring their quest in line with the government's ambitions to achieve accession to the WTO in 2004, and how this matches with the EU-association agreement Algeria has recently concluded. Such fears of competition might be an indicator that even those who consider themselves the largest, most modern, and most productive entrepreneurs of the country (at least vis-à-vis the government) might not really be ready to transform into action their own words, such as the announcement that 'business actors are willing to act together to change old rentier reflexes' (FCE vice-president Reda Hamiani as quoted by Boulhares 2003: 15).

Another important point with respect to the private sector in Algeria is that those who can raise their voices loud enough to be heard are but few. It has been said above that over 93 percent of the Algerian economy are comprised of establishments with ten or less employees. Remain 6.76 percent from which have to be subtracted all large public sector enterprises. Let's assume these are but 3 percent, then there are at most 3.5 percent of all Algerian enterprises privately run *and* employ more than ten people. Consider then that those private entrepreneurs who are successful run not one, but a number of establishments, then this reduces the number of private sector actors even more.<sup>18</sup> In fact, those who do matter could almost be listed by name. While the few prosper at an extremely fast rate, often due to non-market privileges of either political nature or politically ensured and upheld monopolies, the large rest sees the bureaucracy in place and is cautious to enter into areas that are a 'domaine réservé', i.e. an area which is occupied by private entrepreneurs and their often military backers. As Ludwig (1998: 106) remarks:

'To better secure themselves against the pressure of the next generation, the military have progressively enlarged the second circle of power by incorporating further persons. These are technocrats of mainly the oil industry, top civil servants like the directors of large state-owned enterprises, and some few influential entrepreneurs whom the people call "the billionaires"' (Ludwig 1998: 106).

This quotation also demonstrates the dependence of the private sector: Those few newly enriched entrepreneurs discussed here are obviously not acting as subjects in their own

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had opened an under-license assembly line for Austrian bicycle and motor-bike producer *Puch*.

<sup>17</sup> One prominent such example was the 'Carrefour de l'Entreprise', a two-day meeting held in spring 2001 at the Algiers Sheraton, that brought together government technocrats (such as the ministers of energy (Khelil), privatization (Temmar), finance (Benhachenou) and others, plus more public sector representatives (e.g. the director generals of the public sector holding companies) on the one hand, and private business representatives such as Issaad Rebrab, Habib Yousfi, or Abderrahman Raïs Chams (as representatives of the leading business associations) on the other.

<sup>18</sup> A business survey conducted by the *Caisse nationale des assurances sociales* (CNAS) counted 159,507 employers in 1999. Take 3.5 percent of these, then divide by the average number of companies an entrepreneur controls who employs more than ten in a single one of his or her establishments, and the number of private entrepreneurs of size is at margins where areas of activity can almost be shared among them by consensus in order for each arriving at a (quasi-)monopolistic position.

right, but are being used and co-opted, as will become clear from the case of Khalifa's downfall discussed below, as the object in the hands of another, different actor.

It is questionable if, in the absence of a greatly enhanced overall performance of the economy and in the light of a dreadfully slow and inconsistent privatization process that is loaded with political infighting, as has been described above, the Algerian market can become attractive enough for more than those few dozens – if at all - who know the politico-economic landscape well through their personal relationships to power-holders and who know how best to avoid the pitfalls of stepping on important peoples' toes in one's own economic activities.

On the other hand, there have been some larger investments from well-renowned foreign companies in Algeria, mostly in joint-ventures with public enterprises. The gate-opener for such schemes was an alliance by Germany's *Henkel* with ENAD, the state-owned *Entreprise national algérienne des détergents*, but others, such as the public sector pharmaceutical enterprise Saïdal which entered into a partnership with *GPE*, a European consortium, and produces under license for *Glaxo – Smithkline Beecham*, another one of Saïdal's partners, apart from *Shering-Plough* and a wide range of yet others, were quick to follow. However, long-term productive investment occurs, as a rule, only if profits are guaranteed politically. Such opportunities, outside from buying minority shares of large public enterprises, is virtually restricted to the hydrocarbons sector where *Sonatrach* regularly enters into large-scale joint production agreements with foreign companies, and, secondly, one-shot investment schemes such as the sale of GSM licenses to foreign companies.<sup>19</sup> Other than that, investment of foreign companies is mostly limited to buying minority stakes in public enterprises or else in setting up representative offices to serve the local market, which is the case, for instance, with automobile companies such as *Renault*, *Peugeot* or *Hyundai*. On the whole, foreign activity in the Algerian market remains very limited.

This limited foreign interest can be explained: Algeria's attractiveness to FDI has, first of all, suffered over the 1990s by the cruelties of the civil war. With the renewal of conflict between the regime and the Berber minority of Kabylia in 2001/-02, and the continuation of Islamist violence outside the city of Algiers, the security situation is a major disincentive to direct investment in the country. But the question is whether the picture would look very much better if the violence had not been there or of a lesser scale. As ever more evidence accumulates that the Algerian military parts of the '*pourvoir*' find it highly functional to maintain a certain level of violence and insecurity in order to justify their continued control and continuous influence over Algerian political *and* economic outcomes, and as a number of newly established private clients benefit grossly from that circumstance, the question whether economic development is a concern that takes priority, for Algeria's secretive rulers, over possibilities of quick private enrichment or the maintenance and extension of patronage networks, seems almost unnecessary to answer. Certainly, the top generals and officers who constitute what is called '*le pouvoir*' in that kafkaësk way, as well as their clients from

private entrepreneurial circles, live well and prosper through a range of semi- and illegal economic activities and privileges, many of which would be difficult to maintain if market economic reform policies were implemented stringently.

Therefore, while the army certainly does have their internal quarrels and conflicts of interest between its various factions, including a conflict of generations, the fact remains that, for the time being, that the regime’s top political goal is regime maintenance rather than to create brighter long-term prospects for economic performance and an alleviation to the unsustainable situation of large parts of the country’s population. In such an environment, it is no wonder that FDI remain a rare exception and do not keep pace with the development of direct investments elsewhere in the region, let alone in other parts of the developing world, as table (8.6) suggests.

*Table (8.6):* DIRECT INVESTMENT IN ALGERIA, 1995-2000 (IN M US-\$)

	1995	1996	1997	1998	1999	2000
Net direct investment	0	270	260	500	460	420

*Source:* EIU (2002: 66); IMF (2000b: 84).

The possibilities of acquiring wealth privately have grown with the liberalization process (cf. Werenfels 2002; Dillman 2000b), which should be expected to trigger a rise in FDI. But the avenues through which private use of *public* resources can be made have also changed and diversified and become more difficult to discern through a quickly shifting pace of inconsistently implemented reforms. Therefore, it seems to be not mere speculations when ordinary people ask about the large private entrepreneurs: ‘who is his general?’ In fact, much speaks in favor of the assumption that large-scale private business success, especially in areas where the state once held monopolies which were abolished in the course of liberalization, is regularly owed to political guarantees provided by individuals that do not usually figure on Algerian cabinet lists. It is primarily the key military decision makers, whether officially retired or belonging to a younger generation, who after a decade of structural reform retain the power to protect individual entrepreneurs from competitors, from tax obligations, and from the law in case of circumvention or illegal activities. However, the new social fabric as it begins to emerge as a consequence of structural adjustment does not or not yet appear to be consolidated. Instances such as a blown up ship in the port of Algiers are attributed by insiders not to militant Islamism, but to the militant fight for import monopolies controlled by powerful ‘import-import generals’ in areas ranging from coffee to chemicals<sup>20</sup> (Karabadji 1998).

Second, there are not only coalitions between high officers and private business, but also a growing amalgamation between the military decision-makers and private

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<sup>19</sup> No surprise, it was *Orascom Telecom Algeria* (OTA) of Egypt (more on the company above in chapter 6) who recently won the bid for Algeria’s second GSM license, at a cost of 737 m US\$.

entrepreneurial strata pushing into political bodies on the local, regional and even national level. Whether it is through the manipulation and instrumentalization of armed social groups attacking public enterprises that those who rule ‘behind the scenes’ open up their spaces for non-market gains or realize new private monopolies, as Werenfels (2002: 16–19) and others (e.g. Martinez 2000: 119ff.) have repeatedly alluded to, or if this is not the case does not matter much. The economic effect is the same in both cases, namely (a) a very fragile investment climate, and (b) the cementing of an economy which for private economic reasons and for the sake of power maintenance (in order to retain control over economic individual chances for the future) competition is ruled out more or less systematically. No price mechanism can therefore be said to be in place, and it would be an extreme surprise to find a foreign enterprise who successfully operates in the Algerian market without having invested, beforehand, in the right contacts not only to be able to set up a business, but even more so to keep it going. It is in this most lucid and forceful article that Werenfels not only demonstrates in-depth knowledge of the working mechanisms of the Algerian economy, but also analyzes them sharply on a conceptual level by writing that the current persistence of import monopolies and/or oligopolies does not only politically hinder privatization (see above), but also creates strong disincentives for foreign investors since it ‘contributes to raising the transaction costs by making the search for investors lengthy and thus costly’ (Werenfels 2002: 14).

## Banking

The banking system is the backbone of Algeria’s economic order as it takes shape in the very special course of the implementation of structural adjustment in the country. In essence, up to the late 1980s, Algeria had a banking system that operated ‘de facto as a financing instrument for public sector investment,’ with ‘virtually non-existent’ capital markets (Nashashibi et al. 1998: 29). The key actor was the treasury which mobilized savings through post office savings accounts and through development bonds that were issued to be subscribed compulsorily to by the CNEP and the state-owned insurance companies. The central bank, at the time, only played a minor role, with interest rates that were set administratively, with no relation to the market, and which soon turned negative in real terms. Public enterprises, as described above, relied on loans from the state’s five commercial banks for their investments, and with ever increasing debts, much of this loan stock turned non-performing, with the obvious repercussions on the banks themselves, and, in turn, on the treasury.

After the downturn in world oil prices in 1986 which resulted in diminished foreign exchange being available in Algeria, the non-sustainability of that system became apparent and, in 1987, the decision was taken to change the role of the treasury away from serving as

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<sup>20</sup> Author’s interviews with private entrepreneurs, Algiers, March 2001.



the economy's financier. But real watershed came in 1990 with the Law on Money and Credit which gave the central bank, renamed *Banque d'Algérie* (BA), autonomy from the ministry of finance in monetary policies by establishing the six-member Council on Money and Credit chaired by the governor of the bank, thus guaranteeing a majority from the central bank (RADP / BA 2001; see esp. arts. 85 through 96). Also, it established equal treatment of public and private enterprises in terms of access to credit, interest rates, and refinancing possibilities (from the BA). Apart from such early institutional changes, the sector remained in the state's hands, even though, in several steps from 1993 to the end of 1995, interest rates were liberalized and thereby, the incentive structure for the banks' lending practices experienced a virtual U-turn (Nashashibi 1998: 33). From now on, state-owned banks were, apart from their function as a financier for public investment by SOEs, allowed to extend credits to private business as well.

When a stand-by agreement was concluded with the IMF in 1994, these previous steps aiming at creating incentives for greater efficiency and market orientation in banks' demeanor seemed to facilitate the task of reform. However, the country's banking sector still consisted mainly of five state-owned commercial banks<sup>21</sup> plus the savings-housing bank *Caisse nationale d'épargne* (CNE), with a combined network of more than 1,000 branches. Since, the market had been opened for private participation in financial services, be they foreign or Algerian. Several private banks were attracted by this opportunity.

*Foreign* banks that wished to enter the market were extremely careful to include politically secure, influential, and economically potent local partners or stake-holders in their ventures in order to assure the political approval of their operations in the country. Such companies included big fish like *Société Générale d'Algérie* who upgraded its initial representative office to a full branch recently, and in which the French parent company owns 61 percent. Another tranche of the shares (28 percent) is held by *FIBA* of Luxembourg, a group whose chairman of the board is Ali Bennouari, a Geneva-based former Algerian minister of state at the treasury. The Bahrain-based *Arab Bank Corporation*, too, came in, managing to employ Mustafa Achour as its executive director who formerly served as director general of the state-owned *BADR* (*Banque algérienne de développement rural*). *Natexis Banque d'Algérie* saw 80 percent of its 500 m AD capital held by the French parent company and named Hocine Mouffouk, a former central bank governor, as their CEO while another ex-governor of the central bank, Abderrahmane Hadj Nacer, who also was the co-founder of Algeria's first private bank (*Union Bank*), served as the chairman. *Citibank Algeria* was the first private Western bank to set foot in the country in 1998. Here, Kamel Driss, a home-grown expert of the bank acted as the chief executive. However, Driss is also well-connected in Algeria with 'long-standing ties with Algerian state-owned energy companies *Sonatrach* and *Sonelgaz*' (*Algeria-Interface*, 22.12.1999), plus stakes in a range of private companies,

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<sup>21</sup> These were the *Banque nationale d'Algérie* (BNA), the *Banque extérieure d'Algérie* (BEA), the *Cédit populaire d'Algérie* (CPA), the *Banque algérienne de développement rural* (BADR), the *Banque de développement local* (BDL).

mostly notably in the pharmaceutical sector. *Al-Baraka*, already mentioned above, was founded in 1990 already, and had secured its political backing through a partnership between its Bahrain-based parent house and an institutional partnership with the state-owned *BADR*. These were the five foreign banks present in Algeria at the turn of the decade.<sup>22</sup> But private Algerian businessmen are also interested in taking shares in banks that are thus relatively safe against political interference. Issaad Rebrab, Salim Othmani and ElHakim Cherfaoui are shareholders in the private Ryan Bank, Arab Banking Corp. and Housing Bank, respectively. All three were hit by a new Law on Money and Credit when in December 2003 it became clear that the government, in response to a scandal lined out below, decided that banks were no longer allowed to extend loans to its own shareholders, in order to avoid the creation of ‘ad-hoc banks’ that could be created just to extend loans for projects that might not even be economically feasible.

What is remarkable: There is no single foreign bank that thinks it can safely operate without any politically well-connected shareholder or chief executive. Even then, it seems, banks are eager to have international institutions like the IFC (*International Financial Corporation*, the World Bank’s private sector development arm) on board, as does Société Générale, even though with just one percent of the shares. However, while acting extremely cautiously, nothing seems to indicate that those banks that *are* in the market do not do well.

The picture looks different when turning to private *local* banks. Of course, private Algerian businesspeople also came in to reap profits from an underdeveloped sector where public banks were no serious competitors. And ‘just as foreign banks who open shop in Algiers prefer to have the *International Finance Corporation* or the *Caisse Française du Développement* (French Development Fund) among their shareholders, so private Algerian investors need assurance’ (*Algeria-Interface*, 13.04.2000). As has already been hinted to, the first private local bank was *Union Bank*, co-founded in 1995 by Hadj Nacer (see above) and the majority shareholder (82 %), Brahim Hadjas. Another prominent example of private Algerian banking is – or rather: was – *Khalifa Bank*, owned and founded in 1997 by the same Rafiq Abdelmoumen Khalifa whose business empire has already been mentioned above. Within a short time, the bank had opened more than 130 branches and had a turnover of over 400 m. US-\$. – A prosperous development, similar to the one foreign banks took, it seems. However, serious doubts have arisen recently as to the performance and activities of private Algerian banks. On one of his own TV channels, *K-News*, Khalifa announced a turnover for the group of 1.7 bn. Euros in 2002, while the bank had 1.5 bn. US-\$ in deposits, he said.

In spring 2003, Algeria experienced what probably was the greatest scandal the country had seen ever since the start of economic reform.<sup>23</sup> In November 2002 already, *Khalifa Bank* was denied all foreign exchange transfers, before worth hundreds of millions of

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<sup>22</sup> Two other foreign banks, notably the Arab Bank (Jordan) and Ryan Bank (Qatar) were said to have plans to enter Algeria at the time of writing. Other information stems from author’s interview with senior official, Ministry of Finance, Algiers, March 2001.

<sup>23</sup> The information given below largely stems from *Algeria-Interface*.

US-\$ because those in charge were not able to provide the necessary documents for at least half of the sums of the transfers in question. In late February 2003, then, three of Khalifa's top staff were arrested upon arrival at the airport, carrying with them over two million Euros in cash – apparently trying to circumvent the blockage of foreign exchange transfers.<sup>24</sup> *Algeria Interface* quotes an unidentified source from the Ministry of Finance as saying that officials both at the Ministry and at the *Banque d'Algérie* had been informed since 2001 already, but had not reacted, alluding to the fact that, suspected of capital flight, it became known that *Khalifa Bank* had dealt with vast deposits from several large public sector enterprises and other state agencies. Apparently, these public funds included moneys from the social security system, the pensions fund, the state's housing fund, the FLN's treasury, and others more (*El-Watan*, 05. 03. 2003).

The question is at hand how second-range, non-autonomous state authorities could precipitate channeling their funds into an all-new private bank, given the legendary cautiousness and reluctance to decide in matters where decision-making competence might be located on a higher level. *Algeria Interface* concludes that 'only the green light from the *pouvoirs publics*' could explain such moves, in the light of the existence of five state-owned commercial banks and the savings-housing bank (*Algeria Interface*, 07.03.2003). Knowing further that *Khalifa Bank*'s main client and loan recipient was called *Khalifa Airways*, that might help in finding an explanation to the question why *Khalifa Bank*'s interest rates on loans were lower than those on deposits. Apparently, Larbi Belkheir, retired general and wielding immense influence as the '*directeur du cabinet*' of president Bouteflika (some say in order to control him), this *eminence grise* and in Algerian terms: one of the very few core figures of the *pouvoir*, is said to have actively sought for means to avoid the issue becoming public (*ibid.*: 13.06.2003). But this option became obsolete when the president himself, with the help of Finance Minister Benhachou, a close ally of the president who formerly had served as his economic advisor, brought the case to the public.

But the story continued: After this affair, the bank was put under supervision and an interim administrator installed who was to assess the bank, and bankruptcy soon followed, with debts of around 1.2 bn US-\$. It must be stressed that this amount does not yet include the public funds Khalifa had abused and which are estimated to be within a range of three to four billion dollars, and are likely to include the lion's share of Algeria's former public savings. Prime Minister Ahmad Ouyahia assured parliamentarians that the due judicial processes would ensue which were to discern the responsibilities of those institutions [sic. ! i.e.: that had deposited funds with *Khalifa Bank*]; however, given the fact that Ouyahia is close to the military, and to General Belkheir who plays an extremely ambiguous role in the affair, and also considering the fact that military officers are suspected to figure behind the campaign of solidarity that had been launched in favor of Khalifa before the whole extent of the scandal

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<sup>24</sup> Two of the arrested had outstanding positions in the business empire: Sami Kassa was a personal advisor to Khalifa, while Djamel Guelimi was the president of the TV station *Khalifa TV*, founded in Paris a couple of months earlier.

had become known, Ouyahia might not be the person to set too great hopes in disclosing the backgrounds of the affair.

In the light of the above, it seems not surprising that *Khalifa Bank* did not, as is required by the law, publish annual reports and statements on its numerous international transfers. ‘One cites, as an example, a desalination plant generously offered by “Moumen” to Algeria. It was estimated [to have cost] five million dollars - whereas his bank demanded [permission for] a transfer 50 m dollars’ (ibid.). At any rate, in early april, *Khalifa Air* also had to stop flights for lack of finance.<sup>25</sup> What is more, it was only through the scandal that it became know that Khalifa had, few years earlier, bought, from Ali Bennouari, so to speak, *FIBA*’s 29 percent shares in *Société Générale Algérie* – without ever declaring anything about his purchase.

Thus, here is an example of a private businessman who could, quite obviously with the consent of those who have the power to bring the central bank and the minister of finance to a halt – make a fortune through the manipulation of public assets such as the country’s pension funds, not to mention the unclear questions concerning possibilities of money-laundering that have never been clarified. It also is a clear indicator of existing and extremely strong networks between the top power-holders and their private business sector clients. Third, it is an indicator for the relative weakness of *any* private sector actor when compared to where real power lies, even if, as was the case with Khalifa, it is the economically most powerful of the country’s business community. Now, the question is: Is that affair a singular case?

In its magnitude it may be unique. The case seems also outstanding the clarity in which it makes apparent existing tightly knit informal networks with a high degree of criminal and increasingly internationalized illegal activities, and which do not only involve, but are effectively controlled by those individuals who are at the same time the top *political* decision-makers (which, as must be remembered here, is in most Arab countries likely not the government or the minister in charge). In all that, the Khalifa file might be unique. Yet, it was not long until *Union Bank*, too, was placed under the supervision of the *Banque d’Algérie*, although the reasons were somewhat different when the bank asked the *Banque d’Algérie* for a ‘help’ in the range of several dozens of millions of US-\$, attributing its gap to the ‘Khalifa effect’ that apparently numerous customers had withdrawn their deposits. Whether this is the entire story or whether co-founder Brahim Hadjas had really borrowed tens of millions, in 1995 and in order to establish the bank in which he holds more than 80 percent, from an Algerian businessman named Troudi who was, at the end of the 1990s, searched for by Interpol and Russian authorities does not change the overall picture one gains from looking at the extremely political banking sector.

Apart from these two ailing companies of which one had utterly failed, there were only two other private Algerian banks left in the sector by mid-2003. Therefore, to note that ‘the Algerian banking system essentially consists of the *Banque nationale d’Algérie* (BNA),

the *Banque extérieure d'Algérie* (BEA), the *Cédit populaire d'Algérie* (CPA), the *Banque algérienne de développement rural* (BADR), the *Banque de développement local* (BDL) and the *Caisse nationale d'épargne et de prévoyance*<sup>25</sup> (CNEP, a government savings and housing bank) was still correct at the end of the 1990s (cf. *Jeune Afrique*, No. 2032, 21-27 Dec 1999: 54). All of the named banks were still 100 percent government-owned, with privatization ruled out by the government.

As for these state-owned banks, they were seriously undercapitalized at the outset of Algeria's liberal reform program as a heritage from former lending practices, with the treasury already having broken away as a source of finance of last resort in the early 1990s. Therefore, the banks had to be recapitalized – *after* the new rules had become operational – several times since 1991, and at some times even directly through cash transfers from the treasury. In addition to that, they also benefited from substitutions of government bonds for non-performing loans to public enterprises, mainly in 1992/-3, again in 1997/-8 (IMF 2000a: 36), and most recently they were, once again, recapitalized in 2002 with yet another 1.2 billion US-\$ funneled into the system (*Algeria Interface*, 6.11.2002). This is why, in 2001, Minister of Finance Abdelatif Benhachenhou called the country's banking system 'a threat to national security' (*Algeria Interface*, 2.2.2001) – a word that in retrospect, and knowing the particularistic interests of high-ranking military figures in the sector, takes on a completely different and quite ambiguous meaning...in fact, the entire banking sector, and most of all the public sector banks, are a politically highly sensitive area in Algeria because they represent maybe *the* major channel through which public funds are 'privatized' in a – one is tempted to say – much more elaborated and most likely financially more significant, informal privatization scheme than the official one authorities discuss with the IMF and the World Bank.

In the absence of reliable data on re-financing moves as mentioned above, the IMF's staff estimates the total cost for such operations over the 1990s to have been as high as 45 percent of GDP (IMF 2000a: 36) – an extremely expensive undertaking by all standards. Where does all that money go, some might ask? The conventional reading – much like in Egypt – is that it is the poor performance of inefficient and overstaffed public sector enterprises acting as employment machines rather than as productive units which are the big drain on the state's finances. However, the case of *Khalifa Bank* already hints in a different direction, since the Khalifa Group also owed, as it turned out, money to public banks. And while the public sector as a whole is in deed outperformed by the private sector in various respects, as has been demonstrated in the above section on public sector reform, this reading of developments does not tell the whole story: Add to the Khalifa scandal discussed above another information known about the state-owned banks: While in 2000, *Algeria-Interface* stated in a relatively neutral tone: 'Though officially put down to years of shoring up cumbersome, loss-making public enterprises, the bad debt also stems from loans to well-

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<sup>25</sup> Ironically, the producer that took back seven aircraft already delivered to *Khalifa Air*, later sold them to *Air*

connected private entrepreneurs', less than two years later the agency becomes more explicit: Public banks, is now the news, are owed, 'chiefly by private companies tied to political barons' (*Algeria-Interface*, 02.02.2001), more than 4.6 bn US-\$, signifying an extremely large increase of 500 m US-\$ within half a year (cf. *Algeria Interface* 12.05.2000). And the agency goes on to state: 'The Finance Minister's hands are tied and he is reduced to appealing to the intelligence services to help recover the debt'. Another case in point is the *Banque de développement locale* (BDL): scheduled for privatization as early as 1997, nothing indicated, at the time of writing, any advancement in these plans. The bank's former manager Muhammad Malek was imprisoned over a loans deal to a private importer, while his successor resigned half a year later for not having gotten anywhere with preparing for privatization. Asks a former bank manager: 'Who'd buy shares in a bank that lends at loss to the generals' businessmen anyway?'. Answers *Algeria-Interface* (12.05.2000): 'Certainly not the generals' businessmen.'

This casts serious doubt on the conventional reading of the poor performance of public banks being a result of an inefficient public enterprise sector who lives on the banks' resources.

Algeria's banking sector is therefore still more heavily dominated and controlled by governmental players than is even Egypt's, and while the picture is currently changing, at the time of writing, foreign and domestic private banks taken together still accounted for ca. 5 percent only of assets and deposits (IMF 2000a: 36). The sector remains prone to the political interference motivated by individual private interests which have turned out to be of an extremely large scale and, at least sometimes, backed by key power-holders even though they are, needless to say, illegal. To add to the crisis, in 2001 an amendment to the 1990 Law on Money and Credit, stipulating that the *Council on Money and Credit*, responsible for formulating monetary policy, would no longer consist of seven members with a central bank majority, but instead of ten members, the additional ones being nominees of the president upon recommendation of the minister of finance. As one former presidential economic advisor noted: 'The Bank of Algeria will no longer be able to make any decision without approval from the Finance Ministry' (*Algeria-Interface*, 12.04.2001). De facto, central bank independence which was a major achievement of the 1990 Law, has thereby been abolished – a sign that international financial institutions will watch with concern, given the fact that the sector is in urgent need of reform anyhow.

## Conclusion

In conclusion, Algeria was, in comparison to both Jordan and Egypt, the latest to embark on structural adjustment. Also, its achievements are to date far from reaching the depth they have

reached in the other two countries. However, the fact that the former rentier economy did change structurally has also been demonstrated. While strong rentierist elements remain in place because of the high foreign exchange revenues generated by the hydrocarbons sector, many of those who have the power to gain wealth through their political strength have changed strategies: They created import monopolies and acted primarily as patrons for a new and increasingly private dominated clientele. The majority of smaller public enterprises have been sold or liquidated, as has a less than 50 percent, but still not negligible portion of the larger ones. Moreover, many of the larger ones have entered into partnerships with foreign companies. Private banks were allowed and legislation been put in place to encourage private investments.

On the other hand, not everything has changed: The patterns of co-optation have remained unaltered, even though the clientele has partially been exchanged. Government infights between dubious generals and high officers who profit most from the current non-market conditions on the one hand, and a handful of pro-reform advocates in the government on the other continue and have, at times, paralyzed the government's ability to conduct economic policies in both formulation and implementation. Moreover, with 'the pouvoir' coming under pressure as reform advocates turn to international institutions and organizations for help in order to speed up the pace of reform, reactions (at least seem to) have become more violent. It is clear that those who benefit today will not cede their privileges without resistance, and it seems likely that the reform process will continue to remain unpredictable, slow, and cumbersome for the foreseeable future. This, of course, impacts directly on economic performance: Transaction costs are probably higher than in the countries observed in chapters six and seven above, simply due to the fact that real power remains so closed that in many instances it cannot even be identified and therefore, the chances of economic success can not be assessed properly by economic agents. Law enforcement remains as far away as it has always been from anything that could reasonably be called the rule of law, and informal mechanisms of bargaining dominate even while the ruling coalitions have changed, excluding some of the more inflexible statist and bureaucratic parts of the former political subelites and including, in their place, several large private sector business representatives.

'The political system in place since three decades has progressively evolved towards clientelism and corruption.' (Benbitour 1998: 173) is the conclusion of somebody who was part of this system – not as an undersecretary, but as a prime minister. The fact that 'corruption is widespread and many aspects of the political economy remain opaque' (*Algeria-Interface*, 07.01.2003) is not surprising, given the stock-taking undertaken in this chapter. Quite the contrary is the case: The opacity of the Algerian political economy is a direct result of this economy being primarily a *political* economy, or, as Rex Brynen has put it in a different context: 'a *very* political economy' (Brynen 2000). Once again, the very apt terms Steve Heydemann used when he looked at Syria's political economy more than a decade ago come to mind: Similar to the time when Hafez al-Asad's regime had just introduced a new investment law, the Algerian regime's economic policies are driven by a

political rather than by an economic logic. While structural adjustment was unavoidable due to the country's vulnerability to world oil prices, the implementation of these policies has been subject not only to trade union interference, as is often said by conservatives when looking for an explanation for hesitant or lacking implementation of reforms.

Rather, the '*pouvoir*' including president Bouteflika, but most of all the clique of top military officers and generals, has adapted to the threat of vested interests becoming questioned through any market-conform implementation of adjustment policies. Therefore, '*le pouvoir*' in Algeria managed to implement reforms so selectively that the business interests of major political and economic players were not negatively affected despite the inherently destabilizing political influence of economic stabilization and adjustment. That this goes not without ruptures has become clear over the years. Contradictory privatization policies, overlapping competences, and individual scandals like the various illegal dealings of the once *pouvoir*-protected, then dumped *Khalifa* group of enterprises are just singled out instances that help in understanding how the informal clientelist system works behind the façade of formal rules and laws. As one financial official said with respect to the financial sector: 'If central bank rules were applied, much of the banking system would cease to exist.' (*Algeria-Interface*, 13.04.2000)

The closed inner circles of power keep out of the limelight and have for the most part been left out in the economic analyses written by international organizations and donor institutions alike, which renders any understanding of the principles of this type of economic order impossible. Werenfels (2002: 5) grasps precisely that point when she writes: 'What all of the [...] neoliberal concepts have in common is that they circumvent the central issue of power' – an error the consequences of which are fatal for an analysis of this sort of an 'economy of favors', as Ledeneva (1998) terms that particular kind of economic order with respect to the Russian case.

In the course of the 1990s and early 2000s, as has been said, distributional coalitions have changed in nature. In parallel to other Arab countries, it was not only in the political sphere that the ruling party's dominance was effectively broken. While parts of the statist elite saw their standing decline, others who adapted flexibly to the new policy orientations managed to remain afloat during the process of restructuring the economy – and the parallel process of reshaping of distributional coalitions. The most prominent of such personalities is probably Abdelaziz Bouteflika himself who, after losing his ministerial post in the 1970s and spending many years in exile in Geneva, returned to lead the country precisely into a new era of an adjustment-shaped political-economic order. The ministers known to be 'his' choice (i.e. not imposed on him by the '*pouvoir*', the generals, or by the necessity to pay respect to remnants of collectivist ideology and social groups such as the UGTA) are precisely those who advocate economic liberalism today: Hamid Temmar, in charge of the privatization portfolio, Chakib Khelil as Minister of Energy, and third, Minister of Finance Mourad Benhachou. These three had been nick-named by an economic magazine 'the three



musketeers' of reform at the time when they occupied the said posts simultaneously (*Economia*, April 2001: 48).

On the other hand, the president's *chef du cabinet* Larbi Belkheir is by many Algerians considered to be a watchdog who, among many other things, keeps a close eye on economic and financial politics in order to ensure that they do not harm the more shadowy business interests of the '*pouvoir*' and the '*décideurs*.' In association with large private businessmen as united, for instance, in the FCE, the generals have found allies who, unlike themselves, became lively actors on the stage of those voicing opinions on economic policy formulation. However, this does not signify, as Bouolhares (2003: )thinks, a new institutional arrangement that tends 'more towards the pluralist than to the corporatist pattern'. Rather, it stands for a trend that can be observed elsewhere in the region, too: Like in Jordan, the established business institutions were gradually made redundant by new organizations. Algerian organizations that incorporated the representatives of that old guard of inward-oriented entrepreneurs who operated within the frame of the rentier economy such as the *Confédération Algérienne des Opérateurs Economiques Algériens* (CGEA) or the *Confédération Algérienne du Patronat* (CAP) have largely disappeared from the scene.

The civilian government itself naturally realized the formation of a new collective actor while at the same time it was squeezed between international obligations towards the Bretton woods institutions on the one hand, and domestic obligations on the other, namely the narrow political leeway left to them by those *eminences grises* who allow or forbid policies to be implemented. This chapter suggests that the liberal factions within the government try to gain a minimum of autonomy from the military decision-makers in order to execute their increasingly impossible tasks. The above sections have demonstrated that it is neither the ministers nor the head of government, and even the president to a limited extent who have the power to formulate policies and, more importantly, implement them. Therefore, any study that leaves out the category of power will not be able to understand the working mechanisms of Algeria's economy. While the paper recently presented by Boulhares (2003) is empirically rich, it generously ignores this essential analytical reflection. And while Werenfels (2002; 2004) is not an economist, her contributions provide far more convincing insights into the basic logic that underlies economic policy reform - and of politics in general, for that matter, namely the question of 'who gets what when and how.'

It is, in economic policies just as well as in the domain of security, the heads of the army and the intelligence services who have the ultimate say not only in which policy will be endorsed and which will falter, but who also, through an only thinly veiled threat of the use of force or economic destruction in the case of disobedience, decide upon which individual will be economically successful and who must fail. Therefore, if Western observers and donor agencies criticize Algeria's lack of progress in transforming the vanishing rentier economy into a liberal market economy, they should be aware of the need to name those whose signature that 'failure' bears.

And again, as has already been lined out in the above chapters on Egypt and Jordan, it is incorrect to term this evolution of economic policies a ‘failure’ since it does not primarily aim at sustainable development or long-term macroeconomic growth prospects. Rather, as has been shown to be the case in both Egypt and Jordan, it is a very distinct *political* logic that determines the course of economic reform in Algeria. And this political logic of power maintenance in the wake of an externally induced inevitability of reform is not only stringent, but it is also highly *successful*. Politics and the economy in Algeria, as elsewhere in the region, are not only inseparable, but this chapter should have left no doubt about the causal arrow: Establishing a market economy while maintaining current power relations intact is impossible. Looking at the Algerian case, it seems clear that those who still advocate in the direction of ‘liberalize the economy, the political system will follow’ are fatally mistaken.

In sum, it seems hard to disagree with former British Foreign Minister Robin Cook who thought that ‘Algeria is a very sick country whose illness has not been diagnosed’ (quoted in Boulhares 2003: 14). - Except maybe that this chapter suggests a clear diagnosis.

## Chapter 9

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### ‘Sultans of Swing’ or: Still a Rentier Economy The United Arab Emirates

The United Arab Emirates in the Arab Gulf are the odd man out in this study, and they are so in more than one respect. First and foremost, they represent the ‘exception’ with respect to the concept of ‘patrimonial capitalism’ proposed in Chapter (11) below. The federation has been included as a counter-example because their case shows a number of points.

First and foremost, it is due to the abundance of mineral resources that the UAE were – as the only case discussed here - not forced to pursue structural adjustment. While this does not mean that no changes in the economy had occurred since the late 1980s, there were no externally designed and imposed structural reforms. Consequently, the central goal of this chapter is to demonstrate the economic (and political) continuity that makes the Emirates *the* ideal-typical case of an oil rentier economy that has successfully avoided systemic economic transition until today, and will most likely be able to do so for at least the mid-term future.

Second, they have retained one of the most ‘traditional’ monarchical systems of political rule world-wide; this is the form of political organization that Max Weber and, after him, Chehabi and Linz (1998: ch. 1) as well as Linz and Stepan (1996: 38ff.), have labeled ‘sultanistic’ regimes. A third specificity of the young nation of the UAE that achieved sovereignty in 1971 only is its federal organization which is unique not only on the Gulf peninsula, but in all of the otherwise highly centralized political systems of the Arab world (cf. the excellent contribution by Heard-Bey [1982] on the UAE’s nation-building process).

#### Evolution and Current Structure of the National Economy: Still a Rentier

Recently, some authors have questioned the rentier nature of the Arab Gulf states, including the UAE, on grounds that their dependence on oil and natural gas exports had considerably decreased due to the successful diversification of the economies since the concept of the ‘rentier state’ had been developed in the 1970s (Mahdavi 1970) and 1980s (mainly Beblawi & Luciani 1987). Second, it was maintained, the Gulf economies had become more and more globalized in the course of the 1990s, and this at an even quicker rate than the non-oil economies of North Africa and the Mashriq. In fact, the argument that a

diversification and an increasing internationalization of the Gulf economies has taken place can hardly be denied. This holds true not only for those countries who saw their oil output decreasing due to the rapid depletion of limited reserves (such as Bahrain), but also for the Emirati economy. Back in 1983, a ministerial publication read:

‘Industrialization is a main aim of the state for the correction of the structure of production in which the crude oil sector accounts for about two thirds of the GDP. The industrial sector, according to economic criteria, is the sector on which economic efforts should be concentrated.’ (UAE / Min. of Planning 1983: 58).

Depending on how one reads the figures, the overwhelming dominance of the oil-sector as expressed in this statement exists no longer or, at least, to a lesser degree than a quarter of a century ago. Table (9.1) shows not only a significant increase of the output of manufacturing as well as a buoyant services sector, but also a shift in the relative importance of sectors, away from mining and quarrying, since 1980.

*Table (9.1):* GDP (AT FACTOR COST) BY SECTOR, 1980 – 2000 (in m. AED at constant prices):

Sector	1980	1985	1990	1995	2000*
Agricult., livestock & fish.	827	1,440	2,056	3,550	6,720
Mining & quarrying					
Crude oil	70,532	44,707	57,632	49,200	75,620
Others	235	309	307	450	n/a
Manufacturing	4,191	9,255	9,701	12,500	24,800
Electricity & water	1,297	2,143	2,461	3,210	4,190
Construction	9,834	8,882	9,687	13,300	16,600
Wholesale, retail trade, Restaurants & hotels	9,094	8,715	11,237	17,800	26,470
Transp., storage & commun.	3,731	4,224	6,211	8,500	15,170
Finance & insurance	2,123	5,154	5,126	7,150	12,660
Real estate	4,006	5,176	6,864	11,700	17,910
Other services	814	1,645	2,467	1,640	n/a
Less imputed bank charges	(1,403)	(1,025)	(1,950)	(2,550)	(4,490)
Government services	5,989	11,001	12,968	16,320	21,500
Domestic services	200	364	499	1,200	n/a
<b>Total</b>	<b>111,470</b>	<b>101,990</b>	<b>125,266</b>	<b>143,970</b>	<b>222,980</b>
Non-oil sectors	40,938	57,283	67,634	94,770	147,360
<b>Non-oil sectors (in %)</b>	<b>36.73</b>	<b>56.17</b>	<b>53.99</b>	<b>65.83</b>	<b>66.09</b>

*Sources:* Ghanem (2001: 268); EIU (2002a); \* figures for 2000 are in current prices

The table demonstrates first of all a rapid increase of the relative weight of the services sector, including financial services and the insurance business, as well as in the tourism industry and in both wholesale and retail trade. Manufacturing output, too, rose at roughly the same pace as did services, but the balance remains clearly in favour of a thriving services sector. The latter accounts for a robust 63-64 percent of total non-oil GDP. Within services, government services grew fastest.<sup>1</sup>

At first sight, thus, the oil sector seems to have lost a significant part of its former, dominant position in the economy. However, this is misleading. First, nation-building and

<sup>1</sup> ‘Domestic services’ consists for the most part of hired migrant housekeepers who often live with the family who employs them.

‘economy-building’ coincided in the UAE more than in other Gulf oil countries such as Kuwait or Saudi-Arabia where the commercial exploitation of hydrocarbons started much earlier (in Abu Dhabi, for example, commercial oil explorations did not start before the late 1950s). Therefore, at least to some extent, the ‘diversification’ of the Emirati economy that took place since its reaching sovereignty also reflects the rather natural process of building up the range of downstream industries and industries directly related to the increased wealth (construction, banking, or services, for instance) which had been established earlier in countries where the petroleum industry has a longer history than in the Emirates.

Second, the ‘economies’ of the seven individual Emirates that together make up the federation have extremely divergent structures, which is another point in which the UAE are an exception in the Arab world, and beyond. The poorer northern Emirates (Fujairah, Ras al-Khaimah, Ajman, and Um al-Qaiwain) have virtually no mineral resources to exploit and are based in their incomes on both transfers from Abu Dhabi and on the non-oil sectors of the economy (services and manufacturing). A quick view of the relative GDPs of each of the Emirates easily demonstrates that discrepancy in relative wealth:

*Table (9.2):* GROSS DOMESTIC PRODUCT BY EMIRATE  
(AT CURRENT FACTOR COSTS, IN M. AED)

	1996		1997		1998		1999	
	m AED	%	m AED	%	m AED	%	m AED	%
<b>Abu Dhabi</b>	104,442	59.6	106,684	59.2	94,078	55.3	108,280	56.9
<b>Dubai</b>	44,883	25.7	46,556	25.8	47,419	27.9	50,941	26.7
<b>Sharjah</b>	15,501	8.9	16,091	8.9	16,808	9.9	18,250	9.6
<b>Ajman</b>	2,686	1.3	2,803	1.6	3,334	2.0	3,631	1.9
<b>Ras al-Khaimah</b>	4,547	2.6	4,694	2.6	4,772	2.8	5,272	2.8
<b>Fujairah</b>	2,321	1.3	2,413	1.3	2,569	1.5	2,882	1.5
<b>Umm al-Qaiwain</b>	1,398	0.8	1,389	0.8	1,086	0.6	1,199	0.6
<b>TOTAL UAE</b>	<b>175,778</b>	<b>100</b>	<b>180,630</b>	<b>100</b>	<b>170,066</b>	<b>100</b>	<b>190,455</b>	<b>100</b>

*Sources:* EIU (2001a: 61); Ministry of Planning.

But the four years represented in table (9.2) are not arbitrarily chosen; they do not only demonstrate the unequal distribution of wealth among the seven emirates, but – because they incorporate with 1998 a year when world oil prices reached a historical low – they also show the dependence of the Emirates’ overall economy on the oil and gas sector. Especially drastic is the picture in the case of Abu Dhabi, whose economy could not substitute for decreased oil prices. While Dubai’s economy, as well as those of all other emirates (with the exception of Umm al-Qaiwain) still grew, albeit at a slow rate, Abu Dhabi’s GDP contracted by roughly 12 percent in 1998 compared to the previous year. This impacts so strong on the federal GDP of the nation that the overall GDP also developed negatively, despite the fact that five out of seven emirates had positive growth rates. Despite all efforts at diversification, a slack in oil

prices affects the entire rentier economy of the UAE so strongly that non-oil sectors still cannot make up for losses in hydrocarbon revenues.

While Dubai's per capita GDP at the end of the twentieth century, for instance, was, with 59,372 AED significantly lower than the average per capita GDP in the federation (64,825 AED), when it comes to non-oil GDP per capita, Dubai fares a lot better than the average, with 53,913 AED (Dubai) compared to only 48,240 AED on the federal average (Govt. of Dubai 2001: 15). This shows not only that Dubai, despite the fact that oil still does play a role, has in fact come to rely far less on the oil industry than the average of the federation. Also, 'average', of course, means mainly 'Abu Dhabi' here, since oil reserves and exports in the other five emirates are marginal in the first place.

On the other hand, this also demonstrates the still overwhelming importance of the hydrocarbons sector not only for the Emirate of Abu Dhabi, but also for the overall UAE economy. The important point is that much of the non-oil economy can only grow due to petro-moneys that are pumped into other sectors (see the example on Abu Dhabi's agriculture below).

Considering that six out of seven Emirates boast relatively little or no oil revenues compared with the dominant player of Abu Dhabi, the revenue side of government finance also tells a different story than does table (9.1) above, as can be seen from table (9.3) below.

*Table (9.3):* GOVERNMENT REVENUES, 1992 – 2000 (IN M AED)

	1992	1994	1996	1998	2000
<b>Tax</b>	3,330	4,837	9,612	7,853	7,373
Customs	310	736	1,427	1,821	1,779
<b>Non-Tax</b>	43,095	32,627	41,619	34,860	67,012
<b>Oil &amp; Gas</b>	<b>37,212</b>	<b>28,694</b>	<b>37,007</b>	<b>25,500</b>	<b>56,020</b>
Enterprise Profits*	3,997	1,422	1,989	3,051	3,936
<b>Total</b>	<b>46,425</b>	<b>37,464</b>	<b>51,231</b>	<b>42,713</b>	<b>74,386</b>

*Source:* UAE, Central Bank (1999a [no.1]: 65 and 2000a [no.2]: 65); MEED (8 Nov 2002: 33). \* Joint Stock Corporations.

It is easily discernible from table (9.3) that the oil sector dominates not only the revenues of the Emirate of Abu Dhabi, but of the UAE as a whole. The fact that the share of oil revenues in proportion to other state income declines in 1996 and even more so in 1998 is due to the collapse of oil prices on the world market in these years.<sup>2</sup> It is correct, therefore, that 'repression in the oil sector has a negative impact on the overall performance of the non-oil GDP' (Sadik 2001: 223).

<sup>2</sup> The inflation-adjusted oil price in 1998 was the lowest ever since the oil price 'revolution' in 1973 / -74, with an average price in that year of 12.4 US-\$ per barrel only, compared to 26.1 US-\$ in 2000.

The Emirates' more than 98 billion barrels of proven oil reserves (EIA 2001: 2) represent almost 10 percent of the world's total reserves; the UAE are one out of only three countries world-wide (together with Kuwait and Iraq) whose oil reserves are projected to last for more than the next hundred years, assuming current production levels (Gulf Research Center 2004: 110). But it is the uneven distribution of wealth between the individual emirates with ca. 94 percent of all Emirati oil reserves (ca. 97 bn. Barrels) being located on the territory of Abu Dhabi that accounts for the peculiar constellation of powers and economic structures of the UAE.<sup>3</sup>

## Fiscal Structures

Both the general structure of revenues as well as the inter-Emirate economic constellation has repercussions on the financial and fiscal organization of the UAE. But maybe the most remarkable trait of the Emirates is its unique fiscal organization with federal and Emirati budget structures that seem bizarre at first sight to the Western observer.

First of all, each of the seven emirates has its own budget. Of course, there also exists a so-called federal (state) budget, but that is established only after the emirates have established their priorities individually. Finally, there is the so-called 'consolidated budget', which is made up of the federal budget plus the individual budgets of the four largest emirates (Abu Dhabi, Dubai, Sharjah, and Ras al-Khaimah).

The largest individual budget by far is Abu Dhabi's, followed by the federal budget. Next come the budgets of the other six emirates. Put in somewhat simplified terms, this is due to the fact that Abu Dhabi, so to speak, organizes its own finances first, and then allocates the remaining free resources to the federal budget, of which benefit the other Emirates. Nominally, the federal budget is made up to 90 percent by contributions from Abu Dhabi and 10 percent which are supposed to come from Dubai. In practice, however, the relative shares tend to shift even more towards Abu Dhabi contributions since Dubai is 'helped' financially, in various respects, by the Emirate of Abu Dhabi and ultimately, there are years in which virtually the entire federal budget stems from Abu Dhabi.

The federal budget, however, comprises only about one third of the 'consolidated budget'; the latter one is therefore more relevant for economic analysis, as a quick comparison between the two easily demonstrates. Table (9.4) below gives an overview of the typical relation between the federal and the consolidated budgets.

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<sup>3</sup> Next comes Dubai with an estimated 4 bn barrels of reserves, then follow Sharjah and Ras al-Khaimah with 1.5 bn and 100 mn barrels respectively. (EIA 2001: 2).

*Table (9.4):* UAE FEDERAL AND CONSOLIDATED BUDGETS (IN M AED)

	1999		2000	
	Federal	Consolidated	Federal	Consolidated
<b>Revenues</b>	<b>20,428</b>	<b>43,761</b>	<b>20,680</b>	<b>73,903</b>
Oil and Gas	n.a.	28,054	n.a.	56,200
<b>Expenditures</b>	<b>22,910</b>	<b>72,009</b>	<b>23,120</b>	<b>80,793</b>
Current	n.a.	55,782	n.a.	69,066
Investment	n.a.	13,682	n.a.	11,099
<b>Balance</b>	<b>- 2,482</b>	<b>- 28,248</b>	<b>- 2,440</b>	<b>- 6,890</b>
Financing	n.a.	28,248	n.a.	6,890
Nat'l. Banking System	n.a.	1,108	n.a.	- 5,953
Investment Revenues	n.a.	27,140	n.a.	12,843

*Source:* Schlumberger (2002b: II/ 2-3); EIU (2001: 61).

Given the fact that Abu Dhabi comes up for the federal budget almost alone, it is not grave that since 1992 at the latest, no detailed data on the individual budget of the Emirate of Abu Dhabi are available.<sup>4</sup> A comparison of various pieces of available data can help.

The first question is where Abu Dhabi's resources which enable it to finance so generously the federal budget stem from. Throughout the 1990s, the budget line 'petroleum royalties and tax' or (for different years) accounted for 75 (1998) to 94 percent (1990) of all revenues (Emirate of Abu Dhabi 1993b: 35; n.d.[1999]c: 32), with an annual average of 84.9 percent of all revenues of the Emirate of Abu Dhabi over the entire decade of the 1990s (ibid, n.d.[1999]c: 32; n.d.[2000]c: 37; 1993b: 35).

The second point of interest is what portion of its own revenues Abu Dhabi spends in order to finance the federal budget, which can primarily be seen as a means to maintain the political unity of the federation and ensure its future lead role among the seven emirates. Available data suggest that pursuing these political goals cost the rulers of Abu Dhabi between 30.8 percent (in 1991) and 47.7 percent (in 1993) of their total revenues during the 1990s. While annual percentages fluctuate, the general pattern does not shift towards generally higher or lower shares of contributions. Over the 1990s (1990 – 1999), Abu Dhabi contributed each year an average 39.95 percent of its individual revenues to the federal budget (ibid., n.d.[1999]c: 34; 1993b: 36; n.d.[2000]c: 41).

That means that while the Emirates as a whole are rich, at least five out of six emirates depend on Abu Dhabi's financial support for economic survival. The only emirate that comes close to being economically able to survive without Abu Dhabi's steady support is Dubai, but even in that case survival is questionable.

<sup>4</sup> The 'Statistical Yearbooks' of the Emirate of Abu Dhabi unfortunately do not include any details on the emirate's budget. There are, however, other Arabic statistics which at least give percentages on a certain number of items on both the expenditure and revenues side of the Abu Dhabi budget.



In order to get a more accurate picture of the relative economic position of the emirates among each other, some further comparisons are needed: For simplicity reasons, one can assume that the federal budget consists *de facto* of Abu Dhabi's contributions only (an assumption that certainly is not very far from reality). Second, we know that this is in the range of forty percent of the budget of Abu Dhabi, or in different terms: Abu Dhabi's budget alone lies within the range of 250 percent of the UAEs' national budget. We thirdly know the relation of the federal vs. the consolidated budget, which is roughly 1:3. This composition leaves no space at all for contributions to the federal budget from *any* of the six other emirates. It is therefore reasonable to assume that *de facto*, the federal budget is financed entirely by Abu Dhabi, and that these resources enable the other emirates to survive. But this is not all. Abu Dhabi's economic dominance is so large that the emirate could, apart from financing the federal budget, also afford to spend an additional annual average of 12.36 percent (between a high of 39 % in 1991 and a low of 4.7 % in 1994) of its revenues on foreign aid over the 1990s (cf. *ibid.*)! In the light of these figures, it seems justified to concentrate, in the remainder of this chapter, on the two emirates of Abu Dhabi and Dubai only, since the other emirates (with the exception of a non-negligible 9-10 % of the federal GDP that is contributed by Sharjah) are of marginal importance when looking at the UAE economy.

### Development of the Non-Oil Economy: Oil-Dependency, Limited Diversification, and Tight Regime Control

While the above section already leaves a huge question mark behind the possible transformation of the rentier economy, a closer look at the non-oil economy confirms that such a kind of systemic economic transition can, for the time being, not be the subject of serious discussions. While the oil and gas industry, including upstream activities in exploration and the downstream refining business, still constitutes a significant part of the national economy, other non-oil sectors that are seemingly unrelated to oil and gas, too, exist and survive only due to the abundant capital inflows that oil and gas exports generate.

Agriculture is a prime example of how economic sectors that are seemingly unrelated to the oil industry can survive grace to the petro-wealth: While the total output of agriculture rose as well, the importance of the sector for the national economy remains marginal with a GDP share of 2.0 to 3.5 per cent only, despite the fact that the UAE boast, with around forty million palm-trees, nearly ten percent of the world's date trees.

Nevertheless, agriculture where ca. eight percent of the labor force find work remains a political rather than an economic priority on the government's agenda mainly because of its positive employment effects. The government continues its heavy subsidization of the sector in order to create sources of private income through free public well-drilling and the free

provision of technical services such as water pumps, the provision of seeds, fertilizers and insecticides at half cost, or the allocation of plots free of charge to any UAE national, and if this is not sufficient, farmers can receive interest-free agricultural loans for equipment since 1978.

To take a concrete example, the government of Abu Dhabi provides a wide range of free services to farmers. It distributes seeds for cereals and potatoes at no cost, provides seedlings (the plants) for vegetables and other plants for free, drills wells and takes care of their maintenance, installs irrigation networks, provides free water pumps, ploughs the soils, fixes fences, maintains the farmer's machinery, takes care of plant protection, and also helps with the demarcation and leveling of farmlands. Water, of course, is also heavily subsidized. Furthermore, farmers can access interest-free 'loans' of which he or she need only pay back half the loan's value for certain items or 'investments' such as barbed wire, machines and pumps, fertilizers, dripping irrigation, spraying and sprinkling motors, as well as other materials needed to run the farm (cf. for details and statistics: Emirate of A.D./Dept. of Planning 2000: 149–53).

To minimize the risk of such 'entrepreneurship' – if any such risk exists – the government guarantees a market for the farmers' produce at 'favorable prices' (Shihab 2001: 251). This holds true even in those cases where farmers grow conifers or grass in the desert south of Abu Dhabi where the quality of the water does not allow to grow fruit or vegetables for human consumption, or where it is simply easier to grow grass than tomatoes. Water being provided free of charge, and with a price of one AED per kilogram of grass in 2000, farming can be an attractive business in the Emirates earns the larger ones of such nationals engaged in farming between 500,000 and one million US-\$ in net annual profits which makes agriculture not only a safe business, but also a lucrative one by all standards.<sup>5</sup>

For such farming, the state does not only pay for the seeds, irrigation, pumps and machinery, but also incurs costs for the destruction of such 'crops' that can neither be used for humans nor for animals. It is therefore not surprising that in the Emirate of Abu Dhabi, the sector employs a number of Abu Dhabi nationals that lies well above the average sectoral share of *nationals*<sup>6</sup> in employment. Almost 73,000 employees in the sector in Abu Dhabi alone is a number far higher than any self-regulating market would allow, and far more than the meager 3.4 percent in national GDP which the sector contributed in all of the UAE in 1999 would suggest. In fact, agriculture ranges third in terms of employment in the Emirate of Abu Dhabi, second only to the public administration (88,172) and construction (118,168).<sup>7</sup>

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<sup>5</sup> Author's interviews with informed residents and hydro-geologists of the German GTZ/DASA who has run, for the Abu Dhabi National Oil Company (ADNOC), a project on groundwater assessment in the desert of the Emirate, Abu Dhabi, March 2001.

<sup>6</sup> The mere percentage of the labor force employed in the sector underestimates the political relevance of the sector because it does not distinguish between nationals and foreigners.

<sup>7</sup> Figures are from the 1995 census; more recent figures were not available at the time of writing. It can be assumed from comparisons with other indicators, however, that the overall employment structure of the Emirate has not significantly changed over the past decade. (See Emirate of Abu Dhabi / Dept. of Planning 2000a: 102)

The fact that individuals (even nationals), as a rule, can not legally *own* land (it all falls under the legal jurisdiction of the state, i.e. the ruling family who then grant plots to citizens) renders agriculture into a state-sponsored and –created job machine that generates income opportunities for nationals - and makes them at the same time dependent directly on the rulers in their living.

Part of the story about agriculture still figuring high on the regime's agenda is reportedly attributable to the president, Sheikh Zayed: Born around 1918, he belongs to the generation that personally experienced the harsh climatic conditions in the desert as bedouins. It is said, therefore, to be among his personal ambitions that he be the ruler who turns the desert into green. While this is an anecdote, the more tangible political reason is that farming represents a source of revenue for a considerable number of UAE nationals who are thus provided with both work and income, and therefore have little reason to worry about their future, their material well-being – or about politics, for that matter. Being a farmer in the UAE does, of course, not mean to stand in the desert heat at 50 degrees Celsius and above day by day; this work is taken care of by migrant workers from Southern Asia, as is the breeding of camels on the edges of the *Rub' al-Khali* (the 'Empty Quarter'). The farmer himself might, from time to time, show up in his air-conditioned Nissan Patrol or Toyota Landcruiser, on the way to or from a little bit of 'dune bashing' with his car, one of the popular fun-sports in the UAE.

Hundreds of kilometers of drip-irrigated flowers, palm-trees and bushes alongside the roads through the desert are a testimony not of a flourishing agricultural sector, but of the oil-wealth of the Emirates. This is not only economically absurd (misallocation of resources to inefficient sectors), but also environmentally problematic: agriculture today accounts for ca. 70 percent of the drinking water consumption – which seems bizarre given the sector's low-single digit share in GDP creation). And while the Emirates already have one of the highest per capita consumption of water in the world (far above Europe), demand continues to grow unabatedly, with the consequence that so-called 'lenses' of high-quality, non-renewable fossil groundwater in the desert are depleted within few years only. Wild well-drilling in the desert had become so frequent by early 2001 that some of the foreign experts of the groundwater assessment project run by the German consortium of GTZ/DASA for Abu Dhabi's National Oil Company (ADNOC) were busy with driving through the desert and looking for newly planted plots of land, assessing their size and type, thereby estimating the water used, and calculating the rapidness of the depletion of water sources.<sup>8</sup> Awareness of this unsustainable usage of scarce resources, however, is limited at best. 'Why care, if we need more water, we will desalinate more of the Gulf water' was a frequently heard answer to such concerns Westerners may raise.<sup>9</sup>

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<sup>8</sup> Author's interviews with experts and participation with them in such exploratory trips through the desert, Abu Dhabi, March 2001.

<sup>9</sup> This energy-consuming 'solution', however, is also fraught with environmental problems, and the already tangibly rising levels of salt in the Gulf sea water are not even the most serious ones till now.

Thus, while subsistence agriculture has always existed in the UAE's oases, the sector today represents, to put it somewhat pointedly, a case of a state-financed private sector that exists primarily due to the abundant oil revenues. Oil money being pumped into agriculture gives a totally different notion to the term of a thus politically induced version of an 'oil-for-food' program for the benefit of UAE citizens who find work and wealth farming the desert, often enough with non-consumable produce.

While, of course, not all agricultural enterprises work the way the extreme examples given here might suggest, it is obvious that the Emirate, over 90 percent of the soil of which are non-arable desert, has no comparative advantage in agriculture. Considering this, As the Economist Intelligence Unit states, the government 'is aware that self-sufficiency in food is unattainable', but 'will continue to encourage agriculture for political reasons' (EIU 2001a: 30). While in the past, some analysts were tempted to consider the UAE a market economy for its relatively liberal trade regulations (especially in Dubai), this example may be taken as evidence for the genuinely rentierist nature of the economic order prevailing today in the UAE.

But trade and manufacturing, too, leave the observer with an at least ambiguous picture when taking a closer look at their structure. First of all, it is noteworthy that any commercial company incorporated within the state of the UAE (and all companies operating in it are required by the law to actually be incorporated, or else they are considered void) must have a local person (i.e. UAE national) as a 'partner', as the Companies Law (Federal Law No. (8) as amended by Federal Law No. (13) of 1988) stipulates.<sup>10</sup> This regulation is not only valid for companies operating in commerce in the strict sense of the term, but to all companies undertaking economic projects, understanding that 'an economic project shall include every commercial, financial, industrial, agricultural, real estate or any other type of economic activity' (Law [8], Part I, Art. 4 (2); cf. ADCCI n.d./f: 8). What does that mean? To put it briefly: Foreign companies wanting to operate within the UAE must first of all find a local partner who must then be willing to own a majority stake in the company. There is no way of avoiding that regulation, and there are reasons for that: This stipulation is a formalization of income creation for national UAE citizens through the law. Since it is a federal law, the regulation is valid in all of the seven emirates. With the exception of free-zones, therefore, any company that sees the UAE as an attractive place to operate in will have to find a local partner. Furthermore, the law is clear insofar as 'the share of a partner may not be his reputation or influence' (Art. 14), it may well be material assets (share in kind), titles to property, rights in the possession of third parties, the utilization of funds, and the like. While this is already a rather wide definition of 'capital', in actual practice, the partner's share in the capital very often consists in him or her lending name and nationality to the project, that is:

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<sup>10</sup> Part I, Article (22) of the said law reads: 'Observing that certain commercial activities are confined to nationals as provided in this Law or in any other Law, every company incorporated in the State must have one

the fact that he or she is a UAE citizen and is needed for the establishment and operation of a business.<sup>11</sup>

But what does that economy look like? The lion's share of manufacturing being made up by mining and quarrying, i.e. the oil and gas industry. This part of the economy is of strategic importance for both the economic survival of the country and the political regime maintenance of the ruling families. It does not come as a surprise, therefore, that senior members of the ruling families in all emirates are personally involved in the business. Abu Dhabi's Crown Prince Sheikh Khalifa b. Zayed Al Nahyan chairs the 'Supreme Petroleum Council' which, since 1988, assumed authority over all matters pertaining to petroleum affairs in the Emirate of Abu Dhabi.<sup>12</sup> In Sharjah, it was not until 1999 that an institution with the same name was established, chaired here, again, by a member of the ruling family (Sheikh Ahmad b. Sultan Al Qasimi),<sup>13</sup> while Dubai's 'Emirates Petroleum Products Company' (EPPCO) is headed by Sheikh Hamdan b. Rashid Al Maktoum, deputy ruler of Dubai and brother of Crown Prince Muhammad who is also chairman of Dubai's Economic Department, 'the emirate's economy ministry' (EIU 2001:10), and of the ruler himself. That means that the ruling families directly control the country's strategically important industries, in addition to the authorities responsible for the infrastructure and means of transport needed to export the respective products.<sup>14</sup>

But not all the economy consists of oil. However, much of the industrial landscape, in terms of its relative importance for the national economy, consists of downstream industries, marketing and shipping companies which export the oil and gas, and of energy- and capital-intensive heavy industries as a natural consequence of the abundance of mineral resources the country is endowed with. Apart from Abu Dhabi's ADNOC conglomerate, a major player in this field is *Dubal* (Dubai Aluminium), the world's second largest smelter with an annual output of almost 540,000 tons in 2000. *Dubal* alone accounts for an amazing 60 percent of Dubai's non-oil and 'non-re-exports' exports, and is, in its turn, chaired by Muhammad Alabbar, who simultaneously holds the post of director-general of Dubai's Economic

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or more national partner [sic] whose share in the company capital must not be less than 51 % of the company capital' (ADCCI, n.d./f: 11).

<sup>11</sup> Interviews with foreign entrepreneurs in the tourism and hotel sector, the military sector, and with resident representatives of the Germany-based law firm *Meyer-Reumann*, specialized in Companies Law and dispute arbitration, Abu Dhabi, March 2001.

<sup>12</sup> Apart from that post, he is also chairman of *ADNOC*, Abu Dhabi's group of oil companies, the *Abu Dhabi Development Finance Corporation*, the *Abu Dhabi Fund for Development*, the *Abu Dhabi Investment Authority*, while his brother (Sheikh Diyab) chairs the important *Abu Dhabi Water and Electricity Authority* (ADWEA) that has recently undergone a thorough restructuring process, and another son of president Zayed, Sheikh Said, chairs *Abu Dhabi Seaport Authority* which administers the emirate's most important port, *Mina Zayed*.

<sup>13</sup> Sheikh Sa'ud b. Khalid Al Qasimi, another family member, chairs Sharjah's *Ports and Customs Department*. In Ras al-Khaimah, Umm al-Qaiwain, and Fujairah, oversight over the ports and is in the hands of Sheikh Muhammad b. Saqr Al Qasimi, Sheikh Sultan b. Ahmad Al Mu'alla, and Sheikh Saleh b. Muhammad Al Sharqi, respectively.

<sup>14</sup> Although oil is not exported via air traffic, that, too, is being held under the close scrutiny of the ruling families with Sheikh Hamdan b. Mubarak Al Nahyan as the head of the UAE's *Civil Aviation Department* and

Department (under the chairmanship of Crown Prince Sheikh Muhammad). He takes credit for much of the implementation of Dubai's economic policies, while at *Dubal*, he has recently successfully overseen a major expansion project.

Apart from such huge players, however, the UAE's private sector consists mainly of family enterprises. 'Family-run businesses are a pillar of the Gulf economy, accounting for over 99 percent of the private sector' (MEED, 1 Aug 1997: 3). Similar to the ruling families' style of handling internal affairs, the strategic decisions of family businesses usually remain closed to outsiders and are not talked about in public.<sup>15</sup> Such family businesses include retail traders and workshops in Dubai's *suq*, but also and more importantly, they include a significant number of large enterprises and groups that flourish in the shadow of the oil economy due to an investment climate that is, for national citizens, smoothly pampered with oil money. The Rostamani or Futtaim groups in Dubai, or Abu Dhabi's Fahim group, the Otaiby business interests or the widespread political, administrative and business interests of the Dhaheri family are well known examples of such family business structures in the Emirates, with most of them being active in the most diverse business sectors.<sup>16</sup>

In brief, while private sector businesses mostly have their pillars rooted in trade, tourism or agencies and – sometimes – construction and light industries, the majority of heavy industry is still state-owned. In this respect, the Emirates' structure is no exception to the general landscape of Arab private sectors where trade is attractive, offers relatively quick returns, and where inadequate credit facilities (see the Egyptian case discussed in chapter 6 above) or a political environment that is perceived as insecure (see the Algerian case analyzed in chapter 8 above) pose obstacles to long-term industrial commitments, let alone in capital-intensive industries. Such investment exists in the Emirates, but is mostly based on personal agreements between those who set the rules and those who exploit them for their commercial and industrial ends. Since the level of capital absorbed is gigantic in relation to the size of the population, the UAE *are* a place where ideas are traded and where, with the right support, one might find excellent business opportunities. However, the decisive step from a spot of trading ideas towards one where ideas are developed has yet to be taken.

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of *Abu Dhabi Aviation*, and with Dubai ruling family member Sheikh Ahmad b. Sa'id Al Maktoum as chair of the UAE's national air carrier, *Emirates*.

<sup>15</sup> Any such internal processes are dealt with in a bargaining manner, aiming at compromises between senior (mostly male) family members. What is more, these attitudes towards family affairs are passed on from one generation to the next, as sociological studies have found (cf. e.g. Alnajjar 1996) and can therefore be expected to persist over time even in a context of rapid urbanization and globalization of the business environment.

<sup>16</sup> 39 year-old Abdulla Sa'id Thani may serve as one example for a new generation of entrepreneurs which also aims at diversifying their business interests: Having started off with a small quarry in the northern emirates, he today heads a corporation with estimated assets of more than half a billion AED. After ventures in retail trade, he went into the real estate market, and, three years later, stretched out into international business consultancy, trade agencies and representation services to several large international companies. In the course of the 1990s, he built an industrial park and an aluminium fabrication plant in Ghussais, before establishing the Emirates Glass Company, in which Dubai's government recently bought shares. He also is the owner of the fancy *Al-Bustan* apartment and shopping mall in the City of Dubai.

## Future Rivals?

### Divergent Structures and Strategies in Dubai and Abu Dhabi

Differences between Dubai and Abu Dhabi are evident at first sight. Dubai very much (and consciously) strives at giving the impression of a bustling, active, incredibly dynamic, service-oriented and technologically up-to-date regional hub. Dubai's Crown Prince General Sheikh Muhammad himself, who at the same time is vice prime minister of the UAE and federal minister of defense, personifies this image of a young and active but nevertheless experienced and knowledgeable ruler, both towards foreign investors and the local population. Although he does not (yet) formally rule the Emirate, even government officials acknowledge his lead role.<sup>17</sup>

Abu Dhabi, by contrast, looks much more self-reliant and –sufficient (in order to avoid using ‘hermetic’) to any non-national arriving at its airports or shores. The story told here is impressionist rather than exact, but can easily be supported by hard facts. Table (9.5) gives an overview of the non-oil economy of the Emirates, or, to be more precise: of the differences between the two largest Emirates' individual economies who together dominate the national economy, and yet more specifically: the differences between the non-oil sectors of their respective economies.

Obviously, Abu Dhabi, despite its superiority in terms of oil and gas reserves and production, and also as concerns surface, population, revenues and the overall economic and political hierarchy among the seven Emirates, lags far behind Dubai when it comes to industrial activity, trade and services. In fact, the only industrial sector in which Abu Dhabi has an edge over Dubai is, again, the petroleum sector.

While table (9.5) provides clear evidence for Dubai's lead role and primacy in the non-oil economy, combining the above table with the fact that the UAE's federal budget is funded to (*de facto*) over 90 per cent by Abu Dhabi, it indirectly also confirms the overwhelming importance of the oil and gas sectors that have been discussed above. On the flipside, the table visualizes the relatively little weight and influence of all other sectors when put in relation to the oil and gas sector and the overall national economy on a macro-level. There is thus not a shred of doubt that the UAE, until this day, remains a rentier economy that probably comes closer to the ideal type of this economic order than maybe any other economy in the world. Yet, table (9.5) demonstrates rather statically the differences between the two leading Emirates in terms of economic structures. But these differences are also reflected in the more dynamic aspect of evolving economic *policies* which shall now be looked at a little closer.

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<sup>17</sup> When asking, in an interview, a senior official at the Dubai Economic Department (DED) about the then newly opened *Dubai Media City* and alluding to the idea of this major establishment as the Crown Prince's ‘personal baby’, the swift answer tellingly was: ‘Well, you'd better call the Emirate of Dubai Sheikh Muhammad's baby’. (Author's interview with the said official, Dubai, March 2001).

*Table (9.5):* ECONOMIC STRUCTURES: ABU DHABI vs. DUBAI

<b>Indicator</b>	<b>Abu Dhabi</b>	<b>Dubai</b>
<b>GDP</b> (m. AED), in current factor costs	108,280	50,941
Percentage of total UAE (1999)	56.9 %	26.7 %
<b>Industrial Establishments</b> with 10 Pers. or more (as of 01/01/2000)	204	678
Food & beverages	18	82
Basic metal industries	4	21
Metal products	41	146
Furniture and other manufacturing	2	64
Chemicals	22	47
Rubber and plastic products	21	42
Textiles, garments & leather prod.	11	23
Electrical equipment & parts	6	25
Machinery & equipment	5	16
Wood & prod's / paper & prod's	9	36
Petroleum products	5	4
<b>Private Companies</b>		
Capital (m AED; reg. with Min. of Ec. & Comm. as of 1/1/99)	2,254	9,256
Number of (as of 1/1/99)	4753	9213
<b>Free Zones</b> (as of 01/01/1999)	(1)*	2
Area in hectares	(3,500)*	10,120
No. of companies	0	1378
<b>Banking &amp; Finance</b> (as of 01/01/2000)		
No. of Banks, Investment Institutions and Finance Comp's (incl. branches)	136	144
Representative Offices (end 2000)	12	25
Exchange Offices (incl. branches)	52	106
No. of Insurance Co.'s (1/1/99)	6	9
Financial & Monetary Intermediaries	24	26
<b>Non-oil trade</b> (shares; 1997/1998)		
Imports	18.1	73.8
Exports	9.0	82.4
<b>Investment in Industry</b>		
1998 (in m. AED)	2,780	7,029
2000 (in m AED)	3,532	12,730

\* A project planned on Sa' diyyat island had not (yet) materialized by the time of writing.

Sources: Ghanem (2001: 262, 271); EIU (2001a: 61-65); Central Bank (1999b: 64-69; 2000c; 2000a: 72); Min. of Economy & Commerce (1999b: 31, 32, 85).

### *Dubai: Preparing for the Post-Oil Era*

Dubai's well-known nick-name 'Do Buy!' can serve as a signal for the most important difference between the two economically and politically most important Emirates, Dubai and Abu Dhabi. While Dubai has the second largest oil and gas reserves of the federation after Abu Dhabi, and while these are commercially exploited since the 1960s, both reserves and production are low in comparison to those of Abu Dhabi. According to estimates, Dubai's oil reserves will be depleted within the next fifteen to twenty years. Therefore, even though the UAE's reserves as a whole will last for more than another century, preparing for the post-oil



era is a very real challenge for Dubai. Its oil receipts have already fallen dramatically over the past 15 years and reached a relatively modest 230,00 b/d by the mid-1990s, down from a 410,000 b/d peak in 1991 (Butt 2001). In early 2000, Crown Prince Sheikh Muhammad then announced a further drop to 170,000 b/d only for 1999. In terms of employment, the hydrocarbons sector has never been able to create much job opportunities for a population that has more than doubled between 1990 and 2005.<sup>18</sup> Therefore, there is a great awareness in Dubai that precautions have to be taken for the relatively near future, and that the emirate's economy inevitably has to be built on pillars other than oil.

While one strategy is to search for gas, which one author described as 'the UAE's fuel of the future' (Butt 2001: 240) (and to switch power plants from oil to gas, as has happened in recent years), gas, too, is not abundant in comparison with Abu Dhabi which sits on, over 90 percent of all the UAE's reserves. Demand, however, is growing quickly as Dubai's industry grows, and the emirate's output is not nearly enough to meet this. At the time of writing, Dubai's major supplier was neighboring Sharjah with ca. 400 m cfd, but this is not sufficient for future development – considering that *Dubai's* needs alone were estimated at 240 m cfd in 2000. Back in 1998, Abu Dhabi had agreed to supply 500 m cfd to Dubai, and construction of a pipeline was well under way as this study was written. The final plan, however, foresees this pipeline to be used to bring gas from Qatar's 'North Field' via Abu Dhabi to Dubai, within the framework of the '*Dolphin Initiative*', the largest pipeline project ever envisaged in the Middle East. This 10 bn US-\$ initiative is managed through the *UAE Offsets Group* (UOG), headed by an American and a German executive director, who has plans to develop the pipeline system further to run as far as Pakistan.<sup>19</sup>

The second option, of course, is to move rapidly away from oil and gas as well as from heavy dependence on downstream industries. Contrary to the impression observers often get from Arab economic policies as mainly an ad-hoc affair in reaction to crises and difficulties, Dubai set new standards in comparison to Abu Dhabi and within the UAE with the establishment of a strategic development plan ('Dubai Vision') in mid-1990s (see Government of Dubai; Economic Dept. 1996). This comprehensive document sets out ambitious targets and intentions for almost all areas related to the future non-oil economic development of the emirate, including investment policies focussing on high-tech industries and the IT sector (in which Dubai competes with Jordan and Egypt as the center of the region), infrastructure, facilitation of administrative procedures and licensing, immigration rules, manufacturing strategies calling for the development of light industries such as food and beverages or clothing, furniture and pharmaceuticals, further growth of the banks, and possibilities of public funding for training schemes in order to upgrade human resources skills within the emirate. Most importantly, there is an explicit reference to overcoming oil

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<sup>18</sup> Estimates speak of more than one million at the time of writing for Dubai alone, compared to 490,000 in 1990, whereas the federation counted some 3.5 m inhabitants in 2004, up from ca. 1.7 million in 1990. (Government of Dubai 2001: 25f.)

dependency by 2010 (the emirate's economy today still depends to 15 to 20 percent on oil revenues; cf. also MEED 6 Dec 1996: 42-46).

In fact, Dubai actively pursues a variety of strategies in order to overcome oil- and energy-dependence. In particular, the emirate's *Department for Economic Development* is active in exploring and promoting new avenues of ensuring sustainable non-oil growth for Dubai. First, tourism was targeted as a potential growth sector. In addition to an elaborated market for gold and jewelry that attracted visitors to the city for quite some time now, a number of high-class promotional events and advertising campaigns were initiated, such as, for instance, the *Dubai Shopping Festival* which is held annually every spring since 1996.

Such strategies also need sites, of course, and newly built or equipped areas were opened. Apart from Golf or Polo clubs, privately run indoor-skiing facilities and a number of shopping malls that is vast in comparison to the number of inhabitants, sites such as 'Dubai Festival City', close to the old palace of Sheikh Sa'id (the current ruler's grandfather) on the banks of the creek that has been turned into a museum, are aimed at hosting folklore dances and performances, exhibitions for culture and tradition, and the like. At least for the local population, this seems an attractive upgrade of the city, whereas it remains to be seen whether such sites of demonstrated traditional Arab identity are welcomed by foreigners who reside in the top-end hotels such as the *Jumeira Beach* or the seven-star *Burj al-Arab* as much as Dubai's government hopes for. Major sports events such as the ATP tennis tournament (the 'Dubai Open') or Golf competitions which have hosted stars like Tiger Woods are invested into in order to make leisure time in Dubai more attractive to tourists visiting the emirate.

But tourism is not the only sector where activities are under way, and today not even the most important one any longer. Dubai has developed, over the past decades and with the help of its favorable geographical location between the Middle and the Far East, between Africa and Central Asia, into a regional hub for trade. Trade is, with 19.9 percent (1999), the single largest contributor to the Emirate of Dubai's individual GDP, grace to – for Arab standards – extremely liberal regulations with a unified customs rate of four percent only. What is remarkable, however, is that more than three quarters (75.3 percent in 1998) of all non-oil exports consists of re-exports, a segment Dubai has focussed on for the past years and which has steadily been increased (figures computed from: Government of Dubai 2000: 16). This is an asset for Dubai as a trading spot of global relevance, but on the other hand there is also a flipside to the recently growing success of re-exports: Apart from the fact that Dubai has become not only a hub for international trade, but also for all sorts of organized crime, money laundering, foreign brand counterfeit, and many other dubious activities, often in relation to wealthy persons who today avoid being too openly visible in their home countries in the former Soviet Union, it also tells a story about the real extent of the productivity of Dubai's industrial sector, if one leaves aside *Dubal* for a moment. 'The only way to go is industry' says Alabbar (MEED 5 Dec 1997: 34) therefore, but whether that wish will

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<sup>19</sup> Author's interviews; Peter Eident and Rainer Beers, UOG, Abu Dhabi, March 2001. See also Butt (2001:

materialize remains to be seen. In any case, the government of Dubai has done a lot in order to approach such goals. A new federal labor law was passed upon pressure from Dubai, a new authority (the *Dubai Development and Investment Authority*) has been created in 2002, the formerly separate entities of *Dubai Ports Authority*, the *Jebel Ali Free Zone Authority* and *Dubai Customs Authority* were merged into the *Dubai Ports, Customs, and Free Zone Corporation* in mid-2001 (MEED 8 Nov 2002: 46), an overhaul of visa regulations for expatriates created more liberties for foreigners, and while the latter still cannot *buy* land, new regulations in the early 2000s make it now possible to get long-term leases for 99 years and acquire, on that basis, real estate for residential purposes.

The fact that protection of trade marks and intellectual property would become a serious problem for trade as soon as the UAE ascend to full WTO membership was realized relatively early in Dubai, where the local government had pressed, in the early 1990s, for the establishment of anti-counterfeit legal provisions. In 1992, the UAE introduced new legislation<sup>20</sup> that entered into force the following year. Except for a loophole in the intellectual property concerning translations into Arabic and which runs against the Berne Convention, the new legislation is in line with international standards. The passing of environmental protection regulation is another area where Dubai acted early (local order no. 61 of 1991 issued by the municipality [*baladiyya*] of Dubai), well before all other emirates were even aware of the need, and well before the Federal Environmental Agency (FEA) was created in 1993, which needed, in its turn, several years to draft a federal law on environmental protection (cf. MEED 6 Dec 1996: 55-58).

To facilitate trade even more and in order to attract productive investments, Dubai also is the spearhead of the UAE's moves towards creating a number of free zones that offer additional incentives to investors, apart from the UAE's general abstinence from charging corporate or income taxes. The most successful and oldest one of these free zones is *Jebel Ali Free Zone (JAFZ)*, established in 1985 already, which grants full foreign ownership, which is not obtainable in the UAE outside the free zones, guaranteed full repatriation of profits, fifteen years of exemption from corporate taxes which are renewable for another 15 years, and there are no personal income or capital taxes. Up to the end of the last century, almost 2000 companies had made use of these facilities and offers, including well-known brands such as HSBC, Nissan, Sony, Sharp, Samsung, DHL, Nokia, Fujitsu, Nestlé, Lipton, Yamaha, Brother, and many others more (cf. Government of Dubai; *JAFZA Directory*; here: 2001). Given Jebel Ali's success, Dubai established another free zone at its international airport, and there were, at the time of writing, many others that had spread across the northern, oil-poor emirates, among them Sharjah's 'Hamriyya' and airport free zones, which are but examples of the more than ten zones in the UAE. Interestingly, the only free zone project Abu Dhabi ever engaged in, to be established on Sa'adiyyat Island, did not materialize for a time-span of

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244ff.), UOG (2001).

<sup>20</sup> Cf. Federal Law No. (32) of 1992 on trade marks and Federal Law No. (40) of the same year on intellectual property; see also MEED (17 May 1996: 42-43) for a detailed review of the two laws and their implications.

almost ten years (by the time of writing), even though the committee that had been formed in order to prepare and execute the work at least initially had the support of the ruling family and was even chaired by Sheikh Hazza bin Zayed Al Nahyan. It seems that the omnipresent fears of too much foreign influence in Abu Dhabi retarded the project or even lead to its being put back on the shelves of once-fancied, then forgotten ideas.

But returning the view towards Dubai, maybe the most spectacular projects within the past decade are *Dubai Media City* and *Dubai Internet City* (the world's first free zone for e-commerce, with engagements ensured by giants of the branch like Microsoft, Oracle or IBM; cf. MEED 10 Nov 2000: 6f.). Moreover, '*Tejari.com*' is Dubai's e-government and e-commerce portal, part of Sheikh Mohammad's personal drive towards the modernization of business-government relations. In a move towards making governmental departments more accessible to the public, the crown prince required all authorities to adopt electronic techniques of government: 'Anyone who fails to do so will be kicked out. This project is a must if you want to stay with me in government', he is quoted (MEED 5 May 2000: 8). *Dubai Healthcare City*, the emirate's latest free zone, adds to this, making it the 'free zone capital of the Gulf' (MEED 30 March 2001: 21). But while taking a lead in free zone development, Dubai still resists the idea of privatizing the utilities sector as does Abu Dhabi, with Ajman recently following Abu Dhabi's path.

However, private participation in public joint stock companies did take place since the 1990s, mainly in the form of the public acquiring shares in initial public offerings made by newly established schemes. The considerable extent of shareholding companies with their shares traded made the opening of exchange markets a *desideratum* not only for Dubai, but also for Abu Dhabi. The practice of informal exchange markets made transactions a risky business for both investors and bank, especially so since bank loans were provided to investors on the basis of assumed gains from buying shares in new companies (MEED 1 Aug 1997: 2,3). In early 2000 finally, the UAE's first stock exchange began trading in Dubai (*Dubai Financial Market DFM*), followed only months later by another floor in Abu Dhabi (*Abu Dhabi Stock Exchange ADSE*). This had certainly not happened, had not prominent private businessmen who are closely connected to both ruling families pushed vigorously for years for the opening of such markets.<sup>21</sup>

In sum, Dubai has turned in an even more vibrant business-oriented place than it has already been for the past decades. While there is ample space for private sector activities, the government sets the frame and also controls the overall economic process through both the

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<sup>21</sup> One example is Mohammad al-Fahim of Abu Dhabi, one of the entrepreneurs most closely affiliated personally to the ruling Al Nahyan, who warned, in 1997: 'We are on extra time. If the stock exchange does not come on line in the near future, we will have a very nasty surprise. Transparency is the first requirement for the creation of a strong financial market, and at present there are not enough rules to carry us through.' (quotation taken from MEED, 5 Dec 1997: 32, 33). Another instance is the above mentioned Mohammad Alabbar, director of Dubai's Economic Department, who is, in the same source, quoted as saying: 'We still have a society that looks at the founder members [of a company in order to decide whether to buy shares or not; OS], before technical feasibility. As a result, the government has been involved in every IPO so far. To change that, a stock exchange is a must.'

ruling family, mainly the Crown Prince, and its Economic Department chaired by the former and run by Mohammad Alabbar. Typical examples of this convergence of public and private business are newly founded companies that combine both material state input and political will with opportunities for private investment, such as *Dubai Investments*, started in 1995 with a 40 percent share held by the government and founding private entrepreneurs, and the remaining 55 percent held by 30,000 nationals who could subscribe to shares through an initial public offering (IPO).

However, most of the efforts that were made since the second half of the 1990s are still financed either by the ruler or the government of Dubai directly, or else with the support of public authorities. In itself, this says nothing about the possible success or failure of post-oil development, but, as one critical Gulf businessman says: ‘Just wait another ten years. When there is no oil left, we will see how strong Dubai’s economic foundations really are’ (MEED 5 Dec 1997: 34).

#### *Abu Dhabi: Privatizing Power, Retaining Control*

As with the federal rules of the UAE, Abu Dhabi regulations up to the late 1990s required any foreign company, even without wanting to have an Emirati partner, to have a so-called ‘sponsor’ whose role was ‘confined to help extracting necessary licenses’ (ADCCI n.d.[1996]d: 20). In turn, the sponsor was entitled to a share in the initial contract of 1-2 percent, depending on the contract volume (up to 3 percent in case the sponsored firm practiced maintenance works), plus 25 percent of annual net profits.<sup>22</sup> While such and other regulations hold for the private sector (mainly construction, trade, parts of manufacturing and tourism) and pose restrictions to foreigners, they represent a major source of income to Abu Dhabi nationals. The ruling family does a lot to ‘help’ their *national* citizens to make a living. While the legitimization of political rule is mainly based on tradition and consensual bargaining, the emirate’s leaders do use allusions to religion in order to legitimize their positions. Sheikh Zayed as president of the country and ruler of Abu Dhabi is quoted as follows:

‘God Almighty has not given this wealth to Zayed – although he is the custodian of it. It is a trust in my hands and all the nationals are the real owners of this wealth, both big and small. Zayed does not spend from the wealth of his people for his personal interest, for it belongs to all. Accordingly, they must be provided with happiness and comfort.’<sup>23</sup>

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<sup>22</sup> Since 1998, the licensing procedures for Abu Dhabi have been slightly modified by Law No. (5) / 1998 and the respective By-Law No. (29) / 1999. General Trading Licenses can be obtained only by Abu Dhabi nationals. In order to open branches of foreign companies, to establish an agency, or to operate any other business, the term ‘sponsor’ was dropped in favor of what is now called a ‘services agent’, but such an agent (who can only be a national) is still required. (see ADCCI n.d./e for the Law, the By-Law, and further details such as executive directives issued by the chairman of the Municipality of Abu Dhabi). As previously, the local ‘services agent’ remains protected and exempted from any liability for losses the company or parts thereof might incur, even in case he or she was directly responsible for that. This means that any UAE citizen engaging as a ‘services agent’ for a local firm enters no risk at all.

<sup>23</sup> The quotation is taken from *Unforgettable Abu Dhabi* (n.d.: 120).

According to that publication, this is the reason why ‘loans are provided [by the ruling families] to nationals to build, in order to save the national from borrowing from the banks who charge an exorbitant rate of interest on the loan’ (ibid: 120). Activities in the construction sector, which contributed eight to ten percent to Abu Dhabi’s GDP over the 1990s, but employed, by the mid-1990s, 22.1 percent of the emirate’s economically active population (Emirate of Abu Dhabi; Dept. of Planning 2000a: 102)<sup>24</sup>, highly depends on such loans and other inputs from the emirate’s rulers: ‘Ninety percent of residential and commercial construction in Abu Dhabi is funded by the emirate government’ (US Dept. of Commerce 1999d: Ch. 7;1). The combination of these figures demonstrate, that the construction sector is another area of the economy which, like agriculture, directly lives off the abundance of mineral resources. Further, for the overall dependence on the oil-sector, the relatively large number of public sector employees (local government, public enterprises, and federal government together accounted for 34.7 percent of the labor force in 1995) must also be taken into account.

While it is not possible to calculate an exact number of the population whose livelihood depends exclusively on the emirate’s oil wealth, no matter what activity they are engaged in, it can safely be assumed that this is the vast majority of the emirate’s inhabitants. Taken together, those employed in agriculture, construction and in public administration already account for almost three quarters of the economically active population. Bearing in mind other sectors’ at least partial dependency on public input and subsidization, which is, in turn, again financed through means that result from the export of oil and gas, it seems a reasonable estimate that in the early twenty-first century, at least ninety percent of Abu Dhabi’s inhabitants could not survive without oil. It is in this light that a senior Western diplomat, when interviewed for this views on economic policies and reform, replied ‘What, economic policies? That is something that doesn’t exist here!’<sup>25</sup> And it is in this light that the following remarks on economic reform and privatization have to be read.

Apart from these and other elements that characterize a heavily dependent private sector, the emirate’s economic mainstays are clearly government-owned or –controlled businesses. Since the latter half of the 1990s, however, Abu Dhabi seems to have embraced the idea of privatization, which has been a much debated subject that gained lots of attention in both the national press as well as from international observers. However dependent on oil, Abu Dhabi is exceptional in the Gulf, together with Oman and Qatar, in that it controls, but not wholly owns its oil and gas industry. ADNOC is the dominating and wholly state-owned enterprise which has stretched out over the years into various activities. Not to mention its overseas interests in downstream activities, the structure of ADNOC and the companies it controls or holds shares in domestically is rather complex; like the Water and Electricity

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<sup>24</sup> The emirate’s employment structure by sector is available only in decennial steps; in comparison to 1985, employment in the sector even increased to the level given above, up from 17.6 percent in 1985 (for 1985 figures, see Emirate of Abu Dhabi; Dept. of Planning 1994a: 73, 74).

<sup>25</sup> Author’s interview with the said ambassador, Abu Dhabi, March 2001.

Department a year earlier, ADNOC was totally restructured in 1999 as a consequence of a comprehensive study on its performance. Operational activities previously supervised directly by ADNOC were split up into five autonomous business units to enhance accountability. Among these, one is responsible for the company's growing interests in petrochemicals, one for the increasingly important gas sector, one for exploration and production, a fourth for marketing and refining, and a last one for shared services. Three other directorates support the business units in the areas of finance, management support, and human resources and administration, while the heads of all eight units report directly to ADNOC's chief executive officer, Yusuf b. Omair Yusuf (cf. Butt 2001: 236-7).<sup>26</sup>

In 1997, the UAE formed a Privatization Committee for the Water and Electricity Sector under the chairmanship of Sheikh Diab b. Zayed. Water and electricity are closely intertwined insofar as electricity generated is used to supply energy-intensive desalination plants which are geared towards meeting the soaring increase in drinking water demand of the UAE's 3.5 m population (estimate, 2004). Also, electricity demand continues to increase at similar rates as efforts of industrialization are expanded, mainly in Dubai. In order to be able to manage these tasks, Abu Dhabi's former ADWED (Abu Dhabi Water and Electricity Department) was transformed into a regulatory body, the ADWEA (Abu Dhabi Water and Electricity Authority) in 1998, following the suggestions of the Privatization Committee.

There are, in fact, remarkable recent developments in the energy sector. Here, the two 'Taweelah' (A1, A2 and B) power plants are among the mainstays. While *TotalFinaElf* and the Belgian *Tractebel* played a crucial role in upgrading *Taweelah A1*, *Siemens* of Germany was responsible for the construction of *Taweelah B*. Of *Taweelah A1*, with an output capacity of over 1.3 megawatts, the government sold a 20 percent minority stake to private investors whereas 80 percent, and thus control, remained with ADWEA. The *Taweelah A2* project is the Emirates' first 'independent water and power project' (IWPP), and only the second in all of the Persian Gulf after Oman's '*al-Manah*' facility. It is run by *Emirates CMS Power*, a joint venture between *CMS Energy* (40 %) and the newly formed *Emirates Power Company* (*EPC*; 60 %) (US Dept. of Energy; EIA 2001: 5). In 2001, ADWEA signed another 1.6 bn

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<sup>26</sup> The companies which ADNOC either fully owns or holds majority shares in are: *ADCO* (Abu Dhabi Company for Onshore Oil Operations; 60 %), *ZADCO* (Zakum [the name of a large oilfield; OS.] Development Company; 88 %), *ADMA-OPCO* (Abu Dhabi Marine Operating Company, 60 %), *ADNOC-FOD* (ADNOC for Distribution), *ADDCAP* (Abu Dhabi Drilling Chemicals and Products), *GASCO* (Abu Dhabi Gas Industries Company), *ADPPOC* (Abu Dhabi Petroleum Ports Operating Company), *ADGAS* (Abu Dhabi Gas Liquefaction Company), *ADNATCO* (Abu Dhabi National Tanker Company), *LGSC* (Liquefied Gas Shipping Company), *NMS* (National Marine Services), *Borouge* (the Abu Dhabi Polymers Company Ltd.), *TAKREER* (the Abu Dhabi Oil Refining Company), *ATHEER* (Abu Dhabi Gas Company), *NGSCO* (Natural Gas Shipping Company), *NDC* (National Drilling Company), *NPCC* (National Petroleum Construction Co.), and *FERTIL* (Ruweis Fertilizer Industries Ltd.).

*ADCO*, *ADMA-OPCO* and *ZADCO* are the major oil companies and together account for over 90 percent of Abu Dhabi's production. Wholly government-owned is *IPIC* (International Petroleum Investment Company), through which Abu Dhabi invests in overseas ventures, mainly in the Spanish *Compania Espanola de Petroleos* (Cepsa, 9.54 %) which is engaged in Algeria, and in the Austrian *OMV* (19.56 %; this company owns 25 % of the shares of *Borealis*, which, in turn, holds 40 % of *Borouge* in which *ADNOC* is the 60 % majority shareholder). It also owns a 50% controlling share in the South Korean *HDO* (Hyundai Oil Refinery Company), as well as shares in two Pakistani Companies (30 % and 48 % respectively).

US-\$ contract with a consortium of *CMS Energy* and *International Power PLC* for the building and operation of another independent power project in Shuwaihat that produces 1,500 MW of electricity and has a desalination capacity of 100 m gallons per day. In the meantime, when this was written, there were three of these so-called independent power-projects (IPP) in the pipeline, and the health sector, too, was under examination for a future opening to private participation.

Hence, there *is* some tangible liberalization and/or *de facto* privatization in Abu Dhabi's economy, but this is restricted to very few sectors (water, energy, health). While it may seem strange at first sight that such a strategically important segment of the emirate's economy is being liberalized and private actors are allowed to operate in such areas, it must not be forgotten that Abu Dhabi's ruling family remains entirely in control of the development of the sector insofar as minority stakes only are being offered and contracted. The main motivation for this new drive to include private sector participation in the sector comes from the wish to integrate foreign know-how, keep the sector up-to-date and equipped with latest technology, and the need to have skilled managers and workers which the national labor market hardly offers in order to operate these high-tech industries efficiently. However, this relatively recent process will not result in any changed constellation of economic powers neither as concerns the relationship between the local private sector and the ruling families or government, neither as concerns political control over economic power. When this author interviewed respective target groups in both the Federal Ministry of Economy, in the Abu Dhabi Chamber of Commerce and Industry, and at the Dubai Economic Department, all respondents agreed that this was a limited effort of the government of Abu Dhabi in order to enhance the efficiency of a sector which is faced with rapidly growing demand, especially since water shortages in the hot summers have been a common feature in the UAE during the second half of the 1990s.

It should be clear by now that such efforts at enhancing effectiveness do not represent anything that comes close to what 'privatization' means in the other countries that are dealt with in this study, such as the above discussed Egypt or Algeria. Nor is structural economic reform anything which was economically necessary and to which there was no alternative. Hence, however significant the above described developments may be in regional comparison and in comparison with former policies, they do not change the overall structure of the economy to the extent that they would impact on questions of economic type and order. After thirty years of oil bonanza, the Emirates economy still can adequately be classified as a rentier economy.

## Conclusion

In sum, it can be said without hesitation nor doubt that the UAE continue to represent a rentier economy that comes close to the ideal-type. Grace to the oil wealth, the country did



not have to succumb to external pressures from the international financial institutions, as did the other three countries examined here. While the oil-price collapse during the 1980s and, again, in 1998 did hit the national economy, it is especially the Emirate of Abu Dhabi which has accumulated overseas assets which generate dividends and interests that, together with still flowing oil export revenues, make an economic collapse as it happened in Jordan, Egypt and Algeria an extremely unlikely scenario. What is more, the current rentier economy seems here to stay, given the magnitude of proven reserves, and with new discoveries in oil, but even more so in gas still being made. While economic diversification does take place to a certain extent, this diversification still depends to a good deal on the continuous inflow of oil resources into other sectors, as has been shown above. Also, diversification as of the time of writing remains limited until this day, with oil and gas revenues still representing the largest single source of revenues and the most important component in the nation's GDP. In the words of Barthel (2001: 24-25): 'the Emirates [...] will continue for a long period of time to depend to a very high degree on the export of two mineral resources they possess by a caprice of nature. The mono-economic specialization – with all its advantages, but also with all its disadvantages – has not been overcome.'

Rather, the rule that where abundance reigns, the need to design comprehensive and long-term policies remains limited seems to be confirmed in the intra-UAE comparison between Dubai and Abu Dhabi. While the former rapidly approaches its post-oil era and tries to set its sights on true diversification which is today state-sponsored, but is hoped by the government to transform into a self-sustainable economic upswing that one day is independent from official financial assistance and inputs, Abu Dhabi's oil wealth is so abundant that there simply is no need to enhance efficiency in the non-oil economy, to increase competition, to abandon non-market privileges for nationals, or to take other measures that would transform the rentier economy into something else. Quite the contrary: The current organization benefits the rulers as well as their clientele, while the not so closely connected population is still well off and certainly does not suffer from poverty. The current political-economic organization of Abu Dhabi seems therefore extremely stable and, if at all, it could for the foreseeable future only be threatened from outside. Prudent foreign policies have helped, in the past, to minimize that risk.

The preceding sections have shown clearly that the Emirates' national economy cannot reasonably be termed a market order (see Chapter [3] for definitions and types), nor are they in any process of systemic economic transition away from the current rentier structure. The economic process is tightly controlled by the respective ruling families. While this does not mean that no freedom and space for private enterprise exists, the private sector in essence remains a dependent one. It is dependent on the government both politically and – in many instances and a multitude of ways – economically. On the national level, the majority of capital and of the means of production remain in state hands, and so does gross fixed capital formation (at least if the ruling families' overseas assets are included, which for Abu Dhabi and Dubai alone come close to some 200 bn US-\$, according to conservative

estimates). At the same time, the ruling families and their closely affiliated loyalists from the private sector form a social stratum that displays some of the features of a class, mainly in that they are closely affiliated and share common interests, - despite the fact that the term is misleading.

As in the political realm, competitive choice or outright competition is a rare thing to be found. Politically, the ruling families enjoy close to absolute powers which is legitimized mainly through tradition (in contrast, for example, to Saudi Arabia where power is legitimized mainly through the Wahhabi interpretation of Islam and the royals as guardians of the holy sites of Mecca and Medina). Whatever the issue at stake may be, important problems will most likely be resolved through bargaining processes within the ruling families, or through extended consultations which would then include their loyal 'clients' (most often larger families and clans as well) that are not direct relatives of the ruler himself, but have qualified to have a voice either through friendship (which is often 'inherited' from one generation to the next among families) or through some kind of merit in the country's affairs.

This alliance of the ruling family plus some other families form something similar to a ruling class which also monopolizes economic power. This, in turn, has several consequences. One of the most important ones is that, as a rule, this stratum of the local society is either *de jure* or *de facto* positioned above the law. In Saudi Arabia, as the US State Department explained, 'judges do not have the power to issue a warrant summoning any member of the royal family.' Whether or not such provisions are formalized or not does not make much difference. *De facto*, members of the ruling family are exempt from legal prosecution, no matter if they act against laws or not. The above discussion of the Egyptian case shows that this is even the case in many non-monarchical regimes, but the undisputed and indisputable immunity of royals, rulers, and rulers' friends is yet more obvious in the sheikhdoms of the Arabian Gulf such as the UAE.

In case a member of an 'affiliated' family (to the ruling family) has committed a crime or breached a law, he or she stands good chances that no action will be taken in case senior ruling family members intervene on his or her behalf. In fact, this is a mechanism people can and do rely upon regularly, and it would be seen as a mistake in office of a ruler not to act on behalf of his loyal – as long as no other, preeminent interests (such as members of the ruling family themselves) are hurt by the unlawful act of a client. In this sense, the ruler acts to a large extent as an arbiter in disputes – a task that comes close to what Cunningham and Sarayrah (1994) describe as the 'intermediary' or traditional form of *wasta*.

It must be noted and stressed that all this does not automatically involve 'unfairness'. Quite the opposite: The hurt party of a dispute will almost certainly be compensated for the losses suffered (if that can be done), but the compensation in such disputes will be such that disadvantages for the member of the ruling family or the loyal client responsible for the damage be avoided as far as possible. This rent-induced system of rulers and clients continues to work smoothly in the UAE, without any sign of the sort of 'political change in the oil monarchies' that Tétrault (2002) speculates about for the Kuwaiti, Saudi and Qatari cases.

Yet, however well functioning this system may be, it is also clear that it is qualitatively different from a system based on the rule of law where legitimate claims can be enforced irrespective of the person, as it would necessarily be the case in a market economic order.

On the other hand, even though the state controls the overall economic process rather tightly and most likely also owns the majority of savings, means of production and other assets, there is neither any type of modern collectivist ideology which rulers would refer to in order to legitimize their rule, nor can the Emirates be said to be less amenable towards private property than other types of liberal economies. To state the obvious, thus, there is also no doubt that we do not talk here about any variant of a socialist economy.

True, Dubai undertakes extraordinary efforts at diversifying its economy, focusing mainly on the high-tech, knowledge based industries such as new media, the IT sector and the top-end segment in tourism. The much sought-for economic diversification does take place, to be sure, but it does so at a slow pace and to a limited extent only. Even in the twenty-first century, when and where it does take place, growth in non-oil sectors often (if not mostly) turns out to be oil-induced. Overall, the economy still vitally depends on oil and gas exports, without which billion-dollar showcase projects such as *Dubai Media City* or *Dubai Internet City* could not have been established the way they were. It is the state that provides most of the inputs and covers most of the costs of investment. In the long run, the question will be whether such investments will establish themselves independently of the initial input provided by the government remains to be seen. For the time being, however, nothing indicates the end of the rentier state in the UAE.

Taken together with the example of the agricultural sector given above, this also confirms the claim made in Chapter (3) that rentier economies are to be distinguished from capitalist ones: The majority of the national assets is clearly owned by the state which also sponsors the non-oil economy. The emergence of a market-driven price mechanism is thereby ruled out. Moreover, this omnipotent state has not, as our above definition of capitalism would require, the accumulation of ever more capital as its goal. Were that so, it could hardly be explained why Abu Dhabi spends between one third and one half of its revenues each year on fiscal transfers to the federal budget and as aid to the rest of the world.

## Chapter 10

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### Differences and Similarities of Economic Reform Processes in the Arab World

As has been outlined in chapter four above, this part of the book speaks not only of the countries that have been examined explicitly, but claims to have chosen those four countries examined in the previous chapters in a way that should allow for some more general remarks that conclude this empirical part. Yet again, such conclusions must necessarily remain tentative because of the nature of analysis that has been presented within each of the individual country assessments. It was not the aim here to provide hard evidence or to present an all-encompassing analysis of each country. Rather, exemplary evidence has been presented, again from three different issue areas of economic reform processes that I have identified as being especially relevant for both structural economic reform and for the purpose of this book. Thus, while, for instance, the Algerian banking sector has been examined, trade has been left out. This non-comprehensive approach can therefore not claim to present evidence as hard as to rule out any possibilities of counter-evidence.

However, several facts speak in favor of the results being representative, and it is these which strengthen the argument made: While some might think spending time and space on conceptual and organizational considerations as I have done on some long pages in Chapter (4) above is a waste, this has the advantage that it makes the points made a lot stronger argumentatively. Therefore, even though within each country analyzed several issue areas have not been discussed, those that *have* been discussed are (a) relevant and (b) diverse. Viewed as an ensemble, the three areas that have been analyzed in each of the countries (banking and/or the financial system, public sector reform and privatization, plus private sector development and the investment climate at large) do result in a larger picture (even though some pieces are missing) rather than in scattered and singled out pieces of which one would not even know if they belonged to the same puzzle.

Naturally, the evidence presented results in two kinds of findings that can be stated for the Middle East and North Africa. First, there are considerable differences between groups of countries on the one hand which may allow for intra-regional differentiation and the detection of diverging patterns concerning economic reform and its implementation in this part of the developing world. But on the other hand, despite the large differences these countries display in terms of political organization, economic structures and the relative wealth they are

endowed with, they also display an amazingly large number of similarities that allow not only for differentiation between Arab countries, but also for generalization. While the differences are significant and also of interest, it is the similarities that provide a fertile ground for generalizations and for theory-building which might even be applied beyond that particular region (see Chapter [13] below for questions of the universal applicability of the concept presented in Chapter [11]).

## Differences and Similarities

The first notable difference does not come as a surprise: Countries with very high rent income were affected by the region-wide economic crisis that had hit the region, but were able to avoid the accumulation of such a high amount of external debt that would have necessarily called in the international financial institutions. The countries that fall within this category of ‘non-adjusters’ are chiefly found on the Gulf peninsula, but Libya and Iraq under Saddam Hussein also figure within this group. The United Arab Emirates are the most extreme case within this group of resource rich countries; they have the highest per capita income stemming from the export of oil and gas by far (roughly twice as much as Saudi-Arabia, if one takes the amount of oil and gas produced and exported and calculates the level of resources gained as receipts from such exports, and which a given regime can then spend on *each* of its citizens). These countries did reform their economies. Also, shifts in economic policies and policy priorities are noticeable. However, during the period when structural adjustment has taken place in other Arab countries (ca. 1990-2000) these resource rich states have remained the same type of economies as before. Significant changes *within* that type of economy notwithstanding, the resource-rich managed to maintain their rentier economies, as has been exemplified through the Emirati case in the previous chapter. Moreover, they will remain in this economic category at least for the mid-term future. The temporary crisis of world oil prices in 1998 is overcome and price levels registered sustained heights in both 2000 and 2001. However large the amplitudinal shifts in world oil prices may be in the future, it seems unlikely that they fall below levels that were sustained in the past. The only way an end of rentier economies is imaginable today is either that an economy runs out of oil (i.e.: reserves depleted), or that world prices remain durably below a level that is required as a minimum for such economies to survive. Both scenarios seem unlikely for countries such as the UAE or Saudi-Arabia. This is likely to hold true even for those countries not endowed with similar levels of reserves, such as Bahrain, which can exploit their geographical position on Saudi-Arabia’s doorstep in order to gain concessions (which will, again, be rent-equivalent external capital inflows) from their richer neighbors in exchange for stability and regional peace. They will have turned, in case any such scenario should occur, from ‘*economic* rentier economies’ to ‘*political* rentier economies.’ Also it is possible that they will have to enlarge

their domestic revenue base – a process that would turn them into semi-rentiers. That they will exit from the category of rentier economies, however, seems unlikely.

Unlike these very resource-rich countries, *all other countries have experienced a systemic economic transition*, namely away from (semi-)rentier economies towards some form of capitalist orders. This does not only apply to the extremely resource-poor countries, but even to those that are –in regional comparison- modestly or even relatively well endowed with natural gas and oil (of course, ‘resource-rich’ or ‘-poor’ is always meant here in terms of exportable natural resources that generate external capital inflows with a large in-built share of rent accruing directly to the regimes). The rule is: The fewer exportable mineral resources a country has, the earlier its economic transition away from the rentier economy order occurs.<sup>1</sup> This is roughly in line with hypothesis four that has been suggested in Chapter (2). The timing and depth of liberal reform as implemented is not determined, but strongly influenced by the level of external capital-generating resources a country is endowed with. Not only has the relative depth of reforms been dependent on the level of external capital flows available, as suggested by Beck & Schlumberger (1999) and demonstrated by Glasser (2001), but also their timing: Jordan and Egypt, the two resource poor countries chosen in the sample of cases dealt with here, began structural adjustment several years earlier than the more resource-rich Algeria. In the United Arab Emirates, finally, efforts at reform were not only far below the structural level and occurred at the rulers’ own pace and tempo, but significant moves towards privatization and enhancing the investment climate have taken off towards the end of the 1990s rather than at their beginning (Jordan and Egypt) or towards the middle (Algeria).

A characteristic which has proven to support hypothesis ten (informality continues to dominate over formality despite structural adjustment) is that all four countries have in common highly informal traits of social and political organization and in the patterns of interaction that govern both decision-making procedures as well as the implementation of policies. Furthermore, this also concerns the possibilities of enforcement of formal laws and rules. As the various examples from the case studies in this part have shown, nothing indicates any weakening of this prevalence of informality. Rather, it seems, as governments were forced to structurally alter their formal legislative framework in vital areas, they did do so, thereby creating a critical frame of reference to which international institutions and donors could point, but the process of decision-making and the question of *which* rules are applied *when* remains just as informal as it was at the outset of the reforms. Structural adjustment policies have in none of the three countries that experienced it lead to a higher degree of formality, neither in business-business relations, nor in state-business relations, and also not in intra-regime relations. This is not surprising because it was not until the end of the 1990s that transparency and accountability in governance, as newly promoted by the World Bank,

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<sup>1</sup> Cf. also Beck & Schlumberger (1999) on that point. However, in contrast to the present study, they describe this relationship with regard to the initiation of economic liberalization, but do not undertake any considerations of order and type or transitional processes.

condensed into actual policy strategies, at least as regards the Arab world. Today, even the IMF recognizes as an 'issue of major concern' goals like 'the provision of adequate information on the fiscal costs and the terms of assistance or of the restructuring of public (or, in some cases, private) financial institutions and non-financial enterprises' (Kopits & Craig 1998: 5). While restricted to financial and fiscal matters here, the growing post-Washington consensus that governance and transparency are key to the success of structural economic reform has not had any tangible impact on the implementation of reforms in the Arab world. In all countries, a large part of the overall reform process was highly intransparent. Policies adopted officially were either not implemented, or postponed, or all of a sudden subject to conflicting or even contradicting, up to the point that new contradictory legislation was endorsed.

It is the enormously important factional and powerful interests at stake that are one of the main reasons for this contradictory evolution of reform policies, and the appearance, in all three countries that did adjust structurally, of a process that was, to say the very least, not always determined by considerations of what would economically make sense or what had been agreed upon with the financial institutions. Egypt's regime hardly seemed to care about the fact that it had committed itself, in 1993, to the privatization of at least one of the four large state-owned banks, and this situation continued up to the time when this study was written. This means an entire decade of the regime's non-compliance with what itself had ruled, signed, committed itself to and agreed upon in international accords.

Yet, not all issue areas are treated with equal suspicion and hesitance by the incumbent ruling elites. Trade liberalization proved to have been met with comparatively little resistance from within the ruling elites. Quite the opposite, all three structural adjusters actively pursued strategies of entering into agreements and bodies (EU-Association Agreements, accession to the WTO, free-trade agreements, mainly with the US) that they knew would require trade liberalization. By contrast, as was assumed beforehand in hypothesis (7) in Chapter (2) (expect reforms in monetary policies, trade etc. to be implemented more smoothly than in the more political areas like privatization or public sector reform), as soon as it comes to questions about administrative or judicial reforms, the rhetoric used by patrimonial leaders mostly proved to be empty. It was only after a presidentially-initiated larger cabinet-reshuffle in 1996 that privatization in Egypt began to take off seriously. In Algeria, there was still no single one of the larger SOEs privatized at the time of writing, with indicative evidence that strong military interests in the maintenance of certain import monopolies controlled by the army or their clients pose some of the greatest obstacles. By contrast, the Algerian case also showed that trade unions and syndicates which were once among the main constituencies of Arab republics' regimes, have greatly lost in influence. In Algeria, unions did (or could do) nothing to prevent the liquidation of more than 900 smaller SOEs. A similar situation characterizes Egypt: After privatization did gain some ground in the second half of the 1990s, here, too, syndicates and unions remained remarkably silent in the wake of the prospective large-scale dismissals of employees. Jordan, by contrast, already had a significant private

sector and, for historical reasons, the public *enterprise* sector never was as dominating for the economy as a whole as it was in Egypt and, even more so, in Algeria where it still accounts for most industrial outputs. By contrast, it is the Jordanian administrative sector that represents an enormous drain on the budget.

As concerns reforms of the public sector in the non-economic realm, nothing has been done in order to ameliorate the problems of overstuffed bureaucracy. While public sector employees' wages have been falling for much of the decade in real terms, the governments' financial support of the public sector and the administration remained stagnant despite temporary stops of public sector employment in countries like Egypt. In Jordan, although the budget drain of the SOEs was manageable, it still is mainly the administrative sector that poses difficulties for the regime since it swallows too many resources, for too little an output, so that one interviewee, himself a top public sector official, called not for public sector reform but for a 'public sector revolution' (cf. Chapter [7] above). As Waterbury suggested, the public sector, both in its administrative and in its commercial and industrial parts, is the centerpiece of any structural economic reform, and the regimes proved extremely reluctant or resistant to tackle that issue area. In fact, none of the three (Algeria, Jordan, Egypt) have seriously addressed the issue of how to curb state expenses by reducing the public administrative sector to the size needed to provide basic services to the populace. In the absence of any strategy for institutional reforms towards better governance and higher levels of transparency, this leads to an overall picture of a process wherein structural adjustment has been implemented in some areas more thoroughly than in others. The question where reforms were implemented more and where less is not the result of an arbitrary lottery, but is determined by (a) their impact on particularistic private economic interests and (b) the perceived likelihood of broad-scale social resistance which would deprive regimes of the last bits of legitimacy they enjoy – if at all. Hypotheses (6) and (7) are thus supported by the illustrative evidence from the case studies undertaken above. Moreover, the empirical support for that as presented in the chapters of this part of the book can be traced back to the wish to remain in control over the entire process of adjustment. And this, in turn, refers back to the political logic taking priority over economic concerns as noted in hypothesis (5). There is no doubt that in all countries, as hypothesis (5) had suggested, *economic policy is subordinated to higher ranking priorities, namely the aim of maintaining existing hierarchies of power (and the patronage networks they are based on) intact, whatever else may happen. Political survival is, in all countries under consideration and from the beginning to the end, the one factor that heavily dominates the logic of economic policy reform, and it does so all the way through. Unlike the views held by many development practitioners or Western observers, this is not an 'intervening variable' of 'governance' alone that somehow impacts somewhere in the course of economic development or on the success of reform programs. Quite the contrary: The nature of the political system, determining the type of governance, is the independent variable at the outset that is non-debatable, and only then enters structural adjustment as an intervening variable which might change the ways and means by which*



power is retained, but not the fact that the maintenance of political decision-making power, strong enough to control economic outcomes, (determination of winners and losers) remains the top priority.

This reluctance to implement the key cornerstones of structural reform obvious socio-political reasons, and therefore, too, this finding should thus not be all too amazing: The very essence of neopatrimonial rule and the social relations of asymmetric, hierarchical networks it is based on is that he who rules provides benefits and well-being to the population. And this had been done up to the area of reforms by a wide range of allocative instruments with which the state provided social security for its citizens. It was with the economic crises of the late 1980s that the state was no longer able to provide services and jobs to its population which, in turn, had been educated for decades that this is precisely what the state is for and what they can ask for from the state.

The regime's top priority being to remain in control of the adjustment process has been neglected from the very beginning in structural adjustment policies as designed and implemented by the IMF and the World Bank. It is only two decades after such programs have been promoted around the globe that both institutions, this time at the initiative of the World Bank (1994c), have started to realize that governance matters, but still, both institutions seem still far from realizing that governance is a matter that (a) is a function of the specific political order of a given polity and (b) it must be taken into account at the beginning, not in the end or somewhere along the way of policy implementation. In fact, maybe *the* major deficiency in development practice over the past decade is that policies were not designed to fit within the socio-political environment in which they are supposed to be implemented. In the Arab world, this has led to a long-term distortion of the developmental process in that it strengthened exactly those public and private elite actors who are themselves affiliated to one another, are in command of decision-making power, and share the least interest among all social groups in transparency and 'good' governance. Predicting this would not have been an especially demanding task for anybody who has an idea about how Arab politics work. All the more, the magnitude of this failure and the associated waste of resources is hard to believe.<sup>2</sup>

In some instances, such as in Algeria, those who occupy the main positions power seem to not even refrain from physical violence against possible competitors for economic wealth. No Arab country enjoys democratic governance, and that means that physical force is regularly used against competitors for *political* power, should such forces dare to emerge and publicly contest incumbent power holders at all. But that even competitors for *economic* benefits must fear outright violence is an extreme case. In other countries, such as Egypt, the logic of political power is more decisive as a factor influencing policies and their implementation, but holds true as well. Here, the priority of political goals over economic

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<sup>2</sup> Obviously, there are other world regions where a similar comment would be in order. A look at many of the former single-party sub-Saharan African countries confirms this (cf. Caffentzis 2002, for instance, who speaks of the 'apocalyptic failures' of neoliberalism in Africa).

outcomes is handled more subtly via the inequitable application of laws which creates uncertainty and dependency among economic actors, through asymmetric access to relevant business information which becomes more important in the absence of the rule of law, and through the very narrow passage through the gates that lead to personal contacts to political power holders. These, by designing policies and implementing them in a way that secures themselves both political power and economic benefits, guarantee the survival and strengthening of elaborated patronage networks in order to continue political rule.

As has also been shown, in the absence of effective means of rule enforcement, a price mechanism cannot be established and work independently. It can therefore be stated that both Jordan and Egypt have turned from semi-rentier economies to capitalist orders, that Algeria was, at the time of writing, stuck somewhere in the middle of the road from a rentier economy to capitalism with the direction clearly tending towards capitalist development, whereas no systemic economic transition at all was in sight in the case of the UAE. However, *out of the three cases of economic transition, none comes close to anything that could be regarded as a market economy*. The prevalence of political power over economically efficient resource allocation or, from the clients' perspective, the primacy of safeguarding membership in exclusive distributional coalitions over the strife for economic productivity has been demonstrated for all of these countries in all of the areas.

To be sure: This is not a consequence of the 'Arab mind' or any other cultural or religious factors, but easily explainable through prevailing incentive structures that are fundamentally different from those market economies provide. In simple terms: Personalistic ties are rewarded more than efficiency, or, to put it in a more economic way: rates of return on social capital (on investment in social alliances) are higher than on the economic investment of labor or capital in the narrow senses of the terms.

The *third hypothesis* advanced above was that the *political will* to implement structural reforms should be expected to be absent or to exist to a limited extent only because of the inherent threats to regime autonomy that comes about with an economy not steered and controlled directly through incumbent rulers. In the examination of the four representative countries above, this has been verified without any shadow of doubt: Were regimes not under extreme economic pressure or loaded with international obligations, they did not embark on structural adjustment in the first place. This holds true for the ideal-typical oil rentiers such as the UAE or Saudi-Arabia where a transition to a market order is totally out of question, but even for some other countries such as Syria during the 1990s under Hafez al-Asad. Note that the appearance of a liberal market does not imply the existence of a market economy. In parallel to an analytical problem political scientists are currently struggling with: The existence of elections is not synonymous with 'democracy'. And neither is the existence of a large private sector in itself, or the existence of a liberal trade regime alone, synonymous with 'market economy' as an economic order or system.

But let me continue with that third hypothesis: While Syria did engineer economic reforms which in many respects resembled those advocated by the IMF and the World Bank,

its program also differed in important respects, for instance that public sector reform, the liberalization of interest rates, or the floating of the currency could be dragged on for as long as the regime thought was necessary without external pressures setting the pace. On the other hand, Egypt, Jordan, and Algeria – the three countries analyzed here which did have to initiate structural adjustment policies and enter into agreements with the Bretton Woods institutions – all failed to perform the tasks laid down in their first agreements with the IMF, and for all three, their initial programs were cancelled. It was only in the ‘second round’ of agreements (Jordan and Egypt in 1991; Algeria in 1994) that the regimes gave in to pressures from ever rising external debts and the associated macroeconomic imbalances that had become unsustainable. Consider then, in addition to what has been said up to now, several other indicative evidence, such as the Egyptian maneuvering concerning IMF-agreements where announcements of further reforms have repeatedly come just weeks before the respective negotiations, and a similar path followed at several instances by the Algerian government, then support for the fact that the Arab regimes have implemented the neoliberal only most grudgingly is so overwhelming –and counterevidence virtually non-existent- that this hypothesis can certainly be viewed as verified.

### Winners and Losers of Structural Adjustment

One key question remains not dealt with yet, and this is the one that concerns the social consequences of economic transition as a result of structural adjustment. Who are the net winners, who are the net loses? Of course, these are questions of a genuinely political nature and economics cannot help in providing any answers to them. On the other hand, they should catch the economist’s attention as well because the social forces who win are presumably those who will shape the future process. Moreover, these questions are so important for the analysis presented here that they deserve not only mention but a (sub-)section in their own right. It is the winners who are particularly interesting in the frame of this analysis because they wield the influence and power to do so, and it is their behavior that will determine future economic structures and outcomes, thus developmental prospects. The focus will therefore be on the winners rather than on middle classes, statist technocrats, unions and syndicates, or public sector managers who must be counted among the net losers of structural adjustment.

In order to discuss this aspect, i.e. the social consequences of structural adjustment in terms of winners and losers, one sentence from the recent literature on the issue may serve particularly well to illustrate several key dimensions of this aspect. Here comes the sentence that will guide the following thoughts:

‘Substantive multipartism emerges, because the regime believes that it signifies the best strategy for the forging of some kind of “democratic bargain” with bourgeois groups contributing resources to the development program and with popular sectors bearing the brunt of economic austerity.’ (Glasser 2001: 122).

While Glasser's work is most valuable in many respects, there is hardly anything that could be more misleading than this. First, speaking of 'democratic bargains' with reference to countries like Jordan or Morocco (or to any Arab country, for that matter), is of course a clear case of parochialism, one out of the four famous mistakes a comparativist can commit (Sartori 1991: 248f). There simply is no such thing as a 'democratic bargain' in neopatrimonial dictatorships.

But apart from that, there might in fact be another point in which Glasser errs here: Do these 'bourgeois groups' he speaks of really contribute resources to the development process? The analysis of Jordan, Egypt, Algeria and the United Arab Emirates at least suggest quite the contrary. Empirical data for all countries have shown the bourgeoisies to be dependent, therefore structurally weak, and anything but interested in development on a macro-societal level. True, there are instances, such as the 'REACH-initiative' and 'Jordan Vision 2020' that have been discussed (cf. Chapter [7]) in which such a bourgeoisie opts for a developmental vocabulary to advance their aims. But neither their strategic rhetoric nor Glasser's conclusion can convince. The fact that everywhere in the Arab world, neoliberal reform has led to the emergence of newly shaped elite coalitions is obvious. The more shiny elements of private business have been incorporated into elite circles and may be consulted for policy-making even though they do not *per se* have the power to decide upon policies. And while the reason for such a re-formation of distributional coalitions is clear (state incapacity to fulfil necessary functions and international pressure for liberalization of economies), the way this has happened also provides an answer to the question why some parts of the bourgeoisie adopt a developmentalist rhetoric today.

Be it the Jordanian *Young Entrepreneurs Association* or *Intaj*, the new IT-association, be it the Algerian *Forum des Chefs d'Entreprises* or the new business alliance of the entrepreneurial clientele around Gamal Mubarak in Egypt, evidence from all countries suggests that such new formal or informal associations try their best to distinguish themselves from old organizations of state-dependent private sector representatives who have long been recognized as corrupt, co-opted and rather rent- than profit-seeking social actors. Therefore, new groups such as the ones mentioned above are instrumental for incumbent power-holders in presenting an imagery of change toward both the outside world and toward the popular masses at home. At times, they are even actively encouraged by the regimes.<sup>3</sup> In some instances, the rulers themselves present themselves as members of such organizations, as does Bashar al-Asad who had been a member of the *Syrian Computer Society* (SCS) before his ascent to the presidential palace and remained so even after. What is more important than the entrepreneurial side of the associations (though most of them in fact *are* business

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<sup>3</sup> At a two-day conference in Algiers in 2001 that united a number of cabinet members, top technocrats (such as the directors of the public sector holding companies) and some of the country's private entrepreneurs, for instance, Prime Minister Ali Benflis, in his opening address, called it a 'lucky incident' that so prominent and distinguished private businessmen as those that were scheduled for interventions were present because the government, as he said, was aware that they are 'the driving engine of development'. (Author participated in that conference entitled *Carrefour de l'Entreprise*, held at the Algiers Sheraton, Club des Pins, 8-9 April 2001).

associations) is the image of modernity conveyed through such organizations. This confers a certain level of legitimacy to the rulers externally as well as domestically since *any* form of societal organization had been forestalled in Arab countries for decades. Second, in some cases economic liberalization and its social consequences brought with them also a real margin of openness and possibilities for upward mobility due to the fact that regimes *needed* new allies when middle classes vanished, impoverishment grew, and public employment could no longer be guaranteed to everybody. It is the search for political inclusion into the privileged positions of the connected, most valuable in insecure times of change, that is at the heart of the emergence of associations such as the ones mentioned here, rather than the will to organize collectively as an autonomous social force, let alone class, and push the limits against the will of a regime.

In all instances analyzed here, there is no evidence that these groups and their representatives would not seek to exploit existing niches and create new monopolies in order to realize distinctively non-market gains. Their strategies of seeking for private monopolies or oligopolies which they can exploit by virtue of their affiliation to the political elite is certainly not a way market economic procedures and orders are brought about. Therefore, it is not only the ‘democratic bargain’ where Glasser is grossly wrong, but also his assessment of the contribution of resources by bourgeois groups for the sake of development where he seems to have fallen prey to the political rhetoric of societal actors who use a certain vocabulary in order to be incorporated into decision-making on economic policies and in order to achieve, once again, non-market privileges through knitting personalistic ties to the political center of power. In conclusion, therefore, and again picking up Glasser’s fatal sentence quoted above, there is neither a democratic bargain, nor do bourgeois groups contribute to any developmental program.

But it comes worse yet for Glasser: The regimes, according to all illustrative evidence gathered here (and by other authors as well), do not seem to have much of the ‘developmental programs’ Glasser speaks of either! If ever any doubts might have existed as to the aims of liberal reform and the maxims under which they were implemented by the incumbent authoritarian and patrimonial regimes, the evidence presented here from Jordan, Egypt and Algeria as a representative group for all those Arab countries that have undergone structural adjustment has shattered any expectations of incumbents pursuing developmental programs. The one core program that *is* pursued is political regime maintenance; any other policy aims are readily sacrificed for that one overwhelmingly important goal. Bourgeois groups do not *contribute* resources, let alone to any developmental program, but their spearheads are allowed to enter the wider elite circles and are thereby *granted* resources rather than contribute them, or else they are granted money-worth privileges and political guarantees for economic success *from* the regime because they represent, under conditions of structural adjustment, a new strategic ally of neopatrimonial rulers. It would be a blessing for our future understanding of Arab politics and economics if we were to reach the point of discarding the often unconsciously held assumptions and the equally frequently met automatic ascription of

some ‘spirit of capitalism’ to the entrepreneurial groups according to which the Arab bourgeoisie would lead their societies towards free markets and democracy.

The contrary is the case: Private business fulfils a role that becomes ever more essential during the process of liberal economic reform in that it helps legitimizing the incumbent patrimonial regimes both internationally and domestically. Therefore, it is a functional alliance of political and economic elites, or an unseen ‘wedding between political and economic power,’ as one retired advisor of two Arab rulers put it in a conversation with this author, which has gained hold across the Arab world.<sup>4</sup> This growing overlap between political and economic power is a direct consequence of liberalist economic reform processes and has been evidenced by various authors across the region (cf. e.g. Perthes [1995] on Syria; Kienle [2001] on Egypt; Schlumberger [2002] and Wils [2003] on Jordan; Tlemçani [1999]; Werenfels [2002; 2004] Dahlami [1998] and Dillman [2000b] on Algeria; Albrecht [2002a] on Yemen, to name but a few examples).

Whether it occurs in the form of an informal alliance or as an amalgamation may differ from one case to the next and is not important. Intermarriages further blur the lines between the private and the public, but the obvious and important feature to observe is a *growing concentration of political and economic power*. This, needless to say, is about as contrary to the very basic principles of a market economic system as anything can be. Ironically, therefore, structural adjustment, by ignoring the socio-political dimension of economic reform and most of all, by ignoring the power-related dimension of the process, can be said to have structurally forestalled the basics of the market economies it was seeking to introduce.

However, most parts of the populations were quicker to notice that than the international institutions. Local populations were not easily deceived: The new entrepreneurs are for the most part strongly disliked by the local people for these latter know and are being made felt on a daily basis that those *nouveau-riches* benefit not from their contribution to whatsoever ‘developmental program,’ but from their informal ‘ties that bind’ them to the top power holders. The street vendor or workshop owner who has to struggle with his tax declaration is well aware of the fact that the happy few who drive their top-end Mercedes models very likely do not even have to pay half the tax the owner of a small grocery shop or newsstand pays. Such ‘entrepreneurs’ are among the well-liked guests at gatherings like the *World Economic Forum* in Davos where they present themselves as personified hopes on which the future of their countries may be built. They may even gain the approval of Western decision-makers who see in them –alas, at last!– exactly this hope for the establishment of modern market economies which their reform designs proved unable to implement. But the picture they present at home differs significantly.

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<sup>4</sup> Author’s discussion with Adnan Abu Oudeh who held various public offices, among them Chief of the Jordanian Royal Court, and who was a senior personal political advisor to the late King Hussein (as well as, for a short time before retiring, to his son Abdallah II) during the 1980s and 1990s. Amman, November 2000.

Moreover, it must be clearly stated that this group is not an autonomous social force that, as some academics would have it, pursues collective own ends as a social *class*. While the concepts of the ‘state class’ (Elsenhans 1984; 1996) or ‘state bourgeoisie’ (Waterbury 1991; Richard & Waterbury 1996)<sup>5</sup> have helped in furthering our understanding of Arab politics in the 1970s and early 1980s, the new distributional coalitions which have risen in the course of structural adjustment have effectively effaced several of the definitory elements of the concept of a ‘state class’ that today no longer exists. The subject studied by the authors mentioned above has thus, so to speak, dissolved. To contend that no state class exists today in the Arab world does, of course, not mean that there were no socio-economic alliances or that there were no social inequalities. Quite the contrary is true. To be fair to Glasser: He captures concisely ‘the reality that, by and large, this new global economic regime has increased poverty and inequality in the region’ (Glasser 2001: 127). But that does not revitalize ‘class’ as an analytical category of explanatory power for the MENA region.

All empirical evidence brought forth from the various countries studied here suggests that while extended families manage to maintain their economic power and political influence in many instances even over more than one generation, this is not enough to collectively call them a social class – at least according to all common definitions of ‘class’. The patrimonial organization of society is essentially defined through informality and *vertical* hierarchies that cut across those *horizontal* lines that may elsewhere be set by class cleavages. Therefore, if one accepts that in the Middle East we find patrimonially organized socio-political systems that rely on *wasta* and patronage networks as organizing principles (and there can hardly be any doubt that this is the case, given the evidence the chapters above have presented), then *by definition* this is not compatible to class-based approaches to the analysis of Middle Eastern politics. In fact, the very idea of patrimonialism excludes the notion of classes as explanations of politics.

Rather, the new business groups are loose associations who have in common mainly that they belong to those who either are co-opted by the regimes and thereby acquire a range of privileges that helps them secure and guarantee non-market gains, or by the fact that they are aiming at such privileges. What they do not display are features such as a common ‘class conscience’ or class-based collective action. Rather, they compete among each other for influence and access to the top power holders who, in their turn, act as ultimate arbiters between such competing interests (cf. Pawelka [1985: 22ff.] on the characteristics of neopatrimonial leaders).

Another important point that becomes gradually visible as the new entrepreneurial strata gain in influence should not be forgotten: All that has been said above about non-market strategies of this group does not mean that the representatives of the Arab private sectors were not *able* to work along the lines of the market-economic logic of competition. Their foremost representatives become more and more internationalized and have, at least in parts, risen to

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<sup>5</sup> The two terms can largely be used interchangeably and it is not important here to carve out the slightly

the heights of the global players, dine with Bill Gates and deal with other international giants. Take the Egyptian Sawiris empire which today extends over Europe, Africa and Asia, or the Algerian Khalifa group which has become an international business empire within five years only, first owning TV stations in Europe, but only months later being virtually non-existent (but with a nice exile in France), again due to the political downfall at home. One can imagine the degree of power Arab incumbents hold if globally active business tycoons can be deprived of their existence in their home countries at any second. And it is, for that matter, no wonder that the tendency to 'go international' increases once the financial resources to do so have been accumulated locally.

The Khalifas, Sawiris, Osmans, or Ghandours and Shomans are clear instances where private individuals have benefited from intransparent domestic economic structures, acquired fortunes through non-market means, and then internationalized their businesses. The effect of such internationalization (the possibility of which is a direct result of globalization of course), is that these very few individuals in fact become independent from their former political protectors at home and build up personal wealth, influence, and not least: security abroad. Thereby, of course, the home country foregoes resources that could have been invested locally. But the strategy of diversifying is totally rational, given the fact that to play top league with the ruler can always become a dangerous game if one falls from grace with him for whatever reason. The economic consequence of this situation is easy to understand: the result are capital outflows (as has been described, for instance, for the case of Rafik Khalifa's transactions of foreign exchange abroad until the central bank stopped him) that impact negatively on the countries' record of *net* foreign direct investment.

Those who have lived the developments of economic reform during the 1990s in the region have their own notions of what this process signifies, especially in terms of how it is to be interpreted. Independently from one another, two conversation partners in different countries came up with similar historical comparisons: Adnan Abu Oudeh, already mentioned above, sees the process of economic liberalization as having created social constellations in Jordan that resemble those before independency when the country had a largely tribal-based social structure and large landlords and notables had united in their hands (local) political power and authority and *at the same time* enjoyed economic dominance because they also held great wealth. In Egypt, for his part, Muhammad Sayyid Sa'id, vice director general of the influential *Al-Ahram Center for Strategic Studies* in Cairo, also invoked a historical comparison not dissimilar to Abu Oudeh's, but for Egypt. He finds strong parallels between competing factions of the very large private entrepreneurs under the umbrella of the presidency that took place in the late 1990s in Egypt on the one hand, for instance between Naguib Sawiris and several ones of his competitors (such as Nuseir)<sup>6</sup>, and patterns of social forces and their constellations to one another in pre-revolution Egypt when also large private

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different notions in detail.

<sup>6</sup> There are other cases, but that was the example M. Sayyid Sa'id cited.



fortunes had emerged out of Egypt's first wave of industrialization and represented sometimes clashing interests.<sup>7</sup>

Given the fact that political insiders from within the societies and countries analyzed fancy, independently of one another, most similar ideas about the composition of power and wealth in the Arab world as it develops out of structural adjustment, this might tell a lesson. It is, first and foremost, the increasing injustice of emerging patterns of ownership and economic misery for many of the net losers and unprecedented economic wealth for the top one or two percent of the populations which may remind of the older notables system. Also, the fact that the economic wealth not seldom came as a result of political command over resources and both went hand in hand seems remarkably topical. Unfortunately, there is no space here to engage deeper into such historical analysis and into a thorough cross-time comparative effort. But this might be a rewarding topic for other scholars. If these parallels make sense, then their historical consequences should be carefully analyzed by today's politico-economic elites. The responses in countries like Egypt, Yemen, Syria and Algeria were revolutions or bloody wars, and even where that was not the case such as in Jordan, the state did have to give in to popular demands for more equality-focussed policies over the decades that were to follow. While great social upheavals are not in sight today because the risk of engaging in anti-systemic opposition is considered too high by the majority, there is a high level of discontent with the ruling elites in all Arab countries. Remarkably, exactly in those countries that once set out to nationalize their economic assets and make it the property of 'the people', disenchantment seems larger and more wide-spread than in those countries that did not rely on collectivist ideologies. Adjustment in Jordan or in Morocco did trigger bread-riots and the like, but overall has been implemented with a lesser degree of popular dissatisfaction about the rulers than in Algeria or Egypt.<sup>8</sup>

While all of the discussed parallels and differences between the cases analyzed in this Part (II) of the present study may contribute to an enhanced understanding of the impact of structural economic reform and transition on Middle Eastern power structures, social coalitions and the larger social fabric as they impact on economic performance and the evolution of a new economic order, the attentive reader will have remarked that two of the hypotheses listed towards the end of chapter two have not been dealt with in this short chapter that was meant to wrap up Part (II). These are the questions of (a) the type of economic order which has emerged from structural adjustment in the Arab world, and (b) the question of its development prospects.

As for the question of economic orders, some first statements have been made above. They will be picked up and discussed in greater detail in the following chapter. This chapter is an outline of a model to be used as a framework for framing the analysis of economic policy

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<sup>7</sup> Robert Vitalis' (1995) *When Capitalists Collide* is an excellent account of that historical phase which analyzes exactly the point mentioned here.

<sup>8</sup> I freely admit that, in the absence of data on popular opinion (let alone comparative ones), this is merely an impressionist statement resulting from my travels in the countries concerned.

reform. While the present study could not present enough hard evidence to prove that the model suggested holds true, this Chapter (11), plus the following on future economic development prospects and policy recommendations form, in fact, part of the conclusions of this book and are therefore essential.

As regards the question of longer-term development prospects, it is Chapter (13) below that sets out to discuss both prospects of patrimonial capitalism in comparison to other types of capitalist and non-capitalist economic orders. Second, it will reflect on the question of policy recommendations: If the results of structural adjustment as implemented in the Arab countries have led to a systemic economic transition, and if the result is, with 'patrimonial capitalism', in fact the type of order this study suggests, then what should best be done in terms of policies in order to possibly enhance the developmental prospects of such types of economies? These questions shall be answered in Chapter (13) below. Yet, in anticipation of some of what there is to say on development prospects, the impact of the analyzed structures on the overall business climate may serve as a reference.

The general frame is such that, within twenty years, FDI have become the single most important resource for development. While in 1980, more than forty percent of all aggregate net resource flows to the developing world consisted of official transfers, by the end of the century it was only 17.8 percent. Over the same period, the importance of private capital flows has increased from 57.8 percent to 82.2 percent. The picture looks even more dramatic when isolating FDI from all private capital flows and neglecting portfolio equity, bonds, bank lending and others for a moment. Proceeding thus, it becomes clear that the FDI share in aggregate resource flows has risen from a mere 5.3 percent in 1980 to 66 percent in 1999 (World Bank 2000 [GDF]; Sadik and Bolbol 2001: 55). When compared to portfolio investment, it is also clear that the developing world's prospects depend far more heavily on FDI than on investments in capital markets, due to the low costs of labor and the fact that financial markets are relatively little developed in many developing countries.<sup>9</sup>

A quick look at the Arab countries demonstrates their malaise quite clearly: Of worldwide FDI (which are but two third of the aggregate flows), they manage to attract only a meager 0.4 percent (2000); of all FDI to developing countries, the Arab world also lags behind with a mere 1.9 percent in 2000 (Eid & Paua 2003: 109f.), which is certainly not enough to create any sort of acceptable long-term economic prospects (cf. also Henry & Springborg [2001] for a generally skeptic outlook as concerns future development chances of the region).

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<sup>9</sup> The share of portfolio investments in overall capital flows was null in 1980, 4.1 % in 1989, 23.3 % in 1993, but declined again, until 1999, to 9.5 %. By contrast, the FDI share rose continuously without any interruption over these twenty years to reach more than two thirds of all capital flows by 2000. In conclusion, it is far more important for developing countries that they attract FDI than portfolio investments. While one does not exclude the other, there seems hardly any economic survival in the 21<sup>st</sup> century without larger FDI inflows than the Arab countries attract today.

# Part III

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## Reflections on Patrimonial Capitalism

## Chapter 11

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### Patrimonial Capitalism: An Economic Order

This chapter presents some first suggestions on how to assess the results of neoliberal economic reform in the Middle East and North Africa. While it would be over-ambitious to introduce a ready-made theoretical concept, the chapter contends itself to providing a first checklist that can help in finding out in any specific empirical case that has undergone reforms of the SAP style whether a market economy has been established or something else. This ‘something else’ is put in more concrete terms here insofar as some crucial elements are carved out that seem common to many non-democratic post-reform economies. The aim is therefore conceptual and practical at the same time: On a conceptual level, presenting patrimonial capitalism as a distinct type of economic order strives at a refinement of our classifications of different types of economies. This, in turn, is relevant for practical economics since different types of economies have not only different performance prospects but also behave differently when under similar influences. While it may seem trivial to say, it has too often been forgotten that policy measures that lead to desired results in a specific type of economy (e.g. in market economies) may not yield the same results in other types of economic orders. It is the most basic, the most important, and, alas, the most often neglected task to arrive at conceptually and methodologically sound classifications, precisely because classifications are the basis of every comparison (cf. Sartori 1991). Only if our assumptions about what we see are correct can we sensibly find out the specific characteristics of the class of economies that resulted from economic liberalization in the Arab world and, on that basis, design policies that are more conducive to development than were the SAPs of the late 1980s and 1990s in the Arab region.

#### Delineating Patrimonial Capitalism

The type of economic order that has evolved as a result of liberal economic policy change – which, in turn, lead to economic change on a *systemic* level in the cases of Algeria, Egypt, and Jordan, that is: in three out of four cases examined in part two above – this type of economic system is still rather vague on an analytical level and does not lend itself easily to

adoption or practical use unless we sharpen our view as to what makes that subtype of capitalism specific with regard to other variants of capitalism, notably market economies. Therefore, an effort at outlining some of its key characteristics seems imperative at this stage. However, the problem of defining new categories is seldom achieved in a lastingly satisfying way. Therefore, I aim here at approaching a preliminary characterization of what the defining *elements* and specific *traits* of 'patrimonial capitalism' are. A number of points can be listed that seem to represent such definitional elements. These are listed in box (10.1) below; some of them will then be further explained in the remainder of this brief chapter.

Box (10.1): ELEMENTS OF PATRIMONIAL CAPITALISM AS AN ECONOMIC ORDER

- *First*, as in every social system, there are formal rules (laws, regulations, etc.) and institutions, and organizations on the one hand, and informal norms, values, and patterns of behaviour on the other. In a patrimonial capitalist environment, however, the two sets of rules and norms do not work to reinforce each other, but stand in opposition. The starting point for the analysis of patrimonial capitalism is to recognize the *clash of formal rules with informal norms*. Obviously, any concept that does not enable us to *distinguish clearly* between these formal institutions and informal norms or rules falls short of what we must require from analytical tools in this field.
- Second, in different economic systems, the relative weight that formal rules and informal norms possess differ. While in Western-style market economies it is the formal rules that are decisive, patrimonial capitalism is special in that informal norms and patterns of behaviour are observed and being followed more strictly than formal rules or laws (this is the logical consequence of a personalized system of political rule and a patriarchal social fabric). We can even state that, as a rule, *informality dominates* economic transactions and, in fact, the economic system as a whole.
- Third, and as a result of the first point, a *general absence of the rule of law* that is not accidental, but an integral feature of the functional logic of patrimonial capitalism belongs to its specific traits. However, this does *not* mean that formal rules are applied arbitrarily, as is often read. Rather, *formal rules are applied in a way that ensures and promotes the interests of the social alliance or coalition of incumbent political and private economic elites*, that is: those social groups who are in a position to influence and formulate the legal-institutional framework.
- Fourth, since actors are assumed to be rational and utility maximizers, *patrimonial capitalism tends to have ineffective or non-existent policies of competition*. De facto, *in patrimonial capitalist systems, effective competition will systematically be ruled out in sectors where the political-economic top-elite is operating*.
- Fifth, *property rights and contract security can be achieved, secured and guaranteed only through personal socio-political relations with the 'right' individuals*, that is: elite members on a possibly high level who are either themselves in a position to guarantee the

smooth operation of businesses on the basis of their political power, or who are, as a second-best choice, closely enough affiliated through personal or familial ties to individuals who can then secure property rights and contracts on behalf of their clients. As an individual agent in the marketplace, to find out who these persons are requires up-to-date information that is not easily accessible and, therefore, requires considerable ‘social’ investment in time, energy, and possibly also in material resources.

- Therefore, as a sixth feature, *the pace or tempo, timing, and sequencing of further policy reform in patrimonial capitalist systems follows not the economic logic of international development organizations, but the political logic of power maintenance as perceived by incumbent regime elites*. While this is not new to political scientists and political economists (cf. Heydemann 1992; Brynen 2000), it is the conceptual background of patrimonial capitalism that elucidates the ‘why’.
- My seventh point is also a direct consequence of the fifth: Compared to market economies, *patrimonial capitalism has structurally higher transaction costs* because the costs necessary for measuring and enforcing contracts and property rights rise as the legal and institutional setting of the economy is kept up, but often does not fulfil the functions formally ascribed to it. Furthermore, a ‘*second layer of transaction costs*’ arises: the costs of assessing the *probability* of formal rules being enforced or not, that is: of gathering information on which persons to approach and with whom to interact in order to get one’s rights guaranteed and benefit from economic transactions. This weighs heavily, and *efficiency*, even in the restricted sense of constrained maximization, *can therefore not be reached*.
- Eighth, and this goes almost self-understood as a consequence of points two and three above, an economic system of *patrimonial capitalism can not exist in a democratic political environment*. It necessitates a political leadership that is not subject to the consent of a majority of citizens, because only then will it be possible for political and economic elites to pursue the application of formal rules in the way outlined above. Thus, while not every authoritarian or totalitarian polity will bring about patrimonially capitalist economic orders, *non-democratic governance is a necessary condition for patrimonial capitalism to emerge and survive*.
- Ninth, an essential element of patrimonial capitalism is that it is characterized by the dominance of intra-societal structures based on personal relationship, kin, and patronage or, respectively, clientelism. Therefore, *patrimonial capitalism is an economic order that is shaped and to some degree defined by the prevailing socio-political order – and not vice versa*.

Admittedly, the few points presented in the gray box above are a preliminary list rather than an ultimate definition in the scientific sense of the term. But it may still be helpful in tracing and recognizing patrimonial capitalism in the real world. For practical purposes,

this short ‘checklist’ of criteria is hoped to serve as a helpful analytical tool for future research.

Even more importantly, this outline of key elements of patrimonial capitalism allows us to distinguish clearly between market economies and a fundamentally different form of capitalism, and, therefore, also enables policy-makers to assess more coherently and realistically the systemic effects of economic policy reform. Therefore, this effort at finding some elements for a definition of patrimonial capitalism could ideally have a considerable impact on policy-assessments, and a very practical relevance for all those involved in development cooperation and policy-making. What market economies have in common with patrimonial capitalist economies is not more than the general principles of capitalism (that is, dominance of private ownership, and the few other criteria mentioned in chapter three).

In all other aspects, patrimonial capitalism and market economies do not resemble each other the least: The legal and institutional framework serves to lower transaction costs in market economies, whereas it raises them in patrimonial capitalist systems because it has to serve the particular interests of a narrow stratum of ruling elites. In fact, the legal and institutional framework in patrimonial capitalist economies fulfils completely different *functions* than it does in market economies: In the former, it is an instrument of elitist economic control and the prevention of unwelcome competition. It serves thus as a mechanism for market closure, whereas it works as a means to achieve just that competition and to secure the basic economic rights for the individual in market economies.

It should be evident from what has been said by now that there is no ‘twilight zone’ between those two contradicting economic orders. I would like to point out very clearly here that speaking of any such thing as a ‘patrimonial market economy’ would mean committing a serious methodological error. Also, speaking of ‘capitalist market economies’ is like speaking of ‘wet water’ since, by definition, market economies are one among other types of economies that are capitalist – just as water is one among other fluids that are wet.

### Why ‘Patrimonial’ Capitalism?

At this stage, a question is at hand: why should we should call the type of economic system discussed here ‘*patrimonial*’ capitalism? – Accepting that we observe here a specific ‘variety of capitalism’ (Hall & Soskice 2001), there are two things to mention: First, the relatively new mainstream political economy and policy analysis literature that discusses such varieties of capitalism has not dealt with developing economies, but originates from comparative research on OECD countries such as Japan, the US, Germany or Great Britain. By analyzing the distinct type of capitalism discussed here means therefore entering an entirely new field of research in comparative economic systems that has hitherto escaped the attention of scholars of both political economy and political science, and of economics.

Second, literature on developing countries until now has referred to subtypes of capitalism as described in the three cases of Egypt, Jordan and Algeria as ‘crony capitalism’ (Kang 2000; 2002 on Southeast Asia; Henry & Springborg 2001 on Middle Eastern cases), ‘savage capitalism’ (Azm 1995), and a number of other labels. However, what all of these labels lack is analytical clarity and, thus, applicability. ‘Crony capitalism’ is an *ad-hoc* invention that cannot possibly serve as an analytical tool because no criteria have been established that would allow us to define this as a distinct type of economic order and, consequently, there is then also no way of finding out what ‘crony capitalism’ is *not*. Likewise, ‘crony’ does hint to the centrality of personal relationship, but neglects the power-related aspect that is omnipresent in that type of economic order.<sup>1</sup> Also, it does not capture the direct link to the political system and the political elites that, according to the approach of a definition given above, is an integral characteristic of what I call ‘patrimonial capitalism’.

The adjective ‘savage’, on the other hand, implies something somehow ‘unjust’, I shall think, and one might in deed argue intuitively that there might be something ‘unjust’ about patrimonial capitalism. Yet, apart from the fact that I do not wish nor intend to engage in normative discussions here, this term does not lend itself easily to any academic definition either.

There are until this day no serious efforts at finding a term to describe the economic orders dealt with in this study. Therefore, I propose to maintain, for the time being and until more thoroughly elaborated suggestions are advanced, ‘patrimonial capitalism’ as a preliminary analytical category by which systemic economic change can be analyzed in a number of cases as regards the Middle Eastern region – and, as the next chapter will show, well beyond. The advantage is that we have, for patrimonial capitalism, clear criteria for finding out whether any given economy is characterized by the definitional elements carved out above or not, so that a distinction between patrimonial capitalism and other possible (sub-)types of capitalism becomes feasible. Second, the adjective ‘patrimonial’ is able to capture the intimate *link between the political and the economic* that shapes this type of economic system. It is clear here, too, that it is the political logic of power which influences prevailing patterns of interaction between economic agents – as the adjective ‘patrimonial’ implies (which originates from a socio-political context [Weber 1947, Pawelka 1985, Theobald 1982]; see also the discussions above in Ch. 2). The term chosen here is thus clear in that it depicts the politically determined shape of this type of economic order. Third, the asymmetrical power constellations and patronage networks which play such an essential role in patrimonial capitalism are reflected ideally in this term. In sum, I can not think of any other label that would capture equally well both the economic and the political or power-related dimensions which define this type of economic order.

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<sup>1</sup> We would face similar deficiencies if we chose to name this sort of economic system ‘network’ capitalism or stick other sociological labels to it which could be derived from those approaches discussed in chapter (2) above.



For a lack of more convincing alternatives and for the reasons outlined here, I propose to adopt the term ‘patrimonial capitalism’ for the time being. Some scholar may come about with a better terminology one day, but at this moment, I do not see any better solution to the terminological question. Also, I am convinced that there is a rather urgent need of finding *some* term to describe this particular form of capitalism, as will be explained and, hopefully, become clear in the following chapters: It is the practical implications of the differentiation made here, for both academic analysis and for policy-making, which makes the establishment of this category of economic order necessary.

## Patrimonial Capitalism and Political Regimes

As already indicated in the characteristics of patrimonial capitalism above (see criterion no. 8), there is no empirical evidence for the existence of patrimonial capitalism in democratic polities, but this deserves some further explanation. Even though there are occasions where the rule of law seems to be absent in democracies, too, or when laws and regulations seem to be drafted and passed in favor of individual members of the political-economic elite, as was the case, for instance, in Italy under Silvio Berlusconi,<sup>2</sup> there is a *qualitative difference*, that is: a difference in kind, not in degree, between such incidences in democratic polities with market economies on the one hand and patrimonial capitalism as an economic *system* based on certain political structures on the other.

Had Italy an economy of patrimonial capitalism, one should, first of all, not expect large-scale popular opposition to legal changes that obviously aim at the individual benefit of an elite member. Second, such opposition would surely not influence in any form the policy-making process. Also, for patrimonial capitalism to exist and install itself, it is necessary that the economic and political elites have *long-run time frames* in order to be able to establish themselves firmly in ruling positions. In democracies, where at least political elites are regularly subject to the citizens’ approval of them remaining in office, short-lived signs that resemble singled out features of patrimonial capitalism may emerge, but will also disappear again. The crucial question is whether over time, *all* mentioned elements of patrimonial capitalism can be found over a time-span that exceeds the legislature of a democratically elected government. Of course, this depends to a good deal on what we understand by ‘democratically elected’: Does not, say, Jordan, have an elected parliament, plus a king, as does Great Britain? Yes, it does, but apart from the fact that only one of the two parliamentary chambers is elected by vote, parliament has no say in the formation of government: The prime minister is an appointee of the king. Apart from that, there are numerous other points in which

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<sup>2</sup> Other instances might as well include a number of processes under the administration of George W. Bush in the US (for instance the six-fold increase of government contracts that were awarded to ENRON *after* the scandal), but these are less obviously geared towards the benefit of an individual person as was the case with Berlusconi in Italy.

the Jordanian regime doubtlessly cannot be considered a democratic regime - which takes us back to the question of how we define democracies.

I continue to use here, for reasons I have explained elsewhere (Schlumberger 2000), a definition established by Diamond, Linz and Lipset (1988: Vol. II, xvi) according to which a polity can be termed 'democratic' if and when three conditions are met:

- (a) Meaningful competition for all *effective* (!) positions of government power
- (b) Participation (at least through free and fair elections at regular intervals and excluding the use of physical force) so that no major social group (of adults) is excluded
- (c) Guaranteed civic and political freedoms that ensure the integrity of participation and competition (points [a] and [b]).

While this is in essence a shortened version of Robert Dahl's classical 'institutional guarantees' (Dahl 1971: 2-3), this definition is yet more elegant because it is shorter and still includes all major issues Dahl requires political systems to display in order to speak of them as polyarchies. On the other hand, it is more substantial since when reducing Dahl's eight institutional guarantees, he ends up with only participation and contestation left, without any further emphasis on what is required to guarantee the integrity of these two, namely civil liberties and political rights. Once the three conditions listed above are met, then, patrimonial capitalism does not exist, or vice versa: Non-democratic forms of governance are a *necessary condition* for the existence of patrimonial capitalism because a democratic regime can not ignore formal rules and regulations or apply them in a systematically inequitable way over a longer span of time. Secondly, it can not build up patronage networks over time without the consent of the majority of voters. Only where vote has no decisive impact on 'all *effective* positions of government power', as the above definition puts it, have political elites the possibility to build up clientelist networks and systematically co-opt possible counter-elites (such as large private business) and form distributive coalitions with them that are beyond the reach of the electorate.<sup>3</sup>

On the other hand, not every type of non-democratic political regime triggers economic systems of patrimonial capitalism. One evident example is what O'Donnell (1979) described as 'bureaucratic authoritarian regimes' as he found them in dictatorial Latin America during the 1970s. Chile under Pinochet, for instance, which served as a playing field for the neoliberal 'Chicago Boys' since 1976 in an effort to implement the blue-print of a free

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<sup>3</sup> One might argue that patronage networks were (quite successfully in fact) built up in Germany under Helmut Kohl as a chancellor (1982 – 1998), who managed to remain in office for sixteen years and become the 'patriarch' of his Christian Democratic Union (CDU). Sixteen years were certainly time enough to build up patronage networks, install some sort of clientelist mechanisms, and to form ever-shifting circles of a loyal entourage, even when acting against legal provisions, as he did. However, this did not save him from being elected out of office, and illegal or semi-legal activities within patronage circles were largely confined to a small number of party elders rather than penetrating society as a whole. Also, when the judiciary found out about financial practices in Kohl's cabinet, laws were in fact applied equally (not least because by then, a new government had taken over office).

market economy, can not be said to have had a patrimonial-capitalist order even though parallels to features of today's Arab political landscape (one-person leadership, high levels of repression, etc.) are evident and the Arab economic setting, too, has been one of structural reforms during the 1990s. The Chilean economy was thoroughly liberalized (exceptions such as the copper mines notwithstanding), and the leeway for distributional coalitions to achieve non-market gains in a lasting manner were much smaller there than in, say, the Philippines under Marcos or in the Arab economies with an only partially implemented structural adjustment process (on the Chilean reform, cf., e.g., Roesch 2002; Kurtz 1999).

Third, not every country that has a patrimonial-capitalist economy also has a (neo-) patrimonial polity in the sense Pawelka (1985) uses the term in order to construct an ideal-type model: There has, for instance, not been a personal leader acting as a patrimonial ruler in Algeria since at least the days of Chadli Ben Jedid. And yet, the economy functions according to the same principles as do the Egyptian and Jordanian ones. When looking over the brim of the Middle Eastern region, Russia is a case in point that also clearly displays signals of a patrimonial-capitalist economy even though there, too, president Putin cannot (yet?) be depicted as having established himself as a typical patrimonial leader - even though he leaves observers with little doubt that this is precisely what he intends (see Chapter [12] below for details). Likewise, there are other economies such as those in Ukraine, in Zambia and maybe in Malaysia that can obviously coexist with non-democratic *and* non-patrimonial political systems. It must be realized therefore, that even though 'patrimonialism' in this concept hints to the political, as explained in the previous section, it is not used here in the classical or purist Weberian fashion, but rather in the way many social scientists have today adopted the term in order to refer to the dominance of informality and to describe the predominance of strictly hierarchical power-based socio-political relations. Rather than the question whether there is the typical single-person traditional political leader at the top of the state, whether there is a 'presidential monarch' (Hinnebusch 1990), or whether ultimate decision-making power lies with a clique of officers, it is the impact of personalized, hierarchical, and informal politico-economic relations on economic outcomes which is the central idea of the concept.

### A Remaining Conceptual Problem

Even if one found the theoretical model presented here compelling, it also is problematic in several respects. In fact, it is a very preliminary concept. The main point why this is so is related to the term of patrimonial capitalism itself: There is no problem, as far as I can see, with describing the economic systems that I have discussed in this book as forms of 'capitalism'. The criteria for doing so, as outlined in Chapter (3), are all fulfilled.

Much more problematic, however, is the adjective 'patrimonial' in order to describe economic systems that are influenced, or even determined, by a certain non-democratic form

of political rule. I have deliberately chosen the Algerian case (Chapter [8] above) in order to be able to demonstrate this problem: Here, we have a polity that is clearly not patrimonial in the sense of the definitions given by Pawelka (1985). True, the term patrimonialism has come to be used in innumerable ways in political science, adopted to analyze political systems and forms of political rule that are, according to any Weberian or Pawelkan definition not characterized by an absolute patrimon at the helm of the state who controls everything below himself. Also true, the majority of Arab countries, with the exceptions of Algeria and Lebanon, are, in fact, typical neopatrimonial polities with single-person leaders. But the essential point here is that there are economic systems that display precisely the features I have outlined here as defining elements of ‘patrimonial capitalism’, and that are clearly not located within a patrimonial political environment if one understands the term to include one-person-absolute-rule only. That is problematic because I explicitly emphasized the importance of the political system in shaping (though not determining) the type of economic order.

In Algeria, the political order is not neopatrimonial in the classical sense; the country is, by contrast, ruled by a clique of military officers known as *‘le pouvoir’* (the power). On the other hand, we can observe the emergence of an economic order that clearly falls into the category of what I term patrimonial capitalism (absence of the rule of law, dominance of informal patterns of behavior over formal rules and institutions, asymmetric power relations that dominate economic transactions on the whole, political leadership that perpetuates an inequitable application of business laws and regulations because it benefits directly from them, and an elite that guarantees, through the use of patron-client relations, the economic success of those individuals that are politically connected; harsh repression of those elements of society that try to undermine the inequitable application of laws and the personalist informality as a principle of the economic process).

Since this problem concerns the political part of the term, I should, as a political scientist, admit that the origin of the problem lies in political science, not in political economy: The point is that there are today numerous ‘hybrid’ (Karl 1995) political orders<sup>4</sup> which, as the discipline has only just begun to realize, are not democratic (see Maćków 2000; Schlumberger 2002c; Albrecht and Schlumberger 2004). On the other hand, they are neither totalitarian socialist dictatorships, nor bureaucratic authoritarian polities, nor even patrimonial types of authoritarian systems. What the systems of political rule in parts of the Far East, Russia, some of the other Eastern European polities, some African countries, and most of the newly independent states in Central Asia and the Caucasus have in common, is that they are, by all reasonable definitions, non-democratic polities. Yet, comparative politics has not managed until today to find adequate categories to differentiate between non-democratic political systems through the establishment of commonly accepted sub-types, as has been successfully done for different types of democracies (parliamentary vs. presidential, two-party

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<sup>4</sup> Even though the term is better at pointing to a problem of analytical categories than constituting one.

vs. multi-party systems, federal vs. unitary traits, etc. (cf., among many others, the famous works by Arend Lijphart [e.g. 1990; 1968] for an introduction).

While some efforts have been undertaken at establishing different subtypes of non-democracies (see, i.a., Linz and Stepan 1996: 38-54; Sorensen 1996: 76-81; or Brooker 2000; Diamond 2002; Levitsky & Way 2002; Chehabi & Linz 1998: ch. 1), none of them convincingly captures the core elements of polities that have emerged from the transitions in the former Soviet Union, as well as in other parts of the developing world. While some of them, such as Turkmenistan or Kazakhstan, are quite clearly approaching the neopatrimonial type and can be characterized as such, Russia itself remains a problem. Likewise, cases like the Philippines, Malaysia, Belarus, Moldova or Zambia all seem to consolidate in what has become to be called the 'twilight zone' that exists somewhere between democracies and autocracies. This represents unsolved problems and, for all means, await proper systems analysis that could integrate the changing political systems into a convincing model for the future analysis and explanation of non-democratic polities and their characteristics.

This is a problem within the discipline of comparative politics, a problem which dozens of researchers have engaged in for years and that has still not been solved.

At the core is the lack, thus, of convincing answers by comparative politics, to establish convincing (sub-)types of non-democratic regimes. This is a task in which, since Linz established the category of 'authoritarianism' forty years ago, generations of scholars have failed to provide us with a convincing differentiation for the vast category of non-democratic polities. Hence, there is good reason not to embark on that subject in this political economy study and come up with little reflected ad-hoc suggestions. The 'Comparative-Politics Problem' cannot be solved here. But that, in turn, means necessarily that we have to content with what there exists in terms of analytical categories, with the available choice of concepts. From among these, there is no doubt that patrimonialism captures better than any other concept (sultanism, totalitarianism, or even 'defective democracies') the key traits and defining elements of the new economic orders that have emerged out of structural adjustment and the recent economic transitions.

What I have aimed at here is an analysis of economic policy reform, and, via that track, to grasp developments on an economic systems level as well. What has been found by thus advancing is the evolution of a *new type of economic order that is determined by the political rules which prevail in the countries concerned*. Then, if there is a lack of terminological clarity with regard to the 'patrimonial' or political part of the economic orders that have been found to emerge in various parts of the world, solving this comparative political systems problem is simply beyond the scope of this book., all the more since the problem has only just begun to be realized as such<sup>5</sup> The aim here is to achieve a step towards the definition of a type of *economic order* that has been found to spread in various parts of the world, and the fact that

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<sup>5</sup> See the – also preliminary – efforts that Andreas Schedler, Larry Diamond, Steven Levitsky, and Nicolas Vandewalle have undertaken in this direction in their respective contributions to the special issue of the *Journal of Democracy* in April 2002, as well as Carothers (2001).

this type has been found not only in one-person-leadership pure patrimonialist countries such as Egypt, but to flourish also in other non-democratic environments, may even be a helpful insight, and certainly makes the Middle East more easy to compare and situated less on another planet than some would like to have it. Therefore, the Algerian 'exception' is one with regard to the Middle East and North African region, but as will be shown below, not with respect to other world regions.

## Chapter 12

\* \* \*

### Patrimonial Capitalism and Systemic Economic Transition: Beyond the Arab World

It has been demonstrated in Part (II) that in the Arab world, structural adjustment (where implemented, i.e. with the notable exception of the pure rentier states that introduced more moderate economic policy reforms without impact on the economic systems level) has led to systemic economic transitions, from rentierist to capitalist economies. Chapter (11) has suggested a concept that could serve in order to analytically capture such processes and thereby avoid confusion over the results of structural reform. The results of structural adjustment were not always market economic orders as intended by the IMF, the World Bank and others, but often triggered hybrid sorts of economic orders that displayed some of the liberties associated with capitalism on the level of formal rules while dominant informal rules in reality serve to neutralize such liberties and *de facto* work to rule out law and competition.

While there is no time to conduct a world survey on the results of neoliberal economic reform, this patrimonial type of capitalism may not sound unfamiliar to specialists of geographical regions other than the Middle East. In fact, looking at the results of structural adjustment in Central Asia, in sub-Saharan Africa, or in South Asia, there are numerous instances where results of structural adjustment have been observed that display most striking parallels to the Middle Eastern cases examined here. But on the other hand, all similarities, however stunning they may be, also have their limits, and not all outcomes of structural adjustment have been the same around the globe. However, the parallels mentioned seem, at least at first glance, compelling. The question is at hand whether the concept of patrimonial capitalism may be able to ‘travel’, i.e. be applied to other cases outside the Middle East and North Africa without losing much of its explanatory power.

#### Looking Around: A First Glance

*East Asia* is a puzzling region in many respects. However, important for the purpose of this study is that, in parallel with the Middle East and other developing regions, informality is prevalent in East Asia just as it is in the Middle East, but seems to have quite different

consequences. Apparently, it *enhances* the possibility of attaining developmental goals instead of impeaching them. How come? The decisive difference between Middle Eastern and East Asian economic development and liberal economic reform, it seems, lies *not* in the issue of informality. This is a salient feature of state-business relations and of political-economic systems in both regions. What might then be the reason why in East Asia, despite widespread informality just as in the Arab world, economic development took place and the Middle East was left behind?

‘Of particular note in considering the close relations between the state and business in East Asia is the organization of industry, which has helped to formulate and implement government policy’ (Yoshimatsu 2000: 13). This, the reader might think, is certainly also the case in the Middle East: Think about all those business tycoons and private sector barons who even have laws adopted for their own individual purposes. But this is precisely where the difference might lie: In the mode of organization of this relationship. Looking at the Japanese system of sectoral associations of private businesses in so-called *gyokai*, the author highlights the fact that ‘the associations also implement activities to aggregate and enhance the collective interests of the members such as market surveys and the organization of seminars and study groups. This role serves to coordinate competing claims among the firms and prevent them from conducting rent-seeking behavior for particularistic interests’ (ibid. 2000: 13). For Yoshimatsu, the difference thus lies in the fact that ‘the state is connected with broader encompassing interests of the organized business, on the one hand, and is insulated against narrow particularistic interests of individual firms that often lead to rent-seeking’ (ibid.: 14). And a last quotation from Yoshimatsu (2000: 16):

‘To summarize, economic development in East Asia has been sustained by active state intervention. However, the state has not been insulated from the society including business but has been embedded in it, forming a wide range of institutional arrangements. The state also favors non-binding policy instruments and its policies have been formulated and implemented flexibly based on an intensive consultation process.’

Whether this is the ultimate explanation might be subject to discussion. In any case, it provides us with the insight that it is not primarily informality *per se* that hinders economic development or which is responsible for the lack of satisfying economic performance in the Arab world. Rather, we have a strong hint here that some East Asian economies developed well under conditions of informality. Whatever there may be suggested in terms of a future Middle Eastern development strategy, and whatever such a strategy may look like, if the interpretation of East Asian development given here is sound, there is no reason to fight against informality as such, but rather to search for creative ways of circumventing its negative developmental impacts it currently has in the Arab world. The next chapter provides maybe not an entirely elaborated and ready-made strategy, but at least some reflections on policy recommendations that differ considerably from any reform measures that have seriously been thought of until now. The fact that development can be reached *with* informality, as the above paragraph shows, will enter explicitly into these reflections.



But let me turn back to the question of patrimonial capitalism: Although there are traits of patrimonial capitalism found in the East Asian context, it would seem that what we observe there is not equally well grasped with the concept of patrimonial capitalism as are the Arab cases. While there is informality, the state seems not to be as independent as in the Middle East, where at least two decades of primarily rent-induced development have left their traces in the degree of the autonomy of the state vis-à-vis its society. Also, in contrast to the Arab world, the state – as a rule – does not seem to have regularly influenced competition for the benefit of some few particularly well-connected clients. These are certainly two important differences when comparing the state's role in the economic process in East Asia with the Middle East.

Evidence of informality as a salient feature also exists for *Chinese* economic policies: From 1980 to 1994, it has been argued (Agarwala 1992; Wang 2002), the central government's fiscal relations with provincial governments were based on a highly intransparent system of negotiations and bargains which each local government had to strike individually with Beijing. While almost all taxes were collected locally, the share of revenues that were allowed to be kept by local authorities differed firstly because 'at any given moment, there were at least five different sets of arrangements governing the revenue-sharing between the center and the provinces' (Wang 2002: 141) What is more: Even within each of these arrangements, actual revenue-sharing rates varied significantly. With a thus in-built premium on effective bargaining, 'improving productivity and mobilization of resources becomes a lesser priority than skillful bargaining and exercise of leverage. Reliance on such skills, however admirable they may be in themselves, is not conducive to efficiency in the economy' (Agarwala 1992: 17). Most of what has been described here sounds familiar in that it refers to a bargaining process the outcomes of which are determined by informality that leads to collectively sub-optimal performance. Yet, this example provides no evidence for hierarchical relations between political and economic agents, or for the decisive importance of patron-client relations in the overall economic process. This is due to the nature of the subject examined in the cited article, not to the nature of the economic order in China or the nature of economic reform in that country.

Wang finds that, despite high rises in overall GDP growth, fiscal receipts of both the central and the provincial governments have lagged greatly behind the growth of the economy.

This means that the governments' extractive capacities have decreased during the process of economic reform. A hint to the possible existence for patrimonial capitalism would only be given in case one could trace back this declining performance of the state to underlying changes in the political-economic constellation of the actors involved that would have to point more clearly to the systemic attributes of patrimonial capitalism as outlined above in Chapter (11). And this is possible: Not only has the central government courted private entrepreneurs ever since the recognition of the private sector as an important element of China's 'socialist market economy' in 1997, which was then pinned down in a 1999

constitutional amendment. Even the ruling party's doors were opened for members of the private business community, as was announced by Jiang Zemin in summer 2001. More importantly yet are the direct political-economic interactions and relations 'on the ground', that is, between government officials on the local level and entrepreneurs. While bound to the central government's political directives, local officials have often enthusiastically welcomed privatization because it created chances of additional personal income (cf. Sun 1999). Secondly, it is not uncommon for officials to set up private companies and register them under the name of family members. They 'tend to reciprocate favors by granting privileges and benefits to one another's enterprises under their jurisdiction' (Chen 2002: 419). *Nota bene*: the identical process has become fashionable in the Arab countries, as I have demonstrated in Part (II) above. Third, 'some entrepreneurs set up a special coffer to feed the officials, who use part of the "donated" money to bribe their superiors for job security or promotion. In turn, they let the entrepreneurs enjoy tax reduction or exemption [remember the above stated decline in fiscal revenues relative to economic growth; O.S.], and grant them government contracts and loans' (Chen 2002: 419). One local report that deals with 'officials living upon wealthy entrepreneurs' even discusses the phenomenon of government officials *physically* setting up their offices on the ground of thus protected businesses (Huiguo 1999: 11)

In sum, Margaret Pearson (1997: 95–99) is therefore certainly right in insisting on the increased degree of 'autonomy' which private business representatives have acquired over the reform process; the same can also be said about large Arab entrepreneurs. However, 'autonomy' does not seem to be the adequate term here since it is the symbiotic relationship between large private businesspeople and powerful government representatives that is so characteristic of patron-client relationships – which in turn are an integral element of patrimonial capitalism. Patron-client relationships, however, are asymmetric by definition, and it is certainly not the entrepreneurial side (without political office) where power ultimately rests. More apt seems Chen's assessment who detects more than one of the systemic attributes of patrimonial capitalism: 'A fragile legal system' (absence of the rule of law), and an 'entrepreneurial class in a situation in which political protection and favor proved, if not crucial, important for its economic successes', 'unfair and unequal market competition in which entrepreneurs well connected to political power enjoy numerous privileges', 'the strengthening of commercialized patron-client ties between the government and private business' (on this aspect see also Wank 1999) with a simultaneous 'economic vulnerability and political submission of the entrepreneurial class' (all quotations from Chen 2002: 406-8). To speak of autonomy in such an environment is certainly misleading; rather, there is strong indicative evidence for a typical case of patrimonial capitalism that may be in the making.

Taking up the point that informality per se is not enough to create economic orders of patrimonialism and forestall long-term development, David Kang (2002) has suggested interesting arguments with respect to *Southeast Asia*. In his book, he asks about the quite

different achievements of Korea and the Philippines: While corruption, as he says, is endemic in both, Korea managed to develop while the Philippines did not. His answer is maybe somewhat simplistic, but roughly compatible with the findings of this study. In essence, his contention is that while state and business had always been dependent on one another in Korea, this was not the case in the Philippines. In Korea, he maintains, both the state and private business were dependent on one another and no one of them could decisively gain the upper hand. On the Philippines, by contrast, he refers to the patrimonial regime consolidated under Marcos which established a clear hierarchy with private business dependent on the political protection of the Marcos regime for economic success, much like the situation of Arab bourgeoisies that have here shown to be dependent on the top representatives of the regime, the ultimate centers of power.

In *Russia*, ‘the Soviet collapse opened up a legal vacuum in which the *nomenklatura* capitalists moved to advance their own interests’ (Rutland 2001: 4). It was in particular under the presidency of Boris Yeltsin that privatization, the establishment of an entire system of middlemen, new commercial firms and banks took place. Thus, there was ample space for new private business to operate in a legal vacuum with laws, rules, as well as their enforcement being erratic. Some new private ‘businessmen’ grew extremely rich in a very short span of time precisely through the absence of the rule of law and of institutions that would regulate the market. During the early 1990s, the IMF that came in with a reform package, consciously chose to postpone regulatory measures to a later date in order not to discourage ‘the new agents of the market economy’. While informality had always been existent, especially in the periphery where local representatives of the central government were relatively independent in how they ruled their republics, this became an ever more prominent feature of Russian economic policy-making and decision-making structures. What has emerged out of Russia’s simultaneous transition from Soviet communism and from the centrally planned economy was a type of economy that strongly resembles those that have emerged from the Arab economies’ transition from rentierism through structural adjustment. The characteristic features of patrimonial capitalism as listed in the above Chapter (11) can almost all be found in today’s Russia.

Determining who wields economic and/or political power, and who has chances for economic success are today most intransparent and dominated by informal agreements between often murky representatives of political and economic elites. While the origins of this rise of informality, as Ledeneva (1998: 83ff.) explains convincingly, are likely to lie in the vast and impenetrable Soviet bureaucracy which made the individual citizen feel helpless unless he or she was able to find a human being within, the increased prevalence of informality in achieving one’s own ends seems to have become even more accentuated and vital to everyday life *after* the fall of the Soviet empire. Most interesting is the way how Ledeneva argues that the very *nature* of *blat* (the Russian term for what is called *wasta* in Arabic) has changed along the transition from the Soviet Union to the Russian Federation. While *blat* was already essential in Soviet times, as she argues, ‘bribery and corruption have

taken its place' (ibid. 175; cf. also her entire Chapter 6). This can be seen to some degree as an equivalent to the difference sketched out in Chapter (2) between intermediary and intercessory *wasta* as Cunningham and Sarayrah (1993; 1994) have perceived it: While 'traditional' or intermediary *wasta* refers much more to the arbiter-role of tribal leaders in questions of conflict settlement, intercessory *wasta* is equated in the West with corruption and creates, as has been said and demonstrated, social welfare losses. And much reminiscent of the Algerian case, the readiness of new private entrepreneurs to pursue their goals by using 'all available methods, including violence, to defend their interests' (Guardian, 05.07.1995) has become an infamous feature of the post-Soviet economy in Russia. Protected by 'power structures', these businesspeople grew rich often through the channeling of public funds into private bank accounts. This lack of a clear distinction between the private and the public spheres is another parallel that makes the working mechanisms of Russia's economy today so similar, in the underlying principles of organization of the economic system, to the phenomena observed in the Arab economies during structural reforms.<sup>6</sup>

A first look at the post-Soviet economic system in Russia therefore leaves no doubt: All informed authors agree that the economic system has not evolved into a market order. As Yavlinski (1998) put it aptly: 'Far from creating an open market, Russia has consolidated a semi-criminal oligarchy that was already largely in place under the old Soviet system' (quoted in Florio [2002: 390]). In fact, former director general of the IMF (which pumped, in the course of the 1990s, over 20 bn US\$ into the Russian economy!) Michel Camdessus seems the only one who thinks that 'the fundamental laws of market economy have been gradually introduced in Russia' (Camdessus 2000), and considering his personal role in the process, it is not difficult to guess where his positive evaluation comes from. However, apart from such bizarre views of non-insiders to the Russian economy, there seems to be a large consensus about the 'unwritten rules' according to which 'Russia really works' (thus the title Ledeneva [2001] uses).

Concerning the future of Russian economic development as shaped mainly by the informal interactions between large business, organized crime and top state officials, not much can be said today. However, as president Putin consolidates autocratic power in his hands, cuts down the oligarchs and expands 'super-presidential' powers, it may well be that the rather chaotic 'wild' years of Russian capitalism are now channeled into some sort of system in which the top political leaders assert more control of the economic processes inside their territory. The recent clampdown on some of the 'billionaires' (some of whom had rivaling political ambitions) in 2003 seems to point in that direction. If this holds true, then the economic foundations of the *nouveau-riches* are being shaken by the core political elite which is trying to reassert itself at the top of decision-making and demonstrates its unwillingness to leave economic chances unregulated. While most likely this struggle

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<sup>6</sup> For a fuller account on how precisely these mechanisms work in practice, see Kryshtanovskaya (1995). She inquires into the connections between the 'mafia' and the state as well as between the 'mafia' and legal private business.

between the Presidency and the oligarchs on the one hand, and between the presidency and dubious large entrepreneurial structures that extend well into the army and the security services on the other are likely to continue for some time, the business climate is unlikely to improve. Russia today seems in the hand of a re-shaped politico-economic elite that comprises both old cadres and new elements and who combine political influence with economic power. '[...] the lobbying of economic interests turns into political clout. These developments create a special infrastructure which includes every day relations between the politician and the mafia boss, with traditional meetings on a tennis court, in a sauna, sports clubs, remote rest homes and cottages or residence houses. Nowadays, a politician's love of sports is often interpreted as affinity to mafia communities' (Kryshtanovskaya 1995: 611).

This is the context in which Fabry and Zeghni's (2002: 289) 'main question' remains: 'Why is Russia an exception in the context of FDI globalization' in that it attracts relatively little foreign investment compared to the size of the country and to the theoretical possibilities of investment? - The suggestion this study offers as an answer needs not to be elaborated at length: It is the absence of the institutional and legal political setting that would minimize the economic risks of investing in the country which leaves Russia a relatively unattractive place for FDI. 'Although about one million of small businesses were registered,' writes Rutland (2003: 134), 'their development was choked off by bureaucratic regulation on one side and mafia extortion on the other.' A last quotation from this author (ibid.) may serve to demonstrate the parallels to the Arab cases discussed above:

'[...] Russia was in fact ruled by a small number of individuals, loosely allied into rival "clans" that were jostling for the ear of the all-powerful president. Yeltsin's crushing of the Congress of People's Deputies in October 1993 had removed the last major challenge to presidential rule. But Yeltsin lacked the power, and the inclination, to rule as a dictator. Instead, he was pushed this way and that by cliques of influential advisers - the security apparatus, represented by the head bodyguard Aleksandr Korzhakov; the economic reformers, led by Anatoly Chubais; the gas lobby, represented by Victor Chernomyrdin; the military-industry complex, whose advocate was Oleg Soskovets. Real power lay with these individuals, and not with the formal democratic institutions - parliament, the courts, political parties.'

It is precisely the political underpinnings of informal and authoritarian rule which set the frame for the patrimonially capitalist type of economy to take hold. Economic success, as in the Arab countries, is not primarily determined through entrepreneurial talent or competitiveness, but through both political guarantees of being exempted from legal prosecution for illegal activities and by possessing the means (again, often secured through informal contacts to political and military elites) of resorting to physical violence against possible competitors in the market. Competing businessmen were regularly kidnapped and, by the mid-1990s already, this system was so elaborated that Khrystanovskaya (1995: 601) contended: 'Moscow now has flat racketeer rates: \$ 10,000 for one hostage.' Additional parallels to Arab economic orders and their working mechanisms that could be listed at length, but this first quick look to the East shall suffice for the purpose of demonstrating that patrimonial capitalism is a feature which is by no means unique to the Arab world.

As the Russian case demonstrates, patrimonial capitalism is a concept that might be applicable not only to what were formerly called ‘Third World’ countries, but also to the successors of the ‘Second World’. Especially the simultaneousness of a political and an economic transition and the ensuing insecurity about laws and rules might have been instrumental in opening the door towards an increased reliance, by economic actors, on informal contacts, kin, and friendship. Therefore, it is not astonishing that a first and necessarily cursory impression of where patrimonial capitalist arrangements seem to appear and consolidate include many of the former Soviet republics: Georgia and Azerbaijan in the Southwest, Belarus, Moldova and maybe Ukraine in the West, and Kazakhstan, Turkmenistan, Uzbekistan and Tajikistan to the Southeast are examples that would certainly merit closer inspection.

Regarding the question posed in the previous chapter whether patrimonial capitalism was just a transitory phenomenon that occurred as some interim stage in the course of economic transition, a stage on the way to market economies, the quick look beyond the Middle Eastern region undertaken here does not support this view. Rather, it supports the hypothesis that non-market capitalisms are *not* a mere transitory phenomenon, but a distinct sub-type of capitalism that might spread even more in the context of a politically unregulated globalization process.

This may hold true not only for developing economies, but also for the traditional market capitalist economies since for them, it seems functional in order to maintain growth: In developing economies that display the features of patrimonial capitalism, market assessments are, of course, more costly for those who want to invest from abroad and do not know well the socio-political landscape of political and economic power constellations. Yet, the possible profit margins are also high because once a market entry has been achieved, the absence of the rule of law and the political protection from competition allows for higher and quicker gains. Therefore, there are real economic incentives for investing into patrimonial capitalist economies for those few foreign investors who dare adventure into this political-economic game. On the other hand, the case of Sainsbury’s 200-million loss in Egypt (cf. Chapter [6]) also demonstrates the enormous risks associated with such investments and, obviously, the majority of foreign investors is prudent enough not to engage in such insecure activities.

Investing in patrimonial capitalist economies necessarily means adopting the rules of the game as played in the respective economic system; the fact that it is advisable to follow the saying ‘in Rome do as the Romans do’ is not a new insight. Therefore, all we know of learning processes and according to empirical evidence, individual entrepreneurs who were originally operating in a market economic framework have quickly learned to adapt to the different rules of doing business in the structurally different setting of patrimonial capitalism.

Even though this creates social welfare losses, it is functional for economies hitherto organized along the market mechanism to have their private business community adapt to and enter patrimonially organized markets. There, the relatively narrow stratum of politico-

economic elites manage to maintain a climate that is, true, not conducive to any sort of developmental take-offs in the countries concerned. But on the other hand, it is very attractive for those operating in it since the winners have no democratic limits as regards working hours, legitimacy, etc., so they manage to realize higher profits. More importantly yet, there are lesser (if any) restrictions to business success, legal or illegal, since the right connectedness guarantees exemption from the law and thus to be on the beneficiaries' side of the lawlessness and lack of competition. Seen from the side of patrimonial capitalism, these are functional external incentives for the emergence and survival of such non-market orders that are a major driving force of current style of economic globalization. In fact, the question remains whether non-democratic political systems have *always* developed, in the case of a systemic economic transition driven by structural adjustment as embodied by the now-overcome Washington Consensus, non-market forms of capitalism. While Latin American cases may perhaps provide counter-evidence to this suggestion, an answer to the question must be left to future research in this field.

### Lack of Analytical Categories

In his discussion of the Chinese case, Chen (2002) is a good example because, like so many others, he unfortunately lacks a clear-cut model for classifying the developments he correctly detects in his own field of specialization. He must therefore inevitably resort to ambiguous and at times misleading vocabulary such as '*true capitalism*' versus '*probably halfway capitalism*' or even '*communist-led capitalism*' when trying to circumscribe what actually happened during the post-Maoist reform process. At the same time, this lack of analytical categories is also the reason why Chen (2002: 403) regards the 'future of capitalism uncertain in China'. However, the model of a co-optative, patrimonial capitalist economic order presented in this book suggests a different reading: Not the *future* of capitalism is uncertain in such a reading, but rather the *nature* and *type* of capitalism.

Many scholars' problems in analytically grasping and coming to terms with this typological kind of questions is evident when looking at the myriad of terminological inventions made by scholars studying this phenomenon in various parts of the globe. Whether taking it as '*Chinese capitalism*' or calling it '*Market Bolshevism*' with the implication that it were some Russian peculiarity (Reddaway & Glinski 2001), both is misleading since it distracts our attention from the fact that the phenomenon is, in fact, a global one, and comparative approaches would help in realizing this. '*Crony capitalism*' (Kang 2002; Henry & Springborg 2001), in turn, has the advantage of not being restricted geographically in its application, but it suffers from the fact that there is not much of a concept behind the term which *could* be applied. Rather, it can mean a case of corruption in Chicago or Copenhagen, or else a system like the Russian, Jordanian, or Egyptian one. For lack of clarity, this mean-

all-mean-nothing term also had to be rejected in this study, as has been explained in Chapter (11) above.

Chen's above quoted uncertainty stems precisely from the fact that economic reform and liberalization have 'submitted the entrepreneurial class [...] to a status of political and economic dependency' (ibid.) – a finding that perfectly matches with the characteristics of patrimonial capitalism as carved out with the help of the Arab examples examined in Part (II) of this book. Chen's uncertainty is further deepened by undeniable limits of the method he pursued: Apart from academic literature, he used qualitative fieldwork, impressionist interviewing of a number of private entrepreneurs, and the like. The problem is essentially the same as in this study: We cannot possibly assess the statistical significance of the information gathered through such field missions. In order to arrive at such a point, one would have to conduct an in-depth inquiry into the number, profiles, attitudes and interconnectedness of the private business representatives who collectively shape the picture of the 'how' and 'who' and 'with whom' in such economies. Such an endeavor can only be executed in single-country studies, possibly by a team of several researchers who have the money and time to pursue their subject for a number of years *sur place*. Also, such a project is obviously off limits for a single author or to pursue in a monograph.

However, what I suggest here is to use a background slide for the analysis of such economies different from the established ones that lead us to conclusions like the ones drawn by Camdessus on Russia and quoted above. It is time that our top policy-making economists gain a deeper understanding not only of macro-economic indicators and monetary policies, but also on economic orders. The reasons why they (and we all) should have are obvious and can be traced back to an argument of Kuhnian style: There are simply fewer anomalies once we change the paradigm. As has been argued above, what has emerged in various parts of the world are not competition-based market economies, but another type of capitalism whose main traits are squarely contradicting the basic working principles of market economies.

What Chen (2002: 421), in his conclusions, parochially sees as 'special features of the *Chinese* capitalism' are, in fact, not that special and specific to China; also, China seems not a 'rare phenomenon' (ibid.: 405): We find these characteristics in Arab countries, as this study has attempted to show, and we also see them in Russia and possibly in some other post-Soviet Eastern European cases such as Belarus. They can be traced in sub-Saharan Africa (see, for instance, Caffentzis 2002) as well as in Central and South East Asia; the case of the Philippines under Marcos which has been hinted at above, for instance, is very likely to be an instructive one in this context. In fact, the question arises whether the world-wide strategies of liberal economic reform might even have led to versions of patrimonial capitalism in a *majority* of the cases where they have been pursued in non-democratic contexts.

No matter whether this is actually the case, the cursory review of developments in countries outside the Arab world that has been undertaken here leaves not the slightest doubt that we are here not dealing with the cultural peculiarities of a particular world region; nor can religious or ethnic factors provide any sensible explanation for the emergence of patrimonial



capitalism around the globe. This is important to note since many authors still resort to culturalist 'explanations' in their search for the reasons of processes that diverge from the path countries in the Western hemisphere have taken on their way to development. That any author might come up with common cultural, religious, ethnic or even historical denominators in countries so diverse as Egypt, China, Russia, Zambia or the Philippines seems impossible. Rather, the explanation has to be sought for in other variables.

The dominance of informal patron-client relationships is the major difference and maybe the single most important obstacle to a market economic order based on a functioning price mechanism. As a matter of fact, the question is whether a competitive market economy can exist at all in the presence of clientelist practices as a systemic attribute. The answer that the quick glance at world regions beyond the Arab countries underpins is a cautious and maybe preliminary, but nevertheless clear 'no.'

## Chapter 13

\* \* \*

### Patrimonial Capitalism and Development Towards Policy Recommendations

While it is clear now that patrimonial capitalism is significant as a real world phenomenon in that it is not specific to the Arab world, but can also be found in many other areas of the developing world, the question must be: If this is a fact, then does the emergence of patrimonial capitalism mean for the developmental prospects for such countries and their economies?

The possibilities to achieve sustainable growth and development under conditions of patrimonial capitalism are less optimal than under market economic conditions. The socio-political dimension common to rentier systems as well as to patrimonial capitalism has been identified in this study as a prime obstacle to long-term development, and thus, the prospects of structural adjustment policies to achieve their goals had been much better if market conditions could have been reached. Still today, the influence of *wasta*, patronage and rent-seeking remains evident. Their informal nature and their negative impact on overall welfare makes them the ‘natural opposites’ to effective competition and an equitable application of laws, which have, in turn, been identified as the most important elements of market economies with welfare-optimizing effects (see Chapter [3]).

It becomes clear at this stage that the implications of adopting the concept of patrimonial capitalism as a distinct subtype of capitalism are quite far-reaching. Patrimonial capitalism’s development prospects are lesser than those of competition-based market economies; however, the measurement of success or failure of economic policy reform aiming at the establishment of market economies has, until today, been made on the background of neoclassical economic theory – a practice that turns out to be essentially misleading, if not simply wrong. Why? – I agree with the neoclassical assumption that market economies produce, as an ideal-type, the highest levels of social wealth because the allocation of resources, in an economic sense, will be most efficient when achieved through a functioning price mechanism. However, the criteria by which the establishment of or progress toward market economies has been measured to date are deficient in that they fail to examine almost all of the key elements of patrimonial capitalism (as outlined in Chapter [11]). The problem, then, is that a distinction between market economies and a variant of capitalism based on informal patterns of societal relations and a non-democratic political environment, namely the

distinction between market economies and patrimonial capitalism becomes impossible. As a consequence, the neoliberal background on which assessments of the success or failure of economic policy reform has been made to date is in itself in need of thorough revision. There is, as of yet, no alternative concept on the basis of which well-grounded judgements could be made.

If the three types of economic orders discussed in part one (rentierism, market economies, patrimonial capitalism) were to be ranked according to their inherent potential for achieving sustainable growth and development, market economies as defined above would be the 'winner'. As figure (13.1) below shows, the two non-market types of economies lag substantially behind, with patrimonial capitalism taking the lead over rentierism, yet not significantly. The main reason for patrimonial capitalism's edge over rentierism is that the economic efforts at reducing dependence on external factors for growth that are undertaken in patrimonial capitalist systems after structural adjustment are likely to improve the prospects for development to some degree. In this way, domestic productivity will somewhat increase when compared to earlier rentierist times, and domestic taxation, too, might become somewhat more effective. Yet, both criteria qualitatively lag behind when compared to the performance of economic systems that are based on equitably applied rules and laws and a functioning price mechanism as is the case in market economies.

A serious problem, however, is posed by the increased openness towards the global economy as a result of economic liberalization - if the detrimental impact of patronage and *wasta* on development cannot be curtailed. If these socio-political features of the Arab economies continue to exist unabatedly, free trade and global competition may come as traps because systemic competitiveness,<sup>7</sup> in comparison to other developing regions as well as with regard to industrialized countries, can hardly be achieved. In this case, there is reason to fear that the non-oil Arab economies will suffer from serious shocks and economic crises once the whole impact of liberalization is felt. It must not be forgotten that today, the economies under consideration are still in a phase of relatively strong protection against global competition. Assuming an unchanged socio-political environment, and considering the rapidly increasing social inequalities within the Arab countries, it is not difficult to predict that, as a result of the shocks which occur in this scenario as a consequence of real openness and global competition, social unrest and violence may well increase to levels last seen in the 1960s within the next decade.

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<sup>7</sup> For an overview of the concept of 'systemic competitiveness', see Eßer et al. (1994).



Figure (13.1):

### ECONOMIC TRANSITION AND DEVELOPMENT PROSPECTS

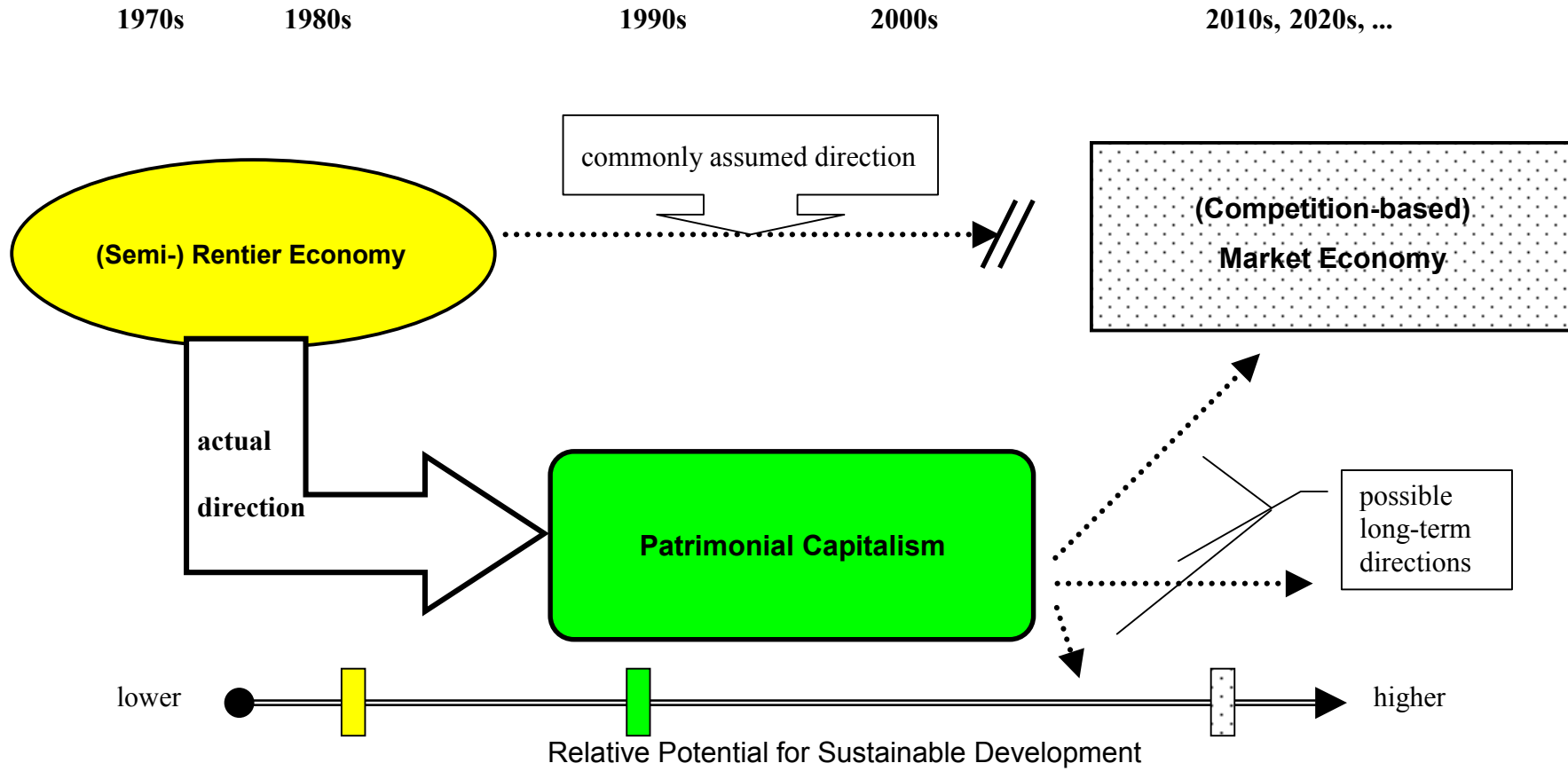


Figure (13.1) above presents, as an overview, the course many Arab economies have taken in their systemic transition from rentier or semi-rentier orders to patrimonial capitalism. As I have argued in the previous chapter, the phenomenon of patrimonial capitalism as analyzed here is not restricted to Arab economies, but is spread today across the globe in many countries that are (a) ruled non-democratically on a political level, and which (b) have undergone neoliberal structural economic reform. The question is whether the grand directions of structural adjustment were still correct in order to achieve market economies in the long run or not. Advocates of orthodox policies might argue that there is simply no shorter road to the establishment of competition-based market economies, and that therefore, SAPs were in deed justified in that they made the liberalizing economies move away from socialist or rentierist modes of production in the first place. According to such an argument, we would expect market economies to emerge in the long run, with patrimonial capitalism being a transitory phenomenon that would ultimately give way to market economic orders. But will market economies come about just so? Are structural adjustment policies strong enough to have the kind of long-term impact on economic structures that the patrimonial capitalist orders that have emerged today will be taken on towards market orders? If that assumption was correct, the emergence of market economies was simply a matter of time. Let me take a closer look at that question.

### Do Market Economies Just Need More Time to Emerge?

Some might argue that the continued implementation of policy reform will eventually turn today's patrimonial capitalist systems into market economies, or to put it in simpler terms: that just more time is needed. To answers this question straightaway: This expectation is ill-grounded. True, the Arab economies still *are* in a transitional period today. The question is whether the situation can be characterized as one in which an earlier order (rentier economy) has eroded and a new one (market system) has not yet been firmly established, so that patrimonial capitalism could be dismissed as a transitory phenomenon and required no further attention. This assumption is against all odds since structural adjustment policies, as has been shown, have proven not to touch on the major socio-political obstacles to economic transition as outlined in the previous chapters. Rather, it seems that indeed systemically different economies have evolved which have been mistaken for market economies because they display some of the outward features of market economies while differing qualitatively from them.<sup>8</sup>

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<sup>8</sup> There is a striking parallel between this rather deterministic expectation on the one hand and the literature on systemic political transitions from authoritarianism to democracies on the other: Strong currents in what political science calls 'transitology' (the study of systemic political transitions) adopt a similar view in that they see democracies as the ultimate focus of any political development. A classical modernization-theoretical

The difficult processes of privatization, where elite resistance has found to be high, are but one out of many examples for this, as has been shown in Part (II). At the outset, entrenched elites strongly resisted even the idea of privatization. When the process eventually gained speed, a wide range of new problems emerged: New, private monopolies, *de-facto* monopolies or oligopolies were created as a result of the transfer of legal ownership. As Cunningham and Sarayrah (1993: 179) have pointed out more than a decade ago: ‘Free enterprise alone neither ameliorates the *wasta* problem nor creates a surge in economic development.’

The core argument is that any ‘technical’ step in the course of structural economic reform neither affects the current socio-political traits of Arab societies as described above nor their adverse impact on both economic development and on the economic transition process proper. At present there is nothing to suggest that structural adjustment programs as designed and implemented in the Arab world throughout the 1990s contribute to any alteration of the socio-political variables which are common to rentier economies and patrimonial capitalism, and which are in no way compatible with the most fundamental exigencies of market economies. It is therefore unrealistic to adopt a wait-and-see attitude with the expectation that a market economy would somehow emerge automatically without tackling the socio-political dimension of the emergent patrimonial capitalist orders. If patrimonial capitalism, however, is a longer-lived type of economic system, obviously the aim must be to re-direct the adjustment process in order to achieve a transition towards the type of economic order with brighter developmental prospects, which, in this case, is a competition-based market order.

## Re-Directing Economic Reform

To be fair: The disastrous record structural adjustment has had not only in the Arab countries but in many parts of the developing world has been recognized by now, and in the early years of the twenty-first century, even the IMF and the World Bank began to speak about ‘moving toward the post-Washington consensus’ (Stiglitz 1998). The importance of governance, or rather what the international financial institutions and other donors normatively call ‘*good*’ governance, has been recognized. It is remarkable that despite their explicitly non-political statutes and their resulting inability of intervening in any state’s

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argument (although mistaking correlations for causation) is by Seymour Lipset (1959) and has been revived in the early 1990s by Fukuyama’s 1992 declaration of the ‘end of history’. In political research, when scholars found that not all cases matched their expectation of the establishment of liberal democracies all over the globe, new classifications were invented in order to ‘solve’ the problem (see Collier and Levitsky 1997): political orders that displayed some of the features of democracies, but lacked other –necessary– ingredients of that type of political regime, were given attributes. However, such attributes (‘defective’, ‘illiberal’, ‘delegative’, etc., and even ‘authoritarian’!) are loaded with grave methodological errors and therefore to be rejected (see Sartori [1991:248-9] on that point). Prominent examples for ‘democracy with adjectives’ include Zakaria (1997), O’Donnell (1994), or Karl (1995).

domestic policies, both the IMF and the World Bank today agree with the UN in perceiving governance as ‘perhaps the single most important factor in eradicating poverty and promoting development’ (Kofi Annan). In this sense, the declaration of the *Millennium Development Goals* (MDGs) and the prominent position issues of governance take on in current development practice can be seen as resulting from the realization of the failure of SAPs to achieve the desired results. To state this clearly: In the Arab world, SAPs swept the region without contributing in any way to the realization of the intended developmental goals. Quite the opposite can be observed: While social inequalities rose and the widening of the social gap between the few rich and the many poor accelerated (a feature which was mostly called the ‘transitional’ or ‘temporary’ costs of adjustment by its proponents, only that these costs often turned out *not* to be transitional or temporary), no significant positive effects on sustainable growth have been achieved through structural adjustment in any of the countries examined here.

All right, says one bored reader at this stage, but: If even those who committed the errors that came as a part of the parcel of structural adjustment have realized that they erred, is it not too easy and vain then to present an *ex-post* criticism of a past that no longer impacts on countries’ present policies? The answer is no. First, these past policies, even if no longer continued in their previous form, still have a large number of adherents in policy-making and policy-advising circles, especially in the Arab world. As I have noted in Chapter (1), orthodox versions of economics are highly fancied in the Arab world and other politically repressive settings because of their seemingly ‘technical’ (i.e. non-political) nature.

Second, while it is true that the importance of governance has been internationally recognized and first efforts of introducing some form of political conditionality in donor activities have surfaced, much remains to be done. ‘Far’ is a euphemism for the distance that divides the current state of research and practices in the main governance-related policy areas (human rights, combating corruption, decentralization, administrative and institutional reform, judicial systems, strengthening the rule of law, etc.) from the long-designed, well-elaborated state and the refinement which structural adjustment policies had reached when they began to be implemented in the Arab countries. If not much more efforts and resources are spent on issues of governance as *the* central, overarching and cross-cutting development-determining factor which impacts on any seemingly technical decision, we are bound to see the failure of programs and projects which do have a governance-component, but which lack the integrated and systemic approach which is needed in order to achieve developmental successes in this area. This, in turn, will most likely lead to the reappearance on the scene of neoliberal approaches that have just been abandoned; orthodox economists will then re-emerge as omniscient development practitioners and tell those who today promote governance that these latter had failed to achieve their goals.

To avoid any misunderstanding on this point: Structural adjustment has thoroughly and, as its name says, *structurally* changed the Arab economies, but without achieving great developmental prospects. Western donors have spent an extremely high amount of resources



in the design and implementation and monitoring of SAPs to achieve this. Therefore, while no figures exist, it is certainly not exaggerated to assume that an equally high amount of resources would be needed to bring these economies on a track with less dim prospects for broad and long-term development. Structural adjustment, as implemented in the Arab world and from an overall perspective, has exacerbated rather than eliminated governance problems in that it created an additional leeway for entrenched politico-economic elites through market liberalization without the introduction of sound competition policies, without improving judicial systems and access to the law at the same pace, and with intransparent procedures having been accepted to remain in place in every core area of reform. In this way, it has strengthened corrupt and unaccountable incumbents and has spared them measures towards a more equal, accountable and transparent application of rules and laws. As a result, structural adjustment has contributed to the creation of an entirely new type of economic order. It is therefore important - not only to satisfy academic curiosity, but also to assess the current situation more properly - to realize where these economies are situated on the developmental track, and what the exigencies are in order to re-direct them to better long-term developmental prospects. Therefore, new governance-focused policies that are currently being designed and which are, at the same time, being implemented by the international donor community will only achieve their desired results if they are based on a correct assessment of previous developments and the current situation. This is the third point why the present study is long overdue but certainly not superfluous.

The current state of affairs is such that governance and institutions are recognized as important variables in the course of development. In development practice however, it has for the most part not been realized yet that the extent of efforts needed to achieve any substantial improvements in the issues at stake will be a great deal higher than current policies foresee. In order not to debase this point from real world developments, a quick look at current practices of major donor institutions may help. The question is: How do the current 'post-structural adjustment' policies look like?

Today's 'post-SAP' development policies are characterized by the IMF's and the World Bank's 1996 *HIPC*-initiative (for those countries classified as 'highly indebted poor countries') and the UN-declared *Millennium Development Goals* with the overarching aim of reducing extreme poverty and hunger by half until 2015. The OECD's *Development Assistance Committee* (DAC) as well as most major bilateral donor institutions subscribe to this goal. In order to achieve this, governance in recipient countries is seen as one crucial factor (among others) which has to be tackled and improved<sup>9</sup> - hence the insistence of donor nations that responsibility for the achievement of sustainable development lies, first and

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<sup>9</sup> Governance issues do not explicitly figure among the MDGs. However, they are recognized in the frame of 'poverty reduction strategy papers' (PRSP) which some of the poorest countries have drafted, and they are also reflected in individual donor countries' strategies towards poverty reduction, including the introduction of sorts of political conditionalities. See, for instance, Germany's 'action program 2015', in which four out of ten core issues are directly related to governance issues.

foremost, with developing countries' governments (see, *inter alia*, the conclusions of the 'Monterrey Consensus' or the contents of the 'Cotonou Declaration', as well as other recent international agreements).

However, governance, as this study has tried to demonstrate, is not only one among many other factors, but may in fact be the single most important factor among all possible other ones. It is not difficult to see why: First, every governmental decision, even the seemingly most technical and nonpolitical one, will trigger social and political effects and impact on existing socio-political constellations of power and resources, or the chances to acquire them. It is only the most obvious ones of such decisions at a macro-level that have been dealt with in this study, but they exist on every level, from rural village neighborhood councils and street vendors on the corners of dusty country roads to the heights of presidential palaces and five-star hotel lobbies.

Second, as Mancur Olson has pointed out decades ago, 'the accumulation of distributional coalitions [as they exist with present Arab politico-economic elites, O.S.] increases the complexity of regulation, the role of government, and the complexity of understandings, and changes the direction of social evolution', while at the same time, 'on balance, [they] reduce efficiency and aggregate income', and, overall, 'reduce the rate of economic growth' (Olson 1982: 74).

The state of governance-related donor policies at the time of writing can be characterized as a gradual acceptance of the importance of the issue. In contexts where the most basic parameters of democratic governance are not a given (as in the Arab polities), governance issues are handled only most hesitantly with local development-cooperation counterparts in practice because of the inherent potential of aggressive good-governance promotion to deteriorate bilateral relations between recipients and donors, but also because no overall concept to which all donors would agree and adhere is available. While the World Bank's governance database that exists since 1996 is a beginning, it is still loaded with methodologically problematic assumptions that lead to incorrect assessments.<sup>10</sup> As concerns policy implementation, governance issues in repressive regimes are mostly limited to some sort of anti-corruption clauses in official inter-governmental agreements that demand compliance with the standards of 'good' governance which is hard to assess and almost impossible to enforce.

It is only logical, therefore, to agree with Kofi Annan in that the role of governance is yet to be fully appreciated. Another point is important to note here: Unlike in proto-type rentier economies such as the Arab Emirates, it is mostly not the abundant influx of external capital which is allocated inefficiently, but increasingly resources of domestic origin. This is so because post-structural adjustment economies come to rely to a greater degree on domestic resources due to the nature of reforms; further, they do so with little alternative since official

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<sup>10</sup> Such as, to give but one example, the ability of a government to remain in place as a criterion for 'good' governance. If this was decisive, Arab rulers were certainly a shining example, representing the world's best mode of governance.

capital transfers, even from the rich Gulf countries, have substantially declined as liberal reforms have been implemented.

If this is the state of affairs in the governance policies, what can then be done at all to achieve more encouraging developmental prospects in neo-patrimonial political regimes with patriarchal societies pervaded by patronage networks? The following section proposes some first approaches that are suggested as a long-term strategy to alleviate the negative developmental consequences of this mode of authoritarian socio-political organization.

### What Can Be Done? – Reflecting on Policy Recommendations

Clearly, the developmental prospects of the economic systems created by liberal policy reform do not match the intentions and expectations of Western development cooperation organizations as formulated at the outset of structural adjustment. Also, well-intended efforts by local policy-makers have yielded rather frustrating results. Accepting this, however, is not easy, since it regularly leaves persons with the best intentions rather hopeless as to the future prospects of the Arab economies: After all, if informal social rules and social structures at large are so deeply founded on norms that prohibit any reasonable prospects for more sustainable development than a few years of increased growth that may even be spurred by foreign aid, then what can be done at all? If any new formal rule, law, or institution that is created will immediately be penetrated by persistent patterns of behavior that impact negatively on performance and development, is there then *any* institutional or legal change that might have prospects of triggering, at least partially, the results that were needed for an economic system with somewhat better prospects of long-term performance? In the following, I take up these questions.

Obviously, there is no easily implementable solution to such complex problems as changing social norms. However, there may be some thoughts which could at least help in distinguishing possible from impossible avenues in such a process and in creating more conducive conditions for development than those currently prevailing. I return, once more, to institutional economics. Even though they are not helpful here in their own, they do provide us with hints that are helpful when carried a little further than does Douglass North in his seminal book (1990b: ch. 10). In his considerations about the connection between institutional change, changes in taste, and changes in relative prices, he establishes the following inter-relations (ibid: 86):

‘The process of institutional change can be described as follows. A change in relative prices leads one or both parties to an exchange, whether it is political or economic, to perceive that either or both could do better with an altered agreement or contract. An attempt will be made to renegotiate the contract. However, because contracts are nested in a hierarchy of rules, the renegotiation may not be possible without restructuring a higher set of rules (or violating some norm of behavior). In that case, the party that stands to improve his or her bargaining position may very well attempt

to devote resources to restructuring the rules at a higher level. In the case of a norm of behavior, a change in relative prices or a change in tastes will lead to its gradual erosion and to its replacement by a different norm.’

What is essential for our purposes here are the remarks on informal norms of behavior. Obviously, it would be welcomed by the vast majority of development cooperation agencies and practitioners if a ‘change in relative prices’ occurred that would result in an erosion of social norms that have been recognized as inhibiting or decreasing prospects for economic development in the long run. Considering the last sentence of the above quotation, the question then is: Under which conditions will that said ‘change in relative prices or a change taste’ occur – or even more: can it be brought about, and if so, how? Since we know hardly anything on the mechanisms of changes in taste, I shall focus on changes in relative prices here. A ‘change in relative prices’, in this context, means that the costs of clinging to existing informal norms of behavior rise and the costs of deviating from it (or behaving according to norms different from those that prevail) decrease when compared with one another.

My point is that even if such a change in relative prices is sought for, it will only occur if an ever increasing number of individuals ‘subscribe’ to a *systematic and voluntary deviation from the norm* (‘deviation’ here means behavior according to the rule of law and a conscious and explicit rejection of any offers or requests for *wasta*). Now, one could ask with good reason: How and why should such a thing ever happen when reality is such that everyone feels better off *with* the employment of *wasta*, since this allows him or her to have a feeling of being personally able to achieve maybe not his or her ultimate goals, but in any case *some* improvement of his or her lot? To start with, if development institutions, politicians and their advisers, or development cooperation agencies want to change the performance of institutions and organizations to the more ‘efficient’ in the conventional (economic) sense of the term, their first goal must be to achieve a change in relative prices of behavior according to various informal norms. Changing relative prices, as is known, alters the incentive structure that shapes human behavior in their actions with one another, ‘and the only other such source is a change in tastes’ (ibid.: 84).

Any strategy towards achieving greater economic efficiency through a change of societal norms must not be a word-by-word translation of Western recipes into an Arab context. Given the deep-rooted skepticism among large parts of the Arab societies vis-à-vis Western influences that results from the very ambiguous experiences the Arab world has made, since the days of Napoleon, with the West (imperialism, colonialism, super-power domination, externally induced economic reforms that did not benefit the majorities of the populations), the question of Arab identity is a very sensitive one in deed that has been a subject of heated debate within the Arab world (see, for instance, Al-Jabiri 1994; Al-Jabiri 1991; Ghoseib 1993; Ghalioun 1992). Any strategy to achieve a change in informal norms and patterns of behavior must therefore be perceived by the populations concerned as originating from within their own societies. Therefore, I suggest, it has to bear key characteristics of the norms that prevail within these societies: It must, most of all, be

*informal and voluntary*. Policy-makers from within the Arab countries as well as practitioners of development cooperation from outside have ample experience with failed institutional reforms on the formal level, and if anything, this experience confirms Sharabi's claim that any formal institution is penetrated by prevailing informal mechanisms: 'wherever it exists, patronage dominates' (Sharabi 1988: 45).

All experience tells us that changes to the formal legal-institutional framework do not automatically lead to changes of socially dominant patterns of behavior. It may sound trivial, but nevertheless has to be stated clearly: changes to the formal rules will only be successful if they do not contradict informal societal norms and patterns of behavior – as they do until this day. Even the introduction of codes of conduct that might go along with the establishment of new institutions or the restructuring of existing ones will therefore, in themselves, not result in lasting changes of behavior unless prevailing norms and rules are tackled themselves.

What is proposed here has to do with the concept of codes of conduct, but is based on a somewhat widened understanding of what is meant by such codes. The most difficult problem with respect to codes of conduct is the question of measuring non-compliance and enforcing sanctions for non-compliant behavior: By what mechanism can non-compliance be identified? If identified, how should non-compliance be sanctioned, and, no less important: who has the legitimacy to impose sanctions? These are problems that necessarily have to be resolved before any sort of code can be expected to trigger encouraging results. Let me get back, for a second, to the above mentioned requirements of informality and voluntariness: 'Membership' to a code of conduct according to new norms has to be voluntary because if required by the law, it simply represents yet another formal rule – whereas I have explained above that the most essential point is that the strategy be based on informality.

The objective of any such strategy obviously is to increase the developmental potential of the economies concerned. In other words, their long-term performance prospects are to be enhanced in a way that eliminates the negative *impact* of currently prevailing socio-political norms and values *without attacking them*. In case it these objectives could be realized to a substantial degree and in a lasting manner, there are two main direct benefits that could be expected, each of which would:

- First, a noticeable *increase in productivity*: Significantly higher labor productivity due to a reduction in the costs associated with the use of *wasta* will lead to increased overall factor productivity, which in turn is a critical element for growth. Thus, *better overall growth prospects* are the result. This holds even more true for the long-term prospects because growth created by an increase in productivity is *more sustainable* than growth resulting from an increase in factor inputs. Through increased productivity, *enhanced competitiveness* on a global scale, in the age of globalization more important than ever, can be reached.
- Secondly, *higher international investment financing*, mostly in the form of FDI inflows, because costs for investors are much lower. FDI will be both higher and more stable,

which results in *increased employment opportunities*, a dire need in all Arab economies today; additionally, the *technological progress* inherent in FDI will contribute to further increases in overall productivity. Such development may in turn lead to further improvements of the overall investment climate which is likely to trigger *positive spill-over effects for domestic private investment* as well.

In the Arab world, even more can be gained from tackling the problematic socio-political dimensions of structural adjustment than in several other developing regions because of the pervasiveness of patronage, rent-seeking and the resort to *wasta* intercession in this region. Spending resources on neutralizing the negative developmental impact of such socio-political factors is therefore bound to bear greater fruit in the Arab world than in developing countries where political systems are of a less patrimonial nature and societal rent-seeking activities are less common.

### What Should be Done? - A Two-Pronged Approach

To tackle the problems discussed here, two basic strategies can be pursued, and in fact, both should be followed simultaneously since they can mutually reinforce one another. On the one hand, the current efforts to arrive at policies for better governance on the formal level must be continued and further elaborated. On the other hand, such efforts are unlikely to bear fruit unless they are complemented by strategies on an informal level. Let me first suggest some steps on the formal level that have been too little reflected until now or have too little weight.

#### a) '*Official policies*' promoting competition

Coercive governmental policies aimed at curbing the use of *wasta* and rent-seeking are problematic: Experience with anti-corruption policies has shown that coercive governmental measures alone are unlikely to substantially reduce corruption. This is so because *wasta* and rent-seeking are just as discretionary patterns of behavior as is corruption, and because they are embedded in the politically as well as socially dominant system of patronage. First, the political will to design adequate policies cannot be taken for granted in the Arab countries because the political regimes' power is based on the existence of patronage networks. Second, even if adequate policies are designed, their *implementation* will most probably, just like the implementation of structural adjustment policies that conflict with vested elite interests, fall short of expectations. The mere establishment of new institutions to combat *wasta* would be useless since they themselves, like other newly built institutions before, would soon be penetrated by the informal influence of rent- and *wasta*-seekers, so that yet another formal

layer of institutions would turn into a façade. Therefore, stress must be laid not on the combat of wasta and rent-seeking, but on the promotion of competition, because one of the most important and negative consequences of wasta-seeking and patronage in Arab economies is their use for the exclusion of economic competitors from the market, which is equal to a market closure.<sup>11</sup> Where competitors already exist, wasta is used to search protection from them and thus create new non-market gains. Therefore, in spite of the dangers inherent in such a step,

- (1) *sound national competition policies must be designed, and*
- (2) *a body be created which supervises their implementation.*

However, this is not enough. These national bodies should be strengthened by the

- (3) *establishment of a regional competition authority (or ‘anti-trust authority’).*

Egypt has recently agreed with eighteen other Arab League states to achieve free trade within ten years. This would be an adequate frame to establish such an authority on a regional level to complement the free trade agreement; furthermore, that would be another step towards urgently needed regional integration. Yet, the (necessary) absolute independence of the representatives of such an authority from their national governments as well as from business interests would be hard to assure. Therefore, the regional authority could at the same time act as an arbitrary body for complaints about violations of anti-trust laws and competition policies on the national level.

In this respect, much can be learned from the example and experience of the EU. Still, it cannot be expected that such new institutions work as intended from their first days. Therefore,

- (4) *international institutions must include competition policies and their implementation as well as transparency in public administration much stronger than today as integral parts of structural adjustment.*

Political feasibility would be enhanced if the necessity to develop and, more importantly, enforce competition policies and the rule of law (as essential elements for economic development and transition) were formally acknowledged by the IMF and hence be included as essential points in official negotiations the Fund holds with national governments in the framework of its regular ‘Article IV – Consultations’. This would *give governments real and material incentives to promote the rule of law* in the pursuit of their everyday tasks. Since competition is maybe the single most important requisite for market economies, monitoring of the progress achieved must be on a regular (if possible even semi-annual) basis. It is absolutely necessary that the two most important financial institutions (IMF and World Bank) leave no doubt that they insist on effective competition policies and will readily freeze funds in case this is neglected or ill-performed. They should:

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<sup>11</sup> Contestability theory tells us that the welfare benefits of ‘perfect competition’ can be achieved already when only one condition is met: freedom of entry to the market. Hence, the role of ensuring competition can hardly be overestimated. For an introductory discussion of various approaches toward competition policy, see Fishwick (1993).

- i) initiate special programs for fostering competition; and
- ii) strongly encourage national governments to evaluate the progress made (in annual or semi-annual reports to be submitted to the IMF and/or the World Bank).

Likewise, they should

- iii) strongly encourage national governments to evaluate transparency in public administration and fiscal administration and present the findings in annual reports to the IMF and/or the World Bank.

Alternatively, in case a country considers this as too much interference in internal affairs, it should then be free to enter into

- iv) regular ‘Competition-and-the-Rule-of-Law Consultations’ with the international organizations.

Such consultations could be modeled along the lines of the IMF’s ‘Article-IV-Consultations’, where the IMF team assesses the situation through a number of consultations with the ministers concerned and the prime ministry, as well as, if possible, with the heads of state, and then draft reports on their findings. These reports should then serve as a basis on which to discuss facilities and their respective level (the amount of grants and loans) that is made available for national governments.

In order to achieve a quick increase in the efficiency of the institutions supervising competition and their implementation, it should be agreed that *the newly established authorities are*, at least for an initial period, *externally financed* (e.g. by the World Bank), and, as the *Bank* already does with great success in other areas, then has *a decisive say in personnel matters* – with the aim of ensuring that *recruitment* is *merit-based* (rather than on patronage) in order to get the most competent, not the best-connected persons to staff these new decision-making centers. Resident representatives must have a strong voice in advising the Bank’s ‘Private Sector Development Department’ on whether objections against employment of certain candidates exist or not, because they are likely to have a better idea about the personalist networks existing in the countries they reside in than have the officials in Washington.

Of course, such action can be morally problematic: Under all circumstances it must be avoided that among local populations the impression takes hold that imperial agencies are at work. This is not the case, and I explain below how such possible resentments can be minimized by turning to the informal level of the proposal. Only if both complement each other will they bear the potential for long-term change.

- b) *‘Informal policies’: the voluntary societal level*

The measures proposed above are but a few out of many more one could think of, but they all touch on areas of the reform process that are crucial for future performance prospects.



Further, they all belong to the track of ‘official policies’ where action can and should be taken. However, the rule of law and the establishment of competition eventually depend on society at large, and, in an economic context, specifically on government administrators and bureaucrats on all levels as well as on private business to accept them, and to realize that the benefits for all could be augmented if intercessory wasta and rent-seeking were reduced.

All recommendations presented until here will, as indicative results show, hardly be sufficient to effectively circumvent the wasta mechanism without further supportive measures – as long as heads of state and their families and proxies tend to benefit most from the patronage system.<sup>12</sup> Hence, ‘official policies’ can, with the help of the international financial institutions and other developmental agencies, be one starting-point, but not the only one. It is by no means self-understood that national governments in the Arab countries would show the commitment necessary to enforce laws and regulations to combat wasta. Secondly, it is at a much more profound level that an evolution of societal norms and values would have to take place; the prevailing patterns of interaction would have to change as a result of the recognition of their nature as developmental obstacles. And it seems unlikely that this can be achieved by yet new legislation and institutions alone. Therefore, the societal level has to be approached. Here, coercion is of no use: Forced change of social behaviour will only create anger and frustration, and social values simply cannot be changed by coercion. Therefore, the second strategy has to be voluntary: Whoever likes to join in the efforts shall be free to do so, who does not shall not be punished in any direct way. But in what efforts?

Robert Cunningham and Yassin Sarayrah (1994), two social scientists who have asked exactly this question, asserted that any attempt at an eradication of wasta was bound to fail ‘because of its centrality to the Middle East value system’ (Cunningham and Sarayrah 1993: 191). Consequently, they have proposed not to combat the very existence of wasta itself since it was too deeply rooted in society. Rather, the goal should be its transformation into forms and ways which economically are not to be considered as obstacles to development. However, their practical suggestions suffer from inherent contradictions and are therefore not convincing. Here is a way how such a transformation of societal norms could be achieved:

The first step is the

(5) *establishment of a ‘code of conduct for the civil service’*

This proposal has already started to be put into practice in Jordan – entirely voluntary and from within the civil service: In the aftermath of a conference on ‘Transparency in Jordan’ held in Amman in May 2000 and organized by the Arab Archives Institute, some civil servants elaborated a ‘code of conduct for the civil service’. This was signed by those who, in some cases encouraged by the insights gained at the conference, wanted to curb patronage and wasta in the civil service (for details, see ‘War on Wasta’, *Jordan Times*, 8 June 2000). The new and promising aspect about such a code is that nobody is forced to sign it. However, those who do sign promise to act according to the rule of law and not to use wasta in the

pursuit of their duties. Such a system seems to require a high degree of idealism on behalf of the signatories; however, as the Jordanian evidence proves, it can in fact take hold. Clearly, it has to be ensured that within this group of signatories, it is acknowledged that the principle of merit only counts, and that no intra-group interactions are tolerated which perpetuate the wasta mechanism.

It is recommended that a list with all signatories is regularly updated and made available to those having signed, which should not pose great problems in the age of electronic communication. This will create a sense of group identity conducive to if not needed for the pursuit of a common objective. Violations against the self-binding code of conduct would have to result in immediate removal from the list of signatories. Here, as well as with updating the list, international organizations like the World Bank, but also NGOs like Transparency International can provide moral, financial and logistical support.

Next, opportunity to sign this code of conduct should be extended towards the whole of public sector management and state-dependent agencies and institutions. The second step is to

*(6) initiate the introduction of a similar or even identical 'code of conduct for private enterprise'.*

Entrepreneurs will ask what their benefits are. These will emerge clearly at the point when

*(7) the signatories' lists of the 'code of conduct for the public sector' and the 'code of conduct for private enterprises' are exchanged.*

Businessmen figuring on the 'private sector list' then know exactly with whom to deal in the bureaucracy without incurring costs for - legally - self-understood services. As a final step,

*(8) the list with private enterprise signatories should be passed on to foreign chambers of commerce and embassies.*

Foreign chambers of commerce and industry and Western diplomatic representations should then use the list as a reference for foreign investors looking for local partners for their businesses. The foreign chambers of commerce would also have to bind themselves to the principle of advertising only and exclusively local partners figuring on the private sector signatories' list. The result is that the perception among international entrepreneurs of how to do business in Arab economies will greatly change. It is not necessary to stress how much such change can improve not only the investment climate, but in the long-run also global competitiveness of the Arab economies.

Once all these steps have been taken and communication between foreign chambers of commerce, local private business and the state bureaucracy is up and working among the members of the mentioned groups who have signed their respective codes, once it has become clear that adherence to them is desirable and cost-saving for all those involved, and once public acceptance of the code of conduct has been established, time would be ripe for

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<sup>12</sup> The fact that they benefit most is an inherent trait of vertically structured patrimonial relations as they prevail in Arab societies.

(9) *the transformation of the code-of-conduct concept from an informal agreement among a small number of signatories into a formal institution supported, not obstructed by national governments.*

At this point, foreign institutions like international organizations, embassies, cultural centers, foreign research institutions, chambers of commerce, etc., can make a start in ‘officializing’ these new institution by requiring membership on the code-of-conduct lists for employees in their respective institutions. The goal is to provide an example for the national public sectors: Once embassies, cultural centers, chambers of commerce, Euro-Arab business centers, etc. advance with giving formality to the hitherto informal concept of a voluntary code of conduct, the importance of the concept will have gained so much publicity that developmental agencies could start encouraging national governments to follow suite. Governments, in turn, will have had time enough to become convinced of the benefits of an efficient administration and may allow the same principles to be adopted for recruitment in their public sectors.

Parallel to the entire code-of-conduct concept, and as a complementary step to be initiated early on,

(10) *donor-financed training* in the understanding of the negative impact of corruption, rent-seeking and intercessory wasta on economic development should be provided, in the beginning with the help of foreign advisors and experts. However, it should be sought for to pass on organization and teaching of such seminars to qualified signatories as soon as possible. Participation in such seminars could be open to both, mid and high level bureaucrats as well as businessmen, since both can benefit from them. This will have the effect of strengthening and spreading acceptance for the code of conduct signatories list even further.

The concept of such lists of voluntary signatories has a wide range of advantages which make its success likely, the most important ones being that

- it is *informal in nature*. Knowing that group structure in Arab societies is characterized and dominated by informality (Bill and Springborg 1994: ch. 3 and 150-75), this makes the concept fit into the social fabric of the existing societies. To this it must be added that
- it is every *signatory’s private decision to join* or not. Those having joined form a presumably *small and informal group*, at least in the crucial starting phase, and small groups have a significant advantage over large one’s when it comes to achieving the desired aims. Smaller groups have better organizing capacities than have large ones (Olson 1965: chap.1), which is valuable especially in an early phase. Also, the free-rider problem is minimized in small groups as compared to large ones (ibid.). Monitoring compliance is easier when the number of members to a group is limited. However, we can reasonably assume that, as membership increases over time, so do the organizational capacities of the group.

In all these aspects, the system of voluntary lists comes very close in its form to the characteristics of the *wasta*-mechanism – with the decisive difference that it has the opposite effect on economic development. But there are further advantages:

- the *concept does not rely on formal institutions, rules or procedures* in order to succeed. Therefore, resistance to this form of organization is difficult to organize. In principle, the new form of organization will be as hard to alter or influence as is the patronage system today. Any attempts to undermine it from outside will therefore be easily discernible and be registered as such. This has the advantage of facilitating the monitoring process of the system's implementation and, more importantly, its continuation by donor organizations who could, for instance, reflect on sanctioning such attempts to undermine it, from whatever side such destructive efforts may come.

However, there is one serious problem that must necessarily be solved: What incentives, other than their idealism, do citizens have to sign? Incentives to sign and remain on such lists should be provided on an individual basis. Within the public sector, the government could pay annual premiums to those who have figured on the public sector list for more than ten months of the respective year. These premiums should not be symbolic sums of money, but at least in the range of two month's salaries. It is easy to predict that even then, the government would have saved enormously on a macro-economic scale. But let me turn to further advantages of the concept:

- it has *extremely low costs*. The distribution and updating of the lists involves virtually no costs at all when compared to the sums spent on less vital reform measures which then fail precisely because of the prevalence of patronage and *wasta*. The only substantial costs are those of support and maintenance of the interconnectedness of the various lists.<sup>13</sup> These can easily be borne by private sector entrepreneurs; they benefit to a higher degree than public sector employees since they have now partners in the bureaucracy on which they can safely rely in not having to pay bribes, socialize, do favors in return, etc. They also benefit from their lists being used as a reference tool in foreign chambers of commerce and embassies when foreign firms are looking for local partners.

However, at some point in time, membership in the signatories' community will be considerable. The groups will thus no longer be small, which could be a threat to their goals. On the other hand, there are several lists for different target groups, and from a theoretical basis, this turns into yet another advantage:

- organizational capacities and the likelihood to achieve collective action in the direction of collective goods increases when large groups are structured as federations, in which smaller units unite to achieve a common goal (see Olson 1965: chs 5.D and 6.D). Identification will first be with the smaller group, but, if goals do not conflict, 'loyalty'

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<sup>13</sup> Technically, this should not be a problem: Free software programmes such as 'oc4ware' and others exist that do not require higher levels of computer literacy than does, say, 'Microsoft Word' (see: [www.oc4.org](http://www.oc4.org)). Thus, the only 'real' costs involved would be those necessary for keeping the interconnected lists up to date. For this,

will also be with the larger federation. In our case, the *signatories of the separate lists are organized in a federal form from the very beginning*.

The expectation, then, is that, slowly but steadily, the benefits of membership on the list, plus the threat of being socially stigmatized when removed from the list or when not having signed at all, outweigh the losses of non-market privileges and rents that can be gained when not signing. This is the point when social norms and values will have begun to change, since then, the value attributed to behavior along the lines of the laws would be higher than the one attributed to their circumvention. Hence, here is a feasible way for

- *a change in social norms and values without imposing alien concepts* of Western origin. In fact, not the whole social system is changed: As with the use of *wasta* intercession, private and informal networking would still be the most salient feature of such a system, and in this sense, social continuity is maintained. Their current detrimental impact on social welfare and economic development, however, is eliminated.
- *The concept proposed here is inherently integrated and systemic; it can be adopted flexibly both geographically and with regard to policy areas*. It is integrated in the sense that wherever such ‘islands’ of new norms are created, they are relatively easy to inter-link. The approach is also flexible insofar as there is no fixed starting point. An introduction of codes can be made either within sectoral reform policies or cross-cuttingly over various areas with different target groups, depending on any given country’s specific conditions. Also, while the approach presented here originates from studies on the Arab world, it is not geographically limited to the Middle Eastern setting. As has been noted above, patrimonial capitalism is not unique to Arab economies. The approach here can ‘travel’ to any economic system in order to re-direct reforms and enhance performance and long-term development prospects wherever the features of patrimonial capitalism are detected.

Clearly, an endeavor similar to the one outlined here aims at lowering the costs of deviating from prevalent societal norms for the individual in the long-run and to effect, thereby, precisely the ‘change in relative prices’ discussed above. However, a change in prices for the individual will only be attained if the number of participants to such a network becomes large. Ideally, that may be the case over time, but the crucial problem is the starting point: There seems little incentive for individuals to start such a project since the number of initiators will always be small. Therefore, there is a need for persons who devote themselves to the establishment of such an informal network even at an early stage when the number of cooperators is small and possible benefits are still far ahead. In the private business and NGO sectors, the only motivation for individuals to initiate such a process can be the conviction that their sacrifice is worthwhile and the belief in that process itself as a means to enhance the prospects of their own countries. Given such requirements, it is clear that the initial number of

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admittedly, one or two persons would have to be employed on a medium-term basis as a minimum. However,

persons willing to make such sacrifices for a benefit that is, by definition, uncertain, will be small. However, one could imagine that, at a later stage, the government could reward private sector list members with tax incentives such as limited holidays or reductions on the corporate tax rate for approved members. Of course, this establishes new enforcement costs (who approves how?), but compared to the welfare losses currently incurred through intransparency and the lack of accountability on all sides, these can safely be assumed to be marginal.

It is extremely important here to bear in mind that such ‘official’ steps can be hoped to yield success only when taken at a relatively late stage of the process when the informality of the system is on the point of being transformed into a formally binding system. Otherwise, if the initially informal system of voluntary lists becomes a formal institution too early, it is almost certain that it will face the same fate as other newly created formal rules and institutions, namely that the omnipresent patronage system will penetrate and pervert the list system.

Second, given the hierarchical and patriarchal structure of Arab societies, it seems essential that at least some prominent and well-known figures of public life lend their names in order to attract others to participate – not least through their own personal and clientelist networks. Such persons, to be sure, will most probably lack the power to sanction behavior according to the ‘old’ norms. Ministers and heads of state, for instance, cannot be expected to participate in such a project themselves, since their political power is essentially rooted in hitherto prevailing norms that are to be changed – which, in turn, could result in a decreasing capability of regime maintenance. Rather, prominent academicians, journalists, Imams, TV-hosts, or lawyers are among those whose presence within such an informal network would be important at the beginning. Also, it should be possible to convince some medium-sized private enterprises to take part. With such ‘spearheads’, membership in the lists would enhance chances for a rapid increase in membership of the lists. Larger entrepreneurs, by contrast and as a rule, will be too closely affiliated to the political leadership. Therefore, the privileged position to which they often owe their entrepreneurial success, is at stake. We can predict that they will tend to estimate the potential costs of becoming a list member considerably higher than the potential benefits.

Yet, a word of warning seems in place here in the direction of anyone who is tempted to embark on such a project: The deliberate change of relative prices in the system of prevalent societal norms is, in any given society and at any given point in time, a highly problematic undertaking because it cuts deep into the culturally inherited and characteristics of society that are passed-on from one generation to the next. Therefore, any society that undergoes such changes will lose some of the traits that makes it distinct from others; thus, a sense of identity may easily be lost on the way of reform – a part of social identity that might not be replaced with a new one with the same ease.

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compared with the social losses that occur today, these costs cannot but be considered negligible.

Having said this, it is hardly necessary to point to the fact that a classical education in economics will not yield great results when tackling the questions discussed here. Economics may be the area where phenomena make their impact felt, but the phenomena as such are of purely social and political nature. Therefore, enhanced cooperation between all social scientists, including economists, political scientists and sociologists is highly desirable for advancements in the cross-discipline field of economic development in developing economies. Hitherto, it was mostly economists who have been regarded as those in charge for questions of economic performance, but as this chapter demonstrates, economic performance is the result of a multi-factor process, and those variables that are directly linked to and can be discerned with the knowledge economics provides us with are but some of them, and not necessarily the most important ones. Political scientists and sociologists should raise their voices to be heard a lot clearer than they are today in both policy design and formulation and in monitoring implementation. Any systematic and integrative approach towards issues of governance, the eradication or alleviation of corruption, transparency and accountability will succeed only when all disciplines join forces. This is all the more relevant for think tanks and donor agencies, including the World Bank and the OECD's DAC, where today economists are over-represented almost everywhere and the necessary know-how from political scientists, let alone sociologists, remains a resource that is still largely untapped.

## Chapter 14

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### Tentative Conclusions: Patrimonial Capitalism and Economic Order in a Globalized World

This study has shown that, while the richest Arab countries introduced only limited economic reform towards the late 1990s, most of the other, less oil-rich Arab countries underwent neoliberal economic reform of the structural adjustment style; they experienced not only an ‘adjustment’ of their economic orders, but a systemic economic transition. This was in line with the international financial institutions’ intentions that aimed at the creation of liberal market economies because these latter were seen, according to classical thought, as maximizing social welfare through efficient resource allocation. However, instead of market economies, economic orders emerged that in several ways displayed some of the outward features of competition-based market economic orders, but work according to fundamentally different principles.

To put it as briefly as possible: Despite liberalized trade regimes and the transfer of ownership from the state to the private sector, it is the core principles of how market economies work that have not been installed through economic reform in the Arab countries, namely a functioning price mechanism built upon competition and the equitable application of laws which, in turn, is necessary to enforce legal claims such as property rights.

The type of economic system that has emerged in ‘structurally adjusted’ Arab economies has been examined with the help of the cases of Algeria, Egypt and Jordan, and while these three differ enormously in terms of their political systems, their economic structures and with respect to demography and size, the strong parallels in their principles of the political organization of the economy served to carve out, in Chapter (11), the key features of that type of economy I called patrimonial capitalism. This (sub-)type of capitalist economy, shaped by the predominance of political power over economic efficiency, has found to be distinct to non-democratic political regimes in which informal patterns of social interaction dominate societal organization and thereby prevent the rule of law from taking hold.

Contrary to what some may have thought, patrimonial capitalism has been found *not* to be determined or shaped by religion, culture, ethnicity or traditions. The opposite is true: it is a genuinely *modern* economic order, combining some traits of market economies with the socio-political features of patrimonialism based on patronage and informal, hierarchical



networks. As has been explained in Chapter (13), this type of economy does not yield the performance benefits of competition-based market economies.

Therefore, patrimonial capitalism differs from market capitalism in terms of long-term performance prospects, in terms of power-distribution and distributional coalitions, and it is fundamentally different from market economic orders in terms of its underlying functional logic and micro-economic rationality.

Of course, the statistical relevance of thus singled-out features is hard to assess or test empirically, which is one weakness of the model proposed here. Testing would require long-term in-depth fieldwork in every single case that has to be assessed. Since this is rarely possible, the argument pursued here was to give an initial list of key features of this type of economic system so that whenever a given number of such systemic attributes of patrimonial capitalism are found, we are likely to do better in our analyses of the economy's performance and workings as well as in the underlying social relationships (and, not least: in constructing policy recommendations!) when assuming that we deal with an economy of the patrimonial capitalist type than assuming some forms of 'defective institutions' (Wang) or 'mistakes', 'inefficiencies' etc. in the economies concerned. The features we detect as 'inefficiencies' or 'defects' are likely to really be efficiencies and weaknesses, since they do not *aim* at maximizing welfare, as many economists tend to think of institutions. Rather, they aim at maintaining control over actors and the relative level of political and economic power they command. It is the viewpoint that is wrong when we speak of this type of economy as inefficient. They are, in fact, *very* efficient *politically*. As long as this is not realized, as long as policy advisors and donor organizations do not explicitly take that into account and are aware of the fact that this is the overriding principle, sound policy recommendations will not be seen.

If patrimonial capitalism is a genuinely modern feature of many non-Western economies that is not related to culture, religion, ethnic composition or historical experience, (see Chapter [13]), then other explanations have to be found. Everything examined here suggests that such an explanation is most likely to be found in the *interrelationships of the political and the economic order*; a non-democratic environment, for instance, is crucial. In sum, the hypotheses of the introduction and Chapter (2) have been supported by the empirical analysis undertaken in Part (II): A political analysis of economics (White 1993) is crucial and even has to *precede* the economic analysis of economics in assessments of cases of patrimonial capitalism. This is so, *inter alia*, because the assumptions of conventional economics are invalid in that type of economic order. The explanatory power of economic modeling is not only seriously flawed in such a context, but utterly useless. Approaching a patrimonially capitalist environment with economic modeling is trying to use a hammer for sawing because it means the application of (analytical) tools for (real world) objects they are not made for.

If today, as has been suggested through a preliminary look over the brim of the Middle Eastern region, many non-Western countries display non-market types of economic orders, then one of the key challenges for the future –apart from those already mentioned (in-depth case studies on the working mechanisms and logic of patrimonial capitalism and the development of analytical tools to economically and politically formalize this functional logic)- is the question how patrimonial capitalist economies interact with competition-based market economies.

Globalization knits ever more densely the net of interactions between systemically different types of economic orders. An intriguing question, even though it cannot possibly be answered here, is: How do such increased levels of interaction impact on the respective types of economic orders? How do they evolve in the course of such interactions? – In the long run, not only a statist typology of economic orders is needed, but process-oriented models are desirable that provide answers on how economic systems evolve over time, under which circumstances, and what influences trigger which kinds of changes to the orders as such. For the time being, it seems reasonable to assume that economic globalization, tremendously accelerated over the past two decades, might in fact be the single most important influencing factor in this issue.

One assumption would be that through increased interaction with market economies, patrimonial capitalist systems will gradually shift away from their present (in this view: transitory) stage of patrimonial capitalism and will, eventually, result in market economic orders. Yet, I see no inherent reason why this should necessarily be so. Rather, there is a good deal of deterministic and scientifically ungrounded thought in this assumption which is well known from classical modernization theory (cf., e.g., Lipset 1959, Huntington 1968).<sup>14</sup>

An alternative assumption that might just as well hold true would be that increased levels of interactions between different types of economies also work in the opposite direction: That patrimonial capitalist economies influence competition-based market economies. In order to find out whether influence in this opposite direction takes place, analyses would have to take under scrutiny competition-based and export-led<sup>15</sup> market economies, then examine, over time, the development of indicators that are typical for patrimonial capitalism (Chapter 11), and see whether or not such non-market traits of economies become implanted into economies that hitherto were characterized as competition-based market orders. One way could be to trace, for example, the development of the

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<sup>14</sup> While it is true that these authors deal with political rather than with economic systems, classical modernization theory also sees a strong link between market economies and democracies. Both are regarded as ‘higher’ stages of development which developing (this term in itself is telling!) nations have just *not yet (fully)* achieved and are *still* struggling towards them. Good work should be aware of this and mind those little indicators such as ‘yet’ and ‘still’ which reveal a whole underlying world-view that is rarely justified through academically valid arguments. Despite its invalidity, it is so wide-spread that it is impossible to list the instances where authors, sometimes consciously, but often unconsciously, adopt this kind of language. We should be a lot more aware of it, recognize the intellectual error it contains and, most of all: avoid it!

<sup>15</sup> Export-led because they are the ones with the highest levels of interaction with non-market orders.

*Corruption Perception Index* (CPI) as established and measured annually by *Transparency International* ([www.transparency.org](http://www.transparency.org)). Significant cross-time changes towards increased levels of corruption need not necessarily be, but *could* be a sign for the alternative assumption holding true, to some extent at least.

While most probably, influence runs both ways, it should be remembered that this opposite direction of impact is likely to exist. In an extreme scenario, that would mean the gradual erosion of competition-based market economies into something ‘less’ (again: note how difficult it is to avoid normative language!) than market economies, and maybe their gradual transformation into non-market types of economies, albeit probably not fully fledged patrimonial capitalist orders. As long as the democratic political environment exists in market economies, however, market orders turning into economies of patrimonial capitalism is hardly possible.

On the other hand, it is also agreed that globalization, in parallel to its economic effects, narrows the political options of nation-states in many policy areas and, therefore, can be regarded as weakening the (still predominantly national) *political* decision-making centers compared to the (by nature non-democratic, and increasingly international) *economic* centers of decision-making. Ironically, there could be said to exist a strong in-built tendency of globalization to erode the very foundations of competition-based markets. Mergers and acquisitions proceed at a rate never known in human history, and the accumulation of power and wealth in the hands of ever fewer individuals associated with it runs squarely counter to the logic of competition and the rule of law that are the foundations of market economies. Furthermore, these developments, spurred and accelerated through the political influence neoliberalism had gained over the past two to three decades, do not only run counter to the logic of the free market, but also against the idea of ‘capitalism and freedom’ (Milton Friedman, see Chapter 2) - which is where neoliberalism initially originated from, and which represents yet another irony of historical developments over the last three decades of the twentieth century. It were precisely the neoliberal policies, forced upon developing economies from the outside, which helped create what Friedman, as quoted above, had warned against: ‘the greatest threat to freedom is the concentration of power.’ Structural adjustment and its underlying neoliberal ideology, while using Friedman as a reference, has proved instrumental in creating and shaping economic orders in various parts of the world that are *defined* by a concentration of both political and economic power in the hands of amalgamated politico-economic elites, and which will be close to impossible to break up again.

At this point, some might be tempted to call the way structural adjustment has changed the economies of the ‘Second’ and ‘Third’ world ‘distorted’. Again, this is erroneous: To use the term ‘distorted’ implies that there is another developmental trajectory, namely an ‘undistorted’ one, with a ‘should-be’ point of arrival that has somewhere been lost out of sight on the way. But this, again, has an underlying tone that is highly normative and implies a distinctively Western viewpoint which is detrimental to understanding ongoing processes in the developing world.

I have started out by asking why the results of economic adjustment did not trigger the intended results, considering that the magnitude of efforts that were spent on this endeavor both in terms of human and financial resources hardly have any precedent in human history. As the analysis of Part (II) has shown, and this is a third major irony in the developments that has occurred in the course of IMF-promoted structural adjustment policies, it is precisely the externally imposed liberalist policies as advocated by foreign organizations and institutions that brought about a transformation that may ultimately – given the likelihood that influence runs both ways - have unforeseen and undesired global implications not only for the developing world, but for the industrialized economies as well. Today, a non-millionaire will *de facto* stand no chances of becoming president of the United States. An Italian prime minister has the political power to introduce legislation in order to save him from being legally prosecuted for corruption. Other examples could be added.

From the other side of the scene, the larger Arab entrepreneurial figures have long diverted their economic interests and fortunes to include major stakes in the West which places them and their representatives on the boards of important international companies. Concentration is an ongoing process. Leaving aside the notion of power, therefore, as does network theory and at times also the New Institutionalism, forecloses the view on these developments which are important in that they contribute to the shaping of today's and tomorrow's face of the world.

Also, there are a number of structural international factors that point in the direction of the said influence running both ways. To name but one: Nobody doubts today that large export markets are needed to maintain growth for the traditionally industrialized economies. However, as this study suggests, many of such markets with which interactions already have tremendously increased over the past two decades are today emerging as non-market varieties of capitalism and can be grasped with the analytical frame provided here. China and even more so Russia are just two of the most significant and important ones. If the influence runs both ways, and if interactions between the agents of patrimonial capitalism and market capitalism are increasing, then the degree to which market economies are changed will increase accordingly.

To come back to the analytical questions of this study, a last word is due on classifications: Of course, as in all typological or classificatory effort, the crucial questions hover around the 'cutting points' of classes and types. For this to be resolved, however, it takes at least another book. For the time being, I contend myself to having argued for a more differentiated view on economic orders with all that implies for empirical research, methodology, development cooperation and policy formulation in practice. One is the possibility of a gradual but global harmonization of economic orders by the dynamics of convergence between different types of capitalism.

Another concerns the causal relations and interlinkages between economic and political orders. Much, maybe too much has been said and written on that topic which can not

be repeated or discussed here. However, it has been demonstrated here for one world region at least that political orders can be coining for economic systems, even the formula is not that (b) follows from (a). Rather, the rule seems to be: If there is (a), i.e. a democratic political order, then there is not (b), patrimonial capitalism. This rule has been deduced theoretically in Chapter (2), and only then has it been empirically verified (in Chapters [6] to [10]). Because it is based in theory and not induced empirically from a few cases only, it can be expected to hold true universally and not show weaker results when testing it in other world regions. It is important, however, to take into account the definitions made in Chapter (3), namely that capitalism is not synonymous with market economies.

The causalities between the political and the economic are, of course, not deterministic, but of an impacting nature. But even the little evidence this book has taken a look at casts more than dark shadows of doubt on those who proposed the formula that economies should be liberalized and democracy would then follow suite. This is a case of wishful thinking (or strategic political rhetoric) which has not happened anywhere in the world where political change was not pursued in its own right. The question whether economic organization can bring about political order, as formerly argued with the example of Europe, is shaken by overwhelming empirical counter evidence from all parts of the developing world. Realizing this, the bases of any argument in the style of modernization theory are severely weakened. The main point of this analysis is that sustainable economic growth seems, for large parts of the world, not possible without a minimum of legal regulatory certainty that is not given in many of the economies that have emerged after the downfall of the Soviet union, and after structural adjustment in a number of Arab, African and Asian countries. If one important conclusion can be drawn for future policies and recommendations, it seems clear that issues related to governance must gain priority over technical economic matters in donor-organized policy reform, and they must do so quickly.

## Epilogue on Method and Policy

Concerning social organization in developing countries, and, in this case, the Arab world with the prevalence of *wasta* and patronage, we are still in a stage of description and exploration. We are, to use an analogy, at a similar stage that Paul and Marie Curie were at when they, unknowingly, observed the first traits of what they later called ‘radium’.

Even farther away seems an accurate assessment of the question: in what way exactly, to what degree, and with what consequences, does social organization and formal as well as informal socio-political rules of interaction influence economic performance? In order to advance on this bumpy road, the exact aspects of the social and political variables impacting on economic performance have to be (a) identified, extracted, listed and isolated, and (b) their relative importance in determining economic outcomes has to be found and measured. As a precondition, this would in turn require new instruments to operationalize and measure indicators that are, *prima facie*, of a genuinely non-quantitative nature. Only with thus operationalized variables and indicators would it be possible to design a formalized model which could then accommodate what both institutional economics and political science see as preconditions for forecasting development perspectives in non-market economies as they exist today in many parts of the developing world. The challenge today for those who want to be ‘exact’ is not to apply models, but to develop them.

Obviously, there is a long way to go until such a point might be reached, and most likely, it will take future generations of researchers to reach it, if this is possible at all. It will, most probably, take decades to take even a few viable steps on the path outlined here. However, I hope that the present contribution to the study of these subjects be an initial such step, even though (or maybe: because) it is in a direction that has not been considered much until now in Middle Eastern area studies.

Also, this direction, from an institutional economics basis to an integrated social science approach, has not been adopted as of yet in the analysis of other developing countries outside the Middle East. This approach leaves open the question of methodology: There is no predetermination of methods that can or should be used when advancing along the integrated approach that has been lined out here. It is therefore not only an integrated, but also an open approach. There are several relatively new methodological roads that have – as far as I know – not yet been explored in development studies, but which might bear a promise of furthering our knowledge with respect to the subjects of this study. Formalized, but non-quantitative approaches such as ‘qualitative comparative analysis’ (QCA), approaches that use Boolean algebra and computer-based programs with the help of linear algebra and simple algorithms in qualitative models, or related and refined fuzzy-set theories that have hardly been applied to

the social sciences as of yet are certainly avenues that have to be checked for their prospective benefits.

Thus, while the integrated approach presented here, and the resulting concept of patrimonial capitalism, do not predetermine the instruments for an analysis of any and all economies, they can be useful background slides for the analysis of economic development in non-market systems. This study, of course, has not been able to provide definite results; rather, it is intended to propose and structure a set of issues that deserve a much more central place in our research on developmental issues, and that might be analyzed more adequately than before with the framework suggested here.

For those involved with practical policy-making, the findings of this study also imply quite clear lessons: Knowing that economic orders with specific features, with distinct developmental prospects, and with traits that distinguish them from other, known types of economies have emerged, and realizing that the single most important aspect of this newly identified type of economy is its dependence on informal socio-political relations based on powerful networks between political and economic elites (or even their amalgamation) implies developmental policies with thoroughly changed priorities. Issues related to governance are, as has become clear, the most important field which any sound donor strategy must prioritize. Most important are issues revolving around the rule of law, competition, political conditionalities, and fiscal transparency and accountability not only on the level of national accounts, but also on the subordinate levels. Approaches aiming at decentralization may gain in importance, but they must be applied carefully in order not to transfer macro-problems of intransparency and inequitable application of rules to the micro-level. In any case, this study leaves no doubt that governance issues, when cooperating with countries that display signals of patrimonial capitalism, gain greater importance for overall long-term development prospects than any 'technical' economic measure or strategy. Further, it is possible to state that any economic reform strategy that ignores the genuinely socio-political dimension that shapes economic performance, is bound to fail. Whoever neglects these findings must know that there is today no way of justifying policies which either ignore the governance-related issues mentioned here entirely, or which place them second in comparison to other issues. There may, of course, be many other legitimate goals such as, e.g., the political stabilization of befriended or strategically important regimes. If, however, sustainable development and a genuine improvement of the people's lot truly is the prime development goal, the findings presented here will make a huge difference for any possible future strategy. In other words, everybody involved into practical policy-making must bear in mind that it is easy to discern now (from the mode of policy reform, its design and ways of implementation) whether long-term developmental improvements are really at the heart of the motives for policy reform or not. Scholars and policy analysts will point their fingers more concretely than before into areas where the political exigencies of genuinely developmental approaches are neglected in favor of more easily implementable policies that stabilize dictatorial regimes and that do not benefit the populations as a whole.

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## Other Sources

Other sources used include local newspapers, weeklies, ‘hebdomadaires’ and magazines which appear in the countries studied in the empirical Part II of the book. Also, independent news-briefs and newsletters such as ‘Middle East International’ have been helpful in gathering information. While not all of them are quoted in the text, all of the following have been used to keep abreast with developments in the Arab world and the international context..

<i>Al-Ahram</i>	(Egypt; Arabic daily; [semi-]official)
<i>Al-Ahram Weekly</i>	(the corresponding weekly in English)
<i>Algeria-Interface</i>	(French & English news; European and Algerian journalists; see: <a href="http://www.algeria-interface.com">www.algeria-interface.com</a> )
<i>Al-Hayyat</i>	(London-based; Arabic daily)
<i>Ash-Sha’b</i>	(Egypt; Arabic daily - an ‘opposition’ paper)
<i>El-Khabar</i>	(Algeria; Arabic daily)
<i>El-Moujahid</i>	(Algeria; French daily in line with government policies)
<i>El-Watan</i>	(Algeria; French daily)
<i>Financial Times</i>	(British, daily)
<i>Frankfurter Allgemeine Zeitung (FAZ)</i>	(Germany; daily)
<i>Gulf News</i>	(Emirates; English daily)
<i>International Herald Tribune</i>	(Britain; daily)
<i>Jeune Afrique</i>	(France; French bi-weekly)
<i>Jordan Times</i>	(Jordan; English daily)
<i>La Tribune</i>	(Algeria; French daily)
<i>L’Economiste d’Algérie</i>	(Algeria, bi-weekly economic paper)
<i>Le Matin</i>	(Algeria; French daily)
<i>Le Monde Diplomatique</i>	(France; international monthly)
<i>Le Quotidien d’Oran</i>	(Algeria; French daily)
<i>Middle East Economic Digest (MEED)</i>	(English, London-based economic magazine)
<i>Middle East International (MEI)</i>	(bi-weekly newsletter, mostly politics, little economics)
<i>Neue Zürcher Zeitung (NZZ)</i>	(Switzerland; daily)
<i>Newsweek</i>	(Britain; weekly)
<i>Süddeutsche Zeitung (SZ)</i>	(Germany; daily)