ARI Thematic Study: Private Sector and Reform

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Has Arab Business Ever Been, or Will it Be, a Player for Reform?

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Both in scale and scope, the private sector is incomparably more important in the national economies of the Arab world than was the case just a few decades ago. While important differences between countries persist, the contribution to employment, sectoral diversification, public service provision, and national capital formation has grown substantially across the region.

However, even in the GCC - the economic bellwether of the Arab world - business remains technologically weak, structurally dependent on the state and, more often than not, governed through opaque and personalized structures – as has become glaringly evident during a series of assets crashes since 2006.

Despite the economic crisis, there is an abiding willingness to delegate responsibilities to business. But states are still leaders of the economic reform process, while business is too often incapable of forward-looking collective action.

The recent crises however are also a chance to change this state of affairs: the ongoing revamp of Arab corporate structures is bound to lead to differentiation and specialization of Arab private sectors. This in turn sets the stage for potentially more mature interest group politics and a wider contribution of business to reform processes. The improvement of business governance in the region will not only benefit economic development, but also, on more than one level, a constructive role of business in politics.

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Arab Business in the National Economies

The **role of Arab business in the political economies of the region is**, without exception, **considerably wider and deeper** today than it was two decades ago. Whether states' historical development trajectories have been populist-nationalist or monarchical-conservative, business now acts and invests in more sectors than ever before, having moved into many areas that were formerly under exclusive state control.

This has in many cases happened by necessity rather than by design: most states in the region experienced a severe fiscal crisis in the 1980s that forced regimes to open up important activities to local and, in many cases, foreign capital, gradually and surreptitiously hollowing out the distributional commitments incurred in previous decades of public sector expansion. But failing major socio-economic upheaval, the process now seems irreversible.

Even in formerly socialist systems like Syria and Algeria, private capital has moved beyond trading and basic services to engage in telecommunications, banking, tourism, most types of manufacturing as well as agribusiness. Health and education as well as utility services are still mostly state-dominated in the Arab world, but in the majority of countries, the share of private provision has grown substantially. Most countries have also witnessed the privatizations of major state-owned enterprises. Although the state lingers in many sectors, sectoral expansion mostly happens through private capital. In the uneasy coexistence of public and private players, of statist legacies and a fledgling bourgeois capitalism, the balance has been tilting towards the latter.

The broader regulatory and economic policy framework has converged to an important extent on international capitalist practice, even in the populist-nationalist cases, which had a long path to travel in this regard: liberalization of trade, capital accounts and financial sectors, stability-oriented macro-economic policies, and the gradual emergence of specialized regulatory agencies for various sectors make Arab republics look like typical emerging markets – at least on paper. Formally, heavy-handed state controls over business activities have been reduced a great deal.

Business has taken up the opportunities offered and stepped into the breach where the state has been no more able or willing to invest. The share of the private sector in consumption expenditure now exceeds that of the government, although in Saudi Arabia, Qatar, and Oman the government remains very significant. (See Graph 1, Appendix)

Even more important, **business now is the main source of capital formation** in the region, or at least on a par with the state, a radical shift from the 1970s when government capital formation dominated national investment even in the "liberal" GCC cases. (See Graph 2, Appendix)

While the share of private investment in total GDP is lower than in other emerging regions, notably East Asia, it has become much more important over time.

Finally, although the employment share of the public sector in the Arab world is still high in international comparison, it has gradually decreased over the years, as most regimes apart from the very small and rich Gulf monarchies (UAE, Qatar, and Kuwait) have had to abandon their policy to provide civil service jobs to every graduate.

While the direction of these trends has been the same all across the region, **countries have started from varied points of departure and drawing on different endowments**. This has resulted in a regional **landscape in which private capital has quite different capacities from one case to the next**. The non-Gulf countries, once seen as the

bellwethers of development and diversification in the region, are now in many regards trailing the GCC countries. Reminiscent of the story of fox and hedgehog, the ambitious statist development projects of non-Gulf countries – the populist republics in particular – have by and large failed and thrown back local development by decades, while the more conservative and much steadier pro-merchant policies in the Gulf have allowed the local capitalist class to mature gradually.

Gulf business is ahead not only in terms of scale, but also in terms of the sectoral breadth of its economic activities, and the accumulated managerial expertise and capacity to operate internationally. Its relationship to the state apparatus tends to be less antagonistic; although Gulf merchant families also complain of obtrusive and obstructionist bureaucrats, the interventionist traditions of local administrations run less deep than those in Algeria, Libya, Syria, or Egypt. In the latter cases, formal liberalization has sometimes changed little about what is in fact a heavy hand of inspectors, license bureaucrats, and customs officials.

With the exception of Egypt's Orascom, the most advanced multinationals of the Arab world are today all based in the Gulf, be it Saudi Arabia's Savola in agribusiness, Kuwait's Agility and the UAE's Aramex in logistics, or Kuwait's Zain in telecoms. As one of us has documented elsewhere, even the public sector in the Gulf is in important parts run in line with international corporate norms, resulting in an impressive array of internationally competitive state-owned enterprises.[1] While non-oil exports constitute 9% of GDP in the GCC, the proportion is only 3.5% in other MENA oil states.[2] Despite large-scale use of cheap foreign labour, GCC economies enjoy the highest total factor productivity in the region.

Outside of the Gulf, there is also a fairly clear pecking order: Monarchies (Morocco, Jordan) and non-populist republics (Tunisia, Lebanon) have generally seen stronger business development than the republics with a longer socialist history and a strong natural resource endowment, namely Algeria, Libya, and Syria. Egypt is an intermediary case with a socialist history and considerable rents but which has liberalized early on, starting (on paper) in the 1970s.

Business in the cases which have experienced no or only limited socialist experiments tends to be more dynamic, more outward-looking, and also more active in associational and civil society terms. In some sectors such as light manufacturing and modern ICT services, its diversification track record has been even stronger than that of GCC business.[3] But it is not able to operate on the same scale, locally and internationally, as Gulf capitalists, who, different from players anywhere else in the region, have benefited from **both** rents and a liberal regulatory environment.

The formerly socialist countries with a significant natural resource endowment are generally behind the curve in regional comparison: their private sector has been thoroughly marginalized in an earlier development phase where nationalizations combined with large-scale public sector experiments to produce a problematic institutional and fiscal legacy. While in the Gulf significant rents were recycled to the private sector, in Libya, Algeria, and Syria, they were used for over-ambitious and eventually disastrous attempts to build autonomous national economic power and, sometimes, new class structures through the expansion of public industry.

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[1] Steffen Hertog, Defying the resource curse: explaining successful state-owned enterprises in rentier states, *World Politics* 62:2 (April 2010).

[2] World Bank, *From Privilege to Competition. Unlocking Private-Led Growth in the Middle East and North Africa*, Washington DC 2010, p. 59.

[3] 25% of exports from Jordan and Tunisia for example are classified as high-tech, a higher share than for any other country in the region; ibid, p. 60.

While Gulf elites sought to protect and nurture their merchant allies, rulers in other oil-rich countries used their ample resources for encompassing economic interventionism and social engineering – an alluring prospect when ample surpluses were available, but ultimately a development trap. Despite a gradual rollback of the state's role, markets for factors (capital, labour, and land) as well as for goods and services remain heavily distorted, while the business sector is small and state-dependent. Total factor productivity is the lowest in regional comparison.[4]

Nurturing Private Business in the Gulf in the 1970s and Early 1980s

In the GCC rentier countries, rents combined with (relative) liberalism to boost the business class. In the resource-rich countries outside of the Gulf, rents combined with statism to destroy business – more thoroughly than in other populist countries in the region, where socialism might have been attempted in some areas, but resources were insufficient for the temptation to replace business wholesale to appear realistic.

It is worth discussing the Gulf experience in some more depth, as the Arabian Peninsula monarchies have in many regards become the bellwether of the larger region, and as the transformation of the private sector is the most advanced there, presaging both its future potential and its limits as a reform player. The following section will therefore look at the dialectical history of resource-rich states and their business classes since the 1980s. We will see how a series of market crashes since 2006 has created new challenges and opportunities for business as an economic as well as political player.

The pro-business policies of the Gulf States have taken the form of creating an environment conducive to private enterprise, and managing government expenditure so as to favour the accumulation of private capital. The government expenditure tool was used to grant contracts to private enterprises – initially at least, with limited attention to cost and value for money – thus making it possible for private contractors to achieve extraordinary levels of profit. At the same time, the government not only essentially abstained from any significant form of taxation on corporate profits and incomes generally, but took several other steps to favour the private sector: most notable among these have been the imposition of local partners or agents to foreign companies wishing to conduct business in the country, the provision of utilities and infrastructure services at very low cost, and labour policies that have thwarted any form of collective representation while opening the doors to the importation of foreign labour under conditions extremely favourable to the employer.

On the negative side, the progressive growth of government bureaucracy and frequently non-transparent regulations have created a web of obstacles and limitations that have increasingly stunted private entrepreneurship, with the ultimate result of favouring the older and better established business families – which know how to manipulate the system to their benefit –to the detriment of newcomers.

There has been considerable difference in the implementation of this broad scheme in individual countries. First of all, access to oil income is quite unevenly distributed: Bahrain and Oman have had more limited resources to directly support their respective private sectors and have had to advance sooner and farther in the direction of genuine liberalization and competitiveness. In the UAE, due to the fact that oil income accrues primarily to the Emirate of Abu Dhabi rather than the federal government, appreciable

[4] The threefold division here is inspired by, but not identical to the one into resource-rich/labour-importing (RRLI), resource-poor/labour-abundant (RPLA) and resource-rich/labour-abundant (RRLA) used by the World Bank to classify MENA economies.

differences have emerged between individual emirates.

Dubai, in particular, has followed a development path characterized by an aggressively entrepreneurial state, and considerable ambiguity concerning the boundary between private and public. Dubai has had relatively limited access to oil income, but has successfully leveraged its position to develop a series of activities functional to the needs of the region – in essence profiting from the clumsiness or idiosyncrasies of its neighbours. The outcome of this policy has been very positive in terms of economic diversification, although sustainability remains in doubt, and the financial stability of the emirate has come under significant pressure of late. In terms of private sector outcomes, it has generated a private sector that prospers under the shadow of the exuberant initiatives of state or quasi-state enterprises. Where the state is, in essence, managed like a business enterprise, it becomes difficult to speak of a dialectical relationship between private sector and state.

Important differences emerged also between Saudi Arabia, on one hand, and Kuwait and Abu Dhabi, on the other. In the Kingdom, the state has played much more of an active developmental role, in particular through the creation of the two industrial cities of al Jubail and Yanbu' and through the establishment of some key industrial enterprises, most notable among which has been SABIC. In Kuwait and Abu Dhabi there has been much less of this, primarily because of political events and leadership inclinations (neither Jaber in Kuwait nor Zayed in Abu Dhabi were greatly interested in economic diversification).

Our interpretation of the Saudi case – which in itself is the most important, as the Saudi economy is the largest in the GCC and in the broader Arab region – is very much contingent upon what exactly we consider private sector. Key government-initiated and majority-owned companies such as SABIC, the telephone company STC, and the electricity company SEC, are formally private corporations and have private minority shareholders. Substantively speaking, however, they fully belong to the public sector, although this may change and indeed the stipulation that government ownership be progressively reduced has been on the books for a very long time. Nevertheless, in some cases truly private business corporations have also engaged in large scale investment in sectors such as construction, banking, and heavy industry, and have displayed considerable assertiveness.

Understanding the dilemmas of the private sector in Saudi Arabia as well as in the other Gulf countries requires consideration of the evolution of state-business relations. As mentioned, the state initially supported the private sector through expenditure and the provision of favourable conditions. At the same time, the state became directly engaged in activities that had previously been carried out by private enterprises, in order to speed up growth and overcome major bottlenecks – electricity being a clear example. The state thus also tended to crowd out the private sector, reducing the opportunities for profitable domestic investment open to the private entrepreneurs. This, it must be stressed, is a constant dilemma for the pro-business rentier state: as the rent accrues to the state, it is the state that has the financial resources required to fuel growth, and if the state engages in productive investment the private sector is inevitably crowded out.

Thus in the 1970s and early 1980s, when the process of rent circulation was in full vigour, the private sector ended up accumulating substantial assets abroad, for lack of sufficient investment opportunities at home. When the tables turned and oil prices collapsed in the mid-1980s the state had to rely on deficit spending to continue servicing the multiple entitlements that had been created in the previous decade, and its financial position became increasingly precarious. Here the difference between Saudi Arabia and Abu

Dhabi is very clear, as the latter never came anywhere near experiencing financial difficulties, and never considered turning to the private sector for active support to its policies.

In the GCC, the Pendulum Swings in Favour of Business (1985-1999), Then Back

In Saudi Arabia, the divergent fortunes of the private sector and the state in the period 1985-1999 were very clear. Business families invested a very substantial share of their profits abroad, benefiting from the real estate and equity markets booms of those years. The state saw its expenditure become increasingly unwieldy and the price of oil slowly decline. At the end of the 1990s the mantra in the oil industry was that technological progress would make a further decline of oil prices inevitable.

It was in this climate that the first post-boom round of economic reforms was launched in the Kingdom, aiming in particular at the encouragement of foreign direct investment, the revitalization of the local equity market and the involvement of private capital in previously state-dominated public service sectors. The role and responsibility of business in national development had grown tremendously, as reflected in the scope of its sectoral contribution, its capital resources and its local investment efforts.

In turn, the combination of rising oil prices from 2000 on and the emphasis on the role of the private sector in the major oil exporters also contributed to precipitating further reform and openings in the other Arab countries, such as Egypt and Syria, driven by the realization of the fact that their best opportunity for accelerated growth lied in attracting private investment from the Gulf.

However, while business had in some ways overtaken the Saudi state in the austere 1990s, with the sustained improvement of oil prices after 2000, the pendulum of power between state and business started to slowly swing back. In fact, not only was the state's fiscal position strengthened again by significantly increased oil revenue since the turn of the century, but the private sector suffered a double blow, first because of the Arab stock markets bubble of 2004-2006, then with the global financial crisis of 2008.

When oil revenue started climbing back again thanks to higher prices and production volumes in the early years of the decade, the state decided to adopt a very prudent fiscal stance, and devoted a substantial part of the incremental revenue to paying back previously accumulated debt. This debt was owed entirely domestically to state controlled institutional investors such as the General Organization for Social Insurance or the Pension Fund, and to banks. In both cases, new liquidity was injected into the national economy which flowed towards the equity markets.

The Stock Market Bubble of 2004-2006

At the same time, the terrorist attacks of September 11 took place, and the climate became distinctly less welcoming for Arab capital invested internationally. Although repatriation of capital invested internationally was much more limited than some expected or feared at the beginning, nevertheless a stream of liquidity did flow towards investment opportunities in the GCC countries themselves.

The rapid increase in the valuation of Gulf equities took off in early 2004, when it became clear that the US invasion of Iraq would not have led to a rapid increase in Iraqi oil production, hence to flooding of the oil market and the collapse of OPEC. The stock market bubble of 2004-2006 is a crucial episode for the understanding of state-private sector relations, and must be considered carefully.

Could the state have controlled the bubble? The answer is yes, but with some difficulty.

The government should have controlled the creation of liquidity – thus refraining from paying back the debt and imposing limits on bank lending especially for investment in equities – and moved aggressively to increase the supply of quality assets through the sale of state-owned stakes in major banks and industrial corporations. This was not done, presumably because it would have further increased the government's liquid balances, which the state would not have known how to employ. At the same time, the state should have forcefully encouraged the transformation of informal family business conglomerates into formal, publicly traded corporations to deepen markets. The need for this process has been recognised now for some time, but its actual unfolding meets with considerable resistance on the part of the incumbent families and is quite slow.

Difficult as it might have been, **the fact is that containing the bubble was not even attempted**. The governments of all countries involved in the Arab equity bubble – which included non GCC countries such as Egypt and Jordan – looked at rapidly increasing asset prices as a blessing and spoke of popular capitalism. A large number of small investors was attracted into high debt to buy equity, and lost massively when the market collapsed in 2006. The experience was a magnified version of the Kuwaiti Souk al Manakh crisis from the early 1980s, and the bursting of the bubble was not sufficient a lesson to deflate the parallel real estate bubble, centred on Dubai: the latter finally burst only in 2009, as public authorities used their control of media and communications to dispel any reasonable doubt and kept alive the myth of unlimited growth, systematic success, and guaranteed profit.

The collapse of the equity market in 2006 inflicted serious losses on private investors. To be sure, many of those who bought equities early on may have ended up with limited losses and in some cases very significant gains – but a large number of especially small investors entered in the game only late and was badly burned. Consequently the "appetite for risk" among the larger pool of small and medium investors has collapsed, and there is no sign yet that it might return. The Arab equity markets have gone back to being the turf of few larger investors who hold their shares for the long haul, thus limiting the liquidity of the market and increasing volatility due to the small "free float" of shares.

Consequences of the Capital Market Crisis for Corporate Structures

The side consequence of this has been that the incentive for business groups to turn into proper corporations and float their shares in public trading has been greatly reduced. IPOs have not ceased entirely, but the pace has slowed down considerably. However, **the persistence of informally organized and managed business conglomerates is a major obstacle to the private sector coming of age economically as well as politically**. The financial strength of family business groups remains shrouded in secrecy, and banks have long engaged in name lending, not supported by any solid analysis of business plans or strategies. The disastrous consequences of lack of information and accountability, even within family business groups, have emerged clearly in the case of the Ahmad Hamad al Gosaibi Group and its litigation with the Saad Group of Mana al Sane'a. Shortfalls in internal control bordering on the incredible have emerged in this dispute, and have raised the spectre of many other family groups being as disastrously managed.

The private sector was therefore negatively affected even before the subsequent collapse of the US financial markets at the end of 2008. **The collapse of the Arab equity markets affected all countries, albeit with different degrees of intensity, pointing to the fact that the private sector is effectively regional, and a collapse of financial markets in the Gulf will affect investment in Egypt or Jordan, and vice versa**.

The 2008 financial crisis that originated in the US and rapidly spread globally did of course also affect Arab investors. Initially it was said that the Arab economies would stand out as the exception, being capable of continuing to grow even in the face of global recession – and to some extent this was indeed the case, as governments put aside the fiscal conservatism of the previous years and increased spending even as oil prices first collapsed, then stabilized at levels well below the peak they had reached in the summer of 2008. Supported by liberal government expenditure, the Arab economies did in fact fare better than other parts of the world, but the Arab business leaders must have lost at least as much as the rest of the world on average on their investment abroad.

The State-Business Balance after the Crisis

In short, from 1999 to 2009 the pendulum swung all the way, from a position in which all the wealth was in the hands of private business to a situation in which it is again very much in the hands of governments, while private investors have suffered major losses.

Unfortunately we have very little data that may allow us to illustrate this narrative quantitatively, but the essence of the story is not in doubt. The collapse of the Dubai real estate market at the end of 2009 inflicted a further blow to UAE and other regional private investors, and it will take several years before the effects of the overbuilding frenzy have been absorbed. In the meantime, the ability of the private sector to mobilize large financial resources to undertake ambitious industrial projects in competition with those of state controlled companies is seriously diminished. The reins of economic development and diversification are back in the hands of rulers (in the case of the UAE, in the hands of the Abu Dhabi rulers, the al Nahyan clan). In Saudi Arabia, for the first time since the early 1990s, public capital formation has been growing faster than private capital formation. (See graph 3, Appendix)

The global financial crisis has put a question mark over some of the liberalization and pro-business strategies pursued in the Arab world. The least open countries, such as Syria or Libya, have been less affected by the crisis; against this background, some Syrian technocrats seemed to even vaunt the benefits of weak diversification and a fairly closed economic system.

The crisis **has made Arab business timid**, credit markets remain frozen in many cases, and states, especially in the GCC, have stepped in as consumers and investors of last resort, supporting infrastructure and public service investments that were supposed to be financed by private capital, including major water, power, and railway projects. Even international business has partially or wholly withdrawn from a number of major ventures such as a large refinery joint venture and an integrated aluminum project in Saudi Arabia.

Econometric tests show that the short-term sensitivity of Gulf business to changes in state spending has decreased strongly since the 1970s. Yet, it operates predominantly in non-tradables sectors, for which large local markets exist most of all due to large-scale government spending and employment, even if the trickle-down process today is more diffuse and indirect. The performance of Gulf business in export-oriented manufacturing outside of heavy industry – the golden path to long-term development according to many economists – remains weak. Exports of services are growing quickly, but from a low baseline. The same is true, on a smaller scale, for non-GCC Arab countries. While less dependent on governments than they used to be, Arab capitalists are not quite the autonomous and outward-oriented drivers of development that their peers in more open economies in Europe and Asia have been. The crisis, ushering in a state-provided collective fiscal bailout of business, has demonstrated as much. (See graph 4, Appendix)

The shift in the equilibrium of economic power between the state and the private sector does not however mean that the rentier state is back in its full splendour and all opportunities for its evolution have disappeared. It is very significant that, although the financial health of the state has greatly improved, the discourse has not changed all that much relative to the late 1990s, and the power holders still call on the private sector to take up an increased role in the diversification of the economy. The state has recognized more or less clearly that it will not be able to achieve the required transformation of the economies without the active involvement of business – obviously this is all the more clear in those Arab states that do not enjoy significant oil revenue, but most major oil producers follow the same tack.

No one in the region seems convinced of a sustained return of the state. The basic commitment to privatization and public-private partnerships in infrastructure and utilities has not been rescinded, and most state support has been explicitly framed as temporary. Apart from the increase of government holdings in some troubled banks, no major nationalizations have happened, while future water and power plants are expected to involve local and international business. The new state-owned enterprises that Gulf governments have set up in the boom years are complements rather than rivals to existing private players, as they operate in sectors mostly unexplored by private capital, such as renewable energy or aviation technology. If they are successful, they are likely to engender copycat investments by private actors as has happened before in petrochemicals, aviation services or telecoms.

Governments continue their competition to attract private capital from neighboring countries and overseas, and have not stopped their attempts to deepen and diversify activities and instruments on local capital markets. Business continues to be seen as the main source of future employment, the creation of which will arguably constitute the pivotal socio-economic challenge for the whole region in coming decades.

Paradoxically, however, **it is the state that is the paladin of reform rather than the private sector**. Of course, the private sector is closely integrated into the state, and several businessmen play important roles in the various elected or appointed parliaments and as members of government – but it is not clear that it is their influence which is driving reform. If we take as example the crucial issue of reform of the labour markets to rein in excessive dependence on imported foreign workers, the private sector has clearly focused on pulling the brakes,[5] while governments have attempted several – generally clumsy and ill designed – attempts at tackling the issue. Indeed, in many ways Arab businesses remain followers rather than leaders in national reform debates – although, like in the economic realm, over time their position as interest group in the policy game has improved significantly. As we will argue, advances as well as limitations in both areas are closely linked.

Arab Business in Policy-Making

Just like its economic role, the political position of Arab business has seen important secular trends working in its favour – although without imparting on it the degree of autonomy witnessed in some more advanced economies. Capitalists all over the MENA region nowadays enjoy increased structural negotiating power thanks to international capital mobility, which has become the norm in the region since the 1980s and gives capitalists an exit option in case they are unhappy with local political or

[5] See for example Marc Valeri "State/Business Relations and Labour Market Reforms. Case Studies of Bahrain and Oman" paper presented in the framework of the ARI/GRCF private sector project at the Gulf Research Meeting 2010, Cambridge University, July 2010; and Hassan al Hassan "Labour Market Politics in Bahrain", paper submitted to the Third Research Workshop of the al Jisr Project, Dubai, June 2010.

regulatory developments. As a considerable share of private capital is invested overseas, and much economic activity remains fairly short-term in its orientation, the exit threat is acute. Especially in the formerly socialist countries, capitalists prefer to park their accumulated resources abroad and not lock in too much capital in local ventures with a long lead time that might be difficult to liquidate when things go awry.

The competition for private capital has led to a competition for better economic governance in the region: Regimes are attentively watching their neighbors' reform programs, often to rapidly imitate them if they are perceived as successful. A veritable obsession with international rankings of national investment and business environments has broken out. All this gives business, even in the absence of collective action, considerable structural power through the implicit, if diffused, threat to move to markets with more amenable policies.

But business influence is not only structural, it is also organized and, to an important extent, institutionalized. Through a number of mechanisms, Arab business has come to play a greater role in formal consultations on economic policy. Chambers of commerce and industry have come to enjoy more legitimacy as policy stakeholders; draft laws that used to be pieced together in the backrooms of ministries are nowadays circulated in chambers and commented on by their specialized committees. The Arab world has seen a strong increase in the number of businessmen in parliament, notably in Egypt, but also in post-socialist Syria. All over the region, governments have deployed advisory commissions on various fields of economic policy on which business is represented. In some cases, such as capital markets and telecommunications regulation, draft laws are even published on the internet to seek comments from business stakeholders.

The region has also seen stronger attempts to organize business as a lobbying group, including through more specific, non-chamber organizations of regional, ethnic or sectoral segments of business. In this regard, poorer countries like Egypt, Algeria and Morocco have in fact seen more dynamic developments than the Gulf, where overarching chambers organizations continue to dominate the scene.

Whatever the exact organization of business groups**, however, in almost all cases, their lobbying strategies tend to be reactive rather than proactive**, and there are few cases where organized lobbying with fully formed proposals on complex policy matters has taken place. Policy initiatives often still come from individuals, and state and business rarely engage in sustained, encompassing negotiations. Instead, exchanges are often ad hoc and business input is more often than not limited to asking for the preservation of existing privileges or the postponement or abrogation of specific government initiatives, be it customs tariff reform, FDI liberalization or attempts to increase taxes or fees. While it is true that business groups can fulfill a useful checks and balance function in this regard – if only to prevent governments from issuing non-implementable decrees – the interaction does not amount to the negotiation of comprehensive reform bargains as we have seen it in other regions such as Western Europe or East Asia.

The absence of comprehensive reform bargains is related to the stop and go quality of policy-making in large parts of the Arab world: policies are sometimes introduced abruptly, sometimes rescinded and modified post hoc. This undermines the credibility of government and saps incentives to negotiate complex policy deals that are not expected to hold together in the long run anyway. As long as policy is unpredictable, it makes more sense to lobby reactively and focus on simple issues of immediate concern. And even when the policy-making process unfolds in a more orderly fashion, implementation of policies on the mundane

bureaucratic level is often halting and incoherent, and quite frequently uneven, to the detriment of less well-connected businesses. Bureaucratic incoherence and informal stratification of business work against strong and effective collective action by Arab capitalists. State and business at large remain in many regards in a situation of mutual distrust: Most businesspeople don't expect rules to be applied fairly and consistently, while a large share of Arab bureaucrats believes that business is mostly out to seek rents.

Stratification of Business Groups

Informal stratification is also visible in the organization of business itself, as most representative bodies are dominated by large and established interests, while smaller businesses and newcomers enjoy little voice. A recent World Bank survey has shown that while Arab business organizations tend to focus their lobbying efforts on the defense of existing privilege or requests for additional state support, the majority of businesses are in fact more concerned with issues of equitable access to markets and bureaucracy and the quality of economic governance and administration.[6]

Large players play a predominant role in business associations everywhere in the world, but as alluded to above, they are particularly ensconced in the Arab region. Barriers of entry in most markets are high; the average age of Arab businesses is higher than in other regions, reflecting the limited turnover of elites. Most of the dominant players of today already established their position in the 1960s and 1970s and have since managed to expand into new sectors ahead of most newcomers.

World Bank research has shown that MENA companies are older on average than those in all other developing regions, reflecting relatively high barriers of entry. The particularly strong base of Arab business in family structures tends to add to this rigidity. Recent research by the Hawkamah Institute confirms the strong role of a fairly limited number of families on boards of listed companies in the GCC.[7] (See graph 5, Appendix)

The Prevalence of Conglomerates

High barriers to entry and the family orientation of Arab business also explain the conglomerate structure of many of the large groups, which tend to be spread across many sectors. Such diversification arguably reflects across-the-board privileges of established players, who will be able to leverage their administrative and other advantages in more than one sector, as well as the need to accommodate what are often sprawling family structures in the management of family capital. As a result, despite large groups, depth and specialization of individual business units are often limited – leading to the kinds of governance issues that have come to the fore in the recent economic crisis. As company assets are frequently seen as personal patrimony, mergers and acquisitions that could lead to the emergence of national champions rarely happen. With families invested across many sectors, **policy interests of large groups tend to remain diffuse**, undermining focused and proactive policy lobbying.[8]

It is probably not only the authoritarian political context of the region, but also the conservative and private outlook of many large family businesses that explains the **continuing abstention of Arab business**

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[6] World Bank, p. 189.

[7] The National Investor, Hawkamah and IOD Mudara, *Power Matters: a Survey of GCC Boards*, Abu Dhabi 2008.

[8] There are only a few large consortia that incorporate a larger number of families which have managed to set up world-scale companies; these are mostly located in the Gulf. One example that includes an impressive number of big Saudi merchant families is the Saudi Industrial Investment Group, which invests in world-scale petrochemical plants.

from politics in a strict sense. The businessmen who are openly active in politics – be it as oppositionists or as members of the ruling party – tend to represent themselves more than the interests of their class. Neither dissidents such as Riad Seif in Syria or Hussein Shobokshi in Saudi Arabia nor pro-regime parliamentarians such as Ahmed Ezz in Egypt would claim to speak in the name of business at large.

To the extent that large business players are involved in politics, this often happens behind closed doors; the **privacy of family groups finds its equivalent in the secrecy of regimes** which in many regards are also dominated by kinship structures. That important parts of state-business negotiations on economic issues also would happen through exclusive, intransparent channels hence comes as no surprise. Regime and important sections of business are in an equilibrium in which both sides tend to prefer informal contacts, exclusive deals and shorter-term negotiations to open, encompassing and comprehensive deal-making.

The field of business politics is not completely uncontested: Newcomer businesses have attempted to organize themselves in a more open way in Algeria, Morocco and Jordan; Egypt has an SME lobbying group that was set up with foreign help.[9] Those trying to set up new and independent organizations are often manufacturers with export interests who need to compete internationally and have an interest in a more transparent local environment. Their overall role in Arab economies is still relatively marginal, however, and even the more daring newcomers usually steer clear of political issues that are not strictly related to business. Positions on political reforms, as they have historically been taken by business in advanced Latin American or East Asian countries in times of crisis, are generally avoided. Business-related civil society activism remains largely limited to charitable giving, corporate social responsibility programs or cultural and educational activities.

Most of the Arab world's economic reforms have been as progressive and comprehensive on paper as in any other regions. In practice, however, they are undermined by weak institutions and lack of credibility on the sides of both state and business. Against this background, meaningful negotiations between the two, and the mobilization of broader support for sustained reform projects, remain difficult. By default, state-business interaction reverts to the informal, exclusive, and short-term.

The Continuing Corporate Transformations

Yet the process of transformation of some family business groups into modern corporations is underway. This will tend to create a polarization in the fabric of the private sector between modern and traditional business entities and, arguably, in the way business interests are organized. Governments have progressively introduced reforms to tighten the governance of the equity markets and banks, and are actively encouraging the transformation of informal family business groups into formal corporations. Banks' post-crisis reluctance to fund unreconstructed patrimonial business models, and their impatience with opaque bookkeeping practices, are another important factor pushing Arab capitalism towards modern corporate structures.

So far, even those family conglomerates that have sought a public listing have remained very solidly in the hands of the original family owners – very few have sold more than 30% of the shares. This means that the identification of the company with its original owner – individual or family – is still very

[9] Diane Zovighian, *Foreign Donors and State-Society Relations in Egypt: Negotiating Political Participation in the SME Policy-Making Process,* MA thesis, Sciences Po Paris, June 2009.

strong, and the credibility of the company representing a broader constituency (all of its shareholders and possibly all private investors) is limited. The political clout is therefore also limited, as the best political weapon of a corporation is to be able to argue that it represents broader interests than just its own.

Yet forces are surely at work to continue to further dilute the control of former family corporations. Firstly, there really is no reason why only 30% of the stock should be sold on the market, except the expectation that some of the remaining equity might be sold at a higher price later. The original owner can maintain full control of the company even with 50% of the equity, and in many cases corporations in the advanced industrial countries are controlled by families owning significantly less than 50%.

Secondly, differences of opinion frequently occur between successors and the founder or further down the chain of generations, and some of the heirs may well decide to liquidate their respective stakes to employ the proceeds in separate ventures. Thirdly, a major advantage of transforming closely held corporations into public companies is to facilitate mergers and acquisitions, and the structure of ownership is likely to be affected in the process. Thus **we may expect that progressively the corporatized segment of the private sector will acquire more of a public profile and gain political clout in the process**.

Inevitably, the modern corporations that will emerge will have an interest in pushing reforms in a direction that will make the survival of closely held family businesses more difficult. They will view the prospect of cannibalization of old style family conglomerates as an opportunity to grow and reduce competition, emerging as the national champions in their respective field of activity. Hence the public profile of the private sector will also evolve: today it is still the case that the personalisation of business interests and the preference for privacy discourage the majority of business leaders from articulating their policy preferences or engaging in open debate with government bureaucracies; but this might change in the future. **Greater assertiveness on the part of the private sector may thus be just a matter of reaching a critical mass** – a task which is made more difficult by the fact that the best examples of modern management are in fact companies that are wholly or majority owned by the states.

The state faces the perennial difficulty of how to use money from the public purse to support private capital accumulation. If the state invests in equities, eventually the entire economy will be state-owned – an outcome not as extreme and remote as one may think. This means that the state must find other tools to strengthen modern, well managed companies – thus encouraging the rest of the pack to also adopt modern, professional management tools. The debate on how this may be achieved is not well developed at all, and progress is likely to be rather slow.

One interesting way to look at it is to extrapolate from recent initiatives of the Saudi and UAE (or Abu Dhabi) governments, which have tended to create new institutions with specific mandates, and allocated to them large endowments. In Saudi Arabia the main examples have been the King Abdullah University for Science and Technology (KAUST) and the King Abdullah Petroleum Studies and Research Center (KAPSARC). In addition to fully capitalized pension funds and the rapidly growing insurance companies, these may lead to the emergence of a layer of institutional investors which has been missing so far, and might greatly help in broadening the base of the equity market and improve investors' oversight of corporate governance.

The Evolving Role of Arab Business in Politics

Can we then say that the evolving private sector may be expected to demand

increased accountability, and put pressure on power incumbents to accept political as well as economic reform? This expectation has long been present in the literature on democratisation, and has so far not been supported by the experience of Arab countries.

The impression is that **a causal link may well exist but is extremely diluted in time**. As we have argued, a substantial transformation of the private sector is required before a corporate world emerges that can claim to represent broader national interests and engage in serious dialogue with government bureaucracies. For the time being, the business sector is highly personalised, and individual business leaders are co-opted into the fabric of the state through well rehearsed practices of appointment or inclusion in electoral lists, but none of these individuals enjoys a genuine political constituency. The transformation of the private sector is underway and is supported by the state, but it is a project that may take many years to reach a point where it will make qualitative difference to the policy making process.

Secondly, the business community is more likely to support rather than to oppose whatever government is in power. Business generally strives to be on good terms with public authority, at least for as long as the latter does not take a clear anti-business ideological orientation. Indeed, in the face of populist oppositional ideologies and in the age of mass politics, business often sees circling the wagons together with the regime as the safest options to preserve its interests, not least given the long-term trend of economic liberalization presided over by incumbent ruling elites. Business as spearheads of a democratizing alliance are the historical exception rather than the norm and require, at a minimum, a large and prosperous middle class as coalition partner as was the case in political transitions in advanced economies such as Chile or South Korea.

Thirdly, the pursuit of political reform brings along obvious dangers, especially in countries that are so heavily dependent on expatriates for their survival. This is an important argument also **within the business community** itself, which **includes entrepreneurs, investors and managers who are not nationals, and may feel threatened by a process of political reform which does not promise to offer better representation of their interests in particular**[10]. In the Arab countries of North Africa or the Levant it is the Arab investors from the Gulf that do not enjoy full citizens' rights and are not necessarily regarded kindly by the locals[11]. Another way of looking at this dimension is to note that frequently when business speaks it has the face of a non-national, whose legitimacy to criticise the national government will be greatly limited.

For all the above reasons, it would appear that the link between economic and political reform may play out in the longer run, but is unlikely to exert any significant pressure on the incumbent power structures for many years to come.

In the medium term, the best hope for a business contribution to reform processes is in the economic field and with regards to good governance and accountability issues on a more technocratic level – which can however be of great import for national development,

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[10] See for example Radhika Kanchana "Indian businessmen as expatriate participants in Dubai's private sector and economic/political reform" paper presented in the framework of the ARI/GRCF private sector project at the Gulf Research Meeting 2010, Cambridge University, July 2010

[11] For example, the Hariri family has acquired Saudi citizenship, but obviously remains very much involved in Lebanese affairs, to say the least. Again in Saudi Arabia, the Hadrami business families are prominent yet do not quite enjoy the same national roots as others. In Egypt, the Sawiris are Copt. In Kuwait, the Shi'I merchant families have been strong supporters of the al Sabah: see Rivka Azoulay "The politics of Shi'I merchants in Kuwait" paper presented in the framework of the ARI/GRCF private sector project at the Gulf Research Meeting 2010, Cambridge University, July 2010.

and can deeply affect the daily lives of citizens in fields such as public service, bureaucratic performance, or combating of corruption. Much remains to be done to prepare business for fulfilling its role in these regards.

In addition to supporting the corporate transformations outlined above, collective organization of Arab business arguably is the field with the greatest lacunae: Many countries lack well-organized sectoral associations that could pursue more specific and better-researched policy agendas in cooperation with the national bureaucracies. Policy research capacities at most business associations are weak, undermining capitalists' collective capacity and credibility as policy players and their capability to follow up on and contribute to implementing credible and sustainable reform programs. They are not ready for the "buy in" that is necessary for consistent, cooperative policy implementation. In other developing countries, such as Turkey or Thailand, business associations have played a significant role in self-regulation and even in the administration of state support programs; Arab business organizations need to shape up to be able to take on such tasks, arguably drawing on the dynamism of a new generation of businesspeople and better-governed corporations.

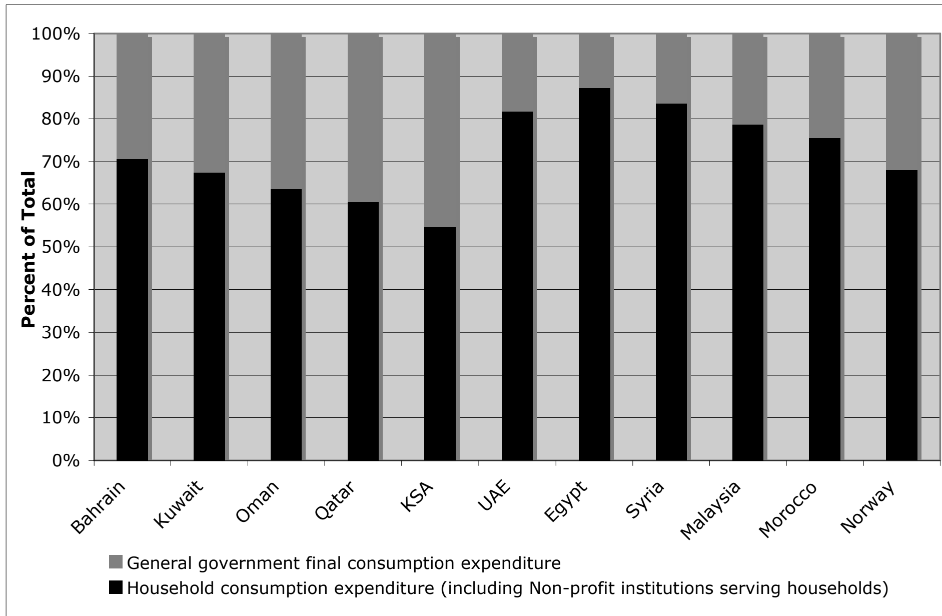
Policy and self-regulatory capacity also needs to be created in new sectors that business has been entering in recent years, including education, health, and utilities. In mature economies, these fields are regulation-intensive, but in the Arab world they have in too many cases been dominated by short-term profit-seeking instead of a focus on long-term investments and competition on quality. Here again, there is an affinity between better corporate governance and improved sectoral governance.

From the regime side, business maturation and professionalization most of all requires further bureaucratic reform to create a truly level playing field; this will not least allow for more inclusive business politics that is less exclusively oriented towards the defense of existing privileges. The steps required to this end are beyond the remit of this paper, but would include measures like a centralized online depository for all laws and ministerial regulations in force, time limits for specific bureaucratic tasks, the creation of ombudsmen, as well as disclosure rules on bureaucratic procedures, performance data, and budgets. Such reforms by and large do not threaten regime survival, hence reform-oriented sections of business should be able to convince ruling elites to implement them.

The professionalization of the private sector as economic player and reform actor would in the long run also be furthered through a binding program to gradually privatize the large, profitable state-owned enterprises of the Arab region, in the Gulf in particular. Once they have fulfilled their infrastructural and developmental function, they need to be transferred to private hands to deepen capital markets and set the stage for true competition in strategic sectors. Through its very successes, the state sector has created the conditions of its own dissolution, moving Arab economies to a more mature stage of development. Taking most Arab technocrats by their word, this is in fact what they originally wanted. The developmental consequences could go far beyond a simple transfer of ownership.

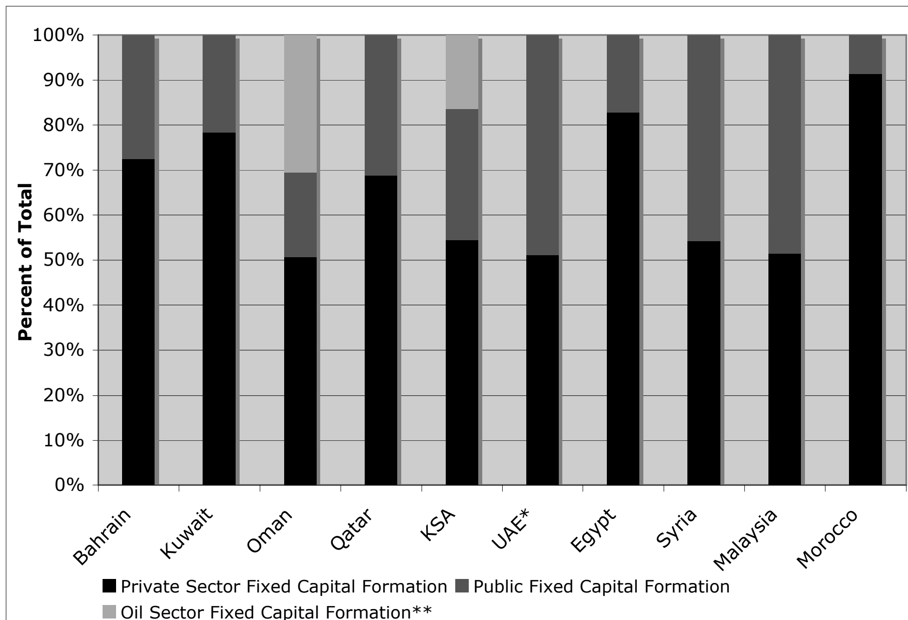
Appendix – Graphs

1. Consumption Expenditure Breakdown (2005-07 Average)



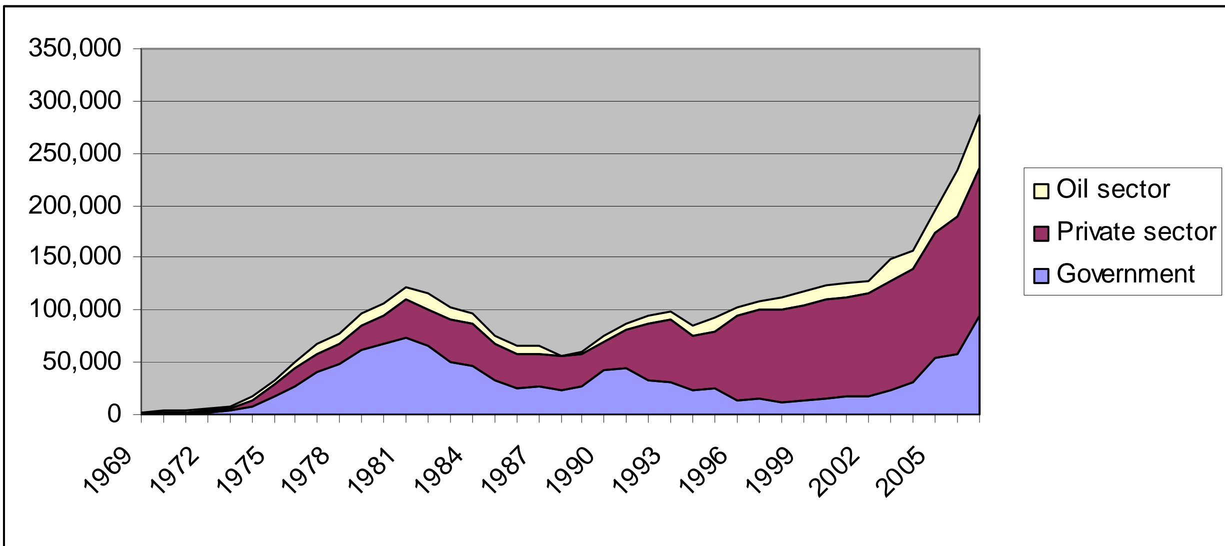
Source: courtesy of Nathan Hodson, based on UN/ESCWA data

2. Fixed Capital Formation Breakdown (2005-07 Average)



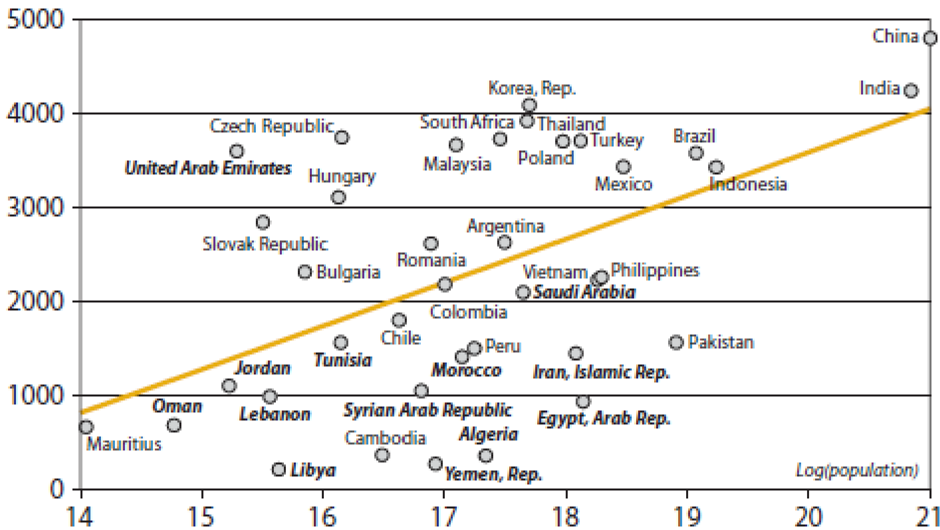
Source: courtesy of Nathan Hodson, based on UN/ESCWA data

3. Saudi gross fixed capital formation



Source: SAMA

4. Diversification of exports



Taken from: World Bank, *From Privilege to Competition* (Washington DC, 2010)[12]

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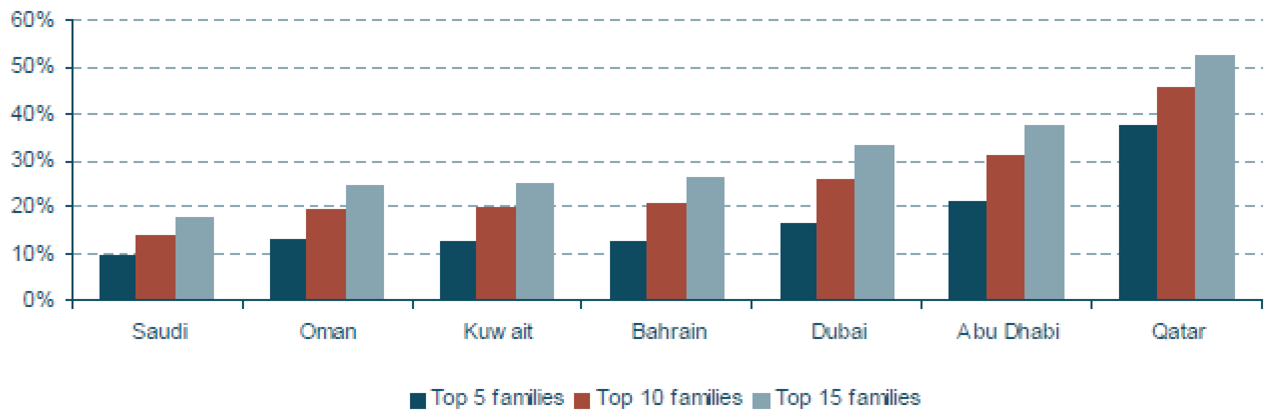
[12] The high placement of the UAE is most likely explained by its role as reshipment hub.

5. Concentration of family influence

Chart 7: Concentration of family influence - Proportion of total board seats held by most influential families



Sources: Stock market authorities, TNI Investment Research, Company accounts

Source: Hawkamah/The National Investor, *Power Matters: A Survey of GCC Boards* (Abu Dhabi 2008)