

Rethinking Development Assistance in the Middle East

by John D. Sullivan

SUMMARY

In its evaluation of U.S. engagement abroad, the Department of State's first Quadrennial Diplomacy and Development Review highlights the need for development assistance to focus on institutional reforms.

Recent unrest demonstrates that with the rising number of youth and the growing importance of the middle class, the region's rulers must move beyond superficial reforms to build inclusive political and economic systems.

The U.S. must support efforts to build democracies that deliver by addressing the underlying structures and practices within both governments and economies.

U.S. development assistance should encourage the simplification of laws and regulations to reduce economic informality as well as the establishment of transparent institutions to address the political roots of corruption.

The large number of unemployed youth in the region requires governments, with U.S. support, to loosen labor market regulations and to reform the education system so that the private sector can become a strong alternative for young graduates seeking jobs.

There are many different messages coming out of the recent events in Egypt, Tunisia, Yemen, Bahrain, and elsewhere in the Arab world. The overarching signal, however, is that truly transformational political and economic development – development that benefits citizens at all levels of society, not just those with preferential access – requires fundamental democratic and market reforms. The current unrest is, at least in part, the expression of popular discontent with the fact that such deep structural changes have long been missing from the region and that governments have failed to deliver real, tangible benefits to their citizens. Democratic and economic reform must go hand-in-hand; political freedoms, economic opportunities, civil liberties, job creation, freedom of the press, human rights, and property rights are all closely connected.

The key dilemma facing United States policymakers and the development community relates to their role in these reforms. The first Quadrennial Diplomacy and Development Review (QDDR), released by the U.S. Department of State in December 2010, provides some interesting insights. While the QDDR lays out a framework for action, robust implementation is essential. In particular, the emphasis on institutional reform is key to success in advancing inclusive democracy and economic growth.

THE NEED FOR INSTITUTIONAL REFORMS

The QDDR is the result of an extensive 17-month process to assess U.S. engagement abroad and identify steps to make it more efficient, accountable, and effective. With the Obama administration's renewed emphasis on "leading through civilian power," it outlines specific changes for how the U.S. Department of State and U.S. Agency for International Development should be organized and should operate to maximize the impact of U.S. development efforts. The review process highlights the fact that past development assistance has too often lacked a clear appreciation for what ultimately generates impact: institutional change. The Middle East today is a poignant example of the importance of sound institutions that ensure that people's civic, economic, and political aspirations and freedoms are realized – and a lesson on what happens when these institutions are missing.

The term "institution" is increasingly used in development discourse without full appreciation for its meaning. Institutional change involves more than

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shifts in political leadership or nominal changes to laws and regulations. Institutional reform must bring legal changes in line with countries' history, culture, and informal practices and take into account trust, enforcement, implementation, and a host of other issues. In other words, institutional reforms cannot simply be transplanted from one country to another.

In debates about reform in the Middle East, the failure of the Washington Consensus model of development is often raised. Indeed, Washington Consensus-style market liberalization has not brought about expected growth, jobs, and poverty reduction. The real problem is that this liberalization was not accompanied by the institutional reforms that make all citizens equal before the law and hold those in power accountable. If democracy is limited to flawed elections that perpetuate the political monopolies of autocrats, underdevelopment persists and public frustrations boil over. Therefore, building inclusive institutions of democratic governance and supporting a strong market economy are crucial to the success of U.S. diplomacy and development efforts as well as to peace and prosperity in the Middle East.

MENA: A REGION ON THE BRINK

The long-standing social contract in the region stipulated social acquiescence to autocratic rule in exchange for welfare benefits and state employment guarantees. Today, this arrangement is crumbling before our eyes. MENA governments are no longer able to ensure sufficient public sector employment and meet the economic expectations of the growing number of young graduates. At the same time, widespread corruption and cronyism prevent the private sector from becoming an alternative source of jobs. The lack of democratic freedoms leaves the disaffected populace with few alternatives to the street for manifesting their frustration. Salary increases for public sector employees, like the ones recently implemented in Egypt, may temporarily alleviate the situation, but they do not solve the deeper underlying problems.

The ousters of Presidents Zine El-Abidine Ben Ali in Tunisia and Hosni Mubarak in Egypt are a testament to the wave of change sweeping across the region. This wave is propelled by the failure to build inclusive political and economic systems that provide and safeguard freedoms. In the political realm, citizens of MENA countries have been deprived not only of free and fair elections, but also of participation in the day-to-day policymaking that affects their lives.

In the economic realm, liberal policies enriched elites but failed to reach the lower levels of society. In 2008, Egypt topped the list of reformers in the World Bank's *Doing Business* ranking. Those reforms, however, did not help the small and informal entrepreneurs who account for the vast majority of Egypt's business community but have no meaningful access to the country's legal system and formal economy. Reforms were often government-driven, lacking widespread buy-in from the business community at large and leaving most enterprises disconnected from the legal system.

Peruvian economist Hernando de Soto addresses these issues in his work on property rights. In Egypt, 92 percent of urban property is informally owned, and 82 percent of entrepreneurs operate extra-legally because of burdensome regulations for registering a piece of land or formally starting a business. As a result, according to de Soto's estimates, Egypt's poor own \$248 billion in dead capital that cannot be used to propel economic growth and generate jobs. Owners of informal housing and businesses cannot use those assets as collateral for loans. They are in constant fear that what they own, or whatever profit they generate, will be arbitrarily taken from them since they cannot enter into enforceable contracts or file grievances in courts.

In order to take root, local reform efforts and U.S. support for reformers should focus on removing such barriers to entrepreneurship. This has to happen from the inside. For genuine reforms to become reality, each country's citizens must take ownership of those reforms. They must be part of the process from beginning to end, with all the give-and-take and public debate that democratic institutions allow.

Encouragingly, the QDDR recognizes that development efforts ought to build on America's comparative strengths: economic growth, democracy and governance, humanitarian assistance, and women's empowerment. It acknowledges that economic and democratic prospects of developing countries are deeply intertwined because "economies thrive when governments are accountable, grow when capital is available based on merit – not patronage – and expand when countries cultivate and draw on the talents of all their people." The big question remains: how do we get there?

This question is particularly relevant in the Middle East today. In most MENA countries, entrenched elites have monopolized political and economic decision-making power for decades, leaving most people, particularly the youth, without prospects for participation or prosperity. Popular uprisings in Egypt and Tunisia grew out of this deep frustration felt throughout the region. Yet removing an autocratic leader from power is not enough; the challenge is to empower long-neglected segments of society and build democratic and market systems that are inclusive, responsive, and accountable.

FOCUS ON ECONOMIC AND GOVERNANCE FOUNDATIONS

In a section highlighting the need for high-impact development based on partnership, innovation, and results, the QDDR explores the shortcomings of existing U.S. policies. The report admits that "U.S. investments in health, education, and other sectors have driven significant improvements in the lives of millions in developing countries – but where there has been insufficient attention to the underlying economic and governance foundations, these improvements have proven difficult to sustain."

Good governance and the entrepreneurial economy matter to development because they are necessary to improve the life prospects of ordinary citizens. However, past U.S. efforts in the MENA region have not been sufficiently focused on these institutional reforms. As a result, American

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aid has done little to reduce the swelling ranks of the disenfranchised unemployed who, lacking better alternatives, will be pushed toward extremism. A new focus on sound economic and governance institutions is not optional — it goes to the core of addressing the region’s pressing security problems.

To constructively engage in the region, we must stop confusing humanitarian or military aid with the development assistance that can spur institutional change. The QDDR report acknowledged that “too often, we have found ourselves in the business of service delivery rather than the business of supporting systematic change.” This approach is often summarized by the old aphorism that contrasts giving someone a fish with teaching that person to fish. But, to extend the metaphor, even the best fishermen cannot make a living in polluted waters. Therefore, the alternative to service delivery aid must go beyond areas such as technical training or technology sharing. Innovations for high-impact development must also focus on engaging with local partners to clean up the corruption, graft, and lack of accountability that continue to pollute the institutional waters of so many countries.

The ongoing demographic transformation in the Middle East makes change unavoidable. One aspect of this transformation is the aforementioned youth bulge. Another is the growing importance of the middle class. In his recent book *Forces of Fortune*, Vali Nasr points out a crucial nexus between the rising middle class and the market economy. As the region’s business owners become integrated into the global economy, demand rises for institutions that protect property rights, enforce contracts, and enable free trade. Whether religious or secular, entrepreneurs are united by a desire for rules of the market to be set so that they can fully participate in the global marketplace.

The Center for International Private Enterprise (CIPE) has worked with business organizations across the region to change the way important concepts of institutional reform are understood and implemented in a local context. Through corporate governance initiatives, CIPE’s partners have helped foster transparent and accountable decision-making in MENA businesses. Through improvements to the regulatory structure of their countries’ economies, these reformers have helped build enabling environments for small and medium enterprises – the engines of development. These are significant reforms that allow economic growth to benefit every citizen, not just regime cronies. The current events in the region provide an opening for more such efforts.

BUILDING DEMOCRACIES THAT DELIVER

Going forward, the U.S. should continue to offer humanitarian aid where needed while recognizing that developmental assistance meant to help transform institutions is different and equally important. Such assistance requires supporting grassroots reforms that focus on better governance and economic empowerment. In his September 2010 United Nations speech, President Obama said, “Our focus on assistance has saved lives in the short

term, but it hasn't always improved those societies over the long term. (...) Instead of just managing poverty, we have to offer nations and peoples a path out of poverty." The U.S. development community should heed that lesson and focus on approaches that help countries find their path toward long-term democratic development. The following steps can be taken to help developing countries in general, and MENA countries in particular, find that path:

- ***Support political and economic development in tandem by focusing on institutional change.*** Protests throughout the region show that economic grievances are intrinsically linked to and rooted in issues of democracy and governance. Institutional reforms that the U.S. supports must therefore address the underlying structures and practices within both governments and economies. Democratic governance and functioning markets share the core values of freedom, competition, participation, transparency, accountability, responsiveness, and equality before the law. Meaningful reforms require working toward a system in which the state does not monopolize political power and control the economy, but rather engages stakeholders in identifying needs and setting priorities and provides an enabling environment for the private sector to thrive.
- ***Reduce economic informality by reforming the regulatory environment.*** Many entrepreneurs who produce legitimate goods and services are excluded from the formal economy because of burdensome regulations, excessive procedures, high tax rates, and other barriers to conducting business. Lacking access to financial resources and legal protection, informal business owners are unable to invest in their enterprises, grow, or create jobs for others. This means less productivity, stunted potential for investment and economic growth, and, ultimately, a less viable economy. The Obama administration has focused on entrepreneurship as part of its engagement with the Middle East. The key element of this strategy should be support for the simplification of laws and regulations with the input of local business communities and the creation of a rule of law system that treats all entrepreneurs fairly.
- ***Tackle corruption through coalition building.*** Companies are often portrayed as perpetrators of corruption, but on the day-to-day level, businesses, especially small companies and individual entrepreneurs, are often victims of extortion by government officials. U.S. development efforts should support collective action initiatives through which the business community can stand up to predatory public officials and create a more transparent and fair business environment. By building broad anti-corruption coalitions within the business community, reform efforts can be depoliticized, with a deeper impact and increased visibility. In addressing grand corruption, efforts should focus on ensuring transparency in decision-making at the top echelons of government as well as in dealings between government and business, especially in public procurement.
- ***Invest in youth by focusing on educational reforms and labor market regulations.*** The ongoing youth-led protests in the Middle East signify

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ABOUT POMED

The Project on Middle East Democracy is a nonpartisan, nonprofit organization dedicated to examining how genuine democracies can develop in the Middle East and how the U.S. can best support that process. Through dialogue, research, and advocacy, we work to strengthen the constituency for U.S. policies that peacefully support democratic reform in the Middle East.

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the importance of the rising generation. Governments can no longer avoid the difficult reforms that will allow youth to engage in their countries' political, economic, and civic spheres. This process begins by expanding job opportunities. With public sector employment no longer guaranteed, the private sector must become a strong alternative for young graduates. The education system must be reformed to promote skills that are needed in the private sector. Moreover, rigid regulations on hiring and firing should be changed to encourage private firms to hire more people. The U.S. should work with private sector organizations such as business associations that understand those important local needs and advocate for reforms to address them.

CONCLUSION

The lessons outlined in the QDDR for America's engagement abroad clearly show that, instead of remaining in the business of service delivery, the United States must be in the business of helping build democracies that deliver. We need to help and empower local reformers to build more effective and responsive governments and more productive and inclusive economies. This point is particularly salient in the MENA region, which may be witnessing one of its largest transformations in recent history.

As Secretary Clinton said during her January 2011 trip to Doha, the imperative for the region is to "create more economic opportunity, encourage entrepreneurship, give citizens the skills they need to succeed, to make the political reforms that will create the space young people are demanding, to participate in public affairs and have a meaningful role in the decisions that shape their lives." What the future holds for the Middle East is fundamentally up to its people. But the U.S. can help more effectively by supporting business, government, and civil society leaders who are working toward institutional reforms in their countries. The question is whether future development assistance will take the lessons of the QDDR to heart.